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# ONE NorthEast

## Access to Finance

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## 1 Executive Summary

ONE NorthEast has been successful in recent years in making available public sector sources of funds to complement private sector activity and to support the development of new businesses in the region. This has, to a large part, been successful and it is now anticipating how this provision should develop in the future given the changes in the region's economy, and in its status as a development area within the European Region. It is particularly concerned that not only should sufficient funds be available but the mechanisms also be in place to enable effective engagement with those who need them.

Qi3 has undertaken a project on ONE NorthEast's behalf to research the mechanisms whereby companies gain access to finance. This report describes the work which has been done and a model which we developed to represent the behaviour of the providers and beneficiaries of funds and related intermediaries and other stakeholders. It analyses the current situation and makes proposals whereby these mechanisms might be made more effective.

We believe that there is a latent growth potential in the region which could be released through improved flow of information, better joined-up business support, encouragement of better business networks and a focus on management skills and at least in the medium term, continued availability of public-sector backed risk capital and local fund management expertise. 'Access to finance' should be 'Access to Growth Opportunities' – the issues are about management skills and ambitions as much as finance.

It is important to emphasise that our study has focused on business perceptions of access to finance in the region. Whilst these perceptions will often differ from reality, the region should take care to ensure that sufficient thought is given to reducing perceptual gaps through its support measures and their marketing.

Specifically:

- An independent quality-assured business support sign-posting account management programme should be urgently implemented:
  - This should be led by Business Link from April 2007 and supported by NSTAR (Regional Financial Services programme) and the Centres of Excellence
  - Companies should be subject to a metric-based diagnosis and support offered by category, focusing resource where it can have most effect
  - Independent signposting must be separated from funds promotion.
  - Confused branding should be avoided where ONE NorthEast funds are the source
  - Accountants and bankers should be targeted for account management to leverage their contacts
  - Companies should be able to select their account manager

- ONE NorthEast should urgently encourage the development of business networks, following best practice in other regions
- A single web site should be established with supporting collateral to signpost funding sources, networks, business support and skills development opportunities
- An over-arching programme should be developed for the enhancement of business skills, with targeted support from mentors and advisors
- ONE NorthEast has a facilitating, funding, coordinating and standards-setting role in the delivery of these services. The agency should ensure that the bodies it contracts to deliver these services are encouraged to cooperate where necessary, including common branding and promotional activities. There is competence in these contracted organisations but insufficient detailed dovetailing of support provision between the various services offered. We found no evidence to suggest that these services should be delivered directly by the agency.

We feel that the current availability of funds meets most needs, current and developing and that ONE NorthEast should resist the urge to create new forms of finance unless there is a demonstrable need. Existing forms of finance should be extended and broadened in preference. Specifically:

- The North East Proof of Concept Fund should be extended beyond its current lifetime and broadened to include non-technology business opportunities
- Equity and mezzanine loan funding should be made available to bridge the gap between proof of concept and co-investment funding from £100-750 thousand
- The North East Investment Fund should be extended to allow loans of up to £1 million to promote development of 'well-managed' SMEs (but not micro companies)
- Micro Loan Finance clearly has a role and should be extended, with careful targeting. The upper limit should be increased to £50 thousand for deserving second-tranche cases

The overall conclusion we have drawn from this project, based on the extensive interviews with companies, funding providers and intermediaries, is of a region with determination and well-supported with financial provision. Although there is always scope for improvement we were impressed by the level of optimism expressed, by the enthusiasm with which people talked about their businesses and by the 'can-do' spirit of most of the respondents to our surveys.

## 2 Introduction

### 2.1 Background

The North East of the United Kingdom has had much positive press in recent years as a result of public and private initiatives: the Angel of the North, the Baltic Centre for Contemporary Art, the Sage Theatre, developments along the riverfronts of Tyne, Wear and Tees, etc. Its cities show signs of confidence with new buildings and structures complementing those of their industrial and trading past. Coincidentally this study was completed during the hot summer months of 2006 when the fine weather enabled the region to be appreciated for its opportunities to enjoy life in the open air, both within the cities and elsewhere.

This view is at odds with recent perception. The North East has often been characterised as a region in decline. Despite a background of prominence in the region's manufacturing and skills base, recent performance has suffered from the decline of manufacturing and the failure to develop new industries. There is much evidence to show the relatively poor status of economic output and public health<sup>i</sup>. Much of the region is classified as Objective 2 for the purpose of European Structural Funding (ESF).

This may be regarded as a poor foundation for the development of new enterprise, but there are other, more recent indicators to show an upsurge in the regional economy. The Regional Development Agency (RDA), ONE NorthEast<sup>ii</sup>, has developed and implemented its Strategy for Success<sup>iii</sup> to stimulate technology businesses in the region. A new 2006 Regional Economic Strategy<sup>iv</sup> for the region is in preparation and has broader aims encompassing all business sectors.

A number of studies (Appendix B) have been undertaken of the provision of finance and business support in the North East and there have been considerable developments in finance provision through the intervention of ONE NorthEast. Nevertheless, ONE NorthEast believes there are significant limitations in companies' access to funds which create gaps and limit the effectiveness of the ONE NorthEast's interventions. ONE NorthEast wishes to ensure these gaps are filled but needs to have evidence of the nature, size and timing of the problems in order to raise appropriate funds and improve information flows to ensure timely access to these funds supports wealth creation in the region.

There are a number of national and regional drivers which are supporting the development of business creation activity in the North East. The continued development of regional policy in the UK creates a focus on the North East as a potential source of new businesses and this has been borne out by numerous studies. Businesses of all types must be considered, with emphasis on regional focus sectors, but the assessment of access to finance needs to include all sectors which generate employment and wealth-creation in the region.

The present project is thus intended to assess the issues of access to finance in the North East, highlighting areas of potential gaps and disparity, showing where a more integrated approach to infrastructure, networks, business support environment and funding streams provides a more coherent outcome. It will be important to ensure barriers to uptake are understood, resulting in specific measures to facilitate demand.

We studied the issues of access to finance in three parts:

- Supply of finance – does the region now offer a satisfactory continuum of financial provision?
- Demand for finance – do companies across the region require this provision at the levels now available?
- Access to finance – are companies able to access finance in a simple and transparent fashion with support from the regional networks and business support environment?

This last part 'access to finance' was regarded as the primary emphasis, although we have taken care to provide input to the development of new supply-side measures by ONE NorthEast.

### **2.1.1 About Qi3**

Qi3<sup>v</sup> specialises in the commercialisation of technology and its principals have considerable experience as practitioners in the development and growth of technology businesses. A number of public sector seed funds have been developed with our support and a significant number of businesses created. We are used to understanding complex and changing markets. The specific value we have sought to add to this demand study has thus been to understand the dynamics of the evolving landscape in terms of the real business drivers.

### **2.1.2 Terms of Reference**

ONE NorthEast provided a briefing note which discussed aims and objectives, the scope and specific themes and issues to be covered by the demand study.

'The outputs from the study will be used to inform ONE NorthEast policy actions for the next 3 to 5 years and will provide a route map for moving forward. The aim is to develop a framework for intervention which will enable delivery to be flexible to adapt appropriately to changes in the economic environment.

The study will need to consider:

- An indication of current provision
- Proposals for integrating/aligning the ONE NorthEast's approach across the areas of infrastructure development, direct and soft support and networking
- Factors to enable the ONE NorthEast to identify and prioritise activities which enable access to finance
- Maximising the return from public sector investment through provision of sustainable interventions
- The interaction with other interventions and strategic programmes operated by the ONE NorthEast and other agencies
- European and National policy and regulations implications and opportunities'

Other discussions within the briefing note and consultation with ONE NorthEast revealed the scope of the study was focussed primarily but not exclusively Small and Medium sized Enterprises (SMEs) and should address all forms of finance and all sectors of business, not just those addressed by the regional Centres of Excellence.

## **2.2 Questions Addressed**

We restate the questions posed in the briefing document in our own language:

What are the gaps and barriers to the access of finance in the North East? How should any gaps or barriers be resolved through improved network provision, development of the business support environment and funding streams?

The answers must include quantification of the barriers to access, be mainly based on field evidence from the financial, intermediary and business communities, and be supported by research synthesising past reports with evidence gained from discussion with businesses.

### **2.2.1 Confidentiality of Responses**

All interviews were conducted according to 'Chatham House' rules in order to encourage stakeholders and other participants in the study to give open and honest input to the process. The views of individuals and specific responses involving commercial or confidential information have been aggregated or anonymised unless specific permission has been granted.

## **2.3 Limitations**

The main limitations of the study are in scope and process. These limitations are described below.

### **2.3.1 Scope of the Study**

The scope of this study has been developed in order to address a meaningful set of questions as posed in the previous section. The focus has been on the experiences of SMEs and somewhat larger companies in the North East in their efforts to raise funds for their businesses. This implies the following:

- Sectors: The sample of companies selected for interview included a number in the focus areas of the Strategy for Success, supplemented by our own research and a purchased database of companies. This latter database provided a large list of companies with turnover under £25 million and otherwise equally split by sector and sub region. The actual split of the survey results was of course dependent on those decision-makers who agreed to be interviewed.
- Prior exposure to regional initiatives: We sourced lists of companies which had prior experience of funding through the initiatives offered by the public sector in the region. This was the starting point for the first phase of face to face interviews. Even in this phase we included several companies without prior involvement in the Strategy for Success.
- Access to finance: There has been previous work<sup>vi</sup> undertaken to examine the 'access to finance' (or 'supply/demand', or 'funding') gap in the North East. This gap describes the difficulty companies find in seeking the right source of funds. We use this expression to refer both to the amount of demand that should be met by equity funding but which is in excess of the available supply and the difficulties which the companies seeking funds encounter.

### **2.3.2 Process**

The study has sought to build a model for the supply, demand and investment process for technology equity finance. This has been tested empirically through interviews with a wide variety of stakeholders. A sample of each type of stakeholder was interviewed in order to provide a test for the assertions developed in the model. The approach, although model-based, is empirical in nature and cannot give definitive or complete answers. It may be that individuals have widely differing opinions from the findings. Nevertheless it was clear from the study that some of the findings can be stated strongly, as the evidence is consistent from a number of sources.

## **3 Methodology**

The access to finance study was carried out in five phases, throughout which Qi3 and the Steering Group collaborated on a regular basis:

- Phase 1 - To identify issues through consultation of the stakeholder community and initial face to face interviews with companies. This phase also included a review of a number of earlier studies in terms of the access to finance issues discussed
- Phase 2 - To develop a working model of the access to finance landscape, and the process through which finance is secured by companies
- Phase 3 - To test this model through telephone interviews with a broader spectrum of companies
- Phase 4 - To identify key issues resulting from the survey and develop a set of answers to the questions posed
- Phase 5 - To test these proposals with a focus group of companies that had participated in the earlier interviews

This work was carried out between June and September 2006. Data was gathered through a combination of desk research<sup>vii</sup>, face-to-face interviews, workshops and telephone interviews. There were several review meetings with the Steering Group and regular correspondence on details of the model as it was being developed and tested.

### **3.1 Stakeholder Consultation**

In order to understand the issues surrounding access to finance it was necessary to understand the funding landscape. This comprises the history of the region in respect of the creation and development of businesses, activities of regional finance providers and the advisory community. This provided an understanding of the baseline of activity in the region. To this end, we consulted representatives from ONE NorthEast and the Government Office for the North East.

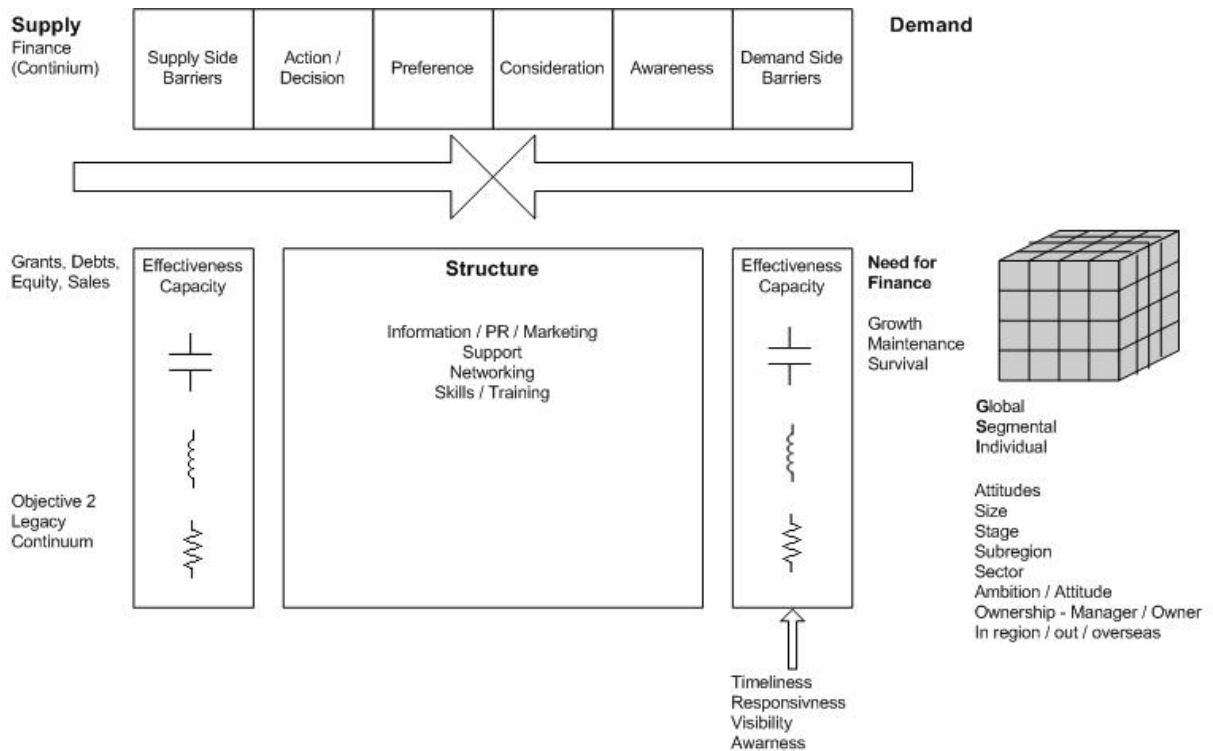
### **3.2 Development of a Model**

Qi3 developed a behavioural model to provide a context for understanding finance issues.

The meaning of 'access to finance' is rather imprecise from the descriptions given by ONE NorthEast. We felt it was appropriate to have a process model which would show clearly the gap between 'supply-side' provision of financial instruments and networking/support structures offered by ONE NorthEast and the demand-side requirements of businesses.

This is illustrated in the process map below. Supply of finance is linked to business demand through a set of structures. These structures include information, support, networking and skills; they may be seen as the 'pipes' through which suppliers supply information to companies and through which companies enable suppliers to become aware of their requirements. But there are barriers at both ends of these pipes. On the supply side, ONE NorthEast and private sector finance providers generate a plethora of initiatives, funds and information flows, together with many intermediaries and support organisations. These may obfuscate the true availability of funds as seen by business. On the demand side, decision-makers in companies may lack the skills, advisory structures and networks to access the financial instruments available in the region.





Process Map Linking Supply of Finance to Business

This process map immediately shows that the subject of this study 'access to finance' could well be broadened to be 'access to skills that enable managers to plan, develop, manage and finance their businesses'.

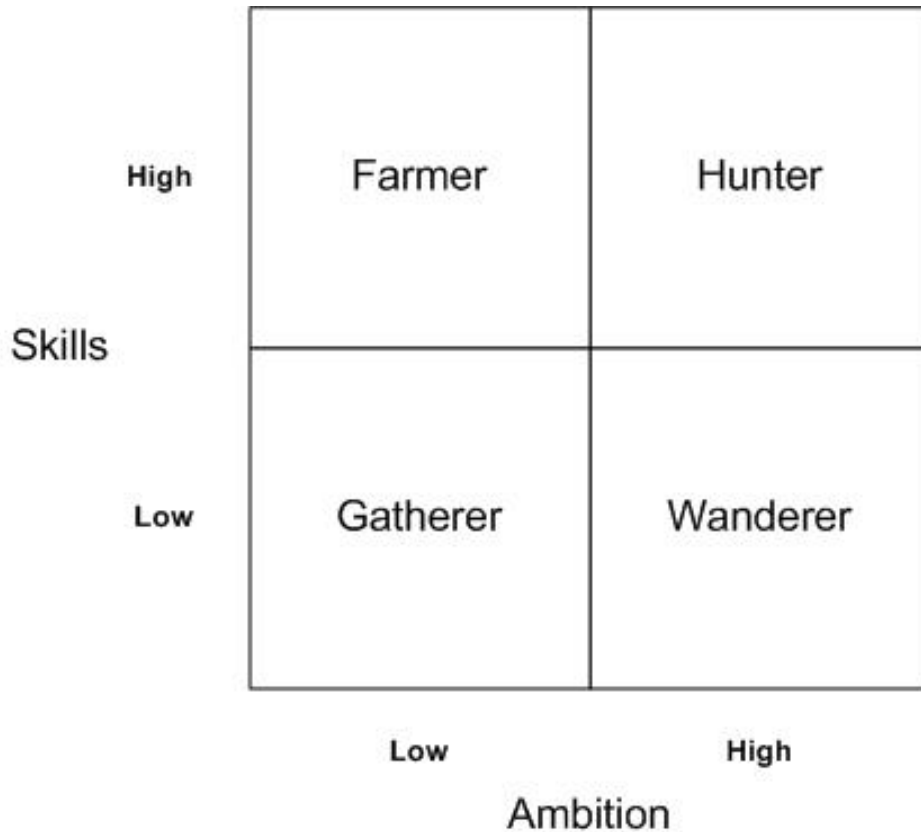
### 3.2.1 Key Factors Influencing Business Behaviour

The initial phase of interviews considered a variety of bases for understanding the differences between the ways in which companies differ in their approach to accessing finance. These included:

- Size
- Stage / Maturity of business
- Ownership
- Sub-region
- Sector
- Attitude of decision maker(s)

It became quickly clear from the first twenty face-to-face interviews that the attitudes of the financial decision-makers would dominate their behaviour in seeking out support and advice from other businesspeople, banks, accountants, solicitors, and intermediary organisations such as business networks and Business Link.

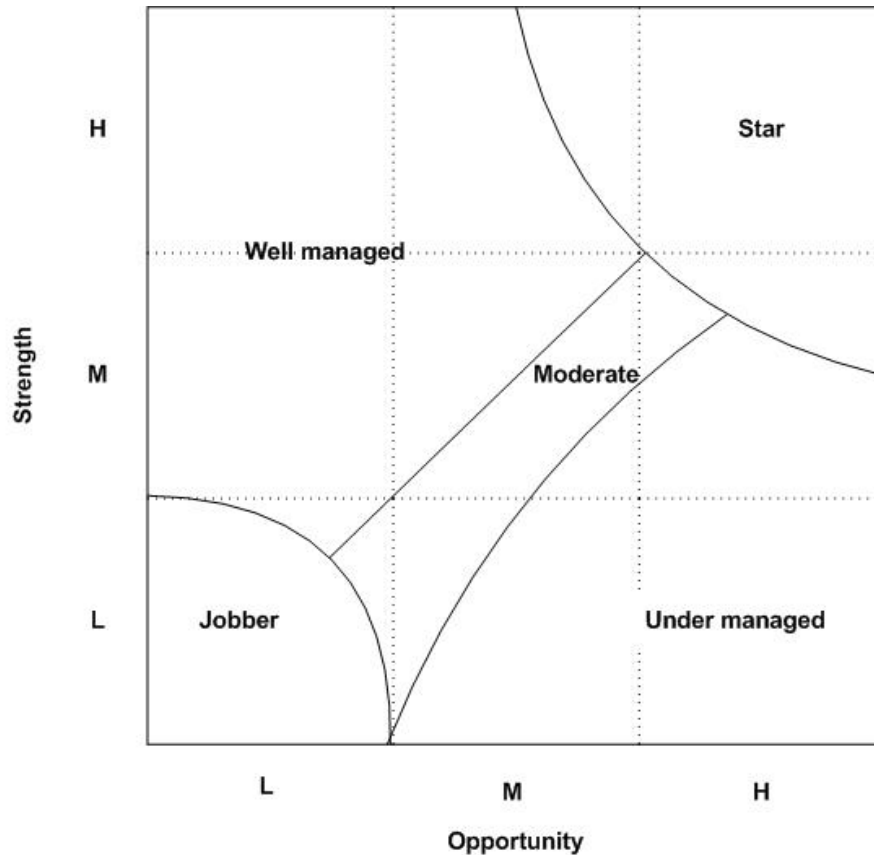
The attitudes of these decision makers may be simply classified as a combination of their skills and ambition, with characteristic types ascribed to the categories. This set of management skills and ambitions comprise the internal business strengths to meet the requirement to plan and finance a business. This is shown in the figure below.



Mapping Management Skills

- Hunters: have entrepreneurial characteristics and will place themselves in attractive markets where they can utilise their skills
- Farmers: run businesses often described as 'lifestyle'. They tend to balance their ambitions for their business with other priorities outside of work. These businesses may thus not achieve their potential as they are limited by management ambition
- Wanderers: are the most potentially dangerous business leaders, as they tend to be ambitious in driving forward their ideas but have a lower level of skills with which to achieve their goals. Such people will also tend not to incorporate additional management in their business or external advice into their world-view
- Gatherers: tend to run smaller micro-businesses or one-man-bands. They are generally most comfortable running a business that makes them a living, without the pressure or risk of expansion

These personal characteristics may then be summarised as low, medium or high business strength and matched with the business environment in which the decision-makers are operating. The external opportunity represented by the business environment is likewise comprised of two components, namely the scale and maturity (readiness) of the market as shown in the figure below.



#### Mapping Management Skills Against Ambition

The resultant map clearly shows the characteristics of companies according to their internal strengths in handling the external opportunities presented by the markets in which they operate. We have ascribed characteristic types as follows:

- **Jobbers:** equivalent to the 'gatherers' and usually managed by them. Generally a one-man-band or micro business where its operational income is sufficient for the wages of those employed
- **Well-managed:** businesses with adequate management competence to run the business and exploit available market opportunities
- **Moderate:** matches well with the 'farmers' above. In these businesses, the market opportunities are greater than the competence or desire of the management to address them
- **Under-managed:** These businesses present the greatest opportunity for improvement with enhanced management skills
- **Stars:** These businesses have the greatest market potential and the management skills to match

The ambitions of ONE NorthEast are easily explained on this map:

- To encourage the development of new businesses in markets which offer greater opportunities than has been the norm
- To support businesses in developing their management strengths (skills and ambitions) which allow decision-makers to address their markets and manage their businesses effectively

This map has thus been useful in understanding the behavioural characteristics of decision-makers in their management of opportunities in their businesses.

### **3.3 Surveys**

The survey process included five elements:

- Consultation with the internal stakeholders
- Survey of external stakeholder communities (finance providers, intermediaries and other government agencies)
- Face to face interviews with about twenty companies
- Telephone interviews with a further eighty companies
- A focus group consultation with eight companies to discuss the preliminary recommendations

The initial interviews were carried out face to face and in workshop/team formats in order to elicit detailed input to the models as they were developed. Telephone interviews were used in the second stage of the survey in order to validate the assertions generated in the first stage.

#### **3.3.1 External Stakeholders**

##### **Regional Venture Finance Providers**

There are five providers of venture finance with headquarters in the region:

- NStar is the entity established by ONE NorthEast, with £33 million of funds under management in the form of a £10 million proof of concept (POC) fund and a £23 million North East Co-investment Fund (NECOIF)
- Northern Venture Managers (NVM) is a private equity firm based in Newcastle with £180 million under management
- Northern Enterprise Limited (NEL) is a private equity firm that manages a number of publicly supported seed corn funds and has about £55 million of funds under management
- Entrust is a support and networking organisation for business angels. Its role as a venture finance provider is through the management of the £2.5 million North East Equity Matching Fund (NEEMF)<sup>viii</sup>
- UK Steel Enterprise provides support to SMEs in areas affected by changes in the steel industry

Given the small size of the local venture capital community, we interviewed all of the players.

