The Drury Report

"Come back Sid: it's time to reignite the equity culture."

There are 4.5 million SMEs in the UK. Only one million employ staff. The total number of people so in work is 13.8 million representing 43% of the private sector workforce.

A report commissioned by GE Capital suggests that if the UK's SMEs had grown, as seen in Germany, an additional 240,000 jobs would have been created.

From 1998 – 2008 the AIM and PLUS markets provided many hundreds of UK companies with early stage equity finance. If the small-cap sector is rejuvenated, as suggested in this Report, we anticipate a further 200,000 people could find work.

The Drury Report

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The Group Members, listed above and in Appendix One, would like to thank **Andrew Selous MP** for his unwavering encouragement during the events leading up to the writing of this Report and for his advice and guidance on its compilation.

Copies of 'The Drury Report' can be obtained by:

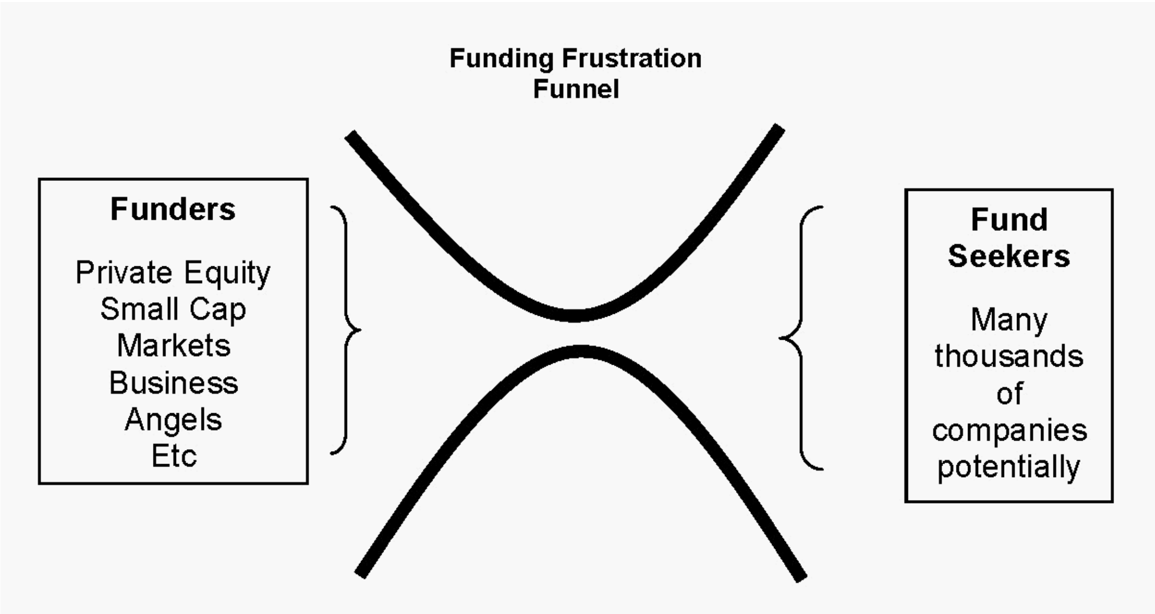
a) emailing tonydrury39@btinternet.com: please state if you require the Report by email or by post (printed version); or

b) downloading it from www.tonydrury.com

The Funding Frustration Funnel

This visually shows the clash between the demand and the supply sides:

See ‘Recommendation 5’ for the full explanation.



“We have lost the ability to be imaginative because we are all worried about the legal liabilities”

Dirk van Dijl. Founder. www.enterprisebritain.com (8 September 2012)

The Drury Report

This Report has been written by a group of experienced and committed financial practitioners who believe that the small-cap sector can make an improved contribution to the UK economy. Our instinct is that optimum solutions come from market-led initiatives. Most of us are paid by results: as a corporate financier my clients expect to reward me on the achieving of an agreed strategic objective: for example, the completion of a successful fund-raising.

During the early months of 2012 the events at PLUS Markets Group formed a basis for a series of blogs on www.enterprisebritain.com. These were read by Andrew Selous MP and a dialogue began between myself, Andrew and Mark Hoban MP, Financial Secretary to the Treasury.

Mr. Hoban encouraged the development of some of the ideas and opinions expressed and in June 2012 I suggested to Andrew that I try to summarise these in a paper. Whilst enthusiastic Andrew cautioned that without peer group endorsement the writing would lack credibility.

I am privileged to work with some of the best financial market practitioners in the UK. I started discussions and was staggered by the positive response. There was a small challenge in that I was asked to complete the paper by the Autumn. The Treasury said that they wanted to read its recommendations and they were nearing making decisions on the small-cap market.

Ever since Harold Macmillan identified the equity gap ('The Macmillan Committee Report 1931: committee on Finance and Industry') and Harold Wilson used the term in 1979, successive Governments have pursued the goal of improving the supply of risk capital to stimulate the growth of small businesses. The Thatcher Government of the 1980s produced millions of Sids who bought (and mostly sold at a profit) shares in nationalised industries. We think it is time to bring Sid back.

We are grateful to the members of the Breedon Taskforce ('Boosting Finance Options for Business': March 2012) for their stimulating report (please see Appendix Three).

We are not political, we are not missionaries. We simply want to use our professional skills to help the UK economy recover from this difficult period of austerity.

Tony Drury
28 November 2012
London, UK.

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Introduction

It’s time for Sid Version 2.0

The objective of the Group members is to enable Government Policy to nurture and encourage private investors, (Sid Version 2.0 if you will), to support the UK economy and aid banks who struggle to support the small-cap sector of the economy. Sid Version 2.0 is a sophisticated and passionate investor who uses technology and markets to make direct investment into small and growing enterprises, and who remains a strong ally of growing businesses.

We can help the successful introduction of Government schemes for SMEs

The Government has many policies which support this space but, as practitioners, the Group members feel that we can, for very little additional revenue cost, significantly encourage the private investment community to back British businesses.

As one example, we believe the introduction of the innovative Seed Enterprise Investment Scheme (SEIS) early stage equity financing plan could have been significantly enhanced by an input from those actually advising both companies and investors.

We can provide practical advice on the proposed employee share ownership model

The Chancellor has issued a package of measures aimed at boosting a new employee share ownership model. We suggest that our practical knowledge and involvement can contribute to its successful implementation.

We can help improve the willingness of banks to lend to SMEs

We feel that an optimum financing package for a SME will combine both equity and debt. As one example, banks could be more willing to lend to early stage SMEs if those companies had already secured equity financing. Thus if more can be done to encourage equity investment this will strengthen balance sheets and allow banks to lend more freely.

We ask the Government to set up a Small-Cap Advisory Committee

We propose that Government maximises our willingness and ability to contribute to the achieving of these ambitions by setting up a Small-Cap Advisory Committee and invites practitioner input before it launches its various initiatives.

OUR RECOMMENDATIONS

The following are the initial recommendations the Group submits for consideration.

1. The Government should place a greater emphasis on the importance of equity finance for early stage businesses:

    a. it will enable banks to lend more freely because SMEs will have stronger balance sheets;

    b. it will enable the high growth companies to secure the support they need to maximise their potential;

    c. ventures such as the Growth Capital Fund will attract more SME support; and

    d. it is compatible with Government's commitment to a long term industrial strategy based on promoting growth companies in strong sectors whilst providing financial benefits (fiscal advantages, dividends and capital growth) to investors.

2. The Government is asked to promote investment by encouraging Trustees of Occupational Pension Schemes to invest up to 5% of their funds into SMEs, with the right to reclaim the 10% Withholding Tax on dividends paid. This would potentially release £40 billion pounds for investment into SMEs.

3. The Government is asked to consider letting businesses with turnover of less than £2m to be taxed on their accounting profits. This removes the requirement for the costly and time-consuming preparation of detailed tax computations.

    The time and cost savings to those companies that would benefit from this concession would be considerable. There would be no loss of income to the Treasury. It is hoped that the actual payment of corporation tax (if applicable) would be accelerated.

