Responsible Finance

MICROFINANCE AND START-UPS IN THE EU

UK country profile

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Contents

INTRODUCTION

This report maps the start-up ecosystem of the UK and the relationship between microfinance and the non-tech start-up ecosystem in the UK. Policy recommendations are included, aimed at deepening the scope and effectiveness of UK microfinance's support for start-ups.

The report supports wider research by the European Microfinance Network into the start-up ecosystem and microfinance support for start-ups across Europe. This report represents the UK component of that research, which will incorporate further components from other European countries.

Section 1 consists of an overview of government-led support for start-ups in the UK, both financial and non-financial, and was formulated by desk review. Section 2 analyses how UK microfinance institutions (MFIs) assist start-ups, including financial and non-financial support, and what changes MFIs believe are needed to better serve start-ups going forward. Interviews were carried out with 3 MFIs: Business Enterprise Fund (BEF), Let's Do Business Group (LDBG) and Business Finance Solutions (BFS); a government-supported loan fund: Start Up Loans Company (SULCO); and the University of Hertfordshire (UH), which has been researching the small business economy. In Section 3, policy recommendations are proposed that would enable more effective delivery of MFI services to more start-ups in the UK. The recommendations are derived from the findings of the interviews.

1. BIG PICTURE

The UK is a leading trading power and financial centre, and the second largest economy in Europe, after Germany. It is a mainly service economy (80% of all economic output) followed by manufacturing (10%) and construction (6%). The main service sub-sectors are, in size order, real estate, professional and support services, retail and wholesale, and financial services[1]. Economic growth has not yet recovered to pre-financial crash levels and has dipped again in recent times following the vote to leave the European Union.

The UK is rated 7th in the World Bank's ease of doing business rankings and 16th when it comes to starting a business[2]. According to OECD figures, the UK has one of the highest levels of inequality in the OECD, particularly among European nations[3]. However, inequality has been declining in the UK over the past decade[4]. Employment has steadily recovered since the financial crash, with unemployment now near record lows at 4.4%[5], though more people are finding employment in part-time or precarious work.

The vote to leave the EU triggered a fall in consumer confidence[6] and the Purchasing Managers' Index[7] , with concerns about economic difficulties ahead filtering into the real economy. Economic growth is expected to slow from 1.8% in 2016 to around 1.4% in 2018[8]. Rising inflation, driven in part by currency depreciation following the Brexit vote, has combined with stagnant wage growth to contribute to squeezed household incomes, record low levels of saving and record high levels of personal debt.

1 House of Commons Library (15 August 2016) Industries in the UK
2 World Bank (2017) Economy Rankings
3 OECD, OECD Income Distribution Database (IDD): Gini, poverty, income, Methods and Concepts
4 Office for National Statistics (10 January 2017) Household disposable income and inequality in the UK: financial year ending 2016
5 Office for National Statistics, Unemployment
6 GfK (30 November 2016) UK Confidence
7 IHS Markit (22 July 2016) Markit Flash UK PMI
8 PwC (July 2017) UK Economic Outlook

2. START-UP BUSINESS LANDSCAPE

According to government research, there are 5.5 million SMEs in the UK, accounting for 99.9% of businesses and 60% of employment (15.7 million people). 99.3% of businesses are classified as small businesses (1-9 employees), accounting for 48% of employment and 33% of total private sector turnover. 76% of businesses are sole-proprietorships (i.e. do not employ anyone aside from the owner. Unlike large businesses, the SME population has increased since the year 2000, particularly sole proprietorships (77% increase)[9].

The Brexit vote is already having an effect on business. The fall in the value of the pound has led to a limited uptick in export volumes and foreign direct investment, but there are signs of a slowdown in service imports[10]. SMEs are more worried about the effects of Brexit on banking services than large corporates, according to research by the Association for Financial Markets in Europe. SMEs are 'concerned' about financing capital expenditure and managing risk, and 'somewhat concerned' about financing ongoing operations and managing cash[11]. The Federation of Small Businesses has reported lower borrowing levels driven by lower investment intentions and confidence levels, and voiced concerns about a messy withdrawal from EIF and EIB funding[12].

