

Improving access to finance

Enabling the enterprise revolution

In 2000, the government set itself the target of making the UK the best place in the world to start and grow a business by 2005. The Small Business Service (SBS) then set out seven themes to deliver this target, including ‘improving access to finance for small and growing businesses’. This CBI brief puts forward key recommendations for building on the work already done, and delivering on this theme.

Summary

The government has made significant progress in improving access to finance for small and growing businesses over recent years. However, it is important for this momentum not to be lost. There are still market failures and anomalies in the system that need to be addressed. Access to finance underpins business start-ups and growth, and creates the employment and wealth needed by the UK economy.

By addressing market failures, government-backed schemes have an important role to play in enabling businesses to access finance. The CBI continues to support these schemes, and believes many of them have helped, and will help, to provide finance to business where no alternative has been available.

But the government must now start planning ahead for the next decade. For example, venture capital funds have a limited life. Many are beginning to make less risky investments and turning their thoughts to exiting investments rather than making investments. A number of schemes are also beginning to run out of money. It is therefore a good time for the government to begin working with finance providers to look at how business demand for finance can be catered for over the coming years. This brief puts forward a number of recommendations to achieve this. These recommendations are focused on England but there are useful lessons that can be drawn for the rest of the UK.

The CBI believes there is an emerging gap in the finance market. Raising finance for innovation which is unlikely to raise high levels of return is becoming an increasing problem. The government should look at ways of making better use of mezzanine finance to tackle this issue.

HM Treasury must also make a number of improvements to tax interventions to help stimulate the market. These include correcting the anomaly whereby the incidental costs of raising equity finance are not deductible for tax purposes, providing cash payments of capital allowances to loss-making businesses, and reducing the problems encountered by smaller businesses seeking to benefit from the R&D Tax Credit.

The UK is a world leader in providing access to finance for business. The government should work with business and the finance community to ensure this position is not lost, and that finance continues to be available to turn sound business ideas into reality.

Key CBI recommendations

- The whole of government must start planning ahead for the next decade to ensure finance continues to be available for business growth.

Business:

- Banks must look at innovative ways of providing unsecured lending to small and growing firms
- Entrepreneurs must do more to improve the investment readiness of their business
- Businesses should sign up to the Better Payment Practice Code
- The factoring industry should continue to work with businesses to develop more innovative and flexible ways of providing services.

RDAs must:

- Look at setting up and supporting more mezzanine finance schemes
- Ensure the business grant network is easy to navigate, integrated and appropriately funded
- Look at what more can be done to help particular sectors struggling to raise finance
- Look at further ways to address the £250,000 to £3m equity gap facing SMEs seeking growth capital.

SBS must:

- Ensure a period of stability for the Small Firms Loan Guarantee rules
- Facilitate further sharing of best practice between the fund managers of regional venture capital schemes
- Look at further ways to address the £250,000 to £3m equity gap facing SMEs seeking growth capital
- Properly fund the Better Payment Practices Campaign.

HM Treasury must:

- Correct anomalies associated with the Enterprise Investment Scheme
- Make the incidental costs of raising equity deductible for tax purposes
- Provide cash payments of capital allowances to loss-making businesses
- Allow recent changes to Venture Capital Trusts to bed down before considering further major adjustments
- Reintroduce 40% income tax relief for investments in technology VCTs
- Look at enhancing tax relief for investments in Community Development Finance Institution
- Extend Enterprise Investment Scheme and Venture Capital Trust benefits to investments in smaller quoted companies.

HMRC must:

- Work with business to look at further ways of improving the decision-making process regarding eligibility for the R&D Tax Credit.

Introduction

This brief is the sixth in a series analysing the progress in making the UK the best place to start and grow a business, and what action needs to be taken to achieve this target.

We focus on the record since the Small Business Service (SBS) was set up in 2000 with the objective of making the UK the best place in the world to start and grow a business by 2005. In 2002, the SBS set out seven strategic themes to drive its work, with specific targets connected to each theme.

This report analyses progress on the theme of ‘improving access to finance for small and growing businesses.’ The report is split into five key sections:

- Debt finance
- Risk capital
- Tax interventions
- Other key areas
- The role of business.