4. There is a potential appetite, particularly amongst professional and genuinely sophisticated and experienced high net worth individuals to invest in SMEs. However following the banking crisis and resultant loss of private investors' confidence, our recommendation is to rebuild that confidence.

5. The Treasury and the Department for Business, Innovation & Skills ("BIS") should provide a proactive link between the demand and supply of early stage funding to enable high growth companies to overcome the financial barriers to growth. We propose that the 'frustration funnel' is turned into a tunnel by using local Chambers of Commerce working with local accountants to assist companies in accessing small capital markets. The costs can be met by deductions from funds raised by this process.

6. The Treasury should consider supporting the regulatory costs of Business Angel networks. This requires a detailed explanation but, in summary, early stage equity should be receiving more support from business angels. However the various groups lack cohesion and some are unregulated. This recommendation is an attempt to create a more united industry.

7. The Enterprise Investment Scheme ("EIS") is an effective way of stimulating early stage equity investment. However, the scheme has become increasingly restrictive since its introduction.

   The Treasury is asked to support early stage companies by recapturing on a selective basis the essence of the original Business Expansion Scheme in the 1980s and the introduction of less restrictive EIS conditions for companies with turnover of less than £5 million. These include relaxing the rules on Qualifying Business activities (as an example: allowing small 'property' companies to raise EIS funds) and on 'control' (so controlling shareholders can claim relief).

8. The Financial Conduct Authority ("FCA") is asked to review its strategic approach to the regulation which defines the Business Angel market and that following this, appropriate enforcement be put in place to promote and protect the well being of participants and create confidence. This is not a call for deregulation or necessarily for amended regulation but rather for clarity and confidence building through considered, decisive and strategic regulation and enforcement.

9. We would ask, as part of a panel, to speak to the Financial Conduct Authority about regulation at the smaller end of the market. We would like to begin discussions on the cost of employment and City reputation. We believe the FCA would attain higher levels of professional competence by working more constructively with its member firms.

10. The Government is asked to promote Entrepreneurs' Relief much more enthusiastically. This is one of the great fiscal incentives available today. The rules are simple. Entrepreneurs risk everything and this tax relief can be a massive reward when value realisation takes place.

These recommendations should be considered in the context of a funding function as shown in our 'Stakeholder Analysis: Small Cap Funding Process' which follows. The process of raising early stage funding, and getting it to those companies who need it, is complex and is dependent on a number of influential Stakeholders. The aim of our recommendations is to move all Stakeholders into a position of active support.

Stakeholder Analysis - Small Cap Funding Process

Key stake holder	Role in Process	Power/ Influence Category	Impact H,M,L	Current/ Desired Position					Reason for Current Position
				Strongly Negative	Negative	Neutral	Supportive	Strongly Supportive	
Treasury	Stimulating growth in the economy and employment	A	H			○→		→●	Growth is an imperative for the country. Tax incentives are powerful eg SEED/EIS. Potential for direct funding initiatives. However position affected by fallout from Financial crisis.
Investors	Provision of risk capital	C	H		○→			→●	Concerns over growth/risk prospects for UK investments due to Banking crisis/uncertainty; Euro crisis; long term UK policy re private sector and wealth creation with uncertainty after next election
FSA	Regulation on investment community	A	H		○→		→●		In response to the financial crisis the regulator has become too risk averse and has a negative influence on IFAs with respect to small cap investments
IFAs	Advice to investors	C	M	○→			→●		In response to the FSA regulatory position IFAs are very negative with respect to advice on investment in small cap markets
Small Cap Markets	Attracting investors and arranging appropriate funding for companies	D	H				○→	→●	Strongly supportive of improving the funding process but have little power and limited influence over regulator, IFAs or SFA. Have a restricted awareness of potential high growth companies seeking funding.
Fundseeker	High growth companies looking for funding	D	L	○→				→●	Very limited view of small cap markets and lack of knowledge of entry needs. Negative perception of external investors.
Funding Funnel	Not part of current process so no current Stakeholder	D	H	○→				→●	No perception of need from other Stakeholders albeit business organisations see a need

Note: Power/Influence column
A-high power/high influence. B-high power/low influence. C-low power/high influence. D-low power/low influence

Recommendation 1

The Government should place a greater emphasis on the importance of equity finance for early stage businesses:

a. it will enable banks to lend more freely because SMEs will have stronger balance sheets;

b. it will enable the high growth companies to secure the support the need to maximise their potential;

c. ventures such as the Growth Capital Fund will attract more SME support; and

d. it is compatible with Government's commitment to a long term industrial strategy based on promoting growth companies in strong sectors whilst providing financial benefits (fiscal advantages, dividends and capital growth) to investors.

The Importance of Equity Finance

The EU definition of 'small' SMEs is up to 50 employees and turnover of up to 10m euros. Micro SMEs have less than 10 employees and turnover of less than 2m euros. The commonly accepted belief is that there are perhaps four million firms in the UK fitting these categories and perhaps eight million employees.

Britain's SMEs are predominately small in that it does not have the 'Mittelstand' structure of medium sized businesses as in Germany. A recent report commissioned by GE Capital suggests that if our SMEs had grown, as seen in Germany, an additional 240,000 jobs would have been created. A full analysis of the small-cap sector can be found in Appendix Two.

This paper prefers a definition based on capitalisation and thus treats the small-cap sector as one where companies are capitalised at under £50m and in truth less than £10m. 440 of the 1,100 companies trading their shares on the London Stock Exchange Alternative Investment Market ("AIM") are capitalised at less than £10m.

For us the small-cap sector is 'Middle England': the millions of people trying to run and grow their businesses against all the odds. The sector is friendless, ignored by the banks, hounded by officialdom, bullied by bigger brothers and misunderstood by some politicians.

An assessment of risk

One of the key issues is the perception of risk. Small caps by their nature are higher risk because they have neither the history nor the reserves to withstand setbacks. The FSA seems to have unilaterally decided that SMEs are so risky that only the most sophisticated investor should be let near them. Yet the little acorns approach can be rewarding.

Case Study:

When at St Helen's Capital Tony Drury acted for a company which had a great product but needed development capital. He introduced an investor who provided £40,000 at 1p per share. Three years later the shares reach £1.00, a gain of £3,960,000. That investor suffered several losses on other shares but he understood the territory.

Sources of finance: own resources, debt, equity

Most businesses start out with the promoter investing their own resources: savings, loans from the family, re-mortgages, redundancy payment etc.

It is the access to development capital which is the problem.

Debt v equity

Generally small caps are better served with equity investment. Debt has to be repaid quite quickly thus increasing the cash demands on the business. Equity anticipates future profitability and allows the business owner to plan ahead.

We understand the banks' reluctance towards lending to SMEs. They are responsible to their shareholders for providing a commercial return on their share capital. They find SMEs troublesome and unprofitable. Some practising banker dislike some or all of the Government guarantee schemes. The paperwork alone is a deterrent.

British banks would find lending to SMEs more attractive if those businesses had secured early stage equity investment.

Recommendation 2

The Government is asked to promote investment by encouraging Trustees of Occupational Pension Schemes to invest up to 5% of their funds into SMEs, with the right to reclaim the 10% Withholding Tax on dividends paid. This would potentially release £40 billion pounds for investment into SMEs.

Pension Fund Support

The National Association of Pension Funds (NAPF) speaks for 1,200 pension schemes with some 15 million members and assets of around £800 billion. NAPF members also include over 400 businesses providing essential services to the pensions sector.

The NAPF is already in close consultation with Government, but we would like to promote consultation between the Government, the NAPF and the FSA/FCA with a view to encouraging Pension Trustees, their Actuaries and Investment Managers to invest up to, say, 5% of their funds into SMEs. As an incentive, we would propose that consideration be given to granting Pension Funds the right to reclaim the 10% Withholding Tax on dividends paid by such SMEs.

The suggestion need not be limited to Pension Funds, but could include other institutional long term investors, such as Life Insurance companies.