We also interviewed a number of other external stakeholders identified in Appendix A.

### ***3.4 Identification of Key Issues***

The survey results allowed final modification of the model to the version presented in this report. At this stage, the inputs generated by the survey and research into funding sources were combined to provide an estimate of the level of supply of equity. The sources of demand were combined in order to provide an estimate of the demand for equity. Input gathered through the various interviews could then be analysed in order to identify and explain failures in the process of fundraising. This process also led to identification of other issues that should be pertinent to future actions in the region.

### ***3.5 Focus Group***

Before finalising this report we reviewed its findings and recommendations with a representative group of companies which had participated in the earlier interviews. It specifically tested its model for understanding and acceptance and asked for complementary input along the dimensions of management knowledge and skills, information, support and networks.

## 4 Supply of Finance

### 4.1 Introduction

We reviewed the current availability of finance - as grants, debt finance, or equity investment available to businesses - not as a thorough analysis as this was not the main focus of the study, but more as a survey of perceptions among finance providers, intermediaries, and stakeholders.

There appears to be a broad consensus among finance suppliers, intermediaries, and stakeholders that the supply of finance available to North East companies has improved considerably, especially over the last two years, following various interventions, including the creation of North Star Equity Investors (NSEI). Many of these observers and practitioners now believe that the sought after 'continuum of finance' is now in place. Some now believe the North East has one of the 'most complete funding ladders in Western Europe'.

Recent changes in the Small Firm Loans Guarantee scheme (SFLG) rules, intended to encourage banks to be more innovative in their provision of risk capital, and the creation of new Enterprise Capital Funds (ECFs), intended to extend the range of available risk capital, have not yet come into effect and will go some way to extending the range of finance options available.

However, many of the public sector provisions backed by the European Union (EU) created in the last few years close at the end of 2008. Reductions in European Regional Development Fund (ERDF) funding and changes in areas qualifying for assistance seriously limit the possibility of follow-on schemes of the scale of the current ones, although there are likely to be, possibly UK-funded, smaller-scale alternatives, following the outcome of Joint European Resources for Medium Enterprises (JEREMIE) assessments of regional gaps between supply and demand for risk capital. Beyond 2012 there is also the possibility of reinvestment of proceeds from earlier investments although the rate of return and hence scale of such activity are uncertain.

There is some evidence of short term excess of supply over demand in certain areas although the degree to which this is exacerbated by limitations in the fund managers' ability to process applications is not clear.

The co-investment vehicles in the region (the North East Equity Matching Fund (NEEMF) and the North East Co-Investment Fund) both expect to expend their allocated funds in the time allowed, although both will need to prove this over the forthcoming year or two. We have thus not prioritised co-investment funds in our recommendations at this time.

There is concern that fund managers brought to the North East in recent years may defect before end 2008. There will be ongoing fund management activity until at least 2012 but the nature of the activity may not be enough to maintain the interest of fund managers who are likely to seek the greater challenges and rewards available elsewhere in UK.

There are a lot of, possibly a confusing number of, funds, many operating at district level and offering only modest impact for the complexity involved.

Whether enough has been done to eliminate the original market failures that led to state intervention is therefore moot.

## **4.2 Current Provision**

There is an excellent summary of finance availability in the North East on the ONE North east web-site at [www.onenortheast/page/regionalsupport.cfm](http://www.onenortheast/page/regionalsupport.cfm).

### **4.2.1 Grants**

Grant-dependence has been a feature of the North East economy for some years as traditional mining, ship-building and steel-making industries went into decline and closure. However it is recognised that grants rarely create sustainable jobs and the debt and equity schemes introduced over recent years have been part of an attempt to change this culture. Nevertheless some grant schemes remain.

Summaries of grants available can be found in Appendix E.

### **4.2.2 Debt**

Debt is the 'preferred form of entrepreneurial finance' according to several experienced fund managers.

Summaries of debt can be found in Appendix E.

### **4.2.3 Equity**

The North East is home to only a very small number of public limited companies with access to mainstream capital markets, such as AIM and LSE.

Much has been said and written about changes in the venture capital market over recent years that has led to a concentration of both expertise and funds in and around London and a perception that, with easier pickings close to home, few venture capitalists (VCs) will venture into the North East however good a deal is on the table. This is compounded by the closure of Newcastle's 3i office, limited local deals by NVM, and the growth of Leeds as a financial centre. However no intermediaries believe there is a need for VCs to be present in the region in order to get finance for a good proposition.

Most players believe that growing firms face an 'equity gap' when attempting to raise equity in the range £500 thousand or £1 million to £2 or £5 million, citing evidence that very few deals are struck in this range anywhere in UK. One recent study by Library House claims this gap is a myth by citing evidence that there are almost as many investment deals made in this 'gap' as outside it. Nevertheless it is likely that there are regional variations with those regions further away from the strong capital-raising and capital-investing communities more likely to see a gap.

The Almeida Capital<sup>ix</sup> report, albeit based on investment data from 2003 commented in several facets of SME investment in the North East. There was a higher rate of investment per SME (number of investments per 1 thousand SMEs) but the average investment was much smaller than elsewhere in UK and almost all the investments being made by in-region fund managers.

Summaries of equity can be found in Appendix E.

## 5 Demand for Finance

### 5.1 Survey

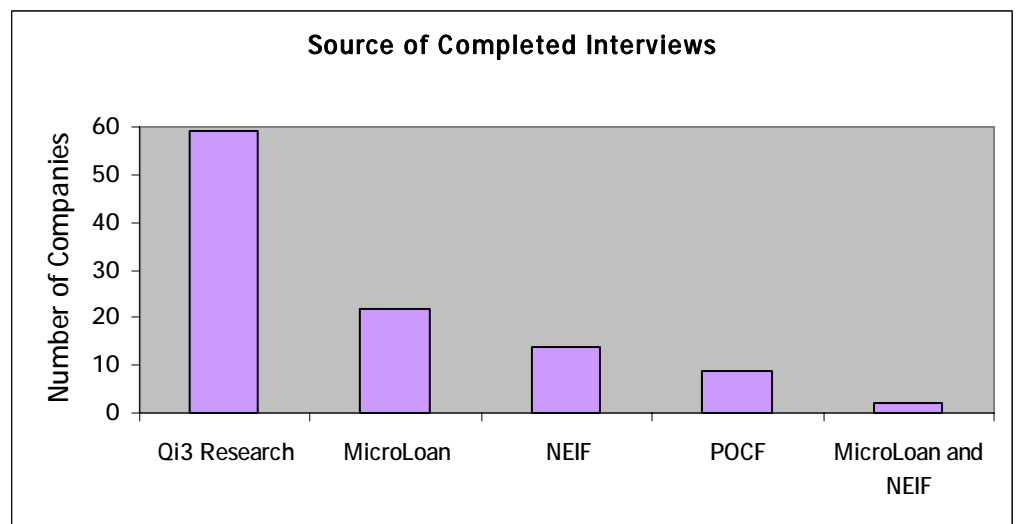
It is important to emphasise that our study has focused on business perceptions of access to finance in the region. For businesses, perception is reality, and the region should take care to ensure that sufficient thought is given to reducing perceptual gaps through its support measures and their marketing.

Graphics relating to the statistics quoted below are provided in Appendix C.

#### 5.1.1 Survey Selection

Targets for both the face to face survey and the telephone survey were identified from three sources. These were lists of companies receiving finance (Micro Loans from Business Link, NEIF3 from NEL and proof of concept and NECOIF from North Star Equity Investors) since early 2004, the results of Qi3 research and a bought-in list of SMEs. The face to face interviews were biased towards the former. The telephone interviews were taken more uniformly from the 3 sources.

The distribution of interviewees across the sources is shown in the figure below:



It was refreshing to encounter a high level of willingness on the part of the companies and their directors to participate in both surveys. Although there were difficulties in making contact with people because of the holiday period only about 15% of those with whom we did make contact refused to be interviewed. In general people were very open and willing to talk about their finance related issues and interviews often exceeded their expected lengths as interviewees used the opportunity to talk more broadly about other business issues.

#### 5.1.2 Segmentation

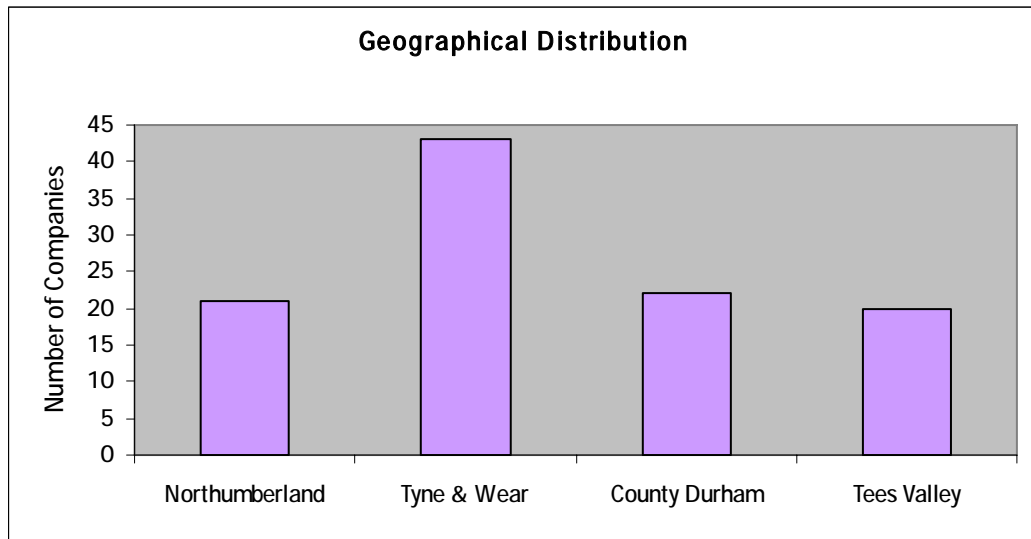
The surveys have been segmented in 3 ways: by geography, industry and company size. We were also conscious to look at a range of industry types and not to be biased towards high technology companies or those particularly attractive for venture capital funding.

**Geography:** the North East comprises the counties of Northumberland, Tyne and Wear (which includes the urban areas of Newcastle, Gateshead and Sunderland), Durham and Cleveland (Darlington, Middlesbrough and Stockton-on-Tees). It stretches as far as Berwick-upon-Tweed in the north and includes the Northumberland National Park in the Pennines over to the west. Although the face



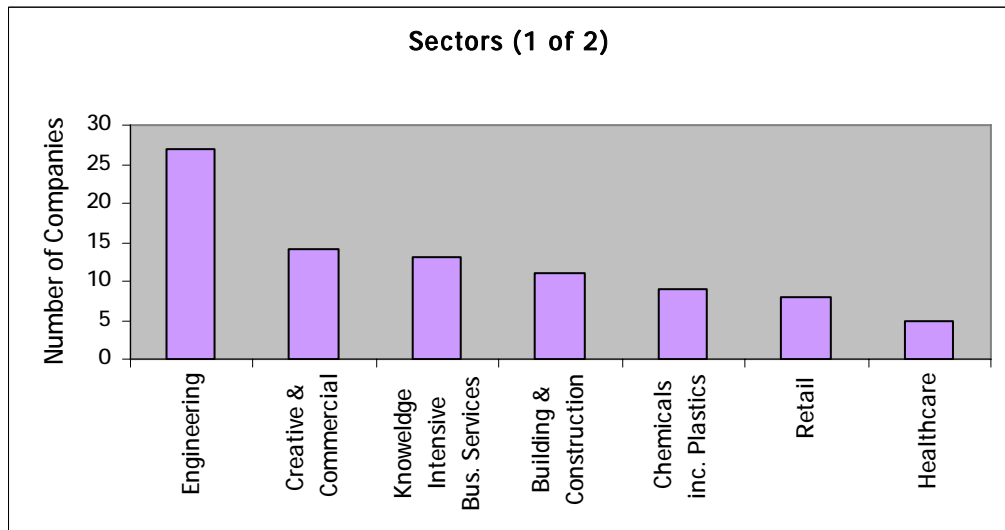
to face survey was biased for practical reasons towards Newcastle and Durham the telephone survey covered most of the region.

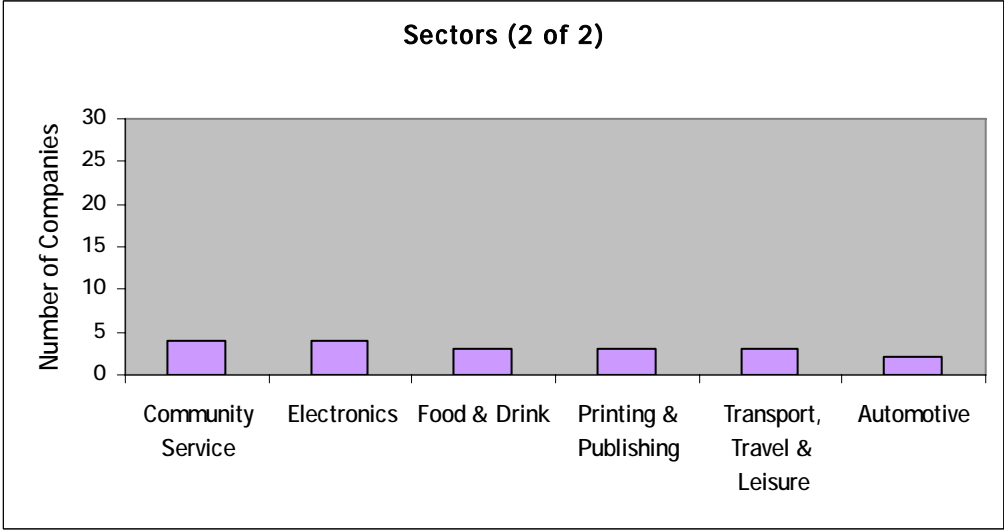
The geographic distribution of interviewees in both stages of the study is shown in the figure below.



**Industry:** the industry picture of the region is defined by both its past and recent plans for the future. On the one hand there is still a heavy emphasis on the industries of the past mainly 'engineering'. On the other hand the Centres of Excellence have built on both this tradition and on the competences of the region's universities to target developments in other industries. There is also the recent call centre phenomenon. This study looked at companies in most industries, traditional and developing ones.

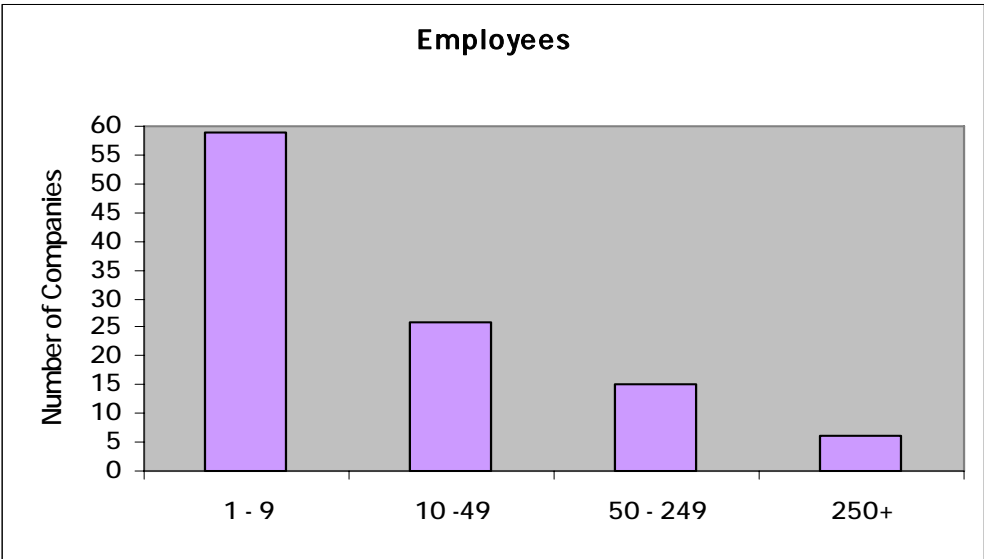
The industry distribution of interviewees is shown in the figure below. Note the continued importance of engineering to the region.





**Company Size:** although the mandate of this work was to look at access to finance for SMEs and this defines reasonably precisely the sort of companies in which it is interested we also looked as companies at both the smaller (micro companies) and larger ends of the spectrum.

The distribution of interviewees according to the size of their companies is shown in the figure below.



## 5.2 Demand for Finance

The companies surveyed have a total current turnover of nearly £750million and raised a total of over £116 million in funding over the last 2 years. They forecast a similar demand over the next 2 years. The spreads of this demand according to the different company sizes is shown in the figures below.

Size of company	Number of companies	Number of employees	Revenue £million	Finance £million	
				Past	Current and near future
Large	5	3200	490	88	92
Medium	9	1190	163	12.7	26
Small	18	855	57	5.5	6.0
Micro	70	402	21	9.9	13.7
No data	4				
Total	106	5695	731	116	138

Finance Demand vs Company Size

Although several companies expressed frustration with the process whereby they secured finance, only a small number declared themselves to have been unsuccessful. There is perhaps an attitude to 'get on with it' and to find ways around the obstacles which are encountered and this is exemplified by the limited number of comments under highlights and lowlights relating to the last financial experience and to the large number of interviewees who have said that they would go about the exercise in a fundamentally similar way next time.

## 5.3 Financial Advice

### 5.3.1 Barriers to Financial Advice

Of the 106 companies surveyed 38% explicitly said that they did not perceive any barriers to getting good financial advice. Of those who expressed dissatisfaction 11% cited poor information and 11% the absence of good support from advisors. Business Link was mentioned several times, sometimes positively and sometimes negatively. Several respondents were also critical of banks suggesting that they were more interested in selling their products and services than in giving good advice.

When they were asked specifically about 4 potentially contributing barriers to getting good financial advice they responded as shown in the table below.

% of sample	Barrier	Enabler	Not an issue	No input
Knowledge and skills	19	15	65	1
Information	35	7	45	3
Support	27	25	45	3
Networks	15	19	58	8

Access to good information and getting good support from advisors are again seen as issues

### **5.3.2 Sources of Financial Advice**

Over 50% of those surveyed named their banks or their accountants as their first point of contact for financial advice. Significant numbers also named Business Link and internal sources (co-directors and non-executive directors).

When they were prompted to name all sources of financial advice banks (46%) and accountants (32%) were again the most frequently named source followed again by Business Link (30%).

### **5.3.3 Membership of Networks**

There is limited knowledge and participation in business networks in the North East. Business Link has the highest knowledge (80%) and participation (44%). Chambers of Commerce were also well known (77%) but had lower levels of participation (25%). The region's Centres of Excellence were known by 64% of interviewees which is a good score given that many would have no reason to be aware of them. Several interviewees also cited the Federation of Small Businesses. The networks associated with venture finance scored poorly and this is perhaps because they are perceived as being exclusive; for example membership of the Entrepreneurs Forum is by invitation.

## **5.4 Financial Experience**

### **5.4.1 Most Recent Financial Experience**

The interviewees were generally very willing to talk about their most recent financial experiences. 54% reported seeking extra funds to support growth; 19% had needed funding for working capital.

46% companies secured simple loans; 11% secured grants. 18% sold equity in their business; of these one half also took on extra debt.

In responding to questions about this experience we very much received the impression that most companies got through a not all together pleasant experience and moved on. There were few strong comments and many companies said that if they had to do it again they would do nothing differently.

Amongst the limited number of highlights recalled 16% people were complimentary about the quality of support which they had been given. Business Link again was mentioned frequently. 12% of people were also pleasantly surprised that the process had run so quickly. There were more negative comments (lowlights) but surprisingly they related to the same categories. 19% of people were unhappy with the support which they had been given and were generally critical of banks. 15% of interviewees complained that the process had taken too long. Others described it as being stressful.

When asked about their approach to their next financial experience 28% said that they would do nothing differently but over one third said that they would make some form of change. 35% gave no answer. A significant number also said that they would seek more support. 18% said that they would fundamentally change their approach to seeking funding; 9% said that they would prepare themselves better before they began the exercise.

### **5.4.2 Next Financial Experience**

71% of companies said that they anticipated raising funds in the future. About 80% of these said that this would be used for growth. Most of the remainder talked about needing to fund working capital; just 3 mentioned restructuring.

35% of interviewees said that they would be willing to sell equity in their companies in the future. This is a high number but it does not differentiate between the sale of equity to increase the capital base of the company and its sale to enable the owners to 'cash in their pensions'.

### ***5.5 Expectations of ONE NorthEast and the Region***

When asked about the one thing that ONE NorthEast and the region could do to support their businesses over one quarter said that it should be more active, promoting the region, stimulating activity, getting out and making itself known. A similar number said that it should simplify itself, make its activity more transparent and make it an easier organisation with which to deal. 8 people suggested that it play a more active role in making capital available and 7 asked that it enable more grant funding to be possible.

Some 9 people expressed no knowledge of ONE NorthEast and so felt unable to say what it should do; 7 said that it should do nothing.

## 6 Access to Finance

### 6.1 Supply of Finance (Current Versus Ideal)

#### 6.1.1 Overview

It is clear from our interviews with intermediaries, finance providers, and businesses operating in the North East that, although there is now a relatively rich set of financing options available to start-up and developing small and medium-sized businesses, there are a number of failures in the communication chains that potentially link appropriate finance to good business opportunities. These shortcomings surface in poor awareness of the role of appropriate financing in the development of a business, poor signposting of where and how to obtain the relevant finance, poor presentation of business cases for financing, and poor preparation of the business itself for investment. The funding provisions themselves may appear continuous but may not always be appropriate for the types of businesses being created. While none of these issues is unique to the NorthEast, they are particularly important when such significant improvements have been made, over recent years, in the availability of various forms of external finance.

Not identifying finance requirements early enough may result in missed growth opportunities, inappropriate finance being sought or higher than necessary financing costs, all of which are occurring in the North East today.

- Many start-ups and SMEs do not have the financial skills to optimise cash flow and anticipate needs for external finance
- Some start-ups and SMEs are funding growth inappropriately and not making optimum use of factoring, invoice discounting, and external finance
- Funding providers need to be more transparent over what is on offer, for what purpose, selection criteria, response timescales, and progress information

There are a confusing number of financial schemes, each with restrictions on applicability - e.g. former coalfield locations, greenhouse gas reduction, high growth technology, assisted areas, job creation targets, scale, or form of investment - e.g. grant, loan, equity and combinations.

These schemes are administered by a variety of organisations (DTI, ONE NorthEast, local government officials etc) or finance providers (Barclays, Royal Bank of Scotland, NorthStar Equity Investors Limited, Northern Enterprise Limited, Northumbria Enterprise Limited etc).

The exception is where the business is raising larger amounts and has access to corporate finance departments of larger accountants or specialist corporate finance advisors, although many businesses regard this advice as too expensive, despite rates in the North East being lower than elsewhere<sup>x</sup> in UK. Business Link advisors appear to reinforce this perspective by their preference for referrals to low-cost Regional Financial Services rather than the private sector corporate finance advisors. There is an advice gap with some firms willing and able to access advice from the specialist corporate finance advisors, such as Quantum Corporate Finance and Tait Walker or the corporate finance groups of the major accountants such as Grant Thornton, KPMG, or Price Waterhouse, etc. active in the region or nearby; many others do not have access to this specialist quality-assured advice.

More established and even high growth businesses have more complex issues mostly around the balance of equity and debt finance. The cost (in equity and/or fees) of raising sums as low as £1 million can be prohibitively high and prevent these firms obtaining best corporate advice on finance.

Difficulty accessing information reduces awareness of the support and finance options available.