Importance of access to finance

It is absolutely crucial that there is sufficient access to finance in the UK. Affordable and appropriate finance enables business to operate efficiently and grow. It:

- Facilitates business start-ups
- Ensures that business is able to finance potentially viable investments, enabling them to expand operations to meet demand
- Provides funds for business to innovate, generating new technologies and new, more productive ways of operating
- Allocates resources in the economy to their most productive use
- Funds business growth, creating employment and wealth.

KEY RECOMMENDATIONS

In order to improve access to finance for small and growing businesses, the CBI has identified twenty recommendations that should be implemented.

As a priority, the government must now start planning ahead for the next decade. For example, venture capital funds have a limited life. Many are beginning to make less risky investments and are turning their thoughts to exiting investments rather than making investments. A number of schemes are also beginning to run out of money and it is not yet known whether the market will fill the gap.

It is therefore a good time for the government to begin working with finance providers to look at how business demand for finance can be catered for over the coming years.

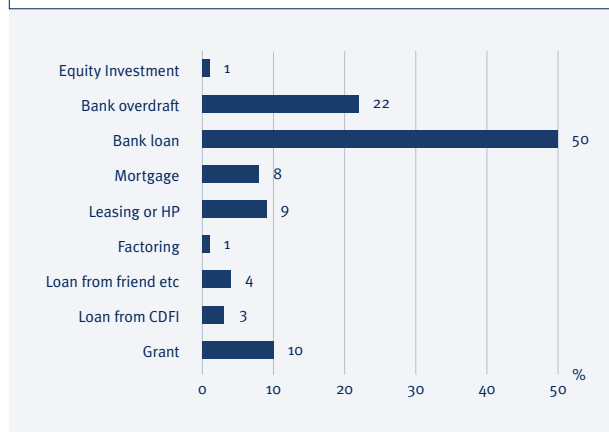
Recommendation: The whole of government must start planning ahead for the next decade to ensure finance continues to be available for business growth.

1 Debt finance

Bank finance

Banks provide part of the finance for most businesses in the UK. The SBS Annual Survey 2004/05 showed that of businesses which had sought finance, half sought a bank loan and more than one fifth sought a bank overdraft.

EXHIBIT: 1
Types of finance sought



During 2005, term lending rose by 11% to £33.3bn, overdraft lending rose by 10% to £8.8bn, and deposits increased by 6% to £41.3bn. 515,000 small businesses also established their first banking relationship (source: British Bankers Association).

But despite these figures, there are indications of shortages in unsecured bank finance. Cashflow-based lending remains relatively rare, and growing businesses rarely have unused security available.

As part of the Graham Review into the Small Firms Loan Guarantee (SFLG), a separate pot was created to provide funding for new lenders, growth, wider availability and innovation. This fund should now be used to work with the banks to look at innovative ways to fund small and growing firms, particularly those who are unable to provide adequate security.

Recommendation: Banks must look at innovative ways of providing unsecured lending to small and growing firms.

Small Firms Loan Guarantee

The SFLG is a scheme which the CBI continues to support. Since its introduction over two decades ago, the scheme has facilitated growth and created employment in 70,000 businesses where no other financing alternatives were available.

Despite the changing debt market the evidence still shows that one of the main reasons small businesses fail to get the debt finance they need is their inability to provide adequate collateral.

In 2005, the recommendations of the Graham Review into the scheme were implemented. This included limiting the scheme to start-ups and early-stage businesses. In addition to this, the SBS is working to accredit additional lenders to operate SFLG. In the recent Enterprise Brief on *Boosting enterprise across the UK population*, the CBI recommended that these new lenders should include those which can focus on providing finance in deprived areas, to women and ethnic minorities.

In the National Audit Office (NAO) report on 'supporting small business' (May 2006), concerns were raised about the default rates for SFLG. But as this report comes very quickly on the back of the implementation of the Graham Review, its conclusions are unable to reflect the long-term impact of the changes made.

The Graham Review recognised the high default rate and recommended a greater degree of oversight and management should be used. It recommended that if a lender's default rate rises significantly, the lender's lending limit should be reduced to reflect the increased cost of supporting the lending.