Recommendation 3

The Government is asked to consider letting businesses with turnover of less than £2m to be taxed on their accounting profits. This removes the requirement for the costly and time-consuming preparation of detailed tax computations.

The time and cost savings to those companies that would benefit from this concession would be considerable. There would be no loss of income to the Treasury. It is hoped that the actual payment of corporation tax (if applicable) would be accelerated.

A Tax Change for the Better

Group members spent much time discussing the changing moral climate for fiscal policy and practice: this is summarised in Appendix Five. The recommendation is based on our practitioners' view that the change benefits qualifying SMEs without losing revenue for the Treasury.

Recommendation 4

There is a potential appetite, particularly amongst professional and genuinely sophisticated and experienced high net worth individuals to invest in SMEs. However following the banking crisis and resultant loss of private investors' confidence, our recommendation is to rebuild that confidence.

Come Back Sid

There are a number of ways by which the involvement of the private investor in the SME sector can be encouraged providing the risk profile is carefully managed.

This can be brought about by the following:

1. An improvement in the quality of companies seeking funding;
2. An improvement in the quality of Company Advisors. This includes Accountants and Solicitors as well as Nominated Advisors and Nominated Brokers;

3. Consultation with Government and HMRC with a view to re-introducing Taper Relief for Small Companies. The structure we propose is:

Number of Whole Years	Percentage of Chargeable Gain
+ Year One	28%
+ Year Two	20%
+ Year Three	15%
+ Year Four	10%

This rewards long term investment, discourages short term strategies and offsets, to some extent, the risks involved in smaller company equity investment:

4. Consultation with HMRC to simplify the SEED EIS ("SEIS") scheme in order to enable Government and Professional Advisors to promote it better:

5. Consultation between Professional Advisors and the Regulator to examine ways in which the cost of Initial Public Offerings can be reduced to a more affordable level:

6. Companies to understand that financial skills are vital to the successful running of a company. A Non-executive Director need not be expensive and can provide important guidance:

7. Consultation with market makers to examine how a more efficient secondary market can be established. The market maker system for smaller companies listed on share trading facilities such as AIM and ISDX is the most efficient but is open to improvement.

We believe that the foregoing would go a long way to re-establishing Private Investor confidence to invest in smaller companies.

Note: If in 1986 Sid had bought the minimum of 100 British Gas shares at the subscription price of 135p per share (cost £135), his holding would today, including the reinvestment of dividends, be worth around £2,000.

Recommendation 5

The Treasury and the Department for Business, Innovation & Skills ("BIS") should provide a proactive link between demand and supply of early stage funding to enable high growth companies to overcome the financial barriers to growth. We propose that the 'frustration funnel' is turned into a tunnel by using local Chambers of Commerce working with local accountants to assist companies in accessing small capital markets. The costs can be met by deductions from funds raised by this process.

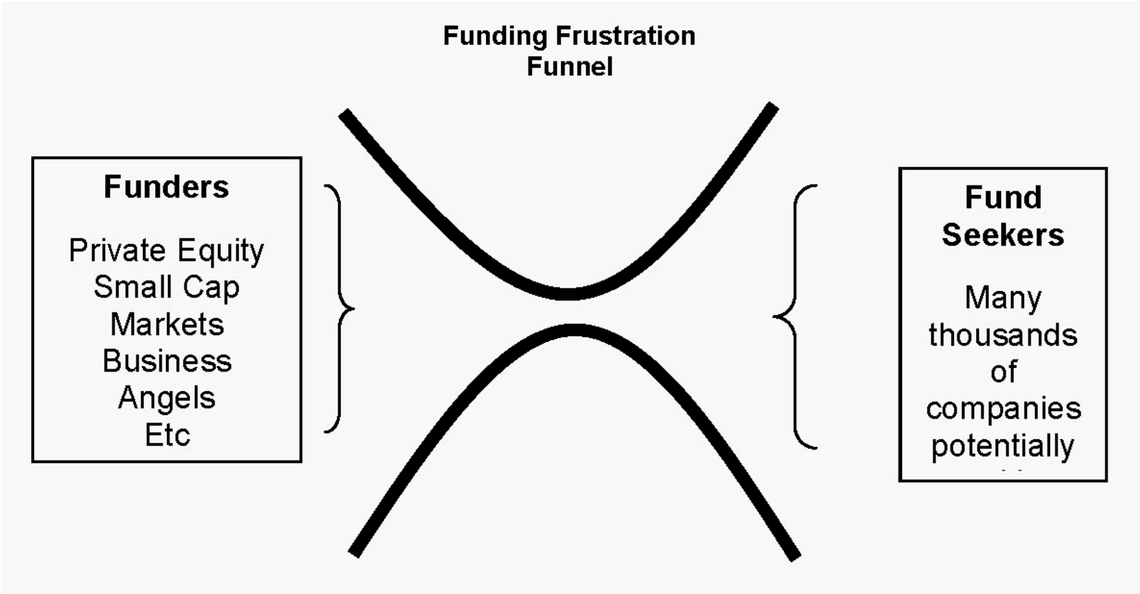
Creating an Effective Process for Funding Growth Companies

In order to stimulate growth in the UK economy it is critical that the private sector creates prosperity and growth in employment. Research from the National Endowment for Science, Technology and the Arts (NESTA) shows that 50% of all jobs growth is created by a limited number of high growth companies. These represent less than 10% of all businesses. Typically such companies have more than 10 employees and have been in existence for 5 years or longer. Further research from NESTA ('Barriers to Growth: the views of high-growth and potential high-growth businesses') shows that these companies find it proportionately harder than other companies to obtain finance. In order that growth can be maximised it is important that the barriers to growth experienced by high growth companies are tackled systematically. This must include removing the barriers that these companies face in obtaining appropriate levels of finance. Proposals from the Centre Forum (Vicky Price) suggest that this is a process failure and we need to be looking at what she describes as a "4th Generation Industrial Policy". The following takes a view of this as a process and looks at how we might effectively link high growth companies to those able to provide finance.

The Business Growth Fund ('BGF Growth Companies Barometer 2012') has identified 4,000 high growth companies across the UK. It has plans to fund up to 25 companies this year and 30-40 each year thereafter. Whilst helpful this results in only 1% of the companies identified getting funding via this route in each year. Having identified these 4000 companies we need to find a way to ensure as many as possible of those companies can access funding if they need it.

Linking Supply and Demand – the "Funding Frustration Funnel"

Taking the view that the providers of capital are frustrated in finding candidates for funding and, that many businesses are frustrated that they cannot obtain adequate finance, we can express this view this as the " Funding Frustration Funnel" shown below



With many providers and many companies the Funders and Fund Seekers are only seeing a very limited view of what is at the other end of the funding funnel. This leads to a hit and miss process in terms of matching potential growth businesses with appropriate funding sources. The following gives a process which could significantly improve success in linking funders to fund seekers and removing the barriers to successful business growth. This could be seen to supplement the Breedon Report recommendation to establish a Business Advice scheme.

High Growth Companies have insufficient knowledge of the sources of funding so we need to link a large number of diverse and geographically dispersed companies with a large number of diverse and geographically dispersed investors.

The lack of visibility through the Funding Frustration Funnel suggest a need for an intermediary to be established as a focus at the centre of the funnel looking both ways, and with sufficient knowledge, to connect the funders and fund seekers. This would best addressed at a local level where the number of companies to be dealt with can be reduced to a manageable number (e.g. considering 4000 high growth companies then say 80 intermediaries each looking at 50 companies would be manageable). A new structure set up to do this would be expensive and unaffordable so there is a need to look at existing local agencies. The newly formed Local Enterprise Partnerships ("LEPs") are a possibility but many of these have very limited resource. They do however have partnerships with business organisations who have a local presence and existing trusted links to the business community.

Chambers of Commerce and the Federation of Small Businesses are organisations which have local structures with sufficient granularity to interface with business on these issues (e.g. there are 50 Chambers of Commerce across the country). The work that Chambers of Commerce does with UKTI on export is a good example of how this works in practice.