A minority of firms have difficulty obtaining access to very modest amounts of start-up or early stage finance due to lack of business track record, poor credit history, or are from a disadvantaged group. The main barrier is lack of awareness of the available sources of finance also knowledge of the providers approval criteria and process requirements. Project NorthEast's Micro Loan Fund seems to work exceptionally well with a very low write-off rate and has some capacity to expand. The Regional Micro Loan Fund is understood to have a higher write-off rate as does, understandably perhaps, The Prince's Trust.

Many firms still do not understand that banks are not sources of risk capital; are not aware of the value of factoring or invoice discounting, do not conserve cash effectively for organic growth, and often perceive equity based finance as last resort finance due to a perceived loss of control. That said "entrepreneurs always prefer loans" as one veteran financier opined.

Going forward we believe that the current landscape of funding in the North East is appropriate and largely sufficient. However it can improve and should develop to better respond to the regions needs going forward in terms of the funds themselves, as outlined below, and in terms of the infrastructure which connects them with potential users as described in the model above. The elements of this infrastructure (knowledge and skills, information, support and networks) are addressed in connection with the demand for finance later in this chapter.

### **6.1.2 Grants**

Grants are recognised as an increasingly counter-productive means to stimulate business growth other than in very specific circumstances such as are addressed by the various aspects of the grants for R&D and Selective Finance for Investment schemes; each of which involve an element of matched effort or funding.

### **6.1.3 Equity**

Equity Finance secured against current or future equity in a developing business is necessarily difficult to obtain and requires the investor to be convinced that the business will grow quickly enough and with high enough margins on its revenue to generate a substantial return on capital within a limited number of years. A complex relationship exists between the perceived risk, amount of capital injected, projected growth rate, and time to exit which contrive to increase the amount of equity sought by the investor and resisted by the investee. Equity finance of very early-stage businesses is especially difficult with those investors prepared to deal in this area perceived by businesses to demand 'greedy' amounts of equity to offset their risk. This is of course a common perception, but we feel that this may be partially overcome by better coaching and explanation to companies of the valuations upon which equity stakes are proposed.

### **6.1.4 Loans**

Loans are favoured by most entrepreneurs as a means of raising the necessary capital without ceding any control of the future business. They are understandably difficult to obtain before a firm is generating revenue as notional interest accrues to increase the debt burden. Nevertheless many businesses with a sound proposition, good management, and a well-defined business plan have the potential to service the resulting debt in the medium term if they are given the opportunity. Most of these businesses do not have the 'star appeal' level of projected growth to attract venture capital nor the revenues to support a conventional bank loan, with or without the Small Firms Loans Guarantee scheme. The NEPOC Fund works well as a starter but is capped at £60 thousand, after which businesses are encouraged to cede equity for modest amounts of risk capital, although if a scheme such as NERIF3, with its lower equity demands, operated closer to the top threshold of the NEPOC Fund, a continuum could be restored up to the levels where Enterprise Capital Funds may operate.

It may be desirable, therefore, to extend both the range and scope of NEPOC and NEIF3, or equivalent, primarily debt-based funds as a direct continuation vehicle for milestone-based debt finance of early-stage firms with equity finance. If feasible, such a scheme, alongside simpler, more transparent, evaluation procedures and appropriate quality-assured, training, coaching, mentoring services should offer a continuous, readily understandable and hence more accessible, ladder of sub-£1 million finance from just two sources of funds.

## 6.2 Demand Side (Current Versus Ideal)

We have found it useful to characterise the demand side of access to finance in terms of the knowledge and skills of the management of the companies seeking finance, the information to which they have access, the support which they get and the contribution which networks can make.

These four dimensions are not independent and improvements in one will generally result in improvements in others. This is shown in the matrix below.

		improvements in these dimensions			
		Knowledge and Skills	Information	Support	Networks
deliver additional improvements in these	Knowledge and Skills		managers develop specific knowledge and skills	managers can learn from the input of third parties	managers can develop knowledge and skills through networking
	Information	managers are better equipped to decide how to access information		support agencies can complement information from other sources	networks can complement information from other sources
	Support	managers are better equipped to know where to go for advice	support agencies can deliver better and more well informed support		support agencies can learn and better target their activity
	Networks	managers are better equipped to discuss issues with network	managers are better informed; can share knowledge	support agencies can make a better contribution to network activities	

Dimensions of Demand for Access to Finance

### 6.2.1 Knowledge and Skills

Although only 19% of those surveyed cited their own knowledge and skills as being a barrier to gaining access to finance it should be noted that this is still a significant number and given the independence and general intent on finding a solution which characterises people in the north east it perhaps does not give the complete picture.

It is believed managers in the North East, in common with managers elsewhere, develop knowledge and skills largely as they go along and in response to what they need. This inevitably gives them a narrow base with which to operate and may limit their ability to address situations as they arise.



It is probably also a truism that what are often perceived as financing issues are in fact more general management issues and this lack of knowledge and skills can result in the wrong response to such a situation. It is therefore our belief that there is a need for a mechanism to raise the general level of management capability in the north east and not simply to address it in terms of finance.

Business Link today plays an important role. By way of its diagnostic programme it signposts businesses to a wide range of locally-available (RFS etc) short courses and there are several mentoring schemes, including Entrusts' 'Money with Management' concept to provide more intimate coaching and advice.

The RFS (Regional Financial Services) programme has been provided by Entrust and in future NSTAR to offer financial expertise and consultancy to SMEs in the North East. It is sponsored by ERDF and ONE NorthEast and supported by the Regional Business Links, to spearhead a region-wide service helping businesses get the advice they need to deal with critical financial issues.

However there is always an incentive to fill publicly-backed courses with numbers attending taking precedence over suitability of participants. In particular, the investor-readiness training course seems too short and poorly-focused to achieve its objectives, especially if many participants are essentially investors rather than the core teams of emerging businesses.

The ideal situation will be one in which management of micro firms and SMEs have continual and easy access to a learning environment whereby they can self assess their own needs and develop relevant capabilities within the context of their day-to-day activities. Business Link is generally regarded as being the appropriate agency to enable this to take place but is perhaps reactive and not always perceived as being of the highest quality. A revitalised Business Link would take a proactive stance and would provide an environment whereby managers could self assess and take on board improvement in advance of need.

ONE NorthEast might also look at the provision of training within the RFS umbrella and look at ways that this can be better integrated with other training available in the region. It is a strongly held belief that finance is just one of the many issues which managers need to be able to address and to split it out gives it an inappropriate focus.

Although there are many providers of management training in the North East these are often run with a view to maximising participation rather than to delivering the right training to the right people at the right time.

The range of training options needs review to ensure that it is focussed on what is needed and is promoted accordingly.

Critical to success, as identified in SQW's report to SBS<sup>xi</sup>, will be measures to overcome aversion to external finance, preparation of compelling business propositions, and persuasive presentation of those propositions.

### **6.2.2 Information**

About one third of the people surveyed said that information was a barrier to being able to access finance. This is not surprising given the number of different sources and the various rules which apply. However it should be noted that ONE NorthEast has produced a summary in an A5 ring binder summary 'Access to Finance: Your guide to funding' which is a good start. Unfortunately there is no obvious link to this guide on the ONE NorthEast web-site (although there is an excellent summary available if you look for it). It has been produced in partnership with Business Link and distributed to intermediaries such as accountants. Although other past initiatives have addressed intermediaries, none of these appear to be recent. We feel that intermediaries are an important audience to be readdressed in future. In particular, this includes accountants and bank managers of regular SME companies, not just the higher level corporate finance houses.

There are also two Business Link 'No Nonsense' guides, to 'small business funding' and 'to finance for high growth companies'<sup>xii</sup> are also good reference materials for qualified intermediaries but are perhaps not sufficiently clear for use as primary sources.

There needs to be greater transparency on all funding options available, including their purpose, selection process, and response timescale.

Funding providers need to do much more to reduce aversion to external finance and clarify what exists, on what basis they are offered, the selection criteria used, and expected response times for key stages of any application. This may also require an increased shift from equity to debt finance.

ONE NorthEast and Business Link need to do much more to de-mystify the available sources and purpose of risk capital of all forms. The existing book and web guides are a start but do not readily signpost a user to the most suitable type of funding or fund provider

Several interviewees asked for some form of 'one-stop shop'. This is believed to be impractical given the ultimate complexity of much financing (see below) but this should not mean that there should not be an easy entry point for companies needing information about finance and ONE NorthEast should provide an easy link on its web-site to replicate its A5 binder. This should furthermore be widely communicated through Business Link and other advisors. Such a link should not be seen as an alternative to getting expert advice but complementary to it.

There is a need for greater transparency of information about sources of quality-assured business and financial advice.

### **6.2.3 Support**

Support, or lack of it, is as big an issue as information and sources of support can be divided into three groups.

The first group comprises those people closest to the business: the managers themselves, their friends and family, their fellow directors, non-execs and other immediate business contacts. This group will provide better support as its knowledge and skills are increased, as information is more readily available and as a consequence of increased networking. Note that support by this group is largely ad hoc and there is little quality assurance.

There is one other way in which advice from this group could be enhanced and that is by the increased involvement of non-executive directors. In common with everywhere else companies in the North East do not make sufficient use of them and the contrary should be encouraged.

The second group comprises the 'traditional' professional advisors: accountants, lawyers and banks. As noted above this group is easily the most important source of support and it received a mixed press. Accountants were generally well respected but too often banks were regarded as ill-informed and/or more interested in selling products than in providing the support which their customers need. Lawyers by and large did not figure as being important sources of financial support. ONE NorthEast could take a leadership role and orchestrate better support by these groups through local professional fora.

There is a strong argument for the establishment of some form of quality standard which would identify those people whose advice can be used with confidence because it is both expert and independent.

The third group comprises the non-traditional advisors: specialist financial advisors and other paid for business advisors and mentors (who are defined for the purposes of this study as being pro bono). This group also includes Business Link and the Centres of Excellence. This activity should be encouraged but it is important that the standard of support be high and that it is visible and easily available. Providers of support should also be encouraged to provide it in such a way that the recipients benefits beyond simply getting support. It is important for the region that such support also results in an overall raising of knowledge and skills.

One final point about support: some providers of funds make it conditional on the party receiving the funds that it takes on board some paid for input. This immediately reduces the funds available, it seems cynically self serving to the recipient and too often the quality of the support is less than it should be. There is no doubt that it is appropriate for providers to want to see some improved management on the part of the recipient but some way should be found to enable this to be appropriate and to give the recipient some choice as to how it might be provided.

There is a need for more user choice in the selection of mentors and business and financial advisors. The referral relationship between Business Link, Regional Financial Services and the public sector financial providers needs to be loosened and efforts should be made to bring in more mentors from outside the region.

#### **6.2.4 Networks**

There is little appreciation of or involvement in networks in the North East. Although many respondents to the survey recognised Business Link, not strictly a network, and Chambers of Commerce few claimed any significant networking activity. This appears to be a major weakness of the North East.

Good networks are a mix of opportunity, insurance and safety net and provide an informal way for companies and their managers and directors to share experience, to motivate each other and to provide support. They are prevalent in many active commercial areas and Cambridge and the East of England provide many good examples. By contrast the North East is ill-served and this perhaps reflects its history of major employers and a somewhat scattered economy. The Centres of Excellence are a start and were recognised by many respondents but it must be recognised that most businesses fall outside their ambit.

Networks rarely develop spontaneously and it is stretching confidence in the market to expect the North East to suddenly become well served.

ONE NorthEast should establish the environment within which the development of broader business networks can take place.

Specifically there is a need to stimulate business networking at three levels:

- Between businesses in a sector. To some extent this is addressed by the Centres of Excellence today and this initiative should be broadened to other sectors
- Between businesses in the sub-regions. This must be inclusive, existing business networks appear to be by invitation only and consequently exclusive
- Between business in the region and potential advisors and partners elsewhere.

Lessons can be learnt from initiatives in other regions and elsewhere:

- The East of England Development Agency's 'Destination Growth' and 'Ideas Region' multi-stream events which include financial and other business surgeries
- The Cambridge Network's Corporate 'Gateway' brings external and international investors to the region to network and do business
- National and international trade missions bring together businesses with similar interests around an out-of-region, possibly overseas, trade event supported by UK Trade and Investment

It should go without saying that such activity should be co-ordinated with other initiatives suggested above and should probably involve Business Link in some way or another.

### **6.2.5 Gender Dimension**

Although no specific focus was given to addressing the gender dimension of Access to Finance and the gender mix of contacts was substantially the same as for the business financial decision maker population at large (18 people, 17% of the survey compared with 14% of the overall database) we were able to review our findings with a stakeholder currently active in this area with ONE NorthEast. In order to achieve a more substantive understanding of differences between the genders we would need to extend the survey by interviewing up to 70 more female business decision-makers.

We were referred to key documents <sup>xiii</sup> which highlight access to finance as being a major barrier to business success for women. Research suggests that 'different women at different stages of their lives and different stages of business ownership face specific finance needs which are often different to their male counterparts and other women'.

There is evidence that women typically have less collateral, score less well on credit checks and pay more for loans. They are more risk averse and have a different lifestyle focus. They often work part-time, from home and have a fear of both debt and losing control.

Although women are collaborative in nature and network well within women's networks they are often excluded from mainstream business networks which are dominated by men.

Although they are generally highly skilled and are often IT literate information is not always presented in a manner which is easy for them to access.

Women are not hesitant in asking for advice but too often the source of advice is a man from an essentially masculine environment. In discussion with this stakeholder this, viz gender sensitive advice, was seen as the biggest barrier for women in successfully accessing finance. The difficulty of effective networking was second.

## **6.3 What Does this Mean for the Region?**

### **6.3.1 Implications for Business**

We have identified five or six classes of good businesses within our model as described in section 3 above. Four of these are likely to need external financial injections from time to time in order to optimise success:

#### **Stars**

These are high growth potential businesses which need a continual series of capital injections as they move too rapidly from stage to stage to finance themselves from revenue. These injections may begin with R&D grants (ONE NorthEast/DTI) and/or proof of concept loans (NorthStar/NEPOC), progressing via a series of larger loans (eg NEL (Evolve)/NERIF) or combinations of loans and equity finance from one of more fund providers (eg NEL (Evolve)/NERIF, NorthStar/NECOIF, Entrust/NEEMF) to raise up to around £1 million in capital. Further funds for excellent propositions can then be raised, usually from financiers in neighbouring regions or London.

#### **Well Managed**

These are low growth but substantial businesses that rarely need or seek substantial external capital injections but may be the target of an acquisition that seeks to release the potential of the business. These should be encouraged (using Destination Growth style events and surgeries with specialist corporate finance advisors or strategy consultants) to develop, incubate and spin out a new line of high growth business that could become a Star immediately. Such firms have real untapped potential!

### **Moderately Managed**

These are modest growth potential businesses which need external capital injections from time to time but will self-finance all but the most substantial activities. These injections are likely to be bank-financed fully-secured loans, SFLG-underwritten Bank loans where risks are not fully secured or other loan finance (eg NEL(Evolve)/NERIF). Larger amounts for excellent propositions can then be raised, usually as combinations of debt and equity finance, from financiers in neighbouring regions or London.

### **Jobbers**

These are low growth businesses which need a very modest external capital injection to begin operation and occasionally to stabilise against an unexpected setback. These injections are likely to come as unsecured MicroLoans (eg Project NorthEast Micro Loan Fund, Regional Micro Loan Fund, Environmental Micro Loan Fund).

And the rest:

### **Under Managed and/or Under Resourced**

- These may be medium/high growth potential under-resourced businesses but are unlikely to win external finance unless they round out their management to a capability commensurate with their opportunity. This is the community most able to benefit from investor-readiness training with a focus on achieving Star or Well-managed (possibly medium potential) status
- Inventors are both under-managed and under-resourced businesses that may obtain Proof of Concept Loans and/or R&D Grant to improve their lot. This is the community that benefits most from good quality business mentoring with a focus on becoming – at least as a next step - well-managed businesses
- Long terms Jobbers should not be ignored. These sole traders and other small businesses will always stay small but will benefit from increasing their skills base and from occasional access to funds to renew capital equipment and/or to work through difficult trading conditions

### **6.3.2 Implications for Intermediaries**

Business Link needs to focus on signposting, after appropriate diagnosis, the most appropriate advice available from both the public and private sector with no direct delivery mandate.

Regional Financial Services might ideally be redefined as 'Regional Business Services' by incorporating provision of many of the training, coaching and mentoring services formerly arranged by Business Link or Regional Financial Services. It would become, in effect, the service delivery arm of Business Link.

Professional Advisors should be incentivised to participate more directly in the delivery of regional business services, especially as quality-assured SME Funding Advisers, so as to ensure the best available advice is available to medium and high potential firms that are, as yet, unwilling or unable to buy their services.

### **6.3.3 Implications for Public Sector Risk Capital**

Beyond the end of the current ERDF-backed schemes, several possibilities are in planning:

- NERIF: North East Investment Fund 3b (NEIF3), extends the NEIF3 loan fund to the end of 2008 with additional funding of £12 million
- NEL Growth Fund, a £5 million equity fund, aimed at equity investment but not start-ups
- Legacy Funds, reinvesting returns from existing regional funds with a current aggregate value of around £50 million due to close between 2011 and 2014

It is not clear how the SEED Capital Fund will interact with, replace, or possibly compete, with existing funds and recycled legacy funds after 2012.

## **7 Conclusions**

### **7.1 Access to Finance**

- We believe that there is a latent growth potential in the region which could be released through improved flow of information, better joined-up business support, encouragement of better business networks and a focus on management skills and at least in the medium term, continued availability of public-sector backed risk capital and local fund management expertise
- Current strategy focuses too much on 'star' prospects and not enough on 'well-managed' businesses that could create increased value with greater management ambition and financial resources
- ONE NorthEast is very supply-side focused in its thinking:
  - The definition of Access to Finance in the Regional Economic Strategy is incomplete
  - The 'continuum of finance' is about supply, not access
  - The key mechanisms of access are information, support, networking and skills

### **7.2 Supply of Finance**

- One NorthEast has successfully established a 'continuum of finance' in the region
- There is still 'under-demand' not 'over-supply'. Demand requires further stimulation, mainly by making access to finance easier
- Some gaps in provision remain, these may mainly be filled by extending current offerings
- There is perhaps too much disparity between the ways in which technology focus areas and other businesses are treated
- There is considerable concern in the region about the status post-2008 when the North East will be in competition with the rest of the UK and less supported by European Structural Funding
- Our emphasis on 'well-managed' firms leads towards a greater emphasis on mezzanine/debt finance rather than equity

## **8 Recommendations**

### **8.1 Summary of Issues**

The interventions of ONE NorthEast have been very supply-side focused. Many of our proposals are based on viewing access to finance as a company (demand-led) issue. Indeed this study could be renamed 'enabling business management and growth' (company needs) rather than 'access to finance' (specific requirements for funds).

The definition of Access to Finance in the Regional Economic Strategy is confusing in that the emphasis continues to be focused on supply of finance rather than on access issues. We propose that the definition of access to finance should clearly distinguish between:

- The 'continuum of finance', whereby sources of funding for companies in the region are available from the private sector and, where not available through evidenced market failure, publicly supported finance
- 'Access to finance', which we define as the combination of information provision, networking, business support and management skills which together enable companies to access finances effectively. Gaps and mismatches in supply-side organisation by finance providers and lack of skills and ambition in the demand-side give rise to suboptimal access to finance

There is under-demand rather than over-supply of finance for SMEs in the region. Whilst we found some evidence to support a perception of short-term over-supply, other evidence showed that further demand is present and could be further stimulated. We believe that there is considerable scope to make access to finance easier for companies and this will stimulate demand.

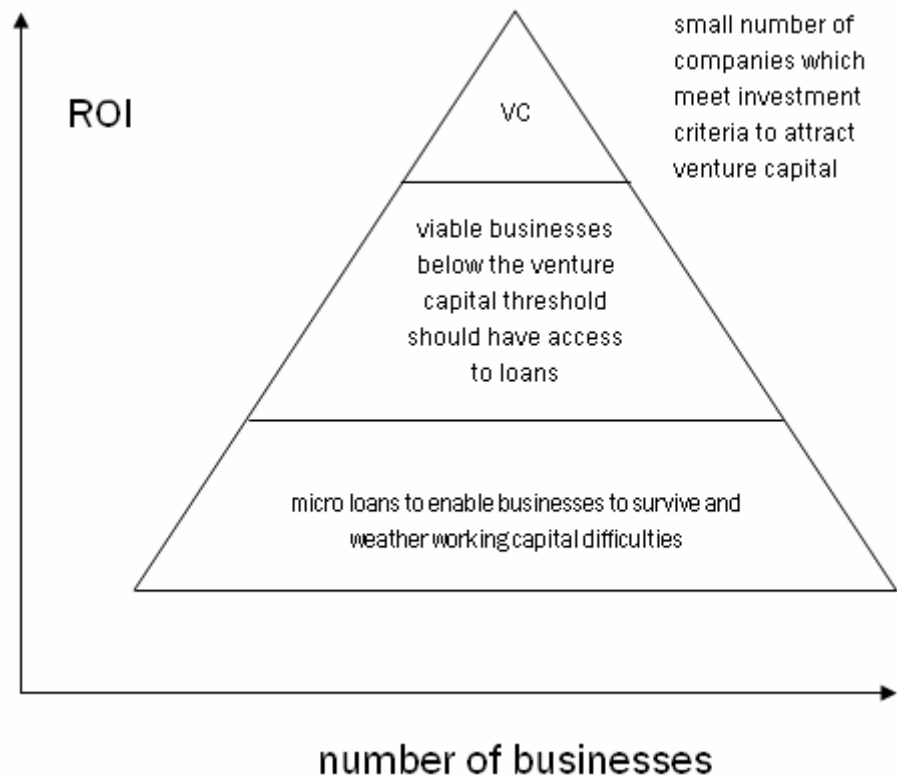
The region rightly focuses on 'star' high-growth potential businesses and these require special attention through business support and a mix of grant, debt and equity finance. Nevertheless, there are many 'moderate' and 'well-managed' businesses that have scope for growth but which cannot offer the return on investment demanded by equity investors. These businesses represent a significant opportunity for the region and should be targeted with business support and primarily debt or mezzanine finance.

### **8.2 Supply of Finance**

#### **8.2.1 Suggested Areas for Funding Intervention**

This study has focused on the means by which companies access finance in the North East of England, and potential improvements in the information flows, networking, business support environment and skills that enable access to finance. This investigation and discussion with a wide range of companies has allowed us to gain some perspective on the public sources of finance offered in the region. Please note that we have only partially quantified potential demand for these sources or assessed their fit to State Aids regulations.

Our study reinforces our support for a pyramid of financial provision as illustrated in the figure below and developed later in this section. This pyramid clearly sees the need for a continuum of finance with 'risk tolerant' loans bridging the gap between micro loans on the one hand and equity on the other.



Pyramid of Financial Provision

### 8.2.2 General Proposals

We are assured by the fund managers that each of the funding schemes offered in the region is expected to be fully expended. We believe that easing access to finance barriers will stimulate further demand.

Given this, we believe that new funds in the region should be either continuations of existing schemes or demonstrably extensions of the 'continuum of finance' filling in financial support in areas of market failure. Continuations of existing schemes are to be welcomed as they embed the funding principles and reduce the further confusion caused by scheme proliferation.

We believe that there are many businesses in the region that may generate employment and profits for their shareholders without meeting the rate of return criteria of a market equity investor. These businesses are not the 'stars' that attract venture finance but the 'well-managed' or 'moderate' businesses that make up a far greater proportion of the regional economy. We thus believe that these businesses should be offered loan rather than equity finance in conjunction with other forms of business support. Public support for loan finance should continue to be offered at the level of risk beyond that usually available from banks.

The distribution of early stage equity finance is uneven between technology and other businesses. Whilst pre-revenue early stage technology companies face specific finance issues, we see merit in extending existing schemes to cover a broader sector base. The deciding factor in equity investment should be growth potential, not sector.

