House of Commons
Committee of Public Accounts

Improving access to finance for small and medium-sized enterprises

Thirty-eighth Report of Session 2013–14

Report, together with formal minutes, oral and written evidence

Ordered by the House of Commons
to be printed 18 December 2013
Committee of Public Accounts
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Additional written evidence may be published on the internet only.

Committee staff
The current staff of the Committee is Sarah Petit (Clerk), Claire Cozens (Committee Specialist), James McQuade (Senior Committee Assistant), Ian Blair and Yvonne Platt (Committee Assistants) and Alex Paterson (Media Officer).

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Summary

Small and medium-sized enterprises (SMEs) play an important role in job creation, but many of them struggle to obtain the finance they need to start-up, operate or grow. The Department for Business, Innovation and Skills (BIS) and HM Treasury manage several schemes that aim to provide SMEs with access to finance where the market is failing to do so, but the departments have not done enough to raise SMEs’ awareness of the financing options available. The departments have not undertaken the necessary research and evaluation to understand the impact of those expenditures and cannot demonstrate the success of individual schemes, nor have they managed the schemes as a coherent programme with a clear view of how each scheme contributes to the departments’ overall objectives for supporting the SME sector. The departments have no common understanding about which parts of the SME sector generate the most growth, and where government support would therefore be most beneficial. In addition, the departments are unclear how much taxpayers’ money is reaching SMEs via the banking system or venture capital funds used to deliver these schemes, or what impact the money delivers in the longer term.
Conclusions and recommendations

1. BIS manages six main schemes that are intended to provide around £2.85 billion of financial support for SMEs between 2011-12 and 2014-15. In 2012-13, these schemes helped just over 5,900 firms. In addition, HM Treasury and the Bank of England jointly oversee the Funding for Lending scheme, under which banks and other lenders have been provided with £17.6 billion at cheaper than market rates, with the intention that they will lend this on to businesses and households. The new British Business Bank, which will start operating in 2014, has £1 billion of capital at its disposal in addition to the resources of the existing BIS-led schemes, and is designed to better identify and fill gaps in the market for financing SMEs.

2. The departments’ schemes are managed as a series of ad hoc initiatives that are launched to address particular weaknesses in the market, rather than to act as a coherent programme. The departments have developed the schemes over time, to address particular areas of the finance market where there are problems. These schemes include finance guarantees, loans, equity support and efforts to diversify financing options beyond the traditional channels of the high street banks. But neither department has a clear view of what success will look like for the programme as a whole. They have also found it difficult to meet the needs of many different types of SME operating across a variety of sectors, whose outlooks range from those seeking funding for high growth to others seeking finance to start up or to continue operating.

Recommendation: The departments should use the establishment of the British Business Bank to start managing the various schemes as a coherent programme, clearly setting out what it wants to achieve, and how each scheme and the programme as a whole will contribute towards the departments’ overall objectives for making it easier for SMEs to access finance.

3. The Government spends a considerable amount of taxpayer funded money promoting better access to finance for SMEs but the departments could not demonstrate that their schemes have successfully addressed the market failures they were designed to correct. Indeed far from encouraging more lending to SMEs, investment has declined. The departments are trying to positively influence the markets for business finance and get them to work more effectively, as well as benefiting individual SMEs through targeted schemes. However, the departments could not provide compelling evidence of where schemes had made a significant impact on the financial markets’ willingness to support SMEs. Among the debt-based schemes, for example, the performance of both the Enterprise Finance Guarantee and the Funding for Lending schemes do not suggest that the banks are more prepared to lend to SMEs. Indeed overall lending is down. The number and value of loans backed by the Enterprise Finance Guarantee has fallen each year between 2010 and 2013 and net lending by the Funding for Lending scheme participants has reduced by £2.3 billion since the scheme was launched. Similarly, the poor performance of the early equity support schemes—where government commitments of over £140 million have generated returns of just £38 million—leads
us to question their contribution to the development of the wider market for venture capital for smaller businesses.

Recommendation: When the departments establish a scheme to address a particular market failure, they should set out clearly both what a successful impact on the market will look like and how they intend to evaluate its success.

4. There is scope for the departments to better match the nature of their interventions with the specific needs of SMEs. The markets are changing rapidly, and there is a range of different financing options available. However, most of the funding associated with the current schemes involves delivery via the banking system, reflecting the importance of the main banks to the UK market. BIS has begun to support the development of alternative financing options such as peer-to-peer lending, crowdfunding and supply chain finance, and is exploring how further government support can encourage new entrants into the market. It is important that the departments work to maintain business confidence in crowdfunding, which is becoming a vital funding route for many businesses. In researching how the British Business Bank might be set up, BIS has examined markets in other countries, and concluded that there was a particular need to address long-term growth finance in the SME sector.

Recommendation: The departments must ensure that the British Business Bank draws upon emerging evidence of SMEs’ changing financing needs, and tailors its interventions accordingly, implementing, refining or withdrawing schemes as circumstances change.

5. BIS has not done enough to ensure that SMEs have access to information on the potential range of financing options available to them. Credit cards and overdrafts, though mostly more costly, remain the most frequently used financing option for many SMEs who need working capital quickly. BIS has developed a number of web-based tools intended to improve awareness among SMEs of the funding options available. But the owners of small businesses very often lack the time to seek out such advice, and do not necessarily think of government as a source of such information. BIS acknowledges that it needs to improve its communications, both with SMEs to raise awareness of the support available to them, and also with intermediaries who can raise the profile of the products and advice on offer. The lack of awareness may have been exacerbated by recent changes in retail banking practice which have scaled back the skills and capability of local banking staff, who are often unable to make bespoke decisions or signpost companies to other sources of finance.

Recommendation: The departments must establish a clear strategy to ensure that SMEs are made aware of appropriate funding options for their needs, both through government information and through advice from lenders and others. The departments should use their influence with the mainstream banking sector and across Whitehall to ensure high street banks understand the needs of their local businesses in order to encourage lending.
6. For some of the schemes, the amount of funding reaching UK SMEs is either unknown by the departments or appears lower than we would have expected. At the launch of the Funding for Lending scheme, the Bank of England stated that its main objective was to encourage net lending to be higher than it would have been without the scheme. An extension to the scheme in April 2013 provided incentives for the banks to increase lending to SMEs, but HM Treasury does not currently have any information on the number or value of loans to SMEs under the scheme. The UK Innovation Investment Fund has received £150 million of taxpayers’ money but UK companies account for only 40% of the total number of the Fund’s investments. BIS could not tell us the total cost of management fees paid to administer this Fund. We heard from BIS that it was often easier for lenders to make larger investments than smaller ones. Moreover, we did not hear what BIS is doing to encourage smaller investments by lenders and funders.

7. Recommendation: The departments must gather and publish data about how much financial support is reaching SMEs, and how much is diverted to other recipients or used to run the schemes.
1 Maximising the impact of the schemes

1. Small and medium-sized enterprises (SMEs) play an important role in job creation, but many struggle to obtain the finance they need to start-up, operate and grow. On the basis of a Report by the Comptroller and Auditor General, we took evidence from Department for Business, Innovation & Skills (BIS), HM Treasury, the British Chambers of Commerce, the Federation of Small Businesses, and Barclays Bank on the financing problems faced by SMEs, the way that the banking sector does business with SMEs, and the performance of BIS and HM Treasury in supporting improved access to finance for SMEs.¹

2. BIS and HM Treasury published *The Plan for Growth* in March 2011, which cited access to finance as one of the reasons why it is problematic to do business in the UK. Both departments then set out their priorities and a series of measures to address this market failure. BIS’s priorities included helping to improve the flow of credit to viable SMEs and diversifying external financing options for all businesses. One of HM Treasury’s priorities was to support the development of new ways for SMEs to access finance.²

3. Under a broadly defined Access to Finance programme, BIS has developed and runs six main schemes, summarised in Figure 1, which address areas of the finance market where there are problems. These schemes are expected to provide around £2.85 billion of support for SMEs between 2011-12 and 2014-15, and include finance guarantees, loans, equity support and efforts to diversify SMEs’ financing options beyond the traditional banks.³

**Figure 1: The main BIS-led Access to Finance schemes**

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<tr>
<th>Name of scheme</th>
<th>Nature of scheme</th>
<th>Total amount of funding</th>
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<tr>
<td>Enterprise Fund Guarantee</td>
<td>Loan guarantee to SMEs lacking security or track record for commercial loan</td>
<td>Guarantee up to £2bn of lending, 2011-12 to 2014-15</td>
</tr>
<tr>
<td>Start-up Loans</td>
<td>Loans to start a company</td>
<td>£120m from 2012-13 to 2014-15</td>
</tr>
<tr>
<td>Business Finance Partnership, SME tranche</td>
<td>Non-bank channels for small businesses, including peer-to-peer lending, supply chain and mezzanine finance</td>
<td>£100m from 2012-13 to 2014-15</td>
</tr>
<tr>
<td>UK Innovation Investment Fund</td>
<td>Venture capital fund of funds to invest in technology-based businesses in sectors strategically important to the UK</td>
<td>£330m, comprising £150m from government and £180m from private investors</td>
</tr>
<tr>
<td>Enterprise Capital Fund</td>
<td>Public-private venture capital funds to provide equity finance to early stage companies</td>
<td>£200m from 2011-12 to 2014-15</td>
</tr>
<tr>
<td>Business Angel Co-investment Fund</td>
<td>Co-investment fund to support early stage SMEs with high growth potential</td>
<td>Initial £50m in 2011, and additional £50m in March 2013 budget</td>
</tr>
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¹ C&AG’s Report, Improving access to finance for small and medium-sized enterprises, Session 2013-14, HC 734, 1 November 2013
² C&AG’s Report, paragraph 4
³ C&AG’s Report, paragraph 5 and Figure 1
4. HM Treasury and the Bank of England jointly oversee the Funding for Lending scheme, which has provided £17.6 billion of funding to banks and other lenders at cheaper than market rates, to lend on to businesses and households. HM Treasury regards Funding for Lending as an important scheme which complements its wider efforts to support the recapitalisation of the banking system and to encourage more competition in the banking sector. However, since April 2013 the Funding for Lending scheme has included additional incentives to boost lending on to SMEs. HM Treasury does not currently have specific data on the number or value of loans made to SMEs under the scheme, but it admitted that the scheme had had difficulties in improving lending to SMEs. In late November 2013, after the hearing, HM Treasury and the Bank of England announced additional changes to the scheme that would further incentivise lending to SMEs in 2014.

5. The Federation of Small Businesses highlighted to us that the departments’ response to SMEs’ problems accessing finance had been characterised by a series of initiatives that were not well coordinated. BIS accepted that government had to do better at pulling together all that it was doing to support SMEs, and said that the British Business Bank—plans for which were announced in September 2012 would be an effective way of coordinating individual schemes with improved overall management. The British Business Bank, which is likely to start operating in 2014, will incorporate the existing BIS-led schemes, including their stock, and will have an additional £1 billion of capital at its disposal. Its aims include improved provision of finance to viable businesses, particularly SMEs, and it is also likely to identify and fill gaps in the market for SMEs’ access to finance.

6. All witnesses recognised the importance of SMEs to the economy, and emphasised that this was not restricted to high-growth companies, but also those whose main focus was on continuing to be viable from one year to the next. Such businesses have different funding needs—SMEs ambitious to expand need growth finance, while others’ needs may be more about cash flow and overdraft facilities. The departments maintained that the schemes needed to work in the interests of all parts of the SME sector, and that the current schemes had evolved over several years to try to meet these different debt and equity finance requirements. There was no common understanding about which parts of the SME sector generate the most growth, and departments did not articulate priority sectors or particular circumstances which justified taxpayer funded intervention.

7. BIS said that its overall aim is to get the markets for business finance working more effectively at providing SMEs with the funding they need, but it accepted that it must
improve the way that it coordinates its efforts to support small businesses.\textsuperscript{10} BIS asserted that the majority of firms will get their funding without government support, and it is only at the margins that government intervention is required.\textsuperscript{11} BIS said that it was unable to identify the amount of government money across all schemes that had gone to SMEs which would have secured alternative sources of funding without taxpayer funded support. The only specific piece of research on the issue relates to the Enterprise Finance Guarantee scheme, which suggested that over 80\% of loan recipients would not have received funding otherwise.\textsuperscript{12}

8. The departments could not provide compelling evidence of where their schemes had made a significant impact on the financial markets’ willingness to support SMEs.\textsuperscript{13} BIS asserted that the Enterprise Finance Guarantee had encouraged banks to lend to more risky businesses, but admitted that overall lending levels under the scheme had reduced, with both the number and value of loans backed by the scheme having fallen each year between 2010 and 2013. In 2009-10 9,200 loans had been offered with a total value of £947 million through the Enterprise Finance Guarantee, but in 2012-13 this had fallen to 3,300 loans offered with a total value of £350 million.\textsuperscript{14}

9. HM Treasury claimed that when the Funding for Lending scheme was introduced in summer 2012, gross lending to SMEs was shrinking by 23\% per year, whereas a year later it was growing at 11\% per year.\textsuperscript{15} At our hearing, HM Treasury could not reconcile its claim to Figure 4 in the National Audit Office report, but subsequently provided us with a note, based on Bank of England data, confirming its figures for gross lending. However, the National Audit Office uses the same data in its Figure 4, and shows that repayments made by SMEs to all lenders have exceeded new loans being made to SMEs in all but two months since the scheme was launched; over the same period net lending by those financial institutions participating in the scheme fell by £2.3 billion.\textsuperscript{16}

10. In the past, government-run equity support schemes have failed to generate financial returns. Four such schemes established in 2003 or earlier had received government commitments of over £140 million, but they are generally returning sums much smaller than the amounts invested—only one scheme has reported a gain, and the total return is likely to be just £38 million.\textsuperscript{17} BIS said that the terms under which it is investing have changed since these earlier schemes—with its current schemes it was investing on commercial terms and was seeking to maximise its return on investment.\textsuperscript{18} BIS admitted it could do more to use the equity schemes to support a rebalancing of the economy, as much
of the funding presently goes to London and the south-east rather than northern England, and to high technology business rather than the manufacturing sector.\textsuperscript{19}

11. For several schemes the departments use the banking sector as the primary route for passing on funding to SMEs. HM Treasury said it believed that the Funding for Lending scheme had been successful overall in creating incentives for banks to lend more than would have been the case had the Bank of England not acted, but conceded that there is no robust evidence available at present regarding the success of the scheme in transforming lending to SMEs.\textsuperscript{20} Barclays Bank explained that the majority of failed loan applications are declined because the bank does not believe that the business will be able to afford the repayments. As a result, Barclays said that interventions such as the Enterprise Finance Guarantee, which are designed to address businesses’ lack of security, and the Funding for Lending scheme, which is designed to tackle the cost of banks’ funding, have only limited impact on banks willingness to lend to SMEs.\textsuperscript{21}

12. BIS said that as part of its strategy for diversifying sources of finance and encouraging challengers to the main high street banks it had begun to support the development of some alternative funding options such as peer-to-peer lending and crowdfunding (where individuals pool their money to finance an initiative or business). For example, it had recently awarded a total of £30 million to two peer-to-peer lenders through the Business Finance Partnership. BIS also said it was exploring how further government support can encourage new entrants into the market.\textsuperscript{22} HM Treasury said it had spoken to a number of big companies to investigate the scope for more supply chain finance, where large companies lend to their smaller suppliers. It claimed that partly as a result of government championing supply chain finance a number of major companies had adopted it—including Rolls Royce, Vodafone, J Sainsbury, Tesco, Asda, Carillion and B&Q.\textsuperscript{23}

13. BIS told us that its research for the British Business Bank had identified long-term finance as a significant gap, and acknowledged that more could be done to help manufacturing and other sectors access finance. BIS accepted, for example, that it has much to learn from the KfW development bank, which was set up in Germany in the post-war period to provide capital over a long term to German firms. It also said it was seeking to expand the remit of the Enterprise Capital Fund programme to ensure that other types of firm are served, rather than concentrating on technology start-ups.\textsuperscript{24}

14. To 31 March 2013, 60% of the total number of investments made by the UK Innovation Investment Fund—which has £330 million at its disposal—have gone to overseas companies rather than UK companies.\textsuperscript{25} BIS told us that money from the UK Innovation Investment Fund has been invested in two underlying ‘fund-of-funds’, that have themselves invested in other pan-European equity funds. BIS suggested that

\begin{itemize}
\item \textsuperscript{19} Q 181; C&AG’s Report, Figures 14 and 15
\item \textsuperscript{20} Qq 117-120
\item \textsuperscript{21} Qq 28-30
\item \textsuperscript{22} Qq 90, 110
\item \textsuperscript{23} Q 115. Ev 31 – additional evidence supplied to the Committee by HM Treasury and BIS, 19 November 2013
\item \textsuperscript{24} Qq 180-181, 184-188
\item \textsuperscript{25} C&AG’s Report, paragraph 3.24
\end{itemize}
proportionately the UK is doing well, on the basis that the UK government has contributed £150 million while a total of £174 million has been invested in UK firms. BIS was not able to say how much in total had been spent on management fees for these funds, but stated that a fee of between 0.65% and 0.75% has been paid to each of the two appointed fund-of-funds managers, and that market appropriate fees would be applied to the equity funds in which these managers invested.\textsuperscript{26}

\textsuperscript{26} Qq 162-170. Ev 32 – additional evidence supplied to the Committee by HM Treasury and BIS, 19 November 2013
2 Improving communications and raising awareness

15. BIS told us that it is a significant challenge to make SMEs aware of the financing options available to them, and ensure that they have the knowledge to select facilities that are right for them. It admitted that it needed to do more in this area. BIS said that some SMEs lacked confidence in their ability to get funding and so did not seek it, which can stifle their growth, while others did not understand the best form of funding for the situation they were in, and so used more expensive sources such as credit cards or overdraft facilities. The business representative groups told us that there is a general problem with the way that government communicates online with small businesses – their members often complain that government websites are not easy to navigate, and that they do not have the time to search for information that should be readily available to them.

16. BIS said there was a two-fold challenge in improving communications with SMEs. First it needed to enhance its direct communication with SMEs’ to raise their awareness of the support available. Second it had to ensure that its partners—such as banks, lenders and investors—were more proactive in raising the profile of the products and advice on offer. BIS told us that it is currently improving its online information, particularly through the interactive tool called the Business Finance and Support Finder. In early November 2013, it had placed this tool under the banner of the new “Great Business” campaign, and it plans to seek feedback from SMEs about the tool’s usefulness. BIS undertook to consider our suggestion that it might use the existing annual communication with SMEs about business rates as a way of advertising the government-backed finance schemes that are available.