SMEs also face challenges that are not related to Brexit. Currently, almost half of UK SMEs experience barriers in accessing finance and a quarter are turned down at a crucial stage of growth[13]. SMEs also frequently report not being well understood by lenders and policymakers. There is often a perception of 'start-ups' being mostly fast-growing STEM or tech-based businesses, distinct from SMEs which tend to be regarded as more common 'high street' services such as beauticians and bakeries.

9 Department for Business Energy & Industrial Strategy (13 October 2016) Business Population Estimates for the UK and Regions 2016
10 Office for National Statistics (July 2017) Economic review: July 2017
11 Association for Financial Markets in Europe (3 July 2017) Bridging to Brexit: Insights from European SMEs, Corporates and Investors
12 Federation of Small Businesses (24 August 2017) Small business lending worsens as EU funding dries up
13 Close Brothers (November 2016) Banking on Growth: Closing the SME funding gap [PDF]

3. THE SURROUNDING ECOSYSTEM

3.1 Government support

EXISTING SUPPORT

There is no overarching national strategy for supporting entrepreneurship in the UK. In general, business creation has faded as a national policy priority in recent years as the economy has recovered and employment is at pre-recession levels. However, there are existing national and regional initiatives around finance for start-ups, skills and productivity designed to be locally-driven but centrally supported. Several of these initiatives target all SMEs (not only start-ups).

This section outlines the UK government initiatives supporting small businesses through financial and non-financial support. Where relevant, we have highlighted the role of MFIs in delivering these programmes.

British Business Bank

The British Business Bank (BBB) is a state-owned economic development bank created in 2012 to provide a 'one-stop-shop' for SMEs incorporating a number of existing government financial schemes, advice services and expertise. The BBB was initially capitalised with £1.25 billion to combat access to finance problems following the 2008 financial crash. It works through intermediaries, providing partial-guarantees to loans made to SMEs.

The BBB also publishes the annual Business Finance Guide[14], which helps businesses to navigate debt or crowdfunded equity, alongside references to other available support. An online 'journey'[15] is also available to walk young and start-up businesses through their finance options.

In 2016, the BBB introduced finance platforms that match SMEs with 'alternative' finance providers. The biggest banks in the UK are mandated to refer SMEs whose applications for loan finance they reject to these platforms[16]. The scheme is currently under review after it seemed banks were not effectively referring businesses in the volumes expected.

The Enterprise Finance Guarantee (EFG)[17], administered by the British Business Bank, is a Government-backed guarantee on 75% of the value of a loan made to a business that would otherwise be turned down due to inadequate security. EFG also included a wholesale facility aimed at loans from banks to UK microfinance institutions (MFIs), allowing credit borrowed for on-lending to be covered by EFG.

Most recently, the BBB launched a series of regional funds – including the Northern Powerhouse Investment Fund, pooling and matching allocations of EU structural funds. These funds are delivered through intermediaries such as MFIs, and target the broader small business population, not only start-ups.

14 British Business Bank (2016) The business finance guide [PDF]
15 British Business Bank, Start your journey today [web]
16 British Business Bank, Finance Platforms Referral Policy [web]
17 British Business Bank, Enterprise Finance Guarantee – EFG for Lenders [web]

Start Up Loans Company

The Start Up Loans Company (SULCO) is a BBB-owned programme to deliver loans to businesses that have been training for 18 months or less. This market was identified as one with the most persistent challenges accessing commercial finance from banks. Start Up Loans is delivered through intermediaries such as MFIs. Microentrepreneurs can borrow up to £25,000 at 6% for up to 5 years. Businesses also receive pre-loan business support and mentoring during the course of the loan.

Since its launch in 2012, 46,508 businesses have been supported with £301 million in loans. As a government-funded programme with 26 delivery partners but largely delivered through its 15 MFIs, the programme seeks to reach underserved market segments: 39% of businesses funded have been women-owned, 43% of microentrepreneurs were unemployed before applying, and 46% were young people (under 24)[18].

