TheCityUK

LlewellynConsulting
Independent Economics

ENHANCING THE ABILITY OF UK SMEs TO EXPORT

OCTOBER 2015

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Independent Economics

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TheCityUK

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FOREWORD

Sustainable and secure long-term economic growth is a priority for this government, and the success of UK companies in international markets is central to securing this growth.

But there are still a lot of British companies who are yet to dip their toes in the export waters, or who set their sights too near our shores, and could go further into exciting opportunities in overseas markets.

This is particularly true of small and medium-sized businesses.

SMEs are the backbone of our economy, and the driving force of jobs and growth.

But while SMEs account for over 99% of all UK businesses and 60% of private sector employment, they account for only 33% of total goods exports.

This government is committed to working with SMEs to help them to fulfil their export potential. I welcome the proposals set out in this report on some of the ways government might address challenges faced by businesses, and the opportunity to highlight the ways in which we are driving forward our export ambitions.

There should not be a UK-based business who does not export to their potential should they wish to do so, and to enable this, we are mobilising all government departments to support the export drive. With our private sector partners, we create links to the vital support that companies need from local chambers, banks, lawyers, accountants and consultants. It's only by working together that we can reach this Government's aim of doubling UK exports to £1 trillion by 2020.

We provide a range of support to help companies to develop their business internationally. This includes expert help from a trade or finance adviser; advice on international e-commerce and online selling; and a variety of international support to help connect UK companies to potential overseas clients.

I recently launched UK Trade and Investment's First Time Exporters initiative. In addition to advice for companies selling overseas for the first time, the package includes the opportunity to take part in export insight visits to gain invaluable on-the-ground understanding of selling goods or services in international markets.

Through UK Export Finance (UKEF), the nation's export credit agency, we are helping firms to minimise the financial risks of overseas trade. Accessing working capital to fulfil export orders and making sure an overseas buyer will pay on time can be particularly daunting for SMEs, and in recent years we have increasingly focused support on them.

We are improving UK finance markets for the sector through the British Business Bank, which is currently supporting over £1.8 billion of finance to over 40,000 smaller businesses, and a further £1.4 billion of finance to small mid-cap businesses.

We want to make sure that the UK's world-class smaller firms are aware of the trade credit insurance and trade finance support on offer and that it is easy to access when needed. We've made progress on this – the majority of firms who benefit from UKEF support are now SMEs – but, as this report makes clear, there is more to do.

The goal is to make the pathway to all government export support simpler, clearer, and faster, so it bears comparison with the best examples from digital commerce. Companies are leading the way in exploiting digital channels to grow faster, and I want the Government to revolutionise our approach to do the same.

The time to do this is now. We have just changed the law through the Small Business, Enterprise and Employment Act to allow greater flexibility in the export finance help we can offer UK exporters, for example in exporting supply chains, and smaller firms stand to benefit.

In the coming year, we will continue to level the playing field for SMEs. To ensure we are focusing our efforts where they are needed most, I ask that our partners in business continue to tell us where the barriers and challenges lie. I assure you that as your Minister for Trade and Investment, I'll be listening and taking action.

The Rt Hon Lord Maude of Horsham
Minister for Trade and Investment

INTRODUCTION

One of the concerns that business leaders often raise is that the growth potential of many UK small and medium-sized enterprises is not being realised, in particular in relation to exporting. Although SMEs account for 99% of all UK businesses, 60% of employment, and 50% of national gross value added, they only account 40% of total exports. This represents a huge opportunity for the UK economy if that potential can be unleashed.

Just one in five UK SMEs export – lower than the average of one in four of their EU counterparts. There are no economic prizes to be won by being inward looking. While exporting might be on the agenda of all businesses, it is estimated that anywhere between 25,000 and up to 150,000 of those currently not exporting could do so.

Finance constraints have long been recognised as a major barrier for SMEs to expand and export. Although the majority of these firms are still primarily reliant on bank financing, innovations in UK-developed technology and market-based financing solutions could offer viable alternatives. Exporters and would-be exporters stand to benefit from these new developments.

This report, prepared by Llewellyn Consulting, considers how UK SMEs can move towards an export-led approach and makes practical proposals that can be progressed by both the private and public sectors to increase export opportunities, create more jobs and boost economic growth. These are not expensive to deliver and are focussed on the proposition that 'governments should do only those things that only government can do'.

The evidence shows there is much that government can do to harness the existing potential that doesn't require significant financial investment. In fact, much of what is needed centres on providing trusted information and guidance and targeted programmes that time-scarce businesses can easily access. A number of these programmes are already up and running in some form, but awareness of them is generally low, and it is clear that the sheer diversity of what is available is acting as a disincentive for many SMEs who want help to export.

For its part, the UK-based financial and related professional services industry continues to develop and deliver the innovation and vision that is needed to help SMEs realise their exporting potential, opening up international markets to those who have been unable to export as well as those who simply haven't considered it as an option.

Given the ambition of this government to double exports by 2020 and the sheer scale of the SME market in the UK, innovation that enables its growth is essential. The challenge to be met is in combining the efforts of the public and private sectors to support export opportunities successfully and meet the global demand that exists for UK goods and services. I believe this report and its recommendations add considerable evidence to how better assistance can help SMEs that aspire to be more active exporters. That is in their – and the UK's – long term national interest.

Chris Cummings
Chief Executive, TheCityUK

EXECUTIVE SUMMARY

SMEs and export performance

- While SMEs account for 99% of all UK businesses, 60% of employment, and 50% of the total value added, they account for only 40% of total exports.
- The proportion of UK SMEs that export is around one in five – below the EU average of one in four.
- Thus where exporting is concerned, UK SMEs – with the exception of many micro companies – collectively export too little and are failing to maximise their potential.
- Medium and mid-market UK companies perform particularly poorly in international comparison:
  - Only 34% of medium-sized companies export, compared with 49% in Italy, 68% in Germany, and 85% in Spain;
  - Only 29% of mid-market companies have international operations, well below Germany, where nearly half of the 'Mittelstand' have international operations, and lower than the US (34%), France (35%), and euro area (41%).
- Addressing the issue requires policies that are directed not only at existing exporters but, potentially even more importantly, also at those that currently do not export.
- Indeed, it is estimated that anywhere between 25,000 and 150,000 currently-non-exporting firms in the UK could, potentially, export.
- SMEs generally are at the forefront of technological diffusion, entrepreneurism, competition promotion, and innovative capacity, and are in many ways the 'dynamo' of the UK economy.
- UK SME productivity performance however is also poor in international comparison.
- As in all economies, the 'birth' and 'death' rates of SMEs are high. Small increases in the 'birth' rate, small decreases in the 'death' rate, or both can exert a significant positive cumulative impact on aggregate output and employment.

99%

SMEs ACCOUNT FOR 99% OF ALL UK BUSINESSES, 60% OF EMPLOYMENT, AND 50% OF THE TOTAL VALUE ADDED, THEY ACCOUNT FOR ONLY 40% OF TOTAL EXPORTS

34%

ONLY 34% OF MEDIUM-SIZED COMPANIES EXPORT

Export competitiveness

- UK SMEs wishing to export face a wider range of active constraints than their non-exporting counterparts.
- Well-targeted policy initiatives to overcome these constraints would put UK SMEs on a more even footing vis-à-vis their international competitors, and thereby contribute positively to exports, jobs, and growth.
- Innovation, skills, knowledge, and an 'exporting' spirit or culture, are key drivers of firms' competitiveness and exports.
- Ambition and confidence to sell in international markets is, however, generally low by international standards.

The finance constraint

- Lack of financing is evidently a major constraint to SME expansion and exporting.
- At root, the financing process involves satisfactorily bringing together willing lenders and willing borrowers.
- However SME financing is basically reliant on (a few) banks; and bank lending, which has been declining since 2008, is not meeting their needs.
- Export finance facilities from banks have also generally been more difficult to negotiate in recent years and, where funding is provided, banks now appear to prefer asset-based lending.
- At the same time, traditional capital markets are not open to SMEs in the way that they are to larger companies.
- SMEs tap only a small number of the available financing sources, however, with exporters particularly narrow in their exploration of existing options:
  - Nearly three-quarters of exporting SMEs rely only on their balance sheet, and have no external financing.
  - Only about 1% of SMEs that import and/or export use export/import finance, with little variation by business size.
- Getting the right financing and insurance is especially problematic for exporters and would-be exporters: not only do they need to finance their activities, they need to reduce the risks to which they are exposed when selling abroad.

1%

ONLY ABOUT 1% OF SMES THAT IMPORT AND/OR EXPORT USE EXPORT/IMPORT FINANCE

- Lack of information is apparently a major constraint. SMEs typically possess incomplete knowledge of alternative sources of finance. On the supply side, the limited track record of SMEs makes lenders hesitant to lend.
- It will become increasingly important that alternatives or complements to traditional bank financing develop at a sufficient pace to sustain investment spending as the UK economy recovers.
- Encouragingly, however, new technologies and developments are opening up novel ways to match lenders to borrowers. And although many of these options are currently small, they are growing fast and are scalable.
- New developments include: innovative ways to access capital markets; new financing platforms (e.g. peer-to-peer lending and crowdfunding); and new forms of asset-and sales-backed finance and supply-chain finance.

SMEs TYPICALLY POSSESS INCOMPLETE KNOWLEDGE OF ALTERNATIVE SOURCES OF FINANCE

The awareness issue

- An array of existing government support policies and schemes should in principle be able to address many of the financial constraints faced by UK SMEs, and especially exporters and would-be exporters.
- Take-up, however, is low, apparently due in large part to unawareness of what is on offer.
- Those who advise SMEs on accounting, legal, tax, and other issues are often themselves ignorant of these schemes.
- Many respondents speak of the need for a clear, user-intuitive centralised, one-stop-shop website.
- In fact, much of the requisite information has been assembled already on the gov.uk website.
- However, almost no respondents mentioned the site, and few were aware of it, even when prompted.
- Inspection of the site reveals that, while impressive in its coverage, it has become complicated, untidy, unwieldy, and at times confusing.
- Respondents are clear that they trust government sites much more than private sector sites.

NEW TECHNOLOGIES AND DEVELOPMENTS ARE OPENING UP NOVEL WAYS TO MATCH LENDERS TO BORROWERS

The technology story

- New IT technologies are helping to solve a range of issues.
- UK-developed IT is on the cusp of reducing financing constraints, in at least three ways. Variously, these technologies:
  - Give rise to new intermediation between lenders and borrowers – the 'dating agency' function;
  - Reduce the risk of lending by monitoring financial developments in real time – the 'risk reducing' function; and
  - Facilitate early and/or guaranteed payments to suppliers – the 'secure payment' function.
- These developments are starting to result in: insurance companies being able and willing to offer guaranteed fixed-term financing insurance; and banks in turn becoming more willing to offer bigger loans, cheaper, and sooner.
- Exporters and would-be exporters stand to be particular beneficiaries of these new developments.

Policy proposals

- There is considerable scope for policy to realise the existing potential within the SME sector and raise exports.
- Much of what is needed would not involve the government spending large amounts of money.
- The broad policy proposals from this paper are to:
  - Adhere to some important overarching principles;
  - Promote better what already exists;
  - Increase the diversity of funding options; and
  - Proselytise a range of new-technology applications.

And are detailed more fully in section 6.0.

INSURANCE COMPANIES BEING ABLE AND WILLING TO OFFER GUARANTEED FIXED-TERM FINANCING INSURANCE; AND BANKS IN TURN BECOMING MORE WILLING TO OFFER BIGGER LOANS, CHEAPER, AND SOONER

CONTEXT

Untapped potential

Small and medium-sized enterprises (SMEs) in the UK are collectively failing to maximise their potential, particularly as regards their export capacity. Dividing the SME sector into three groups – those which export and have no problems; those which export but face problems; and those which do not export but in some sense ought to – reveals the third category as the principle one in which the UK performs poorly in international comparisons. This is particularly the case relative to its continental European counterparts.

Policy initiatives which seek to bolster UK SME exports stand, given the importance of these entities to the economy, to make a considerable difference to the outlook for UK growth and job creation.

Government finances are likely to continue, for some years at least, to be severely constrained. And the public and business mood today is that regulation should be confined to cases where it is both necessary and cost effective.

Accordingly, in seeking to determine what the government can and should do to help, this paper offers a range of proposals that are in general not expensive in budget terms, and are limited to the proposition that government "should do only those things that only government can do".

SMEs' EXPORTING POTENTIAL IS NOT BEING REALISED

WELL-TARGETED POLICY WILL IMPACT POSITIVELY JOBS AND GROWTH

1.0 THE CONTRIBUTION OF SMEs TO THE UK ECONOMY

A major driving force of the economy

SMEs, however defined, are in many ways the dynamo of the UK economy. They make up 99% of all UK businesses; provide 60% of employment; and around 50% of total value-added – somewhat below the 60%-odd EU average.[1] SMEs are also a vital catalyst for technological diffusion, entrepreneurial achievement, competition promotion, and raising innovative capacity.

