BRITISH BUSINESS BANK

ENTERPRISE FINANCE GUARANTEE (EFG) SCHEME STRATEGIC AND OPERATIONAL DESIGN REVIEW

2015 /16

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FOREWORD

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We approached this 2015/16 review with one core objective in mind: to maximise the support that the Enterprise Finance Guarantee (EFG) offers to smaller businesses. Past evaluations of EFG have demonstrated high levels of finance additionality and economic benefits. It is therefore important that EFG is continually reviewed and where appropriate developed, to ensure it remains fully effective in supporting economic activity amongst smaller businesses.

For this 2015 /16 review, we took the views of a wide range of stakeholders, from our delivery partners to the end users themselves: the smaller businesses. The British Business Bank is delighted that our stakeholders remain of the firm view that the EFG scheme is wholly relevant in helping smaller businesses unlock finance they would not have otherwise received.

While the evidence gathered shows that on the whole EFG works well for both delivery partners and businesses, stakeholders believe that more could be done to ensure that eligible businesses are able to access the scheme. Stakeholder feedback and wider analysis by the British Business Bank confirms that some demand for finance remains unmet, which potentially impedes the contribution such businesses can make to the economy. I am therefore pleased to see that a number of recommendations set out in this report are being put in place to address these issues.

These improvements are the latest recommendations to emerge, following a series of EFG reviews over the past few years. In 2004, I led a review of the then Small Firms Loan Guarantee (SFLG) – the precursor to EFG. It found that SFLG could be enhanced to ultimately better support businesses. The 2004 review gave me insights into areas that were working well but also aspects of the scheme that needed reforming and many of the recommendations of my 2004 review were adopted in the relaunched SFLG and subsequently carried forward into EFG.

SFLG was replaced in 2009 by EFG, with feedback indicating that stakeholders believed that the replacement scheme was an improvement to the previous programme. In the same year the operational performance of EFG was examined, and an early assessment helped embed the refreshed scheme. This was followed by a fuller economic evaluation in 2013 that estimated EFG had a net economic benefit of around £1.1 billion - a clear statement of EFG's positive impact.

The 2015/16 review therefore provides the latest in a series of assessments as to how delivery can be further improved, and provides an opportunity to consider the best set of EFG products on offer to suit market needs. I am pleased to announce that the British Business Bank will be engaging further with the asset finance sector and asset finance providers to explore appetite for and take views on the design of an asset finance variant. Also, the British Business Bank will re-open the EFG lender accreditation process which will lead to a greater number and more diverse set of lenders.

I would like to thank everyone who contributed to the 2015/16 review. Many individuals and organisations generously gave their time and support to provide feedback and propose ideas for change. I look forward to EFG being developed further to the benefit of the smaller business community and the economy as a whole.

EXECUTIVE SUMMARY

The Enterprise Finance Guarantee (EFG) scheme is a loan guarantee programme that targets smaller UK businesses that cannot otherwise get a bank loan because they lack sufficient collateral or sufficient years of operating track record. It, or similar predecessor programmes, have been in operation since the 1980s. Since 2009 when EFG was created, it has supported smaller businesses by delivering nearly £2.7 billion worth of lending via more than 25,000 individuals loans. To ensure its continued relevance and efficacy, the Government periodically solicits broad feedback, assesses performance and makes adjustments to the programme as appropriate. Since its formation in November 2014 the British Business Bank has managed EFG on behalf of Government. This paper summarises the result of the latest EFG review conducted in 2015/16 by the British Business Bank.

EFG CONTINUES TO MEET A NEED IN THE UK MARKET FOR SMALLER BUSINESS FINANCE

Our research shows financial markets have improved since the recession, when lenders were particularly cautious and young, smaller businesses were particularly fragile. This review however found that the UK market for finance does not deliver sufficient finance to viable smaller businesses unable to provide enough security or years of accounts. The information asymmetry, driven by the high cost for a lender to otherwise establish viability where collateral is lacking or data is not available to support the forecast revenue, continues to create a need for intervention.

Technology may have cut some of the cost of gathering data to determine viability and potentially narrowed since the recession, but the broad stakeholder consensus is that the gap persists. Indeed, there is concern that the smaller businesses with step-change growth and/or innovation plans who are key drivers of national productivity improvement are particularly susceptible. We also continue to see evidence of the market failure more broadly in survey data of smaller businesses.

EFG IS BROADLY EFFECTIVE AS CURRENTLY CONFIGURED

This review found that the EFG programme is broadly effective. It helps those smaller businesses that get access to it prosper, and the vast majority of those who do get access would not get bank finance otherwise. In doing so, it disproportionately boosts the UK economy and is likely to continue to be good value for money for the UK taxpayer[1]. For example, data-matching analysis suggests that smaller businesses that took an EFG loan in 2011 grew both their employees and their revenues faster (and for some businesses also their productivity faster) than the general body of smaller businesses. While this work is only indicative at this point, we intend to complete a full evaluation of EFG for publication by early 2017.

Lenders in the programme follow protocols to ensure that borrowers have exhausted all other financing options. These are now well established and work well to ensure that only those that need help get it. Similarly, other major elements of EFG such as the portfolio-level claim limit, the 75% guarantee rate, and the 2% guarantee fee were generally positively commented on by stakeholders as being well accepted and effective in achieving their intended effects.

Therefore, the British Business Bank intends to retain these core programme parameters as they are. Not least, some stakeholder feedback suggests continuity enhances a familiarity and comfort with the programme amongst our lenders that facilitates greater and more effective utilisation of it by smaller businesses. Where this review has identified material areas where EFG has not been able to address a need, we have looked to new, more focused and separate interventions to respond rather than readjust EFG.

For example, research found that although EFG may be utilised for loans up to £1.2m with terms of less than 5 years, very few EFG loans for greater than £600,000 are made – this may be due to affordability issues. Similarly, EFG has some restrictions with regards to supporting smaller businesses with an export contract. The British Business Bank is developing a Help to Grow guarantee that will initially target loans from £500,000 to £2m with terms of up to 10 years and which has no export contract restrictions. We believe that this will address the gap in larger loan sizes more effectively than any attempted change to EFG.

BRITISH BUSINESS BANK WILL UPDATE SOME EFG PROCESSES TO ENHANCE RELEVANCE AND EFFICACY

Notwithstanding the importance of continuity for major programme elements, EFG should remain responsive to feedback from our stakeholders. There are some operational enhancements that we believe would help ensure its continued relevance and smooth the user experience for both lenders and smaller business borrowers.

Operational actions include: providing greater clarity around certain eligibility criteria within the EFG Lender Manual to accelerate lender decision making (see Action 1); upgrading the EFG Web portal to allow greater lender functionality (see Action 2); streamlining the EFG audit process to improve lender comfort in their delegated decision making while maintaining the same stringent oversight and assurance (see Action 3); and providing more support to lower volume EFG lenders (see Action 4).

Other related operational actions involve adjustments to the contractual agreement with EFG lenders and will require further work before finalising any actions. These include exploring with lenders alternative options for collecting the 2% guarantee fee (see Action 5), and which Government entity legally provides the guarantee to lenders (see Action 6).

A broader efficacy issue that this review found was that there are probably many more viable smaller businesses who are eligible for the scheme but are not benefiting from it. Research[2] suggests many smaller businesses did not know that such support is available. Indeed, greater awareness of EFG amongst potential borrowers may be essential to encourage them to approach an appropriate lender.

We intend to address this in two ways. First, where utilisation of specific EFG variants such as overdrafts (see Action 7) and invoice finance (see Action 8) is lower than expected, the British Business Bank will work with the relevant trade associations and lenders to address any barriers to use.

Second, the British Business Bank will run an awareness raising campaign for EFG amongst the smaller business advisory community (see Action 9). By targeting advisors rather than smaller businesses themselves, we hope to efficiently get more qualifying borrowers to successfully apply for support whilst minimising the number of ineligible borrowers approaching lenders and being disappointed.

TO INCREASE ITS REACH TO SMALLER BUSINESSES, EFG WILL INVITE NEW LENDERS TO JOIN

Since its launch in 2009, EFG has facilitated significant additional lending to viable smaller businesses. Given its positive impact on qualifying smaller businesses, we believe we should take action to ensure EFG can reach even more eligible businesses.

The awareness campaign amongst the business advisory community mentioned in Action 9 will support this; however, we also observe that in the years following the financial crisis, greater numbers of smaller businesses have been using alternative finance providers to meet their needs.