The tie between certain forms of public sector finance and requirement for advice is well-intentioned but gives rise to criticism given the closeness of the financial and business advice community in the region. Recipients of these funds should be given choice in selection of suitable mentors and perceptions of the value of mentoring support need to be addressed.



The survey evidenced criticism of the organisations managing funds and the complexity of gaining funding. There will naturally be many individual cases where perceptions are tarnished by rejection. Nevertheless, attention should be given to the perception of the process of fundraising through the publicly supported schemes. In particular, there should be greater distinction between independent signposting business support and the administration of public funding schemes. There needs to be clarity and confidence in the roles and boundaries of these organisations. NStar, North Star, NEL and Entrust should be encouraged to develop clearer information about their roles in brokering and finance provision, perhaps using clear branding for these roles.

### **8.2.3 Specific Proposals**

#### **Proof of Concept Funding**

We understand that demand for the North East Proof of Concept Fund is considerably higher than the funds available. ONE NorthEast should consider a significant extension of POC to allow additional projects to be funded within its existing remit and for broadening to suitable non-technology early stage business opportunities. We believe that this form of finance does not compete with private sector finance. After consultation with the fund managers, we believe that about £2.5 million per year, equivalent to the current rate of expenditure, should continue to be set aside for this purpose.

The 'continuum of finance' at present has a gap between proof of concept and co-investment funds. Successful completion of proof of concept does not necessarily lead to the investment readiness required to secure external investors. We suggest that ONE NorthEast should investigate the potential for both mezzanine and equity funding of early stage technology businesses at a higher level than currently available. Our consultation with companies and the fund managers did not yield a consensus on the exact targets, but we surmise that funding of around £500-750 thousand maximum per deal and approximately £2.5-4 million per annum would be appropriate to plug the gap. This builds on the central and regional government support to R&D by extending financial support away from grant finance in cases where a viable business will be the outcome. The purpose of these funds should be to enhance technology readiness levels at the pre-revenue stage and enhance the attractiveness of such businesses for first round investment. Some of this need may be met by the Regional Venture Capital Fund and the Seed Capital Fund, so some further work will be needed to establish the gap.

Particular care should be taken to ensure that the means of application for NEPOC and NECOIF equity finance is simple and transparent.

#### **Loan Funds**

The North East Investment Fund is clearly a long-standing and popular means of providing access to finance for companies at greater risk than will be borne by the banks alone. We are concerned that there is too much emphasis on micro businesses, but there are 'well-managed' companies at the 10-250 employee level that lack access to growth finance because they are not suitable for equity investment and cannot offer sufficient security to the banks. These are real growth opportunities for the regional economy. We suggest that ONE NorthEast should investigate whether such mezzanine finance could be made available at a higher level (to at least £1 million).

We understand that demand is currently running at £4.5-6 million per annum. This will increase substantially if a number of larger loans are made each year to address this group of companies. Consultation with the fund managers indicates that this would require an additional £5 million per annum because of the average deal size.

Such offerings should be designed to operate above the level offered by the North East Investment Fund and the Small Firms Loan Guarantee scheme.

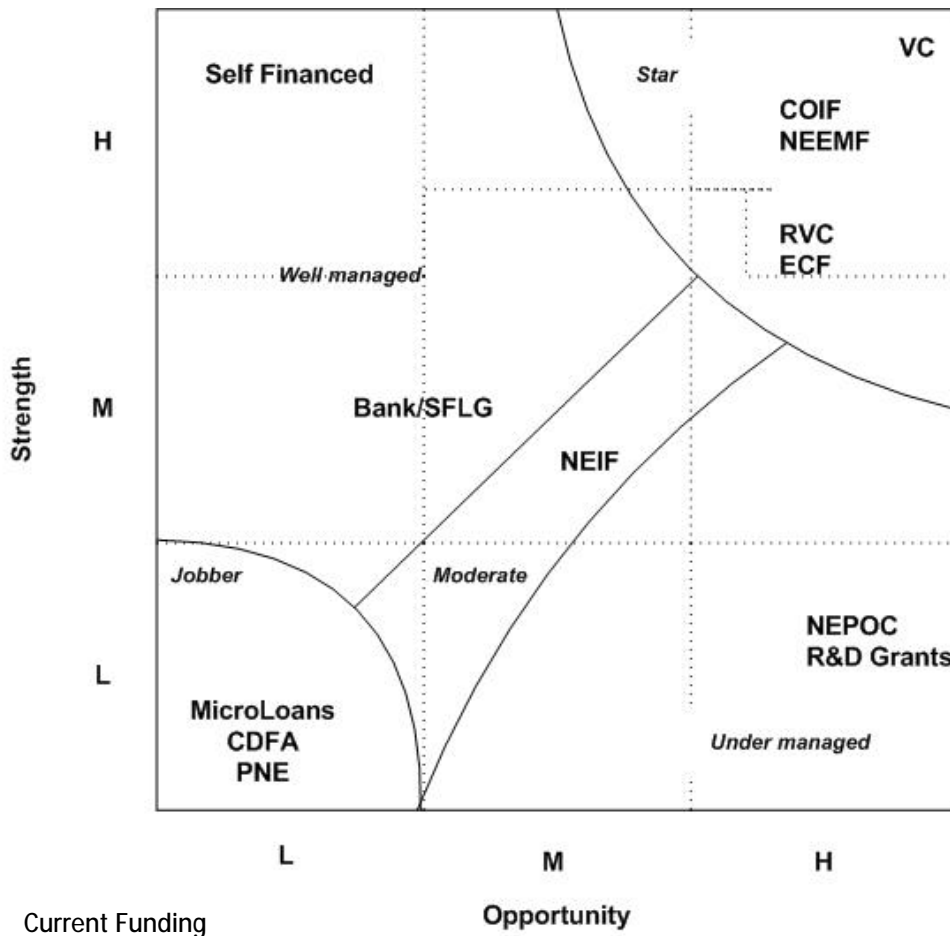
### Loan Based Micro Finance

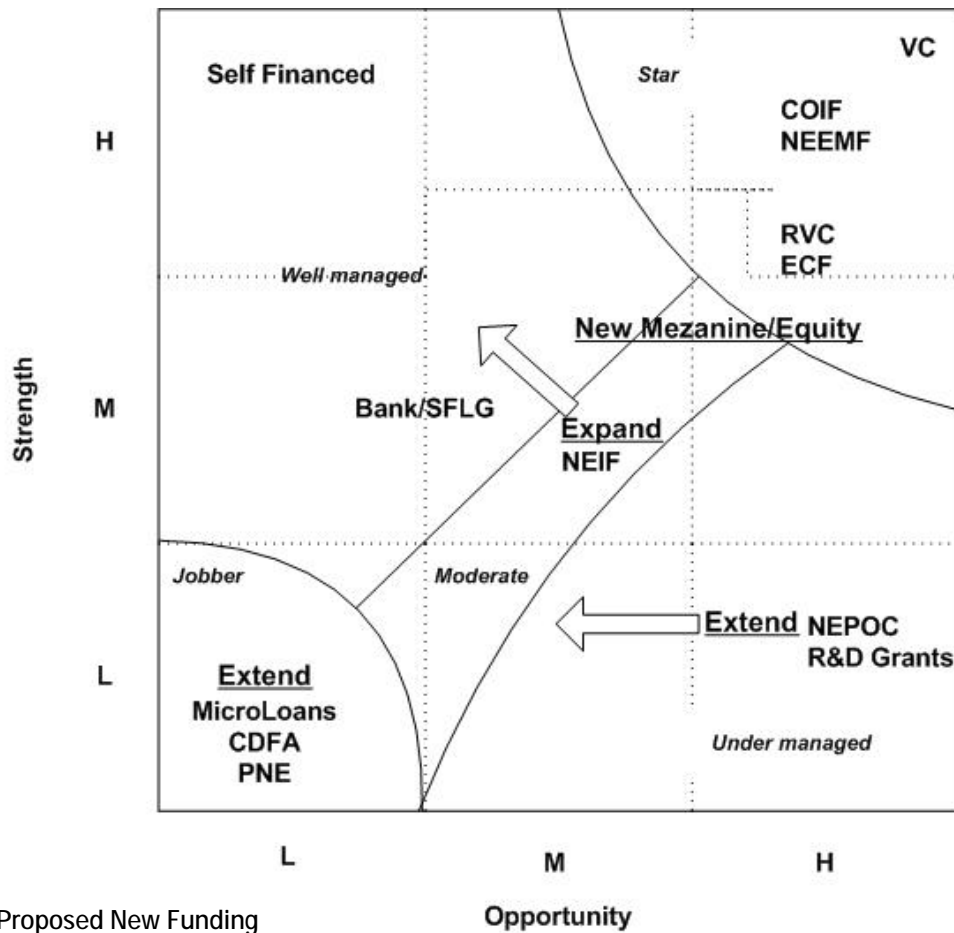
Small loans through the Micro Loan Fund are offered at high risk to companies that are struggling or those that need small unsecured loans to bridge a gap in working capital. We came across several instances of 'jobber' companies where such loans have been vital in protecting employment. Whilst helpful in individual circumstances, such intervention is at high risk and unlikely to create or protect significant employment. Nevertheless, there is a case to continue such intervention and in exceptional cases, business owners may be encouraged to develop the management skills and ambitions to become larger, 'well-managed' businesses.

We are not clear as to whether there is a gap between the Micro Loan Fund and the Small Firms Loan Guarantee or North East Investment Fund schemes. There is contradictory evidence about the experience of companies in raising Small Firms Loan Guarantee finance, and recent changes in the flexibility of the scheme.

The average size of North East Investment Fund Loans has increased to over £100 thousand. This leaves a potential gap in the 'continuum of finance' at the sub-£50 thousand level. If this is the case, there may be grounds for extending both the scale and volume of the Micro Loan Fund. We are advised that the Micro Loan Funds are being expended at a rate of about £1m per annum and this recommendation may give rise of an increase to allow larger loans to be made.

We could not understand why there was more than one source of Micro Loan Funding. ONE NorthEast should consider pooling these funds and unifying their management to improve coherence, whilst retaining the remit of the targeted groups.





### 8.2.4 Summary

We feel that the current availability of funds meets most needs, current and developing and that ONE NorthEast should resist the urge to create new forms of finance unless there is a demonstrable need. Existing forms of finance should be extended and broadened in preference. Specifically:

- The North East Proof of Concept Fund should be extended beyond its current lifetime and broadened to include non-technology business opportunities
- Equity and mezzanine loan funding should be made available to bridge the gap between proof of concept and co-investment funding from £100-750 thousand
- The North East Investment Fund should be extended to allow loans of up to £1 million to promote development of 'well-managed' SMEs (but not micro companies)
- Micro Loan Finance clearly has a role and should be extended, with careful targeting. The upper limit should be increased to £50 thousand for deserving second-tranche cases

## **8.3 Access to Finance**

### **8.3.1 General Proposals**

We found that there is considerable scope for improving access to finance for companies through improved flow of information, better joined-up business support, encouragement of better business networks and focus on management skills.

Such actions should be targeted by the five types of business that we have identified. Most resource should be targeted towards 'stars', 'well-managed' and 'moderate' businesses. 'Jobbers' and 'under-managed' businesses may consume resource without yielding growth, but care should be taken to encourage the exceptions to this, and availability of micro finance remains valuable.

It is important that ONE NorthEast should recognise the urgent need for improved networking and more joined-up business support as a means for stimulating demand in advance of 2008.

### **8.3.2 Specific Proposals**

#### **Information**

ONE NorthEast and associated bodies are blurred – which provide independent advice and which are promoting their products, causes or businesses? This should be explained much more clearly in literature.

The survey highlighted confusion over flows of information. Some respondents would like a 'one-stop shop' approach to business advice. We believe that this is not healthy in terms of the variety of personal advice that can be offered. Nevertheless, a single web site signposting funding sources, networks, business support and skills development opportunities would provide a better overview for companies and intermediaries. Such an information source would also be an alternative to expensive business support for companies that are identified as being outside the priority targets.

#### **Business Support**

ONE NorthEast finances the Regional Financial Services initiative, the Centres of Excellence and, from April 2007, the regional Business Link contract. These sources of business support are not seen as being joined-up in any way. Other business support services are financed by the universities, charities and sub-regions, making the overall network very complex. In particular, there should be greater distinction between independent signposting business support and the administration of public funding schemes. There needs to be clarity and confidence in the roles and boundaries of these organisations.

ONE NorthEast should consider the potential for those business support organisations which it directly finances to agree an 'account management' system whereby companies are offered a single point of contact for independent signposting support. Companies should have the discretion to ask for an alternative individual as the trusted relationship with their account manager is paramount.

The proposed account management programme should specifically include:

- High potential growth companies (rising stars)
- Moderate and well-managed businesses (these are opportunities currently not well identified in the region and offer significant potential)
- Intermediary groups, particularly accountants, bank managers and the corporate finance community

In order for companies to have confidence in exercising the choice recommended above it might be appropriate to implement some form of quality standard which recognises the role of a 'corporate financial advisor'.

### **Networking**

Business managers benefit from local, regional and in some cases national and international networks. Such networks provide access to peers, potential advisors and sources of finance. Whilst there are business networks in the region, they lack penetration and activity in the key groups that must be encouraged to develop their skills, ambitions and attitudes towards growth. Some of the more relevant business networks are narrow in focus or exclusive in membership.

ONE NorthEast should sponsor business networks that attract target companies and provide independent signposting to sources of business support, finance and training.

### **Management Skills**

We perceived an attitude of self-reliance amongst managers interviewed in the survey. They seemed also to lack appreciation that development of management, business planning and financial skills could enhance their business prospects. Existing investment readiness courses have been narrowly focused. ONE NorthEast should look at the development of broadly-based management skills as a key priority offered alongside the proposed network development and targeted business support activities. This activity should include the provision of mentors and recruitment of non-executives to target companies.

### **8.3.3 Summary**

We believe that there is a latent growth potential in the region which could be released through improved flow of information, better joined-up business support, encouragement of better business networks and a focus on management skills and at least in the medium term, continued availability of public-sector backed risk capital and local fund management expertise. 'Access to finance' should be 'Access to Growth Opportunities' – the issues are about management skills and ambitions as much as finance.

It is important to emphasise that our study has focused on business perceptions of access to finance in the region. Whilst these perceptions will often differ from reality, the region should take care to ensure that sufficient thought is given to reducing perceptual gaps through its support measures and their marketing.

Specifically:

- An independent quality-assured business support sign-posting account management programme should be urgently implemented:
  - This should be led by Business Link from April 2007 and supported by NSTAR (Regional Financial Services programme) and the Centres of Excellence
  - Companies should be subject to a metric-based diagnosis and support offered by category, focusing resource where it can have most effect
  - Independent signposting must be separated from funds promotion.
  - Confused branding should be avoided where ONE funds are the source
  - Accountants and bankers should be targeted for account management to leverage their contacts
  - Companies should be able to select their account manager
- One NorthEast should urgently encourage the development of business networks, following best practice in other regions
- A single web site should be established with supporting collateral to signpost funding sources, networks, business support and skills development opportunities
- An over-arching programme should be developed for the enhancement of business skills, with targeted support from mentors and advisors

## **8.4 Proposals by Type of Business**

'Stars' will receive disproportionate attention and those with real skills and potential will succeed and attract the capital which they need.

However the success of the stars may attract others with unrealistic expectations of the potential of their 'under-managed' businesses. The danger is that what had been perceived as stars become 'jobbers' or 'under-managed' in a year or two and will fail to 'cross the chasm'. Investment readiness criteria are paramount.

'Well-managed' firms receive adequate attention from private sector finance providers and intermediaries but remain a significant and under-exploited opportunity for growth in the region. Support activity should include a '100 club' of selected firms with diagnostics to identify those that could benefit from further support. Account-manage and target increased awareness amongst directors and advisors (accountants and bankers). The objective must be to unlock potential without denying owners the right to run their businesses as they wish.

'Under-managed' companies are prone to product push from grants/loan sources which are not necessarily to their advantage without coincident improvements in skills. This group is the key focus area for identification of those companies that would benefit from regional business growth services.

'Moderate' businesses include missed opportunities for the region. With increased ambition, they could grow. Support should include business networking and development of an understanding of business growth potential.

'Jobbers' need pragmatic business management support through Business Link, with coaching and training through the Prince's Trust, Bridges etc. Identification of potential growth opportunities should be part of the Business Link diagnostic.

## **8.5 Action Plan / Next Steps**

The recommendations of this report are here presented as a check-list of next steps:

1. Access to Finance (general): Form a coordinating team of delivery agents (such as NSTAR, entrust, NEL, Business Link) with external facilitation, with a clear steer from ONE NorthEast towards dovetailing and common branding where appropriate.
2. Business Support: Develop positioning of key agencies, support rebranding, perception issues and implementation of a two-tier (independent signposting and tied funds promotion) corporate advice structure including vision, branding and targets / metrics
3. Networks: Develop an action plan and implement improvements in regional support for business networks, including targets / metrics
4. Management Skills: Develop an action plan and targets / metrics for management skills improvement including business planning and access to finance
5. Information: Develop a needs-driven approach to access to finance information, deliver a new web site and literature
6. Finance provision: Investigate (a) broadening of the fund remit to include non-technology business opportunities and (b) extension of the North East Proof of Concept Fund beyond its current lifetime
7. Finance provision: Develop the case and specification for a new equity / mezzanine loan fund to bridge the gap between early stage seed funding and full equity / co-investment vehicles. This new fund would cover the approximate range from £100-750k for early stage and pre-revenue opportunities

8. Finance provision: Investigate extension of The North East Investment Fund to allow loans of up to £1m to promote development of mid-sized SME companies
9. Finance provision: Investigate continuation of the Micro Loan Finance programme, together with an increase of the upper limit to £50k for second-tranche deserving cases
10. Gender dimension: Extend telephone survey to a further 70 women if required

## A. People and Organisations Interviewed

### Companies

Company	Sector	Postcode	Employees
AAP Bradley	Engineering	NE32 3EG	39
Abstract Polymeric	Chemicals Including Plastics	TS10 5SQ	1
Aidan Lynn Consultancy	Creative & Commercial	NE43 7SS	1
Almaritec	Engineering	NE66 2PQ	27
Apex Cables	Building & Construction	DH7 8RJ	72
Applied Neurodiagnostics Ltd	Healthcare	NE23 1WG	6
Autopoietic Systems (Tann Ltd)	Knowledge Intensive Business Services	DH3 2T	4
BD Electronics	Engineering	DH7 8BQ	2
Belmach Ltd	Engineering	NE6 1BT	900
Big Display	Creative & Commercial	NE6 2XX	8
Body Work Direct	Automotive	DL15 8JN	25
Bowe Digital Access	Knowledge Intensive Business Services	NE3 1HP	7
Bundles Ltd	Knowledge Intensive Business Services	NE46 4DQ	8
Business Travel	Creative & Commercial	NE8 1NY	17
C. & A. Pumps Ltd	Engineering	DH6 5PF	60
CAV Aerospace	Engineering	DH8 6SR	450
CDS Disabled Supplies Ltd	Building & Construction	TS1 5PE	5
Century Composites	Engineering	NE38 0AH	Not known
Chemical Process Solutions Ltd	Engineering	SR7 OPR	14
Chocpix	Food & Drink	DL12 8XT	2
Clarizon	Chemicals Including Plastics	NE99 1SB	6
Clevecrete Concrete Ltd	Building & Construction	TS23 1PX	5
CNG Food Services	Building & Construction	NE10 OJP	7
Comesys Europe Ltd	Knowledge Intensive Business Services	NE23 1BB	5
COVER HATS LTD	Retail	DL15 8LU	2
Crabtree of Gateshead	Engineering	NE11 OSU	131
Cramlington Precision Forge Ltd	Engineering	NE23 1WA	49
Creative Gene Technology	Healthcare	DH1 2NS	4
CRS Engineering Ltd	Electronics	NE66 2PQ	6
C-Tyres Ltd	Automotive	DH7 8HJ	90
Darchem	Engineering	TS21 1LB	600
Dartek (UK) Ltd	Engineering	TS14 8DB	1
Datawright Computer Services	Knowledge Intensive Business Services	NE37 1EZ	30
Durham Brewery	Food & Drink	DH6 5PF	6
Durham Organic	Chemicals Including Plastics	DH7 8JE	2
Durham Pipeline Technology	Engineering	NE10 0EW	8
Durham Scientific Crystals	Electronics	TS27 3FD	5
ED N Mark	Retail	DH7 8HG	2
Epigem	Chemicals Including Plastics	TS10 ORB	12
Farfield Photonics	Electronics	TS27 3FD	7
Flexi Link Ltd	Engineering	NE24 2AS	2
For Sale Sign Analysis Ltd	Knowledge Intensive Business Services	SR5 2TJ	55



Services			
Forget me Not Pet Crematorium	Community Service	DL5 6UP	2
Generic A.I.	Knowledge Intensive Business Services	NE1 6BX	1
Godfrey Syrett	Building & Construction	NE12 6DY	210
Hargreaves	Creative & Commercial	DH7 9PT	1200
Harris Tiles Ltd	Building & Construction	DH3 2BQ	3
Henry Colbeck Ltd	Food & Drink	NE11 0HG	120
Hetherington Associates	Creative & Commercial	DH3 1DX	1
Hillside Plastics	Chemicals Including Plastics	DH7 8XQ	105
i2media	Printing & Publishing	NE1 4XF	4
Innovation Recycling	Creative & Commercial	NE1 3SQ	4
KC Engineering Ltd	Engineering	DH8 9HU	41
Komodo Designs Ltd	Creative & Commercial	NE8 1AN	4
Launchpad Media Ltd	Knowledge Intensive Business Services	NE5 1BP	3
M & W Engineering	Engineering	TD15 1UP	20
Madventure	Transport, Travel & Leisure	NE1 5HX	10
MDF Powder Coating Ltd	Chemicals Including Plastics	TS17 7AQ	17
Mere Mortals	Creative & Commercial	NE6 1AB	30
Metal Tech Ltd	Engineering	DH8 9HU	19
Microchem Ltd	Chemicals Including Plastics	DH1 1TN	17
NEWTOWN COACHES	Transport, Travel & Leisure	NE37 1PF	12
Nexus Conferences & Training Ltd	Creative & Commercial	TS1 5JA	1
Non Linear Dynamics	Knowledge Intensive Business Services	NE1 2ET	37
Novagen Ltd	Healthcare	NE42 6PJ	7
P H D Automation	Engineering	NE22 7AD	3
P Q H & Sons Fabrications Ltd	Engineering	NE15 6EP	2
Parsons & Crosland Ltd	Engineering	TS2 1HH	50
Parsons Containers	Creative & Commercial	TS21 3EE	12
Paul Hodgson Transport Ltd	Transport, Travel & Leisure	NE22 7LQ	60
Penny Plain	Retail	NE1 4HZ	204
PLASTERPIECE LTD	Building & Construction	NE34 9PH	30
Play Shack	Community Service	DL4 2RD	14
PMM Process Solutions	Engineering	TS21 3EE	8
PointOv	Retail	NE1 4XF	7
PointOV	Retail	NE1 4XF	12
Premier Leisure Events	Creative & Commercial	NE47 0BY	40
Premier Vets	Community Service	NE9 6XA	3
Purple Patch	Creative & Commercial	NE6 1AS	4
Reinnervate	Healthcare	DH1 3UP	2
Rem-Tie Ltd	Building & Construction	NE61 5QE	2
Renown Engineering	Engineering	NE23 7RH	70
S K Plastics Ltd	Chemicals Including Plastics	DH9 9XB	5
Saturn Event Management & Services Ltd	Creative & Commercial	NE1 2DA	2
Scott Logic	Knowledge Intensive Business Services	NE1 4XF	14
Sekura Window Centre	Building & Construction	NE33 5LE	11
SMD Hydrovision	Engineering	NE6 3QS	100
Sovereign Light Engineering	Engineering	DL1 2NS	5
Spittal Day Nursery	Community Service	TD15 1RG	13
Storey Carpets Ltd	Retail	NE37 2AW	350
Storychest Ltd	Printing & Publishing	DH2 1LR	5

Sue Fuller Interior Design Ltd	Creative & Commercial	NE65 9HL	2
TCS Engineering Ltd	Engineering	NE24 5TW	1
The Green House	Building & Construction	NE65 0XQ	4
The Italian House	Retail	NE2 3DH	2
The Selection & Development Store	Knowledge Intensive Business Services	NE27 0JE	2
Thermastrate Limited	Electronics	NE66 3DW	1
Trackaphone	Knowledge Intensive Business Services	NE28 9NZ	6
Traveller NCL	Retail	NE13 8BZ	4
Vivid Acoustic	Healthcare	NE23 1WG	10
Wellstream Ltd	Engineering	NE6 3PF	400
Wessington Cryogenics	Chemicals Including Plastics	DH4 4UG	75
Whittle Printers	Printing & Publishing	NE11 0RY	5
William Oliver Ltd	Engineering	NE29 6NW	8
WilsonArt	Building & Construction	DL41PA	110
Zebra Hosts Ltd	Knowledge Intensive Business Services	NE1 1SG	7

## Intermediaries

Company
Alchemists, The
Bridges Community Ventures Ltd
Business Investors Group
Business Link, Tyne & Wear
Deloitte & Touche LLP
entrust
GO-NE
Grant Thornton UK LLP
KPMG LLP
NEL Fund Managers Limited
Northern Film & Media
Northern Venture Managers
NStar
ONE NorthEast
Project North East MicroLoan Fund
PwC
Quantum Corporate Finance
Small Business Service
Tait WalkerCorporate Finance
The Bridge Club Ltd
Yorkshire Fund Managers

## ***B. Review of Earlier Studies***

### ***I. Introduction***

In relation to the current study being carried out by Qi3 for ONE NorthEast it has been considered appropriate to undertake a review, and identify key conclusions, of a number of related studies that have been conducted in recent years.

