

Government finance

Teresa Graham, Government Advisor, outlines her review of the Small Firms Loan Guarantee scheme...

Helping entrepreneurs with great business ideas but without collateral to access the finance they need was the intention of the DTT's Small Firms Loan Guarantee (SFLG). Now, almost 25 years on, I've been working to help the Government make the scheme even better and easier to use.

In 2003, the Chancellor and the Secretary of State for Trade and Industry asked me to undertake a review of the scheme. I was tasked with examining its structure and rules, and to look at whether SFLG was sufficient to tackle the barriers faced by start-ups and small businesses in the 21st Century. They have now accepted my recommendations and a new look SFLG will be rolled-out later this year.

SFLG, currently administered by the DTT's Small Business Service (SBS), was launched in 1981 to help Small and Medium Enterprises (SMEs) with viable business propositions, but without sufficient collateral on which to secure a loan, to access debt finance. It provides lenders with a government guarantee, worth 75% of the loan, in cases where they would have provided cash were it not for this lack of collateral. Therefore, SFLG works in addition to, rather than in competition with, commercial lending.

Indeed, this partnership between government and the lending institutions is a unique strength of the SFLG programme. Over 7,100 loans worth over £489m were made under SFLG in 2004/05, demonstrating the value of the existing lender network as a route to market. Since the start of the Scheme, 80,000 loans with a value of over £3.5bn have been made.

Although SFLG has successfully helped many businesses over the years, I found that its operational systems were bureaucratic by today's standards and the programme lacked a strategic focus. I believed that it needed to evolve into a modern scheme characterised by strategic and targeted usage, and a high level of understanding about its performance, which could be monitored through 'light touch' regulation and focused on the achievement of broad policy goals.

Their concerns weren't just mine. Comments I received from entrepreneurs and lenders highlighted a number of

important practical difficulties affecting the operation of SFLG that could usefully be resolved. Its objectives are not well understood and its availability has been patchy. Small firms need SFLG but they need an updated, focused and modern scheme.

The evidence from my consultation identified that the barriers to accessing finance are more acute for start-ups and early stage businesses than for more established businesses. Established businesses have access to a wider range of financial products and are more likely to have retained earnings. In addition, surveys indicate that young businesses are more likely to have high growth ambitions and contribute positively to UK productivity.

For these reasons, I recommended that SFLG be focused specifically on start-up and young businesses. In addition, to ensure that these ventures could be adequately funded, I recommended that the maximum amount of finance available be increased from £100,000 to £250,000.

I also found frustration amongst the business community about a perceived inconsistency of delivery of SFLG in different parts of the country. Ensuring that front line managers are aware of the scheme and how it should be used is important, and should be a key part of being an SFLG lender. Encouraging lenders to develop their managers, and demonstrate to the SBS the effectiveness of delivery at a regional and local level, will be a key component for the future.

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Contrary to the popular perception, SFLG costs the taxpayer considerable amounts of money (over £40m in 2004/05) driven by the high default rate on SFLG loans (which average around 30-35%). My review found that default rates are higher than can be explained by risk profiles of borrowers alone and lower default rates would



Rt Hon Gordon Brown MP, Chancellor of the Exchequer

enable more lending to be done at the same cost to government. Moving the supervision of the scheme away from a focus on individual loans to understanding and influencing the performance of the portfolio will ensure that the Government achieves greater value for money.

I also recommended massive deregulation of the Scheme's administration. Simplifying the complex eligibility rules and removing the SBS from the loan approval process will free the lender to make SFLG loans without prior approval, and increase the efficiency of administration for lender and borrower alike. Greater autonomy for the lender will make it easier and more attractive for lenders to make use of SFLG in appropriate circumstances, and will focus the decision on the quality of the business proposition, rather than unrelated eligibility rules.

Enabling successful, serial entrepreneurs to access the new look SFLG will encourage support for competitiveness and innovation in the SME sector, and communicate a powerful message from government for its support for business.

Accompanying deregulation and the devolution of autonomy to lenders comes increased responsibility to utilise SFLG with integrity. Supervision by the SBS using 'risk-based' audit techniques will lead to a 'light touch' approach to ensure that taxpayers' funds are used wisely and efficiently.

It is not intended that my recommendations add to the costs of SFLG; indeed, I have recommended, for the first time, a mechanism for capping government expenditure. It will be for the SBS to decide each year how best to spend the money allocated to SFLG to maximise the amount of lending that can be supported and report progress to Parliament, ensuring transparency in the way SFLG is used.

Modernising SFLG and using web-based delivery tools will remove outmoded and unnecessary regulation, and streamline and reform the administration of SFLG. It will help the Government to deliver on its drive to reduce 'red tape' and the administrative burden on businesses, and assist with UK competitiveness.

It will be important, as the SBS and lenders work in partnership to bring about these changes, for progress to be kept under review and the changes to be evaluated. It will take two to three years for the full impact of such a radical programme of changes to be felt, in particular the impact on default rates and the refocusing of SFLG on younger businesses.

Nevertheless, I believe that the changes will be viewed as successful if: the number of young businesses accessing SFLG has increased; lenders are making effective use of the proportion of funding allocated to them, in an innovative and strategic way, to reach all markets and types of businesses; and the audit process indicates that SFLG is having a positive effect on the UK economy.

In addition, it would be very welcome to see an increase in the number of financial institutions authorised to use SFLG, and that default rates had declined through improved credit assessment techniques and better monitoring of the SFLG portfolio.

Following the acceptance of my review by the Chancellor and the Secretary of State for Trade and Industry, the SBS and lenders are currently working hard to bring about a revolution for this long established intervention. This will result in a modern, efficient, strategic source of funding delivering long-term benefits for the SME community, lenders, the Government and UK enterprise alike.

It will be interesting to watch the component parts of the new SFLG unfold over the next months and years, but with the commitment of the SBS and the lending institutions working in partnership to change the way they manage SFLG, the future of the Scheme looks strong for another quarter century.

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