To maximise growth the start point of the process should be a focus on High Growth Companies. We should know who the High Growth Companies are (via the BGF research) so we can link the local business organisations to these companies directly.

The local business organisations, working with local accountants, can then provide a link with the appropriate funding providers at both a local and national level. The business organisations will need to have at least one trained individual who will need to be kept up to date on the sources of finance available in the market. After an initial in depth review with a business organisation the individual puts the business in contact with appropriate suppliers of funding.

High growth companies are often not adequately prepared to obtain risk capital. The structure outlined above can be used to improve awareness and suggest routes by which companies can improve their position before approaching potential funders.

Companies often have a negative view of private equity, business angels and the small-cap markets. According to an independent study provided by Coutts Bank 72% of businesses do not believe venture capital is the best way to realise their growth and 24% believe it increases risk of business failure. However, of those that had worked with venture capital, 74% said they had a good relationship with their investors and 80% would recommend it to other entrepreneurs. The structure outlined above can be used to improve awareness. It will be fairly easy to involve local companies who have already had successful experience in working with venture capital providers in the process. They will provide a practical insight in to how such relationships work. At a later stage the process could be extended beyond the high growth companies.

Whilst using existing infrastructure will minimise cost it cannot be free. The cost areas are likely to be

- Training the local business organisation representatives.
- Funding the local business organisations to establish links with high growth companies and for them to make links with the funding providers. (say 10 hours per company going in to the process plus travel expenses for two visits). This can be funded by the companies or from Government. In the second case if companies go through the process to funding then the funds raised could include a sum to be returned to Government. The sum would be determined by making an assumption on the number of companies who would go through to funding and then aiming for the process to be cost neutral to Government.

Some form of process ownership should be established such that performance can be measured and improved over time. The British Chambers of Commerce already audit all accredited local Chambers of Commerce and might be prepared to take on this role. There will be a cost but it would be less than Government oversight.

Recommendation 6

The Treasury should consider supporting the regulatory costs of Business Angel networks. This requires a detailed explanation but, in summary, early stage equity should be receiving more detailed support from business angels. However the various groups lack cohesion and some are unregulated. This recommendation is an attempt to create a more united industry.

Business Angels and Crowd Funding

While the Angels have been wrestling with the Dragons to become the popular image of individuals investing in small companies, suddenly the Crowd has appeared at the gates.

Of course, each of these clichés disguises the variety of motives and outcomes experienced by real individuals making investments into early stage companies. The Angels range from "friends and family" (doubtless some of whom have in mind Mark Zuckerberg's financially supportive father who earned a $60m reward for his doting) to hard-nosed professionals intending to bring detached analysis, insight and a wealth of connections to their investment activity, maybe hoping to emulate Ron Conway whose Angel investments include Ask Jeeves, Facebook, Google, Napster, PayPal and Twitter.

The Dragons are perhaps the most fanciful of the clichés; we have certainly never met an investor who has any desire to melodramatically lord over nervous entrepreneurs (and we can't imagine that it makes for the best post-investment relationship). The Crowd, though still emerging and taking many forms, promises to be the next step in the evolution of investment by individuals in early stage companies.

We are ignoring the friends and family end of the market which will, by its nature, remain informal, substantially hidden, and almost entirely immune to the contrary influences of tax incentives or regulation. Likewise, we'll forget the imaginary Dragons and focus on the real-life Angels, organised through groups and networks, the role of EIS funds, and the fast-growing area of Crowd funding.

We refer to both Angel groups and Angel networks because there are two distinct models for this kind of collaboration (although there's no agreed or settled meaning to the terms themselves). 'Groups' as referred to them tend to be smaller, relatively informal, less professional though perhaps more charming, gatherings of Angels run by Angels, for Angels. 'Networks' on the other hand are run by third party professionals who realise there is a role to be played, and no doubt money to be made, in facilitating and formalising Angel investment. Neither is necessarily more effective or worthy than the other and both have successful and lasting examples in the private sector.

If Angels deserve that name, it is not solely for their financial support. Angels certainly bring money and often at a time in a company's life when the friends and family have run out and yet it is still too early for bank lending or venture capital, but a good Angel will bring so much more. Contacts, governance, fresh thinking and most of all experience will take the company further than money alone can ever achieve. For this reason, it is important that the right Angels find the right companies and so Angel groups and networks are the connectors and enablers which allow otherwise isolated Angels to share opportunities, swap intelligence, find expertise, and collate data. This is an aspect of the ‘frustration funnel’ experienced by high growth companies.

There is also safety in numbers; with the notable exception of Mr Zuckerberg Senior, Angels are extremely unlikely to find success in a single investment and building a portfolio of holdings is the only reliable way to protect against the substantial failure rate among early stage companies. Angel groups and networks are therefore what turns an informal, private activity into an industry and one that many believe is the key to bottom-up growth in the UK economy.

In the past, the public sector has recognised the value of providing this catalytic connector between Angels and companies. Unfortunately, rather than supporting the successful examples already to be found in the private sector, they have instead established competing models, often copying private sector innovations but ultimately suffering from a lack of sustained commitment and operating only within regional boundaries which have no meaning to either investors or high growth companies.

There is a need for public sector support in the provision of connections and aggregation for Angel investment, not least because of the general lack of profitability among angel networks themselves which makes their continued existence precarious and over dependent on the altruistic intentions of their founders. This essential part of the market is the key to unlocking the potential of EIS reliefs and realising bottom up economic growth but is dependent on the evermore fragile existence of a small number of groups and networks.

Public funds should be made available to meet the regulatory costs of Angel networks (including the fees levied by the Financial Conduct Authority, the Financial Services Compensation Scheme, and the Financial Ombudsman Service) and the costs of networks and groups relating to legal, due diligence and transaction fees. Such support should be focussed towards proven, successful connectors while allowing innovators to develop. To ensure it remains effective, these funds should be allocated in proportion to investments completed directly through that network or group.

Crowd funding is fast emerging as the new wave in Angel-type activity. It must be remembered, however, that the Crowd is different to Angels in two fundamental ways. Firstly, being made up of people investing as little as £10, it is not necessarily experienced or sophisticated (nor is it wise in the sense of Surowiecki's 'Wisdom of Crowds' as it is likely always to lack the scale on both sides of the market to exhibit this phenomenon of group wisdom). Secondly, the Crowd, in marked contrast to both Angels and EIS fund managers, offers no assistance to its investee beyond the money it invests.

While it may be fashionable, it is not clear that Crowd funding will offer long term benefit to smaller companies. Unless its growth is truly phenomenal, it is likely that the Crowd will achieve little more than investing in some otherwise high risk companies and then watching impotently as they wither due to a lack of experienced support.

Recommendation 7

The Enterprise Investment Scheme ("EIS") is an effective way of stimulating early stage equity investment. However, the scheme has become increasingly restrictive since its introduction.

The Treasury is asked to support early stage companies by capturing on a selective basis the essence of the original Business Expansion Scheme in the 1980s and the introduction of less restrictive EIS conditions for companies with turnover of less than £5 million. These include relaxing the rules on Qualifying Business activities (as an example: allowing small 'property' companies to raise EIS funds) and on 'control' (so controlling shareholders can claim relief).

Enterprise Investment Scheme ("EIS")

Since the introduction of the Business Expansion Scheme in the 1980s through to the introduction of the successor Enterprise Investment Scheme the Treasury has rightly sought to reduce the scope for the use tax driven schemes and projects with little or no economic growth or commercial risk taking as part of the equation. However, for the SME today it is so difficult to raise equity finance that we believe that there is a strong case for relaxing some of the EIS and VCT requirements and limitations over areas such as qualifying activities and control. For example, why not let small property development or financial services business qualify within the scheme on the basis that these companies will be generating economic growth and creating jobs? These relaxations could be based on the size of the company concerned and the amount of the funds being raised. In this way SME's may find it easier to attract equity finance at the margins, where the availability of tax relief can often tip the balance for smaller investors, while at the same time not opening the floodgates to wholesale abuse.