The EFG programme has always sought to support potential borrowers across a variety of different types of lenders, and currently has over 40 accredited lenders ranging from the very largest banks to specialist invoice finance providers to not-for-profit, local, responsible finance providers. Although the majority of smaller business loans and EFG loans continue to be provided by the main clearing banks, we intend to continue this practice and support diversity of choice in access to finance for smaller businesses.

The British Business Bank will therefore invite new lenders to apply to be accredited EFG lenders from summer 2016 (see Action 10).

TO INCREASE ITS REACH TO SMALLER BUSINESSES, EFG WILL ALSO EXPLORE A NEW ASSET FINANCE VARIANT

Similarly, to enhance the reach of EFG to encompass a form of alternative finance that growing numbers of smaller businesses are adopting, the BBB will develop a new asset finance variant in 2016 (see Action 11).

This is based on both internal research that suggests that a material, distinct and incremental market gap may exist within asset finance as well as consultation with the FLA and a number of asset finance providers. Notably, we found that lack of sufficient years of operating track record, lack of up-front cash deposit and lack of 'hard' assets with an established resale market (such as intellectual property, or customised equipment) may be creating market inefficiency in asset finance.

CONCLUSION

Overall, we are encouraged by the strong positive feedback received about the EFG programme. It is clear that the programme is working well, helping both UK smaller businesses and the UK economy, and we should take action to ensure that even more qualifying businesses make use of it. We look forward to working with the broader community of interested parties as we introduce enhancements that secure the on-going relevance and efficacy of the programme.

CASE STUDIES

MDIVE LTD

Partner: DSL Business Finance (Central Scotland)
Region: Scotland
Location: Isle of Mull
Programme: Enterprise Finance Guarantee

MDive Ltd is a commercial diving company based on the Isle of Mull. The company was set up in December 2013 by Helen Dewar and Murdo Smith, establishing their first contract with Scottish Sea Farms diving for fish. In July 2014 it became apparent that they needed to purchase a transportation vessel for their divers to enable them to reach customers further afield and to reduce the costs they were incurring relying on Calmac ferry service.

In order to purchase the right vessel that would be suitable not only for transportation but would also be large enough to allow them to install all of the necessary diving equipment such as a compressor, a generator etc. MDive Ltd through Business Gateway, was introduced to Glasgow-based DSL Business Finance. DSL is a not-for-profit lender that provides loans, under the Enterprise Finance Guarantee, for small to medium-sized businesses throughout Scotland, the majority of whom have been declined finance from mainstream lenders.

MDive purchased their new boat in September 2014. Apart from saving more than 50 per cent on annual ferry costs, it has opened up new markets: "The boat has been brilliant," says Helen Dewar, MDive Owner and Director. "We now have 14 customers, most of whom are not fish farms, we do mooring inspections for marine research facilities and are also doing salvage work."

BIOWISE (TRADING AS WASTEWISE)

Partner: Clydesdale and Yorkshire Banks
Region: Yorkshire and Humber
Location: Willerby, East Yorkshire
Programme: Enterprise Finance Guarantee

Biowise (T/A Wastewise) is a leading provider of total waste management solutions across Hull and East Yorkshire. The company specialises in the collection, recycling and composting of household and commercial and industrial waste to help reduce greenhouse gas emissions and recover valuable raw materials.

James Landau, Managing Director at Wastewise, said:

"Securing the funding through the British Business Bank's Enterprise Finance Guarantee Scheme has given our business the boost it needed to take us to the next level. As a result, we have opened our new plant which will help reduce the impact everyday waste has on the environment by providing a sustainable alternative to traditional landfill sites."

"The whole process was simple, from applying right through to receiving and allocating the funding. Our customers are thrilled with the new plant which will have a real impact on the way Hull and East Riding manages its organic waste."

BIRD STEVENS MANUFACTURING LIMITED

Partner: BCRS Business Loans
Region: West Midlands
Location: Dudley
Programme: Enterprise Finance Guarantee

Bird Stevens Limited, established in 1936, has a long history of providing metal pressing and engineering solutions from its base in Dudley, West Midlands. Since a management buy-out was successfully completed in 2014, the new company, known as Bird Stevens Manufacturing Limited has emerged as a key player in its sector.

After banks declared that they were unable to provide Bird Stevens with the finance they needed to prosper, BCRS Business Loans was on hand to bridge the lending gap and support the business in its efforts to grow. BCRS provide loans ranging from £10,000 to £150,000 to West Midlands based businesses that are unable to secure finance from mainstream lenders.

Nicola Price, Managing Director of Bird Stevens Manufacturing, said:

"After implementing successful new management solutions, our business was in the fortunate position to progress and to increase sales; unfortunately the only restricting factor was a lack of accessible finance."

"BCRS Business Loans could see the potential in our plans, which filled us with a sense of confidence that we so badly needed to transform our plans into reality. We are now one of the leading companies in our sector. The loans process was quick, efficient and fair and we formed a great relationship with our Loans Officer."

SOLO BUILDING SUPPLIES

Partner: South West Investment Group
Region: South West
Location: Longrock
Programme: Enterprise Finance Guarantee

Solo Building Supplies is a local builders' merchant and building supplies company based in Long rock, Cornwall.

Launched in August 2008 by Andy Dommett, the business has been steadily, growing the company turnover from £1 million in 2009 to £4.5 million in 2014 and now employing 31 staff.

Solo Building Supplies sought investment for business growth in order to expand into a second unit in Hayle, with improved access to the A30 and negotiate a new space at the Longrock site.

With ambitious plans for growth, Solo Building Supplies approached Lloyds Bank and SWIG Finance for a combined funding package of £280,000 in August 2014 with company secretary and mentor, Graham Ashton supporting the business through the application process.

Solo Building Supplies Managing Director, Andy Dommett said:

"The investment has enabled us to grow our team to 31 employees as well as expand our operation. The help we had from SWIG Finance and Lloyds Bank was invaluable and we're really pleased with the growth of the business so far and we hope to continue to move the business forward in the future."

INTRODUCTION

EFG HAS DEMONSTRATED GOOD VALUE FOR MONEY FOR THE TAXPAYER

Evaluations of EFG have found a significant positive impact on many of the businesses who have received EFG loans. In 2009 there was an early review of EFG[3] which found generally high levels of satisfaction and evidence of tangible benefits for recipient businesses, for example, in terms of jobs saved and created and improved business prospects.

This was followed by a fuller economic evaluation of EFG published in 2013[4]. The economic evaluation found that, for businesses which received an EFG loan in 2009, there was an estimated net economic benefit of £1.1 billion demonstrating good value for money for the taxpayer.

SUMMARY: THE CURRENT ENTERPRISE FINANCE GUARANTEE SCHEME

The EFG is a national loan guarantee scheme to facilitate lending to viable businesses that have been turned down for a loan or other form of debt finance due to inadequate security or lack of track record. EFG is the successor scheme to the previous SFLG and was introduced in 2009, at the height of the financial crisis.

The delivery of EFG, including all lending decisions, is fully delegated to the accredited EFG lenders. They decide whether EFG is appropriate and confirm whether a business is eligible. EFG is open to viable businesses that have a turnover of up to £41 million and are seeking finance of between £1,000 and £1.2 million. Loans with a term of up to 10 years are permitted, although for terms beyond 5 years, the maximum loan amount is capped at £600,000.

By providing lenders with a government-backed guarantee for 75% of the value of each individual loan within a lender's portfolio, subject to a cap on the total exposure across a lender's annual portfolio of EFG-backed lending, Government and lenders share the risk and facilitate lending that would otherwise not take place. In addition to the costs and fees charged by the lender, businesses supported under EFG are required to pay a 2% annual fee to Government as a contribution to the cost of providing the guarantee.

Following the principle of devolved decision-making, lenders follow their normal commercial lending criteria and administrative processes when delivering EFG loans. The scheme operates under de minimis State Aid rules.