Local Enterprise Partnerships and economic zones

In England, support for SMEs has largely been delegated to 39 Local Enterprise Partnerships (LEPs)[19] run by Combined Local Authorities (local councils collaborating on economic plans over larger combined areas)[20]. LEPs are business-led initiatives that help local authorities set local economic priorities. They are primarily funded through European Structural Investment Fund allocations and the Department for Business, Energy and Industrial Strategy (BEIS)'s Local Growth Fund. It is up to each LEP to come up with its own multi-year economic plan they can then use to bid for a share of funding from a centralised Local Growth Fund[21]. Individual LEPs may identify supporting start-ups through MFIs as a priority, but there no national commitment by the LEP network to delivering through MFIs. LEPs are an England-only initiative and do not exist in Wales, Scotland, or Northern Ireland, where the remit LEPs cover is devolved to local government.

Regional Growth Fund

The Regional Growth Fund (RGF) is a £3.2 billion fund created in 2010 to address regional economic imbalances and overreliance on public sector employment[22]. A £30 million RGF fund was allocation to the MFI sector, and was matched by £30 million from private banks (Unity Trust and the co-operative banks). This £60 million MFI RGF programme has been highly successful. As of the end of 2016, MFIs had lent the full £60 million to over 2,000 businesses, creating and saving over 8,000 jobs. MFIs are now recycling repaid RGF funds. The RGF programme is only available in England.

18 The Start Up Loans Company, Achievements [web]
19 The LEP Network, The Network of LEPs [web]
20 Local Government Association, Combined authorities [web]
21 House of Commons Library (2017), Local Growth Deals: Briefing paper [web]
22 House of Commons Library (2016) Regional Growth Fund

Labour market instruments

The New Enterprise Allowance (NEA) programme is a mentoring programme, delivered in partnership with SULCO, for those receiving unemployment benefits and who want to become self-employed[23]. The scheme delivers direct financial support and SULCO delivery partners provide mentoring and access to loans up to £2,500.

ESIF money is available for those marginalised in the labour market in each region. The European Social Fund is derived from ESIF and supports skills training aimed at the needs of local economies[24].

Community Investment Tax Relief (CITR)

Community Investment Tax Relief (CITR) is tax relief for corporate, institutional and individual investors investing in MFIs for on-lending to small businesses, including start-ups. Investors receive a relief of 25% of their total investment over five years, or 5% per year. Through CITR, MFIs have secured over £100 million in new funding, primarily through bank loans. This has facilitated more than £100 million in onward lending.

Non-financial support for start-ups

Incubators are seen as a mechanism to scale for start-ups, but they are focused on high-growth potential businesses mostly in the STEM (science, technology, engineering, mathematics) or digital sectors. There are fewer incubator and accelerator options for non-tech businesses.

ENTREPRENEURSHIP EDUCATION

There is no national strategy supporting entrepreneurship education beyond the mentoring and support included in the Start Up Loans programme and the Government's online signposting service, Great Business[25]. Individual institutions may provide entrepreneurship education at their own discretion.

Higher education

A Higher Education Innovation Fund has been launched in England to allow surpluses from higher education institutions to be directed into collaborative projects between those institutions and local businesses, public services, charities and communities to create societal and economic benefit. £160 million was allocated in 2016-17 for projects ranging from joint research and development projects, to consultancy, training and setting up new companies[26]. Beyond this initiative, there is no coordinated link between higher education and entrepreneurship.

23 House of Commons Library (2017) New Enterprise Allowance
24 Department for Work & Pensions (2015) European Social Fund Operational Programme 2014-2020 [PDF]
25 Great Business, Start [web]
26 Higher Education Funding Council for England (2016) Higher Education Innovation Funding: Institutional five-year knowledge exchange strategies

Direction of future support for start ups

The UK Government released a green paper in January 2017 laying out the skeleton of a vision for an Industrial Strategy that would aim to build on existing strengths of the UK economy and improve productivity levels that lag behind other OECD nations[27]. The paper points to a successful rate of start-ups in the UK (ranked 3rd by the OECD) but suggests more support is needed to help the start-ups with the greatest potential to transition beyond the small business (0-49 employees) and SME (50-249 employees) phases.

