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Submitted to **Building our Industrial Strategy**
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About you

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Are you happy to be contacted if we have any questions about your response?

Yes

Are you happy for your response to be published?

Yes

Comments:

Postcode

Postcode:
WC2E 8PS

Are you answering on behalf of:

an organisation (in an official capacity)

About you - organisations

What is the name of your organisation?

Name:
Responsible Finance

Approximately how many employees are there in your organisation?

1-10

What type of organisation is it?

Voluntary sector

Voluntary sector

What type of voluntary sector organisation is this?

Social enterprise

Other (please describe):

Responding to this consultation

Introduction

1 Does this document identify the right areas of focus: extending our strengths; closing the gaps; and making the UK one of the most competitive places to start or grow a business?

Free text field:

2 Are the 10 pillars suggested the right ones to tackle low productivity and unbalanced growth? If not, which areas are missing?

Free text field:

3 Are the right central government and local institutions in place to deliver an effective industrial strategy? If not, how should they be reformed? Are the types of measures to strengthen local institutions set out here the right ones?

Free text field:

4 Are there important lessons we can learn from the industrial policies of other countries which are not reflected in these 10 pillars?

Free text field:

Investing in science, research and innovation

5 What should be the priority areas for science, research and innovation investment?

Free text field:

6 Which challenge areas should the Industrial Challenge Strategy Fund focus on to drive maximum economic impact?

Free text field:

7 What else can the UK do to create an environment that supports the commercialisation of ideas?

Free text field:

8 How can we best support the next generation of research leaders and entrepreneurs?

Free text field:

9 How can we best support research and innovation strengths in local areas?

Free text field:

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Developing skills

10 What more can we do to improve basic skills? How can we make a success of the new transition year? Should we change the way that those resitting basic qualifications study, to focus more on basic skills excellence?

Free text field:

11 Do you agree with the different elements of the vision for the new technical education system set out here? Are there further lessons we can learn from other countries systems?

Free text field:

12 How can we make the application process for further education colleges and apprenticeships clearer and simpler, drawing lessons from the higher education sector?

Free text field:

13 What skills shortages do we have or expect to have, in particular sectors or local areas, and how can we link the skills needs of industry to skills provision by educational institutions in local areas?

Free text field:

14 How can we enable and encourage people to retrain and upskill throughout their working lives, particularly in places where industries are changing or declining? Are there particular sectors where this could be appropriate?

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If you would like to add any other supporting evidence relating to this section please upload document here.

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Upgrading infrastructure

Call for evidence on UK infrastructure policy

15 Are there further actions we could take to support private investment in infrastructure?

Free text field:

16 How can local infrastructure needs be incorporated within national UK infrastructure policy most effectively?

Free text field:

17 What further actions can we take to improve the performance of infrastructure towards international benchmarks? How can government work with industry to ensure we have the skills and supply chain needed to deliver strategic infrastructure in the UK?

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Supporting businesses to start and grow

18 What are the most important causes of lower rates of fixed capital investment in the UK compared to other countries, and how can this be addressed?

Free text field:

19 What are the most important factors which constrain quoted companies and fund managers from making longer term investment decisions, and how can we best address these factors?

Free text field:

20 Given public sector investment already accounts for a large share of equity deals in some regions, how can we best catalyse uptake of equity capital outside the South East?

Free text field:
The responsible finance sector provides a route to market for local equity investment. The network of responsible finance providers are ready-made, locally-based ethical entities with knowledge of local markets, networks and expertise in dealing with public funds. The extensive engagement the sector has with start-ups through the provision of loans and mentoring puts responsible finance providers in contact with early stage ventures that are suited to equity rather than loan finance. Opportunities for larger scale equity deals (sometimes alongside responsible finance provider or bank investment) are often identified amongst the sector's existing customer base.

Given its grassroots presence, working with local responsible finance providers is an effective way to understanding the barriers and opportunities to equity funding outside of the South East, and presents a ready-made delivery vehicle for equity finance or a referral scheme for an equity finance fund.

