



Lowlands and Uplands Scotland Programmes 2007 - 2013

## PARTNERSHIP BETWEEN CITIES AND MANAGING AUTHORITIES

### SME FINANCE

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## The Scottish Context

**The size of Scotland's cities necessitates economies of scale for risk capital**

**European Commission encourages development of support at a national or sub-national level**



## The Scottish Context

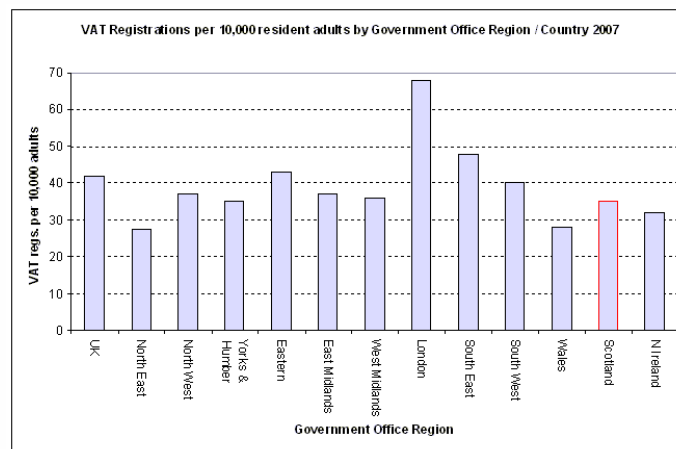
### Significant market failings in regard to the development of the SME sector

- The rate of new company starts was lower in Scotland than anywhere else in the UK
- Many potential entrepreneurs were put off by worries over raising the necessary finance
- Concern existed that many new ventures failed because of under-capitalisation



## Business Birth Rate in Scotland

### ♦ VAT Registrations



## Restructuring of Local Banking

### Savings Banks

- Structural changes introduced in 1975
- Savings bank movement concentrated in regional banks under a holding company and expected to become competitive with commercial banks and offer wide range of services to personal and corporate customers
- Further consolidation until there was just one bank (TSB Bank Scotland PLC) which was sold to the public in 1986
- Share capital from TSB acquired by Lloyds Bank in 1995 to form Lloyds TSB Scotland



## Restructuring of Local Banking

### Demutualisation

- 10 building societies of the UK were demutualised between 1989-2000, either becoming a bank or being acquired by a larger bank
- By 2008, every building society that floated on the stock market in the wave of demutualisations of the 1980s and 1990s had either been sold to a conventional bank, or been nationalised
- The traditional community service of the old mutual society no longer applies



## Progress on the Lisbon Strategy

- ◆ Need to increase the availability of risk capital
- ◆ The limited availability of finance is an obstacle to setting up and developing business in Europe
- ◆ Company financing in Europe is currently too lending based and not enough risk capital based
- ◆ Insufficient mobilisation of capital
- ◆ The infrastructure to channel more capital to investment opportunities is underdeveloped



*[Wim Kok, November 2004]*

## Added Value of Equity Risk Capital

### **‘Smart’ Money**

- Entrepreneurial Experience
- Mentoring Skills
- Contacts
- Access to More Cash



## Contributory Factors to the Equity Gap

### On the Demand Side:

- Insufficient Concept Development.
- Poor Proposal Presentation.
- Management Inexperience.

### On the Supply Side:

- Inaccessibility of Finance Providers.
- Inadequate investment skills.
- Insufficient knowledge of new technologies.
- High transaction costs.

### On the Support Side:

- Major knowledge and skills gaps.



## It's Angels Who Fund Early Stage

***“In 2002 and 2003, business angel investment in Scotland was more than twice the level of early stage investment recorded by British Venture Capital Association members”***

*[Richard T Harrison, “The Equity Capital Market in Scotland: A Benchmark Analysis and Report “ (2004)]*



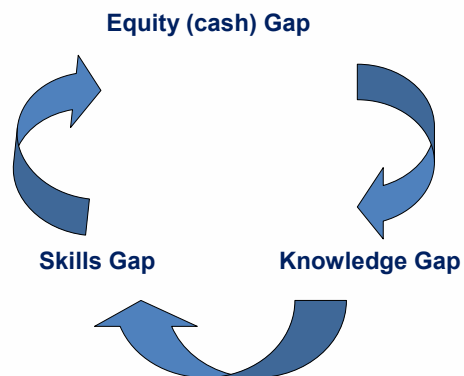
## Business Angels - Essential

*“Business angels are an essential part of the financing food chain and from public policy perspective they need to be well integrated with other sources of financing”*

*[The Directorate-General for Enterprise and Industry Report “Best practices of public support for early-stage equity finance” September 2005]*



## The Principal Funding Gaps



## Co-Investment Funds – Scottish Enterprise

- ♦ The Scottish Co-Investment Fund (SCF) is a £72m equity investment fund, part funded by the ERDF, to invest from £100,000 to £1million in company finance deals of up to £2million
- ♦ The Scottish Venture Fund (SVF) is a £50m equity investment fund, part funded by ERDF to invest from £2m to £10m in early stage companies



## Lending to SMEs

### A Federation of Small Businesses survey in December 2009 showed:

- 32% of respondents were charged more over past year to borrow money
- 31% said banks lending more money or more fairly would be key in improving business prospects, but
- 27% said profitability had increased over the past year
- 51% would continue to innovate in the next year



## Lending to SMEs

- JEREMIE – improving access to finance and risk capital for SMEs and development of microcredit
- Evaluation of Structural Funds support 2000-2006 confirmed:
  - The supported Venture Capital Loan Funds addressed areas of continuing market failure
  - Co-investment model helps develop the local financial community
  - Evidence suggests high additionality



## Continuing Need To Support Innovation And University Commercialisation

- Very early stage Seed Capital (Low IRR).
- Proto-Businesses.
- Inherently very high risk.
- Conventional Investors not interested.
- Essential to create investment pipeline and quality deal flow.





## West of Scotland Loan Fund

- Structural Funds Programmes contribute to economic recovery plans at Scottish, UK and EU level
- West of Scotland Loan Fund (WSLF) provides loan finance to new and early growth, SMEs
- Independent evaluation showed that in the last 5 years, at the Scottish economy level, businesses supported by WSLF achieved net impacts of:
  - €64.3 million increase in turnover,
  - 760 new jobs created,
  - 2,280 jobs safeguarded
  - €30 million gross value added.



## Response to Banking Crisis

- Danger of distorting the market through public sector intervention
- When should public sector support withdraw once improvements in financial situation?
- What are the State Aid/competition implications?



## Market Research

- **Increased need for regular market research**
- **Must reflect changes in market conditions**
- **Looking for new players, particularly from the private sector**



## Creating an Educated, Dynamic Local Investment Community

- Recognise the evolutionary nature of the programme of actions and package of measures/investment vehicles
- Ensure that these measures/funds are coherent, market driven and do not overlap
- Do not implement projects without first ensuring that any other supportive development work has been done
- Recognise the need to simultaneously develop skill and knowledge levels in both the demand and supply side
- Development must be done in a manner designed to bring the demand and supply sides together, in partnership



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