However, it is important to recognise that many businesses using SFLG do not default. Banks and other finance providers should be looking closely at the lessons that can be drawn from this.

Following recent changes to the SFLG, a period of stability for the Graham Review changes to take effect would be welcome. The CBI therefore believes that no major changes to the rules regarding SFLG should now take place for some time.

Recommendation: The SBS must ensure a period of stability for the SFLG rules.

There are concerns though over the five-year business age eligibility rule. This is the requirement that a business must have been trading for no more than five years to be eligible for an SFLG loan. Lenders are unclear on how the five-year period is defined: the DTI must clarify this with all lenders.

There are also concerns that since implementation of this rule, it has removed a source of financing for businesses looking to make intangible investments with returns below venture capital levels.

Mezzanine funding

Mezzanine funding generally refers to finance that blends debt and equity finance. While it shares characteristics of both debt and equity financing, a mezzanine investment includes a loan to the borrower in addition to the borrower issuing equity. Mezzanine finance is particularly flexible, which means it can be used in a variety of financing situations.

However, there is a real gap in the availability of debt-based finance of a mezzanine nature—particularly for intangible investments, such as R&D. This is in the area below returns of 40% which can be catered for by venture capital. Larger companies have the option of using more sophisticated instruments, such as the London market, but these are not as easily available to smaller growing companies.

The SFLG scheme used to help to provide finance in this market, before it was focused on new and early-stage businesses. A number of the Community Finance initiatives also help for very small investments, but there is clearly an emerging gap.

Some regional mezzanine initiatives are operating on a small or specific scale. For example, there is the North East Investment Fund 3. The West Midlands also introduced a fund following the MG Rover crisis in a bid to support suppliers to find new business. This operated in conjunction with the financial community and alongside existing bank lending. It was successful because it addressed a gap in the market and had the support of a number of banks. Lessons should be taken from these examples for wider application.

The fact that it needs public intervention to fulfil this lending suggests that there may be other gaps in mezzanine finance. Similar approaches should be tried with less acute and more

opportunity type investment needs, particularly for intangible assets towards profitable growth. Money should be sourced from Europe, the national government and the RDAs. But the DTI should provide active support to organisations on the ground who are keen to set up schemes.

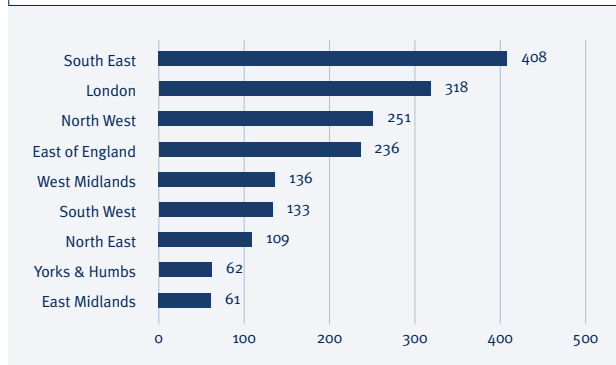
Recommendation: The RDAs must look at setting up and supporting more mezzanine finance schemes.

2 Risk capital

There are now a number of schemes available which have been developed with government backing and with the idea of providing equity for new and growing small businesses. One of the purposes of these schemes has been to demonstrate to private investors that commercial returns can be achieved by investing in such businesses.

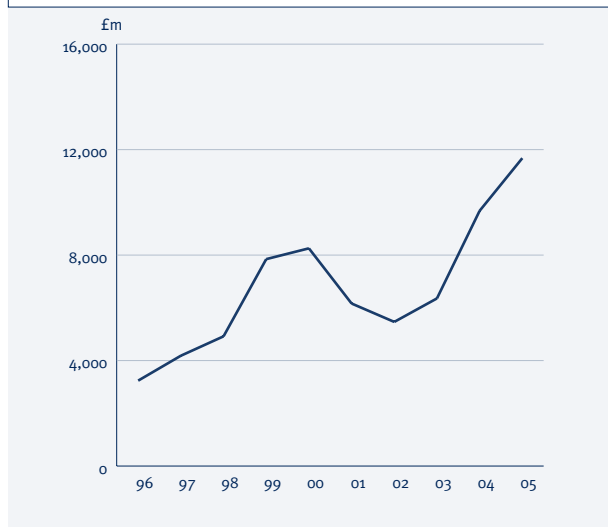
A recent SBS report (put together in partnership with the CBI) *Venture capital provision to SMEs in England* showed variance in venture capital provision between regions. But it argued that the distribution would be considerably more uneven were it not for the activities of publicly-backed funds. The government has backed funds almost unique in the venture capital population in that they have an explicit regional focus. In this way the government has gone some way in addressing regional equity gaps.