21 How can we drive the adoption of new funding opportunities like crowdfunding across the country?

Free text field:
Access to finance is a key component for businesses across industrial sectors when making strategic decisions. It is important for the supply side of finance to be well functioning to meet business' demand. However, a diverse supply side extends beyond alternatives such as crowdfunding, and includes additional sources of funding, such as responsible finance providers.

Peer-to-peer (P2P) lending, invoice trading, and crowdfunding have lent £4.4 billion to SMEs since 2012. This is a positive development in the face of the retraction of bank lending (the stock of bank lending to SMEs fell some 20% between 2009 and 2013; in the 5 years since 2011, banks withdrew approximately £25 billion from the SME lending market). However, evidence suggests that alternative lenders such as P2P are increasing competition at the top end of the market for SMEs that can already access bank finance, and not unlocking finance for the segment of the market that persistently cannot access finance.

The goal as indicated in the Green Paper is to increase access to better finance for businesses. Investors into crowdfunding and other P2P lending platforms are retail investors and therefore likely to be risk averse and will not invest in higher risk micro and small businesses. Driving the adoption of new funding opportunities like crowdfunding – while diversifying the market for businesses that already have access to finance – will do little to address the lifting of financial barriers to growth in underserved markets.

The responsible finance industry is effective because it is delivered through responsible finance providers who are locally-based social enterprises with understanding of local market conditions and business needs. This makes them a vital fair alternative to banks which are reluctant to provide credit where there are low profit margins or in times of uncertainty. SMEs and microbusinesses trust responsible finance providers and become repeat customers because they provide a service rooted in the local context that often comes packaged with advice, mentoring and an approach that assesses future viability rather than only past performance.

A key challenge for crowdfunding platforms – and alternative finance in general – is to build this kind of relationship with the SME market based on trust and communication, which is something that cannot be achieved solely through automation. There is a perceived trend that those seeking finance do so more and more online using automated platforms. The British Business Bank (BBB) designated three business lending referral platforms that connect SMEs with finance options; initial anecdotal feedback from this initiative is that because of the complexity of the SME market, mandated referrals are one method of raising awareness about alternatives, but it is not a universal solution for the entire market.

Another lesson from the responsible finance sector regards customer referrals. Out of the top three sources of customer referral in the sector, 60% of responsible finance providers cite their own marketing activities. The next most popular sources are word of mouth/informal referrals (51%), referrals from Start Up Loans Company (SULC) (30%), referrals from banks (28%). In fact, SULC delivery partners are mostly responsible finance providers and this is because of the sector's grassroots reach to small businesses. Online platforms are the seventh most popular referral source, with only 12% of responsible finance providers putting it in the top three. This is further indication that intelligent marketing, word-of-mouth and a strong local presence are still important channels for building the profile of non-bank finance, and online propagation is not always the most effective channel.

Ultimately, P2P and crowdfunding platforms are just one form of alternative finance. They are still nascent models that have not yet gone through a business cycle. New FCA regulations on the P2P market may place further restrictions on their risk appetite.

While an alternative format for delivering finance, crowdfunding and P2P are not additional, they are in direct competition with banks. They are not a silver bullet to address market failure and there needs to be a focus on other options for harder to reach businesses and those that still rely on face to face support for more complex financial needs. 85% of small business employers have less than 9 employees and have usually been trading for less than three years. That is the gap in the market that is unable to access unsecured finance and not served by P2P and crowdfunding, is the one covered by responsible finance providers.

Simple measures by the government can be taken to drive the growth and adoption of responsible finance. Bolstering overall awareness of responsible finance options can make a significant impact. A wider view of the non-bank finance market, including the responsible finance sector needs to be included going forward in any industrial strategy and intervention to seriously tackle access to finance issues.