That said, the productivity of UK medium-sized and mid-market companies lags that of its counterparts in many European countries, and not just larger competitors such as France and Germany. Mid-market companies in Ireland and Austria, for example, are respectively 65% and 40% more productive (as defined by turnover per head) than their UK peers.[2]

The SME sector is also particularly fluid and dynamic: the 'birth' and 'death' rates of companies are both high. This is important. Most large and successful businesses start out as SMEs. Every year, between 200,000 and 250,000 private sector firms are 'born' in the UK. Of these, 90% are very small, with fewer than five employees. A decade later, most of these new-born firms typically are gone (70% to 80%) and, of those which survive and which started with fewer than five employees, around 75% still have fewer than five employees.[3]

Given the high rates of both birth and deaths of SMEs, therefore, small increases in the 'birth' rate, small decreases in the 'death' rate, or both can cumulate over time into a large net positive effect on aggregate output and employment.

'High-growth' firms and 'clusters'

One area of the SME universe that is of particular importance is 'high-growth' firms, and their associated 'clusters'. The enduring success of this group can bring considerable benefits to the macroeconomy, while its failure can be costly. Hence targeting these entities, at least in the sense of going to some lengths to avoid their dying through neglect, is important.

'High-growth' firms are taken here to be those that start with more than ten employees and have average employment growth of more than 20% per year over a three-year period. They are often in transition, either from small to medium-sized, from medium-sized to large (less frequent), or from being domestically-focussed to more export-orientated.

So-called **'Gazelles'** are an important subset of this group, and are taken to be those firms that have been in existence for less than five years. In the UK, as in most countries, these firms tend to be more prevalent in the services sector.

SMEs ARE THE BACKBONE OF THE UK ECONOMY

BUT PRODUCTIVITY OFTEN LAGS BEHIND EUROPEAN COUNTERPARTS

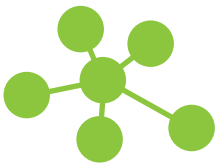
SMALL CHANGES IN 'BIRTH' AND 'DEATH' RATES HAVE LARGE IMPACTS

TARGETING 'HIGH-GROWTH' FIRMS CAN BE COST-EFFECTIVE

While high-growth firms typically represent only a tiny proportion of the business population, they employ a considerable number of people, and make a large contribution to net job creation. These fast-growing firms do not generally need widespread support from policymakers, but they do need a suitably sympathetic business environment: one which helps them avoid major pitfalls, and affords them the best chance of achieving their potential and of avoiding a premature 'death'.

Successful high-growth firms often tend to coalesce in geographical clusters of mutually-supporting and reinforcing activities and skills. The advantages of such clusters are numerous, including a greater opportunity for specialisation, productivity enhancement, and the emergence of centres that drive innovation. Clusters have been proven to be central to dynamic growth.[4]

While it is not the business of government explicitly to create these mutually-supportive corporate constellations, it is important that emerging groupings of this nature do not run into avoidable constraints, whether regulatory or otherwise, that the government can obviate.



'CLUSTERS' ARE A MAJOR SOURCE OF ECONOMIC DYNAMISM

A HETEROGENEOUS GROUP

The customary system of 'SME' classification groups companies that in fact differ widely in terms of size, expertise, business models, and operational sectors. 'S' firms are in many respects quite different from 'M' firms; and a range of definitions is employed for each.

Most commonly, SMEs are characterised as businesses with fewer than 250 employees, but SMEs can be, and often are, defined in various other ways too. According to the European Commission's 'standard' construct, SMEs are those with (Figure 1):[5]

- Fewer than 250 employees; and
- Turnover of less than €50m; or
- Balance sheet size of less than €43m.

The broad SME grouping is often also further divided into:

- **Micro** firms, with fewer than 10 employees and less than €2m turnover or balance sheet;
- **Small** firms with 10 to 50 employees and turnover or balance sheet between €2m and €10m; and.
- **Medium-sized** firms with 50 to 250 employees, and a turnover of €10m to €50m or a balance sheet of between €10 and €43m.

In parallel, the concept of the 'mid-market' company has arisen, and is increasingly referred to. While there is no standard definition for this grouping, whether across or within countries, it generally can be said to encompass medium-sized firms and some large firms, whether measured by number of employees or revenue (Figure 2). This is however not the case in Germany and Italy, where mid-market companies also include some small companies.

The heterogeneity of the SME sector, together with the non-standardisation of definitions and the increasing use of the term 'mid-market firm', often leads to confusion.

Figure 1: European Commission's definition of SMEs

Category	Employees	Turnover	or	Balance sheet
SMEs	<250	≤€50m		≤€43
Of which: Micro	*<10*	*<€2m*		*<€2m*
Of which: Small	*10 to 50*	*€2m to €10m*		*€2m to €10m*
Of which: Medium	*50 to 250*	*€10m to €50m*		*€10m to €43m*
Large companies	≤250	>€50m		>€43m

Source: European Commission

Figure 2: Definitions of mid-market companies

Country	Source	Definition		
		Employees	Revenue/Turnover	Balance sheet
All EU	EU Commission	50 to 249	€10m – €50m	€2m – €10m
UK	Department for Business Innovation and Skills (BIS)	50 to 249	€25m – €500m	
UK	Breedon Report		€25m – €500m	
UK	GE Capital		€20m – €1bn	
Germany	Ifm Bonn – Insitut fur Mittelstandsforschung	10-500	€1m – €50m	
Germany	Hoppenstedt		€24m – €397m	
Germany	GE Capital		€20m – €1bn	
France	Loi de modernisation l'economie, Article 51	250-4999	< €1.5bn	< €2bn
France	GE Capital		€10m – €50m	
Italy	GE Capital		€5m – €250m	

Source: TheCityUK and ARES & Co (2013)

2.0 EXPORT COMPETITIVENESS

The contribution of exports to SMEs and the economy

Exporting brings many benefits, at both the micro and macro levels. Exporters are generally the most productive, innovative, and resilient to shocks,[6] and data suggest that businesses that export are on average 11% more likely to survive.[7] This is due partly to 'learning by exporting' effects, whereby firms improve their productivity in preparation for entry into new markets, and through subsequent exposure to new ideas and competition. Companies can also achieve substantial economies of scale by exporting, and are frequently encouraged to increase their outlays on research and development.

Exports play a central role at the macro level by contributing to economic growth, employment, and aggregate productivity.[8] On the evidence of firms in 16 separate UK industry groups (covering 1996-2004) exporters generally have higher productivity relative to non-exporters.[9] It has been estimated that over the period 1996 to 2004 exporters accounted for 60% of UK productivity growth.[10]

UK SME export performance

In the UK, as in most advanced economies, it is large companies that account for the bulk of exporting capacity (there are a few exceptions, including the Netherlands and Ireland, where more than two-thirds of total exports are by SMEs). Nevertheless, UK SMEs still account for around 40% of the UK's total exports.

The proportion of UK SMEs that export is around one in five,[11] below the EU average of one in four. The problem is that, within the group, performance is mixed.

For their part, micro and small UK companies perform relatively well. The proportion that actively exports is similar to, or even exceeds, that of Britain's European counterparts, and they account for around a quarter of UK exports.

Medium-sized companies, however, perform markedly less impressively. The proportion that exports is approximately half of, or even less than half of, that of their European peers: only 34% export, compared with 49% in Italy, 68% in Germany, and 85% in Spain.[12] Moreover, medium-sized companies account for only 14% of total exports, a proportion that is unambiguously low when compared with other countries: in France, for example, the figure is 15%; in Germany it is 18%, and in Spain and Ireland, 24% and 44% respectively.[13]

For mid-market companies 29% of UK mid-market companies have international operations, well below Germany, where nearly half of the 'Mittelstand'[14] have international operations, and lower than the euro area average (41%), France (35%), and the US (34%).

EXPORTING IS HIGHLY BENEFICIAL TO SMEs AND THE ECONOMY

MICRO AND SMALL COMPANIES PERFORM RELATIVELY WELL

MEDIUM-SIZED COMPANIES PERFORM PARTICULARLY POORLY ...

... AND ARE A MAIN FOCUS OF THIS PAPER

Medium-sized and mid-market companies are seen as having the greatest untapped potential, and for this reason they are a large part of the focus of this paper.[15]

Factors affecting competitiveness

For a nation, the OECD defines competitiveness as:

> *"… the degree to which it can, under free and fair market conditions, produce goods and services which meet the test of international markets, while simultaneously maintaining and expanding the real incomes of its people over the long term."*[16]

A firm's export competitiveness in turn can be defined as its ability to compete and sell overseas.

Enhancing the competitiveness of UK-exporting and would-be-exporting firms involves ensuring at the least that they do not face inadvertent barriers or obstacles that prevent them from competing on an even footing with their international counterparts.

Many factors affect a firm's competitiveness. Macro factors, including the general business environment and incentive structure, infrastructure, competition, and economic openness are central, and in these areas the UK fares quite well in international comparisons.

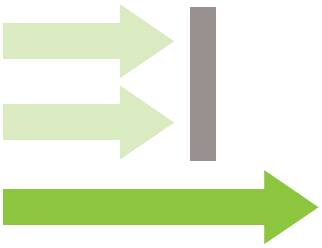
Where more micro, or firm-specific, considerations are concerned, however, the UK scores less impressively. Of these, several appear to be particularly important, including innovation; skills and knowledge; and an 'exporting' spirit or culture.

Innovation

The UK's definition of innovation echoes that adopted by Eurostat, and extends to:[17]

- The introduction of a new or significantly improved product (good or service) or process;
- Engagement in innovation projects not yet complete or previously abandoned;
- New and significantly improved forms of organisation, business structures or practices, and marketing concepts or strategies; and
- Activities in areas such as internal research and development, training, acquisition of external knowledge or machinery and equipment linked to innovation activities.

A considerable amount of empirical literature suggests a positive, constructive link between innovation and exporting, implying that SMEs which have a track record



REDUCING THE BARRIERS FACED WILL ENHANCE COMPETITIVENESS

INNOVATION IS A KEY DRIVER OF EXPORTS

of innovation are more likely to export, more likely to export successfully, and more likely to generate growth than are non-innovating firms.[18] The UK government agrees:

> *"SMEs who are innovative, those who undertake Research and Development, or have intellectual property, and those with higher productivity are all more likely to export, and to do so sustainably."*[19]

Innovation can be stimulated in several ways, not least by helping businesses to fund the development of ideas. Uncertainty around the outcomes of innovation, and the often-long lags before reasonable returns are generated frequently combine to limit SMEs' enthusiasm for early-stage research.

To address this, SMEs in the UK turn to Innovate UK (formerly the Technology Strategy Board) which funds, supports, and connects innovative businesses.[20] Bringing innovative businesses together is particularly important for entities that lack the scale and breadth to develop innovative solutions on their own. Fostering greater collaboration between small firms can therefore enhance both productivity and exports.

A further consideration is the need to protect the intellectual property of innovative SME initiatives through patents, copyright, trademarks, etc. This is particularly the case for actual or potential exporters.

FUNDING AND HELPING IDEA DEVELOPMENT STIMULATES INNOVATION

SO DOES COLLABORATION AND CLUSTERING

Specialist skills and knowledge

Appropriate skills and knowledge are also central to success abroad. Exporting SMEs need specific skills over and above those required for producing and selling at home. These extend to: the accumulation of knowledge of overseas markets and cultures, language skills, and the capability and willingness to travel abroad.

Engaging with experienced exporters has been found to be particularly helpful in boosting confidence, knowledge, and expertise – firms like to learn from each other. 'Dating events' such as those organised by finance providers, where SMEs with growing export businesses share their experiences with other companies looking for opportunities in international markets, are popular, and are generally perceived to pay dividends. Supply chains can also be useful sources of contacts, as can customers who operate in international markets.

Understanding market conditions in the requisite overseas countries is usually fundamental to winning and successfully delivering export contracts. The CBI has found that 67% of medium-sized businesses rank lack of market knowledge/insight as a high or moderate challenge to doing business internationally.[21] Particular challenges in this area include:

MARKET KNOWLEDGE IS CENTRAL TO WINNING EXPORT CONTRACTS

- Understanding cultural differences, and being able to overcome language barriers;
- Dealing with the additional logistical issues of delivering products and services abroad; and
- Complying with local requirements (e.g. regulations) and standards (e.g. some goods sold in the UK may not meet another country's standards, or indeed for that matter be legal).

Successful exporting SMEs also report that travelling to meet potential customers in person is the most effective way of building international networks, although this is more the case in some regions than others. Businesses in Asia and Latin America, for example, tend to be particularly personal relationship driven. UK SMEs have, historically speaking, tended to be more reluctant to travel than their continental European counterparts.