Recommendation 8

The Financial Conduct Authority ("FCA") is asked to review its strategic approach to the regulation which defines the Business Angel market and that following this, appropriate enforcement be put in place to promote and protect the well being of participants and create confidence. This is not a call for deregulation or necessarily for amended regulation but rather for clarity and confidence building through considered, decisive and strategic regulation and enforcement.

The Regulatory Protection of Business Angels

Through the Financial Promotions Order and its subsequent amendments, the Treasury has created exemptions allowing promotions with minimal quality standards to be made by unauthorised firms to individuals who self-certify as either being sophisticated or of high net worth as long as such promotions relate to equity investments in unlisted companies.

It is likely that traditional Angels are exactly what the Treasury had in mind when creating these exemptions. An anomaly arises because there are two parts to any regulated activity; the documents used and the activity undertaken. While the Financial Promotions Order allows unauthorised firms to pass information to Angels, the Regulated Activity Order does not. Certain exemptions to the regulated activity of 'arranging deals in investments' may be of some use but none maps well on to Angel investment.

This approach, along with a seemingly blind eye being turned to high profile unregulated firms, has led to a great deal of market confusion with even experienced Angels and investees being unsure whether they should conduct their investment business through the growing number of small, often internet-based, Angel and Crowd funding providers. While many such providers are not significant enough to damage the market as a whole, the danger is of a general view developing that Angels and investees' well being is not properly protected. In such circumstances, a failure directly affecting relatively few people could prove to be the undoing of an already fragile market lacking in regulatory confidence.

Recommendation 9

We would ask, as part of a panel, to speak to the Financial Conduct Authority about regulation at the smaller end of the market. We would like to begin discussions on the cost of employment and City reputation. We believe the FCA would attain higher levels of professional competence by working more constructively with its member firms.

More Effective Regulation: working together

It is accepted and understood that during the period of excess credit in (say) 2001 to 2008 standards within the financial services industry and elsewhere fell below acceptable levels. The majority of those of us working in the small-cap sector relish improving standards.

However there is a fear that regulation alone will create tensions and barriers to progress. The capital markets function to service its clients – in our case SMEs – by raising equity finance so allowing growth and job creation. Regulation must be a part of the process rather than judge and jury.

We ask that we be allowed to play a role in working with the regulatory authorities as we believe the active involvement of practitioners will lead to better and more effective regulatory processes.

Recommendation 10

The Government is asked to promote Entrepreneurs' Relief much more enthusiastically. This is one of the great fiscal incentives available today. The rules are simple. Entrepreneurs risk everything and this tax relief can be a massive reward when value realisation takes place.

Entrepreneurs' Relief

Subject to a number of conditions if an entrepreneur owning more than 5% of the shares of a trading company sells some or all of his shares after one or more years, the capital gain is taxed at 10%. It is perhaps the most exciting and best wealth creation personal tax available. It is one of the main reasons entrepreneurs can flourish. It is a tax that needs promoting.

As a first step we ask that the Department for Business, Innovation & Skills includes a reference to this fiscal concession whenever they produce material promoting entrepreneurial activity and development in the UK.

Appendix One

The Group Members

Tony Drury

Tony is a Fellow of the Chartered Institute of Bankers and a Member of the Chartered Institute for Securities & Investment. He is Chairman of Axiom Capital Limited, a corporate finance house based in London and of Ford Eagle Group, a business advisory company based in Hong Kong. He has been a director of four Chinese businesses whose shares have been traded on AIM and PLUS Markets. He has travelled extensively in the Far East. He is the author of six financial books including the textbook for finance houses and 'Investment Clubs: The low-risk way to stockmarket profits' which sold over 20,000 copies.

From 1998 – 2006 he built St. Helen's Capital into the most successful PLUS Markets advisory business and in his final year raised £2.8m in equity finance to establish Quercus Publishing who later found success with 'The Girl with the Dragon Tattoo'. He has begun a new career as a writer of romantic thrillers: his third book 'Cholesterol' is due to be published by City Fiction in June 2013. He has recently been made a full member of The Romantic Novelists' Association.

He is the co-founder and a regular blogger on www.enterprisebritain.com

Roger Hardman

Roger Hardman founded Hardman & Co after spending 11 years as head of Small Company Research at Hong Kong Bank James Capel. He realised that the golden age of investment coverage of small companies in the conventional stockbroking environment was drawing to a close. Another way had to be discovered in order to provide investment managers with much needed research on companies with a sub £500m market cap.

He began his career in journalism, editing the Mining World and the Investors Guardian. At the Sunday Times his work led to the investigation by Parliamentary Select Committees of the brain drain of British scientists to work abroad, and to abuses in company pension schemes, this latter investigation led to a change in the law, strengthening employee pension rights. He also unsuccessfully campaigned against the safety risks in Roll-On Roll-Off ferries two years before the Zeebrugge disaster. Later, when City Editor of Financial Weekly, he came top of the newspaper share tipster league table for two consecutive years.

At Hong Kong Bank James Capel, he and his team were rated highly in the Greenwich and Extel surveys. His team pioneered the stockbroking research analysis of shares from an environmental viewpoint with publication of 'The Green Book', and helped companies to a stock exchange listing.

David Scott

David Scott is Chief Executive and Head of Corporate Finance at Alexander David Securities Group Plc and he has over 28 years of corporate broking and investment banking experience in advising small and medium sized companies on both the LSE´s Official List and AIM. He has extensive experience in private equity and has also advised many unquoted companies. David began his career in the corporate finance department of L. Messel & Co in 1985. Previously he was a director of corporate broking at ING Barings, a director of Resolution Partners Limited and more recently a Director of Corporate Finance at Lewis Charles.

He is a co-founder of Alexander David Securities, which was formed in 2007 to provide equity finance to the smaller company market. It has over 1,000 high net worth clients and provides advice to quoted and unquoted companies in the UK and around the world. In 2008 it joined the AIM market.

Michael MacDougall

Michael is the senior partner of Charles Stanley & Co Ltd, Milton Keynes, as he has been for the past 14½ years. He is a Chartered Fellow of the Chartered Institute for Securities & Investment.

Following ten years with the stockbrokers L Messel & Co, being involved the successful flotation of a number of companies and joining the Private client department after 1974, the second worst market crash in English history, he became the investment manager of a small insurance company.

He was co-proprietor Crawford's Directory of City Connections, co-editing a major expansion of this publication. Being under-capitalised and finding it impossible to raise capital, the business was sold to the Economist. He was involved in the flotation of Tottenham Hotspur and then became the senior Sterling /US Dollar investment manager of the Gulf Bank Kuwait. After three years of sand and the smell of crude oil, he returned to England and joined Manchester Exchange and Investment Bank ('Manex') in 1984 as their Investment Director.

He left soon after 'Big Bang' and opened the first stockbroking office in Milton Keynes in January 1990; in 1998 he joined forces with Charles Stanley.

Simon Webber

Simon is the managing director of Styperson Pope Limited, a strategy and compliance consultancy advising regulated corporate finance, fund management and fund administration firms. Simon has spent ten years working in corporate finance and fund creation, advising professional firms and promoters based both onshore and offshore. Since 2006, he has focussed on building and running compliance functions within investment businesses. He has been a director of firms with assets under management of more than

£3.5bn, has been retained as a long-term adviser to three global fund operators, and has been approved by the FSA to act as a compliance officer, director and chief executive of authorised firms.

Simon holds two undergraduate degrees with honours and a masters degree and is proud to be chairman of a charity giving over £5m a year to community projects.

Robin Stevens

Robin is a Corporate Finance Partner at Crowe Clark Whitehill, the UK member firm of international accounting group Crowe Horwath International. He has had an extensive career in corporate finance including corporate advisory and reporting assignments, raising venture capital, management buyouts, capital reconstructions, pre-flotation planning and valuations. He has also advised on acquisitions and disposals by public and private companies as well as on numerous IPOs and secondary share offerings both in the United Kingdom and overseas.