### ***II. Related Studies Reviewed***

A total of eight studies and reports have been considered relevant for consideration within this review. The studies are listed in the following table and references made to the report numbers in the following text.

Report	Study	Commissioners	Authors	Date
1	A Mapping Study of Venture Capital Provision to SMEs in England	Small Business Investment Taskforce	Small Business Service	Oct. 2005
2	Northern Film & Media		Irwin Grayson Associates	May 2006
3	Technology-based Venture Fund Demand Study	ONE NorthEast	Qi3	Jun. 2004
4	Assessment of the Demand for Micro Finance in the North East	ONE NorthEast	Trends Business Research & Irwin Grayson Assoc.	Jun. 2004
5	Evaluation of the North East Micro Loan Fund	Business Link Tyne & Wear	Durham Business School	Jun. 2005
6	A Review of Business Support Organisations and Services	ONE NorthEast	PACEC	Feb. 2003
7	Access to Finance: Demand for Financial Engineering Tools in the North East of England	Regional Access	Deloitte & Touche	Nov. 2002
8	Evaluation of Objective Two Business Support in the North East	ONE NorthEast	Regeneris	May 2006

Recent studies considered relevant to the Access to Finance Study

### **III. Highlights**

The following represent a number of key findings and conclusions from the reports cited in Table A1. These findings and conclusions are those considered relevant to the current processes employed by companies 'accessing finance'. These have been grouped under a number of process headings. The origin of the finding/conclusion is given by the end as a bracketed number which cites the reference number per Table A1.

#### **Information**

A number of reports arrived at various conclusions as to the quality and availability of information for companies 'accessing finance':

- There were too many organisation and services on offer in the region which companies found confusing (report 6)
- Businesses were generally not happy with the financial information available to them on grants, loans and equity. Around 55% of businesses are not at all satisfied with information provided on equity, 43% on grants and 35% on loans (report 7)
- The Micro Loan Fund (MLF) was largely promoted through Business Link, with 54% of applications originating via this route. The second most popular route was through company's financial advisors at 16%. The above report also added that their survey concluded that the MLFs promotional material was both 'modest and old fashioned' (report 5)

#### **Advice and Support**

A number of reports arrived at various conclusions as to the availability and quality of advice and support:

- There were too many organisation and services on offer in the region which companies found confusing (report 6)
- Banks are the main source of financial information for 54% of businesses, followed by accountants/advisors (20%) and Business Links (10%) (report 7)
- A large number of companies were suspicious about the advice received from banks, feeling that this advice was 'skewed' toward protecting the bank (reports 4 and 7)
- Businesses are more likely to be satisfied with the advice they received from banks and professional advisors than Business Links and the RDA. The lowest level of satisfaction was recorded for the RDA (report 7)
- Companies would like banks to refer them to relevant business support (report 7)
- Companies, especially SMEs, had a preference to locally based services (report 4)
- The Micro Loan Fund (MLF) report, stated that companies had stated a high degree of satisfaction (> 90%) with the application process and especially its 'speediness', with the majority of loans being made within 2 weeks (report 5)
- The MLF report also highlighted that mentoring was an integral part of the loan process and that this feature was well liked (report 5)

### **Networking**

A number of reports touched on the issue of networking opportunities in the region and concluded that:

- The region was poorly served with networking opportunities and that networks specifically for SMEs and key intermediaries should be developed to improve the efficiency of information flow in the region (report 7)
- Community Development Finance Institutions (CDFIs) were widely recognised as 'lynchpins to small companies' that it would be beneficial if a CDFI forum were to be established in the region (report 4)

### **Skills and Training**

A number of reports arrived at various conclusions on the issues of 'access to finance' skills and training, concluding:

- The development of region wide business support/investment readiness programmes to develop the SME base, improve survival rates and reduce the risk of future investments (report 7)
- The development of entrepreneurial development programmes to improve the communication and awareness of self-employment and business creation (in line with the Regional Enterprise Strategy and Regional Economic Strategy) (report 7)
- The report covering the Micro Loan Fund (MLF), stated that a large number of applicants (39%) had utilised the service of a mentor in preparing their application (report 5)
- It was concluded that there was a poor understanding of 'state rules' and that a simple guide should be written (report 4)

## ***IV. Summary of Studies/Reports***

The following sections provide an overview of the studies listed in Table A1 and their key conclusions and recommendations.

### **Review of Business Support Organisations and Services**

This study was undertaken for ONE NorthEast by PACEC, over the period September 2002 to February 2003.

The overall objective of the study was to carry out a review of the publicly funded business support services and agencies in the North East. The outcome of the review was fed into the Regional Business Development Plan. The review focussed on the three main aspects of business support, provided through public funding – programmes, financial support and support agencies.

The study concluded that there were a significant number (over 140) of organisations involved, at the time, in the delivery of business support services (over 500) and finance and that there was considerable scope to rationalise and streamline the process. Of the 500, or so, services available, approximately one third of these offered financial support. In summary the study recommended that, improved effectiveness and efficiency could be achieved, if consideration was be given to:

- Streamlining the number and roles of delivery organisations
- Streamlining and clarifying the overall number of services being offered
- Reassessing and re-balancing the nature of the services being offered to strengthen competitiveness and specifically a shift from grant to equity financing
- Consolidating resources from a 'local' to a more 'sub-regional' level
- Introduction of a process to 'monitor and evaluate' to enable changes to be gauged for impact effectiveness

It is worth noting that this study was undertaken without seeking any input from the 'customers' of these programmes and services, with the study and its conclusions being derived through a review and discussions with the various organisations and agencies involved in the delivery.

On the specific issue of finance, relevant to this study, the review concluded that the majority of funding transacted was in the form of grants and that this should be shifted to equity-based loans.

#### **Micro Loan Finance in the North East**

This study was undertaken for the One NorthEast Access to Finance Expert Group jointly by Trends Business Research and Irwin Grayson Associates concluding with a final report in June 2004.

The overall objective of the study was to carry out a review of the micro finance 'gap' in the North East, the current level of activity, likely future demand over the following five years and whether existing funds were likely to cope with this demand.

The major findings were that:

- The region had a large number of micro finance providers
- SMEs had a gap in funding (above their own resources and bank loans) in the range £6-10k
- Around 2,500 new starts, in 2003, had sought additional 'gap' funding with the majority looking for less than £15k

The survey indicated that demand for gap funding was around £6m but the authors felt that this was an over estimate and that £3.75m would be sufficient to satisfy demand.

The key finding and conclusion was that micro finance provision in the region is not being efficiently delivered and its nature and availability is confusing to all parties.

The key recommendations were:

- ONE NorthEast make micro finance loans a key component of their business support policy
- Actively market SMEs the nature and availability of micro finance
- Make provision for £1m per annum of this type of funding from 2006 onwards

This area of funding, and specifically the North East Micro Loan Fund, was subject to a further review, reporting in June 2005, undertaken by Durham Business School for Business Link Tyne and Wear.

#### **Evaluation of the North East Micro Loan Fund**

This study was undertaken for Business Link Tyne and Wear by Durham Business School concluding with a final report in June 2005.

The overall objective of the study was to carry out a review of the North East Regional Micro-Loan Fund (MLF), which had been launched in April 2003, following a modest pilot project run in Tyne and Wear in 2001/02. LLF is managed by and made available by the four sub-regional Business Links and their local delivery partners. The fund has been aimed at the smaller end of the SME market.

MLF, since launch had advanced approximately £2.25m, in 167 transactions (average value £13.5k) and had achieved a default rate of 30.5% at the time of reporting.

The major findings were that:

- Fund recipients found MLF easy to access, well managed and were highly satisfied with the product and its delivery
- There was a huge unsatisfied demand for the product

Default rates were high but falling

Targets for take up were above expectations – both numbers and rate

The key finding and conclusion was that MLF had been very successful, very well received and that there was significant further demand.

The key recommendations were:

- MLF should become the 'flagship' product in the portfolio of Access to Finance schemes in the region
- Additional funding of £10m should be made available for the fund over the following three years
- Active intervention should be undertaken to reduce default rates to a more acceptable level

### **Mapping Study of Venture Capital Provision SME's in England**

This study was undertaken by the DTI Small Business Service concluding with a final report in October 2005.

The overall objective of the study was to map out the provision of venture capital provision available to SMEs in England. The study explored the nature and extent of funding available and the interaction between public and private sources. The analysis and findings is presented on a regional basis.

The major findings were that:

- Funding sources, shapes and sizes are constantly changing with presently 191 funds, heavily weighted to London
- Public sector involvement is significant – around 26% of funds
- Public sector involvement is more significant in the regions

The North East's key statistics were:

- Regional supply of finance - £66.5m
- Average size of investment - £70k
- Funds – 11 (6 fully of partially publicly backed)
- Investments – 109 (Public 72, Private 37)
- Investment by type:
  - Seed 31
  - Start-up 39
  - Growth 20
  - Other 19
- Investment (%) by sector:
  - Services 24
  - IT 23
  - Manufacturing 21
  - Healthcare /Life Sciences 25
  - Other 7



In terms of looking at the North East in comparison to the other regions in England, the major findings were as follows, with the region having a:

- Higher level of investment per number of SMEs (Chart 40)
- Good 'within region' correlation between investment and investor (Cht 41)
- Poor level of investment from non-regionally focused funds (Cht 42)
- Very high ratio of publicly (66%) versus privately (34%) backed investments (Cht 43)
- Very low 'average investment' of £0.07m (Cht 45)
- Very low estimated investment (2003-04) of £17m (Cht 47)
- Very high, by %, of 'seed funding' and very low 'growth funding' (Cht 48)
  - Seed 28%
  - Start up 37%
  - Growth 18%
  - Other 18%
- Equally balanced investment by sector (IT/H&L/Services/Manuf./Other) which is far more even than other regions which typically have two strong focus sectors (Chart 49)

### Evaluation of Objective 2 Business Support Activities in the North East

This study was undertaken for One NorthEast by Regeneris concluding with a final report in May 2006.

The overall objective of the study was to carry out a review of the region's Objective 2 programme to date and to provide recommendations for the future. The study covered the programme's four types of support: generic, access to finance, targeted and sites/premises.

As part of its Access to Finance support, the region has assigned, in the period 2000-04, close to £50m of ERDF funding to the Strategy for Success (S4S) programme, the majority of this being made available through NStar's Proof of Concept and Co-investment Funds.

Despite a slow start and concerns over the regions capacity to absorb the level of funds available, all funding has now been largely committed. The following tables (summarised from the Reports Tables 4-1 and 4-2) provide a summary of the funding take-up. The tables provide the target number of firms, by funding level and the forecast outcome along with the achievement as of August 2005.

Task	Target	Forecast	Achieved
Funding (£2-4k)	235	1,456	848
Funding (£4-10k)	861	505	318
Funding (>£10k)	480	377	104
ERDF Grant £/%	c.£6.0m	101%	79%

Funding Provided to Start-Ups

Task	Target	Forecast	Achieved
Funding (£2-4k)	113	152	74
Funding (£4-10k)	568	374	207
Funding (>£10k)	1,590	830	425
ERDF Grant £/%	£6.8m	76%	66%

Funding Provided to SMEs

The findings above indicate:

- There appears to be lack of SME demand for this form of funding, this being largely the case across the range of funding available
- The form of funding is in demand by Start-ups but largely at the lower end of the funding ranges

The study also estimated the cost effectiveness and 'value for money' resulting from this support.

ERDF Cost	Start-ups	SMEs	Programme Average
Firm assisted	£10,300	£22,800	£14,500
Gross job created	£1,500	£800	£1,000
Net Additional Job	£2,700	£4,800	£3,500
Per Add.£10k Gross T/O	£700	£100	£160
Per Add. £10k Net T/O	£1,800	£300	£540

In summary the study concludes that, on average, the ERDF cost in the region for creating an additional job is £3,500 and £540 for creating an additional £10k of turnover which the author regard as representing very good value for money.

With particular reference to access to finance, the key finding was that, despite its high gross cost, this support generated the largest additionality and best value for money. Around 30% of the firms' surveyed reported that they had, or will, see benefits in terms of increased revenue and employment through this support.

#### **Technology-Based Venture Fund Demand in the North East**

This study was undertaken for ONE NorthEast by Qi3 concluding with a final report in June 2004.

The overall objective of the study was to carry out an examination of the potential need for further publicly supported venture finance provision in the North East. The study reviewed the recent history of equity-base funding in the region, estimated short and medium term demand and funding sources.

Specifically the study addressed the region's:

- Demand for 'early stage' technology equity finance
- Ability to supply funds which should be met through public funding
- Specific needs in uptake simulation and outcome optimisation
- Approach compared with other regions, specifically Scotland and East of England

The major findings were that:

- The region has had a low rate of business formation in the technology sector despite seed funding being available
- Early stage funding has not been satisfied
- Equity gap, covering roughly the range £300k to £2m

The key finding and conclusion was that, without a substantial intervention, there is likely to be a significant shortfall in the availability of funds and therefore the efforts of the Centres of Excellence to create new high value-added technology businesses are likely to be frustrated.

The key recommendations were:

- Further public sector intervention is required to provide a continuum of finance
- The extent and phasing-in of the above needs careful monitoring
- Current Centres of Excellence should rank their prospects and support accordingly
- NStar should be recognised as having a key role in the region

#### **Creative Industries IP Investment Fund**

This study was undertaken for Northern Film and Media by Irwin Grayson Associates in partnership with Olsberg SPI and TBE Economics, concluding with a final report in May 2006.

The specific objective of the study was to undertake a feasibility study to identify options for the delivery of a Creative Industries Intellectual Property Investment Fund in the North East, which has a particular focus on film and media. The overall objective is to develop ideas for providing finance to support the creation and retention of intellectual property by creative industry businesses.

Although estimates vary considerably, the creative industries sector is a major generator of revenues and jobs. Upper estimates, in 2002, suggest revenues in excess of £112bn and employment in excess of 1.9 m jobs. It is also a sector which is regarded as growing at twice the rate of the economy as a whole and is subject to Government support through the Department of Culture, Media and Support's 'Creative Economy Programme'.

ONE NorthEast sees considerable potential in the creative industries and has identified the sector as one of nine priority sectors requiring support within the region.

The study covered:

- review of best practice in the sector
- analysis of the sub-sector supply chain with particular regard to where funding would be beneficial
- review of existing funds available to the sector
- recommendations

The major findings were that:

- The region has nearly 20,000 employed in over 3,000 firms in the sector
- Revenues are in excess of £1bn

The key finding and conclusion was that there is a real need in the region to establish funding in this sector which has the potential of creating several hundred new jobs and tens of millions of pounds in additional revenue. It was also concluded that the region would best be served through the creation of a new fund.

The key recommendations were:

- That a new loan-based fund should be created which had a broad sector remit and be open to both new starts and established businesses
- Fund should be managed by an organisation with sector experience
- The fund would need to be in excess of £3m to allow 30 projects (of £100k) to be funded
- The fund should commence with a one year 'pilot fund' of £500k to prove the concept which would allow 10 investment of £50k

## ***V. Funding Access and Supply Conclusions***

A number of studies have been carried out in recent years which, within their scope, have addressed the provision and 'access to finance' for businesses located in the North East. The studies, considered relevant to this study, have been listed and summarised in the above sections.

The broad conclusions of these studies are summarised as follows:

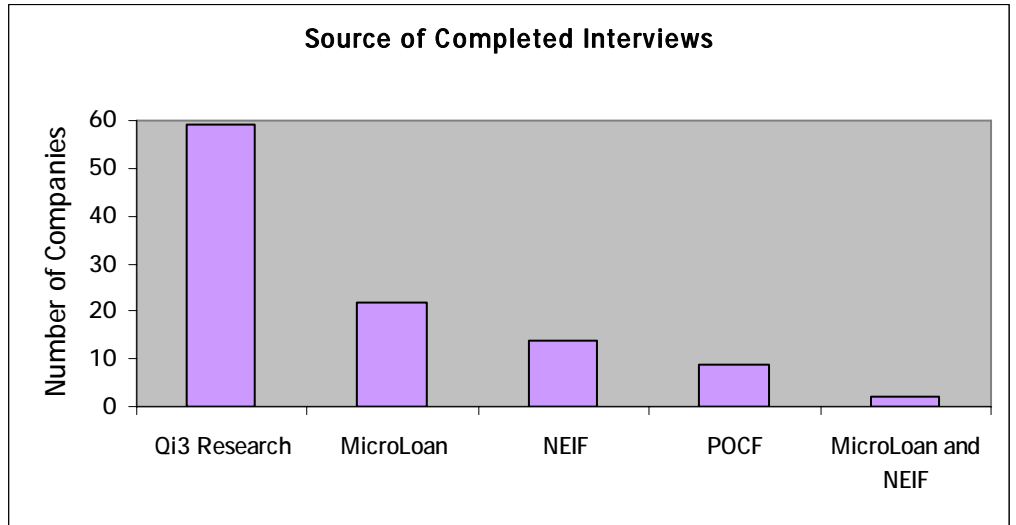
### **Funding Access**

- Historically there has been a number of criticisms with regard to the 'access to finance' in the region. These were raised in the 'Regional Access to Finance Expert Group of the North East' report, dated 2002, and subsequently the 'Review of Business Support Organisations and Services' report, dated 2003. Specific issues were:
  - A confusing array of means whereby finance was being made available to start-ups and SMEs
  - Poor speed in processing applications
  - The requirement for applicants to provide evidence of funding from 'other sources' has proved to be a major barrier to some firms. (Reg Rpt)
- The Micro Loan Fund and Objective 2 Funds appear to have addresses the above issues, to a large extent:
  - A review of the MLF concluded that it had been well 'advertised', been easy to access (67% of clients responded positively) and quick (approx. 2 week process)
  - The Objective 2 fund for 'new starts' had over 90% clients responding positively and over 70% for SMEs
- Objective 2 Funds, as last reported, remain below well their original targets with this being especially the case for SMEs