Trade missions organised by the UK government, business organisations, and trade associations are seen as particularly helpful by SMEs for gaining international experience and increasing their knowledge base. Various bodies have developed a series of overseas excursions specifically for medium-sized businesses. Such trips provide a platform for business-to-business networking, as well as for gaining advice from local embassy staff.

OPPORTUNITIES ABROAD HAVE TO BE SOUGHT ACTIVELY

CONFIDENCE OF SELLING ABROAD CAN BE LACKING

Culture

While many SMEs have the potential to export, UK SMEs are often held back by a lack of confidence to pursue opportunities abroad. Many assume, for example, that international business is for big companies, or that there is little international demand for their goods or services. A CBI member survey, however, shows that around two-thirds of businesses that export sell essentially the same products or services as they sell in the domestic market. This suggests that many non-exporting SMEs would likely be able to find decent demand abroad.

Broadening the ambition of UK SMEs therefore stands to increase exports. Many new-to-exporting medium-sized UK businesses choose to sell to countries with familiar regulatory and politico-legal regimes, and cultural characteristics. For UK medium-sized businesses that are expanding, for example, Western Europe and North America are by far and away the most common destinations.[22]

The UK government is now specifically targeting high-growth markets which could offer richer, if more challenging, pickings for UK firms. On-the-ground support has been increased for companies seeking to export to China and India, and there is an increasing focus on parts of Africa and Central America.

AMBITION TO SELL TO HIGH-GROWTH MARKETS NEEDS TO BE RAISED

Challenges faced by exporting SMEs

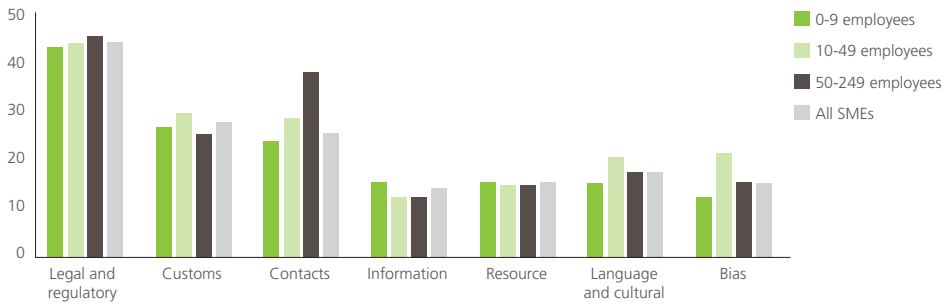
Legal and regulatory barriers are frequently cited by SME's as a major obstacle to their expansion and to exporting. Issues cited include labelling, branding, patents, copyright and trademark, rights of distributors/sales agents abroad, and compliance with local health and safety.

In addition to, and inextricably linked with overcoming, many such constraints (Figure 3),[23] is finance – also cited by SME's as an obstacle to their exporting.

While such challenges are probably confronted by exporting SMEs in all countries, how companies are equipped to overcome them makes a real difference. Companies on the European continent appear in many cases to be better prepared, or at least more used to selling outside their home country.

Studies suggest that anywhere between 25,000 and 150,000 currently non exporting firms in the UK could, potentially, export.[24] Creating the conditions to enable budding exporters actually to do so therefore offers the prospect of substantial benefits, both to the firms themselves and to the economy as a whole. In this context, finance, awareness, and technology are three particularly important and interrelated areas that need to be addressed.

Figure 3: Barriers to exporting, reported by SMEs that currently export or plan to export in the next year



Source: BIS (2013a)

EUROPEAN COMPANIES APPEAR IN MANY CASES TO BE BETTER PREPARED

MANY UK SMEs HAVE THE CHARACTERISTICS TO EXPORT SUCCESSFULLY

3.0 THE FINANCE CONSTRAINT

Introduction: Matching lenders and borrowers

Maximising the contribution of SMEs to the economy necessitates that their financing needs be met fully and appropriately. Small exporting firms, for their part, face not only the financing needs common to all SMEs, but also a further, specific set of funding challenges. New technologies are starting to help, but they stand to offer much more.

The fundamental context within which lenders and corporate borrowers congregate is depicted in Figure 4:

- **Large companies** are in general well served by banks, and can also fairly readily access the capital markets for equity and bond finance;
- **Medium-sized companies** are largely reliant on bank loans, and traditionally have had only limited access to capital markets;
- **Small companies** are almost wholly reliant on banks.

Exporting firms, whether small or medium-sized, and whether actually or only potentially exporting, face an additional set of quite specialised financing needs.

SMEs ARE FINANCIALLY LESS WELL SERVED THAN LARGE FIRMS

Financing exports

International trade involves buying and selling over extended periods across countries with different legal systems, cultures, and business environments. Financing exports is therefore often more complex than financing domestic business. Typically there is:

- Less understanding between suppliers and customers across different countries;
- A requirement to transact in foreign currencies; and
- Longer lead times for physical trade to take place.

EXPORTERS FACE THESE NEEDS MORE

Given that few exporters are able to sell to customers that will routinely pay in advance, there is habitually a cash-flow hiatus, and thereby an interim financing need.

THERE IS HABITUALLY A CASH FLOW HIATUS

A range of financial products and services have been developed over the years to allow businesses to bridge this financing gap. In the UK, these have traditionally been provided by banks. Historically, trade finance options have tended to fall basically into two categories:

- The financing of all, or a substantial part of, the associated receivables; or
- The financing of individual larger contracts, where payment terms may either be short or medium-term.

Over the past 20 years or so, however, a third type of short-term export finance has emerged, based on what can be described as the 'end-to-end trade cycle'. Here, the finance provider offers support that mirrors the funding requirements through the different stages of an export contract, from initial supply requirements through stock-holding and on to the ultimate sale.

The more traditional products used to facilitate trade finance extend to Letters of Credit, Forfeiting, and Project Finance. More recently, however, newer initiatives have emerged to provide SMEs with working capital, including: factoring; invoice finance; invoice discounting; credit insurance-backed trade finance; leasing; and supply chain finance. (For more on these products see Box: *Alternative sources of finance for SMEs*).

Insurance

The risks associated with exporting also give rise to demand for various types of insurance. Insurable risks include:

- Credit risk; e.g. the risk of customer non-payment;
- Pre-delivery/work-in-progress risk; e.g. the risk of contract frustration before dispatch;
- Bond-calling risk: e.g. the risk of 'unfair' call of an on-demand contract bond;
- Cargo risk: e.g. the risk of goods in transit, sometimes insured by logistics suppliers; and
- Liability risk: e.g. overseas local statutory insurances such as employers liability/ workers compensation.

The role of insurance, and of wider supply chain management in reducing the risks and costs of disruption are increasingly high-profile issues. As global supply chains become progressively more complex, the greater becomes the likelihood of routine operations being seriously disrupted by external events outside the control of the individual company. This is leading to the development of, and greater emphasis on, specialist insurance that offers coverage against factors such as political risk.

Taking a more holistic view of the supply chain stands to improve export performance, and here the expertise and support of international finance/ insurance providers can be useful, including for dealing with sovereign, counterparty, and supply chain risks.

A RANGE OF RISKS GIVE RISE TO DEMAND FOR INSURANCE

Lack of financing: a major obstacle to SMEs' business expansion

In many economies, including the UK, aggregate potential saving currently exceeds the totality of intended borrowing. Yet, at the same time, SMEs frequently cite a shortage of available financing as an ongoing hindrance to their business expansion: 38% of SMEs recently quoted financing as an obstacle.[25] Moreover, only a minority (39% in Q2 2014) of SMEs receive any external financing at all, although the figure is much higher for larger entities (64% of those with 50-249 employees).[26]

Historically, the connection between borrowers and savers has been intermediated in large part by banks. However, banks are manifestly not meeting all the financing needs of SMEs, especially since the 2008 global financial crisis. At the same time, traditional capital markets are not open to SMEs in the way that they are to larger companies. While medium-sized and mid-market firms have somewhat wider financing options than those available to smaller firms, they do not have access to as many options as the largest firms.

Reliance on the traditional banking sector

In the UK, SME borrowing is particularly reliant on the traditional banking sector. UK SMEs receive 90% of their funding from banks,[27] compared with just 29% in Germany.[28] Furthermore, UK SME banking relationships are highly concentrated, with the largest four UK banks accounting for 80% of the overall business.[29] This heavy reliance on, and the high concentration of, the UK banking sector seriously limits SMEs' access to finance. The vast majority of SMEs approach only their main bank for finance:[30]

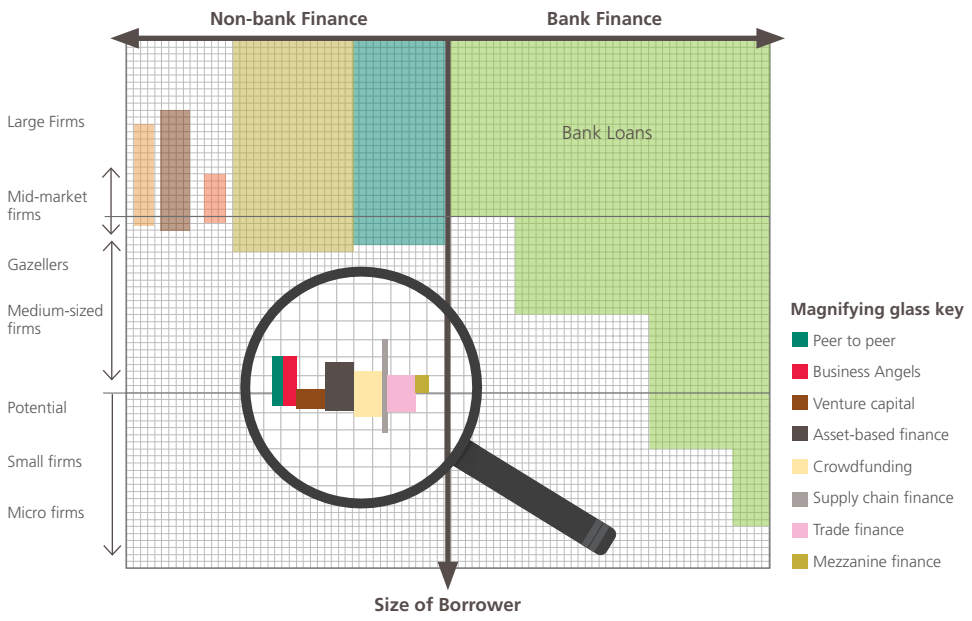
- Around 70% of SMEs seeking finance contact just one provider;
- Over half of SMEs that sought finance in the past three years went directly to their main bank;
- Around 40% give up their search if they are unsuccessful.

Financing sources used

Furthermore, SMEs largely use 'core' forms of finance, such as overdrafts, credit cards, and bank loans. Seven per cent of all SMEs use only credit cards as their source of external finance, although larger SMEs tend to make more use of other sources of funding.

SME FINANCING IS HEAVILY RELIANT ON (ONLY A FEW) BANKS

Figure 4: External funding sources by size of borrower



Source: Llewellyn Consulting
Notes: Not drawn to scale, but indicative of UK financial sector funding sources by size of borrower.

SME exporters exemplify these behaviours. Indeed, only around 1% of SMEs that import and/or export currently use export/import finance, with little variation by size of business.[31]

This is notwithstanding the advantages that well-structured trade finance can offer relative to more generalised credit facilities. For example, with trade finance:

- Exporters receive finance on export, rather than having to wait for cash from customers;
- Borrowing evolves more in line with turnover, and exporters are not committed to loans that may be inappropriate for the trade they actually conduct;
- Payment risk can be reduced, as exporters can use 'nonrecourse'[32] trade finance facilities; and
- Trade finance facilities may be more extensive and cost effective than with overdraft borrowing.

SMEs TAP ONLY A SMALL NUMBER OF FINANCING SOURCES; AND ...

... EXPORTERS MAKE EVEN LESS USE

Recent trends in bank lending

Lending from banks to businesses has fallen sharply since its December 2008 peak. While the extent to which the decline in SME borrowing from the banks has been due to weak demand or to weak supply is unclear, there is little doubt that the tightening of regulations – including higher capital ratios and new rulings on risk weightings for SME loans and overdrafts (Basel III) – have led banks to become more risk averse. Hence:

- Credit facilities now take longer to approve;
- The average maturity of loans has shortened; and
- Collateral requirements have been tightened.

While lending to large corporates has stopped falling, lending to SMEs continues to shrink, albeit at a much slower pace than the past few years. In March 2015, for example, lending to SMEs was 1% lower than 12 months earlier, notwithstanding government initiatives such as the Funding for Lending Scheme, designed to incentivise banks and building societies to boost their advances to the UK's 'real' economy, and in particular SMEs.[33]

Recent data also show that a large number of loan applications by SMEs are rejected. Indeed, for first-time SME borrowers, the rejection rate is around 50%.[34] And these trends are unlikely fully to be reversed anytime soon.