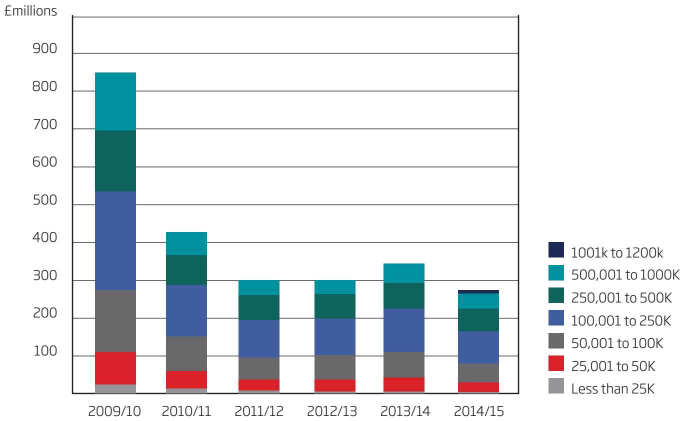
The scheme is used to support a wide range of small businesses, including start-ups and early stage businesses (50% of all EFG lending is to businesses less than around 5 years old), and high growth and expanding businesses (60% of all EFG lending is for expansion). The average loan size is £120,000 (this has gradually increased from £100,000 in 2009) though the vast majority of lending remains below £500,000 in value. Geographically, EFG is supporting businesses throughout the UK, with loan distribution broadly in line with that of the smaller business population. All sectors, other than those exempted on State aid grounds, are supported. Approximately 84% of all EFG lending is currently facilitated via the main high street banks although this has reduced by approximately 5% since 2009.

LENDING SUPPORTED VIA EFG

As smaller business credit conditions and the economy generally have improved, the extent to which EFG is used has fallen from the exceptional levels experienced at the time of its launch in 2009 during the financial crisis. The highest annual value of EFG lending experienced was £850 million during the 2009/10 financial year, reflecting the effect of the financial crisis driven recession in the UK from Q2 2008 to Q2 2009. At that time, asset values were under significant downward pressure and lending was subdued as lenders' confidence in their internal risk assessment models was shaken. This increased lenders' desire to use the EFG scheme to support new proposals.

FIG 1

EFG LOAN VALUES DRAWN BY LOAN SIZE



Source: British Business Bank

KEY THEMES OF THE 2015/16 REVIEW

This 2015/16 review has explored two key themes:

1. In the current environment, what are the remaining barriers and funding gaps for smaller businesses wanting to access external finance?
2. How effective is EFG in addressing the gaps in the market? Are there any enhancements which can be made to bring about more efficient delivery? Is the scheme appropriately targeted, what more can be done to ensure eligible borrowers can access the scheme and is there a more optimal mix of EFG product variants?

Within the context of examining these key themes for EFG, the British Business Bank was also mindful of ensuring optimum design fit between EFG and the new Help to Grow guarantee programme, which is being introduced in 2016. The target business segment for the Help to Grow programme is more established smaller businesses with an intention to grow (scale-up businesses) seeking loan values of between £500,000 to £2 million.

When considering any changes to the design and/or operation of EFG as a consequence of this 2015/16 review, the British Business Bank was conscious that the strategic and operational fit between EFG and Help to Grow programme needed to be aligned.

METHODOLOGY ADOPTED FOR THE 2015/16 REVIEW

To inform the 2015/16 review there were three key work streams:

1. Guided by Teresa Graham, an independent non-executive director and review sponsor, the British Business Bank consulted with a wide spectrum of stakeholders to gather input into the 2015/16 review. The British Business Bank received input from over 50 stakeholders including individual businesses and business representatives, representatives from the accountancy and advisory professions, representatives from banks, Responsible Finance Providers, asset based lenders and academics. Our approach was to hold and document semi-structured conversations based around the key themes outlined above.
2. An independent study was conducted by IFF Research to undertake a qualitative assessment with EFG delivery partners and borrowers to assess the effectiveness of the scheme and identify potential delivery barriers. This research involved conducting in-depth interviews and focus groups with 15 EFG lenders and in-depth interviews with 24 EFG borrowers. The borrower interviews were structured by the type of lender from which they had accessed their EFG supported loan.
3. The Enterprise Research Centre (ERC) was commissioned to analyse some of the economic impacts of EFG. ERC analysed employment and turnover growth outcomes of 12,089 businesses that received an EFG loan through analysis of the Business Structures Database.

The key findings from the work strands informed the set of actions presented in this report.

Through gathering input from over 50 stakeholders and commissioning independent pieces of research, the 2015/16 review was based upon a strong evidence base. As with all qualitative type of research, statements made provide a deeper understanding of the issues being researched but may not always be representative of the views of the wider population.

The next step is to produce a full economic evaluation of EFG in due course. This evaluation will build on the approach and findings from the ERC analysis.

FURTHER DEVELOPMENT OF EFG

The British Business Bank is still a relatively new organisation, operating at arm's length from Government and with both strategic and operational responsibilities for the schemes under its administration. In pursuit of its objectives, the bank is growing its balance sheet significantly and building-out the required infrastructure to support its operational independence. It therefore makes sense to take the next steps and consider transferring responsibility for EFG to its own balance sheet from Department for Business, Innovation and Skills, with the scheme guarantee being provided directly by the British Business Bank.

Whilst this proposal was not formally part of this Review, it is logically related to, and fits strategically with, this stage of the development of EFG in light of changes to the EFG legal agreement. Consequently, is included as one of the actions, set out in Chapter 4 that will be taken forward.

STRUCTURE OF THIS REPORT

- Chapter 1 of the report sets out an overview of the smaller business lending market context.
- Chapter 2 summarises the main themes that emerged from stakeholder feedback.
- In Chapter 3 the findings from the independent IFF study are presented. Perceptions of the degree of effectiveness in targeting EFG, experiences of the process and impacts on business are presented in this chapter.
- Chapter 4 covers recommendations drawn from this 2015/16 review plus actions to be taken forward by the British Business Bank.

CHAPTER 1

SMALLER BUSINESS LENDING MARKET AND EFG

- The recession had a severe impact on SME lending, as the risk-taking capacity of lending institutions reduced, leading to unusually high EFG values in 2009/10.
- Applications for external finance fell during 2011 and 2012, but have now stabilised.
- More recent developments are encouraging, with flows of finance increasing over a range of financial products over the last year.
- As overall supply of finance has improved, we believe more would-be applicants for EFG will be able to meet their need for finance through both mainstream and alternative finance channels.
- But there are businesses that are less likely to be approved for bank finance and who would benefit from EFG.

THE RECESSION HAD A SEVERE IMPACT ON SME LENDING, AS THE RISK TAKING CAPACITY OF LENDING INSTITUTIONS REDUCED, LEADING TO UNUSUALLY HIGH EFG LENDING IN 2009/10

Following the recession, the SME loan stock fell back sharply as credit conditions tightened, leading to less new lending to smaller businesses[5]. The tightening in credit during 2008-09 disproportionately affected lending to small businesses– there were higher rejection rates for smaller businesses, reflecting constraints to the supply of credit, and suggestive of a partial withdrawal from smaller business lending as an asset class[6].

The exceptionally high EFG lending in 2009/10 was most likely due to tightening in smaller business credit conditions at that time. Figure 2 plots the percentage of smaller businesses with at least one employee who cite obtaining finance as the main obstacle to business success compared to EFG loan values drawn. The data suggests that EFG volumes are higher when greater shares of smaller businesses find it more difficult to obtain finance.

As the economy recovered in 2010/11, the overall risk profile of smaller business loan applications improved. As economic growth became more stable, volumes of EFG normalised from 2012 with lending approaching around £300 million.

FIG 2

PERCENTAGE OF SMALLER BUSINESS EMPLOYERS WHO CITE OBTAINING FINANCE AS MAIN OBSTACLE TO SUCCESS AND VALUE OF EFG LOANS DRAWN

Source: BIS Small Business Survey and EFG MI

APPLICATIONS FOR EXTERNAL FINANCE FELL DURING 2011 AND 2012, BUT HAVE NOW STABILISED

There has been a decline in the share of SMEs using external borrowing since the financial crisis. SME Finance Monitor[7] data shows that the percentage of smaller businesses who had a borrowing event in the last 12 months fell from 12% in Q3 2011 to 9% Q4 2012. This figure remains low from 2012 onwards, with 7% to 8% of smaller businesses having a borrowing event over the last 12 months.

MORE RECENT AGGREGATE FLOWS OF FINANCE TO SMALLER BUSINESSES ARE ENCOURAGING

The British Business Bank's Small Business Finance Markets 2015/16 report[8] provides a comprehensive assessment of developments in smaller business finance. The overall picture is an encouraging one, with flows of finance increasing over a range of financial products over the last year.

The net flows of bank loans (new loans, excluding overdrafts) has turned positive with five consecutive quarters of growth through to Q4 2015. In addition, the evidence on overdrafts and deposits suggests that smaller businesses' balance sheets have generally improved in recent years.

Data commissioned by the British Business Bank shows that the value of new equity deals with known amounts grew to £2.2 billion in 2014. It expanded further in 2015, with nearly £2.4 billion in the first three quarters of 2015, continuing the strong upward trend since the data series began in 2011[9].