17. HM Treasury agreed that it should be putting pressure on the banks to encourage SME clients who have relied on overdrafts for a long time to move onto a more secure financial footing. But it suggested that a real change is only likely to occur if SMEs have more choice about where they can go for additional funding. One option for the British Business Bank would be to invest in the capital of the ‘challenger’ banks (smaller, newer banks) in order to stimulate this additional competition.

18. HM Treasury told us that there was an effective independent appeals system, whereby a business that has been refused a loan by a British bank can appeal to an independent arbitrator against the decision. The Federation of Small Businesses said that 40% of its members’ appeals against loan refusals had been upheld, yet awareness of the appeals system is currently very low. HM Treasury explained that it is talking to the British Bankers’ Association about steps that can be taken to raise awareness of the appeals

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27 Qq 94, 111, 132
28 Qq 19, 91, 121
29 Q 25
30 Qq 111-114
31 Q 131
32 Qq 25
process, so that SMEs can better judge whether an appeal challenging a loan refusal has a chance of succeeding and is therefore worthwhile.\textsuperscript{33}

19. BIS claimed that in recent years much of the retail banking sector had been deskilled—a state of affairs also acknowledged by Barclays. As a result, banks do not always have local staff equipped with the skills and expertise required to examine different types of businesses and make rounded decisions on loan applications.\textsuperscript{34} BIS said it was looking to improve the way it worked in partnership with the banks to make sure SMEs understand that the banks are “open for business”. BIS said its survey evidence suggested that businesses are twice more likely to be successful in getting new funding than they think they will be. Similarly, only 32% of firms looking to refinance their existing facilities believe they will be allowed to refinance, but in practice over 90% have been successful.\textsuperscript{35}

\textsuperscript{33} Qq 103-105
\textsuperscript{34} Qq 23, 132
\textsuperscript{35} Q 92
Draft Report (Improving access to finance for small and medium-sized enterprises), proposed by the Chair, brought up and read.

Ordered, That the draft Report be read a second time, paragraph by paragraph.

Paragraphs 1 to 19 read and agreed to.

Conclusions and recommendations agreed to.

Summary agreed to.

Resolved, That the Report be the Thirty-eighth Report of the Committee to the House.

Ordered, That the Chair make the Report to the House.

Ordered, That embargoed copies of the Report be made available, in accordance with the provisions of Standing Order No. 134.

Written evidence was ordered to be reported to the House for printing with the Report.

[Adjourned till Monday 13 January at 3.00 pm]
Witnesses

Monday 11 November 2013

Mike Spicer, Head of Research, British Chambers of Commerce, Mike Cherry, National Policy Chairman, Federation of Small Businesses and Dr Richard Roberts, SME Market Analysis Director and Economic Adviser, Barclays

Martin Donnelly, Permanent Secretary, Ceri Smith, Director, Business Bank and Public Data Group (PDG) Unit, Shareholder Executive, Department for Business, Innovation and Skills and John Kingman, Second Permanent Secretary, HM Treasury,

List of printed written evidence

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Oral evidence

Taken before the Committee of Public Accounts
on Monday 11 November 2013

Members present:
Margaret Hodge (Chair)
Mr Richard Bacon
Jackie Doyle-Price
Chris Heaton-Harris
Meg Hillier
Mr Stewart Jackson
Fiona Mactaggart
Austin Mitchell
Ian Swales
Justin Tomlinson

Amyas Morse, Comptroller and Auditor General, Gabrielle Cohen, Assistant Auditor General, Peter Gray, Director, National Audit Office, and Marius Gallaher, Alternate Treasury Officer of Accounts, were in attendance.

REPORT BY THE COMPTROLLER AND AUDITOR GENERAL
Improving access to finance for small and medium-sized enterprises (HC 734)

Examination of Witnesses

Witnesses: Mike Spicer, Head of Research, British Chambers of Commerce, Mike Cherry, National Policy Chairman, Federation of Small Businesses, and Dr Richard Roberts, SME Market Analysis Director and Economic Adviser, Barclays, gave evidence.

Q1 Chair: The purpose of this introductory session is for you to provide us with some experience from your perspective, both as representatives of SMEs and as people with responsibility for providing funding to SMEs, of what the key issues are for which we then hold the accounting officers to account. I would be grateful for short answers. Say what you like and what you think will help us in our later hearing.

I was going to start with the FSB and the British Chambers of Commerce. What should Government be doing? Having read the report in front of us, do you think that what they are currently doing is helping? If not, what, if anything, would you do differently? I am talking about the Government’s role in supporting access to more credit for SMEs, which we all think are hugely important for growth. Who wants to start out of the two Mikes?

Mike Cherry: I will kick off if I may. I think the Government are at last beginning to understand that initiative-itis, as I call it, is not a good thing. With the advent of the Business Bank—

Chair: Another initiative.

Mike Cherry: It may be another initiative, but we see it as having longevity, if it is set up in the right way as a true wholesale bank and helps to stimulate more competition in the marketplace, and if the Government make sure that more challenger banks are brought forward and that adequate support is given to alternative forms of finance—that is a real benefit that the Government can play in taking this whole thing forward. It is very clear that, for too long, small businesses, particularly at the micro end of that sector, have not been able to get the finance they need, and that is a problem that we see not just with the banks’ own figures when they come out but with the Bank of England’s figures. They do not actually split SME lending into its constituent parts of micro, small and medium. If there was one thing that we could ask going forward, it is that that be done as a matter of urgency, so that we get a true picture of the lending going down to the smaller end of the marketplace in particular.

Also, it is more helpful if the banks in some way could align their commercial, business and other sides on a similar sort of definition, whether that is a £1 million, £2 million or £5 million turnover. Greater transparency over what it means between the constituent lenders would be helpful going forward. Those would be my opening remarks.

Mike Spicer: Having read the National Audit Office Report, understandably, as an NAO Report, it focuses on what the Government are doing and the various schemes that are run out of Departments to improve access to finance. What it does not do as much on— as business organisations, we try to focus on this—is the bigger picture as explained to us by our members. We have various roundtable events regularly to engage our members on the issue.

In terms of specifically what the Government can do, if I can build on what Mike has said, on the Business Bank, we have campaigned for that for quite a long time, but it has to be of the right scale. Various estimates are there about the scale of the so-called funding gap for SMEs; some put that as high as £10 billion. The scale that we are talking about right now is that the Business Bank is an initial capitalisation of about £1 billion. Even with fairly generous assumptions about how much finance that can lever in, that is still quite a small portion of the overall finance gap.

We need to ensure that the Business Bank is, first of the right scale. It also has to be the right kind of institution. At the moment, we are talking about it as if it is purely an institution that will exist in the shadows, as a vehicle for aggregating SME loans, or a purely wholesale beast. We would like to see it be
more like what it is in other developed countries, such as Germany or South Korea, where it is more customer facing.

One of the issues that has got in the way of previous Government schemes that are picked up in the NAO Report has been the transmission mechanism of using the banking sector primarily as the route to market. Having that additional route to market through a customer-facing institution will really add something in the longer term.

Q2 Chair: One of the things that came at me when I was reading the Report is that everyone talks about 75% or 76% of growth coming from the SME sector. That is such a big, broad definition. Where is the growth coming from in that? Is it coming from the new start-ups? Is it coming from ones that have a turnover of over £1 million, from brand new companies, or from companies that have been around for more than five years? Where is the real engine of growth? Do you know?

Mike Cherry: We do not split it out as such, but from our quarterly surveys, which, as you know, are now used widely across Government and by the Bank of England, from our members’ perspective, it is across the patch. It includes sole traders, one-man bands and the micro and small businesses that we represent. We can probably split that out when we have done our bi-annual survey that is due for publishing in March. I would be happy to share some of the information with you.

Q3 Chair: I will tell you the reason why I ask the question, and then Mr Spicer can come in. In the lending market, the total amount of Government money is relative peanuts, but £2.8 billion is a lot of money from the taxpayer. It is not big in the totality of borrowing for SMEs, and within that total, the people you represent are not getting the money they need. Yet for the taxpayer, £2.8 billion is a lot of money. If we are going to use this money, where will it be used to best effect?

Mike Spicer: I think you can make a distinction between two types of SMEs. There are the SMEs that have growth ambitions. These are organisations—the start-ups, as you said—that go on and take on more businesses. I have sold businesses. I hope to run small businesses again in the future. To me, the patch is very much about growth finance, not just for a few years but perhaps for ever and since money-lending days back in the middle ages. How much risk do you feel the Government should take when it comes to doing these sorts of things for small businesses?

Q4 Austin Mitchell: It is good to see the Federation of Small Businesses getting on to the main problem facing small businesses, which is not the perpetual argument about whether they can grow if they have a greater ability to fire people, but the problem of finance. The Chambers of Commerce says in its evidence that there has been an increasing use by banks, who we all agree are bastards, to use products which give lenders security over loans rather than to the benefit of the business. That coincides with the complaints that I get in Grimsby that bankers are demanding guarantees on the house of the small business man. Others are insisting on warrants to be signed by the lender which give the bank an option to buy the company—in other words, to take over the company. Is this in your experience a real problem?
you have to try to make sure that businesses get the right information as well on what the banks require and how to apply for a loan, and all the other bits and pieces that we have repeatedly called for since our survey back in 2008, which highlighted all of the problems that have been raised in some of the other reports that have come out recently on where the banks have been failing small businesses.

Q7 Austin Mitchell: Are the banks also using the opportunity to foist unsuitable products on small and medium businesses, such as interest rate swaps?

Mike Cherry: The interest rate swaps are a scandal, quite frankly. It has taken far too long to resolve even now. These products should never have been offered in the first place to the vast majority. When you have such a large number of businesses so adversely affected by this mis-selling, then something needs to be done. Hopefully the FCA will now be getting a move on to encourage the banks to get their act together and get all those businesses that have been so badly affected put back to where they should have been if these products had not been sold in the first place.

Chair: Hang on a moment, Austin; this is the pre-hearing, before moving to the accounting officers. Many people want to speak and I want to get on to the accounting officer hearing. You can ask the question of the accounting officer. We have not asked Richard Roberts any questions; I just want to make sure that Chris has one.

Chris Heaton-Harris: I just want to ask Mr Roberts about risk, but if he could sweep that up when he answers something, that would be great.

Chair: Meg, do you want to ask Richard Roberts anything?

Q8 Meg Hillier: Partly, Mr Spicer, you said you hoped the Business Bank would function properly in all its areas, or words to that effect. If I may say so, there was a little obfuscation—that all we need to do is to pin down the Department and the Government to make sure they are doing the right thing. What I am hearing from my small businesses is that loan finance is not such a big issue; it is more about overdraft and that line of credit. Are you hoping that the Business Bank will be able to back overdrafts, or not—that question is for both you and Mike Cherry—and is that an issue?

Mike Spicer: That is not what we are calling for. We are calling for an institution that is similar to what you see in other countries, which can perform a wholesale role, so that it can perform as an aggregation vehicle for SME loans in the wholesale market, but we also want it to be customer facing. This is the key point of difference between what we are calling for and the current plans, as well as the scale of the thing. We are talking about an initial capitalisation of £1 billion, with perhaps a ratio of 2.5. We think that is just too small. We would prefer it to be much larger—probably of the order of £10 billion as an initial capitalisation—and customer facing. There are two clear points of difference.

Q9 Meg Hillier: When you say “customer facing”, what do you mean? Does that mean overdrafts?

Mike Spicer: What I mean by that is that it would be possible for a business to have a direct relationship with that institution. It is not about the product.

Q10 Meg Hillier: So basically it would be a state-run bank, like some of the others.

Mike Spicer: A state-backed bank.

Q11 Meg Hillier: Okay—Mr Donnelly may have some interesting things to say about that. Mr Cherry?

Mike Cherry: We see it being in the wholesale market and not with a direct face. We also see it being at arm’s length or independent of Government going forwards.

Chair: One more Meg, then we must move on. We will come back on the accounting officers.

Q12 Meg Hillier: Okay, I will wrap up my points. I do not know if any of you business organisations have anything to say about order book financing, because I am hearing that some of my businesses are managing to get streams of credit that way. Do any of you have anything to say on crowd funding and—this is particularly for you, Mr Roberts—the issue of overdrafts, which are being withdrawn from many of my businesses? They find that their overdraft is cut off, and that is what is causing them most bother. They don’t mind paying a little extra for a loan, but they don’t want the loan, they just want the credit. Dr Roberts, perhaps you could answer first, as you haven’t answered a question yet.

Dr Roberts: The independent research shows that the actual number of overdrafts that are reduced are outnumbered every month by the number that are increased. Indeed, more than half of the reductions are caused by customers asking for the overdraft to be reduced because they then have to pay a lower fee. I am not disputing that that occurs occasionally for risk reasons—perhaps the customer’s risk profile changes—but the independent research shows that, in the context of the whole marketplace, it is relatively modest in scale, although I don’t underestimate that it might have severe consequences in some cases.

Q13 Meg Hillier: Particularly in Shoreditch.

Dr Roberts: I would add that for every pound of overdraft that the high street banks have extended, we have as much again, if not more, in terms of unused facilities that customers can draw on without already asking us. Our utilisation of overdrafts is currently well under 50%, so there is lots of headroom for overdrafts overall in the marketplace.

Q14 Meg Hillier: A comfort, but not for small businesses. Could the other two briefly pick up the points about crowd funding and order book financing?

Mike Spicer: On order book financing in particular, we are starting to hear a lot more from small businesses in the supply chain of, for example, large multinationals based abroad that are having their payment terms squeezed quite a lot. They are turning to things like that to manage their cash flow.
Q15 **Meg Hillier:** Is that working? Is that a good thing?

**Mike Spicer:** It is expensive, so it is something we hear quite a lot about. Over the last six months we have heard quite a lot about that kind of thing, but it is mainly from companies in long supply chains. Specifically on the challenger banks, that extra competition is welcome, but they are still a very small part of the market. When we tested that with our members last year, less than one in seven had used a finance provider outside the mainstream banking sector. It is still a small part, which is why we need to focus quite a lot on the competition with the mainstream banks.

Q16 **Chair:** I want to get Dr Roberts on the key issue, which is that the net funding is down. Government are spending £2.8 billion trying to encourage greater funding to SMEs, yet it is down, so is there any point in the Government doing anything? What is going to persuade you guys to lend more to SMEs? Or is it the system?

**Dr Roberts:** It is absolutely right that the Bank of England data shows that net lending to SMEs is still falling. You have to unpick that, though. If you look at the share that is provided by the high street clearing banks, that figure has not fallen very much at all over the past couple of years. Indeed, if you adjust the figures for one bank that has had well publicised problems in this area, the remaining clearing banks actually increased their lending to SMEs to some degree.

The biggest reduction by far—three times the rate of decline in terms of the net lending to SMEs—has occurred because there has been a reduction in the number of non-high street banks, particularly foreign-owned banks, which were very active in the market prior to 2007–08, but have stopped writing new business. They are collecting repayments on their loans, but they are not issuing any new loans, and that is dragging down the total net lending. Of course, a lot of those non-high street banks are not heavily involved in any of the Government initiatives.

Q17 **Chair:** Does the £2.8 billion complement what you do or stimulate what you do?

**Dr Roberts:** We obviously have a range of interactions with Government around enterprise finance guarantees.

Q18 **Chair:** Does it complement or stimulate? Or does it do nothing?

**Dr Roberts:** Well, it helps us undertake certain types of lending for certain types of customers where we would not otherwise be able to do, because they would be outside of our lending criteria.

Q19 **Chris Heaton-Harris:** Does that mean there is something in Europe would be imploding. Therefore, if I am right, for the first time in living memory, something in Europe would be outside of our lending criteria.

Thirdly, is it a reflection that a lot of the businesses in terms of growth firms, as Mike has said, that are seeking to use straightforward debt finance where it is inappropriate to do so. They need alternative forms of funding or access to growth capital, which cannot necessarily be delivered through high street banks in terms of their day-to-day lending activity.

As both my colleagues here have said, you have to analyse the market and look at different segments of it. Some businesses have considerably more difficulties in obtaining access to funding, because they are not necessarily seeking debt finance that the banks can reasonably provide in their current lending conditions. Obviously, as we have always indicated, one of the aims of the Business Bank will be to look across the market to try to identify where those gaps are and put things in place to try to fill them.

Q20 **Chair:** But the Government’s funding through its main scheme is down. The funding through the enterprise finance guarantee—whatever it is called—is down.

**Dr Roberts:** The number of loans being written under the enterprise finance guarantee is down. Obviously the amount available is still there.

Q21 **Chair:** Of course, but the point is, it’s not working—that is the whole question for me, underpinning all of it. Why is this not working? Is it adding any value?

**Dr Roberts:** The enterprise finance guarantee addresses a particular finance gap, where the business cannot obtain a loan purely because of insufficient security. In my bank, for example, we no longer ask for security on loans under £25,000, so for the vast majority of people who we turn down, it is not because they haven’t got the security; it is because we actually don’t think that they will be able to afford to repay us the loan and so it is not prudent to lend to them. The enterprise finance guarantee doesn’t directly address that because it is nothing to do with affordability. It is to do with whether you have security.

Q22 **Justin Tomlinson:** Three quick questions—two for Dr Roberts and then one for the representatives of the business community. I must say that my dealings with Barclays have been very good when dealing with businesses. Also, like Mr Heaton-Harris, I used to own my own business. On the point about net funding being down, there are three things that I think might be impacting on that, and I wondered what your thoughts were. First of all, is it a question of business owners getting out of the habit of borrowing, because it was very difficult as the economy went down, so you change your business model so you don’t use borrowing?

Secondly, is it that for some of the small businesses it is simply cheaper just to draw money from your mortgage? If you are going to have to guarantee it against your house, you might as well do it on your own terms, and that is cheaper than the business costs. Thirdly, is it a reflection that a lot of the business community were very cautious? Although we were having record low interests and we weren’t seeing unemployment increase, there was always an expectation that things could go horribly wrong—you could come home from a hard day’s work and something in Europe would be imploding. Therefore, if I am right, for the first time in living memory,
businesses had more money in their current accounts than they were borrowing. I just wondered whether those three were all factors.