With banks reviewing their risk exposures, taking a more rigorous approach to breaches of covenants, and operating in a tougher regulatory environment with higher cost of capital, export finance facilities from banks have generally been more difficult to negotiate in recent years. Where funding is provided, banks now appear to prefer asset-based lending; however export receivables are, in most cases, considered to be a measurable quality asset.

BANK LENDING TO SMEs HAS BEEN DECLINING SINCE 2008

The information constraint

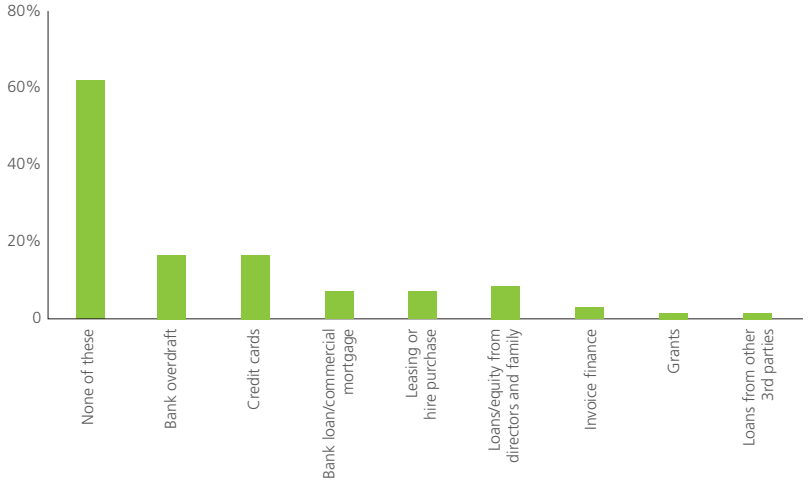
Many of the sub-optimal characteristics of SME financing reflect a lack of information.

This information gap has two main dimensions:

- Finance providers and SMEs do not necessarily know how to connect efficiently with one another; and
- Finance providers do not have the full range, appropriate up to date, information about SMEs, and vice versa – a market failure of information asymmetry.

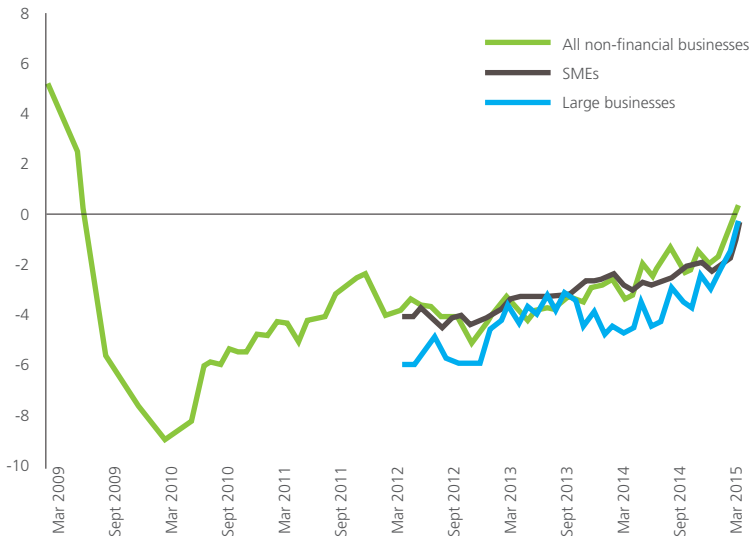
LACK OF INFORMATION IS A CONSTRAINT

Figure 5: UK SMEs' use of external finance



Source: BDRC Continental (2014)

Figure 6: Lending to UK businesses (y-o-y change, %)



Source: Bank of England

The supply side

On the supply side, the first level of information deficiency is that finance providers, and especially those other than the major banks – challenger banks and other finance providers – often cannot identify which SMEs are potentially seeking finance, even though they may be willing in principle to make a loan.

Furthermore, even when lenders are able to identify SMEs which are seeking finance, whether for trade or other purposes, the lack of business track records, due to their short lifespan, or an inability to present their business and financing plans coherently, and hence the difficulty of assessing their viability and associated risks, often makes lenders hesitant:

- The cost of addressing information barriers is higher for smaller firms than for bigger ones;
- Forecasting SME cash flows often requires the consideration of qualitative factors; and
- Alternative finance providers often have even less access to SME information than do banks.

The latter is particularly the case for institutional investors which have a limited track record of investment in SMEs, notwithstanding the fact that they have been looking to diversify away from traditional fixed income markets, and have considerable funds to deploy. Main reasons:

- Institutional investors are reluctant to lend money in small amounts. They prefer larger transactions where risk is easier to calibrate;
- Statutory requirements constrain risk-taking (these affect pension funds in particular);
- The perception that SME businesses are too specialised, or an unknown quantity;
- Lack of coherence in structure of incentives for investment;[35] and
- A lack of capacity to investigate the credit-worthiness of individual SMEs – importantly central credit registers and credit scoring standards are undeveloped across Europe.[36]

The UK could learn from the US here. For example, the Securities and Exchange Commission (SEC) is working to make it easier for investors to compare the financial information of companies. An SEC pilot program organises financial data that companies report into distinct groups, which can be downloaded in bulk. The program is set to expand to include data in the footnotes of financial statements.

FINANCE PROVIDERS OFTEN CANNOT IDENTIFY SME FINANCING NEEDS

SMEs' LACK OF TRACK RECORD MAKES LENDERS HESITANT TO LEND

The demand side

On the demand side, the lack of information among SMEs about potential financing options is evident on several levels.

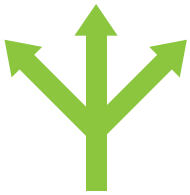
First and foremost, SMEs often do not understand the potential benefits to their business of raising finance, or they simply assume that their application will be rejected. These considerations have, if anything, been amplified by the loss of confidence in banks seen since the 2008 financial crisis.

Furthermore, SMEs have limited knowledge of alternative finance sources, such as challenger banks, and are rarely aware of the range of financing products potentially available, not least for exports. While the vast majority of SMEs are aware of credit card finance (95%) and leasing/hiring purchase (85%), only around one-third are conscious of options such as business angels, export/import finance, and peer-to-peer lending; and fewer than 12% are aware of crowdfunding or mezzanine finance.[37]

One reason for this dearth of knowledge may be that only a minority of those responsible for making finance decisions in SMEs are financially trained. This is particularly the case for SMEs with a turnover below £5m.[38] They also very rarely seek external advice when applying for finance (only 16% of those seeking finance between 2010 and 2013 sought external advice on the type of finance to apply for, or the type of provider to approach).[39]

SMEs are also often unaware of the many government support schemes and how to access them. Only 15% of SMEs that used finance between 2010 and 2013 said that they were cognisant of government finance schemes; and, among these, the majority were not able to say which financial products were covered by these schemes.[40]

> *"… it is imperative that confidence in the system amongst commentators on SME finance be increased as there is an unintended consequence that continual negative publicity serves to further suppress demand for finance on the assumption that it would not be available"*[41]



SMEs LACK KNOWLEDGE OF ALTERNATIVE SOURCES OF FINANCE…

… AND OF GOVERNMENT SUPPORT SCHEMES

The particular constraints on exporting SMEs

For SMEs that export, or wish to export, getting the right financing and insurance is particularly important, because not only do exporters need generally to finance their activities, they also need to reduce the risks to which they are exposed when selling abroad. However, the economic downturn, changing regulations, and capital constraints have led to both trade finance and insurance options being restricted by banks.

Short-term working capital is frequently the first requirement when an SME receives its initial export order. But other forms of finance, including invoice financing, supply-chain financing, and short-term loans, take on progressively greater importance.[42] Credit, currency, and political risks also add to the cost of exporting, and the cost protecting against these risks has to be taken into account: the fear of not being paid by foreign customers, together with worries about currency and political instability, are major deterrents to overseas expansion for SMEs.[43]

Getting the right export financing and insurance is in turn seriously hindered by lack of information. On the supply side, finance and insurance providers often see exporting activities as much more complex than domestic business operations. To be able to provide the right export finance and insurance, accumulating accurate information about the exporter's customer is just as important as being able to assess the economic and political risks associated with the country into which the sale is being made.

On the demand side, SMEs lack knowledge about the trade financing and insurance options available. A recent survey by Urica[44] found that nearly three-quarters of SMEs that export rely only on their balance sheet, and have no additional external financing. SMEs also make only limited use of insurance or hedging, thereby assuming significant credit and currency risk. Rather, they often ask their export customers for cash up front (about 65%) – which can put them at a significant disadvantage compared with local suppliers.[45]

To promote UK SME exports, UK Export Finance, under the Direct Lending Facility, provides loans of up to £3bn in aggregate to overseas buyers to finance the purchase of capital goods and/or services, from UK exporters. While this is helpful at the margin, there is scope to do more, not least to raise awareness of such schemes. Some encouraging developments are coming from the private sector – some of the UK's major financial institutions appear now to be taking a more proactive role in supporting the efforts of UK SMES in conjunction with government.[46]

GETTING THE RIGHT FINANCING IS ESPECIALLY HARD FOR EXPORTERS

EXPORTERS' LACK OF INFORMATION IS AGAIN A MAJOR CONSTRAINT

The rising role of alternative sources of finance

Alternative sources of finance other than traditional bank lending have many advantages.

First, they help to overcome the aggregate finance constraint. And with the banks likely to remain constrained by tighter regulation, as well as generally conservative in their approach, it will become increasingly important that alternatives or complements to traditional bank financing develop at a sufficient pace to sustain investment spending as the UK economy recovers.

Second, SMEs' financing needs differ greatly, depending on their stage of business development. An SME which is just starting up does not necessarily need the same type of financial support as a mature SME, or an exporting SME. This is illustrated by the so-called 'finance, or funding, escalator', shown in figure 7. Given that the vast majority of SMEs avail themselves of only a very small number of funding sources, and rarely venture outside the traditional banking sector, tapping into alternative funding sources stands to be instrumental in helping SMEs develop their business, and in particular in overseas markets.

The expansion of alternative sources of finance can bring other benefits too, including reduced cost of financing, and greater resilience of the financial system as a whole.[47] Non-financial advantages also follow from funding diversification: by taking an equity stake in a company, for example, venture capital providers can help signal growth potential.

New developments

Encouragingly, a range of new financing options are emerging, providing alternative channels to match lenders to borrowers and fill the 'white space' depicted in Figure 4. They include importantly:

- Challenger banks;
- Wider access to capital markets, through:
  - Corporate bond markets; including the private placement market;
  - Securitisation; particularly for SME loans;
  - Equity finance; including business angels and venture capital;
  - Mezzanine finance; and
  - New, innovative financing sources, including: peer-to-peer lending and crowdfunding.
- A changing landscape for trade finance, including growth of asset- and sales-backed finance; and supply-chain finance.

ALTERNATIVE FINANCING SOURCES HELP SOLVE THE FINANCE CONSTRAINT

VARIOUS OPTIONS CAN UNLOCK AND EXPAND SME FINANCING

New technologies are helping additional innovative sources of external finance, and these are starting to reduce the traditional dependence on banks, not least for trade-related products and services. To date, many of these options are limited in size; but they are scalable, and indeed they are currently growing fast. For more details on each of these alternative sources of finance, see Box: *Alternative Sources of Finance of SMEs.*

NEW TECHNOLOGIES ARE HELPING

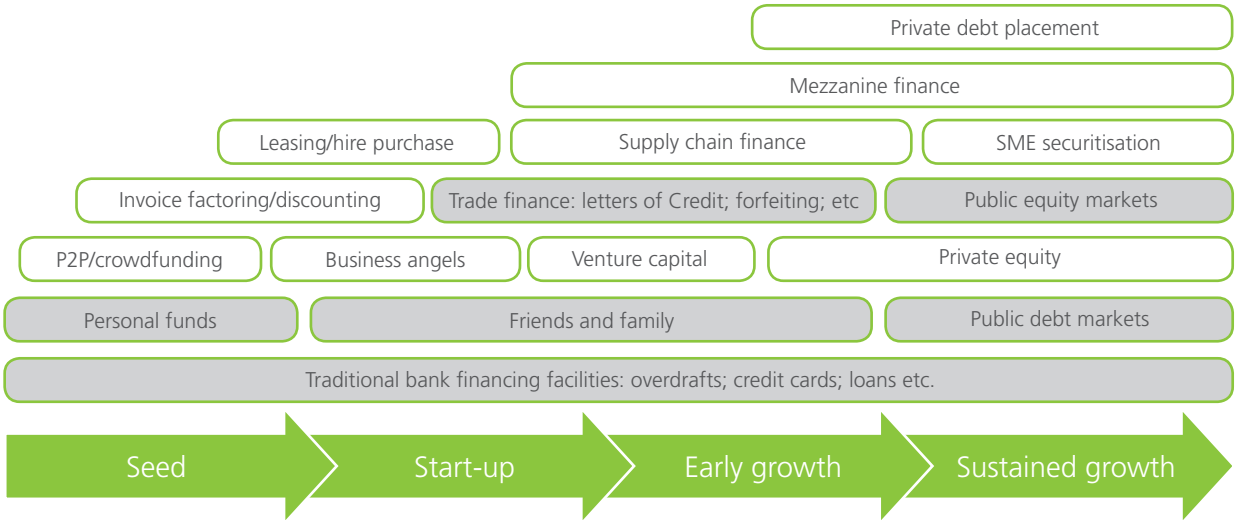
Raising competition among finance providers

The use of these alternative financing options could be encouraged by increasing the intensity of competition among finance providers. Recent legislation has taken a step in this direction.[48] Historically, the largest banks have only rarely referred SMEs which have had a loan application rejected (typically some 6% of SMEs are referred) to other potential lenders.[49] But banks are now legally obliged to share customer data with alternative lenders, and to point would-be borrowers to these sources of financing.