EXHIBIT: 2
Total number of investments per region



Publicly-backed funds are also significantly more likely to make smaller investments—sub-£500,000—than the other providers of capital, thus helping to address an investment stage gap. Indeed, the report suggests their establishment has been almost entirely complementary to the existing venture capital providers, rather than creating distortions in the market.

EXHIBIT: 3
UK private equity investment



Source: BVCA Report on Investment Activity, 2005

An analysis of the UK private equity investment market during 2005 showed that the number of UK companies financed at start-up increased by 9%, early stage increased by 8% and expansion stage of investment remained relatively steady. Worldwide investment by UK private equity firms increased by 21% in 2005 to £11,676, with investments in the UK now representing 58% of the total (Exhibit 3).

Regional Venture Capital Funds

Regional Venture Capital Funds (RVCFs) exist in each of the nine English regions, and are designed to facilitate equity investments of up to two rounds of a maximum of £250,000. The government has committed £74.4m to the funds which now have over £250m in total commitments. In 2004-05, government expenditure of £20m supported investment in 61 small businesses and by December 2005, 218 small businesses had been supported in total.

The SBS has responded to concerns about the £250,000 upper limit for investments, and has now applied to the European Commission to increase this to around £330,000 to reflect changes in the market since RVCFs were introduced. While the CBI supports this move, it remains unclear if the increase will be enough.

What is clear is that there are significant variations in the number and amount of investments when the different regional funds are compared. There are also concerns over whether the funds will be able to make 'successful' exits from investments.

Recommendation: The SBS must facilitate further sharing of best practice between the fund managers of regional venture capital schemes.

Enterprise Capital Funds

Over the past few years, evidence indicates that there is a growing equity gap in the £500,000 to £3m range. Recent data by the BVCA provides no indication that the gap is diminishing, with the average amount of equity investment continuing to increase (Exhibit 4).

To help tackle this problem, the CBI successfully persuaded the government to establish Enterprise Capital Funds (ECFs). The ECF model is based on the US Small Business Investment Companies, which have played a key role in stimulating venture capital activity and in tackling the equity gap in the US. Household names such as Apple, Federal Express and AOL are some of the businesses to have benefited from investment.

In the UK, ECFs will be able to invest a combination of private and public money in small high-growth businesses seeking equity finance of up to £2m. While there are now a total of six 'pathfinder' ECFs, the CBI believes that the government should continue to push ahead and announce further funds over the coming months. Planning should also begin for further rounds of funding.

The CBI also supports the work to set up a 'Capital for Enterprise' company to manage and oversee the government's SME investment portfolio.

Other funds

The UK High Technology Fund was established to encourage institutions to invest in early-stage, high technology venture capital specialist companies. By the end of June 2005, 216 small businesses had been supported since the fund's establishment.

Early Growth Funds were established to ensure that every region in England had access to early-growth funding by making risk capital investments of up to £100,000. As at December 2005, 107 small businesses had been supported since the funds were established.

Other funds in the regions have also been established. For example, in the West Midlands there are seven funds of which only two have been sponsored by the SBS. The RDAs, European Commission, universities, private individuals and the money market are all sources of funding.

Recommendation: The SBS and RDAs must look at further ways to address the £250,000 to £3m equity gap facing SMEs seeking growth capital.