Robin will be providing corporate finance advice to companies operating in the UK and overseas with a particular focus on assisting clients in China and East Asia seeking to join capital markets, in the region or in Europe, and advising clients entering into cross border joint ventures or strategic alliances.

Robin regularly lectures on corporate finance and capital markets issues to business audiences in Europe, North America, China, South East Asia and the Middle East.

Brian Hibbert CBE

Brian was Chief Executive of Lockheed Martin UK Insys Limited until his retirement in November 2006. Since then he has taken on a number of non-executive roles including, Chair of the Bedfordshire Chamber of Commerce, Director the national Board of the British Chambers of Commerce, founding Chair of the South East Midlands Local Enterprise Partnership. Brian joined the long established Ampthill defence systems company Hunting Engineering Limited from Rolls Royce in 1973. After a number of different roles in engineering and project management, he was appointed Engineering Director in 1991 and Managing Director in 1993. He was Chief Executive for a private equity funded management buyout of the company in 2001. The company was then acquired by Lockheed Martin UK Holdings in October 2005. A Chartered Engineer and registered European Engineer, Brian is a member of the Institution of Mechanical Engineers as well as former Vice-President and Honorary Fellow of the Society of Environmental Engineers He is also a member of the Institute of Directors and a Fellow of the Royal Society of Arts. He has served on a number of influential bodies such as the Society of British Aerospace Companies, the CBI Technology/Innovation committee, and the Court of Cranfield University. In the 2004 New Years Honours list he was appointed a CBE for services to the defence industry.

Group Co-ordinator:

Charity Walmsley

Charity is a corporate finance executive at Alexander David Securities Limited, which she joined in June 2011. Since graduating from Kingston University in 2006 she has also worked for ZAI Corporate Finance Limited and Athanor Capital Partners Limited, which offered a full range of corporate finance and advisory services to a clientele of small and medium sized companies.

Review editor:

Laura Keeling

Laura Keeling is an experienced editor of fiction and non-fiction material. Since graduating from Cambridge in 2007, she has worked in-house as editor for an independent publishing house, co-directed a large literary festival in Paris, and worked freelance for a number of wonderful publishers. More recently, she has edited Tony Drury's first two romantic thriller novels, published by City Fiction, and is currently working on his third work 'Cholesterol'.

Public Relations:

(General) Teresa Quinlan

Love PR & Communications is an established lifestyle and consumer PR consultancy dealing with clients across all areas of industry. Current clients are in health, technology, publishing, and entertainment. Celebrity clients include Marco Pierre White, Jean-Christophe Novelli, Gail Porter and Sean Wilson.

Teresa Quinlan has over 12 years experience delivering fully integrated campaigns combining broadcast, print and online media platforms. Previously a chairman of a PLUS quoted PLC she has first-hand experience fund raising for a SME.

(City) Paul Quade

City Road Communications is a specialist financial PR consultancy concentrating on SMEs in both the corporate/plc and financial services sectors. The majority of its quoted clients are listed on AIM although it does have others on the main London Stock Exchange. Its financial services clients range from SIPP providers and IFAs to legal firms and specialist fund managers.

Founder director Paul Quade is a former national newspaper Night News Editor and financial journalist and weekly newspaper editor with nearly 30 years experience in the Financial PR consultancy profession.

Appendix Two

The Structure of the Small-cap Sector

Small Companies and the British Economy

There are 4.5m small businesses in the UK. Three quarters of these are one person operations, and just over 1m are large enough to have employees. Between them, these 1m SMEs employ 13.8m people – 43% of the national employed workforce – and have an annual turnover of £1,500bn – 48% of all turnover of the UK business community. This is equivalent to over 90% of the national GDP.

The UK Government's Department for Business Innovation and Skills defines small companies as those with fewer than 250 employees. There are only 6,320 enterprises in the UK that fit the DBIS's definition of "large", In stock market terms, over half the companies on London's AIM, over 10% of the companies on the main stock market "Official List", and over 95% of the companies on the dominant third tier stock market, Plus, have fewer than 250 employees and therefore can be categorised as "small". There are 5 times as many medium sized companies in the UK – those with between 50 and 249 employees – as there are large companies. These medium sized companies, the "M" in "SME", account for 13% of all employment in the UK, and 14% of all sales revenue.

Historic trends show a reduction in the number of large private sector businesses, by 12%, from the start of the year 2000 to the start of the year 2011. This is not surprising, and in our view does not suggest that that the large company is in decline. Over this period a great deal of labour intensive manufacturing has been outsourced to foreign factories. Since the start of the recession there has been a modest increase in the number of one person business and sole trader and partnerships. 60% of all incorporated companies have employees; only 10% of sole proprietorships and 40% of partnerships do so.

The importance of SMEs varies considerably by industry. It is abundantly clear that the construction industry would cease to operate without its vast network of small building firms, sub-contractors and self-employed tradesmen. SMEs account for 72% of construction industry turnover and 84% of employment. Over half of all sector sales revenue is also provided by SMEs in the wholesale and retail trades, accommodation and food service, real estate, professional scientific and technical, health and social work, and the statistical dustbin of "other service activities". One third of all SMEs are based in London and the South-East, slightly higher than its share of the population. By contrast, SMEs are hugely under-represented in Scotland and North-East England.

Funding for SMEs

Business enterprises primarily use equity finance for risk bearing activities involving business growth, and a combination of debt and equity in order to fund working capital and asset purchases. In some areas, such as invoice discounting and the leasing of machinery, debt, provided by the banking industry, can become effectively the sole source of capital for some companies.

It is a given that bank finance for business enterprises has become both more difficult to obtain and more expensive since the onset of the 2007 financial crisis.

This has come about in a number of ways:

- Covenants are being drawn very much tighter, so the funds available for borrowing are much reduced.

- There has been a shift away from interest rate calculations using Base Rate to calculations using LIBOR.

- For much of the last four years, the benchmark 3 Month Sterling LIBOR has been significantly higher than the Base Rate.

- The risk premium has increased, so companies are being required to pay a higher premium over either Base Rate or LIBOR than previously.

- Fees have increased. Set-up fees are being levied where they were not previously. Facility fees (charges for the unused part of a facility) are either being levied where they were not previously, or are being increased.

- Loan periods are being shortened, so the overall rate of borrowing for the period of a loan is increased because set-up fees need to be amortised over a shorter period.

We estimate that the combined impact of these changes has resulted in an increase in borrowing costs for SMEs of between 2 and 4 percentage points since 2007. At the smaller end of the SME market it has resulted in an increased reliance on credit card debt, at 17% and upwards. One estimate we have seen suggests that as many of 55% of SME's may be financed to a greater or lesser extent by credit cards at these interest rates.

To be fair, the result of these changes has still been an overall cost of borrowing that is probably little changed on the early 2000s, of c. 7% - 9%. Any decent business model ought to be able to stand that. However, bearing the credit card interest rate of 17% plus is another matter entirely. Very few legal businesses can produce that rate of return in the current economic environment.

Equity Finance

Equity finance is provided from four main sources. These are:

- Friends and Family;

- Quoted stock market;

- Venture Capital Trusts, Private Equity houses, and similar vehicles; and

- Accountants and lawyers.

Of these, the first, Friends and Family, we believe to be the most important, and is still important even for the second category, because in practice at the small end a lot of quoted company fundraisings are accomplished by this route rather than through total strangers subscribing money through accredited stockbroking firms.

Both the second and the third categories are handicapped by the need for considerable due diligence and outside investigation that pushes up costs. This means that to be viable, stockbrokers and private equity funds will rarely look at a company that has a value of less than £5m. In the eyes of the general public, a sum of £5m would not be described as a 'small' amount. Also the total cost of floating a company on AIM is rarely less than £200,000, which is a serious limiting factor.