The green paper reflects the wider policy conversation around scale-up, which is heavily focused on start-ups in STEM industries or in digital. In fact, this is a very limited view on the breadth of UK start-ups and focuses narrowly on the South East around London where those types of businesses tend to be located.

The growing consensus among policymakers appears to be that access to loan capital can be a barrier to growth, and therefore, emphasis is shifting towards promoting equity or long-term finance. HM Treasury and BEIS are carrying out a review of access to finance for start-ups, due to report in the autumn of 2017, entitled 'The Patient Capital Review'[28]. The review is tasked with suggesting changes to support the expansion of equity capital. However, it is the view of MFIs interviewed for this research that equity finance is only appropriate for a small portion of the UK's start-up landscape because of the need for a high rate of growth to provide adequate returns and the difficulty to value very early stage businesses.

With relation to catalysing private sector investment, the Government intends to expand the BBB by £400 million and work to increase low levels of awareness among start-ups of the funding options available to them[29].

27 HM Government (2017) Building our Industrial Strategy: Green Paper [PDF]
28 HM Treasury and the Department for Business, Energy & Industrial Strategy (23 January 2017) Patient Capital Review
29 British Business Bank (2017) 2016 Business Finance Survey: SMEs [PDF]

4. CURRENT MICROFINANCE INITIATIVES

This section outlines the specific role that the UK MFI sector plays in supporting start-ups. The information in this section is based primarily on the findings of interviews carried out with UK MFIs Business Enterprise Fund (BEF), Let's Do Business Group (LDBG) and Business Finance Solutions (BFS); government programme Start Up Loans Company (SULCO); and the University of Hertfordshire (UH)

Financing start-ups

DEFINING A START-UP

MFIs and public bodies in the UK follow the European Commission definition for micro, small and medium-sized businesses[30], but there is no established definition for start-ups. Due to the volume of businesses supported, SULCO and the BBB's definition of a start-up as a business that has been trading for less than 24 months is prominent. Both BFS and LDBG reported applying programme-specific definitions for start-ups when administering, for example, SULCO loans. Otherwise, the term is employed very generally as a descriptor and start-ups are not treated differently for more mature businesses in principle.

SEGMENTS SERVED

UK MFIs tend to be highly specialised into a single market: such as business, social enterprise, consumer or energy. Within market segments, MFIs report being as inclusive as possible, however much of their lending parameters is determined by funding. For example, some EU funds have industrial sector restrictions – such as agriculture and fisheries. In terms of start-ups, most MFIs that lend to businesses will also lend to new businesses with some sector restrictions; for example, the SULCO programme does list some business types it cannot support, such as weapons manufacturing and gambling, due to potential political repercussions[31].

FINANCIAL NEEDS SATISFIED

Start-ups usually turn to microfinance for early-stage capital investment and working capital because banks consider it too risky and unprofitable. The SULCO programme was launched to provide this finance so long as the amount is less than £25,000 and does not support property purchase. Outside of financial needs, MFIs often provide non-financial support to help start-ups with business planning and cash flow forecasting. For example, BEF reported many start-ups they work with do not adequately forecast their capital needs, which can lead to a cash flow crunch partway through the loan lifetime. Upfront planning and understanding a business' financial needs help to avoid this situation.

OTHER SOURCES OF FUNDING USED BY START-UPS

Start-ups will sometimes have the support of family and friends or accumulated savings. For example, 25% of SULCO loan applicants come to BFS with some degree of their own contribution. To a lesser degree, some applications use crowdfunding and a small minority use loan funding to leverage angel investment. The latter is more common for high growth potential businesses.

30 European Commission, What is an SME? [web]
31 Start Up Loans, Eligibility: Excluded business types [web]

START-UP PRODUCT OFFERINGS

Given the SULCO programme, most UK MFIs that support start-ups provide the SULCO loan product (up to £25,000; up to 5 years repayment; 6%; business support and mentoring included).