Dr Roberts: The latter point is true. It is a long time since this happened. The basic point is that every time there is a recession, there is a period of debt aversion, and the longer and deeper the recession, the longer the period of subsequent debt aversion, during which businesses generally want to pay off debt and are cautious. There will always be some people who get back into the expansion and growth habit earlier than others, but that description is typically true.

On the point you made about mortgages, it is slightly different, in that prior to 2007–08, an awful lot of businesses actually took money out of their mortgage and put it into the business as cash. Going back to the point I made to the Chairman, this is why many businesses are now approaching banks with what is effectively a quasi-equity proposal. In the past, they would have put cash from several sources into the business. Many such sources have dried up because of regulatory change, so the banks are being asked to do deals that they cannot sign off because it is not prudent for them to do so.

Q23 Justin Tomlinson: The second point—I agree with Mr Heaton-Harris on this—is that, to a certain extent, it is right that banks have to be a bit more robust in deciding who is a fair risk for business lending, because pre-2008, everybody, whether for businesses generally or for households to pull some money and the chickens came home to roost.

There are two elements here. Some businesses presumably turn up with a business plan that is not strong enough and they are sometimes asked to include some of their own equity and to share in some of that risk, but they simply are not prepared to do so. That is one side. On the other side—I did say that Barclays are not the worst for this—there is a genuine complaint that the staff in banks making such decisions are still responding, “Computer says no”. They do not have the skills or expertise to be able to make bespoke decisions. Businesses that are non-standard and not off the shelf can come along with something that, if you have knowledge of that market, is a good risk to take, but the banks do not have that skills and expertise. Other countries have decision makers with greater skills.

Dr Roberts: I recognise the issue in your second point. You have to say that how individual banks compete with one another to do that at a branch level is quite important, because, as you indicated, not all banks are the same, which is important. For example—this depends on the size of the facility required—if it is a small unsecured loan, it might be something that is still largely dealt with over the counter with the relationship manager. One thing that we are working towards at the moment is almost instantaneous lending for very small amounts. If a business is actually asking for a much more significant amount of money, it is quite appropriate that a second or third pair of eyes with much more experience in the market takes a look at it and comes to a more rounded view. Our experience is that that is actually a very valuable process, and you have to look at the different types of businesses. Even when a second or third pair of eyes looks at a loan application, we would still typically try to get a yes or no answer within a matter of 48 hours. It might take a lot longer for that loan to be drawn down, because the paperwork obviously has to be completed, but we do try to make the process as balanced as possible.

Q24 Justin Tomlinson: Some of the very best business people are the least academically able and therefore the least able to present a good, articulate case through a business plan. Where you feel that there is clearly potential, but that they are not ticking the boxes, what help and provision is given to help them to draw up the business plan and jump through the hoops?

Dr Roberts: A number of things. There are two basic routes. When it comes to collecting information, much of the information that we require of a customer comes straight through their bank account details. They do not have to give us those details, as we can see them. The second thing is that we run several thousand seminars and training programmes each year to encourage people to make a better lending application. We have worked both with the chamber and other business organisations to run events either on our own or through the British Bankers Association. We also have tie-ins with all the major accountancy bodies and the National Enterprise Network. There are a number of things that we do to try to improve the quality of a lending application, although at the end of the day we have to acknowledge that sometimes there is only so far you can go to make an application doable.

Q25 Justin Tomlinson: My final point is for the two Mikes. Figure 9 on page 25 of the Report is about the “Key communication tools for providing SMEs with guidance on business finance”. When I ran a business, I was too busy to be Columbo and go and hunt down whatever the Government of the day’s latest clever scheme was. Ultimately, unless somebody sent me a letter—preferably with nice pictures and bar charts on it in colour—that landed on my desk, things just passed me by. I have passed several hearings, in a number of questions in the Chamber and when I have met Ministers. The one thing that this Government do without fail is send a business ratesmailer every year. Would it not be helpful to include with it information on all these different schemes and, while you are at it, information on the apprenticeship schemes and on how to export, which we discussed last week? We have already paid the postage through the taxpayer. It could be just a slightly thicker envelope, and we would probably have a much bigger uptake of all these schemes. From your experience of representing businesses, are you finding that they are simply not hearing about this?

Mike Cherry: I think there is a general problem with Government and how they communicate, particularly with the small business sector of the marketplace. It is not just these sorts of issue that are badly communicated to our members and more generally to the wider business community. That is the case across Government and it needs addressing. Just pointing
members, for instance, to a website or telling them that something is there is not good enough. We do not have the time to go through all the stuff that we need to do. In any case, if you look at some of the Government websites, they are appallingly bad for being able to find your way through.

May I come back on the risk assessment? I agree with Richard as far as it goes, but there is one area in particular that we have real problems with, and again we highlighted this some years back. There is not enough transparency around credit scoring, which needs to be looked into, and there is not enough reporting back to businesses on why an application may or may not have been approved. Four out of 10 of our members, according to our surveys—this hasn’t just come up in the last one, it has come up in the last several quarterly surveys—are being refused applications, and four out of 10 of those are overturned on appeal. That quite simply, to my mind, means that there is something fundamentally wrong with the robustness of the application process internally with the banks, and it does need to be addressed.

Chair: Interestingly enough, if you look at any tribunal system in Government and the stats for things being overturned at appeal, it is always about that level. I will leave that for you to reflect on. I do want to move on, so I am going to limit people to one question each and then we’ll move on to the main session. We’ll hear from Stewart and Ian, and then Austin wants to come back with a final point.

Q26 Mr Jackson: I have two declarations of interest. First, I was one of Mr Tomlinson’s customers. He was always very good and very prompt, and I always paid on time. My second is that I used to be a bank manager, but I was more Captain Mainwaring than Gordon Gekko. I always used to ring people up before I bounced their cheques, which shows how long ago that was—almost 20 years.

Seriously, can I ask about something that was alluded to by Mr Tomlinson? It is about this mountain of cash that members will be prepared to invest in their businesses. I think there is another, much bigger issue about the hoarding of cash by large companies. Depending on which figure you use, £33 billion to £35 billion of that money is tied up in late payments, and late payment is one of the biggest issues affecting small businesses at the moment. We have seen the supply chain finance initiative being abused by companies extending their payments. We have seen the prompt payment code abused by companies extending their payments and still getting signatures to the prompt payment code. If that £33 billion to £35 billion was released and paid promptly—in our view, “prompt” means 30 days, as per the EU directive, with 60 days as the exception—that could do a lot to help to restore more confidence in the economy and to help people to invest.

Q27 Mr Jackson: How would you do that? Would you penalise companies? That is a very noble aspiration, but how would the Government intervene to make it happen?

Mike Cherry: Government have various tools at their disposal. First and foremost, they can use their contracts to ensure that when tier 1 suppliers are paid on time, that is replicated right through the whole of the public sector. Central Government get that; we have had long discussions over many months about that with central Government. Local authorities are beginning to get it. In our local authority survey this year, not only have we highlighted good practice, but we have shown how some of the issues can be tackled going forwards. I encourage all local authorities to look at that survey report and try to take some of those initiatives on board. I would also make sure that the rest of the public sector looks at it—the national health service, the MOD, fire services and police services. If we can achieve something around procurement, that is good. I think then that Government can probably do some moral arm twisting, certainly on the FTSE 350, to get them to start recognising that they should no longer be abusing their supply chains in this way. Many do support their supply chains, but too many do not.

Q28 Ian Swales: I would like to come back, Dr Roberts, to the transmission mechanism mentioned earlier, which the permanent secretary to the Treasury has described as “impaired” in these meetings before. A lot of these Government schemes are, in a sense, an admission of failure—business banks, green investment banks, Funding for Lending and so on. What is your comment on the fact that the Government seem to have to do so much in the banking field? Is it because you have exited certain parts of the market and you just haven’t told people? Why is it happening?

Dr Roberts: No, certainly in the business banking part of Barclays, we have not exited any part of the market. What we have seen is that we have gone from a situation whereby towards the end of the long boom in activity in 2007–08 we had a very wide range of participants in the market, and a lot of those have withdrawn. It has put a lot more pressure on the remaining banks in the market to try to deliver a wide range of initiatives. Clearly there are some parts of activity that we have always done and we continue to
do, but, for example, in high street banking, we have
never been involved in risk capital financing. That
type of business has not been something we have
done. Clearly, as Mike has suggested, that is one of
the things that I think many people would see as being
something some of the other business banks should
look at.

Q29 Ian Swales: I know that the Chair is in a hurry,
but can I pick up the issue of the Funding for Lending
scheme? You now need to have extra incentives to
make you lend to small and medium-sized companies.
Is that because most of it was actually going into
residential mortgages and you have had to be
persuaded to lend to businesses? Do you think that is
a good analysis?

Dr Roberts: No, that is not my analysis. The point is
that the way the Funding for Lending scheme works
is that it allows banks access to wholesale funding at
slightly better than market rates, and we pass all that
benefit on to people who borrow. In the case of the
small business market, of course, as I have said, the
main reason why businesses are turned down is that
we do not think that they can afford to repay the loans.
It does not matter how cheap the funding is; we still
would not want to make that lending in the first place.

Q30 Chair: So the incentive is a waste of time, is it?

Dr Roberts: No, because all the small businesses that
receive funding will get the benefit of the funding. We
pass the full benefit on. Unlike the mortgage market
where, with so many people renting a property, we
have evidence of being able to afford repayments, that
is not the same in the small business market, where
70% or 80% of people are turned down purely
because we do not think they will be able to afford to
repay us.

Q31 Ian Swales: Do you know what the proportion
is between businesses and mortgages in the Barclays
Funding for Lending scheme?

Dr Roberts: That is not published, I’m afraid. We do
not publish those data.

Q32 Ian Swales: Would it be 50:50?

Dr Roberts: That is not published, I’m afraid.
Obviously there are plans to publish it next year, when
the data are collected.

Q33 Chair: You don’t publish, or—

Dr Roberts: The Bank of England does not publish it.

Q34 Ian Swales: But presumably you know the
Barclays figure.

Dr Roberts: We don’t collect it

Q35 Ian Swales: You don’t collect it?

Dr Roberts: No, not on that basis.

Q36 Ian Swales: That brings me to my final point. I
have previously expressed in this Committee my
concern about the quantitative easing scheme, which
is that the Government decide to inject large sums of
money one way or another into the banking system,
and it is not always clear where that money goes. We
are dealing with international institutions for a start,
so if the Bank of England inserts money into Barclays,
for example, we do not even know where that money
goes geographically, let alone which sectors of
lending it goes into. What is your answer to the
Government? If we try to pull those levers, how do
we know what is on the other end of the lever at
Barclays?

Dr Roberts: That is much more to do with the overall
funding of the bank, rather than the particular part
of the market in which I am involved, so I couldn’t
comment. That is not part of my expertise.

Q37 Ian Swales: Funding for Lending has to stay in
the UK by the terms of the ways it works.

Dr Roberts: Yes.

Q38 Austin Mitchell: I think we all agree that we
want more competition in the banking sector, but
would you care to speculate on which of the existing
banks is setting a good example and which is not? I
ask because a couple of businesses in Grimsby were
experiencing difficulty in getting loans. I wrote to
Mervyn King saying, “These people cannot get loans
from the bank, although they are deserving
businesses.” He wrote back—I am paraphrasing—
saying that the big banks are a load of bums, but you
try Handelsbanken. What is your experience? Who is
good, and who is bad?

Mike Spicer: There are examples of good and bad
practice across the whole sector. Some of the
challenger banks, such as Handelsbanken, which you
just mentioned, market themselves on customer
service, but they are known to be expensive. If you
look at some of the mainstream banks, one example
of good practice is the Large review by RBS into its
lending practices, which is quite transparent that more
could be done in that area. Wherever you look, there
are examples of good and bad practice. We have heard
some good examples from Richard on Barclays. Our
businesses bank with all the major banks, as well as
the challenger banks, and it is the systemic problems
that our businesses really want to see addressed.

Chair: Thank you very much indeed for helping us.
We will now move to hearing from the accounting
officers.
Examination of Witnesses

Witnesses: Martin Donnelly, Permanent Secretary, Department for Business, Innovation and Skills, John Kingman, Second Permanent Secretary, HM Treasury, Ceri Smith, Director, Business Bank and Public Data Group (PDG) Unit, Shareholder Executive, Department for Business, Innovation and Skills, gave evidence.

Q39 Chair: Welcome. I am going to start with something I hinted at with our previous witnesses—this is perhaps to you, Mr Donnelly. This is a lot of money. It is £2.8 billion of taxpayers’ money, yet both the summary and the conclusions of the NAO Report claim that you have not articulated what your schemes are expected to deliver and that you cannot be sure that the resources will achieve the most impact. There is no statement of what the initiatives, taken together, could realistically achieve. Paragraph 2.4 on page 23 states that you said in 2010 that you needed to know whether the existing schemes were sufficient to ensure that finance is available to SMEs. I think there is some truth in what our friend from the Federation of Small Businesses said. It is all initiatives. You have no idea whether things are working. It is a drop in the ocean. What do you not know? Why have you not got a better or what works, and therefore what to spend precious taxpayers’ money on?

Martin Donnelly: I think it is important to separate out the different schemes and what they are trying to do, before we deal with the fair challenge in the NAO Report of how you pull the schemes together. We are trying to identify a series of long-standing market failures, so we have heard from the previous witnesses. Some of those failures are to do with problems of new companies raising bank lending with limited security or very limited track records. Some of that is to do with the rather smaller proportion of SMEs that want and need equity funding, whether that is through venture capital or business angels. Over the years, we have developed a series of schemes to try to meet those different needs. For each of those schemes—I think the Report fairly recognises this—we have systems of appraising how effective they are.

Q40 Chair: You have no idea about the totality. This is why I keep going back to it being £2.8 billion. I understand that the separate schemes have their own evaluative tick-box exercises. You have no idea with this £2.8 billion of Government money of the totality of the impact. Why? What are you doing? If you look at it crudely, less money is going into the SME sector. Is there any point at all in the Government spending at it crudely, less money is going into the SME sector.

Martin Donnelly: The total SME lending per year is around about £100 billion. We are consciously focusing on specific market failures in areas where firms would otherwise not get the funding that they need—

Q41 Chair: Sorry to interrupt, but is it your assertion that if you were not spending this money, there would be even less lending than there currently is to the SME sector?

Martin Donnelly: That is what the evidence fairly clearly suggests, yes. I would separate out some of the schemes, such as the finance guarantee, where it is relatively straightforward to see the companies that benefit from that. For venture capital funds, we have to look over a rather longer time scale. The figure that you fairly quote represents a lot of spending from the past. Some of those funds are now closed and we are working them out. We will get a full assessment of them over the years ahead. It is possible to say with confidence that companies that would otherwise not have received funding have received funding from these schemes.

Q42 Chair: What is the dead-weight? Of the £2.8 billion, how much is dead-weight and would have happened anyway, and how much is real added value?

Martin Donnelly: That is a fair question, and I cannot give you a detailed answer.

Q43 Chair: If you have an answer as to how the scheme has created business activity that would otherwise not have taken place, you must have an answer as to what the dead-weight is.

Martin Donnelly: It is partly because that figure includes lending schemes and equity schemes, which are different—

Q44 Chair: But I am looking at the totality. I do not want it scheme by scheme. Out of the £2.8 billion, for what would the banks have lent without any of the schemes? Most of it—I estimate 70%—goes to the enterprise finance guarantee. It is not that difficult a question. Even if you could tell me the dead-weight on the enterprise fund, that would be a starter. I am interested in the totality.

Martin Donnelly: If you look at the enterprise finance guarantee scheme, there was some research from Durham university a couple of years ago suggesting that more than 80% of those companies that received loans would not have received loans otherwise.

Q45 Chair: So 20% is dead-weight.

Martin Donnelly: Less than 20% is potentially dead-weight. It is very difficult to know with certainty, but the consistent theme from the previous witnesses, from case studies, from fund managers and from stakeholders is that these schemes are consistently adding value.

Q46 Chair: Mr Kingman, what is the dead-weight across the piece?

John Kingman: I cannot add to Martin’s answer, which I thought was fair, but I want just to back up a bit. It is an absolutely fair challenge to say that we are looking at a big set of problems, not a small set of problems. As you rightly say, we are talking about £100 billion or so of lending a year. The financial system in this country remains pretty damaged. There are a lot of things that we believe we are doing, and a piece is those schemes described in the Report, but there is a whole bunch of other things that we think are probably even more important. Funding for Lending is clearly one, and it is a major central banking intervention. More fundamentally, it is everything we have done to try to ensure that the banking system has enough capital in it, the dialogue...
Martin Donnelly: I am senior civil servant. In the last year, I changed my job to lead on research, working closely with the Treasury. I just want to underline that right, you start with the Report. I want to underline that you rightly started with the Report. Some of the schemes that we are talking about have been very long-standing and have been evaluated many times, and we have confidence in them. There are also some—and some that the Business Bank may want to bring forward—that are more experimental, and will, we hope, learn from some of the mistakes that have been made in schemes in the past. The point I want to underline is that you rightly started with the £100 billion question, but the answer to that question is a lot bigger than what is described in the Report.

Q47 Chair: One real frustration when I read the Report is that here you are, two key Departments, charged with supporting the growth strategy of the Government, which we all feel is hugely important, yet your failure to share even the most basic research—your failure to work together—is the thing that drives this Committee completely mad. If you can’t—if BIS can’t, together with the Treasury—share data and share research so that Mr Donnelly and his lot know that what they are doing is the most effective use of scare resource of the taxpayer’s pound, we are in an impossible situation. It is a terrible indictment for the NAO to have to come forward and say that you are failing to work together. I am trying to find that bit saying you are failing to work together to ensure that the initiatives that we are undertaking really do produce value for money.

Peter Gray: Paragraph 2.8.

Chair: It just drives me really bonkers.

Q48 Chair: You agreed this Report, Mr Donnelly. These are agreed Reports that come to us. Martin Donnelly: The point for us, without being pedantic, was the difference between the words “formal research programme” and what actually happens every day between the Treasury and BIS. We do work really as one team across this range of issues. There are some, which John may want to comment on, where the Treasury is clearly in the lead; there are others, including these schemes, where we are. Some of them—I might ask Ceri to comment, as someone who has worked in both Departments—such as capital for enterprise, we drew up together. We do work as a single culture in this area, because it is far too important not to. While there may be no formal research programme, there is absolute transparency between us on a day-to-day basis to deliver in this really difficult area.