One encouraging arrangement to watch is the relationship forged between Santander and Funding Circle, a peer-to-peer lending platform. Through a referral arrangement – the first partnership between a UK bank and an online finance provider – Santander will proactively refer small business customers for a loan to Funding Circle.[50]

STRONGER COMPETITION COULD STRENGTHEN SME FUNDING

Figure 7: SME funding escalator: 'traditional' and 'alternative'



Source: Bain & Company, 2013 and Llewellyn Consulting
Note: grey shading represents older, more traditional funding options; and white newer, alternative options.

ALTERNATIVE SOURCES OF FINANCE FOR SMEs

Many alternative finance sources can unlock and expand SME funding, not least for exports.

Challenger banks

Challenger banks (usually defined in the UK as any new bank that challenges the 'Big 4') have been on the rise over the past several years, and can provide a viable financing alternative for SMEs, given that they typically have strong balance sheets, good access to funding, and often fewer inherited constraints than do the traditional banks.[51]

With recent proposals by the government to lower barriers to entry into this sector, create a more balanced banking market, and require credit data sharing to increase challengers' ability to conduct risk assessment of SMEs, challenger banks stand to play an increasing role in financing SMEs. Examples of such banks include, inter alia, Aldermore, Atom, Close Brothers, Handelsbanken, Metro Bank, Secure Trust Bank, and Shawbrook.

Widening access to capital markets

UK capital markets are under-developed when it comes to SME funding. There are, however, a number of ways SMEs can in principle access capital markets, including through bond and equity markets, both public and private, and through mezzanine finance. The proposed European Capital Markets Union stands to be important for both the UK and Europe more generally. (For more, see the Independent Economists Group's paper: Investment, Growth and Capital Markets Union.)

Corporate bond markets could offer SMEs greater access to capital markets to obtain funding. While larger companies have accessed corporate bond markets for decades, this has traditionally not been a feasible option for SMEs. However, this is changing, and medium-sized companies can now issue bonds in smaller denominations directly to retail investors via platforms such as the London Order Book for Retail Bonds (ORB), which offers transparent infrastructure.

The private placement market, through which fixed-coupon debt instruments are issued directly to institutional investors, could provide considerable additional funding, but is still underdeveloped in the UK. UK issuers account for about 1/5 of the global private placement market but, given the immaturity of the UK market, companies tend to tap the US market instead. If UK institutional investors invested in private placement in the same proportion as US investors, an additional £15bn of non-bank lending could be made available for UK medium-sized companies.[52] Better standardisation and established credit processes (with the help of technology in particular) could help to increase the number of UK-based investors.

Securitisation could also play a greater role in unlocking affordable credit for UK SMEs. While many perceive securitisation as posing significant financial stability risks that should generally be discouraged by regulators, it can actually offer important advantages, by:

- Transferring credit risk to the capital markets in an effective manner. As a result, banks achieve capital relief and capacity is freed up for new loans;
- Bridging the gap between deleveraging banks and investors seeking to diversify their portfolios;
- Removing the requirement for investors to analyse the credit quality of individual securities issued by single SMEs; and
- Widening the investor base for SME credit risk beyond traditional domestic lenders to international investors, as securitised loans are standardised and liquid, and thereby marketable to a wider range of investors.

Equity finance has traditionally been underutilised by SMEs in the UK, notwithstanding that it can be highly important in the early stages of a business. Indeed, currently only around 3% of UK SMEs make use of equity finance. This is partly due to business owners being unwilling to concede a stake in their business, preferring to sacrifice potential growth for assured autonomy.[53] Partnership with an equity finance investor (e.g. business angels, venture capitalists, or private equity firms), however, can bring much-needed know-how and experience to businesses in early stages of development or to companies looking to export for the first time. Encouraging private equity investment for SMEs, and especially for those looking to expand internationally, offers great potential.

The government has developed a number of schemes (including the Seed Enterprise Investment Scheme, Enterprise Investment Scheme (EIS), and Venture Capital Trust Scheme (VCT)) to offer tax relief to investors attracted to early stage companies. The Business Growth Fund (BGF), established in 2011 and backed by

five of the UK's main banking groups, is also supportive of such initiatives. With £2.5bn in capital, BGF makes long-term equity investment in SMEs with high-growth potential.[54] (For a list of major government schemes see the Annex).

Venture capital, in offering support at the pre-launch, launch, early stage, and later-stage development, can be particularly important for young companies with innovation and growth potential. European venture capital markets, including in the UK, have not developed as much as in the US: new US firms are reckoned to raise around twice as much in each round of financing as European firms do – and twice as fast. While venture capital investment is equivalent to around 1/5th of a percentage point of US GDP, in the UK it is equivalent to only around 1/6th of that (i.e. 1/30th of a percentage point of GDP).

There have been some encouraging signs in recent years, however, with the activity of some firms comparable with their counterparts in the more mature US market. Two London-based examples have come to prominence: Seedcamp and Passion Capital have helped a significant number of companies raise money from other funds.[55]

Mezzanine finance, a hybrid of debt and equity funding, can also help fill the SME financing gap. Loans are made on essentially the same basis as by banks, but the lender shares in the firm's success (or failure) as an element of equity investment is incorporated into the deal. Hence if the business grows as expected, the mezzanine provider secures an additional return through the increased value of a limited amount of equity: if the expected cash flow does not materialise, the debt is often converted into equity, helping to reduce the burden on the firm's cash flow.

Mezzanine finance thus not only provides an alternative source of growth finance where bank lending is unavailable; it also has the potential better to match lender and borrower preferences, not least because most SMEs are unwilling to give up the equity demanded by angels and venture capitals. Though still underutilised, there have been some positive developments. For example, Santander's Growth Capital mezzanine fund is committed to providing up to £200m in growth capital to fast-growing UK SMEs. In its first year (2012), investments in SMEs through this fund purport to have led to 230 job creations in the UK.[56]

Innovative financing sources

Peer-to-peer lending, which was pioneered in the UK in 2005, is starting to offer useful complementarity to traditional bank lending. Allowing individual investors and businesses directly to channel funds to borrowers, lending by major P2P platforms has now reached £2bn (as of September 2014),[57] a doubling since December 2013. While peer-to-peer was originally more popular among individuals, business lending is catching up.

Peer-to-peer platforms include Zopa, RateSetter, and Funding Circle. Not only does such finance bring competition to the concentrated banking market, it also offers an easier and quicker credit process. With an average loan size of £7,500, this type of funding is more suitable for smaller SMEs.[58] While individual loan sizes remain limited, US evidence suggests that there could be institutional interest in the sector were loans to be pooled.

Crowdfunding, whereby a project is funded by raising money directly from a large number of people, typically via the internet, is a rapidly evolving alternative source of finance to SMEs. According to UK Chancellor of the Exchequer George Osborne, crowdfunding represents "the dawn of a new era" in how start-ups can raise capital.[59] Providing a direct link between investors and companies wishing to raise capital via an online platform is a quicker and more flexible process for obtaining finance.

Platforms which provide this service include: Crowdfunder, Seedrs, Crowdcube, BloomVC, WeFund, and Buzzbnk. Investors, however, are largely responsible for their own due diligence about the projects in which they wish to get involved. Educating them about potential risks remains key. Regulation is evolving: the Financial Conduct Authority (FCA) introduced a '10% rule' whereby retail investors who are neither 'sophisticated' nor 'high net worth' must prove that they are not investing more than 10% of their net investable assets.[60]

Specific trade finance products

The more traditional elements of trade finance, including letters of credit, forfeiting, and project finance, are increasingly offered by providers outside the traditional banking sector. A range of alternative, newer products are also increasingly provided in order to help exporters access much needed working capital.

Traditional products

A letter of credit is an undertaking issued by a bank on behalf of the buyer of a good or service to pay a stated amount to the exporter within a specified period, provided certain conditions are met. These conditions generally include receipt of various documents, for example a commercial invoice, transport documentation, and/or an insurance certificate.

Forfeiting is a form of credit whereby a third party effectively buys an export transaction, presented as bills of exchange. The Forfeiter then has the contract with the buyer and pays the exporter for the goods – thereby providing security to the exporter – and agrees a payment schedule with the buyer, typically between two to five years.

Project finance is used by some exporters to fund major overseas projects in a stand-alone manner. A finance provider will typically issue a project loan based on an overall assessment of its viability, including projected future income streams and risks.

Revolving credit is a line of credit or overdraft from a financial institution with a requirement to pay interest only on the money actually withdrawn. Business credit cards are another source of revolving credit. This is typically available to established businesses with good credit and references.

Newer forms of finance: asset- and sales-backed finance and supply-chain finance

Sales- and asset-backed finance is showing potential for raising working capital and dealing with late payments. Cash flow is one of the key operational problems for the majority of businesses, and is often particularly problematic for exporters, not least due to the shipping lags involved.

Sales finance (e.g. invoice factoring and invoice discounting) and asset-backed finance (e.g. leasing/hire purchase) are relatively well-known and growing areas of funding in the UK. In fact, the UK has the highest usage of invoice financing in the world (equivalent to some 10% of GDP, compared with 1% of GDP in the US).[61] While overall awareness of asset-based finance is high (e.g. 8% of businesses seek leasing/hire purchase)[62], practical understanding of whom to approach and how to proceed is much lower. Furthermore, asset-backed finance remains quite a costly financing option.

- **Invoice discounting** allows exporters to receive up to 90% of the money they are owed within a day of submitting an invoice. It is aimed mostly at larger businesses with well-established systems and procedures in credit control and sales ledger management.
- **Invoice factoring** involves issuing invoices as normal, but typically with a financial institution managing the issuing of statements and collecting monies owed to exporters. It is primarily aimed at smaller businesses without a large finance department, and which may have customers who do not always pay on time.
- **Asset finance** is a form of funding that uses an asset as collateral in order to secure a loan. It can help businesses release working capital, and is a flexible means of funding capital investment, with no requirement to take money out of reserves.

Supply-chain finance, also a short-term advance against outstanding receivables, aims to address some of the short-comings of conventional sales finance. It allows large corporates to use the strength of their balance sheets to support their suppliers. The better credit rating of larger companies helps the associated SMEs access funding at a more competitive rate.

Furthermore, the holistic view of the supply-chain offers an improved picture of the risks involved, which translates into increased and timelier lending, and on better terms. It tends to be applicable most to larger SMEs, given the costs and time required to set up the systems. Technology advances have led to better system integration: SMEs get their loans more quickly, and banks have more confidence as a result of increased transparency.

Exporting SMEs stand to benefit particularly from this type of financing. That said, here too awareness is so far limited: while the government announced in 2012 a multi-billion boost for UK supply chain,[63] following the Breedon Report's recommendation to increase the use of supply chain finance, so far less than one-third of SMEs know about it.[64]

4.0 THE AWARENESS ISSUE

A wide range of support for UK SME actual and potential exporters

Numerous policies have been introduced in recent years to address the range of constraints faced by UK SMEs in, or wishing to enter, international markets. Many are public-sector programmes; others are private sector initiatives.

These schemes offer a wide range of support, including the provision of finance; business education; and market intelligence – extending to customs and business conditions abroad. Three institutions in particular have been created/developed to address major market failures and underpin the government's policy objectives:

- The British Business Bank (BBB)
- UK Export Finance (UKEF)
- UK Trade and Investment (UKTI)

The total number of programmes and policy initiatives is large (a list of major government schemes is given in the Annex), and at the sub-national level impressively so. It has been observed, for example, that the County of Worcestershire alone has a total of 28 schemes.