For start-ups that do not qualify for a SULCO loan (because the loan amount is too large, or the business is considered high risk for the programme), MFIs often use their own funds, which mirror the product offering to other SME segments. MFIs interviewed reported that they may charge start-ups a higher interest rate based on the risk of the business.

In addition, BEF are looking at setting up a micro-equity product for equity below £50,000. Currently, equity is available on a larger scale in the form of angel investments in return for shares. The problem is that equity tends to be expensive, with concurrent legal and due diligence costs usually reaching £7-8,000 no matter the size of the deal. This makes smaller equity deals uneconomical. BEF are able to consider a downsized product because they have an in-house legal team and could potentially absorb many of those costs.

BFS works with a network of local investors to source angel funding for appropriate clients. Armed with BFS loan funding, these clients can be more attractive to investors.

PORTFOLIO/SHARE OF CLIENTS THAT ARE START-UPS

There are 48 MFIs around the UK, 30 of which lend to businesses. Last year, they lent £103.5 million to nearly 9,600 businesses, helping to create 8,200 new businesses. This does not present an entirely accurate picture of how many start-ups the sector supports, because some MFIs track the figure, whereas others do not, and there is no sector-wide settled definition of a start-up and whether lending to a start-up corresponds exactly with 'helping to create' a business. According to SULCO, 75% of their loans go to pre-trading businesses and 25% to businesses trading for less than 2 years.

DEMAND FOR FINANCE FROM START-UPS

The BDRC Continental SME Finance Monitor shows a shifting trend from lack of supply being the main issue for debt finance to a lack of appetite from SMEs to take on debt, even at the expense of growth[32]. In 2016, 21% of SMEs had a loan, overdraft or other form of finance. 77% were classed as 'happy non-seekers' of finance.

The remaining 2% of SMEs would seek finance but felt they were prevented from doing so by barriers. Of this group, 32% cited the expense and hassle of the borrowing process as a barrier, 45% were informally discouraged or formally rejected by a bank, 29% felt they would lose control of their business or preferred alternative sources of funding, and 13% were put off by the current overall financial climate.

The data suggests that demand is decreasing, but LDBG maintain that meeting the demand financially is not the key issue, but rather there are limitations on business support provision, examined in the section 'BDS for start-ups'.

32 BDRC Continental, SME Finance Monitor [web]

USEFULNESS OF FINANCIAL INSTRUMENTS

Grants

SULCO's view is that grants are very useful for testing out a business concept before the borrower and the lender commit to debt finance. LDBG reported that grants are useful as match-funding tools to reduce risk and widen the pool of businesses that can be lent to.

However, grants can be problematic from a behavioural point of view. Because businesses do not have to immediately begin to repay grant money, it does not place the same impetus on action and beginning to trade. A concurrent loan is more likely to induce development from a business. It may also set unrealistic expectations that a business does not have to repay capital.

Micro-equity

Equity options have long been regarded as in short supply for smaller businesses in the UK, and there is some movement in the market. As mentioned above, some MFIs offer or are considering introducing equity options. However, all interviewees voiced concerns as to their suitability for the majority of UK start-ups, so they are unlikely to be a long-term solution to any financial access market failure.

Micro-equity is useful for the right type of business, which is one with high growth potential. But most businesses served by UK MFIs – and indeed the majority of small businesses in the UK overall – are lifestyle businesses without much potential or ambition for expansion. Even for those with high-growth potential, it can be very difficult to value early-stage businesses.

Guarantees on bank/MFI loans

Guarantees on loans (for example, EFG) provide financial support to the lender, rather than directly to the firm. This is a very cost-effective method of expanding access to finance because it lowers the risk and widens the margins of an existing model. There is a direct relationship between these tools being available and market expansion.

Peer-to-peer lending

University of Hertfordshire research suggests peer-to-peer platforms are not as transformative or beneficial an option for UK start-ups as sometimes thought. They tend to have the same risk appetite as banks. Crowdfunding websites will often be selective about what opportunities end up before potential funders, so the start-ups most likely to receive funding would also likely receive funding from banks and other specialised investors. Research shows that start-ups that make use of crowdfunding opportunities that emphasise parental support (such as a guarantee) tend to be more successful on those platforms.

