**Business Innovation and Skills Committee: Industrial strategy inquiry**

**Responsible Finance Response**

27 September 2016

**About Responsible Finance’s submission**

Responsible finance providers extend credit to underserved markets and therefore work directly on addressing barriers to accessing to finance across the UK. The sector has been on an upward trajectory, lending more and more each year and finding innovative ways to finance the start up and growth of businesses, which are so important to the economy.[[1]](#footnote-1) In 2015, responsible finance providers lent £251 million, £98 million of which was to SMEs.[[2]](#footnote-2) Academic research into the sector has shown that for every £1 lent, responsible finance providers generate £7 of economic value, given the businesses and jobs they create and save. In terms of interventions, the sector is also excellent value for money, creating new jobs at 10% of the average cost of government programmes.

Responsible Finance overall recommends that the Business Innovation and Skills Committee considers the role access to finance plays in any industrial strategy. Enterprise lending accounts for a large portion of responsible finance providers’ loan books, so the chance to identify opportunities for the provision of finance to underserved segments of the SME market is welcomed.

**About Responsible Finance**

Responsible Finance is the trade body for responsible finance providers (formerly known as community development finance institutions (CDFIs)). Responsible finance providers provide loans and support to businesses and individuals who find it difficult to access finance from commercial banks. Responsible Finance’s mission is to support the development of a thriving and sustainable sector that provides finance for underserved communities and, as a result, contributes to the increasing economic growth and prosperity of these communities.

1. **What does the Government mean by industrial strategy, and what does the private sector want from one?**

1.1 N/A

1. **How interventionist in the free market should Government be in implementing an industrial strategy, for example in preventing foreign takeovers of UK companies?**

2.1 There are different schools of thought on how and when a government should intervene, particularly when it comes to industry. Advocates of various approaches are likely to agree that intervention is needed where market failure has occurred or in some cases can be prevented.

2.2 This is justified by the cost that market failures have on overall society and the economy. There are known areas of longstanding market failure in the UK around access to finance. A significant minority of people and businesses are excluded from mainstream finance because of their credit risk profile and therefore cannot access affordable credit. This is caused by lack of competition in the banking sector, information gap between demand and supply, and externalities from regulation. The cost of this is hundreds of thousands of businesses and millions of people are not realising their potential and therefore not fully contributing to the economy and society. In addition to lack of access as a result of this market failure, a proliferation of high cost lending in the consumer market led to significant consumer detriment; the same trend is now sweeping the business lending market as it is still unregulated.

2.3 Although the government has made a series of interventions, including increased regulation, various independent reviews, stimulus programmes such as quantitative easing and the British Business Bank, access to finance remains a persistent market failure.

2.4 Therefore any industrial strategy should also include an access to finance strategy to support the businesses and individuals working within the sector and enable them to thrive.

1. **What lessons can be learnt from:
• Previous governments' industrial strategies?
• Other countries' attempts to develop industrial strategies?**

3.1 Given our position and expertise, we can mainly comment on lessons learnt in terms of the access to finance element of other industrial strategies, and the subsequent impact it has had on industrial development.

3.2 First, the government’s response in 2012 to the significant gap in businesses accessing finance following the financial crisis was to launch a series of programmes targeted at underserved areas of the market, including the Regional Growth Fund (RGF), Start Up Loans Company, and Big Society Capital. These programmes targeted excluded businesses – such as start-ups, micro businesses, businesses outside of London, and social enterprises – through locally based financial intermediaries (such as responsible finance providers). The impact of these programmes on industry is illustrated by the thousands of jobs created and saved and businesses supported. The £60 million RGF fund delivered through responsible finance providers has supported over 2,000 businesses and created and saved 8,000 jobs. 95% of the fund has been lent outside of London, and in sectors that provide goods and services to the local economy or support local supply chains. Responsible finance providers have supported a range of industries through the RGF programme, including manufacturing, clean energy, engineering, software, and retail; all of which would otherwise not have accessed the finance they needed to succeed.

3.3 In the United States, the CDFI sector was established in the 1970s to combat the exclusion of low income and minority communities. This intervention debunked the assumption that low communities have little purchasing power and therefore cannot support a business sector. In tandem with the launch of the CDFI sector a range of support mechanisms were also enacted:

* The Community Reinvestment Act, legislation that required banks to reinvest into communities they take deposits from. The legislation enabled them to invest through CDFIs, given they had the reach and market knowledge. This created a more integrated ecosystem for providing access to opportunity to people and businesses previously excluded from mainstream finance.
* The CDFI Fund, a c$200 million fund within the Treasury Department that provides grants and loans to CDFIs for on-lending, core capacity, and for leveraging commercial finance.
* Financial instruments such as guarantee products and tax reliefs that enabled more communities and businesses to access finance through intermediaries such as CDFIs.

3.4 Whilst the United States does not have a central industrial strategy (as it is often delegated to the individual states), the central government has a support system in place (particularly around access to finance for underserved and excluded populations) that is versatile and can support any industrial development, even in areas that have historically experienced underinvestment.

3.5 Although specific industrial sectors were not targeted, the support infrastructure enabled access to finance and affordable business support for the range of actors – large employers, small firms in the supply chain, new start-ups, retail and services firms which serve residents, and residents themselves.