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Royal Bank of Scotland, Independent Lending Review, http://www.independentlendingreview.co.uk/RBS_ILR_Full_Report.pdf
Bank of England, Statistical Interactive Database, http://www.bankofengland.co.uk/boeapps/iadb/NewInterMed.asp
British Business Bank, Finance platform referrals – designated platforms, http://british-business-bank.co.uk/finance-platform-referrals-designated-platforms/
Responsible Finance, Responsible Finance: The industry in 2016 – Referrals, http://responsiblefinance.org.uk/policy-research/annual-industry-report/#DT
Financial Conduct Authority, Feedback Statement FS16/13: Interim feedback to the call for input to the post-implementation review of the FCA's crowdfunding rules, https://www.fca.org.uk/publication/feedback/fs16-13.pdf
Department for Business, Energy and Industrial Strategy, Statistical release: Business population estimates for the UK and the Regions 2016, https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/559219/bpe_2016_statistical_release.pdf

22 What are the barriers faced by those businesses that have the potential to scale-up and achieve greater growth, and how can we address these barriers? Where are there outstanding examples of business networks for fast growing firms which we could learn from or spread?

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The Green Paper cites access to finance as a key limiting factor for businesses seeking to expand in the UK. Government actions taken since 2008 to redress the issue have had some success, but the problem is a persistent one. The Business, Energy and Industrial Strategy (BEIS) Select Committee's inquiry into access to finance in 2016 cites research reporting that 6% of SMEs still see access to finance as a barrier to growth. Furthermore, the type of finance available may not be appropriate, with the Committee also reporting that one in four SMEs found it difficult to access finance on acceptable terms.

The BDRC Continental SME Finance Monitor from Q4 2016 points out that more businesses are permanent non-borrowers than not; businesses are less optimistic about finance applications; and 57% of SMEs are not willing to take on external finance to grow and develop. This is contributing to the UK having "one of the lowest proportions of micro enterprises that grow to more than 10 employees in three years" in OECD countries. These figures suggest that the process navigating finance options, applying, and facing rejection is a major barrier to businesses with the potential for scale-up and growth. The Federation of Small Businesses (FSB) has recognised this problem and is lobbying the regional governments of the UK for measures to be taken to improve the lending environment for small businesses.
There needs to be a focus on both simplifying the process of applying for finance and creating a thriving supply and advice side so that businesses at all sizes and stages of growth can access the finance they need.

The Government's response 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 businesses unable to access mainstream finance – such as start-ups microbusinesses, 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 the businesses supported. The ■60 million RGF fund delivered through responsible finance providers has supported over 2,000 businesses and created or saved 8,000 jobs. 95% of the fund has been lent outside of London, into sectors that provide goods and services to the economy or support local supply chains. Responsible finance providers have supported firms across 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.

91% of businesses served by responsible finance providers were previously turned down by a high street bank. This demonstrates the effectiveness of RGF in reaching small business that would have otherwise have been prevented from growing or surviving as a result of barriers to accessing finance. The fund was successful because it was delivered through responsible finance providers – a sector specifically focused on underserved markets. This type of targeted, good value for money and high-impact initiative is necessary to drive growth in small-scale ventures that feel unconfident or unwilling to engage in mainstream finance.

Government interventions aiming to address the barriers of access to finance, in order to drive firm and industrial growth, should recognise and promote the responsible finance sector, in order to ensure that all segments of the SME market are able to access the finance they need.

Sources:
House of Commons: Business, Energy and Industrial Strategy Committee, Access to finance: First Report of Session 2016-17, https://www.publications.parliament.uk/pa/cm201617/cmselect/cmbeis/84/84.pdf
BDRC Continental, SME Finance Monitor: Q4 2016, http://bdrc-continental.com/BDRCContinental_SME_Finance_Monitor_Q4_2016_Final.pdf
Enterprise Research Centre, Goldman Sachs and British Business Bank, Unlocking UK Productivity – Internationalisation and Innovation in SMEs, http://www.enterpriseresearch.ac.uk/wp-content/uploads/2015/11/Internationalisation-and-Innovation-Report-web-pages-.pdf
Federation of Small Businesses, Access to Finance, https://www.fsb.org.uk/standing-up-for-you/policy-issues/finance-and-the-economy/access-to-finance
Responsible Finance, Responsible Finance: The industry in 2016, http://responsiblefinance.org.uk/policy-research/annual-industry-report/#DT

If you would like to add any other supporting evidence relating to this section please upload document here.