Business angels

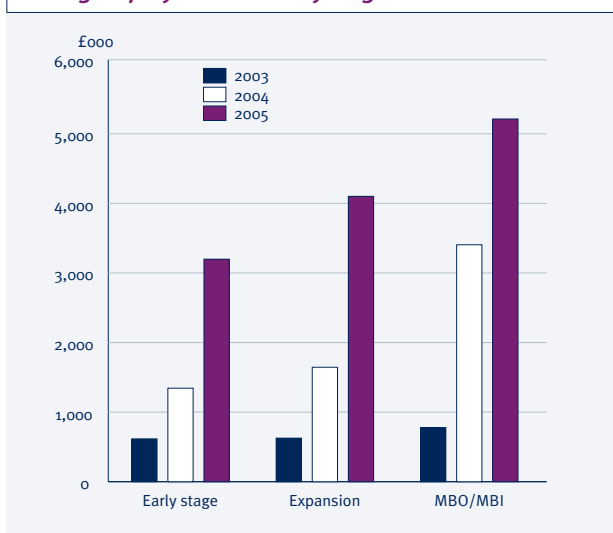
Business angels generally invest between £10,000 and £250,000 in start-up or early-stage businesses with growth potential. Many business angels then expect to take an active management role in the business.

While anecdotal evidence suggests that the majority of business angels are friends and relatives of the entrepreneurs, there are also networks set up to help introduce entrepreneurs with business angels. But many entrepreneurs either do not consider business angels, or do not like the thought of giving over some 'control' of their business.

While the Enterprise Investment Scheme (EIS) has generally been good for business angels, it continues to suffer from a number of anomalies. For example, it is virtually impossible for a business angel with EIS relief to lend money to a business in which they are a substantial investor without losing relief, even if it is the only way of keeping the company afloat. This is because the business angel is likely to lose relief under the 'connection' definition, where the loan is considered on the same basis as the nominal value of share for these purposes (a similarly problematic 'control' clause was removed for venture capital trusts many years ago). This anomaly should be looked at with some urgency.

EXHIBIT: 4

Average equity investment by stage



Source: Annual Survey of Small Businesses, SBS, 2004/05

The government should also modify the pooled EIS scheme to enable it to bring angels together for a reasonable period of time to share expertise and ownership of fledgling companies. At present all money raised has to be spent in 6 months. This is clearly impossible to do unless the opportunities have already been identified and processed. It nearly always takes that long to complete a deal from start to finish.

Other issues that should be looked at in this context are how the gross asset limits exclude small businesses from benefiting from EIS and how the rules can be widened to enable more exchanges of shares without losing EIS relief.

Correcting these anomalies would turn this into a really valuable instrument for the growing numbers of individuals with money to invest.

Recommendation: HM Treasury must correct anomalies associated with the Enterprise Investment Scheme.

3 Tax interventions

Incidental costs of raising equity finance

It is clear that for some businesses, equity is a more appropriate source of finance than debt-based finance. This is especially so for businesses seeking to grow rapidly, or those based on highly innovative activities where product or process development needs significant investment before income from sales can be generated.

The only real distinction between equity and other forms of finance is in the degree of risk involved. It is therefore anomalous that the 'incidental costs' of raising equity finance are not deductible for corporation tax purposes. This either penalises or deters businesses from undertaking certain types of spending. The decision on the most appropriate source of finance should be made for commercial and not tax reasons.

If the government, at this stage, does not want to commit to making the issuance of all new equity tax deductible, relief could be limited to expenditure under £750,000 to initially target smaller businesses. This would apply to fund raising only, and not equity release.

Recommendation: HM Treasury must make the incidental costs of raising equity deductible for tax purposes.

Capital allowances for loss-making businesses

Capital allowances provide a good incentive for established businesses to invest further, both in terms of financial incentive and as a psychological motivator. They also have the advantage of being well recognised by industry.

But many high-growth businesses incur significant capital expenditure before becoming profitable, and are therefore unable to benefit from capital allowances. The government has successfully tackled this issue in the context of R&D activity by providing for tax credit payments to loss-making SMEs.

The CBI has argued that a similar approach should now be adopted for capital allowances, so that the incentive is timely for growing businesses, compensates for their higher risk exposure and reduces the downside risk.

The government should also look at extending the allowances to include assets leased to SMEs. The current exclusion is a clear anomaly.

Recommendation: HM Treasury must provide cash payments of capital allowances to loss-making businesses.