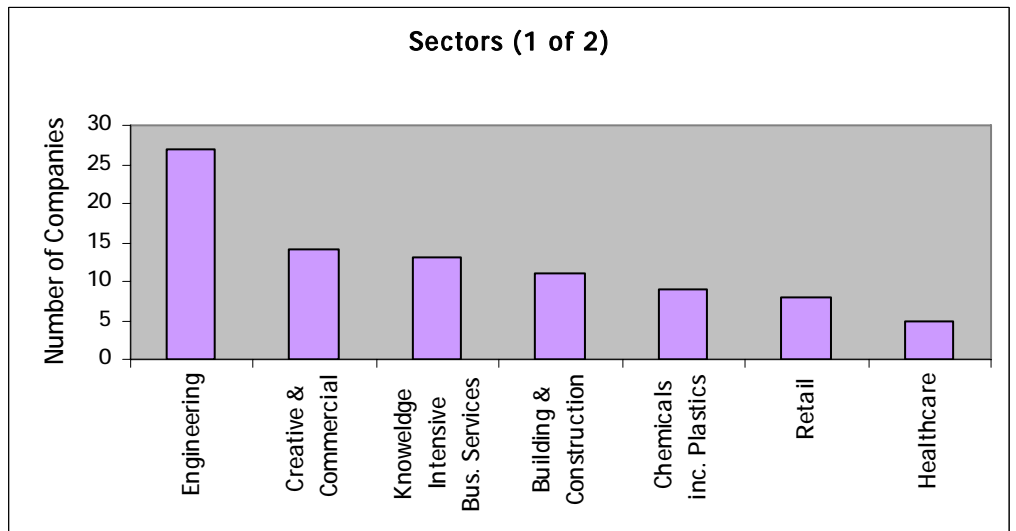
### **Funding Supply**

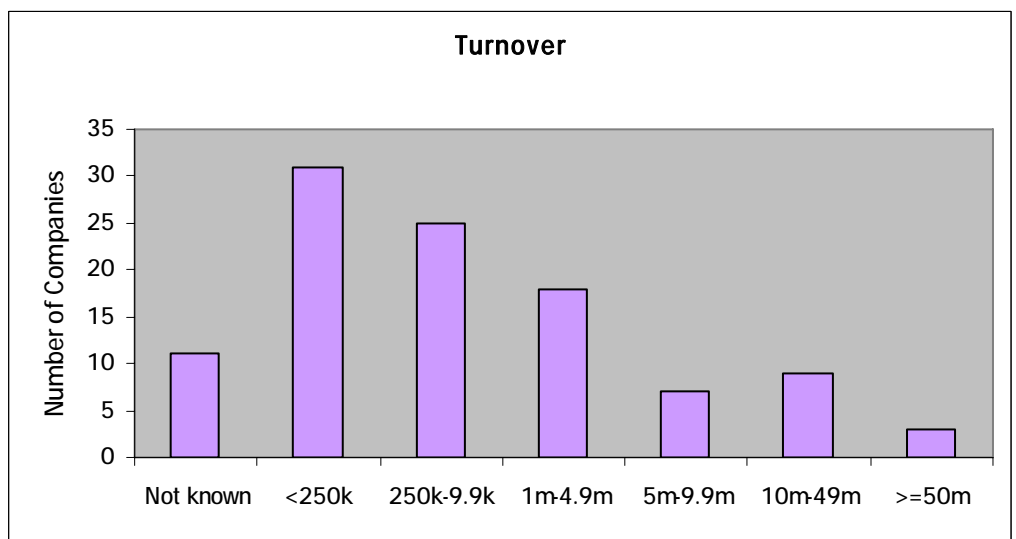
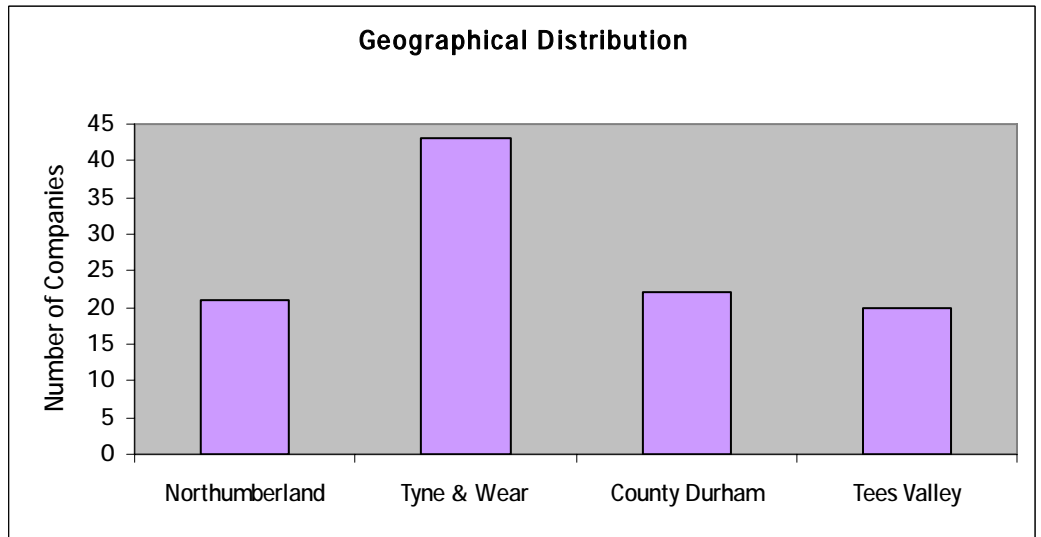
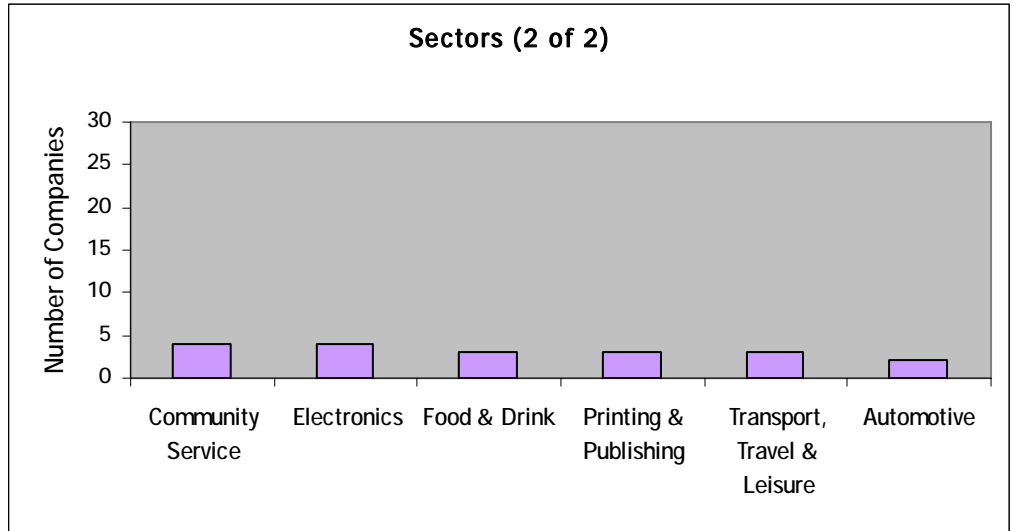
- The key recommendations, with regard to access to finance, were that loans should favoured to grants, (which should be only employed where there was serious market failure), and that the support should focus on quality and not quantity so as to ensure the generation of legacy funds
- There appears to be a significant shortfall in available private venture funding this being cited as being due to the significant supply of public funding
- The Micro-Loan Fund (MLF) should become the 'flagship' product in the portfolio of Access to Finance schemes in the region with additional funding of £10m should be made available for the fund over the following three years. Active intervention should be undertaken to reduce default rates to a more acceptable level
- A fund has been recommended which would establish specific financing for the creative industries sector

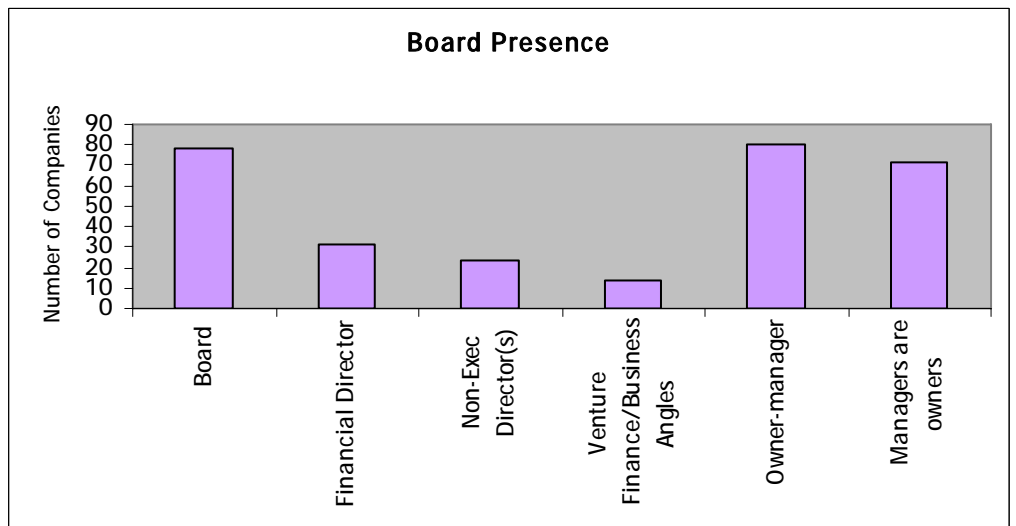
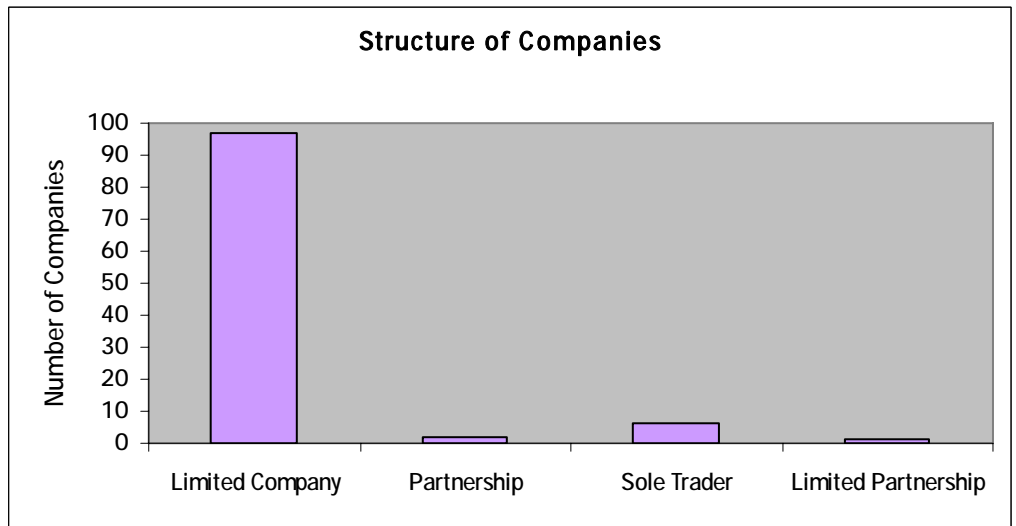
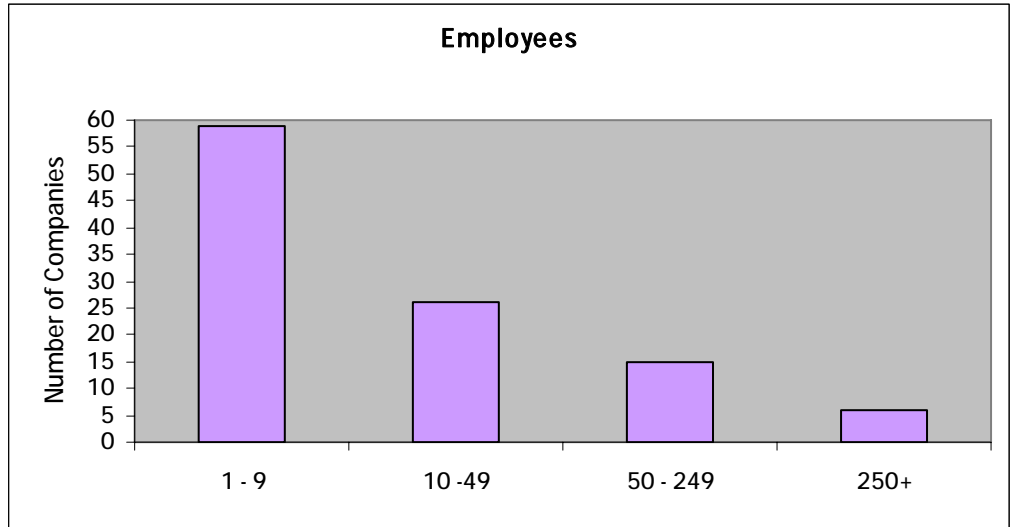
### C. Survey results

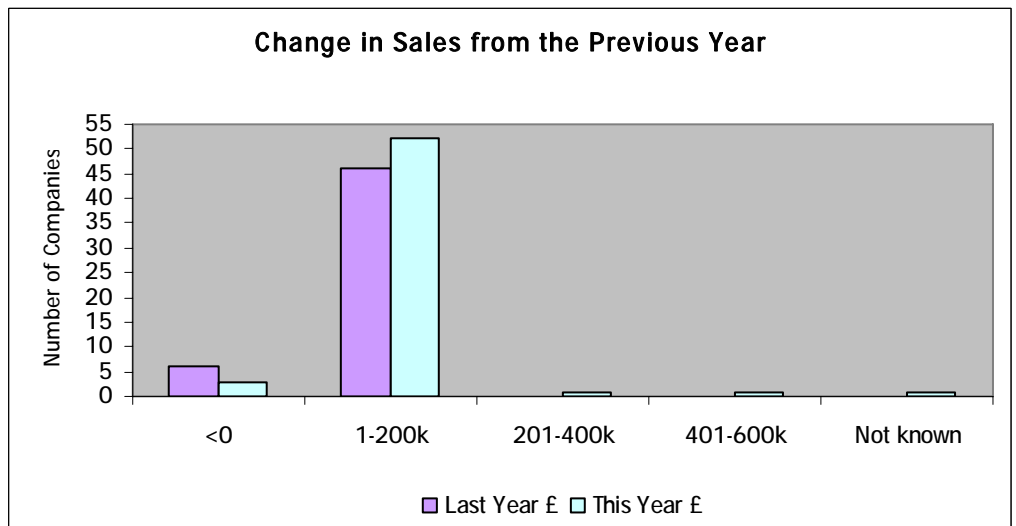
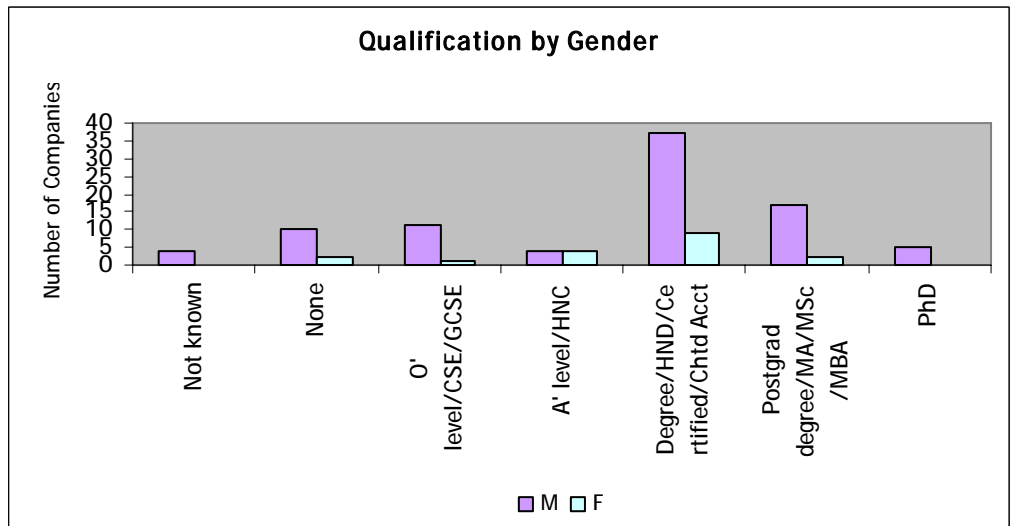
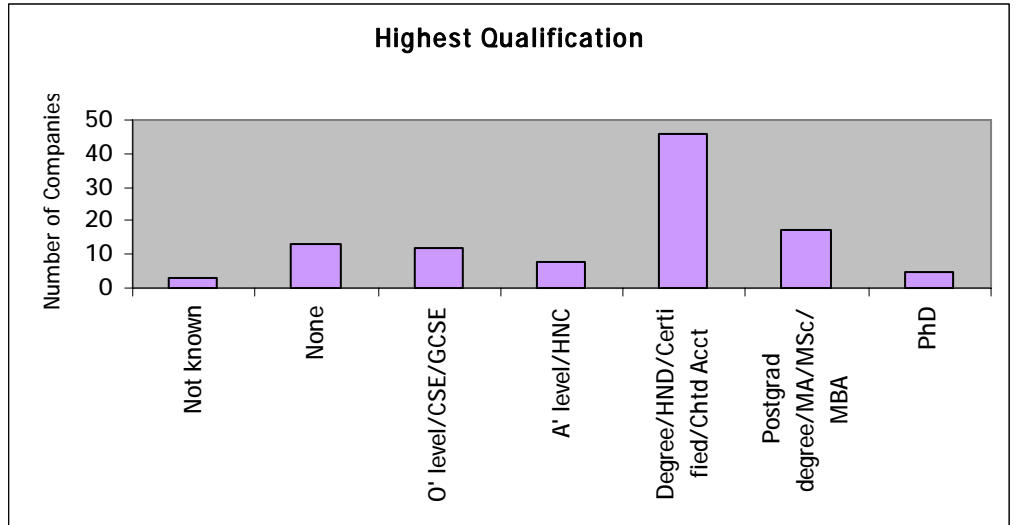


Gender of Contacts and Respondents				
	Female	Male	Total	Female %
Respondents	18	88	106	17%
From Database (combined)	286	1,763	2,049	14%

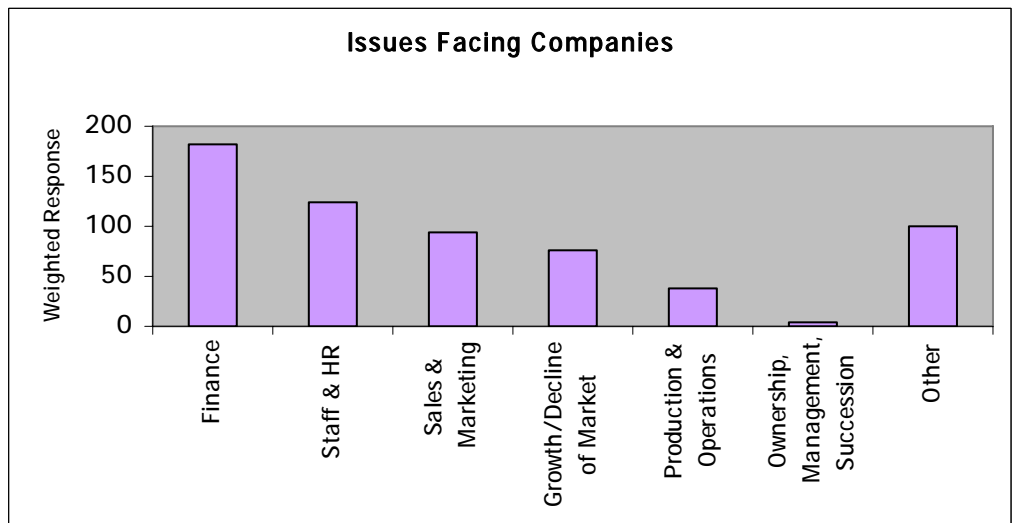
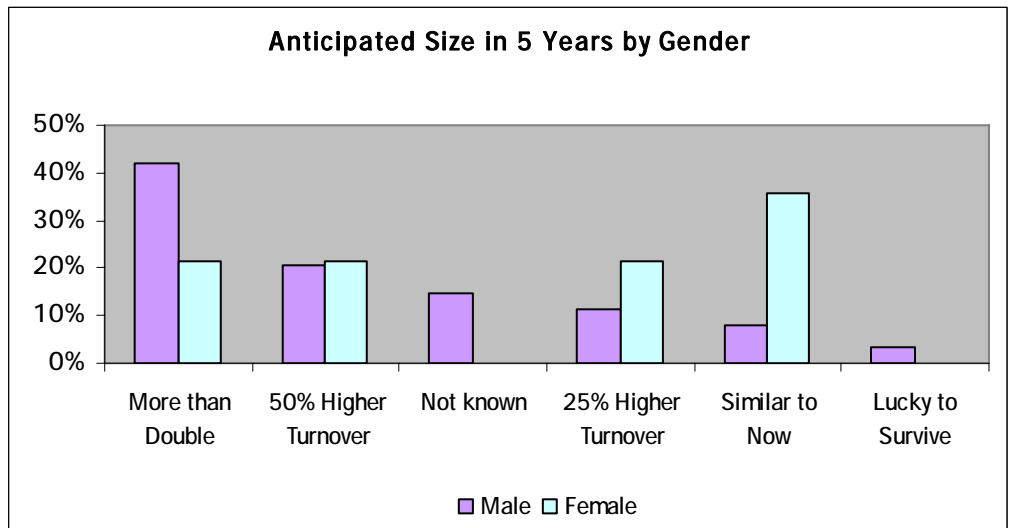
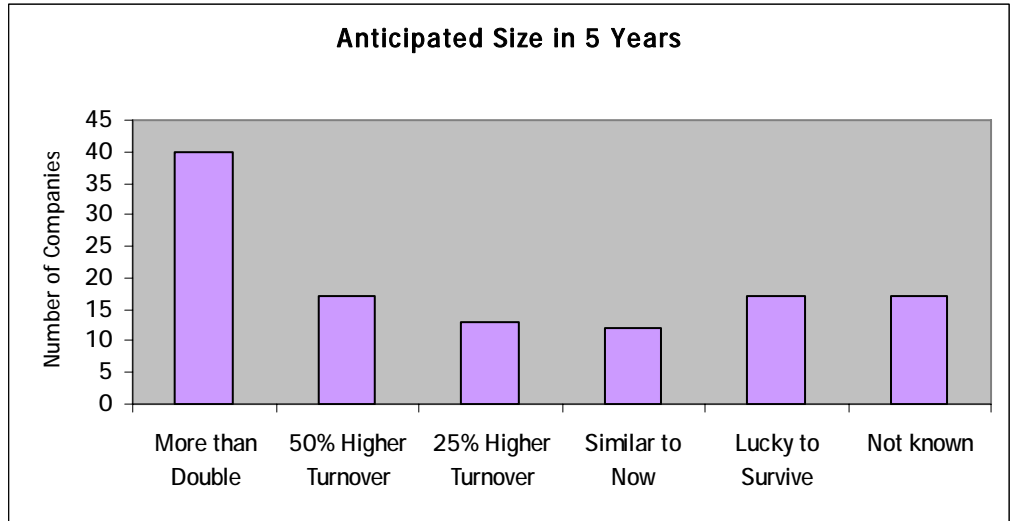


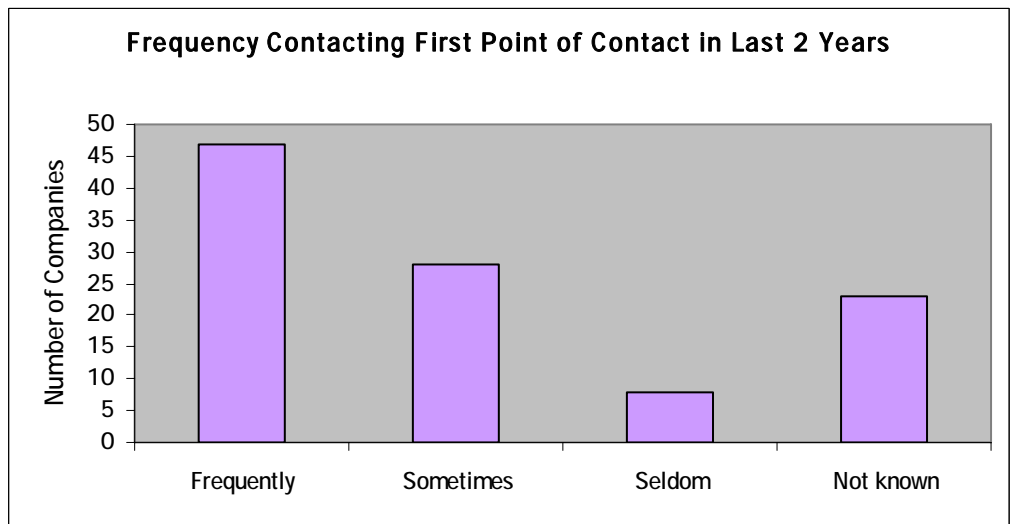
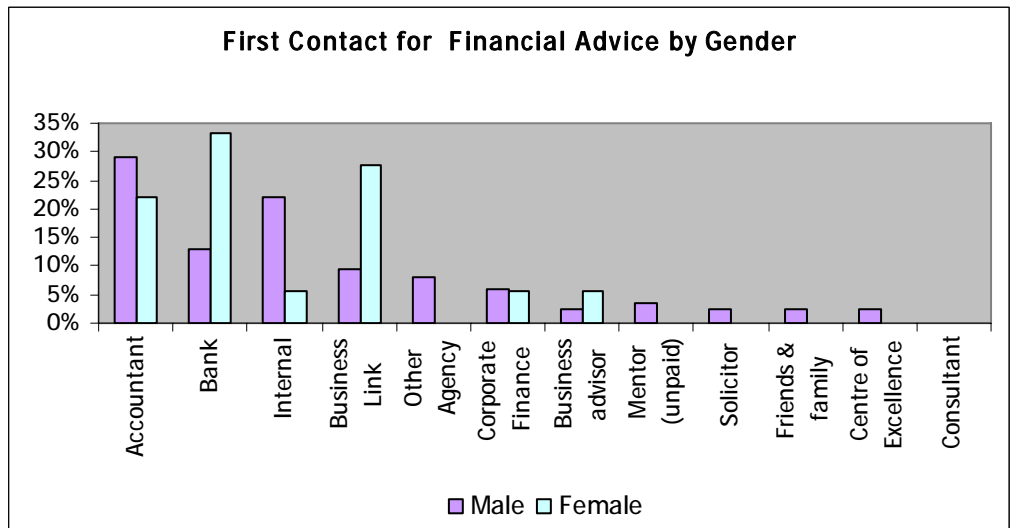
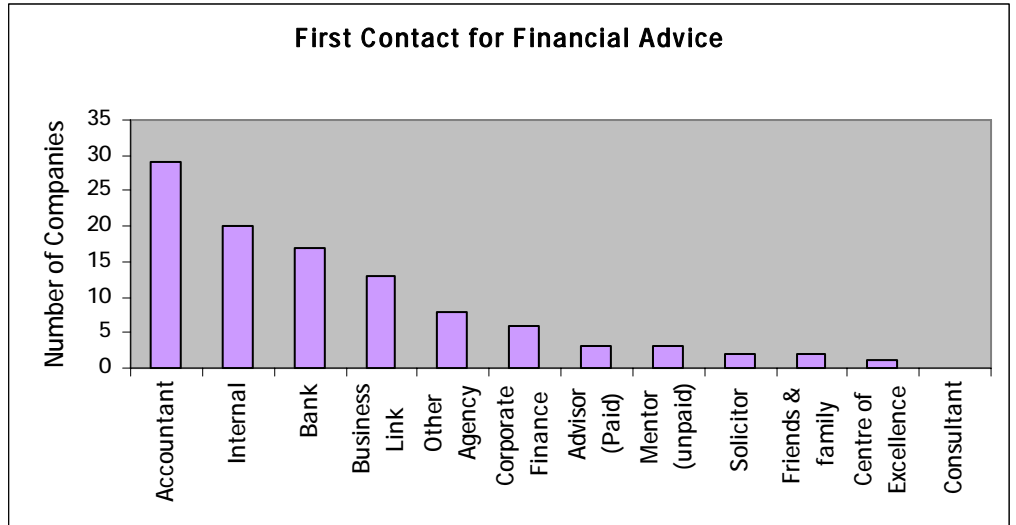