Low take-up

While most of the schemes – including importantly those of the three big institutions above – are widely considered to be useful, the take-up of most of these support policies has so far been quite low; certainly lower than many had expected or hoped for.

Many SMEs are apparently unaware of what is on offer, and report that they do not find it easy to discover anything like the full breadth and depth of support available – even practitioners report that they are unaware of some developments. For example, only 15% of SMEs that had recourse to external financing between 2010 and 2013 claimed that they were cognisant of government finance schemes.[65]

> *"There should be no medium-sized business that does not export simply because it is unaware of the support that Government offers."*[66]

One reason for the low levels of awareness of what is on offer may be that many schemes are new, still fairly small and, in some cases, as yet unproven. Another reason, offered by three-quarters of respondents in a poll, was simple bewilderment, due to:

- The sheer number of schemes and related acronyms (e.g. EFG – Enterprise Finance Guarantee; NLGS – National Loan Guarantee Scheme; BFP – Business Finance Partnership; etc.);[67] while others mentioned

MANY SUPPORT POLICIES HAVE BEEN INTRODUCED ...

... BUT TAKE-UP HAS SO FAR BEEN QUITE LOW

- Frequent and thereby confusing changes of name.

One respondent summed up the overall perception thus:

"When we finally found you, you were great."

The need for a one-stop shop

Clearly, SMEs are in need of better advice about where to seek help on financial issues. Many respondents – over 90% in one poll – say that they see a need for a centralised, clear, user-intuitive website – a single 'brand' and place where SMEs can go, make their choices, and either find the information they require or be redirected to where it is available.[68]

The relevant part of the gov.uk website is a step in this direction. It is evident that considerable effort has been devoted, over a run of years, to bringing together information on, and thereby access to, the wide range of available schemes:

- It contains a large volume of information relevant to SMEs, including about financing in general; non-financial support for exporting; and even educational material; and
- Clearly, a valiant effort has been made to link all this information up.[69]

It is therefore striking that, in the many interviews conducted in the course of the preparation of this report, virtually nobody mentioned gov.uk. This may reflect the fact that the accountants, and tax and other advisors engaged by SMEs are themselves ignorant of the services made available by the government.

However, the main reason for this lack of knowledge about the SME part of the gov.uk site is that, like all large websites that have been in existence for a number of years, the SME-relevant part of gov.uk has become complicated, untidy, unwieldy, and at times confusing.

Users say that in particular they would like to see:

- Classification of the wide range of information on the (relevant part of) the gov.uk site that the user can absorb before being directed elsewhere;
- A short summary of each institution, describing what it does and offers, so that searchers understand more clearly about where to go for what; and
- Terminology that is consistent across websites, institutions, and programmes.

The SME-relevant part of the gov.uk site thus now urgently needs root-and-branch rationalisation, with effort put into establishing, and thereafter continually maintaining, usability. The aim should be to furnish users with, as one respondent put it:

A CLEAR USER-INTUITIVE 'ONE-STOP SHOP' WOULD HELP

ROOT-AND-BRANCH RATIONALISATION IS NEEDED

"a guided walk, rather than the present somewhat random walk".

There are models that warrant emulating. Three countries are regarded by users as having particularly good, pertinent websites that meet modern standards for accessibility and usability: the US, Sweden, and Australia.[70] Of the three, Australia's Efic (Export Finance and Insurance Corporation) website is generally the most highly regarded, being particularly clear and well-organised (for more see Box: Australia's Efic website.)

Interestingly and importantly, feedback consistently reports that information and advice on official government websites is both highly regarded and trusted; whereas broadly similar information on non-government sites is generally viewed with scepticism. It would seem appropriate, therefore, even on this argument alone, that the 'one-stop-shop' should remain the province of the government.

"Ninety-one per cent of SMEs agreed that having a single brand and website covering all Government schemes would be a good idea. Eighty-four per cent of all SMEs agreed that greater awareness amongst banks to direct businesses to appropriate Government schemes would be an improvement.

Having simpler or fewer schemes was also a popular idea, with 78 per cent of SMEs saying they would like to see this. Seventy-two per cent of SMEs would like to be automatically contacted if there was a relevant Government finance scheme appropriate to them."[71]

OTHER COUNTRIES' SITES OFFER IDEAS WORTH EMULATING

AUSTRALIA'S EFIC WEBSITE

The Australian export guarantee website offers ideas worth emulating.

Australia's Efic website www.efic.gov.au is regarded as particularly clear and well-organised:

- It includes an 'about Efic' section, where its mission and structure are explained
- Effort has been made to provide the user with a 'guided walk'
- All the products and services Efic offers are listed in an organised manner, and are clearly explained
  - Moreover, the reader is offered different levels of information for each product

The site goes beyond the products and services offered. It also includes:

- A country analysis section that provides information about the risks of doing business in different export destinations, and the latest world economy and emerging markets' developments
- A case study that offers examples, listed by sector and type of Efic solutions, for both small and large Australian exporters
- An export community section that provides:
  - A well-organised list of links to other organisations (private and public) that collaborate with Efic
  - A list of government, industry, and association events that are sponsored or hosted by Efic, or in which Efic participates
- An "Is Efic for you? Small-medium business" section, that contains:
  - A brief online questionnaire to be filled in by the company, and
  - The possibility of submitting company contact details so that an Efic agent can provide a tailored finance solution.

5.0 THE TECHNOLOGY STORY

The rise of new technologies

No doubt, lack of information is a fundamental constraint on SME financing. Respondents indicated clearly that it affects both the demand and the supply sides of the financial intermediation process. Technologies that enable information to be shared between SMEs and potential lenders are therefore potentially highly constructive.

Encouragingly, new technologies are currently changing the financial services landscape, and at a fast pace. The rapid digitisation of the economy, combined with an exponentially growing amount of data, is transforming banking activities. Evaluation and management of risk are starting to undergo fundamental changes. Traditional credit risk in particular is becoming more accurately managed as the quantity and timeliness of data available to credit providers increase considerably.[72]

While these developments have so far largely been a consumer phenomenon, they are bound to encourage new products and services for businesses and institutional investors. In fact, some new technologies have already been developed specifically for companies, in order to help them gain access to the right financing.

At least two types of path-breaking technologies have been developed recently:

- Software which monitors companies' accounts receivable and cash flows in real time; and
- Software which facilitates early payment to suppliers all along the supply chain.

While such technologies were often initially developed for large companies, they are being extended down, and are starting to be applied even to small companies. Furthermore, a number of these encouraging technological innovations seem to be being developed faster in the UK than elsewhere – including in some cases the US.

Three-way stretch

These new technologies, by helping to improve not only the flow, but also the quality, of information, are starting to make themselves felt in at least three distinct ways, and are particularly important for exporting SMEs. Variously they:

- **Give rise to new intermediation** between lenders and borrowers who previously would not have been able to find one another (the 'dating agency' function.)
- **Reduce risk**, and thereby the cost, of some elements of lending and borrowing, by monitoring in real time financial developments within individual firms, and analysing them using sophisticated algorithms.

NEW IT TECHNOLOGIES ARE HELPING TO SOLVE A RANGE OF ISSUES ...

... AND AT A FAST PACE

EXPORTERS STAND TO BENEFIT PARTICULARLY

- **Facilitate early and/or guaranteed payments to suppliers** by reducing risk and thereby increasing confidence all along the supply chain – including importantly suppliers abroad, traditionally a particularly difficult area for small exporters.

The various roles of new technologies for exporting SMEs

The 'dating agency' function

Some of these new technologies essentially enable the matching of borrowers to lenders through two basic steps.

The first, straightforward, step enables both sets of parties to be aware of one another's existence:

- Financing providers need to know which SMEs need what financing; and
- SMEs need to know the options available and who provides them.

This is particularly important for exporting SMEs, and even more so for potentially-exporting SMEs, which generally have scant knowledge of what trade financing options are available.

The second step is to ensure that both parties have the requisite detailed information about one another:

- Financing providers need to have a clear picture of the risks involved with the SMEs they may lend to, notwithstanding SMEs' frequent lack of track record and collateral. This need is even more acute in the context of lending to exporting SMEs, given that finance providers not only need to gather information about the SME itself, but also about the exporter's customers and risks in the countries where the exporter trades.

The importance of getting the right information about corporates has recently been recognised by the Securities and Exchange Commission (SEC) in the US, which is currently working to make it easier for investors to compare financial information of one company with that of another. Although this program is targeted at public companies, one can easily imagine that it could be applied to smaller companies.[73]

- SMEs, for their part, also need to have clear information to be able to understand every financing option, in what type of situation they would need them, and the benefits associated with each. Particularly important is that the requisite information be available to exporting SMEs which are largely uninformed about the specifics of available trade financing or insurance options.

NEW TECHNOLOGIES MATCH BORROWERS TO LENDERS

Monitoring financial data in real time

Recently-developed software enables lenders to interface with, and thereby monitor and analyse, key company data – including all-important accounts-receivable information. What makes this development truly novel, and thereby increases its usefulness enormously, is that the monitoring is done in real time, enabling instantaneous analysis by means of sophisticated algorithms.

Initially developed for larger firms, this technology has subsequently been further advanced for medium-sized companies, and is just starting to be applied to smaller companies, by interfacing with most of the commonly-available accounting packages used by them.

The software offers daily visibility of underlying cash flow and, by means of automated reporting, provides early indication of financial stress – including of cash-flow problems. Interestingly, this intelligence often becomes apparent earlier than the company itself otherwise would have become aware.

The root technology was developed by a major insurer, but is now being licensed to some banks. The high-frequency information that it provides gives the sponsoring insurance company or bank heightened confidence. One consequence has been the confidence now to offer fixed-term insurance of companies' accounts receivable (previous policies were typically cancellable at will).

That the accounts receivable are insured, and that the cash-flow solvency of the firm is being monitored in real time, in turn brings many benefits to finance providers/insurers, including by:

- Sharply reducing the cost of undertaking firm by firm due diligence or risk analysis; and
- Providing banks and other institutions with confidence to lend to smaller firms.

SMEs for their part gain additional financing options: they receive bigger loans sooner – which is particularly important for exporters – and at a lower interest rate.

ACCOUNTS RECEIVABLE MONITORING IN REAL TIME REDUCES RISK

SOFTWARE FACILITATING PAYMENT TO SUPPLIERS IS IMPORTANT TO EXPORTERS

Facilitating early payment to suppliers

Another software development facilitates early payment to suppliers. A global insurance company funds and supports the exercise, and admits companies, that it has pre credit-rated, to a high-tech digital platform.

The way this software works is as follows:

- Buyers and sellers authenticate invoices between them using a one-time digital code;
- Buyers can either opt to be paid immediately, in cash – in which case they pay a small fee of 2-3%; or they can forgo immediate payment, ultimately to receive payment in full; and
- Sellers can be granted a grace period of up to 90 days by the buyer.

These arrangements are conducted invoice by invoice, i.e. the buyer can for each invoice choose whether or not to take the discounted, immediate-payment, option. The net result is a reduction in risk, and thereby an increase in confidence all along the supply chain.

The platform, being both global and operating in in real time, works equally well with companies anywhere in the world. And early pilot studies are showing that this does in fact work.

Conclusion

Collectively, such developments are having a range of knock-on effects:

- Insurance companies are becoming able and willing to offer guaranteed fixed-term insurance e.g. in respect of accounts receivables, rather than policies which can be withdrawn at short notice;
- Banks in turn are more willing to lend to such companies, given that their accounts receivable are insured, and that the finances of the SMEs in question are being closely monitored; and
- The resulting loans are thereby often able to be bigger; cheaper; and offered sooner than was previously the case.

Such developments are particularly important to exporters, which have the additional financing requirement of bridging the often significant gap between shipping and payment.

SUCH DEVELOPMENTS BRING SEVERAL FUNDAMENTAL BENEFITS

EXPORTERS STAND TO BENEFIT PARTICULARLY

6.0 POLICY PROPOSALS

There is much scope for policy to enable the potential of small- and medium-sized firms to raise exports. And much of what is needed need not involve the government spending large amounts of money.

Some overarching principles

Over the course of this study, interlocutors pointed repeatedly to overarching principles that they regarded as central in any program of support for both actual and potential exporters:

- **Take a holistic top-down view** – factoring in the entirety of the supply chain.
- **Construct policies in consultation with key stakeholders**. These include, inter alia: HM Treasury, BIS/UKTI; the British Business Bank; the British Bankers Association; UK Export Finance; the Business Growth Fund; and the Bank of England.
- **Target policy especially towards medium-sized companies**, particularly those wishing to enter international markets.
- **Regulate to facilitate**, rather than to control.
- **Seek to eliminate inadvertent constraints**, to put competition on an even footing internationally.
- **Encourage 'clustering'**, ensuring that emerging clusters in particular do not run into avoidable constraints, whether regulatory or other.
- **Grow an export culture and raise international ambition**, including through government briefings, school education, improved teaching of modern languages, and advisory services.
- **Examine the range of existing policies, and best practice from around the world**.
  - Establish the key features of each policy; and identify specific problems in their functioning;
  - Consider difficulties that might arise in transferring existing policies to the UK;
  - Suggest detailed strategies that, modified as appropriate, could be transferred from one country to another; and to
  - Outline additional targeted policies that would fill clearly identified but unaddressed gaps.
- **Set up a UK government-backed, or EU-backed, working group**.