Anecdotally, only two businesses have turned down BFS support in favour of peer-to-peer sources. It was a higher cost for the businesses but was seen as the more attractive option due to the speed at which finance could be obtained. Because it serves more developed, less risky propositions than MFIs, peer-to-peer lending may occasionally take some of the better deals from the MFI market. However, because peer-to-peer is not provided at better rates than MFI finance, it is more of a threat to conventional banks than the MFI sector.

Youth start-ups

The SULCO programme was originally piloted for 18-24 year olds, and was then expanded to 18-30 year olds and, ultimately, to all age groups due to the success of the model. SULCO research suggests youth start-ups in the UK are only slightly less likely to survive. This can be explained by youth start-ups lacking sufficient funding options or the starting capital of more mature start-ups, smaller social networks and less general business experience.

MFIs in the UK do not generally have youth-specific programmes, or treat young entrepreneurs differently. BEF trialled a special loan fund that was aimed at educating young people who had fallen out of education in business, while providing financing. However, it put young people in a position they were not ready for or committed to, so BEF discontinued the programme.

BDS for start-ups

In general, UK MFIs provide informal business development support to businesses throughout the application process. This includes feedback on business plans, cash flow forecasts, and pulling together finance options. This is because there have typically been programmes in the UK to fund business support – including government funded business support centres, enterprise agencies, and most recently Growth Hubs (within the LEPs). Any specific business support programmes provided by MFIs need to be funded.

For example, MFIs provide business support and mentoring for SULCO applicants as SULCO provides an income stream for this activity. SULCO provides pre-loan support, which internal SULCO research suggests has a positive effect on starting up. The most effective exercise they do with start-ups is a business plan analysis, taking them through, for example, cash flow forecasts. SULCO also offers 15 hours of mentoring support in the first year, which has a positive effect on survival rates among start-ups who opt in. Around 75% of customers benefit from pre-loan support, around 65% from post-disbursement mentoring, and around 15% engage with neither.

For example, LDBG provides signposting, navigation and some assistance with business diagnostics and planning in their core geographic area, but they are unable to provide those services to the same degree across the full geographic area in which they provide loans. This has a noticeable impact on the rate of enquiries and applications they receive from outside of their core area, suggesting that business support is an important ‘pull’ factor for loan applications. The imbalance in coverage is due to a dependence on a partnership with NatWest bank that funds these services, but specifies geographic limits.

When BFS feel that potential customers who have approached them seeking finance are not ready to receive finance, they refer them to Greater Manchester Growth Hub Group[33]. The service has over 1,100 staff and is supported by the European Regional Development Fund and the Manchester Local Authority. The access to finance group within the growth hub will work with entrepreneurs to provide advice in terms of business planning that could help them access finance should they subsequently re-approach BFS. Generally, these are older businesses that need more specialised support and expertise. If pre-start-up businesses or recent start-ups need advice, BFS usually chooses to provide the advice in-house on an ad hoc basis.

University of Hertfordshire highlighted Goldman Sachs’ 10,000 small businesses programme[34] as a model that demonstrates the value of connecting similar, ambitious businesses. The programme produces measurable change in the behaviour and confidence of start-up business. However, there is a lot of prior screening to the programme, and the businesses involved are not necessarily the type that would turn to microfinance for assistance.

33 Business Growth Hub, homepage [web]
34 Goldman Sachs, 10,000 small businesses [web]

Outcomes

PERFORMANCE OF START-UPS COMPARED WITH OTHER CLIENTS

SULCO reported, from internal research, that early-stage businesses have a 20% higher survival rate than new starts (i.e. those that have not yet begun trading). This is mainly due to early-stage businesses having a higher turnover from trading when they approached for finance. There is no discernible sectoral difference in success rates.