John Kingman: May I underline that? Candidly, there are areas of policy where BIS and Treasury are not necessarily always aligned, but I really do not believe that this is one of them. Like Martin, I read this as a comment on shortage of research. I can tell you—that may or may not be a good thing—that the Treasury has no formal research programme into more or less any area of activity, because we do not have the resources to fund research.

Q49 Fiona Maclaggart: So you don’t know what you are doing well and that what you are doing works.

John Kingman: There has been a great deal of evaluation of the schemes—it is all described in the Report—but I am just saying that the Treasury does not have a research budget; perhaps it should, but it doesn’t. I, for example, have regular meetings with Ceri and his team and the team that is setting up the Business Bank. I think pretty much everything of substance that has been done in this space over the years has been a joint BIS-Treasury enterprise. There is a long history of joint documents that we have published together. This is really not an area where we are throwing mud at each other.

Ceri Smith: Perhaps I can give some examples. About 10 years ago, I was in the Treasury and I actually went over to the then small business service working on a joint project that led to the creation of enterprise capital funds. That was a joint piece of work between the then DTI, the Treasury and HMRC. There has been extensive collaboration ever since then. In terms of the formal research programme, there isn’t a joint formal research programme.

Q50 Chair: Do you mean formal?

Peter Gray: Yes.

Amyas Morse: We do. We are not actually disagreeing with what you say. There is a lot of informal contact. But we do not think that that gives rise to something where you look at the system as a whole. We are not sold on that.

Ceri Smith: If you take the Business Bank, I am the SRO for the delivery of the Business Bank project. I have the Treasury sitting there on the project board. We work very closely with Treasury colleagues as well as with Cabinet Office colleagues, and there is genuinely joined-up thinking.

Q51 Chair: Why aren’t you using the information that you get in the Treasury and HMRC to better inform your analysis?

Ceri Smith: To some extent, we do.

Q52 Chair: So is this wrong? I have to keep reiterating: these are always agreed Reports on the facts. The Report states: “Tax information, for example, could be used...but such data are subject to confidentiality restrictions.”

Ceri Smith: The data are subject to confidentiality restrictions—

Q53 Chair: But you can use HMRC generalities.

Ceri Smith: But that does not mean that you cannot do joint work on the research. This summer there was a joint project carried out between analysts and BIS, working very closely with analysts and HMRC, to look at how we could actually use the tax data, which, quite properly, has to remain confidential. Taxpayer confidentiality is clearly very important, but that does not mean we cannot use the administrative data to join up with data that we have from other sources to come up with joint analysis. There are constraints around
what we can do and the access we have to it, and some of those constraints mean that it is more cumbersome than it might otherwise be to actually do the joint work, but it does not preclude the analysts talking to see how we can marry up, for instance, information on the firms that benefit from VCT and EIS with some of the information on firms that benefit from some of the venture capital schemes.

There is one very important thing that we need to do to be able to evaluate all the schemes. If one of our objectives is to provide funding to firms that would not otherwise have received funding, one of the things we have to do is to get samples of firms that did not manage to get funding and the firms that did manage to get funding in order to be able to see what the difference was. That is very difficult and we have to look at firms with similar characteristics. HMRC data are potentially a very rich source of administrative data, and our analysts have been working very closely with some academics as well to see if we can match that up.

Q54 Ian Swales: Can I just come in? What data rights do you have? When you put this money into banks, what level of scrutiny and transparency are you agreeing with the banks in giving them the money?

John Kingman: I do not have that data at my fingertips. The Bank will be publishing much more information on the banks that are involved in the Funding for Lending scheme. From when to when?

Q55 Ian Swales: They will have that as well. That is my point. If you are putting all this money through the bank, surely you can have an arrangement where you get to see a lot of this information. If you are trying to drive a policy outcome, they ought to be on the other end of that.

Ceri Smith: There is joint sharing of information—

Q56 Chair: Ian is asking what they turn down, and why?

Ceri Smith: There is information that the banks share with us—some of the information is shared subject to non-disclosure arrangements—and the BBA will collect some data. I think the previous witness referred to some of that. On the evaluation, I was making a point about information—we are talking a lot about banks, but of course there are a range of other schemes as well.

Q57 Ian Swales: Going back to something I raised with the previous witnesses, on the Funding for Lending scheme, there was a policy objective largely about small and medium-sized businesses, but we know that households were involved, too. The most obvious thing as a citizen was seeing a rash of cheap mortgage offers and our small businesses not actually talking any differently towards us. Do you know how much of the £17.6 billion on Funding for Lending has gone to small and medium-sized businesses, how much to residential mortgages and how much to large businesses? There is a suggestion in the Report that some of it has gone to large businesses.

John Kingman: This is very important. The Funding for Lending scheme really is not a SME intervention, so I would slightly beg to differ. We hope that SME finance will be one of the beneficiaries of it, and we have seen some evidence of that, but it is important to go back to when the scheme was introduced. This was a massive central banking intervention designed to deal with a very serious problem for the British economy. The entire British financial system was struggling to obtain funding for banks on sensible terms, particularly term funding. That was really true across the piece. The scheme was slightly reshaped and extended earlier this year. One thing we tried to do then was to sharpen the incentives on banks to lend more to SMEs, and we have seen some modestly encouraging evidence. However, the scheme was designed to tackle a really big problem with bank funding in this country and I think most would say that it has been enormously successful in doing that.

Q58 Ian Swales: Do you know what those proportions are that I spoke about earlier? In answering that, do you therefore know what proportion has gone to small and medium-sized businesses from the Funding for Lending scheme?

John Kingman: I do not have that data at my fingertips. The Bank will be publishing much more data on SMEs early next year.

Q59 Chair: But you know that it has got better. You have just told us that it has improved; you must know from what to what.

John Kingman: Let me tell you the evidence that I think shows the scheme has made some difference to SMEs. Net lending across the whole scheme is not as good as we would like to have seen. Gross lending is the flow of new loans being made. At the point at which FLS was introduced, the rate at which bank lending to SMEs was shrinking was by 23% a year. Gross lending to SMEs is now growing at 11% a year.

Q60 Chair: Say that again—gross lending to what?

John Kingman: When FLS was introduced, gross lending to SMEs was shrinking at a rate of 23% a year. Gross lending to SMEs is now growing at a rate of 11%.

Q61 Chair: From when to when?

John Kingman: It is an annual rate.

Q62 Ian Swales: I do not know whether banks are incentivised to do this, but one thing we hear about from small businesses is rollover loans. In other words, one loan is closed and another is reopened, which apparently enables the bank to tick a box about new lending. Is that part of it?

John Kingman: No, because net lending is an even tougher test than gross lending, and what you are describing might increase your gross lending but it will not increase your net lending.

Q63 Ian Swales: You obviously know that the amount of lending to SMEs was inadequate because
that is why you are now “sharpening the incentives,” to use your expression. What ballpark are we in here? Of the Funding for Lending scheme, what proportion was going to small and medium-sized businesses? You obviously knew, because that is why you decided to sharpen the incentives, so what ballpark are we in?

John Kingman: Let me see what information we can send the Committee on that. As I said, there will be much more information when the Bank publishes it next year, which it is committed to doing. The point I am trying to make is that we know the scheme has worked at an aggregate level, but SME lending has been the hardest nut to crack. We have some modestly encouraging evidence. I am not going to say that FLS is the only thing that has been important here—for example, we happen to think that confidence in the economy is actually quite important. We are doing a whole bunch of things, not least in our dialogues with the individual big banks about their policies in this area. You have seen some of that recently with RBS. There is a lot going on—[interruption.]

Q64 Chair: Can you reconcile what you have just said with figure 4? Fiona Mactaggart: Exactly—that is what I am musing about.

Mr Bacon: There is a lot of chuntering going on, Mr Kingman. I am sure that you do not want chuntering if you can avoid it.

John Kingman: Figure 4 is net lending.

Q65 Fiona Mactaggart: Yes, and if you look at the pale yellow line in figure 4, that is gross lending, excluding overdrafts. It has been going down for the last quarter. Indeed, it has not reached the peak it reached in February 2013 or something.

John Kingman: I cannot immediately reconcile this chart with my figures, but I can tell you that my figures are accurate and they are—

Q66 Fiona Mactaggart: But you signed off this Report.

John Kingman: I will happily get this deconstructed.

Q67 Mr Bacon: Can we just be clear about what period you are referring to? This chart shows that there was a peak in March 2013. It went down in April and then slowly crawled up until about July, when it did not quite reach the March peak. It has then fallen very sharply until August 2013, which is the latest figure. To which figures were you referring when you were talking about gross lending being up?

John Kingman: I am referring to the figures I have for gross lending to SMEs over the last year.

Q68 Chair: Time period? From when till when?


Q69 Chair: That is August to August.

John Kingman: I would be delighted to send the Committee a note that deconstructs the chart and reconciles it with our numbers.

Q70 Fiona Mactaggart: I can tell you how you deconstruct it, because August last year was especially low, if you look at figure 4. It seems to be very convenient.

John Kingman: I don’t have this to hand, but I can tell you that I was recently—

Q71 Fiona Mactaggart: August 2012 is the lowest point on the whole graph.

Peter Gray: As the source at figure 4 indicates, we have taken that data from the Bank of England reports.

John Kingman: Let me come back to the Committee on that point.

Chair: Noted.

Q72 Meg Hillier: I want to ask about the lack of join-up that the NAO Report shows between the Treasury and BIS. Mr Donnelly, you gave a robust defence of day-to-day operations, but the Chambers of Commerce talked about a lack of coherence. Could you outline what you expect to deliver for small businesses? Mr Kingman, you talked about an increase, which we have just disputed. Funding for Lending was not just for small businesses—I get that—but what was the overall aim for small businesses? That question is to whichever one of you feels best placed to answer it.

Martin Donnelly: This is an area where we are very conscious that there is no magic wand. These issues have been around for decades, and we have got to go on doing better. I would emphasise that there are four or five issues we need to look at, one of which you rightly looked at last week with UK Trade and Investment: exports, skills, innovation, business advice and finance. We have got to look at the small business sector and the mid-caps. We have got to look at the fast-growing digital start-ups separately from the companies struggling to fund normal overdrafts. We have got to get better at pulling together everything we do.

If I may say so, I think the Report is very helpful in showing the challenges we face. We see the Business Bank as an effective way of pulling together the individual schemes with deeper management, and drawing on the private sector, the people we already are working with in Sheffield, and the civil service, which will pull together some of the schemes that are separately run by the Treasury at the moment and the schemes that BIS runs. I might ask Ceri to say a little more about that. It will also help us raise the profile. A point has been made about communication, and we recognise that we have got to get better at communicating with businesses, whose perceptions are sometimes worse than the reality of what is available.

Q73 Meg Hillier: Before Ceri comes back, what do you think success would look like, and how would you attribute it to Treasury-BIS intervention rather than to normal market forces? We want to see how taxpayers’ money is getting dividends. Linked to that, the NAO, in paragraph 15 of the summary and in paragraphs 2.22 to 2.24, states that there was “no rigorous process for making changes” following evaluations. We talked about the research and so on, but if you have an evaluation you have to look at how
you make changes that will deliver. That ties up with the question about what success looks like. Sorry, that was a bit of a wordy question.

Ceri Smith: Overall, what we are trying to achieve is to work with markets, and to get the markets for business finance—they are very complex, and there are different markets for different kinds of firms looking for different kinds of finance—working more effectively. That will require schemes to be targeted at particular failures, be they information asymmetries or to do with the lack of collateral.

Q74 Meg Hillier: Could you just explain information asymmetries? Is it where the bank passes information to the company?

Ceri Smith: Information asymmetries are when a firm goes to a bank for a loan knowing very well what its strengths and weaknesses are, but the bank, or equity funder, does not know what they are. There can be quite significant costs associated with trying to understand what the strengths and weaknesses are. For venture capital, in particular, there are transaction costs and due diligence, and firms prefer to do fewer larger deals, which allows them to reduce their cost base for deals. We have seen that over many years. We have seen that successful venture capital firms tend to do larger funds. If one fund is successful they will do another fund, and because they have been successful they can raise more money. As a result of that, they tend to do larger, discrete, individual deals. Over time, you see firms moving up the funding escalator. Part of what we want to do is to ensure that new firms and new funds come to the market. They are not static schemes for people dealing with their partners. Some of it is about building capability and capacity in the broader market. If you look at what we are doing on debt—

Q75 Chair: Give me evidence of one case where that has happened. You have been running these schemes for yonks, so give me one case of where you think that that effect, which is perfectly laudable, has occurred.

Ceri Smith: One of the direct objectives when the enterprise capital fund scheme was drawn up was to lower the barriers to entry for new funds. If you look at the recently announced investment of £75 million in the venture capital fund of funds, the Government are helping to close funds that otherwise cannot get to—

Q76 Chair: No, that is a Government scheme. I thought that we were talking about a Government incentive that has changed the nature of the market to enable the market to respond.

Ceri Smith: If you are looking at the venture capital, I cannot, because what we are looking at there is—

Q77 Chair: I know. I did not ask you about venture capital; I asked you to give me one scheme where either this Government or previous Governments have had an initiative to encourage lending to SMEs that paid off and changed behaviour in the market.

Martin Donnelly: Can we come back to the enterprise finance guarantee scheme? I am not sure that I can give you a totally rigorous response, but the evidence overall is very strong that the work we regularly do with all the banks on this scheme has encouraged more lending by banks to smaller firms than otherwise would have taken place.

Q78 Chair: It is down. Martin Donnelly: The net is down, but there is also an issue about when the firms choose to borrow that we have to factor in as well. I support Ceri’s point on venture capital. We now have the fourth highest level of venture capital in the world and I think the fact that we are able to co-found venture capital schemes through business angels has increased the amount of private capital coming in, because all of this is leveraged.

Q79 Chair: Do you think there is any evidence?

John Kingman: Yes. If you take the EFG scheme, which is the largest one, that is, as I mentioned earlier, one that has existed in slightly different forms over, I would guess, decades. It has been evaluated many times, including jointly by the Treasury and BIS and we have a high level of confidence that this makes a difference. We heard from the gentleman from Barclays earlier. Essentially, it makes economic bank lending to slightly riskier propositions than they would normally fund and there is copious evidence that that is good value for money for the taxpayer, because in the round we get a very good return from that spending.

Ceri Smith: The last evaluation for the EFG said that in the round it was a return of 33:1. While that may be overstating at the margins, if you simply look at the jobs created on the GVA, the last analysis we had suggested a return of greater than £10 for every £1 of Government money invested.

Q80 Mr Bacon: If it is in the round a good thing—by the sound of it, it is in the round a very good thing—why do the banks not take the view that, in the round, it is commercially worth doing?

John Kingman: It is simply riskier than they would normally go—

Q81 Mr Bacon: But for a 33:1 return—

John Kingman: I am not going to describe the banks in this country as perfect, for the reasons we discussed earlier. But I would say that successive Governments have looked at this scheme and concluded that it is very good value for money, and Treasury buys into that.

Chair: You have not answered the question, really.

John Kingman: It is a good question.

Ceri Smith: A lot of the return the Government will ascribe to a particular scheme is not necessarily captured by the lender; there will be jobs created and broader economic value. The Government will see a broader economic return from its investment. There will be some returns that are social in nature and some that are broader economic value—

Q82 Mr Bacon: You mean riots prevented and that sort of thing?

Ceri Smith: There will be a broader set of returns—
Q83 Mr Bacon: Do you have any metrics on that sort of thing?
Ceri Smith: I do not have any metrics on the number of riots that the schemes have—

Q84 Mr Bacon: When you say broader social returns, can you give us an example of the things you are talking about?
Ceri Smith: In terms of jobs created—

Q85 Mr Bacon: You mentioned that, but, apart from that, what are the broader social returns?
Ceri Smith: If you look at communities where you have businesses that are able to set up and get access to funding that they would not otherwise be able to get, the Government may say there is a return that is greater than the financial return of that particular firm. So if you are a bank, you may say, “Here is a particular deal which I can do with an individual business, and I will get a return on the loan that I have made, and I will get a risk-adjusted return on that,” but actually the Government will place a greater value on the fact that, in that community, there is now a shop that perhaps was not there and employment for people who might otherwise have been unemployed. There will be a broader set of economic factors that will be taken into account for the evaluation.

Q86 Chris Heaton-Harris: What market failures are we dealing with?
Martin Donnelly: I would use the start-up loans as an example where there is undoubtedly a greater social return than we will necessarily get from those who benefit from the loans to start businesses. Some of those will inevitably fail, but that will give them experience that we hope they will be able to use later to restart businesses as well as, hopefully, to grow businesses that exist. I think there are some wider factors there. Can I briefly come back to Meg Hillier’s point about feedback? It is a fair one, picked up in the Report. We do actually change schemes, like the EFG. We have made it a bit riskier for the Government—although we have not yet returned—in the light of the evidence that we have received. What is the case is that the Business Bank will now have a more structured approach to feedback loops on all the evidence that we pick up from what is happening.

Q87 Meg Hillier: How quickly will they be able to react to changes in the market?
Martin Donnelly: They will have a lot of autonomy. Ministers have decided that they will have more scope to move funding between schemes more quickly than is currently the case. We also have more evidence. Since 2011, we have had the small and medium-sized enterprise finance monitor, an independent survey of about 5,000 SMEs every quarter, which is giving us considerably more data.

Q88 Meg Hillier: In terms of the speed of change, you say it can move very quickly. How quickly would that be?
Ceri Smith: There will be some constraints on how fast any scheme can be changed, particularly aided schemes that require some state aid approval. There is a process that will have to go through, but one of the things we are looking to do is ensure that by bringing together policy delivery experts and people with expertise in financial markets, we will have the people together in one place to be able to react as quickly as possible. How fast? How long is a piece of string? It depends what the issues are. I would hope there is a much greater responsiveness within the constraints thereof.