Promote better what already exists

Many policies and schemes are already directed at supporting UK SMEs, including those wishing to export. But awareness of what is on offer is lacking; there is confusion, the result of the sheer number of schemes, frequent name changes, poor online information; and take-up is low:

- **Create a well-constructed 'one-stop-shop' gov.uk website that is properly accessible and user-friendly**, underpinned by a clear and logical structure and framework. Root-and-branch rationalisation will be required, with effort to not only establish, but thereafter continually maintain, usability:
  - Emulate 'best-in-class' websites of the US, Sweden, and particularly Australia;
  - Maintain continuity of the names of major institutions and schemes;
  - Advertise the general approach aggressively; and especially the one-stop-shop;
  - Keep the website in the government sector: non-government sites are generally viewed with scepticism; and
  - 'Partner' with suitable private institutions and experts who have valuable expertise, networks, and can help, including in the provision of general legal advice and in pointing to common SME-pitfalls.
- **Hold more trade fairs and trade missions** – ensuring effectiveness/value for money – to provide a platform for business-to-business networking, and raise international ambition.
- **Encourage and maintain collaboration** between suitable private sector institutions and bodies such as UKTI and UK Export Finance, to draw on their expertise and networks.

Increase the diversity of funding options

While bank lending may remain the dominant source of funding, creating a more diverse and competitive funding environment through a range of policy initiatives is needed. Effective policy will require the development of robust ecosystems that help lay the foundation for new, alternative sources of finance:

- **Fill gaps in the so-called SME 'funding escalator'**, particularly for young, fast-growing firms, and actual and potential exporters.
- **Help SME's navigate better the changing landscape for trade-related products**, maximising the potential of innovative sources of trade finance and the various types of insurance on offer.
- **Focus on potentially-key funding markets**: including importantly venture capital, mezzanine finance, private placements, and SME securitisation. In particular:

- Develop seed, start-up, and early and later stage venture capital markets;
- Promote the use of more mezzanine finance to help fill the current gap in growth capital for SMEs;
- Improve access to the private placement market for mid-sized companies;
- Unlock access to institutional investment through securitisation of SME loans; and
- Increase competition among finance providers.

• **Address legal, regulatory, and tax constraints** for SMEs, investors, and supporting institutions in order to encourage use of newer forms of finance. In particular:

- Facilitate better access to information on legal/regulatory issues in different markets;
- Create a databank or checklist of issues encountered by SMEs in their dealings abroad, targeting policy to tackle common constraints, including importantly:
  - Labelling, branding, patenting, copyrighting, and trademarking; and compliance with local health and safety standards;
- Consider extending tax incentives for investors in SMEs, such as those offered in the EIS and VCT schemes; and
- Review capital ratios and rules on risk weightings for SME loans and securitisations.

• **Promote better information collection, information dissemination, rating of firms, and scoring**. In particular:

- Maintain central credit registers; and
- Develop scoring standards.

Promote a range of new-technology applications

Limitations to financing by the banking sector are frequently spoken of. But various technological applications, as yet largely unknown, are starting to offer considerable potential for new ways of linking savers and borrowers:

- **Use speeches by ministers, civil servants, industry associations, and others** to proselytise these new, and so far largely unknown, (British) technological applications.
- **Ensure developments in larger companies** filter through to medium and small companies.
- **Stimulate and protect innovations and intellectual property**, both at home and abroad.
- **Promote the use of the newest technologies** to enhance the quality of the engagement between lenders and borrowers.
- **Improve access to enablement tools to support SMEs** in presenting business and finance plans.

ANNEX: GOVERNMENT SCHEMES TO SUPPORT SMEs

Three particularly important government institutions provide financial and business-support advice:

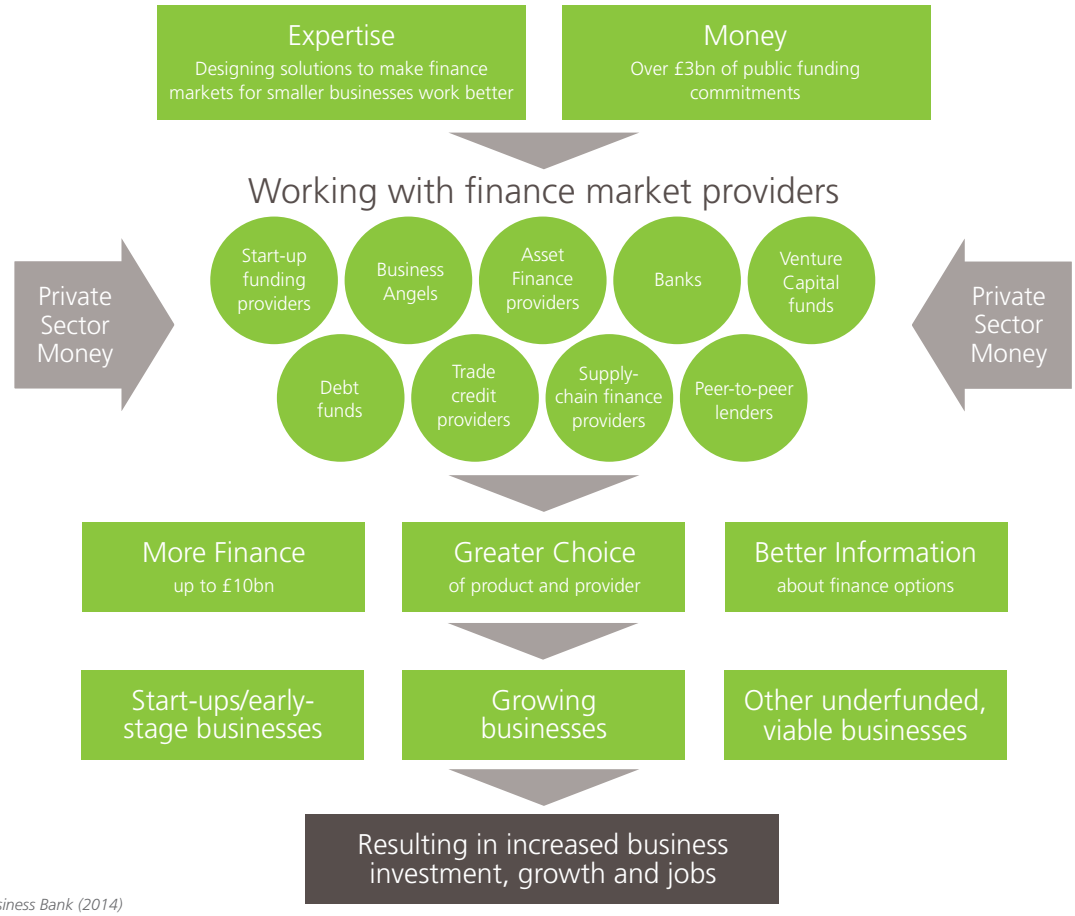
- The British Business Bank (BBB);
- UK Export Finance (UKEF);
- UK Trade and Investment (UKTI).

The British Business Bank (BBB)

The BBB was set up in 2013. Its main goal is to enable finance markets to work more effectively and dynamically for small businesses. It brought together existing government financial schemes, advice services, and expertise to become a one-stop-shop for SMEs. It aims to:

- Increase the supply of finance available to SMEs where markets do not work well;

Figure A: British Business Bank's operating model



Source: British Business Bank (2014)

- Create a more diverse finance market, with a greater choice of options and providers;
- Increase SMEs' understanding of finance options available; and
- Provide, in some cases, guarantees to lenders.

The BBB does not fund companies directly, but works in partnership with private sector financial institutions. Its operation model is shown below in Figure A. Some of the schemes that the BBB manages are described in more detail in the table below, *A selection of government-backed schemes*.

For more details, see their website www.british-business-bank.co.uk

UK Export Finance (UKEF)

UKEF provides support to UK exporters, primarily by working with UK banks to provide exporters with trade finance solutions to help them win and perform on specific export contracts.

UKEF can guarantee bank loans to overseas buyers to finance the purchase of goods and services from UK exporters; insure UK exporters against non-payment by their overseas buyers; and share credit risks with banks in order to help exporters raise contract bonds, access working capital finance, and secure confirmations of letters of credit. It can also now make loans to overseas buyers of goods and services from the UK.

Some of the schemes UKEF runs include: *Export Insurance Policy; Bond Support Scheme; Export Working Capital Scheme; Buyer Credit Facility; Export Refinancing Facility; etc.*

UKEF also provides direct advice via export finance advisors.

UK Trade and Investment (UKTI)

UKTI works with UK businesses already present in, or wishing to enter, international markets, by providing expert trade advice and practical support.

UKTI promotes and supports overseas companies to see the UK as an attractive destination for setting up or expanding their business. UKTI is also increasingly holding seminars and webinars geared at putting SMEs in touch with experienced exporters.

Some of the schemes UKTI runs include: *Passport to Export Service; Gateway to Global Growth; Medium Sized Business Programme; Trade Show Access Programme; Overseas Market Introduction Service; etc.*

A selection of government-backed schemes

Scheme	Purpose
Overseen by the British Business Bank	
Funding for Lending Scheme (FLS)	Provides a greater number of and/or cheaper loans and mortgages (consumers and businesses) based on cheaper funding to banks/building societies from the BoE
Community Development Finance	Provides loans to specific disadvantaged geographic areas or communities unable to access finance from more traditional sources
Enterprise Finance Guarantee (managed by the British Business Bank)	Improves the availability of working capital and investment funding to SMEs lacking security or a proven track record by encouraging lending institutions to lend to viable businesses
Business Finance Partnership (BFP)	Increases the supply of capital via non-bank lending channels (e.g., P2P platforms, supply chain finance schemes),thereby helping to diversify the sources of finance available to SMEs
British Business Bank Investment Programme	Builds on BFP and stimulate the SME lending market by investing alongside the private sector to increase the level and choice of finance options available to smaller UK businesses
Start-up Loans (funded by BIS and managed by the British Business Bank)	Fills the gap where lenders are less willing to finance new start-ups, combining a low-cost loan with advice, both pre-start-up and once the business is up and running
Equity Finance	
Seed Enterprise Investment Scheme	Helps small, early stage businesses raise equity finance from the public by offering tax relief to investors
Enterprise Investment Scheme	Helps small, higher-risk, businesses raise equity finance from the public by offering tax relief to investors
Enterprise Capital Funds (ECFs), managed by the British Business Bank	Provides equity investment for early-stage, innovative SMEs by combining private and public funds, and increases the availability of growth capital to SMEs affected by the so-called 'equity gap'
Venture Capital Catalyst (part of ECFs)	Invests in venture capital funds to unlock funding to growth companies
Angel CoFund (supported with capital investment from the BBB)	Invests £0.1 to 1m in smaller businesses alongside syndicates of business angels to support businesses with strong growth potential
UK Innovation Investment Fund (managed by the British Business Bank)	Supports the creation of viable investment funds by investing in high-growth technology-based companies in strategically important sectors
Aspire Fund (managed by the British Business Bank)	Invests £0.1 to 1m into women-led businesses alongside private sector investors

Scheme	Purpose
Debt Finance	
JEREMIE funds	Operating in the North of England, the fund management companies receive and invest substantial volumes of European Regional Development Funds (ERDF) targeted at SME finance, as well as finance from central government and the European Investment Bank (EIB)
Ex-Regional Development Agency (RDA) funds	Most of the ex-RDA venture capital funds are now closed to new investments; however, they continue to manage their investment portfolios. Four funds continue to invest in new businesses
Others	
Regional Growth Fund (RGF)	The £3.2bn RGF supports eligible projects and programmes that are also raising private sector investment to create economic growth and lasting employment
Local enterprise partnerships (LEPs)	These partnerships between local authorities and businesses aim to set priorities for local infrastructure investments. LEPs and the RGF are both part of the government's agenda for replacing the former Regional Development Agencies
Growing Places Fund	The £730m fund invests in key local infrastructure projects, thereby supporting growth and creating jobs in England
EU funded sources of finance	The European Union supports SMEs via grants, loans, and in some cases, guarantees. Support is accessible either directly or via national/regional programs (e.g. European Union's Structural Funds)
Great Business	This partnership between the private sector and government aims to provide support and advice to businesses and promote entrepreneurial spirit
Business Support Helpline	Provides quick response service to simple business questions
GrowthAccelerator (now part of the Business Growth Service)	A government-backed but private-sector executed programme aiming to provide business coaching and networking to SMEs with the potential to improve and grow
Manufacturing Advisory Service (now part of the Business Growth Service)	A business support and networking service for manufacturing companies in England
Mentorsme	A website operated by the British Bankers' Association (BBA) which brings together support and mentors in one place
Growth Vouchers programme	This voucher scheme aims to help small businesses pay for private sector expert advice

Notes: This list is not exhaustive, does not purport to contain the totality of the available schemes, and specifically it does not include the many smaller schemes: for example, the County of Worcestershire alone reportedly has around 28 support schemes. A number of schemes have undergone name changes over the course. This was not conducive to navigation. We have sought to describe the schemes as accurately as possible, relying on official descriptions where possible.