Finance and Leasing Association data suggests that new asset finance volumes with smaller businesses were almost £15 billion in 2014, an increase of more than 9% on 2013. The value of invoice finance advances outstanding at end of December 2015 totalled £15.8 billion, although the published data series does not separate out smaller businesses recipients from other businesses[10]. It should be noted that given the short-term nature of invoice financing, the total volume of funding within a quarter is much higher than the advances outstanding at the quarter end.

Gross flows of lending to businesses via online platforms continue to grow at a strong rate reaching £1.26bn in 2015[11]. However, the value of these non-bank sources of finance remains small in comparison to traditional sources of bank finance.

As overall flows of finance have improved, we believe more would-be applicants for EFG will be able to meet their need for finance through both mainstream and alternative finance channels.

THERE REMAIN BUSINESSES THAT ARE LESS LIKELY TO BE APPROVED FOR BANK FINANCE AND WHO BENEFIT FROM EFG

The British Business Bank specific analysis of SME Finance Monitor data suggests that of all SMEs seeking a new loan facility, roughly 55% were successful whilst 45% were unsuccessful in obtaining external finance for their business over a 10 quarter period[12]. This equates to around 55,000 SMEs rejected for new loans in a 12-month period. Start-ups are more likely to be unsuccessful in their application for new debt facilities, compared with scale-up and stay ahead businesses[13].

This set of rejected SMEs suggests that, a market gap persists and there remains a core population of SMEs that need and can benefit from EFG due to structural reasons.

The rationale for EFG is based on a structural market failure in the provision of finance to SMEs due to asymmetric information between lenders and businesses. In particular, this information asymmetry can lead to lenders requiring collateral as security for the finance – using this as a proxy for the true viability of the business. Because of this structural problem, some potentially viable businesses are unable to source finance resulting in lower growth amongst those businesses.

CHAPTER 2

STAKEHOLDER FEEDBACK

- Stakeholders contacted for this 2015/16 review agreed that a market gap for smaller business finance continues to exist. A key reason for this is lack of security or proven track record. In particular the market gap is likely to be larger amongst businesses that have significant growth plans because of uncertainty around their future performance.
- Previous evaluations of EFG have demonstrated high finance additionality and a positive economic impact on recipients.
- Changes made to EFG from its predecessor scheme have been welcomed. Some operational and communication issues were also highlighted where further improvements could be made.
- Early discussions indicate that there is merit in exploring further whether an asset finance variant should be developed.

Teresa Graham, an independent non-executive director at the British Business Bank, led a series of discussions with key stakeholders. In total, over 50 stakeholders were consulted, which included lenders, academics, business and accountancy advisory bodies. Devolved Administrations, Government officials and other interested stakeholders. The meetings gathered views on the barriers SMEs face when accessing finance, obtained feedback on the current EFG scheme and gauged views on what the British Business Bank should do differently in the future.

There was generally positive feedback on EFG and the need for the British Business Bank to continue providing a Government-backed national loan guarantee scheme. However, there were also a number of areas where stakeholder feedback suggested that there may be room for improvement.

BARRIERS TO ACCESSING FINANCE

Most stakeholders agreed that a market gap for smaller business finance continues to exist as a result of either a lack of collateral or an unproven track record. They also acknowledged that, given advances in technology, information asymmetry between lender and borrower may now be less of an issue than was the case historically. It was highlighted that the market gap is likely to be larger amongst businesses with significant growth plans because of uncertainty around their future performance relative to past performance. Innovative businesses also have more difficulty raising debt as proving affordability can be more challenging, and the assets owned by such businesses may often be less tangible in nature.

There were also specific issues raised related to access to finance which included:

- Businesses that are heavily reliant on intellectual property struggle more to get finance in the UK.
- There may be a gap for unsecured working capital facilities, particularly overdrafts; a view expressed by accountancy and smaller business advisory bodies.
- Security-related gaps may be focused around borrowers' unwillingness or inability to put up residential property to back a normal commercial loan.
- Accountancy and smaller business advisory bodies said that some smaller businesses are often reluctant to offer personal guarantees to a bank.
- Small businesses tend to spend a disproportionate amount of time looking into export finance products partly due to complexity.
- There are some discouraged SMEs who may limit their growth to what they can organically fund due to an aversion to external finance.

IMPRESSIONS OF EFG

Having been part of the smaller business finance landscape since 2009, EFG is now an established intervention and is deemed by stakeholders an improvement on the previous SFLG scheme. Past economic evaluation has proven that EFG helps those businesses that otherwise could not borrow and is efficient in value for money terms. Lenders generally exhaust all other commercial options before using EFG, thereby contributing to the scheme's high finance additionality.

Lenders reported however that there remains a lingering perception amongst some borrowers that EFG is for failing businesses. This is not the case as EFG is actually aimed at viable lending where there is only a lack of security. Analysis of EFG data shows that around 60% (by volume) of EFG loans drawn are for growth purposes[14]. EFG is a flexible intervention suitable for supporting businesses at all stages of their life cycle. However, some commentators understood EFG to be focused on businesses with low growth aspirations and/or requiring working capital only (the British Business Bank's 'stay ahead' market segment), suggesting a need for greater promotion of the breadth of EFG's applicability. However, the observation was also made that wider promotion could lead to an increase in inappropriate applications and resultant borrower dissatisfaction.

The Federation of Small Business said that the EFG scheme is useful in that it signals to smaller businesses that Government recognises the contribution they make to the economy and that Government wants to support SMEs.

HOW EFG HAS BEEN OPERATING

In general lenders felt the working relationship between the British Business Bank product team and themselves was very good and that this has improved over time.

Lenders felt that some SMEs did not like paying the 2% EFG fee, although it was noted that this is necessary. Lenders highlighted that there are complexities associated with applying State aid rules. State aid is any advantage granted by public authorities through providing state resources on a selective basis and thus potentially distorting competition within the European Union (EU). State aid rules apply to all publicly funded schemes (e.g. a business can only receive a limited amount of state aid in total) and this in itself can lead to a perception of further complexity in the assessment of EFG eligibility.

There were mixed views on whether there are too many variants of the scheme, with some lenders suggesting that EFG might be too broad in its offering whilst others appreciated having a range of variants.

Some lenders suggested that the EFG Lender Manual could be enhanced to provide further guidance on eligibility. They believed that this would make it easier to communicate clearly and consistently on some of the more subjective eligibility criteria and thus ensure greater consistency of the application of those criteria.

A fundamental scheme principle, dating from the 2004 Graham Review, is that guidance to lenders on these more subjective eligibility criteria should be kept deliberately high level (i.e. non-prescriptive) in order to avoid the possibility of EFG criteria distorting a lender's existing in-house procedures and guidelines. Differences between lenders in matters such as their approach to the determination of viability or definition of what constitutes available security were therefore accepted and welcomed, on the basis that lenders also differ in their approach to assessing normal commercial proposals according to their risk appetite and lending practices. In this regard, use of EFG should be no different, which is why lenders are advised to 'follow their normal commercial practice' on such matters. Notwithstanding this principle and the guidance provided to lenders, it is clear that lenders continue to experience difficulties when making the link between EFG eligibility and their normal commercial practice and that further clarification would be welcomed.

Feedback also suggests that in the current banking environment, with lenders being highly sensitive to conduct risk, the current EFG audit process may be acting as a brake on EFG lending.

The British Business Bank notes that there is a balance to be struck between the need to ensure that appropriate use is being made of public resources while not imposing unnecessary bureaucracy on those partner organisations, with which the British Business Bank collaborates in the delivery of the Government's policy goals.

ASSET FINANCE

The British Business Bank has concluded that there is likely to be a material, distinct and incremental market gap for asset finance. The British Business Bank consulted with a number of asset finance and leasing companies to explore whether an EFG variant aimed at their sector should be developed. Key challenges that affect the asset finance sector include new businesses struggling to demonstrate a track record, although there are some niche players that will serve this part of the market. Some higher risk businesses (growth businesses, technology businesses and businesses whose key asset is their intellectual property) also struggle to raise finance for business investment purposes. Another problem cited was there may be viable businesses, who are able to service the debt but do not have sufficient up-front cash or security for a deposit.

INVOICE FINANCE

A stakeholder representing the invoice finance sector suggested that EFG invoice finance volumes are possibly low because the main principle of EFG (a lack of security) does not fully apply to invoice finance as there is nearly always enough security to lend. The invoice finance (IF) market was viewed as relatively competitive and that there would usually be a provider willing to serve a business. As a result, the stakeholder believed that the scope for using EFG in the sector is likely to be marginal. Given the relatively low cost of invoice finance at present, the flat 2% fee (albeit only on the guaranteed part of the book) could potentially be off-putting as it may appear high compared to the base cost. This stakeholder also suggested that having an EFG specialist within the organisation is not always feasible.