Q89 Meg Hillier: Briefly, I want to talk sectorally. We talked about banking to risky businesses. I represent a lot of interesting businesses, including a lot of small creative businesses in the tech sector, which seems to be weathering the storm quite well. What are your views, particularly the Treasury’s views, on crowd funding and why the FCA is looking at it? It is an alternative source of finance. All of these models that you are talking about are failing a lot of our businesses, frankly. They are struggling to keep their overdrafts, and in some cases to get loans. Crowd funding is a way forward for them. Is that something you support? Are you talking to the FCA about the future of crowd funding?
John Kingman: Yes, absolutely. It is not just crowd funding; there are a whole range of providers and potential providers of finance that are not banks, and there are also challenger banks. One of the things we have to do is make sure the regulatory regime—indeed, in some cases, the tax regime—does not get in the way of what we regard as wholly positive and healthy evolutions in a market where we need much more competition. So there is a lot of dialogue with the FCA and the PRA about a regulatory regime that works. There are legitimate questions with some of these models about how to protect potential investors or participants in the schemes. It is certainly possible to imagine abuse, so the regulators have legitimate concerns, which need to be addressed, about how best to make these work. This is high up the agenda, particularly of the chief executive and the chair of the FCA. The FCA holds the key to making some of these things work.

Q90 Meg Hillier: Do you think that anyone in government—the Treasury or the FCA—really understands crowd funding? I am not being rude about them as professionals, but it is quite a new and emerging sector. The UK Crowd Funding Association, which I met recently, has about 24 members from all different sorts of crowd funding. Every time I speak to a business, they are doing it with a different type of crowd funding.
John Kingman: We certainly think it is our job to understand them and to talk to them. I spoke at a seminar last week that we and No. 10 had organised with crowd funders and other challenger forms of finance, because we care about the sector. We do not care because of some altruistic reason; we care for the good reason that we need more competition here.
Ceri Smith: May I give an example? Funding Circle is an online peer-to-peer marketplace. They were awarded £20 million in funding from the Business
Finance Partnership in December 2012. Zopa, another peer-to-peer lender, were awarded £10 million, which with leverage has the potential to translate into £20 million.

Part of our strategy for diversifying sources of finance and encouraging challengers is not just looking at challenger banks; we have the £300 million investment programme out there. At the moment, we are seeing lots from a range of funders, some of which are peer-to-peer funders, and we are in active discussions with a number of them. We are discussing very actively with a number of peer-to-peer funding platforms ways in which there can be further Government support to help ensure they can get access to the market.

Q91 Fiona Mactaggart: I was quite enthusiastic about this, and now I am not sure I am. It seems to me that the schemes are not clear enough about what you are trying to achieve and do not have a mechanism to ensure that small and medium-sized enterprises end up with the extra resource. We are putting taxpayers’ money at risk and not being clear enough about how the companies that can grow our economy are going to end up with this money. Tell me what is wrong with what I have just said?

Ceri Smith: Part of our success is not necessarily just about the money that goes through. One of the key things will clearly be a question of confidence. If you think about a rational firm, they would not apply for funding if they feel that there is no funding available to them. A challenge for us, therefore, is to ensure that the British Business Bank is well understood by SMEs. There is a lot more that we need to do to ensure that that does happen. One of the issues that was identified in the Report is that a lack of confidence in their ability to get funding is a reason why businesses do not go for funding, and therefore it stifles their own growth. One of the challenges we wish to address is to try to ensure that people do have the confidence. Part of that confidence is ensuring that people understand that there is a Business Bank.

Q92 Fiona Mactaggart: But you are only one 60th of the total lending of that bank?

Ceri Smith: Indeed. The Business Bank cannot be the whole solution. In fact, if you look at our survey evidence, businesses are twice as likely to be successful in getting funding than they think they are. If you are looking at refinancing, only 32% of firms think they will be able to refinance their existing facilities, and over 90% are actually able to get it in practice—that is the refinancing they get from the existing sources in the market from existing banks. A lot of this is actually about working in partnership with banks to make sure there are clear messages out there that the banks are open for business. It is very easy to fall into a trap of saying that there are lots of problems and that we need to fix those problems. It is true, but the majority of firms are able to access the finance they need. It is at the margins that they cannot, and we want to be able to have effective interventions at those margins that will make a difference, and there is more that we can do to do that. For the majority of firms, they will be able to access the finance they need from their existing bank or their existing source of finance. It is wrong to give an impression that it is all doom and gloom out there. There are problems, and we need to fix them.

Q93 Fiona Mactaggart: I do not think I was doing that. What you are saying to me seems to be a strong argument for you investing this £2 billion or whatever in PR, so that companies know that they can get borrowing, rather than the state lending it to them.

Ceri Smith: I do not think that the solution is—

Q94 Fiona Mactaggart: I am not suggesting that. I am just saying that that sounds like what you are arguing.

Ceri Smith: No. I am just saying that communication, which I think has been identified in the Report as something that we need to do more on, is clearly a challenge. The Business Bank, as it is set up, is aware that one of the big challenges—

Q95 Chair: How much will the Business Bank have every year under the existing plans?

Ceri Smith: Of new finance?

Chair: Yes.

Ceri Smith: It will have £1 billion of new capital.

Q96 Chair: A billion of new capital. What will they be able to use out of that?

Ceri Smith: You would then use that—

Q97 Chair: You would have to recycle it?

Ceri Smith: We would be expecting to leverage between £5 and £10 of private sector money for every £1 of capital that the Business Bank has. The idea of the capital base—

Q98 Chair: I do not understand what the £1 billion is. Will it be something that they inherit and they will just have to use it and recycle it over time, or will they get additional moneys every year?

John Kingman: They will get £1 billion up front in capital, which, as Ceri says, will be very substantially levered. Exactly how much depends on what you choose to do with it.

Q99 Chair: You hope it will be.

John Kingman: There is every reason to think that they can lever it. We will have to see exactly how much. That will deliver a return. Just like any bank, they will make profits—

Q100 Chair: Not if they do the risky stuff that you want them to do.

John Kingman: We want them to do profitable activity.

Q101 Chair: But if you want them to do profitable activity, you might as well leave it to the banks.

John Kingman: With respect, we are not willing to leave it to the banks.

Q102 Mr Bacon: Can you finish explaining why you are not willing to leave it to the banks?
**John Kingman:** There is copious evidence that, particularly in SME finance—

Q103 Mr Bacon: In what finance?

**John Kingman:** SME finance. This is a market that has had long-standing competition problems, and then, as we heard earlier, one of the effects of the crisis was to take a lot of provision out of the market. This is some way off being a perfectly efficient market. But I do think, just to come back to Ms Mactaggart’s question, and as Ceri says, that these Government schemes are well groundeds and evaluated, but they cannot solve the problem on their own. The big solutions to this will be in the bigger stuff. It is about making sure that the banking system is functioning. For example, we heard earlier that there is a rather good and well-functioning independent appeals system. So anyone who is refused a loan in a British bank can go to this appeal system and get it appealed. We heard, correctly, that currently the success rate in that appeals system is 40%. Notwithstanding the Chair’s comments, it seems to us that 40% is appallingly high. This tells us that this system is not working well. The other thing that alarms us—

Q104 Mr Bacon: Could you just explain who arbitrates in the appeals system?

**John Kingman:** It is ultimately overseen by an academic professor who has done this for a long time. But it does appear to work. The big weakness, it seems to us, in this appeals system is that nobody knows about it. Awareness is very low among SMEs, even SMEs who are looking for finance. We are having a very active dialogue—I must say a good dialogue—with the BBA about concrete steps that they can take to transform, as we believe needs to be transformed, awareness among SMEs, particularly SMEs who want access to finance, of this appeals system. People need to know that there is something that actually works that is not some cynical thing run by the banks that is a waste of time and not worth bothering with. They need to know that this thing has a decent success rate and is worth bothering with.

Q105 Ian Swales: Is there really just one person? It sounds that if you communicate it widely, he’s going to be overwhelmed, isn’t he?

**John Kingman:** He is very enthusiastic about having awareness raised. He is not sitting there doing the forms himself. He oversees the processes that the banks run.

Q106 Chair: Can I just get the funding straight? They have £1 billion capital.

**Ceri Smith:** Yes.

Q107 Chair: And what else?

**Ceri Smith:** They would need the existing stock of the existing scheme. I think that is another £2.8 billion. There is a capital base. So the bank will have to be capitalised.

Q108 Mr Bacon: The money that is already out there will be poured into the balance sheet of this thing and will become assets of the Business Bank?

**Ceri Smith:** Indeed.

Mr Bacon: So it will have £3.8 billion.

Q109 Fiona Mactaggart: Does that mean that all the venture capital that is lurking in figure 13 will become assets of the Business Bank?

**Ceri Smith:** Yes.

**Fiona Mactaggart:** I am very struck by them. The one that seems to be the most successful is the one that is something that you would expect the Government to be better at than banks, which is the community development venture bank that Ronnie Cohen helped to set up. I am not surprised that it is the most successful because the Government understands how to judge that kind of enterprise—solving social problems—much better than it understands how to do business. Are you going to say anything about that?

Q110 Justin Tomlinson: A number of times we have talked about competition challenges. Like most of the other members, I can see that there have been some successes here, but I keep wondering whether the £2.8 billion might have been better spent trying to encourage more entrants to come to the market. I know from my days of running a small business that the challenger banks like the Alliance and Leicesters, who are no longer around, were the ones who proactively—arguably aggressively—chased up businesses to try to borrow money. Whether that was a good thing is another matter, but certainly that drove the competition. We have those players who are strong enough and steady enough, but maybe not spectacular enough, left in the market. Maybe that £2.8 billion might have gone some way to get those traditional high street banks a bit more competition back on the high street. Was that considered?

**Martin Donnelly:** It is worth saying that some of the £2.8 billion was obviously in funds—particularly in venture capital—some years ago, which helped during the downturn, but we are in a different position now. It is a fair challenge, and it comes back partly to the point that five banks provide 90% of the financing to SMEs. We have—Mr Bacon’s challenge—a Business Bank, which we believe can proactively identify market gaps, where it is possible to make money, which are not being currently filled. We believe that one reason for that is because virtually every other major OECD economy has a similar system, including the United States, so there is something quite deeply engrained in the system that we are dealing with. It is also the case that we must increase both current competition—John has commented on that—and bringing in new entrants, particularly digital. The fact that we have systems for online platforms to fund supply chains for peer-to-peer—for funding circles—is potentially a major role which the Business Bank will finance and which we hope will help to deal with that problem.

Q111 Justin Tomlinson: The reason behind my question is that the traditional high street bank with its customer database would invariably send
something with your monthly statement suggesting that you might wish to borrow some money, even if you had no intention of doing so. They were always proactively trying to get you to use some of their products. There are lots of new ways of borrowing money and lots of new things coming to the market, but the typical busy business person might not necessarily be aware of them. That was highlighted in figure 9, on page 25. When we heard from the FSB and the Chamber of Commerce earlier on, they agreed with those findings. A lot of those good but innovative, small and bespoke schemes are simply passing busy business people by. Therefore, there is a question about our communication. I have raised this in a number of other hearings and in a pre-hearing: why are the Government not utilising the business rates mailer? The taxpayer has already paid for the posting, and it goes to every single business person in the country. Therefore, we can promote schemes like this, or apprenticeships and exporting, as we had with the hearing last week—new schemes that otherwise busy business people are simply not aware of.

Martin Donnelly: There is no doubt that we need to do more in this area. We are focused on improving our online offering, particularly through the business finance and support finder. Last month, on gov.uk, we upgraded that significantly. We are linking it in with the new “Great Business” campaign, which was launched a week or so ago, and we are seeking very actively a whole set of feedback from real companies at the SME end.

Chair: Why don’t you do what he is suggesting?

Q112 Justin Tomlinson: I’ve sold my business, but if I was still a business owner, you could be doing all sorts of fantastic things on your website, but until you tell me to go and look at your website, I am not going to look at it.

Chair: He is just suggesting a very simple thing.

Ceri Smith: It is a long-standing problem that small business people are very busy running their businesses. A load of Government communications coming through the door will quite often be filed straight in the waste paper bin. I completely understand it—

Q113 Justin Tomlinson: No, you don’t understand; you have it completely wrong. You are not sending me communication for me to file into the bin; it is just not coming—full stop. That is why I keep suggesting that the business rates mailer is a key issue for all businesses. It is amazing how so many people say, “Oh yeah, that’s a good idea, because we’ve already paid for it”, but it has still never been utilised.

Ceri Smith: I understand. For examples of information that is sent out from Government, I was thinking about HMRC sending out tax information. It has always been problematic trying to ensure that we get information at the right time. I think we can absolutely explore the use of the business rates mailer. It might be a useful additional mechanism that we could use, but one of the key issues is, do you get the information in front of the person at the right time? One of the things that we have research on is where people go for sources of information. A lot of the time, they will go to their existing banks and talk to people in their informal and formal networks to get those sorts of information. Coming to Government is not at the top of their list of priorities for getting access to information.

Q114 Justin Tomlinson: As a business person, I am not asking for me to go to the Government; I want the Government to point me in the right direction. That’s what it is. All those surveys that ask, “Where have you got your information from?” talk to people who did get the information. All those people who didn’t get the information are therefore not being covered by the surveys.

Ceri Smith: With the design of the schemes, which is about working with partners, what we are trying to do is to ensure that we work with commercial partners who have an incentive to do their own communications to segment the markets themselves. I do not dispute that we might be able to use the business rates mailer—I know that work has been done by the Cabinet Office looking at how we can use some of the communications the Government send out more actively to nudge people into doing the right thing. That is certainly something we can take away. However, with the approach that we are taking by using partners, one of the things we want to do is not to have people come to use a Government scheme. We want people to be able to access finance. There may be a Government scheme sitting behind it, but we are not doing B2C—if the SME is the C. Instead, we are working with partners and trying to ensure that partners are aware of the Government schemes and that they are out there talking to individual SMEs. The challenge is partly about ensuring that the partners whom we are working with are out there drumming up the business and ensuring that people are aware of particular products.

Q115 Justin Tomlinson: You don’t half over-complicate things, I tell you that. Successful business people do not have the attention span for things like that.

On a final point, Stewart Jackson raised an interesting point—he did it earlier, but as he has had to leave, I will take it on—which is that for the first time we are seeing businesses sitting on more money than they are borrowing. Is there not a way of creating incentives, perhaps through the tax system, to release that money, potentially to some of the new exciting things that Ms Hillier has mentioned a number of times? I know that when I ran my business I did not have an overdraft, and sometimes some of my suppliers would come to me and say, “I have to pay a VAT bill and I have to pay my staff, so can a deal be done?” and deals could be done. Businesses are receptive to using money they are sat on.

John Kingman: I don’t know about tax incentives, but there are some interesting things happening in various sectors under the general banner of supply chain finance which the Government is very keen on. We are doing a number of things ourselves. We have also been talking to a number of big companies about what they can do, essentially to lend to their suppliers,
because as you say, they have a relationship of trust with their suppliers and they know who they are dealing with. There are people in Government who are actively going around talking to big companies and trying to persuade them to do that.

Q116 Chair: Give us one example of where that has worked.

John Kingman: I will have to check these, but I believe we have had extensive, successful discussions with Tesco and Jaguar Land Rover. Don’t take this as gospel, because I have to check these, but I believe there are a number of sectors where this has taken off.

Q117 Austin Mitchell: I think we have agreed that Government policy has pulled in different directions in the past couple of years. On the one hand, we have these schemes—which I welcome, because they are a Keynesian glimmer in the monetarist gloom around us—and you have the Bank of England stuffing money into the banks through quantitative easing, so they have got more money. But on the other hand, they are subject to increases in reserve requirements consequent on the recession of 2008, which is making them more risk averse. Lending to small and medium-sized enterprises is trouble, and is also a risk for the banks. I see from paragraph 2.12 of the Report that “banks are able to use the funding as they see fit”, which alarms me a bit. John Kingman, how can we ensure that they are passing on the support that is available to the SMEs?

John Kingman: To go back to what I said earlier, this scheme was introduced in a context where the British banking system was seriously struggling to raise funding, and to do so on sensible terms, particularly term funding.

Q118 Chair: Which scheme are we talking about?

John Kingman: The Bank of England’s Funding for Lending scheme. We have taken advantage of the scheme to strengthen the incentives on banks, particularly to lend to SMEs. Essentially, the way it works is that the price at which you can get funding depends on the bank’s track record of lending generally and to SMEs in particular. So the Bank of England has essentially tried to create an incentive regime that says that the more you can grow your net lending—and we heard earlier that, notwithstanding the debate about gross lending, growing net lending is the regime that says that the more you can grow your net lending—and we heard earlier that, notwithstanding the debate about gross lending, growing net lending is tough—the cheaper the finance that the Bank of England will offer you. So the idea is to try to incentivise the banks.

Q119 Chair: The guy from Barclays just said that didn’t work. Unless I heard him completely wrong—Committee members can correct me—actually, he sat there and said, “Whatever you put into the incentive scheme for Funding for Lending, I would look at the proposition, not at the incentive.” So what is the point of the incentive?

John Kingman: I don’t think that is correct. The Funding for Lending scheme was to try to unblock a massive problem at the heart of the British financial system, and I think it is generally recognised that it has been successful in doing that as a central banking intervention. We would like it to be one of the many things that will sharpen the incentives on UK banks to lend to SMEs, and we hope and believe it can do that.

Q120 Chair: You hope, but he says it doesn’t. I am trying to get at the heart of this. Is he standing alone?

John Kingman: We shall see. The scheme was onlyreshaped in this way in April of this year. The Bank will publish a lot of evidence on how it has worked next year, and they have committed to doing that. This scheme is one of a whole set of things that are important to getting the British banking system working right. Bluntly, if this fails, we will have to do some other things that might succeed. We certainly cannot guarantee and would not expect that this scheme alone will transform SME lending. The Bank was crystal clear when the scheme was created that all it could do would be to make things better than the counterfactual, which at the time was looking pretty ghastly.

Q121 Austin Mitchell: Okay, so we will know—hopefully.

Let me move on. I take it from figure 1 at the start of the Report that none of the schemes covers the problem of what you might call the payday lending area for SMEs. In other words, I mean the sudden need for working capital that has to be provided quickly in order to tide them through in the short term. Why is that?

Martin Donnelly: I think that raises the wider issue of where many SMEs actually go to fund themselves. It is concerning that we have evidence that many of them, if they are very small, will often fund themselves with credit cards or that they will go to other very expensive funders. There is an issue there both about ensuring that SMEs understand what the best form of funding is for the situation they are in, and about banks and other lenders giving them the information they need to fund themselves. For example, if it is trade credit that they need, rather than an overdraft, then that is going to be more cost-effective for them. There is an issue about skills levels at the retail end in many banks, which has been touched on and is a real challenge for us going forwards. There is also an issue—this is the information point again—about getting to small firms so that they understand what is available. They sometimes need mentoring advice to find out in which direction they should be going. We are trying to work on that separately, through the business advice schemes.