1. **What tensions exist between the objectives of an industrial strategy and the objectives of other policies, and how should the Government address these tensions?**

4.1 From our perspective as the trade body for responsible finance providers, tensions may exist between the objectives and outcomes of an industrial strategy and objectives of the government’s localism agenda, given that localities now have more influence over their own industrial development, particularly for the devolved nations. Ensuring that an industrial strategy is adaptable can help mitigate this tension and any others that arise. It will be important that the strategy is driven by the government’s general policy priorities – to improve people’s life chances, etc. – and is supportive rather than prescriptive. This will enable it to be ‘future proof’ by having support mechanisms in place to enable an array of industrial sectors to thrive, and will reduce the shock if a specific industry falters.

1. **What are the pros and cons of an industrial strategy adopting a sectoral approach?
• Should the Government proactively seek to ‘pick winners’?
• What criteria should be used to identify which sectors are supported?
• Should the Government prop up traditional industries that it considers to be in the national interest?
• If not a sectoral approach, should the industrial strategy have a broader objective, such as improving productivity?**

5.1 The economy and industrial sectors can change rapidly, often influenced by exogenous factors that the government does not have control over. For example following the financial crisis an innovative financial technology (“FinTech”) sector emerged providing an alternative to traditional banking products (such as loans, current accounts, money management, savings). The government’s response to the rise of FinTech – to ensure it is regulated appropriately and to raise awareness about it as an alternative, rather than fund it directly – helped it thrive.

5.2 Whether or not the government decides to target specific sectors, a support system is still needed to ensure all industries are resilient and innovative in the long term. Access to appropriate finance, a skilled workforce, and good physical and digital infrastructure are all factors that businesses cite as critical to their success, regardless of industry.

5.3 From the perspective of the responsible finance sector, any industrial strategy should be underpinned by broader objectives to improve the prosperity of a place and people’s life chances. As the responsible finance sector provides access to opportunity to segments of the market traditionally underserved by the mainstream, it is important that any industrial strategy seeks to be inclusive.

5.4 The decision by the Financial Conduct Authority to respond to the rise in FinTech by introducing a ‘regulatory sandbox’ (where firms could test their products against regulation) is an example of a broader, inclusive approach in action. The purpose was not to prop up an established industry or ‘pick a winner’, but to encourage growth in a nascent sector which promises to have beneficial knock-on implications both for consumers, through increased competition and product diversity, and for financial services in terms of productivity, innovation and cost-savings. Without the necessary flexibility and a clear mandate to go beyond consumer protection and actively facilitate increased market competition, the FCA may not have taken this step.

1. **Should the industrial strategy have a geographical emphasis?
• How should an industrial strategy link with devolution initiatives aimed at devolving taxation and decision making away from Westminster?**

6.1 Any industrial strategy should complement and coordinate with local strategies that devolved nations and cities develop. Devolved governments, local governments, and LEPs will have significant insight into the health and trends in the local economy enabling them to invest or intervene in a targeted way. The central government can support local strategies by developing a toolkit that enhances local initiatives. For example, the RGF programme and Enterprise Finance Guarantee Scheme (EFG) are both nationally available resources that enable responsible finance providers to respond to local need. Making tools like this available and competitive at the national level can complement local efforts and enable those with local market expertise to drive local growth.

**• What examples are there of interventions from central Government that have successfully supported economic growth away from London and the South East of England?**

6.2 In terms of access to finance, a successful intervention from the central Government was the launch of the Regional Growth Fund programme, to provide access to finance to viable businesses that had been excluded by mainstream finance. The Responsible Finance RGF programme, launched in 2012, was a £30 million scheme that successfully secured a commercial bank match of £30 million, structuring a £60 million fund. To date the full £60 million has been deployed to over 2,000 businesses across England. 90% of the fund was lent outside of London, with 35% concentrated in the West Midlands, and 35% in the North of England. The programme has created and safeguarded 8,000 jobs, with a very low cost per job to the government of £3,900 per job supported. The success of this programme in enabling business sectors across the country to thrive, is attributable to the responsible finance model of specialist market knowledge, tailored products, and the provision of business advice and support.

6.3 As an example, a software developer and serial entrepreneur in the West Midlands was declined by a bank loan when he tried to start his new business, Synapse, in 2014 because his business was viewed as high risk and the finance sought was too low to be profitable. He was able to secure a £26,000 loan from ART Business Loans, a responsible finance provider, through the RGF programme and since has grown his business from 3 employees to 28, and is generating a £1.5 million turnover[[3]](#footnote-3). SMEs like Synapse demonstrate this persistent gap in access to finance that businesses still face, and the drag to the economy that a lack of access to appropriate finance creates.

**• How should the industrial strategy work with local authorities and Local Economic Partnerships, reconciling a U.K.-wide strategy and local, regional and devolved nations' priorities?**

6.4 As mentioned previously, any national industrial strategy should have broad priorities, providing the tools and support to complement local and regional approaches. Competitive tools such as guarantee schemes (such as EFG), tax reliefs (such as the Community Investment Tax Relief), and national funds (such as the Regional Growth Fund) that local institutions like responsible finance providers can access and deploy in a more targeted way.

6.5 This will enable devolved administrations, local authorities, and LEPS to make local strategies, and access centrally available funds such as Growth Funds in line with the local strategy. The central government having appropriate tools available at high level will enable strong local economies.

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1. Evaluation of Community Development Finance Institutions (CDFIs), 2010, <http://www.bis.gov.uk/assets/biscore/enterprise/docs/10-814-evaluation-community-development-finance-institutions> [↑](#footnote-ref-1)
2. Responsible Finance 2015, <http://responsiblefinance.org.uk/policy-research/annual-industry-report/> [↑](#footnote-ref-2)
3. ART Business Loans, <http://reinvest.co.uk/casestudy/synapse-2/> [↑](#footnote-ref-3)