In terms of MFI experience, LDBG noticed that start-ups served through SULCO have a less-than-20% rate of failure or default after twelve months, whereas beneficiaries of NEA have a 50-60% rate of failure or default. This is likely due to NEA recipients being a higher risk segment (those previously on benefits), having less business experience and being less likely to have considered starting a business in the absence of the programme.

PERFORMANCE AFTER LOAN REPAYMENT

Selective surveys are carried out by SULCO at six weeks, six months and twelve months after the loan is disbursed. The landmark survey is carried out at twelve months with more than 10% of the total SULCO loan book. Indicators monitored include:

- Has the company started up?
- Have they survived and are they currently trading?
- Do they feel they would have been likely to start up without the loan?
- How important was the loan to their progress?
- What is their turnover?
- How many employees do they have?
- What was the basis for their business strategy (e.g. capture market share, develop new product, gain clients, achieve turnover targets, etc.)?
- Did they seek finance elsewhere at any point? Where they successful in getting that finance?
- What barriers do they feel have impeded their growth?

MFIs typically do not systematically monitor the performance of businesses after they have repaid their loan, as it is resource intensive. For government programmes such as SULCO, we expect that longitudinal evaluations on the performance of businesses supported will be conducted.

EU instruments

INSTRUMENTS USED

UK MFIs access EIF instruments such as Progress Microfinance, EaSI, and COSME. However, future access of these instruments for UK MFIs is uncertain given Brexit. Responsible Finance is lobbying for maintained access or for the UK government to replace them with UK facilities. In addition, new UK applications to EIF have stalled for the last 12 months due to a policy concern in EIF about the level of interest charged by UK MFIs. Responsible Finance is working with EMN to resolve this issue.

Needs

PROGRAMS, INTERVENTIONS OR SUPPORT TO HELP START-UPS USE MICROFINANCE PRODUCTS AND SERVICES

An updated approach from government

It is important that support for the MFI sector is consistently managed. Given the fast-changing political environment in the UK over the last 2 years and departmental restructuring, there has been a lack of a clear channel through which the microfinance industry can engage with government. The new Inclusive Economy Unit could potentially take over some aspects of this role, but it is still learning about the industry and is housed within the Department for Digital, Culture, Media and Sport, whereas previous access to finance initiatives have been within BEIS, further adding to discontinuity and disruption.

Incubatory support is mentioned below, but to most effectively rethink that kind of support, the presumption among policymakers that innovation is a STEM phenomenon needs to be challenged and broken. Community work and new business models (not related to disruptive tech) can be valuable forms of innovation, but the language of innovation and business incubation is substantially limited to STEM industries.

Incubatory support

Access to finance is not the main issue in the UK since the advent of the Start Up Loans Company, but rather the appropriate incubatory support. All interviewees believed that more developed, easily accessible, prominent online tools would be beneficial for start-ups, and that start-up businesses needed to be educated more extensively on basic factors of success such as business planning.

MFIs would welcome more availability of free business advice and support from pre-trading until two years of trading for their clients. For pre-start-up businesses, advice and support are needed on key areas, such as market research, marketing, business planning and relevant legislation. At this stage, it is important this is locally-delivered, as face-to-face engagement is very important to ensure start-ups engage with the process in the necessary detail. Post-start-up, remote support would be adequate.

SULCO would advocate for more grant funding available to very early-stage businesses most at risk from debt finance. This would allow potential start-ups to test a ‘proof-of-concept’ (POC) with less risk. It is also an opportunity for owners to test their own suitability – an important step when many start-ups fail because the personalities behind them realise quite early on that such a venture is not for them. In the long run, this would lower the cost of debt for the borrower and perceived risk for the lender, and could be allied with providing access to other support and avenues to POC.

Enabling MFIs to serve more start-ups

MFIs are the primary source of funding and support for many small-scale start-ups. It is important that the sector has continued access to funding to support the start-up segment. To enable MFIs to serve more start-ups, the government must recognise the sector as a central component of the solution to access to finance. This would lead to appropriate tools being established, such as a fund that could both support increased lending and the expansion of support services.