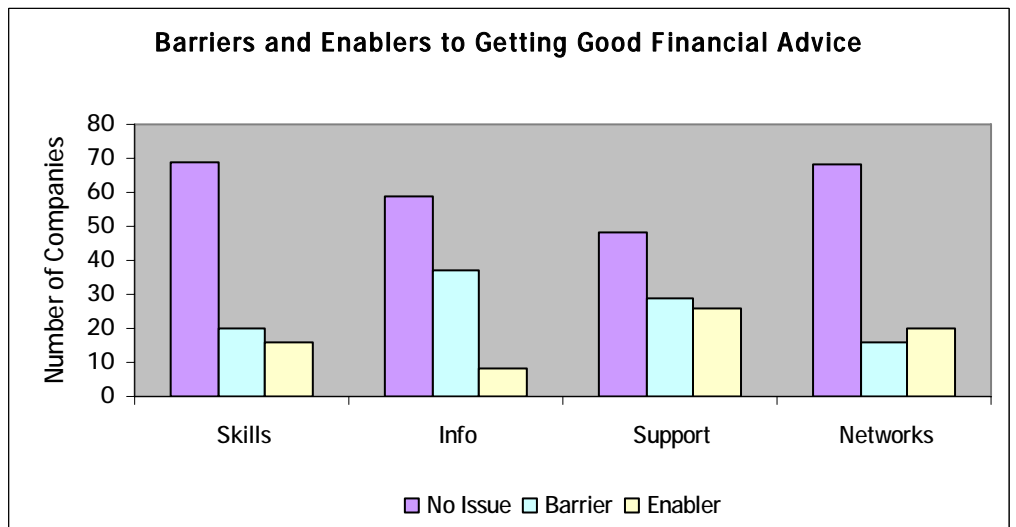
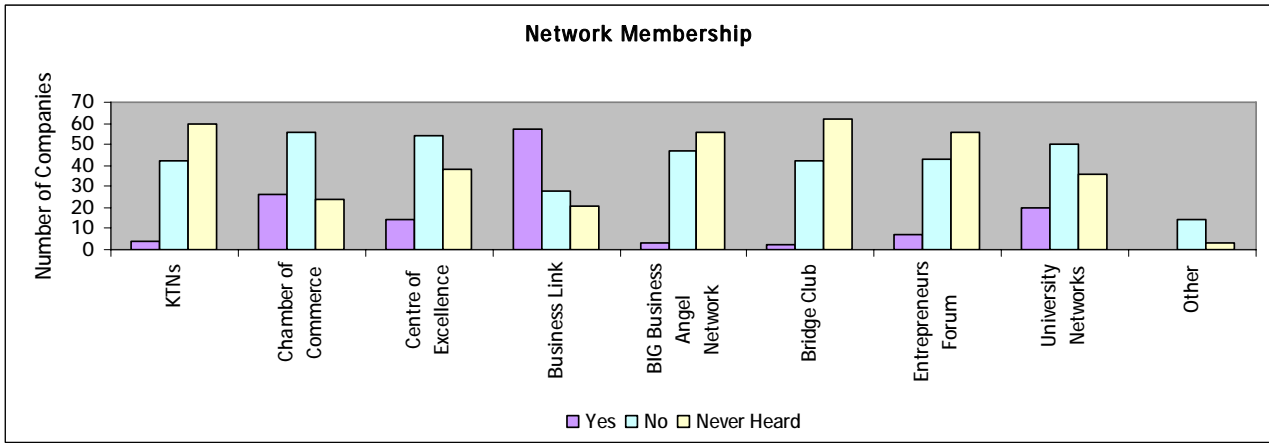


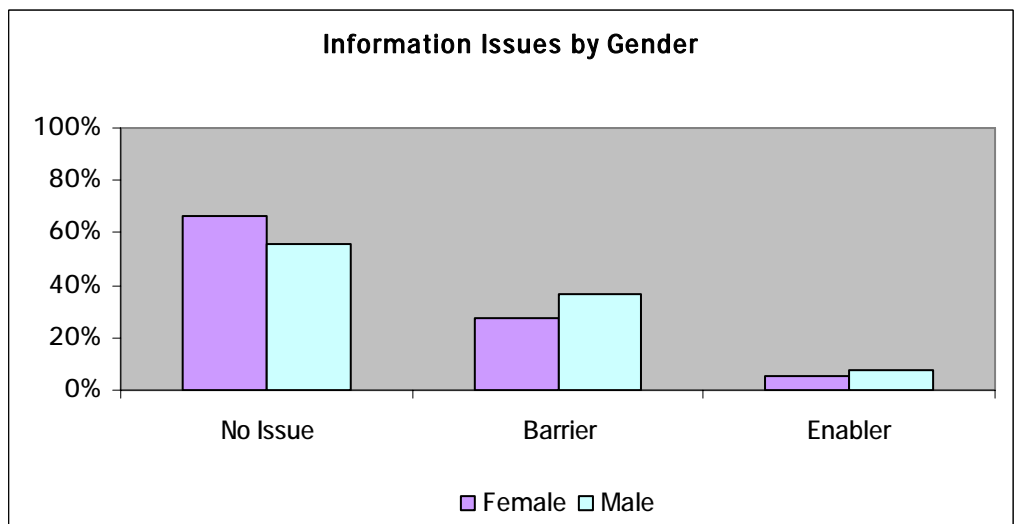
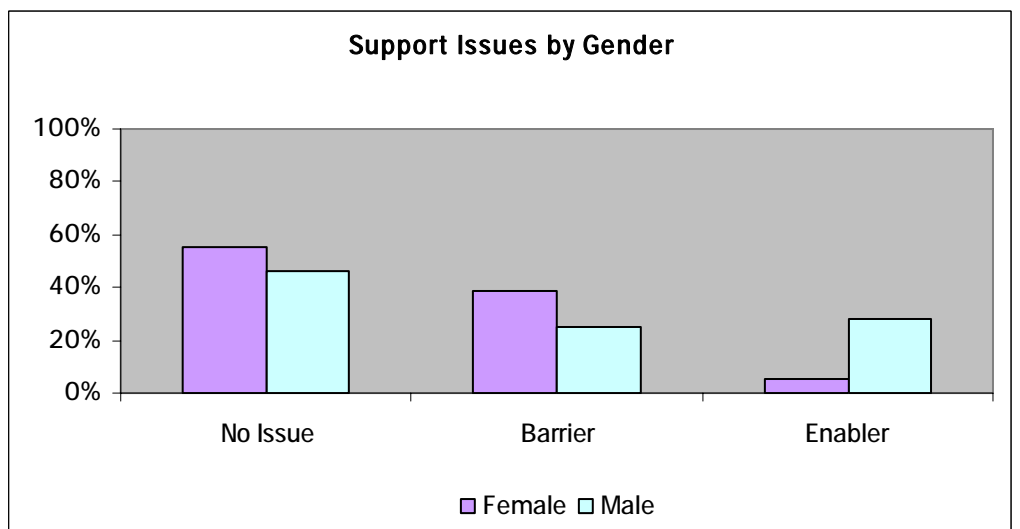
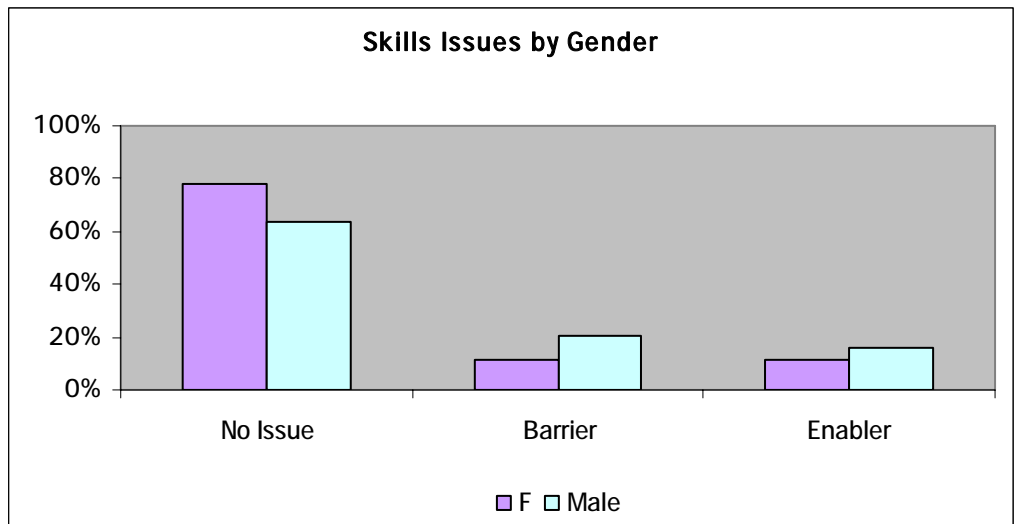


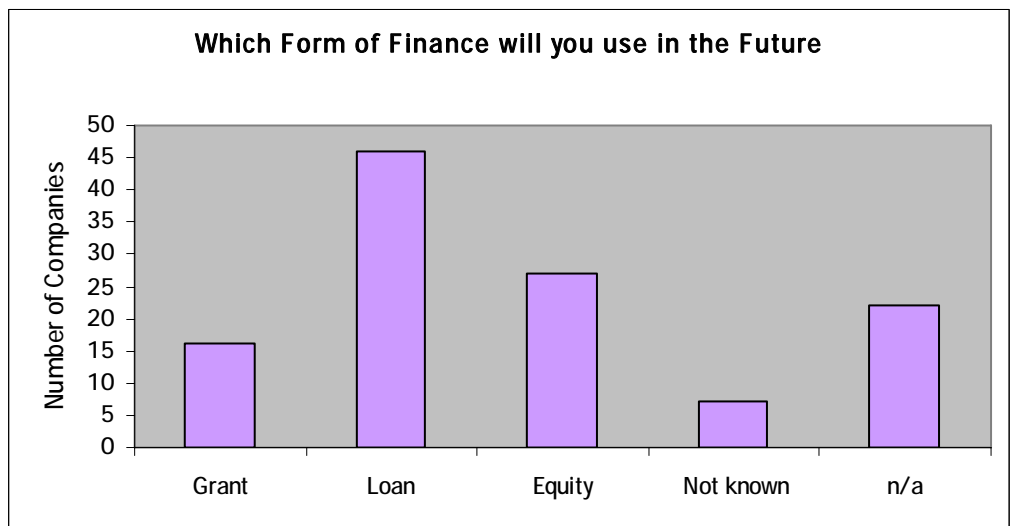
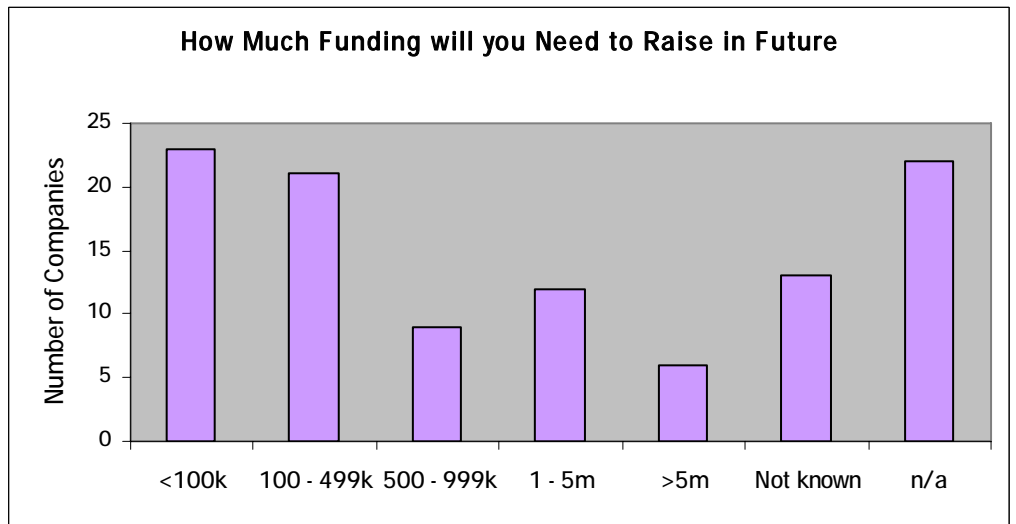
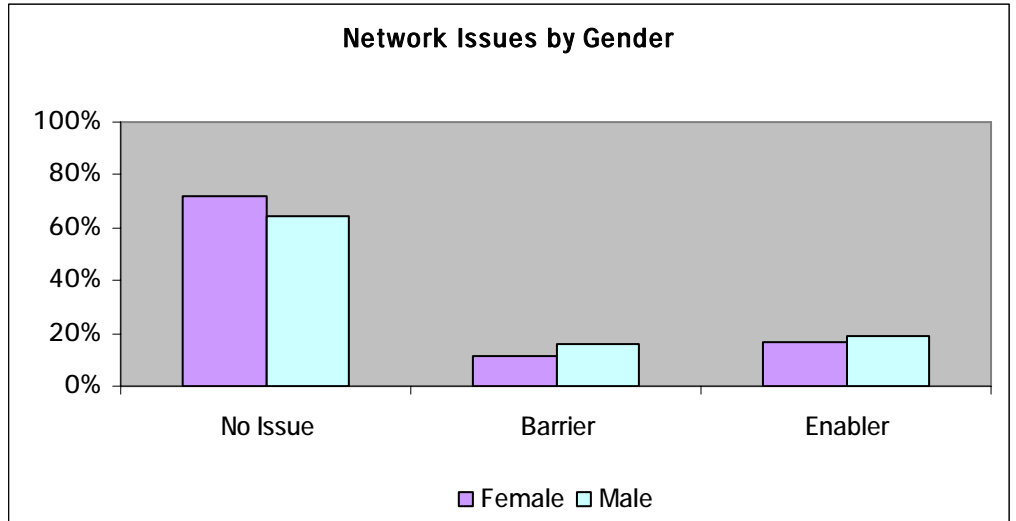




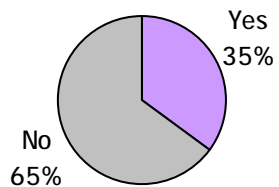




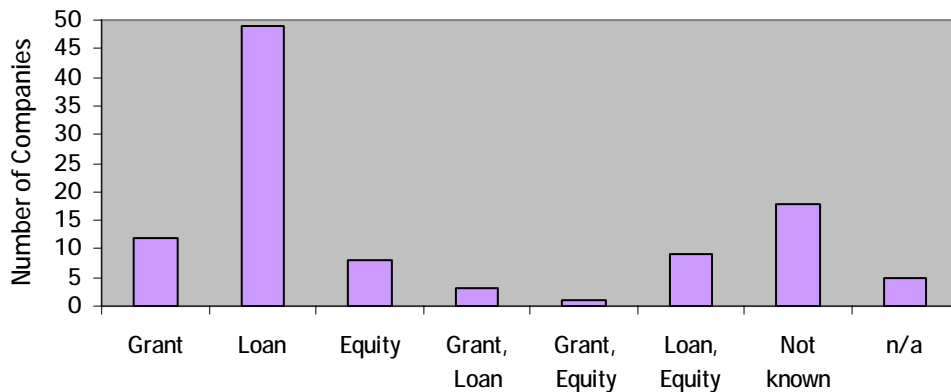




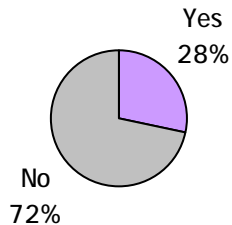
### Would You Sell Equity in Your Business

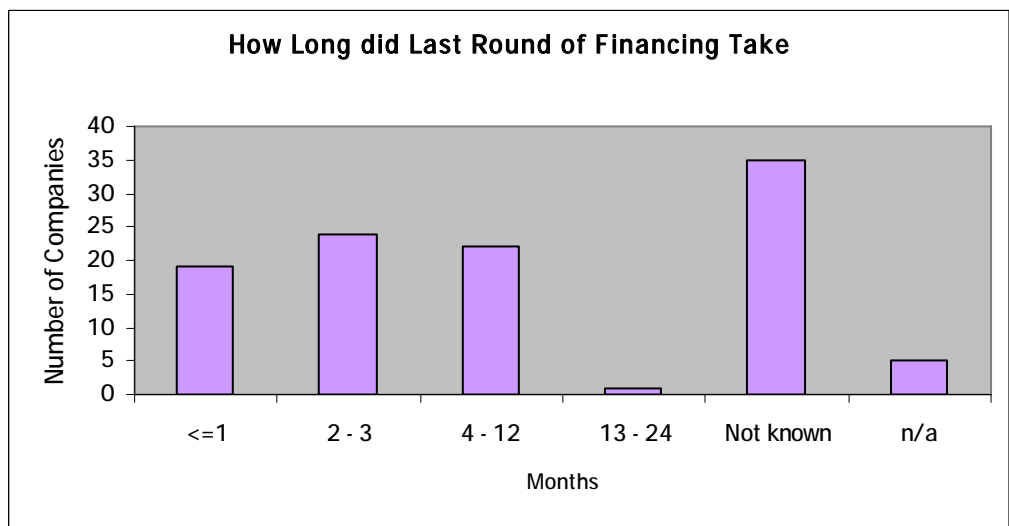
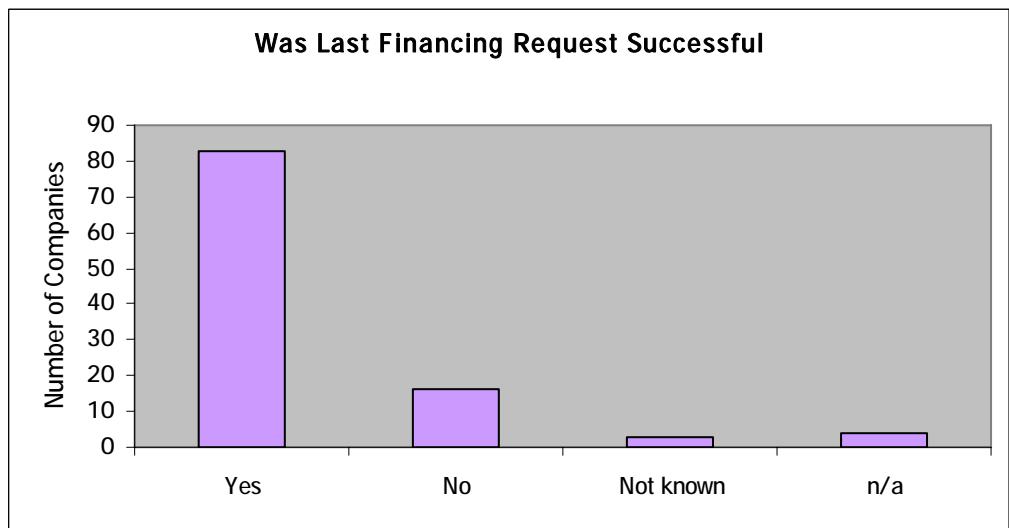
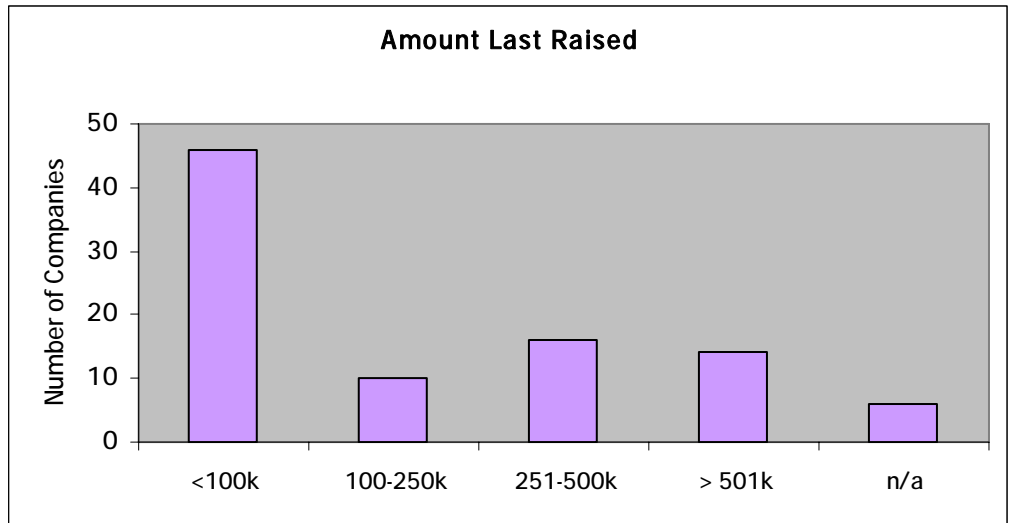


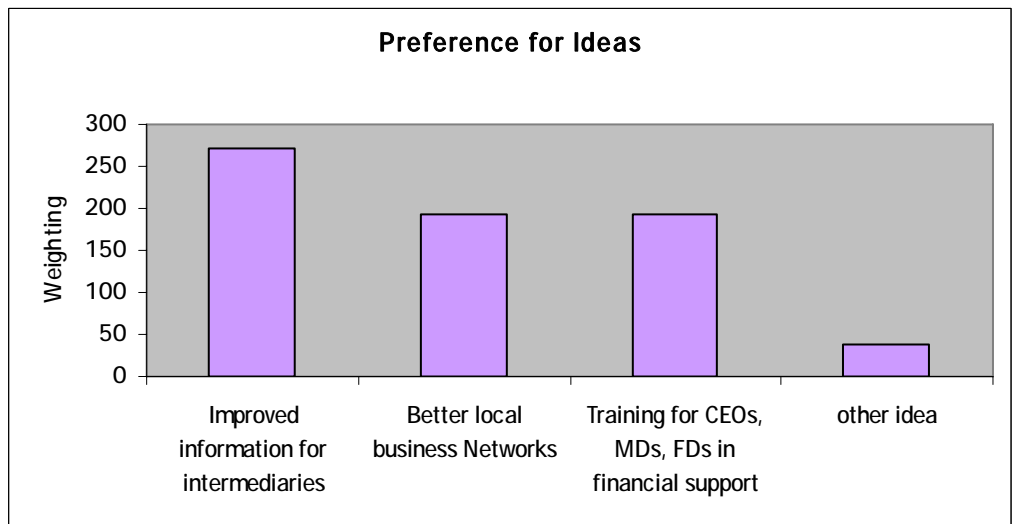
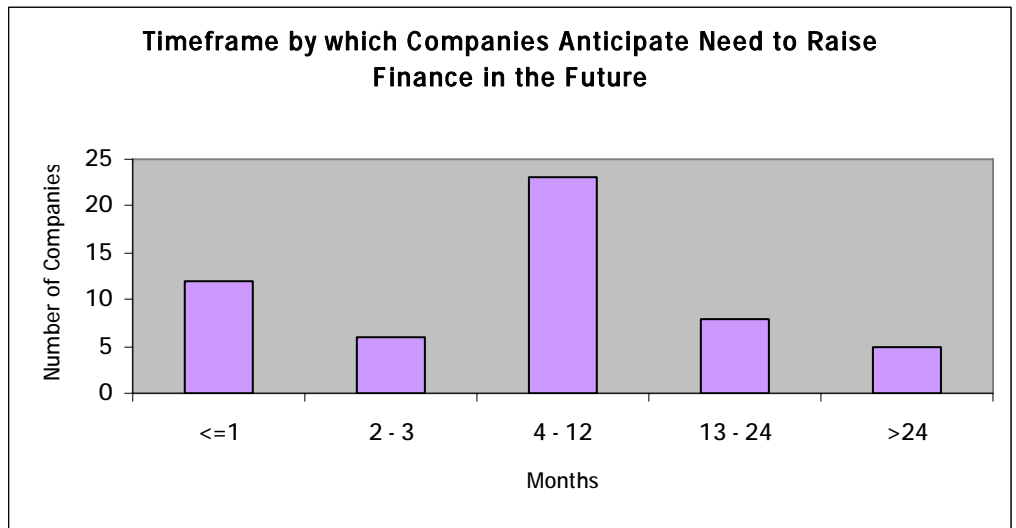
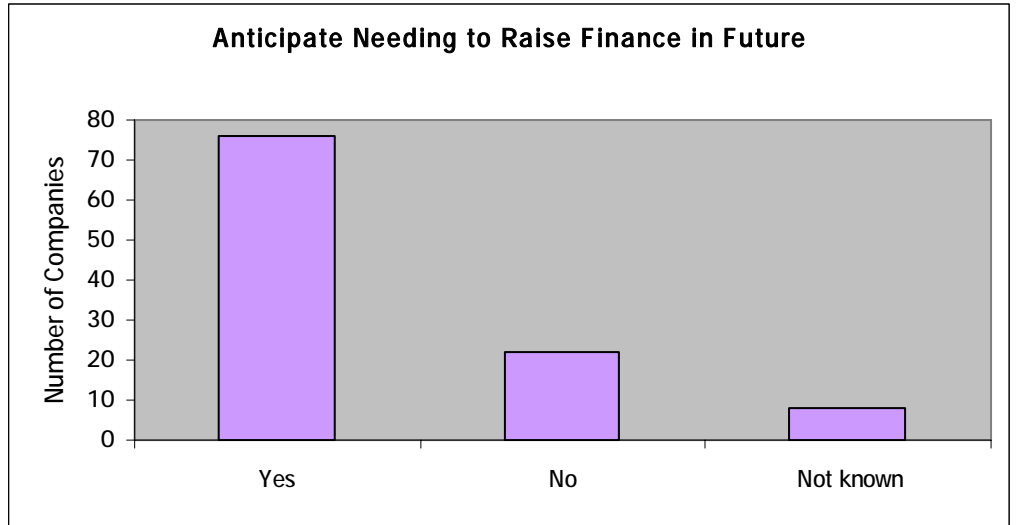
### Purpose of Previous Financing