Q122 Austin Mitchell: But you have to be able to react quickly, because in my experience this is one of the major problems facing small enterprises in particular. When a sudden problem occurs and there is no capital and they cannot survive without help, no help is available.

John Kingman: This point is about the specific case of RBS, which happens to be the biggest lender to SMEs in the country and happens to be 80% owned by the Government, so we are unusually familiar with its affairs. RBS published a very interesting report two weeks ago by a man called Andrew Large, which was
commissioned by the board and asked, “Why aren’t we doing more on SME lending?” It is a fascinating report because it does not describe a bank that was not interested; it describes a bank that tried to grow and allocated more capital from the centre. It then describes a whole set of really nitty-gritty operational issues that badly need to be fixed if RBS is to provide the kind of support to its SME customers that you are describing.

The natural place that your troubled SME will turn is their bank. That is the first place that they will turn. What Andrew describes in his report is a whole set of quite crunchy, precise reasons why, in the case of RBS, that is not working as well as it needs to be. RBS is one player and we have asked other banks to look at Andrew’s report and have said, “Your business may not be identical to RBS’s, but are there any lessons in this report for you and how you organise yourself?”

Q123 Chair: Two things were particularly worrying about that report. One is that the rejection figures do not show up in official statistics because RBS screens out inquiries before the application process is even reached. What are you doing about that? The other thing is that customers perceive RBS to be unwilling to lend.

John Kingman: Look, Andrew Large’s report is a disturbing read. It is a disturbing read for us, for the board—for everybody. As I say, it does not describe a bank that did not want to try to do the right thing; it just did not do it, because the instructions that came down from the board were not correctly turned into different behaviour on the ground. What you have at RBS is a very different chief executive. The new chief executive is a man with a deep operational background as a retail banker, and he strongly believes that RBS’s SME lending business is one of its jewels and is something that he can make a lot more money out of if he runs it better. He is quite lucid on the subject of the business being run a lot better. That is one of the central things that he wants to do as chief executive. By the way, I think it is generally true that if you look at the chief executives of the large UK banks, you have a generation that is a lot more interested in the SME lending business than their predecessors, partly because some of things that their predecessors spent a lot of time doing have blown up or, as in the case of investment banking, the economics have changed dramatically.

Q124 Chair: Given that optimism, when are you expecting to see a change in actual behaviour? When will more money be coming out?

John Kingman: We will see, but I am just saying that—

John Kingman: He believes that turning round this bank and fulfilling its full potential is going to take him quite a long time.

Q127 Chair: What does that mean, “quite a long time”?

John Kingman: He made one specific commitment the other day. One interesting thing is that at the moment there exists no independent survey of what SME customers think of their bank, so RBS is funding the FSB and the BCC—the two organisations you saw earlier—to create a new survey. He is saying that they are going to fund the creation of the survey and that it will be run by those organisations, and I don’t think anyone would say that they are in the pockets of RBS. He says that they aspire to be the best bank in Britain on that survey. He is also quite clear that that is going to take him some time. That seems realistic.

Q128 Mr Bacon: Why is it taking this long? I have been going to a banking forum in East Anglia, organised by Norfolk and Suffolk MPs, where some very senior bankers and the FSB have been turning up every year for three years. Every year it is a dialogue in different time zones, or space zones, when you compare the two conversations. The banks are saying, “Things are going quite well: there are a few difficulties, but basically the future is so bright we have to wear shades.” The people who are FSB members are saying, “What planet are you on? Because you’re not on ours.”

I am glad to hear what you are saying, Mr Kingman. I hope someone can arrange for RBS to send a copy of the Andrew Large report to every member of the Committee, but why has it taken this long? Why did you not have a retail banker of the kind you describe trying to rescue RBS five years ago, instead of an investment banker, Mr Hester?

John Kingman: It is important to remember that at the time that RBS was rescued—there were four successive rescues of RBS—it was the largest bank in the world, and it was a very scary thing. Stephen Hester used to use the language of defusing a financial bomb, and frankly I don’t think that is over-colourful.

There was a lot to do, and I think that everyone recognises that he did an astonishing job of dramatically shrinking this ludicrously large balance sheet, which ended up on our balance sheet. He did a brilliant job of that.

Q129 Mr Bacon: The one that the Government’s regulators allowed to get that large.

John Kingman: Indeed, absolutely. Andrew Large does not describe a situation such that, as it were, the previous management somehow did not give the SME lending business the capital to go out and lend. They did: they sat there at the centre and said, ‘Have some more capital. Please, please, please go and lend.’

However, I think the answer to your question about talking down different tubes that you described from your meetings reflects the situation where the people on the ground were not giving accurate messages to mission control. That is what is described in Andrew’s report.

Chair: Terribly badly managed.
Q130 Jackie Doyle-Price: We are aware of how much liability the state has had to pick up due to the recklessness of the banking sector. Far be it from me to call for more regulation, but when I look at figure 3, which deals with the principal source of finance for SMEs, it leads us to the issues that Austin raised earlier about the behaviour of banks and their being risk-averse. We see that overdraft is the largest source of finance, at 19%. That has also been historically true, hasn’t it? SMEs have always been more comfortable about relying on overdraft facilities to finance investment. Is that figure consistent with how it has been in the previous two decades before the crash?

John Kingman: I would say largely so, but I would ask Ceri.

Ceri Smith: I don’t know. It feels very familiar. Also with experience abroad, I know that in the US there is a huge amount of utilisation of credit cards again. A lot of it is for the convenience, not necessarily the price. I don’t have the exact figures on what happened in the past.

Martin Donnelly: I was talking to an academic around this over the weekend, who said that traditionally SME borrowing tended to equate with house prices, because they would release equity on that. That is another part of this issue.

Q131 Jackie Doyle-Price: What I am trying to get at is, if we are looking at the behaviour of banks, the Government have released capital and said, “Go forth and lend.” Really, we should expect banking advisers to be advising small firms what their best source of finance is. Frankly, relying on an overdraft leaves you very vulnerable as a business. In a previous life, I worked for an enterprise agency and saw distraught owners come to me because their overdraft had been called in when the market was tight in the early ’90s. Wouldn’t you expect to see banks encouraging their clients on to a more secure financial arrangement if they need credit?

John Kingman: I completely agree with that, but I also think that, to get this right, obviously we should be putting heavy pressure on the big banks to do the right thing, but the thing that will really change this dynamic is if we can establish a world where SMEs have more choice of where they can go for their money. That is the big thing we can do to fix that, and there is a whole bunch of things we are trying to do to fix it.

We are seeing challengers coming in. We have a bunch of regulators who are trying to ensure that their systems are consistent with new entrants coming into the market and growing. Through the Business Bank, one of the options is for it to be investing in the capital of challenger banks so that they can bulk up, and we have done some of that through the business finance partnership. I think the lasting solution to the problem you are describing is more competition.

Q132 Jackie Doyle-Price: To what extent do we have to change the behaviour of these entrepreneurs? Sometimes they like the flexibility that comes with a less contractual method of borrowing. When I first looked at the figures, I was horrified about the figure for credit cards, but there are so many 0% deals now that in some respects it might be the best source of finance for some people. To what extent does it change the behaviour of lenders and owners?

Martin Donnelly: I think you are right. We must do both. It is hard to know from aggregate figures the precise position of very different SMEs, whether it is a high-tech start-up or what people call a lifestyle SME. There are people for whom having an overdraft facility is perfectly sensible, although they may not use much of it at any given time. There may be people who, partly for control reasons, want to use credit card finance for the odd large purchase. The challenge is ensuring that they have the knowledge to know whether those are the right facilities for them, and it is also—I very much agree with John—about competition and a sense of having skilled people at the retail end of finance who will be prepared to go out and assist or challenge people by saying, “Are you sure you should have this size of overdraft when you are using it for, say, trade finance?” It is a problem that we have deskilled too much of the retail banking sector in recent years. We must encourage the banks that are moving back into that space to get there more rapidly.

Q133 Jackie Doyle-Price: When we look at this, “bank loan/commercial mortgage” is only 8%, so you are making capital available for use via that mechanism, but it is actually not reflecting what is really happening in the marketplace. That is not a criticism, because you can use only the tools you have at your disposal, but it illustrates that it is very difficult for the Government to act in a way that will really make a difference.

Martin Donnelly: We have to keep at it.

Q134 Mr Bacon: Mr Kingman, I agree with you about competition. Can you tell us how many banking licences have been issued to start a new bank in the United Kingdom since the financial crunch?

John Kingman: Not as many as we would like.

Q135 Mr Bacon: How many?

John Kingman: I don’t have the number. It will be more than zero—at least, I hope it is more than zero.

Q136 Mr Bacon: That’s what I would like to know.

John Kingman: Let me come back to you on that, but bear in mind that your typical new entrant will tend to buy an existing licence rather than, as it were, just go and do the exams. We take the view that the regulators have historically not had the right attitude to new entrants. We do not believe that their attitude to the capital that new entrants have to hold was correct. We believe that their processes for approving new entrants were ridiculously long.

Q137 Mr Bacon: If you don’t mind—I do not have a huge amount of time and I have two or three questions—would you send us a note of how many since Northern Rock?

John Kingman: I am happy to do that.
Q138 Mr Bacon: I think the answer will be very low indeed. The last time I had a conversation on this, which was admittedly a while ago, I was told how unbelievably difficult it was, but perhaps you would send us a note. The second thing is the OECD. Mr Donnelly, I think you mentioned that there were similar, analogous institutions to the Business Bank in nearly every OECD country. Can you send a list of the ones that are the most analogous in each of the 24 OECD countries?

Martin Donnelly: We can certainly send you a list of the ones we have looked at. I’m not sure we have done that for all the OECD countries, but the most relevant ones.

Q139 Mr Bacon: You looked at the big western European countries: France, Germany, Italy, and the US—

Martin Donnelly: Absolutely.

Q140 Mr Bacon: If you could tell us all the ones you have, that would be great.

Mr Smith, have you run a bank?

Ceri Smith: I have not run a bank.

Q141 Mr Bacon: You are going to be the boss of this new bank; is that right?

Ceri Smith: I am not going to be the boss of the new bank, no.

Q142 Mr Bacon: Sorry, but it says in your biography that you are going to head the Business Bank: “Ceri joined the Shareholder Executive in June 2013 to head the Business Bank”. Is that right?

Ceri Smith: I am delighted to hear that, if rather worried. It is not correct, no. I am heading the Business Bank team within the Shareholder Executive. We have recently appointed a chair to the Business Bank itself.

Q143 Mr Bacon: Who is that?

Ceri Smith: It is Ron Emerson, who has banking experience. We have Christina McComb as the senior independent director, who has venture capital experience.

Q144 Mr Bacon: Will there be a chief executive?

Ceri Smith: There will be a chief executive. There is a recruitment process at the moment. We have just been through the shortlisting process and we hope to be able to make an announcement by the end of the year.

Q145 Mr Bacon: And will having a banking qualification be one of the criteria applied to whether you give somebody the job or not?

Ceri Smith: Having experience of banking and the world of commercial finance will be. They will not necessarily need to have direct experience of retail banking in the UK. We are keen to have people who understand the banking market. Of course, although it is called the British Business Bank, it will not actually be a bank in the retail sense. It will be operating more at the wholesale level.

Q146 Mr Bacon: Right. None the less, it is going to operate as a bank.

Ceri Smith: It will be operating under banking legislation.

Q147 Mr Bacon: And it will have a banking licence.

Ceri Smith: I don’t think it will have a banking licence.

Q148 Mr Bacon: It will not have a banking licence. So in what sense will it be a bank?

Ceri Smith: It will be operating as a wholesale institution that will be financing—

Q149 Mr Bacon: If you are going to call something a bank, it is rather like the word “institute.” As Paul Simon said, “Hey…that’s astute” / I said, “Why don’t we get together / And call ourselves an institute?” You cannot just do that—the word “institute” is controlled by legislation. I am pretty sure that the word “bank” is controlled by legislation as well. You cannot just call something a bank unless you meet certain tests and have a banking licence.

Ceri Smith: Indeed.

Q150 Mr Bacon: And this body is not going to have a banking licence.

Ceri Smith: I think that there are discussions. If there is any risk of confusion that it will be taking deposits from individuals, there will be an issue around us being called a bank.

Q151 Mr Bacon: So it’s not going to take any deposits from anyone.

Ceri Smith: It will not be taking deposits.

Q152 Mr Bacon: So it is just going to take taxpayers’ money and give it to people.

Ceri Smith: It will be investing capital wisely in a range of schemes—

Q153 Chair: Taxpayers’ money.

Ceri Smith: It will be investing taxpayers’ money in a range of schemes and using that to generate a return for the taxpayer.

Martin Donnelly: May I add something to that point? We are building up a team that has external finance expertise to use capital for enterprise. They are people who have been running these venture capital schemes in Sheffield for some years very effectively, and also people from the Shareholder Executive. We believe that having that sort of team of people—there are about 60 of them, and it will go up to about 100—will add value.

Q154 Mr Bacon: You had a pot of 28 different venture capital schemes in DTI or BIS—I forget what it was at that moment. Is that something to do with what you are talking about?

Martin Donnelly: They have been pulled together.

Q155 Mr Bacon: I remember the hearing we did on that. You turned £70 million into £5 million. As Mr Mitchell said at the time, “I could have done that.” In fact, I could have done it as well, without taking a
£42 million management fee, which they did on that occasion.

**Martin Donnelly:** I think we learned some lessons from that.

**Mr Bacon:** That’s good—

**Q156 Chair:** But it is the same people working on the new scheme.

**Mr Bacon:** Is it?

**Chair:** It is the same bunch. Individuals might have come and gone, but it is the same bunch.

**Ceri Smith:** I think the original schemes—the legacy schemes and the regional venture capital schemes—were administered out of the small business service and the DTI. When I was in that joint team I was talking about earlier—the Treasury, DTI and HMRC team—looking at what we could do to try to bridge the equity gap, we looked very closely at and learned some lessons from the early schemes, as is acknowledged in the Report, and we created capital for enterprise. Capital for enterprise is a delivery mechanism that has been delivering enterprise capital funds, EFG and such like. They are the people who will be moving across. That is not to say it is the people from a long, long time ago; it is the people who have been administering the schemes since the enterprise capital funds were set up.

**Q157 Mr Bacon:** Mr Kingman, you have done a lot of quantitative easing in the past few years—I think the figure is now £375 billion or so—which has been used to help the banks to strengthen their balance sheets. They have then gone out and used that money. One of the problems is that they have gone and used it to bet on the world price of wheat rather than to lend to SMEs. Why do you think that is?

**John Kingman:** Do you mean specifically?

**Mr Bacon:** Well, yes. I am not talking about the rigging of the electricity market, although of course they have done that as well—and it turns out recently that they have done the foreign exchange market, too. Betting on the world price of wheat is just one example. They have done that on quite a big scale and made money out of it. Why do you think they do that rather than loan to SMEs?

**John Kingman:** Actually, betting on the world price of wheat or anything else is a much less superficially attractive proposition than it used to be because regulators have got wise to the risks involved in these activities and required banks to hold an awful lot more capital against them. Any UK bank you care to look at will have dramatically reshaped any investment banking operations it has. That is true of Barclays, RBS and HSBC. There is a new world out there. You are right that, rightly or wrongly, we have in this country a number of major financial institutions, which happen to be enormously international businesses. We cannot wish that away. That is what we have in this country.

**Q158 Mr Bacon:** They have grown into enormous proprietary beasts through lack of regulation, haven’t they?

**John Kingman:** They grew, but they have been dramatically reshaped because regulators have completely changed the economics of those activities.

**Q159 Mr Bacon:** The reason I am asking Mr Smith about the question of qualifications to run a bank is that we saw with RBS and HBOS four chairman and chief executives—five, if you add Northern Rock, which was chaired by a science journalist—none of whom had a single banking qualification between them. It is slightly reassuring to hear that it is not going to be a bank, but none the less, it is of concern to me if you are still looking at people who do not have qualifications in this area. Good old-fashioned banking, as the previous Chancellor used to call it, might have prevented many of these problems.

**John Kingman:** I talked earlier about the new generation of chief executives in these institutions; they are very different people and they have very different backgrounds. That reflects the fact that everyone, including these banks’ shareholders, believes that the gung-ho, buccaneering, investment banking-heavy model proved to be a bit disastrous for everyone.

**Q160 Mr Bacon:** Do you remember the scene in “Tom and Jerry” where they go off the edge of the cliff and do not fall? They do not fall because they do not look down, but when they do look down, they fall. Is not that a reasonable proxy for the euro at the moment? The single European currency is still going. We had a whole series of crises, which seemed to be enormously important. Bankers and politicians from all over Europe got together and then it went away, and Mrs Merkel got through her election, which was the main thing. Now they are still over the edge of the cliff and nobody is talking about it. Nothing has really changed. Santander is practically insolvent. I noticed on your CV that you have been busy recapitalising the Portuguese banks, and jolly good too, but no one has recapitalised the French banks, have they? Basically, the thing is still a train wreck travelling at considerable speed and the only reason it has not hit the buffers is because nobody is looking down. Is that not the reason why there isn’t enough lending to SMEs and why there is all this money on people’s balance sheets, which Mr Tomlinson was looking at, and in people’s current accounts? The risk of lending is still far too high.

**Chair:** Finally he got to the question.

**John Kingman:** I think the banking system we have in this country really has changed quite dramatically. I think the people running it have changed. I think the economics of the activities have changed. The business mix is changing very fundamentally. We will end up with a banking system that is less risky—and significantly less risky to the taxpayer—but we will also, I believe, end up with a banking system that is more useful to the British economy.

**Chair:** I want to draw this to a close soon. Two areas have not been covered, so very quickly, Ian, Meg and Austin.

**Q161 Ian Swales:** Figure 1 mentions six different schemes, three of which I would class as equity
finance. “Fund of funds” always sounds like two levels of charges to me, but leaving that aside, figure 13 says that we are not very good at getting reward from this type of activity—in fact, it is a horror story of failure. Every time the Government go into this equity-venture capital world, it seems to be a magical way of getting rid of money. Particularly with what you said about the Business Bank, how can you convince the Committee that the taxpayer will get proper reward from all this money that you are investing on an equity basis?

Martin Donnelly: The first thing to say is that the terms under which we are investing now have changed since those earlier schemes. I will ask Ceri to confirm this in a moment, but the earlier ones have all been closed. We are essentially now seeking to maximise the outcomes from them. They were, to be fair, either pilots or designed to help to deal with the crisis we went through, but with the current schemes, we are investing on commercial terms in the same terms as commercial investors. Therefore, it is a reasonable expectation that we will get a return. Ceri, do you want to add anything?