In light of these views the British Business Bank believes that raising awareness and understanding of the EFG product amongst invoice finance lenders could lead to higher volumes of appropriate EFG supported lending. The British Business Bank will be engaging with the Asset Based Finance Association (ABFA) and the IF sector to ensure the current design of the IF option is fit for purpose. Thereafter, the British Business Bank will work with ABFA to promote EFG's ability to support IF lending to SMEs, either via the bespoke IF option or via term loans.

DEVOLVED ADMINISTRATIONS

The British Business Bank spoke with representatives from the Devolved Administrations in Scotland, Northern Ireland and Wales and the regional SME finance organisations. The main messages from these meetings are presented below.

The view in Scotland is that EFG is a very good scheme, that historically has been well used by Scottish small businesses, and that it should continue, although improvements should be investigated to increase levels of demand. While most SMEs have access to the finance they need, there is still some businesses in Scotland that are unable to access or not trying to access finance, and issues remain i.e. lack of track record (particularly for high growth businesses) and inadequacy of security.

A lack of security amongst smaller business borrowers has been a key market failure in Northern Ireland (NI). Other reasons which have been cited for the relatively low uptake of EFG among NI businesses include the different banking structure in Northern Ireland, and NI having fewer eligible businesses that can access the scheme. In NI, public debt finance support to SMEs is primarily delivered through two debt funds which are administered on behalf of Invest Northern Ireland.

There is a substantial finance gap in Wales – estimates indicate somewhere between £300m - £500m. This includes servicing the needs of micro businesses, which is a key focus for Finance Wales' (FW) support. Around 12 to 18 months ago, Finance Wales was the main provider in this space, but things are starting to change. Banks are selectively expanding their credit risk and alternative providers are gradually becoming more prominent but there is still some way to go. In Wales, businesses that tend to find it difficult to get funding include those with a lack of security. Some banks in Wales have found it easier to get FW involved in a deal than use EFG. This may be because of the banks' own processes that they have layered on top of the EFG process. In addition, FW can take quicker credit decisions and be more flexible in deal structures.

CHAPTER 3

LENDER AND BORROWER EXPERIENCE OF EFG

- All businesses interviewed reported experiencing a significant positive impact as a result of an EFG-supported loan, and the consensus was that this impact could not have been achieved otherwise.

- Lenders and borrowers were generally of the opinion that the businesses that are accessing the EFG scheme are generally the appropriate ones; however they also thought that the scheme was not reaching all the businesses that could potentially benefit from it.

- A combination of factors are perceived to be potentially limiting use of the scheme including, for some lenders, a lack of clarity around certain eligibility criteria, a lack of awareness amongst borrowers, and amongst small lenders in particular, confusion over the claim limit and low awareness amongst front-line staff.

- EFG also sees limited use in certain areas, such as for larger loans (over £600,000), and in support of overdrafts and invoice finance facilities.

- Overall, the process seemed to work relatively well for both lenders and borrowers. That said, some lenders highlighted areas for potential improvement, including greater lender flexibility within the Web Portal. The borrower perspective brought fewer issues to the forefront, with the majority of borrowers finding the process straightforward.

The British Business Bank commissioned IFF Research to undertake independent qualitative research with EFG lenders and borrowers[15] to understand perceptions of:

- Experiences of the current EFG scheme process;
- The scheme's impact on businesses which take out EFG loans;
- The degree of effectiveness with which EFG is targeted and used and;
- Potential refinements to operation and delivery.

In order to meet the research objectives, IFF conducted a series of in-depth interviews and focus groups with lenders offering loans under the EFG scheme. The lenders that participated included five large high street banks, four smaller banks, four Responsible Finance Providers; and two asset-based lenders. IFF also held in-depth interviews with representatives of businesses which have drawn a loan under the EFG scheme. Borrower interviews were structured by the type of lender they accessed their EFG. IFF interviewed 10 micro sized businesses, 11 small and medium sized businesses and three serial borrowers. All interviews and focus groups were conducted between July and November 2015.

A summary of the results are presented in this chapter.

IMPACT OF THE EFG SCHEME ON BORROWERS

All businesses interviewed reported experiencing a significant positive impact as a result of the EFG-supported loan, and the consensus was that this impact could not have been achieved otherwise. All businesses met their original aims, at least in part, with most businesses either fully realising their aims or exceeding these original aims.

EXPERIENCES OF THE CURRENT EFG SCHEME PROCESS

Overall, the process seemed to work relatively well for both lenders and borrowers. The portal received positive feedback from the majority of lenders, especially when compared to the previous paper-based system under which SFLG operated prior to the Graham Review changes of 2004. Lenders perceived there to be an open and constructive relationship with the British Business Bank that allowed for good communication. The available support materials were cited by some lenders to be comprehensive, largely self-explanatory and sufficiently user-friendly.

That said, some lenders highlighted areas for improvement, primarily with respect to greater clarity around the practical application of certain more subjective eligibility criteria.

The borrower perspective highlighted fewer issues, with the majority of borrowers finding the process straightforward.

THE DEGREE OF EFFECTIVENESS WITH WHICH EFG IS TARGETED AND USED

An objective of the research was to understand how effectively EFG is targeted, i.e. whether the scheme was being used by appropriate business borrowers – those who would not have been able to get finance otherwise. Lenders and borrowers were both of the opinion that the businesses that are accessing the EFG scheme are generally the appropriate ones; however they also thought that the scheme was not reaching all the businesses that could potentially benefit from it.

Factors perceived as contributing to this included:

- A lack of EFG awareness among potential borrowers could be suppressing borrower demand. Evidence from borrowers demonstrated that smaller businesses without access to a financial intermediary may be unaware that they could be eligible for a loan; and that increased availability of information about the EFG-scheme may be an essential precondition to those smaller businesses approaching a lender.
- Most lenders report that there remained some ambiguity over how to apply in practice certain 'judgement based' eligibility criteria, leading to uncertainty over whether certain borrowers are eligible for the EFG scheme. Whilst lenders acknowledged the general guidance within the EFG Lender Manual and from the British Business Bank to apply their 'normal commercial lending practice', lenders did not feel this general guidance was sufficiently clear or useful, when the lender had to apply this within the context of their own organisation's risk guidelines. Their appetite to lend had been dampened by this.
- Amongst some smaller lenders, there was confusion about the claim limit which may suppress some lender appetite to use the scheme. The Government's total exposure to any individual lender's annual portfolio of EFG-backed lending is capped, but at a level above the portfolio default rate most lenders would expect to experience in their smaller business lending. In 2014, enhancements were made to the operation of the claim limit for lower volume lenders although, based upon the feedback during the 2015/16 review, some smaller lenders appeared unaware of these enhancements.
- A condition of the EFG scheme is that each accredited lender is responsible for ensuring all appropriate staff within their organisation are fully trained on scheme terms, so that these can be accurately conveyed to potential borrowers. A few smaller lenders reported that their low levels of EFG lending (sometimes only one or two instances a year) meant that an EFG-supported loan was not at the forefront of Relationship Managers' (RM) minds when faced with a case that may be eligible. RMs were also generally unfamiliar with the portal and the rules around eligibility for the scheme, and this could further discourage suggesting this type of loan. A few lenders said there was a perception that using the Web Portal was particularly arduous, and that this was sometimes as a result of unfamiliarity with the scheme. Whereas large banks had whole teams dedicated to EFG-supported lending, and in some instances had created internal versions of the British Business Bank's manuals to help their front line staff, smaller lenders rarely had this level of internal resource or knowledge.

There are also specific circumstances in which the EFG scheme is possibly underused.

LARGER LOANS (OVER £600,000)

Changes to State aid rules in 2014 meant that EFG-supported loans above £600,000 could only be offered over a maximum term of 5 years. For loan amounts below £600,000, maximum loan term could be up to 10 years. Whilst EFG-supported loans can be used for loan amounts up to £1.2 million, it is rare for loans over £600,000 to be requested under the EFG scheme. Most lenders acknowledged this was the case and gave a number of reasons:

- The length of the loan term was mentioned by several lenders; with larger loans (above £600,000) only being available for terms of less than 5 years, resulting in repayments that are perceived to be too high for many businesses that typically seek EFG-backed loans.
- Some lenders also said that in their experience, the primary need for EFG-supported lending is amongst start-ups and smaller businesses, who tend not to need to borrow larger sums.
- Conversely, a few lenders said that larger businesses who did need this level of loan tended to have collateral and so the EFG element was not necessary.
- Finally, a few lenders mentioned the State aid limitations as a reason why larger EFG-supported loans were uncommon. As the EFG-supported loan provides de minimis State aid to the borrower, some lenders said that a particularly large EFG-supported loan could 'tip' the borrower over their State aid limit, particularly if they had received other aid recently.