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Improving procurement

23 Are there further steps that the government can take to support innovation through public procurement?

Free text field:

24 What further steps can be taken to use public procurement to drive the industrial strategy in areas where government is the main client, such as healthcare and defence? Do we have the right institutions and policies in place in these sectors to exploit government's purchasing power to drive economic growth?

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Encouraging trade and inward investment

25 What can the government do improve our support for firms wanting to start exporting? What can the government do to improve support for firms in increasing their exports?

Free text field:

26 What can we learn from other countries to improve our support for inward investment and how we measure its success? Should we put more emphasis on measuring the impact of Foreign Direct Investment (FDI) on growth?

Free text field:

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Delivering affordable energy and clean growth

27 What are the most important steps the government should take to limit energy costs over the long-term?

Free text field:

28 How can we move towards a position in which energy is supplied by competitive markets without the requirement for on-going subsidy?

Free text field:

29 How can government, business and researchers work together to develop the competitive opportunities from innovation in energy and our existing industrial strengths?

Free text field:

30 How can government support businesses in realising cost savings through greater resource and energy efficiency?

Free text field:

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Cultivating world-leading sectors

31 How can the government and industry help sectors come together to identify the opportunities for a 'sector deal' to address - especially where industries are fragmented or not well defined?

Free text field:

32 How can the government ensure that 'sector deals' promote competition and incorporate the interests of new entrants?

Free text field:

33 How can the government and industry collaborate to enable growth in new sectors of the future that emerge around new technologies and new business models?

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If you would like to add any other supporting evidence relating to this section please upload document here.

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Driving growth across the whole country

34 Do you agree the principles set out in this section are the right ones? If not what is missing?

Free text field:
Access to finance is missing from the principles set out in this section of the Green Paper, but it is a crucial aspect to driving growth across the whole country. As addressed in the section 'Supporting businesses to start and grow', access to affordable and appropriate finance is a significant and persistent barrier to business growth, which has implications for developing strong and resilient industrial sectors. Geographical disparities in provision mean businesses in some areas have greater access to financial services than in others, particularly impacting on business confidence and the rate of start-ups in sub-regions.

The Green Paper welcomes inspiration from other countries, and much can be learned from the United States' three-pronged approach to tackling this problem. The CDFI (community development finance institution) sector in the USA was established in the 1970s to combat the exclusion of low income and minority communities from accessing loans and investment. It is the equivalent to the responsible finance sector in the UK. A range of support mechanisms were enacted in tandem with the establishment of the sector:

• Community Reinvestment Act: Legislation that requires banks to reinvest into communities they take deposits from. The legislation enables them to invest through CDFIs, given they have the reach and market knowledge. Banks are subsequently rated on their compliance with the Community Reinvestment Act, and the rating impacts on plans to expand, close branches, merge or acquire other banks. This created a more integrated ecosystem for providing access to people and businesses previously excluded from mainstream finance.
• CDFI Fund: A circa £200 million fund within the Treasury Department that provides grants and loans to CDFIs for on-lending, core capacity, and for first loss capital, to leverage in commercial finance.
• Guarantee products and tax reliefs: Financial instruments that enable more communities and businesses to access finance through intermediaries such as CDFIs.

While the United States does not have a centralised industrial strategy (as it is at the discretion of the individual states), the federal 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.

Although specific industrial sectors are not targeted, the support infrastructure enables access to finance and affordable business support for the range of actors – large employers, small firms in the supply chain, new start-ups, and retail and services firms that serve residents. This translates into economic growth. A responsible finance fund in the UK would bring about a significant economic injection. During 2016, in the UK, £103.5 million of responsible finance lending to businesses generated an estimated £0.428 billion in the UK economy.

Lessons around how the US fostered a diverse and integrated supply side for finance should be explored by the UK government when thinking about driving firm and industrial growth.