Ceri Smith: This Committee has done a very insightful Report on some of the legacy schemes in the past, and I do not suppose we wish to rake over all that again. There were some very important lessons learned. One of the key differences from some of the very early schemes—take something like the regional venture capital fund, for example—is that when they were designed, there was a sense that in order to attract private capital into those funds, the public sector had to subordinate its interests considerably and take first loss in order to make a more attractive proposition. When we were designing the enterprise capital funds, one of the big changes that we introduced was to say that we did not think that was necessary any longer; in fact, one of the things you see in enterprise capital funds is a prioritised return for the public sector. One reason why I think these things have changed is that in some of them, we are investing on a pari passu basis and, in others, we are investing on different terms from the private sector, for example—is that when they were designed, there was a sense that in order to attract private capital into those funds, the public sector had to subordinate its interests considerably and take first loss in order to make a more attractive proposition. When we were designing the enterprise capital funds, one of the big changes that we introduced was to say that we did not think that was necessary any longer; in fact, one of the things you see in enterprise capital funds is a prioritised return for the public sector.

Q163 Ian Swales: Who are the managers of these funds? Who are you entrusting taxpayers’ money to?

Ceri Smith: The managers of the fund of funds—I think we put them into a fund administered by the EIF—

Chair: How much goes on management fees? How much are you leaking out?

Martin Donnelly: The running costs of the UKIF in 2012–13 were £140,000.

Chair: And then they gave it to another management fund.

Martin Donnelly: They are basically leveraging these investments through venture capital funds across Europe, and are increasing investment in the UK by doing that.

Q166 Ian Swales: I can well understand somebody sat with a spreadsheet taking taxpayers’ money and giving it to—how many funds? You say it is a fund of funds. How many funds are they investing in?

Ceri Smith: We have invested in two funds. Beneath that, they have invested in a number of funds on purely commercial terms.

Q167 Ian Swales: How many?

Ceri Smith: I do not have that information available, but I know that beyond the money invested into the funds at the top level, all the money is invested on purely commercial terms.

Q168 Ian Swales: I can well understand why the top fund would have pretty low management fees. It must be one person with a spreadsheet. I would have
thought. That is not too difficult. How much taxpayers’ money is going out to institutions at the next level is what it is important to know.

*Ceri Smith*: Any money going on management fees will be done at a level that other investors believe is appropriate.

*Mr Bacon:* How much is it?

Q169 Ian Swales: Why did you choose to do this on a pan-European basis, anyway? We have these massive financial institutions in the UK. If you have decided to use that route, why didn’t you put it with something that was restricted to the UK?

*Martin Donnelly:* I think this is a comment on the market in venture capital at present. We have examples of British companies, such as the one that makes renewable plastic beer kegs in eastern England, which have benefited from funding from these venture capitalists. Because the market is not large, to be successful these funds have to work across Europe, although, as Ceri said, a lot of the investment does come into the UK, and UK companies benefit from it.

Q170 Mr Bacon: Can we pursue this point about management fees to get an answer to the question? How much is going on management fees? £42 million was not a made-up number. When Mr Mitchell and I were discussing your 28 venture capital funds a while ago—I remember it clearly—some of it was private and some of it was public, because it was a matched fund scheme, but a lot of it was public funds going on management fees. How much are we talking about here?

*Ceri Smith:* I will be able to provide information to the Committee on the management fees that are paid into the deals that we do. Beyond that, I am not sure. Those management fees come under commercial confidentiality. They will be in line with commercial practice.

Q171 Meg Hillier: Earlier I asked what success would look like. In paragraph 3.7 of the Report, figure 10 shows the total number of SMEs helped by access to finance schemes during the last financial year: 5,933 in total. Paragraph 16 states that the SME Finance Monitor reported that “around 22 per cent of SMEs, or just over a million firms in total, acquired a loan or overdraft, or applied for another form of finance, in 2012”. That shows how little you are reaching. That might just be the reality of the market, but, again, what does success look like? If there are a million companies looking for finance, and just under 6,000 are getting it directly, connected to the work that these finance models are doing, is that success or failure?

*Ceri Smith:* First, the latest figures through to June now show 8,000 firms, so we have had a significant increase in the numbers on an annual basis.

Q172 Meg Hillier: That is an increase, but it is still a drop in the ocean.

*Ceri Smith:* We talked about the point of these schemes earlier. It is not the role of Government to go out and provide financing for most firms. The majority of the million firms will have managed to successfully get the funding they are looking for. It is almost an apples and pears question. If you look at the number of SMEs that are looking to raise finance, the Government are not intending to go out and meet all that demand. We want a market that works effectively with a diverse source of funding available to them.

Q173 Meg Hillier: I get that, but if you look at that direct support, would you be able to give us a figure for how much public money has gone into each of those 8,000 firms in terms of taxpayer money setting up the scheme?

*Ceri Smith:* These are all very different schemes, so it is difficult to come up with figures. Enterprise finance guarantees and start-up loans are the most significant by number in terms of firms that are helped. The average size of loan underwritten by the enterprise finance guarantee is, I believe, £100,000, and what you see with that scheme—I think the Report recognises this—is that the trends in lending under EFG tend to mirror trends in lending more generally. To try and target a significant increase in EFG take-up, there are things we can do at the margins to ensure that all the banks are fully aware of what the scheme does, and we can provide regular training to bank managers. But the only way to significantly increase it—if you wanted to triple the take-up of EFG—would be for the Government to take more risk, and that would be a direct cost to the taxpayer.

Q174 Austin Mitchell: By coincidence, I’ve got an Adjournment debate on Premier Motor Auctions, a Yorkshire firm, which was snaffled by Lloyds Bank. When that happened the chief executive who was dispossessed of his company got a reply from the Independent Banking Advisory Service on 28 September 2012 which said that the banks had developed rather a special relationship with the Government which had strengthened them and on the basis of that, it allowed the banks “and other professionals with whom they have conspired to plunder and gain control of very profitable businesses, which the banks had marked as targets of which to take control, some for short-term gain and others to hold for longer-term gain in concert with others, deliberately using the insolvency industry as a shield to conceal their many acts of deception”. What evidence does the Department have of that propensity by banks to take over companies rather than help them in the spirit of all these schemes?

*Martin Donnelly:* May I comment first on the insolvency side? We take very seriously any misuse of that process. We would be happy to look at any allegations that are being made. Obviously I cannot comment in detail. It is important that the insolvency system is fair and transparent. I am not sure that I can add anything on the banking side.

*John Kingman:* I would be delighted to ask the chief executive of Lloyds Bank to look at the case in question. I would say that as a general matter, banks are very tightly regulated including in relation to treating their business customers fairly. The FCA exists to look at these—
Q175 Austin Mitchell: There is no effective regulation of accountancy and insolvency. It is all done by the Institute of Chartered Accountants, which is a front organisation for the big four.

John Kingman: The FCA has been accused of many things, but being in the pockets of the banks is not usually one of them.

Q176 Chair: I am going to finish this off on two really important areas. First, we say that 76% of growth comes from the SME sector. Where does it come from, Mr Kingman? Where is it? Rather than just this broad definition: is it the small, the new— where is it?

John Kingman: SMEs are incredibly different, as you say. You’ve got a very large number of businesses that are an important part of the economy. They grow and they represent competition for other providers and that is incredibly important. You’ve also got a subset—the high-growth companies—which have historically been badly served by the British financial system. They are very important to the ecology of growth. We care about both those categories.

Q177 Chair: But where does the growth come from? Given that this is all part of the strategy for growth—the 2011 document—is there an understanding of where the real growth is coming from and where, if there is going to be any investment by the taxpayer, it will be most beneficial?

John Kingman: We have a very clear view—

Chair: We don’t.

John Kingman: We do, I believe—that most categories matter enormously to the economy. Both need a financial system that is working. The financial system is not working as it properly should in the interests of either group at the moment. That is why we are doing a lot of things about it.

Q178 Chair: Sorry, which are the two groups?

John Kingman: As I said, there are many small businesses out there which are part of economic activity. They employ people. They are a very important part of the economy! But you also have a sub-group of these SMEs who are high growth, who represent an important part of the potential future of the country. The financial system needs to work in the interests of all groups.

Q179 Chair: Which are the high-growth ones? That is what I am trying to get to.

John Kingman: There are high-growth businesses in all sorts of sectors. They need finance, both equity finance and debt finance. They haven’t always had it.

Q180 Chair: Explain this to me. The figures from page 35 onwards look at who is benefitting from all this, particularly the equity-type schemes. Another feature of the plan for growth was rebalancing the economy, yet you look there and very little is going into the manufacturing sector. Worse still, very little is going to the north-west and the north-east. It is all going into London and the south-east.

Ceri Smith: In terms of the design of the scheme, one of the things that we are currently in discussion with the European Commission about is raising some of the limits for enterprise capital fund investments. One of the things we find with the limit of £2 million per ECF is that they cannot invest in some capital-intensive businesses that they feel would otherwise be very good propositions. So you have seen rather a preponderance from some of the ECFs in investing in more of the tech and some of the IT start-ups because they are the firms which the current limits will allow them to invest in. We are therefore looking to expand the remit of the ECF programme to try to ensure that other types of firms and other sectors are well served.

Q181 Chair: So this £2.8 billion has so far failed to do anything to help to rebalance the economy and has failed to do anything to rebalance activity in the north-west and the north-east.

Ceri Smith: I do not think that it has failed. We could do more, but I do not think that you could say—

Chair: On this, it has pretty much failed.

Q182 Ian Swales: Can you tell us where the staff behind the schemes that put this money out are actually based?

Ceri Smith: The venture capital teams? Sheffield.

Q183 Ian Swales: All of them?

Ceri Smith: Capital for Enterprise certainly has its headquarters there. They spend a lot of time coming down for meetings in London, but its offices are there.

Ian Swales: That is not what I expected. Thank you.

Martin Donnelly: I will add that several of the venture capital schemes have been helping companies from Belfast, Newcastle and Lancashire in energy efficiency.

Q184 Ian Swales: 25% of SMEs are actually in the south Yorkshire-south Lancashire corridor, but they are not picking up the money. I suspect that part of the problem in manufacturing is the chronic issue of long-term finance, which I do not think anybody is really addressing at the moment.

Ceri Smith: That was actually identified in the strategy document for the Business Bank as a significant gap. The whole area of growth capital and mezzanine finance is one where there is certainly scope for more to be done. Whether the Business Bank will be able to develop mechanisms that will work to be able to provide some of the answers, we will wait and see.

Q185 Ian Swales: No high-street bank is prepared to take reasonable returns over a 10, 15 or 20-year period. They just will not do it.

Ceri Smith: Absolutely. There are structural problems within the market and, to some extent, there is a question about the pricing of risk as well. If you are looking for potentially mezz-type finance, you might be looking at returns that would be 10% or 20%. I suspect that some banks feel that that is a market that would lead to price-gouging headlines were they to enter into it and that they feel that it is not an area that they wish to operate in, which is something we think that we should try to deal with.
Q186 Mr Bacon: I am sorry that we do not have another three hours, because Mr Swales has just hit on the entire problem. If you look at the Germans, they have these long-term industrial banks that have been lending for years and here we are talking about it in 2013. I remember my economics master talking about it in 1979. Nothing has changed, has it, Mr Smith? Your little Business Bank, which is not even a bank, is not really going to make the difference, is it?

Ceri Smith: KFW, which was created in the post-war period, was set up partly to provide patient capital into German firms and has been very successful in doing that. That is part of the model for the British Business Bank. However, I would note that Germany has an awful lot of patient capital in the form of debt finance and has slightly less well-developed equity finance. The UK has a slightly differently structured market—

Q187 Mr Bacon: It means that it is less easy to shuffle assets and to take huge management fees out of the economy as a result.

Ceri Smith: I think there are different forms of patient capital. For some firms, debt is very applicable. For others, equity would be more applicable. The markets are very different.

Q188 Mr Bacon: The proof of the pudding is in the eating. I have just been in Shanghai and the Germans are decades ahead of us in entering that market, because their SMEs are massively supported and know that the Government is behind them and there is a capital market that works to support them.

Ceri Smith: I hope that SMEs in the UK would know that the Government is very much behind them, too. In terms of interventions, I am very clear. We have much to learn from KFW, and we will do so, but KFW is an appropriate solution for the German market, which is very different from the UK market. While KFW is providing patient capital by way of debt, in the UK you had ICFC and 3i, which tended to provide finance in more of a mezz space and by way of equity. Now, 3i have moved out of that market in the last 10 to 20 years and that is a reason why the Government have tried to step in and replace that. But you can see that the solutions were appropriate for the markets as they existed at the time the solutions were developed.

Mr Bacon: I think the Chair is keen to go.

Chair: Yes. Thank you very much indeed.

Written evidence from the British Chamber of Commerce

The British Chambers of Commerce (BCC) is an influential network of 53 Accredited Chambers across the UK, representing tens of thousands of businesses with millions of employees nationwide.

No other business organisation has the geographic spread or multi-size, multi-sector membership that characterises the Chamber Network. Every Chamber sits at the heart of its local business community, providing representation, services, information and guidance to member businesses and the wider local business community.

The BCC welcomes the opportunity to submit evidence to the Public Accounts Committee on SME access to finance. Getting better access to finance remains a critical issue for our members as while bigger and older companies can get finance when they need it, many SMEs are still frozen out. In August 2013, total lending (loans and overdrafts) to SMEs fell by £5.8 billion.

ISSUES FACING CHAMBER MEMBERS

More difficult for businesses to access external finance now than before the financial crisis

Banks require more information before approving credit facilities, and are more likely to use imperfect information as a justification for rejection rather than incur the cost of assessing risk more fully; certain sectors (such as construction and hospitality) seem to suffer from a negative bias, tending toward swift rejection; and there are greater security requirements when facilities are offered. Many businesses are realistic about the cost of finance and understand that it will be more expensive than the years leading up to 2008, but still report increased obstacles to securing finance in the first place.

Breakdown of the relationship between businesses and banks

It is quite clear that relationships between some small and medium-sized businesses and banks have become increasingly fractious. Financial institutions need to rebuild trust and repair damaged relationships with businesses and improve transparency.

We often hear from our members that banks don’t understand small businesses. Lending decisions are perceived to be made on a narrow, automated basis with credit scoring often to the fore, rather than on a personal level, with decisions made by people with knowledge of their business and the local economy.

For example, although the overdraft remains an important facility for SMEs to support cash flow and working capital, feedback from our members suggests that banks are working to reduce overdraft limits, and are instead encouraging customers to use products which give lenders security over loans, rather than to the benefit of the business. A chamber member who supplies equipment for schools and only uses its overdraft during the
summer holidays had their overdraft facility withdrawn due to underuse and was asked to move onto an asset based finance product.

Banks have a lower risk appetite today than they did in the past. Furthermore, risk appetite is likely to continue to decline over the coming years as new domestic and international regulatory regimes further constrain their capacity to lend.

Our members also talk of the significant differences in the relationship banking experiences between large corporations and SMEs. Large firms often get a tailored one-on-one service, while SMEs typically get a relationship manager with a large portfolio of customers. This approach to SME relationship banking has increased distrust and damaged relationships between SMEs and financial institutions.

Last year, a poll of our members revealed that 50% of firms mistrust banks and building societies. This has led to the phenomenon of “discouraged demand”, which translates as businesses that want finance, but will not approach banks to try and get it because of the assumption that they will either be rejected or that they will have other credit facilities re-evaluated. According to the Q2 2013 SME Finance Monitor, discouraged demand was the main barrier to making an application with 42% of would-be loan seekers stating that discouraged demand was the main reason for not applying.

Banking scandals such as miss-sold PPI and interest rate swaps has also increased distrust in the banking sector. Financial institutions need to rebuild trust and repair damaged relationships with businesses and improve transparency.

Lack of competition in the banking sector

There is a fundamental lack of competition within the highly concentrated UK banking sector. This was discussed extensively by the Independent Commission on Banking, which noted that 85% of SME accounts sat with the “big four” high street banks.

The new current account switching service is potentially very important because it removes an important barrier to switching institutions. Much of the current uncertainty associated with moving banks is likely to be removed by providing a consistent switching service and the presence of the Current Account Switch Guarantee will reinforce this. However, businesses in the real economy still view banks as being “all the same” and so there may be a reluctance to move to a new bank even if the switching process is made easier.

The existing divestments from RBS and Lloyds Banking Group are a welcome step but there is more to be done. Improving competition would mean better terms and conditions for business, and would in time drive down business costs.

Smaller, younger, and higher-growth businesses finding it hardest to access finance

Smaller, younger, and higher-growth businesses find it harder to access finance than more established firms. The Q2 2013 SME Finance Monitor’s results show that 47% of first time applicants didn’t receive a loan, compared to 25% of existing borrowers applying for a new loan.

Many of the oft-mentioned “gazelle” firms, who create a significant proportion of all employment growth, have noted access to finance as a key barrier to further expansion as far back as 2008. Some firms also report that they are discouraged from accessing finance due to a lack of clarity, knowledge, or skills.

Funding for lending scheme only helping “safe bets”

The extension and widening of the Funding for Lending scheme (FLS) and improving the incentive to lend to SMEs were two very positive steps. However, the real test for Funding for Lending has always been whether it is able to get credit flowing to young and fast-growing businesses and not just “safe bets”. Unfortunately many of these growth firms are still being left out in the cold when it comes to accessing finance, which prevents them from expanding, creating jobs and helping to drive a business-led recovery.

Little understanding of alternative finance options

Feedback from our members suggests that the UK’s SME community is heavily reliant on traditional debt finance. Other forms of finance (such as equity and mezzanine) and other non-bank lending are growing but remain niche products. A BCC poll of our members in 2012 revealed that while almost half (49%) of firms use banks or building societies for external finance, only 10% uses equity, and just 8% using grants, venture capital, private equity, peer-to-peer lending and angel finance combined.

There also appears to be a lack of knowledge of how these products work by businesses. That said, there has been a shift to the use of invoice discounting and other forms of asset based finance, resulting from the need to address cashflow issues.
The introduction of state-backed support schemes has been impeded by a lack of coherence

While the government has made a number of attempts to increase the availability of finance to SMEs, from the Enterprise Finance Guarantee, through to the most recent Funding for Lending scheme, these have been bedevilled by a capability expectations gap.