Venture Capital Trusts

Venture Capital Trusts (VCTs) are listed funds that invest according to a set of criteria to qualify for privileged tax treatment. The source of their capital is typically high net worth individuals or retail investors. There are currently around 140 VCTs in the UK.

The CBI has argued that current market conditions and risk levels are a real deterrent to VCT subscribers. Enhanced income tax relief on VCTs is therefore essential to encourage more equity funding for smaller companies.

In Budget 2004, the government introduced a two-year increase to the rate of income tax relief for investments in VCTs. This was intended to provide stimulus to VCT fundraising, which reached a record £520m in 2004-05.

In the CBI Enterprise Budget Submission 2006, we argued that at the very least, the government should extend the 40% income tax relief enhancement through 2006/07 to allow the research on the economic impact of the investment to be completed by the BVCA and HM Treasury. However, HM Treasury announced that a new 30% rate of income tax relief for investments in VCTs would be applicable from 6 April 2006.

This was part of a package of changes to VCTs, the Enterprise Investment Scheme (EIS) and the Corporate Venturing Scheme. These changes included:

- A refocusing of the 'gross assets test' to £7m immediately before investment and £8m afterwards, to focus on the companies most in need of improved access to finance
- An increase to the minimum holding period for new shares in VCTs to five years to incentivise more stable, longer-term investments

- A doubling of the annual EIS investment limit eligible for income tax relief to £400,000, to incentivise greater investment in growth companies.

Recommendation: HM Treasury must allow recent changes to VCTs to bed down before considering further major adjustments.

But there are signs of emerging issues for access to finance in the technology sector. This has been made more acute with the exhaustion of university challenge funding. The CBI therefore believes that at the very least, the government should reintroduce the 40% income tax relief rate for technology VCTs. These are clearly struggling to raise finance to invest in this crucial area. The CBI is happy to work with HM Treasury in defining technology VCTs.

Recommendation: HM Treasury must reintroduce 40% income tax relief for investments in technology VCTs.

Community Development Finance Institutions

Community Development Finance Institutions (CDFIs) operate, for the most part, in deprived areas, making loans to start-ups and existing businesses that are unable to access loans from mainstream sources such as banks. But there are concerns about the sustainability within this sector without the Phoenix Fund.

Tax relief is available to individuals and corporate bodies investing in CDFIs at 5% pa of the amount invested in the CDFI, and may be claimed in the tax year in which the investment is made and in each of the four subsequent years.

But it is clear that if the Community Investment Tax Relief is to meet the objective of significantly encouraging community investment in disadvantaged areas, the tax incentives involved need to be comparable with other tax favoured investments such as EIS and VCTs.

This could be achieved by increasing income/corporation tax relief invested in the first year, making CDFI investments eligible for capital gains tax business asset taper relief and inheritance tax business property relief and allowing CDFI shares to be held within an ISA.

Recommendation: HM Treasury must look at enhancing tax relief for investments in CDFIs.

R&D Tax Credit

CBI research has shown that the R&D tax credit system falls well short of its potential, on average only reducing overall business R&D costs by around 5% for SMEs, whereas the credit should in theory reduce R&D costs by 9.5%.

The discrepancy is due to a number of factors: some costs directly related to R&D activity are not covered, capital expenditure on R&D is excluded, much work at the design and development end of the R&D spectrum is excluded, and there are additional costs involved in making the claim.

The CBI has called for the adoption of the full government definition of R&D for tax purposes, more extensive training for tax inspectors and open training seminars to accountancy professionals and use of specialist R&D inspectors.

The CBI has also highlighted the fact that SME members continue to report facing an uphill struggle in justifying their expenditure as legitimate, gaining timely guidance and the credits themselves. Decisions also continue to be inconsistent. While the government has announced training for inspectors, and the creation of case studies, more could be done in these areas.

In the last Budget, the government announced that it intends to extend additional R&D tax credit support to companies with 250-500 employees. This is intended to provide a boost for innovation among growing enterprises. Currently, only companies with up to 250 employees can qualify for the higher rate of relief. But this proposal is subject to state aid clearance by the European Commission, which could take up to two years.

Recommendation: HMRC must work with business to look at further ways of improving the decision-making process regarding eligibility for the R&D Tax Credit.