5. POLICY RECOMMENDATIONS

The following policy recommendations are derived from the concerns and priorities communicated by respondents during the interview process.

Recommendations

CREATE A DEDICATED POSITION OR TEAM IN GOVERNMENT FOR THE UK MICROFINANCE INDUSTRY

Previously, access to finance issues had come under the Department for Business, Energy and Industrial Strategy. Recent developments have seen an Inclusive Economy Unit set up within the Department for Digital, Culture, Media and Sport, and the Secretary of State for Pensions within the Department for Work and Pensions has had his role expanded to become the Secretary of State for Pensions and Financial Inclusion.

The microfinance sector has an impact across the remit of all three departments, so rather than call for consolidation of financial inclusion, what is needed is an advisor in government who can ensure that assistance for MFIs is strategically managed and the views and impact of microfinance is represented across government departments. This role could be housed within HM Treasury, and would have the task of coordination and communication between departments, the microfinance industry, SULCO, BBB and other stakeholders.

LAUNCH A RESPONSIBLE FINANCE FUND

A Responsible Finance Fund is needed to properly address under-capitalisation of the responsible finance sector that is a significant constraint on growth. The creation of a dedicated responsible finance fund of £150 million would unlock significant private sector investment and scale the sector's impact on excluded and underserved communities, including start-ups. The United States Government invests $200 million annually into its CDFI[35] Fund. The Fund has been an important force in allowing US CDFIs to operate sustainably by providing them with equity and first loss capital; it is cited as one of the major milestones in achieving their $45 billion loan book. In 2015, CDFIs benefitting from the programme financed over 12,300 businesses and provided more than 35,000 individuals with financial literacy training[36]. A responsible finance fund would also reduce the cost of capital for MFIs, by allowing the rate to be spread over a larger value of capital.

MAINTAIN OR REPLACE ACCESS TO EU FUNDING AND FACILITIES

The Chancellor of the Exchequer in the UK has guaranteed that key projects supporting economic development across the country which are dependent upon European Union funding would continue to receive funding. It is important that EU facilities which incentivise commercial investment into the responsible finance sector, namely EaSI, COSME and ERDF, are replaced, or access is maintained.

35 CDFI: Community Development Finance Institution; US counterpart to responsible finance providers
36 CDFI Fund (2016) The CDFI Fund: Empowering underserved communities [PDF]

REVIEW INCUBATORY SUPPORT FOR START-UPS, WITH A VIEW TO EXPANDING IT BEYOND STEM AND DIGITAL FIELDS

The assumptions evidenced in formulating the national industrial strategy demonstrate that innovation is not generally considered as a policy goal beyond STEM and digital fields. This prejudice impacts on policy discussions beyond the microfinance sector and weights support in favour of a minority of UK businesses. STEM and digital businesses may have higher average growth potential and as such benefit from more government focus in terms of providing incubatory structures, but innovation happens elsewhere and steps should be taken to open up the conversation around innovation to support growth in other business areas. This begins with directly challenging the assumption that useful incubators are limited to those focused on STEM and digital businesses. This could also be tied to grant funding for very early stage business concepts.

EXPAND EXISTING FREE BUSINESS SUPPORT TO ENSURE IT HAS A LOCALLY-DELIVERED PHASE ACCESSIBLE ACROSS THE UK, WITH SUPPORTING ONLINE TOOLS

Pre-launch business planning and post-launch mentoring is available, but not uniformly throughout the UK. The benefits offered to SULCO recipients and in selective geographic regions by MFIs should be formalised into local delivery mechanisms that cover every part of the UK. This could be done by offering incentives to local authorities to include these services as part of their local economic plans, or making SULCO delivery or Enterprise Zones support partly predicated on the delivery of business support services.

In terms of online support, government websites are in place that signpost to start-up advice and mentoring programmes, but this is not linked in any integrated sense, and would need to be deepened in order to work together with locally-delivered support.

The evidence from SULCO programme statistics, academic research by UOH and the experience of the three MFI interviewees shows that this support improves the rate of survival of start-ups.

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Interviewees

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