OVERDRAFTS

A bespoke EFG overdraft option was introduced in 2010, to enable main bank lenders to offer EFG in support of existing or new overdraft facilities. This option is only available to lenders which operate current accounts and hence are able to offer overdraft facilities to their smaller business borrowers i.e. main banks. Whilst some of the main banks have made use of this option, overall use has been low, and the IFF therefore explored with lenders why this might be the case. A few lenders said that there was no reason in their opinion why EFG-lending would not be used for overdrafts but, in their experience, there was simply very little demand from their customers.

A few other lenders however did suggest more tangible reasons why overdrafts were not a common vehicle for EFG-supported lending.

The 2% EFG fee was felt to be a contributing factor, as this would need to be paid on the whole overdraft limit rather than the amount of overdraft actually used at any one time by the business, which lenders felt could be prohibitive for borrowers. The current rationale for applying the guarantee fee to the limit is to reflect existing lender practice in setting annual arrangement fees, which are also charged against the limit rather than balance. It also reflects the likelihood that where an overdraft ultimately defaults, they will usually do so at or even above the limit. Lenders appeared unaware of this rationale.

Normal commercial lending practice is to review overdraft availability on an annual basis. Within this context, EFG-overdraft availability has been set for a three year period, to provide some certainty to the lender on its continued availability. At the end of the three year period, lenders have the option to cancel the EFG support, renew for a further three year period or convert to term loan. Lenders appeared unaware of these options. For example, a few lenders also thought that the three year limit on an EFG-supported overdraft would put off potential borrowers, due to the uncertainty created by the need to renew the support after this time, and the possibility that it would not be granted again.

INVOICE FINANCE

A bespoke invoice finance variant of EFG was introduced in 2010 to enable EFG to be used alongside revolving credit invoice finance facilities. The option was designed in conjunction with invoice finance lenders to cover niche scenarios, for example to address instances where lenders assessed borrowers as viable but where the lender was unable to extend extra borrowing facilities to the customer due to, for example, concentration issues within the customer's debtor book. The option was also designed to be used to address overpayment scenarios where the lender has provided finance against a particular debtor but had been unable subsequently to collect the debtor invoice. Use of this option within EFG has been mixed.

Some main banks and specialist independent invoice finance lenders have made use of this option, whereas others have preferred to continue to use the standard term loan option. A review of this option in 2014 altered how the EFG guarantee fee was charged, with the guarantee fee charged against the 'industry average utilisation rate' (as provided by ABFA) rather than the facility limit.

Despite this change, utilisation of this option has remained modest. Lenders were asked why this was.

Several lenders did offer invoice finance but did not offer EFG-supported invoice finance. These lenders were a mixture of large banks, small banks and asset based lenders. Reasons for not offering EFG loans for invoice finance, some of which indicated lender's lack of awareness of the design and purpose of the invoice finance option within EFG; included:

- Administrative complexities specific to the variant;
- An invoice finance product that was already nearly 100% secured via the lenders debtor book and;
- Perception that the EFG scheme was not suitable for the revolving basis on which invoice financing is structured.

Those lenders who cited administrative complexities generally said that the demand for this service was so low amongst their customers that it would not be worth the additional work to add this to their repertoire. That said, one lender did feel that offering EFG loans for invoice finance would bring benefits, however as above the decision was eventually taken that challenges related to system changes, and additional costs, would outweigh the benefits of its introduction.

As noted some lenders said that the reason that they do not use the EFG invoice finance variant is because their invoice finance product is already 90% or 100% secured via their debtor book, whereas using an EFG facility would mean the loan was only 75% backed. From a British Business Bank perspective, this appears to reflect a misunderstanding about how the EFG scheme works as it appears to suggest the lenders think they would be swapping cover via the debtor book for cover via the EFG guarantee. This is not the case and hence suggests that there is a need for further communication of the purpose and terms of this option.

THE EFG WEB PORTAL COULD BE MADE MORE USER-FRIENDLY

All EFG transactions, by all EFG lenders, must be entered on to the Web Portal, where the portal tracks each transaction through all stages of a loan's life cycle.

By necessity for data integrity purposes, certain fields within the EFG Web Portal are 'locked down' once completed by the lender – for example, the loan draw-down amount. Other less sensitive data fields can be changed by the lender following initial input.

IFF found that overall, the EFG Web Portal received positive feedback from the majority of lenders, especially when compared to the previous paper-based system. That said, some lenders highlighted that the Web Portal could be inflexible in terms of amending mistakes when the customer has changed their mind. In order to overcome this, lenders stated that they either have to start the whole process again or get in contact with the British Business Bank directly to make the changes.

GUARANTEE FEE COLLECTION

Guarantee fees, payable to the Department for Business, Innovation and Skills (levied on all EFG-backed facilities at the rate of 2% and which contribute towards the cost of the scheme) are currently collected by Direct Debit by an independent agent. Whilst this is viewed as a cost effective and efficient service, some lenders queried whether these arrangements could be explored to potentially enhance the process.

SUGGESTED REFINEMENTS FROM THE IFF STUDY

In terms of suggested refinements:

- Lenders said that anything that could be done to clarify the most difficult eligibility decisions would be a very helpful step forward and would make lenders more inclined to use the EFG scheme.
- Lenders felt that a greater number of eligible borrowers could be reached if the profile of the EFG scheme was raised, both amongst small businesses and amongst the intermediaries that might be supporting them; borrowers also suggested raising awareness amongst smaller businesses.
- Increasing awareness of the EFG scheme amongst customer-facing staff, particularly in some smaller lenders.
- A more flexible portal that allowed lenders to update or change information would be appreciated.

Chapter 4 of this report sets out changes that the British Business Bank will be introducing to EFG to improve the scheme.

CHAPTER 4

RECOMMENDATIONS AND ACTIONS

1. CLARIFICATION OF BORROWER ELIGIBILITY CRITERIA

It is clear from the feedback provided by some lenders for this 2015/16 review that greater clarification on how certain judgement based eligibility criteria should be applied in practice is desirable. The British Business Bank will therefore engage with lenders to develop further clarification wherever appropriate and these revisions will be incorporated in to scheme guidance materials for lenders.

Action 1

The British Business Bank will review the EFG Legal Agreement and EFG Lender Manual to ensure guidance provided to lenders on borrower eligibility criteria is as clear and comprehensive as possible, without compromising the devolved nature of lender decision-making on individual proposals or individual lenders in-house policies, procedures and market positioning.

2. AMENDMENTS TO THE EFG WEB PORTAL

Feedback from lenders during the current 2015/16 review indicates that whilst overall feedback on the EFG Web Portal is good, there are a number of 'irritations', particularly where customers change their minds on certain aspects of the EFG-supported loan and/or an inputting error has occurred and a change to previously 'locked-down' fields is required.

Action 2

Wherever possible, the British Business Bank should undertake software changes to the EFG Web Portal to address lender concerns, though without any compromise to data integrity. Alerts, to help eliminate inputting errors, should be added where data fields have to be locked down for data integrity purposes. These changes should be available by summer 2016.

3. THE EFG AUDIT PROCESS

Feedback from lenders as part of this 2015/16 review indicates that the current audit process, whilst fully accepted by lenders as necessary, can also be perceived at times as burdensome.

Action 3

The British Business Bank to review the overall EFG auditing approach to ensure the correct balance is being achieved between ensuring taxpayer funds are used appropriately whilst remaining fit for purpose from a lender perspective.

4. LOWER VOLUME EFG LENDERS

Given the continued confusion around Claim Limit amongst lower volume lenders identified during the IFF Research, further communication and clarification of the 2014 revisions to the claim limit for lower volume lenders is required. In terms of improving staff awareness amongst lower volume lenders, the British Business Bank should proactively arrange refresher training sessions, specifically tailored to the needs of low volume lenders.

Action 4

The British Business Bank to arrange a series of EFG refresher training sessions, specifically tailored to the needs of low volume lenders, for these to be run throughout financial year 2016/17. Lower volume lenders to be reminded of the Claim Limit arrangements for lower volume lenders.