Small Company Aid in Britain

In 2011, the UK Government appointed a Crown Commercial Representative for SMEs, Stephen Allott. His task is to build a "more strategic dialogue" between the Government and small suppliers. Specific measures taken include seeking to eliminate Pre-Qualification Questionnaires on all Government contracts under £100,000, and on larger contracts allowing companies to submit pre-qualification data once for all procurements in common commodities, eliminating multiple submissions and red tape. With c.40% of the UK's GDP being spent by the Government, this has been a particularly important development. It has been accompanied by a very much more transparent process of publication of available Government contracts. It does not, however, "red line" certain contracts, or a certain proportion of contracts, for any particular interest group (such as SME's, business controlled by the disabled, by ethnic minorities or by women).

The State sector is required by the Government to give SMEs access to the bidding process for Government contracts. This is accomplished through the "Supply National SME Engagement Programme". SMEs may sign up to this service and receive email alerts of pending contracts in their particular sector. There is no requirement placed upon the public sector organisations concerned to accept any quota of small or SME bids.

The Engagement Programme also provides distance learning programmes to enable SME managers to properly exploit these opportunities.

Other measures include "Project Merlin", a loan guarantee scheme for UK businesses, part of a package of Government-backed lending schemes started with the intention of making £190bn available to UK businesses generally, more generous relief for Venture Capital Trusts, and a projected future return to cash based accounting for very small companies in order to make it easier and quicker for small companies to calculate their tax liabilities more accurately.

Experience in Other Countries

Other countries provide considerably more help to small businesses than the UK. In particular, the USA's Small Business Assistance Programme enshrines in law the right of small businesses to a share of all US Government contracts.

The qualifying size is tightly defined by industry, and broken down into over 1,200 different industries by standard NAICS definitions. These qualifying maximum sizes vary from $0.75m annual sales for most agricultural industries up to a maximum 1,500 employees for telecoms resellers – in other words the qualification levels vary hugely, and in UK terms, some of the categories ensure fair play for medium sized, and not just small companies. A Government organisation called the Small Business Administration is tasked with providing assistance to companies, so they are not defeated by red tape. It provides telephone assistance via a network of 8 area offices. The telephones are answered quickly and sensibly, and are at standard local call rates rather than premium numbers.

In July 2012 the processing system was further improved by the "System for Award Management" which streamlines the Government contracting process. It also saves taxpayer money by reducing costs.

There are additional provisions for small businesses owned by service-disabled veterans. There is an annual Government wide goal of not less than 3% of the value of all prime contracts *and subcontract awards* for these.

An additional programme, the HUBZone, assists small businesses in areas of low median household income or high unemployment. At any given time there are 6,000 companies in the HUBZone programme. Under this, specific contracts are set aside for HUBZone qualifying companies, there is a Government wide goal of 3% of all prime and subcontract work to go be placed through the HUBZone, and in competition, HUBZone companies are given a 10% price evaluation preference.

The USA – Performance of Small Companies

US Government statistics show that quarter by quarter, small businesses with fewer than 500 workers outperformed large firms in net job creation about three out of four times from 1992 through 2010 when private sector employment rose.

It also shows that the growth in US small businesses since the start of the recession has been achieved without any help from the banks. The number of loans of under $100,000 provided by the banking community fell from 21.6m to 19.4m between 2007 and 2011. The number of loans categorised as "under $1m small business loans" fell from 27.2m to 21.3m. Numbers of small businesses, and numbers of self employed, have fallen since the recession, but have otherwise remained remarkably constant over the last 20 years. It is interesting to compare the proportion of companies, and self employed people, to the general population in the USA with that in the UK, however.

Table A.1 Business Counts, USA, 1985-2010

Year	Employer firms		Nonemployers		Establishments	Self-employment (thousands)	Nonfarm business tax tax returns
2010	5,612,000	e.	21,722,100	e.	NA	9,681,000	NA
2009	5,729,000	e.	21,691,600	e.	NA	9,831,000	NA
2008	5,930,132		21,351,320		7,601,169	10,079,000	NA
2007	6,049,655		21,708,021		7,705,018	10,413,000	31,947,600
2006	6,022,127		20,768,555		7,601,160	10,586,000	30,819,400
2005	5,983,546		20,392,068		7,499,702	10,464,000	29,512,000
2004	5,885,784		19,523,741		7,387,724	10,431,000	28,335,300
2003	5,767,127		18,649,114		7,254,745	10,295,000	27,269,500
2002	5,697,759		17,646,062		7,200,770	9,926,000	26,347,100
2001	5,657,774		16,979,498		7,095,302	10,109,000	25,631,200
2000	5,652,544		16,529,955		7,070,048	10,215,000	25,106,900
1999	5,607,743		16,152,604		7,008,444	10,087,000	24,750,100
1998	5,579,177		15,708,727		6,941,822	10,303,000	24,285,900
1997	5,541,918		15,439,609		6,894,869	10,513,000	23,645,200
1996	5,478,047		NA		6,738,476	10,489,000	23,240,700
1995	5,369,068		NA		6,612,721	10,482,000	22,479,000
1994	5,276,964		NA		6,509,065	10,648,000	21,990,300
1993	5,193,642		NA		6,401,233	10,279,000	21,280,300
1992	5,095,356		14,325,000		6,319,300	9,960,000	20,849,200
1991	5,051,025		NA		6,200,859	10,274,000	20,517,000
1990	5,073,795		NA		6,175,559	10,097,000	20,052,900

It is interesting to note, also, that US bankruptcies, while significantly higher than in the boom years of 2003 – 2006, are in fact no higher than they were in the difficult, but not particularly exceptional, early years of the 1990s.

Table A.2 Business Turnover, USA, 1985-2010

Year	Employer births	Employer terminations	Business bankruptcies
2010	NA	NA	56,282
2009	NA	NA	60,837
2008	597,074	641,400	43,546
2007	668,395	592,410	28,322
2006	670,058	599,333	19,695
2005	644,122	565,745	39,201
2004	628,917	541,047	34,317
2003	612,296	540,658	35,037
2002	569,750	586,890	38,540
2001	585,140	553,291	40,099
2000	574,300	542,831	35,472
1999	579,609	544,487	37,884
1998	589,982	540,601	44,367
1997	590,644	530,003	54,027
1996	597,792	512,402	53,549
1995	594,369	497,246	51,959
1994	570,587	503,563	52,374
1993	564,504	492,651	62,304
1992	544,596	521,606	70,643
1991	541,141	546,518	71,549
1990	584,892	531,400	64,853

In 2009, the latest year for which figures are available, there were 114.5m people employed in the USA. Of these, 20.7m, or 18%, worked in companies employing fewer than 20 people. 35.6m, or 31%, worked in firms employing between 20 and 500 people. This is in addition to the 21m people operating one-person companies.

The Richards Report

In 2008 David Cameron commissioned a report for the Shadow Cabinet that stated it was "disappointed" with the low level of support for SMEs by the major banks. It stated that only 15 pc of SMEs used any of the 3,000 support schemes then on offer through Government agencies, and of these only 0.5 pc were "satisfied". It claimed that 33.5 pc of Central Government spending on SMEs was absorbed by "administration".

Recommendations by Interested Bodies

Three organisations have devoted resources during the course of the current year to the needs of SMEs and explored the best way of closing the SME funding gap. These are:

- The Federation of Small Businesses
- The Quoted Companies Alliance
- The Institute of Chartered Accountants

There is some commonality in the proposals of the three organisations.

The Federation of Small Businesses proposes Government intervention in markets to encourage competition and create a more level playing field for small companies vs big ones, improved supply of loans below the £25,000 level, Government intervention in “hard to reach” sectors of the economy such as rural areas and areas of industrial decline, Government payment of all SME invoices within 10 days, payment of subcontractors on the same timescale as main contractors (in other words forbidding main contractors to hold onto money due to subcontractors), requiring all large private companies used by the Public Sector to sign up to the Prompt Payment Code, reform of the Employment Tribunal System and exemption of small companies from the EU Working Hours Directive. It would also like to see a fuel duty stabiliser.