Sources:

British Business Bank, Small Business Finance Markets: 2015/16, http://british-business-bank.co.uk/wp-content/uploads/2016/02/british-business-bank-small-business-finance-markets-report-2015-16.pdf
Responsible Finance, Responsible Finance: The industry in 2016, http://responsiblefinance.org.uk/policy-research/annual-industry-report/

35 What are the most important new approaches to raising skill levels in areas where they are lower? Where could investments in connectivity or innovation do most to help drive growth across the country?

Free text field:
The area of skills is not Responsible Finance’s area of expertise, but responsible finance initiatives have an outsized impact on local economies in terms of business and job creation. The RGF programme delivered through responsible finance providers created 1,191 full time jobs, and saved a further 7,060, while supporting 1,850 microbusinesses and SMEs. The businesses and jobs created and saved through this programme have added £400 million to the local economies in which they are located, and have afforded local people, particularly those in disadvantaged areas, with opportunities they would not otherwise have had to grow their skills through working in and managing a business.

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Creating the right institutions to bring together sectors and places

36 Recognising the need for local initiative and leadership, how should we best work with local areas to create and strengthen key local institutions?

Free text field:
Any industrial strategy should complement and coordinate with local strategies that devolved nations and cities develop. Devolved governments, local governments and local enterprise partnerships (LEPs) will have significant insight into the health and trends in the local economy enabling them to invest and 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 (EFG) scheme 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. It will enable devolved administrations, local authorities and LEPs to make local strategies and access centrally-available funds in line with the local strategy. The central government having appropriate tools available at a high level will enable strong local economies.

Sources:

37 What are the most important institutions which we need to upgrade or support to back growth in particular areas?

Free text field:
An effective, sustainable and adaptable way to support growth is to support the responsible finance sector as it continues to grow and tackle financial exclusion. The sector has been continually scaling up for more than ten years, but faces the challenge of inadequate capitalisation when considering expansion projects or investment in capability-enhancing technology (something highlighted in the Green Paper as a barrier to many UK start-ups). There are existing tools that can be preserved, enhanced or created to allow the sector to continue to increase its coverage; specifically:

- Enable the use of the EFG on Community Investment Tax Relief (CITR) investments
- Bring to parity the relief investors receive on CITR with what they receive on Social Investment Tax Relief (SITR) investments
- Guarantee the continuation of EU facilities for access to finance (EaSI, COSME, ERDF)
- Enhance the wholesale EFG option to incentivise commercial investment
- Launch a responsible finance fund

EFG and CITR
CITR is a tax relief launched in 2002 to encourage corporate and institutional investment into responsible finance providers for the purpose of on-lending to SMEs and social enterprises that are located in disadvantaged communities and are unable to access mainstream finance. CITR is an important tool for responsible finance providers to attract new private investment for onward lending. To date, over ■100 million has been raised through CITR, which has facilitated more than ■100 million in onward lending.

The EFG scheme is a policy guarantee programme that incentivises investment into small and micro businesses that would otherwise find it difficult to access finance due to lack of security. It is a useful tool for the responsible finance sector to extend into underserved SME markets. To date, EFG has stimulated and additional £42 million in responsible finance lending to SMEs and £2.7 billion in total lending to businesses that may otherwise be viewed as higher risk.
There is a clause in the CITR regulations which Government has previously interpreted as not allowing EFG and CITR to work together. The clause is set out below.

“Any investment which benefits directly or indirectly from the security offered by a Phoenix Fund Guarantee or by any similar publicly-funded underwriting or guarantee arrangement’ is not classed as a relevant investment”

We have calculated that used together, EFG and CITR has an estimated net benefit to the Exchequer of ■66.27 million. This would provide a suite of tools to provide a return and cover risk, which could incentivise greater investment into the responsible finance sector. At a time when the availability of first loss funding is diminishing, this would be catalytic in continuing to grow the sector so it can continue to support businesses in need of finance to scale.