This has been commented on extensively by the BCC, and by independent commentators. Businesses expected swift availability, clear information, and efficient processes—but the reality on the ground has been far different, with coal-face bank personnel often unable or unwilling to facilitate access to what is a bewildering array of products. Inexperienced relationship managers and credit officers are still often incapable of explaining how state-backed products work, or how local businesses can access them. It is an open question whether this is down to incomplete information, difficulties in rolling out training, or the fact that banks’ incentive structures are geared to the sale of their own products, rather than helping companies to access Government support.

What Chamber Members Want

Address the current gap in relationships, transparency and trust between banks and businesses

Immediate action by financial institutions to address the gap in relationships, transparency, and trust that arose in the wake of the credit crunch and deleveraging. While steps are being taken through the Business Finance Taskforce including a new appeals button to facilitate SME appeals, more must be done to improve transparency around lending decisions and widen access to information.

RBS’s decision to kick off an independent review of its lending to businesses is both a sensible and welcome step. We would hope that other major lenders follow RBS’s lead, and shine a light on their own business lending practices. In order to improve transparency and trust, is crucial that all financial institutions pledge to address any barriers—real or perceived—to SME access to capital.

Feedback from our membership suggests that a local presence is important whether in the form of a branch network or another format. Having a local presence with a defined market area is important, because local people who are geographically closer to their customers are more likely to better understand the needs of customers, rather than those operating in a central function of the bank.

The banks have a long road to travel to restore relationships with their existing customers, many of whom will still need their help with working capital over the months and years ahead.

Increase competition in the banking system, to ensure real choice and to widen access to commercial lending

The second priority, increasing competition, is being addressed in part through the implementation of the recommendations of the Independent Commission on Banking. The recent expansion of SME lenders such as Handelsbanken and Aldermore is welcome news, as is the development of new peer-to-peer and alternative funding models, such as Funding Circle, Market Invoice, and Platform Black. But these are niche players. Regulators, including the successor to the Financial Services Authority and the further empowered Bank of England, must ensure that mainstream competition continues to expand.

The new current account switching service is potentially very important because it removes an important barrier to switching institution. However, we believe that more should be done. For example, we are in favour of allowing businesses to take account numbers when switching between providers and welcome the Parliamentary Commission on Banking Standards (PCBS) call for a cost-benefit analysis to be carried out on the viability of a move to full bank account portability.

The new business bank needs to be better capitalised

The BCC welcomed the initial £1 billion commitment to the new British Business Bank as an important first step, but investment must be on a greater scale if it is to succeed in supporting growing companies. An additional investment of £9 billion from the Government over the next three years (£3 billion per annum) would provide the necessary capital base to allow the bank to start lending directly to businesses. A stronger capital base would also help raise funding from the money markets. In contrast, an under-capitalisation could undermine the institution’s ability to make a significant contribution to Britain’s growth companies of the future.

Were the Government and the Bank of England to use their balance sheets, to extend the backing of the Funding for Lending scheme’s billions to the embryonic Business Bank, they would energise a new and crucial player in the lending market, and help to solve the long-term structural gap in finance that continues to strangle far too many growth businesses across the UK.

The new institution must also have the ability to lend directly to viable, high-growth, new, or innovative businesses, including SMEs unable to obtain finance through the commercial banking system. The government’s previous efforts to increase the flow of working capital to businesses, starting with the Enterprise Finance Guarantee and ending most recently with the Funding for Lending scheme, all share a fatal flaw: dependence on the existing UK banking infrastructure.
Furthermore, the potential success of the new institution would be greatly improved by ensuring that the Business Bank is sufficiently customer focused. This could be achieved by having a “desk” in every Chamber of Commerce across the UK which would enable the new institution to have significant geographical spread, enabling it to sit at the heart of every local business community.

Bank of England and the Financial Conduct Authority could do more to improve access to finance

For example, the existing QE programme could be used to purchase private sector assets other than gilts, including securitized SME loans, as this would reduce the risk when banks are looking to lend to business.

18 October 2013

Written evidence from HM Treasury and the Department for Business, Innovation and Skills

Q62–69: Reconciliation of SME Gross lending data

John Kingman reported that: “At the point at which FLS was introduced, the rate at which bank lending to SMEs was shrinking was by 23% a year. Gross lending to SMEs is now growing at 11% a year.”

These figures represent the percentage growth in gross lending flows in a given quarter over the same quarter the previous year. In 2012Q3, gross lending flows were 23% lower than in 2011Q3; and in 2013Q3, gross lending flows were 11% higher than in 2012Q3 (see Chart 1 below). These figures are based on the same Bank of England data reported in the NAO report in Figure 4.
Bank of England - Monthly volume of lending and repayments to SMEs by MFIs, not seasonally adjusted (£millions)

<table>
<thead>
<tr>
<th></th>
<th>SME Gross loans</th>
<th>SME Repayments</th>
<th>SME Net Lending</th>
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<tr>
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<td>3,904</td>
<td>4,105</td>
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<tr>
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<td>3,753</td>
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<tr>
<td>Sep-13</td>
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</table>

The difference is that:

i. The data is reported in percentage growth rates of gross lending flows over the same time period in the previous year, as opposed to the level within the time period.

ii. The data is presented in a quarterly format, as opposed to monthly, for the ease of comparability with FLS data released by the Bank of England.

This data is provided below and reconciled to the Bank of England data that the NAO presented in Figure 4 of the report.
Chart 1: SME: Growth in gross lending compared to same period in the previous year
Q115–116: Supply Chain Finance

Supply Chain Finance in the Private Sector:

— In October 2012, the PM brought together the leaders of the 40 largest companies in the UK to encourage them to adopt Supply Chain Finance in order to improve SME access to finance. (https://www.gov.uk/government/news/prime-minister-announces-supply-chain-finance-scheme).

— Supply Chain Finance (SCF) involves companies informing their banks of approved invoices—the suppliers can then opt for early payment from the bank at a low cost of funds that reflects their customer’s credit rating rather than their own.

— Partly as a result of the Government championing UK SCF, many major UK companies have chosen to adopt SCF for their supply chains, including: Rolls-Royce, Vodafone, J Sainsbury, Tesco, ASDA, Carillion, B&Q, Network Rail and the BBC just to name a few.

— Some companies have elected to use their own cash to fund their SCF programme (with their bank acting as a “backstop” just in case they ever need to use the cash for another purpose). Examples include Vodafone and Network Rail.

Supply Chain Finance in the Public Sector:

— In October 2012, the PM announced that NHS pharmacies in England would have access to the first HMG SCF facility. This facility was activated on time and on budget in May 2013 and has received positive feedback from pharmacists and industry.
The Government is actively exploring other parts of Government where this could be applied in order to help SMEs and deliver savings for the taxpayer.

Q134–137: NEW BANK AUTHORISATIONS

The FCA confirms that there have been 31 new banks created since September 2007. 28 have been new applicants and three have been existing authorised firms which have added deposit taking to their permissions and so have become new banks.

Of the 28 new applicants, 17 were subsidiaries of overseas banks, five were branches of non-EEA countries and six were UK entities. Of the three firms that varied their permission to become banks, one was a subsidiary of an overseas bank, one was a non-EEA branch and one was a UK entity.

Over the same period, there have been 10 changes of control where a new entity has acquired an existing banking licence.

Q138–140: UKIIF MANAGEMENT FEES

UKIIF is two Fund of Funds managed by expert private sector fund of funds managers through the Hermes GPE Environmental Innovation Fund (£130 million) and the European Investment Fund (EIF) UK Future Technology Fund (£200 million). These Fund of Funds invest specifically into innovation and technology funds targeting the key sectors: Hermes Environmental Innovation Fund invests into funds which target clean technologies and low carbon, whilst EIF UKFTF invests into funds targeting life sciences, digital and advanced manufacturing.

A fee of between 0.65% and 0.75% is paid to each of the appointed fund of fund managers and market appropriate fees will apply to the funds they invest in. These fees follow the normal “Priority Profit Share” model which means that they can be paid from early investment returns which provides scope for the money to be reinvested.

This Fund of Funds model has significant benefits for supporting innovative high-technology companies in key UK sectors. The structure provides a significant leverage effect enabling UKIIF to make wide range of investments and support more UK businesses. Our “Early Assessment of UKIIF” (BIS, 2012) estimated that the current overall leverage at fund level of the UKIIF public to private investment is around 20 times.

The use of professional fund of funds managers is an important factor in maintaining the credibility of UKIIF; attracting private sector investment to invest alongside public funding, and providing professional and commercial market experience in making investments in these strategic sectors.

Q166–170: OECD EQUIVALENTS OF THE BRITISH BUSINESS BANK

The following is drawn from information compiled by the OECD:

**Austria, aws** The “Austria Wirtschaftsservice GmbH” (aws) is the promotional bank for the SME sector in Austria.

**Belgium** Brussels, Fond Bruxellois de Garantie The Brussels Guarantee Fund’s mission is to facilitate the granting of business loans in the Brussels-Capital Region by providing credit agencies, upon payment of a single lump sum contribution, a substantial share of guarantees they require from SMEs and independent customers.

Flemish, PMV PMV is a Flemish investment company. It finances promising entrepreneurs from the very start through the growth to the internationalisation of their business. It also invests in large infrastructure projects. Wallonia, SOWALFIN

Created at the initiative of the Walloon Government in 2002, the SA SOWALFIN—Walloon Company Financing and Guarantee of Small and Medium Enterprises.

Provision of additional subordinated bank loans (“Co-financed”) loans. They guarantee loans granted by banks to the tune of up to 75%; coordinate the action of the Walloon Invests granting of risk capital to SMEs. Sowalfin also provides SME other specific financial products to meet unmet needs in the market.

**Canada, BDC** Help create and develop Canadian businesses through financing, venture capital and consulting services, with a focus on small and medium-sized enterprises (SMEs).

**Chile, Corfo** CORFO is a public-sector organisation dedicated to promoting entrepreneurship, innovation and growth in Chile. Acting in tandem with the Chilean Ministry of Economy, CORFO’s programs support and finance a wide variety of initiatives in this line, with the goal of stimulating the Chilean economy and providing more opportunities for Chile’s entrepreneurs, innovators and key industries to be competitive on a global stage.

Czech Republic, CMZR Bank CMZR Bank is the only promotional bank in the Czech Republic entrusted with the administration of funds to help the development of small and medium-sized entrepreneurship using financial resources from national or EU funds for guarantees and loans.
Vækstfonden (Danish Growth Fund) is a state investment fund, which aims at creating new growth companies by providing venture capital and advice.

KredEx is a financing institution helping Estonian enterprises develop quicker and expand more safely to foreign markets, offering loans, credit insurance and guarantees with state guarantees.

Finnvera is a specialised financing company owned by the State of Finland and it is also the official Export Credit Agency (ECA) of Finland.

Tekes—the Finnish Funding Agency for Technology and Innovation finances the development of innovations that aim at growth and new business operations.

Bpifrance is a new public financial institution created in January 2013, reorganising several existing operators active in banking operations, innovation and equity funding (OSEO, CDC Enterprises, Fonds Stratégique d’Investissement (FSI) and FSI regions. It will help to expand the existing credit volume and equity funds for SMEs and medium-sized companies, in particular the industrial ones, along with market operators.

KfW is Germany’s largest financier of SMEs. Programmes covering long-term funding, for start-ups as much as for expanding businesses.

The mission of the Hungarian Development Bank Private Limited Company provides funding from money- and capital markets under favourable market conditions in order to enhance the fulfilment of the development needs of the Hungarian economy. The objective of the Bank is to enhance investments and development, to bridge gaps in infrastructure, to encourage the expansion of Hungarian businesses, primarily that of the SME sector both in Hungary and abroad, to stimulate technological and environmental development, energy efficiency and employment and by doing so to actively contribute to the enhancement of Hungary’s competitiveness in the international context.

The Small Business Development Company Ltd. has been incorporated on December 20, 2001. The aim of its establishment was the promotion of development and growth of the domestic small and medium-sized enterprises basically in a way that additional capital is allotted to them by increase of their subscribed capital.

The Small and Medium Businesses Agency in Israel was established at the initiative of the Ministry of Industry, Trade and Labour. The intent was to create a body, which would formulate policy for promoting small and medium sized businesses, and assist entrepreneurs, as well as serve as the focus for activity in this field and coordinate the work of various bodies active in this area.

MedioCredito Centrale is a financial institution whose mission is to support projects for the development of SMEs in southern Italy increasing the availability of credit in the medium—long term and to support central and regional public administration in the management of facilitating measures to support the national production system.

The Central Guarantee Fund supports the development of micro, small and medium-sized Italian companies by providing a government guarantee for loans granted by banks.

Japan Finance Corporation (JFC) is a public corporation wholly owned by the Japanese government, established on October 1, 2008, as the result of the merger of four policy-based financing institutions. As a comprehensive government-affiliated financial institution inaugurated to better serve society and help promote a bright and prosperous future, JFC offers a wide spectrum of services by drawing on the combined expertise of the respective fields of operations.

The Small & medium Business Corporation (SBC) is a non-profit, government-funded organisation established to implement government policies and programs for the sound growth and development of Korean SMEs.

SNCI is a bank specialising in medium and long term financing of investments made by Luxembourg based companies. SNCI financing operations round off the broad range of budgetary and fiscal instruments introduced into law with a view to promoting economic development. SNCI is a public-law banking institution with legal personality whose share capital is wholly owned by the State. It enjoys a State Guarantee covering the repayment of capital and the payment of interest on bonds, saving certificates and deposit bonds which it has issued itself.

Nacional Financiera, S.N.C., is a Development Banking Institution that operates in accordance with the rules of its own Organic Law, in accordance with the Law of Credit Institutions, and the rules issued by the National Banking Securities (NBSC). The objectives of Nafinsa are to promote the overall development and modernisation of the industrial sector with a regional approach; stimulate the development of financial markets and act as financial agent of the Federal Government in the negotiation, contracting and management of credits from abroad.

Innovation Norway is the Norwegian Government’s most important instrument for innovation and development of Norwegian enterprises and industry.
Norway provides competence, advisory services, promotional services and network services. The marketing of Norway as a tourist destination is also considered one of the organisations important tasks. Innovation Norway contributes to: enhancing innovation in Norwegian enterprises and industry; Building competitive Norwegian enterprises at both domestic and international markets; promoting Norwegian enterprises; promoting Norway as an attractive tourist destination; securing development in rural areas; transforming ideas into successful business cases; promote interaction between enterprises, knowledge communities and R&D institutions. Innovation Norway is the Norwegian government’s official trade representative abroad. They aim to assist Norwegian businesses grow and find new markets.

Poland, BGK
The primary business objective of BGK is to provide banking services for the public finance sector, in particular through the support of the government’s economic programs, as well as local government and regional development programs implemented with the use of public funds, including those of the European Union.

Portugal, IFD
Portugal intends to create a public development institution by the second trimester of 2014, as part of its 2013–20 growth strategy, with a special focus on SME finance. Initial founding would come from EU (2014–20) and it is intended to become financially sustainable. It intends to be complementary to the private sector, lending to viable projects and managing risk on a minimum efficiency requirement afterwards.

Serbia, Development Fund
The objective of Serbia’s Development Fund is to foster economic development, the development of balanced regional growth; improving the competitiveness of the domestic economy; encourage the development of production of handicrafts and service industries, employment; encourage the development of capital markets.

Slovenia, Enterprise Fund
Slovenian Enterprise Fund is a public financial institution in the Republic of Slovenia established for the purpose of granting financial support and incentives to the business sector in Slovenia. Every year the Fund announces aid for development and expansion capital to micro, small and medium-sized enterprises (SMEs) in Slovenia.

Spain, ENISA
Encourage the creation, growth and consolidation of the Spanish enterprises, actively participating in financing innovative and viable project and in stimulating venture capital market.

Spain, ICO
From a legal point of view it is a credit institution, and is treated as a State Finance Agency, with its own legal status, assets and treasury, as well as an independent management to carry out its activities. ICO is a state-owned bank and is governed by the financial equilibrium principle, in accordance with its Articles of Incorporation, which were approved in Royal Decree 706/1999 of 30 April. Apart from the Institute, the ICO Group comprises Axis, a venture capital firm, and the Fundación ICO. Axis was the first venture capital firm to be established in Spain, in 1986, and currently provides equity or quasi-equity instruments to companies to finance their growth. The Fundación ICO was created in 1993 in order to promote culture and art. Since 2003 it has existed as an ongoing, not-for-profit, public sector foundation with a national scope and independent assets. The ICO also participates as a shareholder in other companies such as the Compañía Española de Realimentación (CERSA) and COFIDES, as well as the European Investment Fund (EIF).

Sweden, Almi
Almi’s vision is to create opportunities for all viable ideas and companies to be developed. With their advisory service, loans, venture capital and incubation, we have customers in all commercial phases, from ideas to successful companies. This includes ideas with potential for growth in the early stages as well as existing companies that are investing in growth and expansion. Almi is owned by the government and regional public owners, and is near to its customers in 40 locations around the country. Almi are organised into four business areas: Advisory service, Loans, Venture capital and Incubation.

Turkey, Development Bank (TKB)
In accordance with the purpose of achieving development and sustainable growth of the country, the mission of the Bank is; to increase employment, income and welfare. By supporting investments of the enterprises incorporated as joint stock company through either providing loans secured from national- international resources, or by participating into the leader/model firms, By providing technical assistance to the investors, By making contribution to the improvement of the capital markets,

Turkey, KOSGEB
To increase SME’s share in economic and social development by offering quality service and support towards developing SMEs’ power of competition, and spreading culture of entrepreneurship.

United States, SBA
The U.S. Small Business Administration (SBA) was created in 1953 as an independent agency of the federal government to aid, counsel, assist and protect the interests of small business concerns, to preserve free competitive enterprise and to maintain and strengthen the economy. It provides, finance (through public/private funds and guarantees), access to government contracts and access to advice.
Q174: **Banks taking over Insolvent Companies**

With reference to Austin Mitchell’s question: What evidence does the Department have of that propensity by banks to take over companies rather than help them in the spirit of all these schemes, The Treasury (John Kingman) is happy to ask the CEO of Lloyds Banking Group to look at the allegation against Lloyds Bank. However, Austin Mitchell should send details of the specific allegation to the Treasury. John Kingman will then be happy to respond directly to Austin Mitchell.

19 November 2013