Sources: BIS (2013d), British Business Bank, and www.gov.uk websites

FINANCING SMEs: HOME NATIONS WITH DEVOLVED POWERS

Governments in Scotland, Wales, and Northern Ireland have put in place a number of schemes designed to help SMEs increase access to appropriate finance.

Scotland. A wide range of government-supported loan schemes are available to SMEs. These include: Green Deal loans, Resource Efficient Scotland SME loans, Low Carbon Transport Loans, Regional Loan Schemes, and the Scottish Loan Fund.

Many of these schemes involve helping companies to become more energy and resource efficient. Others, such as the Scottish Loan Fund (SLF), are designed to help SMEs secure funding for opportunities that drive growth. For example, the SLF provides mezzanine loans from £250,000 to £5 million to qualifying Scottish businesses, and part-financed by the Scottish Government. Mezzanine finance, a hybrid product between traditional bank debt and equity within the capital structure of a business, is typically used to fund the growth of companies. SMEs may be seeking to:

- Bolster working capital to ensure delivery of new contracts;
- Increase capital expenditure that is key to the fulfilment of business plans; or
- Boost development capital to support new products and enter new markets.

The SLF was established to address such needs and therefore could be an important tool in achieving growth ambitions. It is a potentially attractive funding solution for growing SMEs, as the unique position of mezzanine finance maximises flexibility. [For more on the above, see website.]

Wales. Finance Wales makes commercial investments in small and medium-sized businesses (SMEs) based in Wales or willing to relocate. It can invest £1,000 to £2 million in SMEs through a number of investment funds, and can invest up to a total of £5 million in any one SME. Loan repayment terms range from one to five years, and interest rates are based on an SME's individual circumstances and fixed for the term of the loan.

Whether for starting a business, early-stage development, or firms seeking expansion, products on offer include:

- Micro loans
- Technology venture investment
- Business loans or debt investment
- Equity investments
- Mezzanine investments

Investment is regarded by Finance Wales as the beginning of a long-term relationship with SMEs, combining ambitious business plans with capital and expertise to smooth the expansion phase and help businesses reach their potential. Finance Wales works closely with Wales-based SMEs and their advisors, as well as other investors, including business angels, venture capital funds, and banks, across a wide range of sectors. [For more on the above, see website]

Northern Ireland. To help SMEs compete successfully at home and abroad, tailored support across a variety of areas is available from Invest Northern Ireland, including advice, mentoring, and finance. As part of its Access to Finance Initiative, a number of funds totalling more than £170 million have been created for SMEs with high growth potential:

- Techstart NI is a £29m integrated set of funds offering support for entrepreneurs, seed- and early-stage SMEs, and university 'spin-outs'.
- CoFund NI is a £16m fund that provides equity funding together with other co-investors.
- The £50m Growth Loan Fund provides loans to local SMEs that can demonstrate sales growth or strong potential.
- The £5m NI Small Business Loan Fund offers unsecured loans to individuals, private companies, and social enterprises in the SME size range.
- Two £30m Development Funds offer equity funding between £450,000 and €1.5m (around £1.1m) in any one round of investment, comprising both public and private money. Total funding up to £3m can be provided to a company over a series of funding rounds.

Other innovative solutions are also developing. For example Halo, the Northern Ireland Business Angel Network, is a joint initiative between Invest NI and InterTradeIreland, funded by Invest NI. Coordinated by Northern Ireland Science Park, it provides a matching service between business angels and companies seeking investors. [For more on the above, see website]

ENDNOTES

[1] Ward, M. and Rhodes, C. (2014).

[2] Grant Thornton (2014).

[3] BIS (2013a).

[4] See for example DTI (1998).

[5] <http://ec.europa.eu/enterprise/policies/sme/facts-figures-analysis/sme-definition/index_en.htm>.

[6] BIS (2013a).

[7] <http://www.cbi.org.uk/business-issues/smes/exporting>.

[8] For example, recent estimates for the period 1996 to 2004 suggest firms that are new to exporting experience on average a 34% increase in productivity in the year of entry, whereas companies that stopped exporting saw a drop in productivity of around 7-8%. The better performance of exporting firms over non-exporters in turn contributes to greater overall UK productivity. See http://www.publications.parliament.uk/pa/cm200607/cmselect/cmtrdind/557/55705.htm#n16

[9] Harris and Li (2007) "Firm Level Empirical Study of the Contribution of Exporting to UK Productivity Growth", Report submitted to UKTI March 2007. http://www.gla.ac.uk/media/media_36279_en.pdf

[10] Harris and Li estimate that 60% of UK productivity growth between 1996 and 2004 was attributable to exporting firms, including both established and new exporters. See http://www.publications.parliament.uk/pa/cm200607/cmselect/cmtrdind/557/55705.htm#n16

[11] <http://www.cbi.org.uk/business-issues/smes/exporting>.

[12] European Commission (2014).

[13] OECD (2014a).

[14] 'Mittelstand' refers to small and medium-sized enterprises in Germany and other German-speaking countries.

[15] For more on the untapped potential of these companies see HSBC, 2015. Hidden Impact – The vital role of Mid-Market Enterprises.

[16] OECD (1992), Technology and the Economy: the Key Relationships.

[17] BIS (2014).

[18] Love, J. and Roper, S. (2013).

[19] House of Lords (2013).

[20] For more details see <https://www.gov.uk/government/organisations/innovate-uk/about>.

[21] CBI (2012a).

[22] Grant Thornton (2014).

[23] BIS (2013a) and UKTI and OMB Research (2014).

[24] BIS (2013a).

[25] BIS and BMG Research (2012).

[26] BDRC Continental (2014).

[27] TheCityUK and ARES & Co (2013).

[28] Germany's Federal Ministry of Economics and Technology (2013).

[29] HM Treasury and BIS (2014).

[30] BIS and BMG Research (2013).

[31] BDRC Continental (2014).

[32] Investopedia defines non-recourse debt as "A type of loan that is secured by collateral, which is usually property. If the borrower defaults, the issuer can seize the collateral, but cannot seek out the borrower for any further compensation, even if the collateral does not cover the full value of the defaulted amount." http://www.investopedia.com/terms/n/nonrecoursedebt.asp

[33] <http://www.bankofengland.co.uk/markets/Pages/FLS/default.aspx>.

[34] HM Treasury and BIS (2014).

[35] And this is recognised: Increasing incentives for investing in SMEs is an ongoing process across Europe. In the UK, the Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EISs) are helping small, early stage and higher-risk businesses raise equity finance from the public by offering tax relief to investors. For more on UK schemes, see Annex.

[36] For more see TheCityUK, 2015. Long-term Finance for Infrastructure and Growth Companies in Europe.

[37] BIS and BMG Research (2013).

[38] Breedon, T. (2012).

[39] BIS and BMG Research (2013).

[40] BIS and BMG Research (2013).

[41] The International Trade & Investment Group (ITIG) Concept paper

[42] CBI (2012a).

[43] UKTI and OMB Research (2014).

[44] Urica (2014).

[45] UKTI and OMB Research (2014).

[46] Recent initiatives have included hosting access to finance workshops, helping to provide clarity on how SMEs ought to present a business lending application. Such institutions also report that they are working with UKTI to create and bolster centres that provide 'on the ground support and advice' to UK SMEs in new markets, and to foreign businesses wishing to export to the UK. One major bank, for example, reports that, over the past three years, they have sent 138 dynamic businesses to international exchanges in some of the world's fastest growing markets, and awarded access to over £3bn in funding.

[47] Breedon, T. (2012).

[48] HM Treasury and BIS (2014).

[49] BIS and BMG Research (2013).

[50] Details available on <https://www.fundingcircle.com/blog/press-release/funding-circle-santander-announce-pioneering-partnership-support-thousands-uk-businesses/>.

[51] Sharman, A. (2014).

[52] Breedon, T. (2012).

[53] Rowlands, C. et al. (2009).

[54] See <www.businessgrowthfund.co.uk>.

[55] Llewellyn Consulting (2014).

[56] More details available on < http://www.santanderbreakthrough.co.uk/about/finance/breakthrough-growth-capital-0>.

[57] Palin, A. (2014).

[58] Dunkley, E. (2014a).

[59] Johnson, L. (2014).

[60] More details available at < http://www.fca.org.uk/news/the-financial-conduct-authority-outlines-how-it-will-regulate-crowdfunding>.

[61] See < http://www.cbi.org.uk/campaigns/access-to-finance/guide-to-forms-of-alternative-finance/asset-based-lending/>.

[62] BIS and BMG Research (2012).

[63] <https://www.gov.uk/government/news/prime-minister-announces-supply-chain-finance-scheme>.

[64] BIS and BMG Research (2013).

[65] BIS and BMG Research (2013).

[66] Lord Livingston, Minister of State for Trade and Investment, from HM Government (2014), Britain Open for Business: The Next Phase.

[67] Breedon, T. (2012).

[68] BIS and BMG Research (2013).

[69] Llewellyn Consulting tasked a recently-graduated economics analyst with spending a morning on the gov.uk site. The brief was to seek information on what support, both financial and other, was available, from whatever source, in support of selling the output of a supposed small manufacturing firm employing fewer than ten people. The conclusion was that the material could, ultimately, be found: but doing so was hard work. The site is not up to modern standards of usability.

[70] Over the past 35-odd years, these countries also have had strong export performance compared with the UK. Between 1980 and 2014, US export volume growth averaged 5.5%; Australia's 5.2%; Sweden's 4.4%; and in the UK it was 3.8%. In the period before the global financial crisis (1980 to 2007), US export volume growth averaged 5.9%; Australia's 5.5%; Sweden's 5%; and in the UK it was 4.5%. Between 2008 and 2014, Australia's export volume growth averaged 4.2%; United States' 3.5%; Sweden's 2.4%; and in the UK it was just 1%.

[71] BIS and BMG Research (2013).

[72] Group of Thirty (2014).

[73] SEC Press Release (30 December 2014), available at <http://www.sec.gov/news/pressrelease/2014-295.html#.VK6ztCusWtj>.

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AUTHORS' NOTE

The issue

Small and medium-sized enterprises (SMEs) in the UK are in many cases failing to maximise their potential. This is particularly the case in respect of export performance. While some of the considerations behind this general tendency to underperformance are common to all SMEs, others relate more specifically to actual or potential exporters.

The issue that arises, therefore, is what can – and what should – government do to address these shortcomings and strengthen export competitiveness? To be useful, policy proposals have to take account of two important considerations: first, that the public finances are highly constrained, and likely to remain so for some years; and second, that for understandable reasons the public and business mood is that regulation should be confined to cases where it is both necessary and cost effective.

Accordingly, this paper offers a range of proposals that are in general not expensive in budget.

Approach

The paper is based on a thorough study of the literature but also, more importantly, on interviews with some of the key actors involved – both business people and policymakers. In most cases interviewees were selected through the good offices of TheCityUK. The 'Rules of engagement' were that interviewees' observations would not be attributed: and on this basis all were uniformly helpful, and gave willingly of their time.

The paper adopts a top-down and forward-looking approach, and aims to dovetail with the contemporary agenda 'to boost European jobs and growth'.

Approach

The issue of SME performance is wide-ranging. Indeed, it is a classic exemplar of "the more you dig, the more you find". Although a number of official UK websites have improved the scope and depth of the information they provide on the sector, there is as yet no single 'one stop shop' for data and support. In this context, it is striking that many SMEs have little knowledge of their competitors; and neither do they have an adequate grasp of all the schemes and sources of assistance available to them.

It is inevitable therefore that we will have missed some schemes; and some may be important. For that reason this paper is offered, with humility, as a discussion document: it could well be revised, perhaps considerably, in the light of comments and information received.

Through our research it has become clear – as is to be expected – that many of the issues or themes unearthed overlap and are 'cross-cutting'. That said, it has proved useful to distinguish four particular areas of interest, in each of which 'information' is an overarching 'leitmotif': Export competitiveness; Finance; Awareness; and Technology.

The Executive Summary is organised along these lines, bringing out the main points that illuminate each of these four key areas, and concluding with policy proposals.

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