5. GUARANTEE FEE COLLECTION ARRANGEMENTS

In the IFF research, some lenders raised operational issues around the current method of guarantee fee collection.

Action 5

The British Business Bank will explore with lenders alternative options for guarantee fee collection and will introduce changes as appropriate.

6. PROVISION OF SCHEME GUARANTEE FROM BRITISH BUSINESS BANK

Although this recommendation did not formally feature as part of the review which government entity provides the guarantee has a logical and strategic fit with the current enhancement of EFG. The EFG guarantee is currently provided to lenders by the Secretary of State for the Department for Business, Innovation and Skills. As the independent body responsible for the strategic and operational delivery of the scheme, the British Business Bank wishes to explore the option of providing the guarantee to lenders directly. Any changes would be reflected in updated legal agreements.

Action 6

The British Business Bank will explore with lenders the option of directly providing the scheme guarantee.

7. A REFRESH OF THE EFG OVERDRAFT OPTION

Based upon feedback received in this 2015/16 review, further communication within the clearing banks on the EFG overdraft purpose and terms may be required as well as further investigation with the sector on the true level of potential underlying demand.

Action 7

The British Business Bank to undertake further work with the BBA and clearing bank EFG lenders to further investigate lack of use of this option before considering what (if any) action may be needed.

8. A REFRESH OF THE EFG INVOICE FINANCE OPTION

Whilst some invoice finance lenders, particularly independents, appear very supportive of this EFG option, feedback from the IFF focus groups does indicate that there are a number of misunderstandings and misconceptions amongst some lenders on its purpose and key terms.

Action 8

The British Business Bank should engage with ABFA and the IF sector to ensure the current design of the IF option is fit for purpose. Thereafter, the British Business Bank should work with ABFA to promote EFG's ability to support IF lending to SMEs, either via the bespoke IF option or via term loan. Additional IF lenders should be encouraged to join EFG as accredited lenders.

9. GREATER AWARENESS OF EFG AMONGST FINANCIAL BUSINESS ADVISORS

Evidence from this 2015/16 review's wider stakeholder engagement exercise (Chapter 2) and from the IFF focus groups with lenders and borrowers (Chapter 3) indicated that more could be done to promote general awareness of EFG amongst the smaller business advisor communities to ultimately reach eligible smaller businesses who may not know about EFG. The British Business Bank is the most appropriate organisation to undertake this activity.

In considering this campaign, the British Business Bank must strike a balance between raising awareness of EFG so advisors can suggest the scheme to their clients and ensuring that non-eligible smaller businesses do not inundate lenders with requests for an EFG loan.

Two opposing factors must be balanced: on the one hand, increasing awareness of the scheme amongst potentially eligible smaller businesses and their advisors so that as many eligible smaller businesses as possible can access the scheme. On the other hand, avoiding the scenario whereby EFG lenders are inundated with ineligible applicants who believe that they are entitled to a loan.

In order to strike an appropriate balance between these two opposing factors, a British Business Bank awareness raising campaign, targeting the smaller business advisor community only and focussing upon helping smaller business advisors understand the benefits and key terms of EFG, is proposed. The campaign's aim will be to increase informed demand for EFG via readily accessible, informative and helpful information for smaller business advisors.

Action 9

The British Business Bank will undertake a proactive awareness raising campaign for the EFG scheme from summer 2016, directly targeting the small business advisor community.

10. ENCOURAGING NEW LENDERS TO JOIN EFG

There are currently over 40 EFG-accredited lenders, spanning a wide range of lender types from large high street clearing banks, to smaller banks, to specialist independent invoice finance lenders and also locally based not-for-profit responsible finance lenders.

Achieving a broad spread of lender types ensures availability of the scheme to the widest possible spread of UK SMEs, irrespective of geographic location or sector specialism. It is therefore proposed that a re-opening of the lender accreditation process commences from summer 2016. Lenders operating within the smaller business invoice finance and asset finance sectors will be invited to apply to join the scheme, as well as smaller business lenders offering term loans and overdrafts.

Action 10

The British Business Bank will re-open the EFG accreditation process for all interested and eligible lenders from summer 2016.

11. EXPLORE THE INTRODUCTION OF AN ASSET FINANCE OPTION WITHIN EFG

As part of this 2015/16 review, the British Business Bank spoke to a number of asset finance providers to investigate whether an EFG option aimed specifically at the asset finance sector should be developed. Appetite amongst lenders within the asset finance sector for support via EFG appears high.

Action 11

The British Business Bank will work with the Finance & Leasing Association to explore a detailed design for an asset finance option for EFG, with a view to launching this new EFG option during summer 2016.

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10. ABFA Q4 2015 statistics (http://www.abfa.org.uk/statistics/2015/Q4%202015/ABFA%20Statistics%20Q4%202015.pdf) table 2.4 provides data on advances by turnover size of client. The figures show around 57% of the total value of invoice finance advances are amongst business with an annual turnover of up to £50 million. This figure rises to around 69% of the total for businesses with an annual turnover of up to £100 million per annum.
11. Small Business Finance Markets 2015/16 report, British Business Bank http://british-business-bank.co.uk/research/small-business-finance-markets-report-201516/
12. Definition of successful is consistent with SME Finance Monitor. Rejected applicants, for the purpose of this analysis, are SMEs not obtaining a facility or obtaining funding from family/friends or in a personal name. Subsequently, a very small percentage of SMEs that obtain funding from elsewhere (but not family/in a personal name) are not included in the successful or rejected definitions.
13. The British Business Bank focuses on three main segments of SMEs: start-up (SMEs trading up to 5 years), scale-up (SMEs trading for more than 5 years with some ambition to grow) and stay ahead (SMEs trading for more than 5 years with no ambition to grow).
14. Source: British Business Bank EFG MI data up to end of December 2015. Figures refer to loans drawn.
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ANNEX A: LIST OF ORGANISATIONS CONTACTED

The British Business Bank contacted the following stakeholders to participate in the review.

In addition to the list below the IFF qualitative study conducted in-depth interviews and focus groups with 15 EFG lenders and in-depth interviews with 24 EFG borrowers.

Organisations contacted:

A

The Asset Based Finance Association (ABFA)

ABN Amro

The Association of Chartered Certified Accountants (ACCA)

B

Bank of England

Bank of Ireland

Barclays

The British Bankers' Association (BBA)

The British Chambers of Commerce (BCC)

The British Exporters Association (BEXA)

Bibby Commercial Finance

Building Societies Association (BSA)

C

The Confederation of British Industry (CBI)

Community Development Finance Association CDFA

Chartered Accountants Ireland

Clydesdale Bank

D

Department for Business Innovation and Skills (BIS)

Dr Richard Roberts

E

EEF (the manufacturers' organisation)

Enterprise Research Centre ERC

F
Finance Wales

The Finance & Leasing Association (FLA)

Federation of Small Businesses (FSB)

G
GE Capital

H
HM Treasury (HMT)

HSBC

I
The Institute of Chartered Accountants in England and Wales (ICAEW)

The Institute of Chartered Accountants of Scotland (ICAS)

Invest NI

The Institute of Directors (IOD)

J
Judge Business School

L
Lloyds Banking Group

London Business School

M
Mastercard

Northern Ireland Executive

R
The Royal Bank of Scotland (RBS)

S
Santander

Scottish Development Bank

Scottish Government

Scottish Investment Bank/ Scottish Enterprise

Siemens Financial Services

U
UK Cards Association

UK Export Finance (UKEF)

UK Trade and Investment (UKTI)

UK Government Investments (UKGI)

Ulster Society

Ultimate Finance

University of Birmingham

University of Brighton

University of Essex

V
Visa

W
Welsh Assembly Government

ANNEX B: ECONOMIC IMPACT OF EFG

- EFG recipients add employees faster than non-recipients, and in later years, they also grow revenues faster.

- The economic impact of an EFG loan seems to be related to business age. Businesses who are two years old have the best employment and turnover growth outcomes compared to businesses who are born in the year of the loan being drawn or older businesses.

- Businesses that access EFG loans in general survive better than the rest of the business population. This cannot be attributed to the receipt of an EFG loan, as these results are upwards biased to some extent due to selection effects.

A full economic evaluation of EFG was published in 2013[16]. This study examined the economic impact of the EFG scheme over three years on a cohort of businesses receiving a loan in 2009. The evaluation found that EFG recipients were not necessarily weaker than matched comparison businesses and tended to grow at a similar pace after the intervention, and that finance additionality of EFG was around 83% (e.g. 83% of EFG recipients would not otherwise have obtained finance).