### Use of Factoring, Export Finance, Hire Purchase or Similar Debt Finance









## D. Glossary

Organisation	Acronym	Web-site
	AIM	<a href="http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim_new/AIM">http://www.londonstockexchange.com/en-gb/products/companyservices/ourmarkets/aim_new/AIM</a>
Almeida Capital		<a href="http://www.almeidacapital.com">www.almeidacapital.com</a>
Bridges Community Venture Capital Fund		<a href="http://www.bridgesventures.com">www.bridgesventures.com</a>
British Venture Capital Association	BVCA	<a href="http://www.bvca.co.uk">www.bvca.co.uk</a>
Business in the Community		
Business Investors Group	BiG	<a href="http://www.big-angels.co.uk">www.big-angels.co.uk</a>
Business Link		<a href="http://www.businesslink.gov.uk">www.businesslink.gov.uk</a>
Capital North East (formerly Insight Capital)		<a href="http://www.insight-capital.co.uk">www.insight-capital.co.uk</a>
CapitalISE		<a href="http://www.capitalisenortheast.co.uk">www.capitalisenortheast.co.uk</a>
Carbon Trust		<a href="http://www.thecarbontrust.co.uk">www.thecarbontrust.co.uk</a>
Carbon Trust Loan Fund and Carbon Trust Grant		<a href="http://www.thecarbtrust.co.uk/foundation">www.thecarbtrust.co.uk/foundation</a>
Carbon Trust Venture Capital Programme		<a href="http://www.thecarbontrust.co.uk">www.thecarbontrust.co.uk</a>
Centres of Excellence	CofE	See <a href="http://www.strategyforsuccess.info">www.strategyforsuccess.info</a>
Chatham House' Rules		<a href="http://www.chathamhouse.org.uk">www.chathamhouse.org.uk</a>
Coalfields Enterprise Fund		<a href="http://www.coalfields-enterprise-fund.co.uk">www.coalfields-enterprise-fund.co.uk</a>
Community Finance and Development Association		<a href="http://www.cdfa.org.uk">www.cdfa.org.uk</a>
Community Loan Fund		<a href="http://www.lif.org.uk">www.lif.org.uk</a>
Community Loan Fund North East	CLFNE	<a href="http://www.onenortheast.co.uk/page/regionalsupport">www.onenortheast.co.uk/page/regionalsupport</a>
Department for Trade and Industry	DTI	<a href="http://www.dti.gov.uk">www.dti.gov.uk</a>
Enterprise Capital Fund	ECF	<a href="http://www.sbs.gov.uk/sbsgov/action">www.sbs.gov.uk/sbsgov/action</a>
Enterprise Grant and Regional Selective Assistance		<a href="http://www.onenortheast.co.uk/page/regionalsupport">www.onenortheast.co.uk/page/regionalsupport</a>
Enterprise Ventures Limited		<a href="http://www.enterprise-ventures.co.uk">www.enterprise-ventures.co.uk</a>
Entrust		<a href="http://www.entrust.co.uk">www.entrust.co.uk</a>
Environment Industries Foundation		<a href="http://www.eif.org.uk">www.eif.org.uk</a>
Environmental Micro Loan Fund		<a href="http://www.eif.org.uk">www.eif.org.uk</a>
European Regional Development Fund	ERDF	<a href="http://www.erdf.opdm.gov.uk">www.erdf.opdm.gov.uk</a>

European Structural Funding	ESF	<a href="http://www.europeanfundingne.co.uk">www.europeanfundingne.co.uk</a>
European Union	EU	<a href="http://europa.eu">europa.eu</a>
Government Office for the North East	GO-NE	<a href="http://www.go-ne.gov.uk">www.go-ne.gov.uk</a>
Joint European Resources for Medium Enterprises	JEREMIE	<a href="http://www.wir.europa.eu/jeremie">www.wir.europa.eu/jeremie</a>
Library House		<a href="http://www.libraryhouse.net">www.libraryhouse.net</a>
London Stock Exchange	LSE	<a href="http://www.londonstockexchange.com">www.londonstockexchange.com</a>
National Endowment for Science, Technology and the Arts	NESTA	<a href="http://www.nesta.org.uk">www.nesta.org.uk</a>
North East Business and Innovation Centre	NEBIC	<a href="http://www.ne-bic.co.uk">www.ne-bic.co.uk</a>
North East Co-investment Fund	NECOIF or COIF	<a href="http://www.northstarei.com">www.northstarei.com</a>
North East Equity Matching Fund	NEEMF	<a href="http://www.neemf.co.uk">www.neemf.co.uk</a>
North East Proof of Concept Fund	NEPOC or POC	<a href="http://www.northstarei.com">www.northstarei.com</a>
North East Regional Investment Fund	NERIF or NEIF	<a href="http://www.evolve-finance.co.uk">www.evolve-finance.co.uk</a>
North East Social Enterprise Partnership	NESEP	<a href="http://www.capitalisenortheast.co.uk">www.capitalisenortheast.co.uk</a>
North Star Equity Investors	NSEI	<a href="http://www.northstarei.com">www.northstarei.com</a>
NorthEast Business Angels		
Northern Enterprise Limited	NEL	<a href="http://www.nel.co.uk">www.nel.co.uk</a>
Northern Film & Media	NFM	<a href="http://www.northernmedia.org">www.northernmedia.org</a>
Northern Intellectual Property Fund	NIPF	
Northern Pinetree Trust		<a href="http://www.northernpinetreetrust.co.uk">www.northernpinetreetrust.co.uk</a>
Northern Venture Managers	NVM	<a href="http://www.nvm.co.uk">www.nvm.co.uk</a>
NStar		<a href="http://www.nstarfinance.com">www.nstarfinance.com</a>
ONE NorthEast		<a href="http://www.onenortheast.co.uk">www.onenortheast.co.uk</a>
Prince's Trust		<a href="http://www.princes-trust.org.uk">www.princes-trust.org.uk</a>
Project North East		<a href="http://www.pne.org">www.pne.org</a>
Qi3		<a href="http://www.qi3.co.uk">www.qi3.co.uk</a>
Regional Development Agency	RDA	<a href="http://www.englandsrdas.com">www.englandsrdas.com</a>
Regional Economic Strategy	RES	<a href="http://www.onenortheast.co.uk/page/res">www.onenortheast.co.uk/page/res</a>
Regional Micro Loan Fund		<a href="http://www.onenortheast.co.uk/page/regionalsupport">www.onenortheast.co.uk/page/regionalsupport</a> or <a href="http://www.businesslink.gov.uk">www.businesslink.gov.uk</a>
Regional Financial Services	RFS	<a href="http://www.regionalfinancialservices.org.uk/">www.regionalfinancialservices.org.uk/</a>

Selective Finance for Investment	SFI	<a href="http://www.onenortheast.co.uk/page/regionalsupport">www.onenortheast.co.uk/page/regionalsupport</a> or <a href="http://www.businesslink.gov.uk">www.businesslink.gov.uk</a>
Small and Medium sized Enterprise	SME	<a href="http://ec.europa.eu/enterprise/enterprise_policy/sme_definition">ec.europa.eu/enterprise/enterprise_policy/sme_definition</a>
Small Business Service	SBS	<a href="http://www.sbs.gov.uk">www.sbs.gov.uk</a>
Small Firm Loans Guarantee	SFLG	<a href="http://www.businesslink.gov.uk/sflg">www.businesslink.gov.uk/sflg</a>
Social Enterprises		
Spirit of Enterprise Fund		<a href="http://www.northernpinetreetrust.co.uk">www.northernpinetreetrust.co.uk</a>
Strategy for Success		<a href="http://www.strategyforsuccess.info">www.strategyforsuccess.info</a>
Street North East		<a href="http://www.streetnortheast.co.uk">www.streetnortheast.co.uk</a>
UK Steel Enterprise		<a href="http://www.uksteelenterprise.co.uk">www.uksteelenterprise.co.uk</a>

## ***E. Sources of Finance***

### **8.5.1 Grants**

Grant-dependence has been a feature of the North East economy for some years as traditional mining, ship-building and steel-making industries went into decline and closure. However it is recognised that grants rarely create sustainable jobs and the debt and equity schemes introduced over recent years have been part of an attempt to change this culture. Nevertheless some grant schemes remain.

#### **Selective Finance for Investment in England**

Much of the North East's industrial area currently qualifies for Selective Finance for Investment in England (SFI). Delivered by the UK Government, this scheme replaced both the Enterprise Grant and Regional Selective Assistance. The scheme is open to inward investors as well as local firms and is normally focused on a capital investment to protect or create jobs in an assisted area, although there must be a benefit to the UK as a whole. Subject to job creation milestones and the scale of the investment, up to 20% of the capital investment may be provided. Changes to assisted area maps may affect the availability in future. Many larger scale deals in the North East currently have an element of SFI. One area of difficulty is large employers based in rural areas which generally do not qualify for SFI.

#### **Carbon Trust**

Investments with potential to reduce greenhouse emissions may qualify for Carbon Trust Grants. Delivered by the Carbon Trust, this scheme is open to UK businesses and research institutions undertaking innovative development and commercialisation of CO<sub>2</sub> emission reduction technologies. Grants can be up to 60% of allowable costs up to £250 thousand per project.

#### **NESTA**

SMEs or small groups of individuals may be able to obtain a grant to support the costs of proving a high risk concept and obtaining intellectual property protection for it can be supported by a grant from NESTA, the National Endowment for Science, Technology and the Arts. The grant can be up to £65 thousand although this can be raised to £150 thousand where additional private sector funding is obtained.

#### **DTI R&D Grants**

Individuals planning to start businesses and existing SMEs maybe able to benefit from a range of DTI- led grants for research & development. These grants are intended to help businesses carry out development work leading to technologically innovation products or processes. Four categories of project may qualify.

- Microprojects: available to businesses with less than 10 staff, provide between £2,500 and £20 thousand (up to 50% of eligible costs) over a period of 12 months
- Research projects: available to businesses with less than 50 staff, provide between £20 thousand and £75 thousand (up to 60% - 65% in Tier 2 areas - of eligible costs) over a period of 6 to 18 months
- Development projects: available to businesses with less than 250 staff, provide between £20 thousand and £200 thousand (up to 35% - 40% in Tier 2 areas - of eligible costs) over a period of 6 to 36 months
- Exceptional Development projects: available to businesses with less than 250 staff, provide up to £500 thousand (up to 35% of eligible costs) over a period of 6 to 36 months

## **8.5.2 Debt**

Debt is the 'preferred form of entrepreneurial finance' according to several experienced fund managers.

### **Commercial Loans**

Larger firms with substantial (greater than £0.5 million) earnings before interest and tax (EBIT) are readily able to negotiate debt finance through various corporate finance intermediaries and mainstream banks based or represented in the North East with Barclays and Royal Bank of Scotland seen as particularly active at present.

### **Small Firms Loan Guarantee**

Relatively young SMEs may be able to raise debt finance through the recently revised Small Firms Loan Guarantee Scheme (SFLG) operated by banks but partially underwritten by the DTI (75% of loan underwritten for an insurance premium of 2% of outstanding capital). SFLG focuses on credit scoring focused on the quality of the business plan and can provide £5 thousand to £100 thousand (£250 thousand if the SME has been trading more than two years).

### **North East Investment Fund**

Most SMEs in assisted areas of the North East, irrespective of development stage and transaction type (eg start-up, expansion, MBO, MBI), may benefit from predominantly (there is usually a small equity element) debt finance using the North East Investment Fund 3 (NEIF3), an £18M fund financed by Barclays Bank and ERDF, which can invest between £15 thousand and £1, million managed by Northern Enterprise Ltd (through its Evolve Finance specialist mezzanine and debt division) and operated alongside the Money with Management mentoring scheme operated by Northumbria Enterprise Limited (Entrust). This fund is experiencing strong current demand.

### **NESEP**

Social enterprises unable to acquire loans from mainstream sources may be able to borrow between £15 thousand and £100 thousand (up to £250 thousand when the Community Loan Fund North East is also involved) from the North East Social Enterprise Partnership (NESEP) under the CapitaliSE scheme.

### **Community Loan Fund**

Not-for-profit organisations, including social enterprises, registered charities, and voluntary associations, unable to acquire loans from mainstream sources may be able to borrow between £15 thousand and £100 thousand (up to £250 thousand when the North East Social Partnership is also involved) from the Community Loan Fund North East managed by Business in the Community.

### **North East Proof of Concept Fund**

Technology and Science-based SMEs, potential businesses, and University spinouts may be eligible for loans of £10 thousand to £60 thousand from the North East Proof of Concept Fund (NEPOC), a £10M partly ERDF-financed fund managed by NorthStar Equity Investors limited on behalf of ONE NorthEast. The fund, operating as a pipeline-primer for future deals, has been closing deals (around 80 to date) consistently at the top of its range but will be under some pressure, given current deal flows, to invest all its fund by the closure deadline despite there being more than enough well-qualified demand. There is some concern over future problems arising because these loans come without access to independent business strategy and planning advice.

### **Northern Intellectual Property Fund**

Northern Film & Media (NFM) is developing a similar scheme, the Northern Intellectual Property Fund, to overcome some of the specific barriers involved in obtaining investment in media creation.

### **Carbon Trust Loan Fund**

Established SMEs investing in energy-efficient equipment or carbon saving projects may be eligible for interest-free unsecured 4-year loans of £5 thousand to £100 thousand from the Carbon Trust Loan Fund.

### **Micro Loans**

Two regional Micro Loan Funds, financed by ONE NorthEast and GO-NE come to an end of their investment period this year. They provide unsecured loans up to £15 thousand:

- Regional Micro Loan Fund, administered by the Business & Innovation Centre, helps SMEs start up or expand their business
- Environmental Micro Loan Fund, administered by the Environment Industries Foundation, helps SMEs in the environment sector start up or expand their business

It is not clear to us why these two funds cannot be managed as one.

### **Street North East**

Established, cash-flow positive but cannot access traditional loan sources, self-employed and micro-businesses with less than 10 staff may be eligible for unsecured loans of £500 to £10 thousand from Street North East. This Fund has been running for several years, has a good investment record, and some management capacity to expand its investment base.

### **Spirit of Enterprise Fund**

Disabled people may be able to obtain between £1 thousand and 5 thousand in unsecured loans from the Spirit of Enterprise Fund to help them start up or expand a business. This fund is managed by the Northern Pinetree Trust.

### **Project North East Micro Loan Fund**

Individuals, who are clients of a recognised Enterprise Agency and cannot access traditional loan sources, may be able to obtain up to £5 thousand in unsecured 3-year loans from the Project North East £1 million Micro Loan Fund to help them start up a business. This programme is managed by Project North East and its Board of Trustees.

### **Prince's Trust**

Unemployed people between 18 and 30 may be able to obtain between £4 thousand (as a sole trader) and £4 thousand (in a partnership) in unsecured loans from the Prince's Trust to help them into self-employment. This fund is managed by local offices of The Prince's Trust.

## **8.5.3 Equity**

The North East is home to only a very small number of public limited companies with access to mainstream capital markets, such as AIM and LSE.

Much has been said and written about changes in the venture capital market over recent years that has led to a concentration of both expertise and funds in and around London and a perception that, with easier pickings close to home, few venture capitalists (VCs) will venture into the North East however good a deal is on the table. This is compounded by the closure of Newcastle's 3i office, limited local deals by NVM, and the growth of Leeds as a financial centre. However no intermediaries believe there is a need for VCs to be present in the region in order to get finance for a good proposition.

Most players believe that growing firms face an 'equity gap' when attempting to raise equity in the range £500 thousand or £1 million to £2 or £5 million, citing evidence that very few deals are struck in this range anywhere in UK. One recent study by Library House claims this gap is a myth by citing evidence that there are almost as many investment deals made in this 'gap' as outside it. Nevertheless it is likely that there are regional variations with those regions further away from the strong capital-raising and capital-investing communities more likely to see a gap.

The Almeida Capital<sup>xiv</sup> report, albeit based on investment data from 2003 commented in several facets of SME investment in the North East. There was a higher rate of investment per SME (number of investments per 1 thousand SMEs) but the average investment was much smaller than elsewhere in UK and almost all the investments being made by in-region fund managers.

#### **Northern Venture Managers**

Medium-scale equity investments between £500 thousand and £5 million are within the deal range of Northern Venture Managers (NVM) which manages a range of venture capital trusts. NVM is strong and, although, regionally based, operate nationally in UK.

#### **North East Investment Fund**

NEL also make available equity plus loan funding via its Evolve channel of £15 to 250 thousand.

#### **Enterprise Capital Funds**

SMEs with a high growth opportunity may be eligible for equity investments up to £2 million by one or other of the various Enterprise Capital Funds currently being set up around the UK.

#### **Carbon Trust Venture Capital Programme**

Businesses developing low carbon technology solutions may qualify for equity co-investment of £250 thousand to £1.5 million from the Carbon Trust Venture Capital Programme. This fund is managed by the Carbon Trust.

#### **North East Co-Investment Fund**

Technology and Science-base SMEs may be eligible for equity investment of £100 thousand to £1 million from the ERDF-financed £23 million North East Co Investment Fund (NECOIF) as part of a larger finance deal. NECOIF is managed by NorthStar Equity Investors Limited. The fund has to apply commercial principles and has completed only a handful of matched deals to date, committing less than 10% of its funds. Although the deal rate is expected to accelerate in the next 18 months, average investment values are understood to be falling putting more pressure on the team to find and execute deals.

#### **Business Investors Group**

Owner-managed businesses in any sector may be eligible for equity investment of £10 thousand to £1 million from the Business Investors Group (BiG), often with integrated business support expertise from the NorthEast Business Angels.

#### **Bridges Community Ventures**

SMEs, irrespective of development stage and transaction type (eg start-up, expansion, MBO, MBI), based in multiply-deprived wards and connected with the local community by employment, market, or supply chain with a high growth opportunity may be eligible for equity investments between £150 thousand and £500 thousand by the Bridges Community Venture Capital Fund.

#### **Coalfields Enterprise Fund**

SMEs based in, or employing people from, coalfield wards and in eligible sectors (excludes automotive, shipping, and textiles) with growth potential may be eligible for equity investments between £40 thousand and £500 thousand by the Coalfields Enterprise Fund managed by Enterprise Ventures Limited.

#### **Capital North East**

SMEs with high growth potential, irrespective of development stage and transaction type (eg start-up, expansion, MBO, MBI), may be eligible for equity investment of £50 thousand to £250 thousand from SBS-financed £15M Capital North East (formerly Insight Capital) managed by Northern Enterprise Ltd. This fund appears to be obsolescent in the face of the more flexible NERIF3.

**UK Steel Enterprise**

SMEs planning to expand, and start-ups to be based in the traditional steel areas of Derwentside, Hartlepool and Teesside, may be eligible for equity investments between £15 thousand and £400 thousand by UK Steel Enterprise.

**North East Equity Matching Fund**

SMEs planning to expand and start-ups may be eligible for equity investments between £25 thousand and £100 thousand as a co-investment by the North East Equity Matching Fund managed by Entrust.

**Northern IT Research Fund**

This fund makes available up to £50 thousand to SMEs working in the IT and associated sectors in the North East.



## *F. References*

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- <sup>i</sup> See for example <http://www.statistics.gov.uk/CCI/article.asp?ID=1400&Pos=&ColRank=1&Rank=374> for a recent regional comparison of Gross Value Added in the economy. The North East was the second lowest performing region in 2004, adding £13,433 per head of GVA, compared with a national average of £16,802. The index compared with the UK as a whole decreased from 85% in 1992 to 80% in 2004
- <sup>ii</sup> See [www.onenortheast.co.uk](http://www.onenortheast.co.uk)
- <sup>iii</sup> See [www.strategyforsuccess.info](http://www.strategyforsuccess.info) for further information
- <sup>iv</sup> See <http://www.onenortheast.co.uk/page/res.cfm>
- <sup>v</sup> See [www.qi3.co.uk](http://www.qi3.co.uk) for further information
- <sup>vi</sup> For example "Improving Access to Finance for Small and Medium Enterprises in the North East", Deloitte & Touche April 2003. Commissioned by the Regional Access to Finance Expert Group. A number of other studies are referenced and analysed in Appendix B
- <sup>vii</sup> Sources included company and Venture Capital provider web sites, previous studies listed in Appendix B, Office of National Statistics and similar sources, press reports and our own knowledge
- <sup>viii</sup> Enterprise Matching Funds are an initiative supported by funding from the UK Department of Trade and Industry
- <sup>ix</sup> A Mapping Study of Venture Capital Provision to SMEs in England; see [www.altassets.com/dti\\_vc2005.php](http://www.altassets.com/dti_vc2005.php)
- <sup>x</sup> Evidence from interviews with intermediaries
- <sup>xi</sup> Evaluation of the investment readiness demonstration projects fit4finance; see: [www.sqw.co.uk/pdfs/investreadiness\\_finalrept.pdf#search=%22sqw%20sbs%22](http://www.sqw.co.uk/pdfs/investreadiness_finalrept.pdf#search=%22sqw%20sbs%22)
- <sup>xii</sup> Business Link 'No nonsense guides'; see [www.businesslink.gov.uk/bdotg/action/publicationOrder](http://www.businesslink.gov.uk/bdotg/action/publicationOrder)
- <sup>xiii</sup> Business Support with the 'F' factor funded by the European Social Fund under the Equal Community Initiative Programme and published by Prowess; see [www.prowess.org.uk](http://www.prowess.org.uk)
- <sup>xiv</sup> A Mapping Study of Venture Capital Provision to SMEs in England; see [www.altassets.com/dti\\_vc2005.php](http://www.altassets.com/dti_vc2005.php)