The Quoted Companies Alliance hosted a conference in June 2012 at which 85% of delegates stated that small and mid cap quoted companies should have their own set of proportionate reporting requirements. 53% of those at the conference felt that IFRS accounting was NOT a force for better reporting, compared to only 30% in favour of it. It highlighted engagement issues between investors and the smaller quoted companies. Only 23% felt that boards and investors understood each others’ priorities well enough. One senior investment manager, addressing the subject of the scarcity of capital, said that there were “too many choices for investors, while advising companies on listing on AIM is now not profitable enough for investment banks”. 92% of those at the conference felt there was a funding gap, and 53% felt that new funding options would help deliver the growth needed. 77% felt that the European Parliament and the European Commission were hindering the UK’s small and mid-cap quoted companies. Among the conclusions covered in the closing speech by Dr Kay Swinburne, MEP, were the need for tax incentives such as no stamp duty for SME growth markets and tapered tax relief on capital gains. Dr Swinburne said that SMEs account for two thirds of all employment in the EU

The main recommendations of the Institute of Chartered Accountants' report, prepared under the chairmanship of Tim Breedon, Head of Legal & General Assurance, were:

- Establish a business finance advisory network;
- Set up a body to bundle loans to SMEs so that the resultant securities could be resold in the secondary markets;
- Major companies to pay SME invoices promptly; and
- Government to use its power as the UK’s biggest purchaser to encourage main suppliers to adopt supply chain finance.

Appendix Three

The Breedon Report

In March 2012, following on a request from the Secretary of State for Business, Innovation and Skills ("BIS"), Tim Breedon, the CEO of Legal and General, published a Taskforce report 'Boosting Finance Options for Business'. The remit was to chair an industry-led working group (including Xavier Rolet, Chief Executive of The London Stock Exchange) which was to consider an alternative debt market.

The wide ranging paper went well beyond this and the final contents included recommendations on increasing the awareness and demand for alternative forms of finance, improving access to capital markets, stimulating growth through supporting smaller companies, developing new products and importantly (although not without some confusion) reviewing the evolving regulatory environment.

The Government response was cautiously enthusiastic and included a commitment "to welcome the market-led solution" (increasing awareness), support for a feasibility study (the development of aggregation models), a welcoming of ideas to expand the UK private placements market and, amongst others, a commitment to speed up payments to SMEs in its own supply chains.

The Breedon comments on the regulatory environment and the Government's response have been carefully noted. We regret to say we were disappointed by the lack of dynamism in these sections.

We consider that sections 4.2 ('Improving communication of existing Government support schemes') and 4.3 ('Creating a Business Support Agency') warrant closer examination.

The Breedon Report recommendations

The Breedon Report under 'Chapter 4 increasing awareness and demand for alternative forms of finance' made a number of recommendations as follows:

- Introduce a Business Finance Advice scheme;
- Improve communications of Government support programmes through the creation of a single brand for its interventions; and
- Responsibility for delivery of Government Access to Finance programmes should be consolidated into a single delivery agency.

Appendix Four

Small-cap Markets

The AIM Market

There are 1,115 companies quoted on London's AIM, of which 892 are clearly UK companies and 223 have bases in other countries. The number of UK companies using an AIM quote is down from 1,347 in 2007, a fall of 33%.

During the first seven months of 2012, 22 new UK companies joined AIM, and between them raised £133m from investors, an average of £6m each. During the first seven months of the year AIM companies, both UK based and overseas that were already quoted raised an additional £1,357m. This latter figure is impressive, and shows that in spite of the current stock market malaise AIM is fulfilling a function. However, 49% of this money was raised by oil, gas, mining and basic material companies, whose primary interest is in investing overseas. The 10 largest fundraisings accounted for 37% of all money raised, and of these, 5 were natural resources companies and one a company of "equity investment instruments". AIM, however, caters for just 0.01% of all British SMEs by number, and even its biggest enthusiasts cannot currently foresee a time when the number of companies on the market recovers to its 2007 peak. www.londonstockexchange.com

ICAP Securities and Derivatives Exchange (ISDX)

ISDX is a London based stock exchange providing UK and international companies with access to European capital through a range of fully listed and growth markets.

ISDX Growth Market

The ISDX Growth Market helps dynamic, small- and mid-cap companies from all industry sectors to achieve their ambitions. It is a proven source of equity finance for companies coming to a public market for the first time, as well as being an established venue for existing issuers to raise further funds. It provides wide exposure for companies within a marketplace dedicated to growth companies.

The admission process and ongoing regulation are designed to meet the needs of smaller companies, allowing them to focus on running their business while helping to provide confidence to investors.

This market was formerly known as PLUS and before that, Ofex.

ISDX Main Board

The ISDX Main Board is an EU Regulated Market serving the needs of companies and other issuers seeking cost-effective admission to trading through the UKLA's Official List, or other European Competent Authority.

A wide range of instruments are eligible for admission to the ISDX Main Board.

GXG Markets

GXG Markets has established a range of services designed to support growth companies and the wider SME community. GXG Markets offers a market solution which gives companies clear and effective market access and provides existing and potential shareholders with a transparent and fairly priced entry and exit point.

GXG Markets offers a three tier market solution, providing companies with a choice of market to suit their needs as they continue to grow. The GXG OTC / First Quote Market is the junior market for companies looking to gain a price for their shares and a valuation for the first time. Many companies then choose to move up to the GXG MTF Market where their shares are then available to the widest pool of investors. Finally, companies can choose to join the GXG Regulated Market, to gain a full listing and greater exposure.

GXG Markets provides a straightforward and cost-effective route to market, allowing companies to gain a listing or quotation without being overburdened with the red tape and legal costs often associated with admittance to a public market. Trading on all three markets is conducted through Tellus, the trading platform owned and operated by GXG Markets. Further information, along with details of admission & annual fees and rules & regulations specific to individual markets can be downloaded from the GXG Markets website: www.gxgmarkets.co.uk

ShareMark

This innovative market which operates a unique auction process in its secondary share trading platform was set up and owned by Share Plc. See www.sharemark.com

On 25 October 2012 it was announced that ShareMark was being sold to Asset Match Limited although The Share Centre is retaining the rights to operate the Multilateral Trading Facility and will retain regulatory responsibility.

AltCapX

An online exchange which may provide an exit for existing shareholders in unlisted SME shares. See www.altcapx.com

BritDAQ

A recent and innovative junior market offering a range of services. See www.britDAQ.com

Appendix Five

The Burden of Fiscal Reforms

The HMRC is under pressure to increase the tax revenues by £17.6 billion in 2012/2013.

How does it plan to achieve this target?

There are changes to the law to block loopholes, more focus from the Revenue on tax compliance and a consequence whereby businesses and individuals lose their appetite to legitimately plan their affairs to minimise their tax bills.

The moral climate is changing in that fiscal policy and practice is now discussed in terms of what is fair, not what the law says. Campaigning organisations highlight those companies that pay little tax but no coverage is given to the context in which corporate tax might be low, for example if losses carried forward from earlier periods, or there are limited UK operations (Vodafone). Losses are now seen to have arisen as a result of tax planning rather than as a result of commercial operations that have not succeeded. There is an assumption from politicians and campaigners that because an individual or organisation has large revenues, it should automatically pay large amounts of tax in the UK.

Ultimately it is for Parliament and the courts to decide what the correct amount of tax should be. Government has considerable resources that should enable it to draft clear and unambiguous tax law. For some reason, either through a lack of knowledge, planning or ability this appears too difficult. This failure is then blamed on taxpayers who follow law rather than guessing what parliament originally intended. The position is compounded by public statements that deliberately try to tar genuinely commercial transactions with tax avoidance motives. For example, entrepreneurs who borrow to support their businesses will soon lose the ability to offset full interest charges and to carry losses forward. (Until recently philanthropic donations were described as acceptable tax planning. The rationale is that such people are said to be abusing the tax system as opposed to funding their businesses, taking commercial risks, giving to charity and risking their own capital.

Most businesses and individuals accept the necessity of paying tax on profits and want to meet their obligations. However, creating an environment of uncertainty is likely to be counterproductive as it may diminish economic activity by putting business people off from making economic decisions.

END.

NOTES

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