Bringing to parity CITR and SITR
Investors can use SITR to deduct 30% of the value of an investment in social enterprise from their tax liabilities. CITR, used in the same way for responsible finance providers, allows for only a 25% deduction. Given the social mission of responsible finance providers and their support for social enterprises through on-lending, a coherent incentive structure would equalise the benefits for investors regardless of whether they invest through CITR or SITR.

Wholesale EFG
The Enterprise Finance Guarantee has a wholesale options, where wholesale lenders can have their investment into an intermediary guaranteed in line with EFG's rules (15% of the portfolio), on investments up to £1 million. This option has been utilised in the past by responsible finance providers, as it provides first loss cover, incentivising new investment. However, responsible finance providers now raise investment funds exceeding £1 million, so they are not able to take advantage of the wholesale EFG option; without it they may not have an alternative first loss guarantee to catalyse the investment, and therefore miss out on it overall. The sector would benefit from an increased wholesale lending limit, which would then stimulate greater on-lending to SMEs.

European funding
The BEIS Committee investigating access to finance recommended that the European Investment Fund contributions to access to finance initiatives be replaced once the UK leaves the European Union. The Chancellor 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.

Responsible Finance Fund
An outline and cost benefit analysis of a responsible finance fund is in our response to question 38.

Sources:
Responsible Finance, 10 years of Responsible Finance, http://responsiblefinance.org.uk/2016/03/10-years-of-responsible-finance/
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House of Commons: Business, Energy and Industrial Strategy Committee, Access to finance: First Report of Session 2016-17,
https://www.publications.parliament.uk/pa/cm201617/cmselect/cmbeis/84/84.pdf

38 Are there institutions missing in certain areas which we could help create or strengthen to support local growth?

Free text field:
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 complement the measures recommended above and the Green Paper's pledge to increase BBB venture capital by £400 million, aimed at equity solutions. The typical leverage of responsible finance capitalisation is 1:3, which would equal an estimated total of £600m in released capital (more than the BBB's 2:5 ratio).

The United States Government invests $200 million annually into its CDFI Fund. The Fund has been an important force in allowing CDFIs to operate sustainably by providing them with equity and 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. The CDFI Fund also manages guarantee programmes, technical assistance to CDFIs, capacity building trainings, and tax relief programmes.

The Regional Growth Fund (RGF) was launched in 2010 and distributed £60 million through responsible finance providers. A £30 million fund from the Department for Business, Innovation and Skills was combined with £30 million in private investment from banks (Unity Trust Bank and the Co-operative Bank), targeted at the micro and small segment of the market that struggles the most to access finance, and for which this finance has a disproportionate impact, not to mention the benefit to the local economy. The resulting cost per job to the government is £3,459, which is 7% of the total cost per job across the entire RGF programme. The businesses and jobs created and saved through this programme have added £400 million to the local economies in which they are located. 90% of the fund has been disbursed to businesses outside of London and the South East: nearly 40% has been distributed to the West Midlands, and a further 35% to the Northern Powerhouse region (North East, North West, Yorkshire and the Humber), driving business investment to rebalance the economy. 100% of the nearly 2,000 businesses supported had been previously declined by a bank, and a large proportion have been high growth, as evidenced by the number of new jobs created.

As evidenced by these KPIs, this was a very effective intervention by the government that was also good value for money, that and improved the landscape for access to finance for those businesses that experience the greatest difficulties. However, no new rounds of RGF have been announced.

A dedicated £150 million responsible finance fund could replace and build on the success of RGF. Together with CITR, EFG, and European instruments, this package of support could foster a healthy and sustainable responsible finance sector that bridges the gap in access to finance and underpins wider industrial strategy.

Sources:
CDFI Fund, The CDFI Fund: Empowering underserved communities, https://www.cdfifund.gov/Documents/CDFI_Brochure%20Updated%20Jan2016.pdf
House of Commons Library, Regional Growth Fund, http://researchbriefings.parliament.uk/ResearchBriefing/Summary/SN05874#fullreport

If you would like to add any other supporting evidence relating to this section please upload document here.

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