4 Other key areas

Regional interventions

It is estimated that there are around 1,300 different grants available to businesses in the English regions. These include grants for setting up businesses, innovation, marketing, buying equipment and skills development.

The CBI has welcomed the commitment by government to radically rationalise the number of business grants available, as part of its wider deproliferation exercise of business support. The CBI continues to emphasise that although the number of schemes should be cut, freed up resources should be diverted to those schemes that are effective, add value and respond to business demand.

When the DTI rationalised the number of national business support schemes and launched ten ‘business support solutions’, the business community supported the initiative as these schemes were seen to add value, and it believed they would be well funded by the government. But the recent closure of a number of these schemes, including ‘The Grant for Investigating an Innovative Idea’, throws this commitment into doubt.

Recommendation: RDAs must ensure the business grant network is easy to navigate, integrated and appropriately funded.

It is also clear that funding for technical spinouts is declining. While a number of regions are trying to fill the gaps in different ways, more needs to be done. In particular, there is a need to bridge the gap between having an idea and being ready for venture funding. In part this was sometimes filled by Challenge Funds, which have now finished.

European interventions

The European Commission’s communication Financing SME Growth calls for community institutions and the member states to create the conditions allowing the sustainable tripling of investment by venture capital funds in seed and start-up companies by 2013. It recognises that better access to debt and equity finance will help all SMEs achieve their potential and that if finance for innovative, growing firms is not available the EU will be unable to achieve its growth and jobs targets under the Lisbon Agenda. The communication particularly highlights a desire to work towards a single market for venture capital funds, a desire to lever lending programmes towards innovative SMEs, evaluation of the use of tax relief for young innovative companies and enabling discussions between banks and SMEs. The CBI will be engaged with these initiatives as they are taken forward through its membership of UNICE (Confederation of European Industry).

Smaller quoted companies

Traditionally, smaller quoted companies in the UK receive too little attention and under-perform against international competitors. The CBI has argued that new measures are needed to assist this key sector of the UK economy to reach its potential.

To achieve this, the government should reduce or remove stamp duty on share dealings for smaller quoted companies. This would improve the flow of equity capital to smaller businesses, as well as promoting the use of share incentives for employees and a more vigorous ‘savings and investment culture’ in the population at large.

It should also extend EIS and VCT benefits to investments in smaller quoted companies. This would require agreement on a working definition of a ‘smaller quoted company’. The CBI suggests an appropriate definition may be quoted companies outside of the FTSE350.

Recommendation: HM Treasury must extend Enterprise Investment Scheme and Venture Capital Trust benefits to investments in smaller quoted companies.

Specific sectors

The CBI has argued that there remain specific areas where finance is difficult to raise, and there is a case for government intervention to cater for these needs through a range of financial instruments. These include:

- ‘Seed’ finance for pre start-up activity
- The contracting sector, where financial institutions disregard debtor books as security
- Knowledge-based SMEs. Due to the nature of the assets of these companies, lenders struggle to assess their value, and are less likely to offer finance for propositions put forward. But there are some innovative schemes taking place in the market that finance providers could learn lessons from.

Recommendation: The RDAs must look at what more can be done to help particular sectors struggling to raise finance.

5 Role of business

Investment readiness

The demand for finance is at least as important as the supply of finance in increasing the flow of growth capital to SMEs. But many in the business community, particularly new entrepreneurs, have a general lack of understanding of the provision of finance, and particularly equity capital.

There are also investor readiness problems in relation to deficiencies in management, finance and marketing skills within some businesses seeking finance. Businesses that lack awareness of sources of finance are also not in a position to properly explore the options offered by equity-based investment.

Potential investors have also reported that a large proportion of business proposals submitted are of low quality. There are also information asymmetries between the business and investor which result in increased incidental costs for both.

Efforts need to be made to improve investment readiness. The involvement of mentors—particularly through the RDAs—is something that should be further developed.

Business should look at using non-executives who can bring external expertise to guide investment decisions. RDAs should improve the quality of signposting within their regions to information on investment readiness. There is some best practice already taking place in this field, with the Route to Investment programme in the West Midlands.