Given that economic and lending conditions have changed since EFG was launched in 2009, the British Business Bank commissioned research to update the evidence base on the economic impact of the scheme. While the data matching project did not use experimental methods to attribute causality of economic impacts to the EFG loan, it served as indicative evidence.

Monitoring data covering all businesses in receipt of EFG between 2009 and mid-February 2014 and also those in receipt of its predecessor, the Small Firms Loan Guarantee (SFLG), was matched to the Business Structure Database (BSD) by the Enterprise Research Centre (ERC).

In total, the original dataset contained 29,664 records; however, 7,847 had missing matching variables. Removing these from the dataset left 21,817 records which equated to 18,102 businesses. Focusing specifically on those with EFG loans i.e. all those in receipt of loans post February 2009 equated to 13,016 businesses. Of these, 12,089 were matched to the BSD.

The matched data was used to analyse the trajectories of aggregate turnover, employment and turnover per employee of cohorts of EFG recipients before and after accessing the loan. The analysis also looked at unmatched comparison groups from the wider business population that did not get Government support. Some caution is needed when looking at the differences between EFG businesses and non-EFG businesses (the wider business population) as this comparison is based on unmatched data.

COHORT ANALYSIS

Cohorts were constructed to examine if recipients of EFG experienced different outcomes as the economy improved post-recession.

IN GENERAL 2011 EFG LOAN RECIPIENTS GREW EMPLOYMENT AND TURNOVER FASTER THAN NON-RECIPIENTS

Cohort one consists of businesses that drew down an EFG loan in 2011 and who were still active in 2014. Figure 3 shows the difference in percentage growth across EFG businesses and non-EFG businesses between 2011 and 2014. Three metrics of growth were examined (employment, turnover and turnover per employee). The results show that in general 2011 EFG loan recipients grew employment and turnover faster than non-recipients.

EFG RECIPIENTS OF A LOAN IN 2009 INCREASED EMPLOYMENT MUCH FASTER THAN NON-EFG RECIPIENTS

Figure 4 shows that employment growth of EFG loan recipients in 2009 was much faster than non-recipients. Also, the employment growth of the 2009 EFG loan cohort tended to be greater than the 2011 EFG loan cohort. Turnover growth for EFG businesses was similar to non-EFG businesses resulting in lower turnover per employee growth amongst the 2009 EFG cohort compared to the general business population.

FIG 3

EFG COHORT 1: DREW DOWN LOAN IN 2011, DIFFERENCE IN PERCENTAGE CHANGE (2011-2014) WITH NON-EFG BUSINESS

EFG cohort 1: drew down loan in 2011, difference in percentage change (2011-2014) with non-EFG business

A positive number indicates that the percentage change for the EFG business was larger than non-EFG business

(% points)	Employment growth	Turnover growth	Turnover per employee growth
Cohort 1.1 Born in 2011	-4	-1	3
Cohort 1.2 Born in 2009	46	75	11
Cohort 1.3 Born in 2006	48	14	-25
Cohort 1.4 Born in 2001	6	10	3

Source: ERC analysis of EFG MI data and Business Structure Database

FIG 4

EFG COHORT 2: DREW DOWN LOAN IN 2009, DIFFERENCE IN PERCENTAGE CHANGE (2009-2011) WITH NON-EFG BUSINESS

EFG cohort 1: drew down loan in 2011, difference in percentage change (2011-2014) with non-EFG business

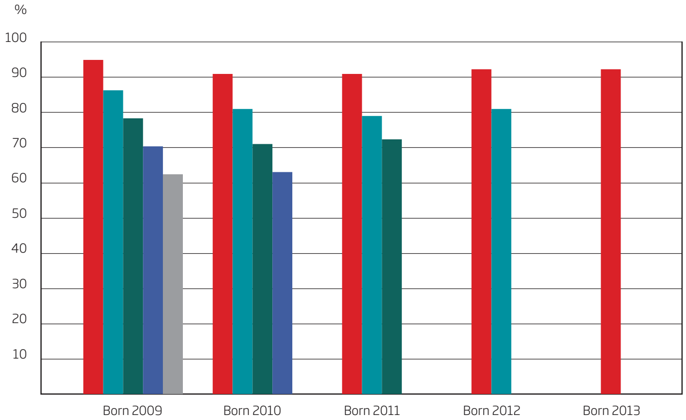
A positive number indicates that the percentage change for the EFG business was larger than non-EFG business

(% points)	Employment growth	Turnover growth	Turnover per employee growth
Cohort 2.1 Born in 2009	129	1	-58
Cohort 2.2 Born in 2007	60	10	-31
Cohort 2.3 Born in 2004 or earlier	16	-2	-18
Cohort 2.4 Born in 1999 or earlier	12	-8	-19

Source: ERC analysis of EFG MI data and Business Structure Database

FIG 5

SURVIVAL RATES OF FIRMS IN RECEIPT OF EFG LOAN THAT RECEIVED A LOAN IN ANY YEAR

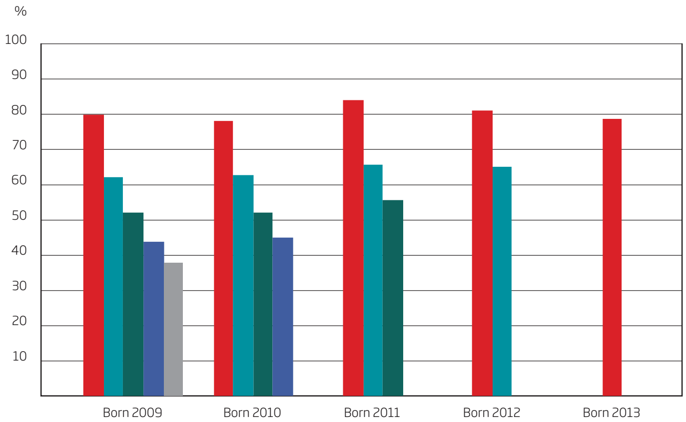


Source: ERC analysis of EFG MI data and Business Structure Database

1 Year
2 Years
3 Years
4 Years
5 Years

FIG 6

SURVIVAL RATES OF NON-EFG LOAN RECIPIENTS FROM 2009



Source: ERC analysis of EFG MI data and Business Structure Database

1 Year
2 Years
3 Years
4 Years
5 Years

SURVIVAL ANALYSIS

Businesses that access EFG loans in general survive better than the rest of the business population. Taking businesses born in 2009, 5 years after birth businesses that had accessed EFG over their lifetime had a 63% 5 year survival rate, compared with 38% for businesses that did not access EFG. This cannot be attributed to the receipt of an EFG loan, however, as these results are upwards biased to some extent due to selection effects.

Survival rates for businesses that obtained an EFG loan in the year that they were born were slightly lower, 49% of businesses born in 2009 and getting an EFG loan in this year were still alive 5 years later. However, this is still more than 10 percentage points higher than the general population of SMEs born in 2009. In addition, those that did survive tended to grow more in both employment and turnover than older EFG recipients.

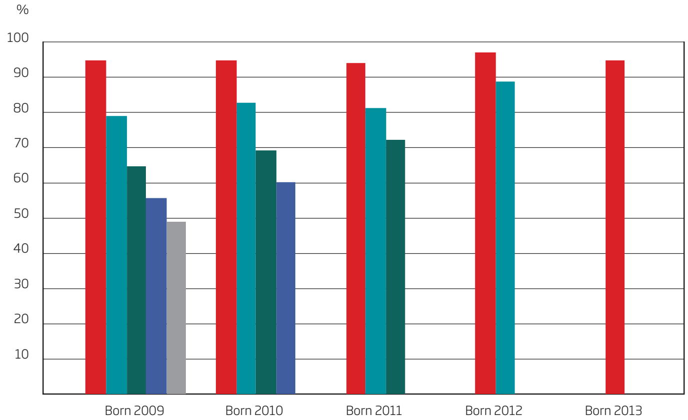
CONCLUSION

The data matching analysis has been a helpful demonstrator project which will inform future economic evaluations. We intend to build on this approach and conduct a full value for money assessment in due course.

The indicative results point towards EFG continuing to help SMEs and moving more towards helping higher productivity, and higher growth companies. During the early phases of EFG it helped promote employment which supported a more explicitly employment focused policy goal during and after the recession.

FIG 7

SURVIVAL RATES OF EFG LOAN RECIPIENTS THAT RECEIVED THE LOAN IN THEIR YEAR OF BIRTH FROM 2009



Source: ERC analysis of EFG MI data and Business Structure Database

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LEGAL NOTICES

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