ACCESS TO CAPITAL AND FINANCE: STRATEGIC CONTEXT, CHALLENGES AND POLICY RECOMMENDATIONS

The UK's capital, finance and investment markets are currently ill-equipped to narrow the UK's regional productivity inequalities and they urgently need help in doing this. Research at The Productivity Institute shows that at present the investment risk premia gaps between London and most cities and regions away from the South East are of the order of 250-300 basis points, equivalent to today's sovereign spreads between the UK and Romania or Chile, and as wide as the sovereign risk-premia spreads across the whole of Europe or the USA. Closing these investment attractiveness gaps is of paramount importance in driving productivity growth across all of the UK and requires public-private coordination to make progress. Neither the private sector nor the public sectors can achieve this on their own, and coordinated public-private actions are essential. What is needed is to create commercially sound and sustainable reasons for people from successful centres to spend time and moneys in other UK centres.

- To do this, there is a need to build on existing strengths of the UK financial system and its business services system, and greatly connect and extend this into areas where the financial institutional system is inadequate. The current system is fragmented, dysfunctional in terms of SME capital-provision, and overly skewed to London and its immediate hinterland. Building a much deeper UK-wide footprint of angel investments, venture capital and long-term relationship-banking institutions targeting local SMEs is therefore essential for the UK-wide fostering of the start-ups and scale-ups which underpin innovation-led regional economies. Rather than simply 'blue-skies' innovation, for rapidly driving local productivity and employment enhancements, there needs to be a greater focus on SME scale-up and process innovation. For regalvanising regions, there is also a need for much greater levels of patient capital - equity and debt - in UK regions, in order to underpin the long-term turnaround of many of these places.

- Most SMEs do not borrow money but rely for their survival on their ability to self-fund. This severely limits their ability to scale up, which is critical to the challenge of levelling up the UK economy. Of those that borrow, UK Finance estimates that more than 60% comes from outside the big five banks. A willingness to support growing companies with debt is a key factor behind the growth of the German Mittelstand. The debt offering in the UK is limited. As the large banks have reduced their connections in local communities, so they restrict their lending to the short term, or to term property finance. The experience of the SBA (Small Business Administration) in the USA, working alongside the local community banking network in providing long-term finance for businesses, is instructive in this regard, helping to foster a wider local SME entrepreneurial and innovative offering. To achieve this, there is a crucial need for removing impediments such as weak planning bureaucracies and regulatory constraints.

- Bringing into play the expertise, convening powers and, in many cases, also the financial resources of universities, is also essential, wherever possible, to act as a potential bridge between different stakeholders, as well as providing leverage in key aspects of the SME-capital-access nexus, especially regarding local innovative start-ups and scale-ups. Universities should be heavily incentivised to undertake these activities. The current incentives are minimal.

- At the city-region level, there is an urgent need to re-galvanise the local financial ecosystem in ways that are attractive to the investment markets. The experience of rotating finance vehicles such as the GM Housing Investment Loans Fund and Brownfield Housing Fund, the Jessica Fund in South Yorkshire, and the Chrysalis Fund in Liverpool City-Region, have demonstrated a tremendous ability not only for galvanising finance into a region, but also shifting local public policy to becoming much more market-oriented and investment-aware both in the real estate and SME arenas. However, in comparison to many other similar-sized OECD and EU countries such as Germany, France, South Korea and Japan, in the UK the scale of development finance flows into local and regional development is tiny.

- The UKIB UK Infrastructure Bank and the BBB British Business Bank are ideally placed to develop and organise programmes to attract third party finance and seed deals with their own money. Joint UKIB-BBB capital injections along the lines announced for the UK National Wealth Fund, but in this case aimed squarely at fostering local rotating finance vehicles and institutions, will be essential for galvanising local capital markets, enhancing the attractiveness of regions to investors, and linking local economies to national and global investment channels.

- The capacity of local government to manage financial interactions must also be significantly enhanced. At present, there is a chronic lack of business-related and financial skills in local councils, inhibiting conversations with investors aimed at promoting investment. Central government needs to support capacity-building and the reskilling all core departments involved in programmes of re-energising local investment activity in the areas of financial literacy and business engagement.

- Moreover, scale is essential in driving economic development. Institutional reforms at the delegated level aimed at rebuilding confidence and capacity in sub-central government is essential, and the proposed constitutional reforms put forward by the Denham-Lidlington proposals map out the legislative architecture for a devolution framework. These proposals provide a pathway for localities to achieve scale in their governance systems in a manner which is appropriate for that locality.

- Central government needs to make it unambiguously clear that narrowing regional productivity divides and raising growth in all regions is an integral part of driving national growth. Without such an unambiguous statement, the Green Book principles will inadvertently and systematically lead to public investments being further skewed towards London and the South East.

POLICY RECOMMENDATIONS

Finance and Financial Institutions.

In view of the Government's announcement on 9th July 2024 that it intends to align UKIB and BBB under a new National Wealth Fund, The Productivity Institute, working alongside senior industry and institutional professionals, recommends the following actions as essential for helping finance to drive productivity growth:

- The UKIB and BBB should be jointly tasked with providing the capital needed for establishing or scaling-up rotating financial vehicles and institutions in the combined authorities (CAs) aimed at local commercial real estate development alongside SME promotion which must be professionally managed at arms'-length from the CAs with an independent and financially literate governing board:
- To leverage scarce financial resource for essential infrastructure, that UKIB set up a programme to bring in market sources in parallel to its own lending, on the model of ICFC (Industrial and Commercial Finance Corporation).
- That BBB and Innovate UK develop joint programmes, requiring BBB to have direct contact with its clients and a presence on university campuses; allow BBB to seed new rounds for new regional VC/PEs to encourage institutional co-investors.
- Use BBB to administer soft 10-year loan programmes so that businesses do not have to take impatient equity early. (This is a lesson from the UK's experience of emerging countries finance)
- That support for Innovation encompasses SME process improvement and scaling up, with contact facilitated by Innovate UK's advisors.

Business Innovation, Cities and Regions

- The Department for Business and Trade should convene consortia of local businesses and universities to agree their roles in supporting investment in their regions, including skills and training with post-1992 universities and Further Education Institutions. Universities should receive additional funding for engaging with these programmes.
- The Russell Group universities working together should be convening the development of university spinouts, commercialisation and private sector entrepreneurial funding, with local businesses in promoting entrepreneurship and the retention of businesses in the regions.
- Establish Innovation Councils on the US Tech Hub model focussed on activities outside of the Golden Triangle. UKRI Catapults need a dual mandate of translational research and local economic growth.
- Encourage and fund partnerships between spin-offs from the 'Golden Triangle' and universities in other regions outside of the wider South East able to offer resource for manufacturing. Allow cities to determine which networks of research centres they wish to partner with.

Authors:
Professor Philip McCann, The Productivity Institute, University of Manchester
Charles Lord Aldington, Ditchley Foundation, Former Chair Deutsche Bank UK
Dr David Cleevely CBE FREng, Trinity Hall, University of Cambridge
Professor Sir Paul Collier CBE, University of Oxford
Ron Emerson CBE, Former Chair of the British Business Bank
Dr Susanne Frick, Cardiff University and The Productivity Institute
Professor Vincent Goodstadt, UK2070 Commission
Professor Colin Mayer CBE, University of Oxford
Dr Paula Prenzel, Greifswald University and The Productivity Institute
Ian Taylor, University of Oxford, The Productivity Institute and Business in the Community

Cite:
The Productivity Institute (2024) Access to Capital and Finance: Strategic Context, Challenges and Policy Recommendations, The Productivity Institute