It is also interesting to note that a number of investors are put off investing in businesses because of previous decisions regarding funding taken when the business was established. Better help regarding investment decisions therefore needs to be provided when a business is set up.

The Business Link publications *No-nonsense guide to small business funding* and *No-nonsense guide to finance for high growth companies* have been praised by entrepreneurs from across the country. The SBS should keep these publications up to date, and identify ways of working with the RDAs to distribute them more widely. The CBI also welcomes the launch of the web-based self-assessment tool by March 2007.

Recommendation: Entrepreneurs must do more to improve the investment readiness of their business.

Invoice financing

Invoice finance generally covers invoice discounting and factoring. This is where a business sells its bills and invoices to a factor who then advances a large part of the money owed, and then the balance minus a fee after collection. Factoring is increasingly being used as a way of improving cashflow, and mitigating against late payment.

It is anticipated that by the end of 2006, the invoice finance industry will be worth around £158bn. Over 44,000 UK companies now use invoice finance with 47% choosing factoring and 37% using invoice discounting (Source: FDA).

But factoring is not a universal panacea. Evidence suggests there is a reluctance to advance cash on services, and where a debt takes up more than 25% of the sales ledger.

Recommendation: The factoring industry should continue to work with businesses to develop more innovative and flexible ways of providing services.

Internal finance

Many businesses fund growth through internal sources of finance. But poor cash management and working capital management are frequently cited as problems holding back many businesses.

In addition to this, late payment of commercial debt is a problem for one third of UK firms (source: SBS Annual Small Business Survey 2004/05). It impacts heavily on a business' cashflow, and therefore potentially its ability to survive. It is estimated that thousands of businesses fail each year because of late payment.

There is no single reason for late payment and no single solution, although problems with late payment tend to be related to the position in the economic cycle. A number of initiatives have been implemented to try to combat the problem.

Late payment legislation means that late payers from firms of all sizes, and the public sector can be charged interest on invoices not paid within the agreed credit terms—but evidence indicates SMEs are not using the new legislation. They fear that it may jeopardise future business by upsetting customers.

Over the past few years, the CBI has supported the business-led, government-backed, Better Payment Practice Code, which built on the former CBI Prompt Payers Code. This commits businesses to agree payment terms at the outset of a deal and stick to them.

Recommendation: Businesses should sign up to the Better Payment Practice Code.

While 42% of businesses are not aware of the late payment legislation (source: SBS Annual Small Business Survey 2004/05), the SBS has decided to substantially reduce the resources devoted to the Better Payment Practices Campaign. This move is short-sighted and threatens the campaign's long-term viability.

Recommendation: The SBS must properly fund the Better Payment Practices Campaign.

Enabling the enterprise revolution

In 2000, the government set itself the objective of making the UK the best place in the world to start and grow a business. In 2002, the Small Business Service set out seven strategic themes to focus its work to achieve the overall goal.

Throughout 2005 and 2006, the CBI is publishing a series of reports—*Enabling the enterprise revolution*—looking at whether progress has been made, and will provide key recommendations on each of the themes to the government on how to achieve its targets.

The reports will be published and be available at www.cbi.org.uk/enterpriserevolution:

2005

- August – The Small Business Service five years on
- October – More dynamic start-up market
- November – Building an enterprise culture

2006

- January – Improving small businesses' experience of government services
- May – Boosting enterprise across the population
- July – Improving access to finance
- August – Enabling and encouraging business growth
- September – Better regulation and policy
- October – Making the UK the best place in the world to start and grow a business—recommendations

Further information

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CBI

The CBI is the UK's leading business organisation, speaking for some 240,000 businesses that together employ around a third of the private sector workforce. The majority of CBI members are from the SME sector.

The SME Council is the focal point within the CBI for identifying and addressing issues of particular interest to small and medium-sized firms, and provides a voice for them to influence mainstream CBI policy and influence government at home and abroad. The Council currently has a membership of around 40 companies, spanning all UK regions and business sectors.

The Enterprise Group ensures the views of CBI SME members are directly represented to government. It has achieved considerable success over the past few years. The information flows in the other direction, too, with the Enterprise Group gathering and summarising data from the legislative programme and giving pointers to likely changes that will affect members' business.

Enterprise Group
July 2006

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