Quarterly Survey of Small Business in Britain

SMEs and the British Business Bank:

THREE CASE STUDIES

January 2013
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Introduction

These case studies are based on a series of interviews conducted by Dr Ross Davidson. Interviews were conducted in January 2013 and are based on a sub-sample of respondents to the Quarterly Survey of Small Business in Britain.

The case material is designed to complement the main survey report (Q4 2012), which includes a special topic section on the British Business Bank. The main report is available to download at: www.open.ac.uk/quarterly-survey.

This research project and the special topic section of the main report were sponsored by the Finance and Leasing Association (www.fla.org.uk). However, it is important to note that any opinions expressed in this publication are not necessarily those of the sponsors or of the Open University.

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Case study A:
The technology-based company

Cornelius Group Plc is a British SME with headquarters in Bishops Stortford, Hertfordshire, and operations in UK, Eire, France, Poland, Russia and Scandinavia and sourcing offices in China and India. The company employs approximately 120 people in the UK and specialises in the creation and distribution of speciality chemicals for cosmetics and personal care, food and beverage, industrial and pharmaceutical markets across Europe. Cornelius Group is showcased in the inaugural The Sunday Times HSBC International Track 200; international sales have grown 26% a year, increasing from £5.3m in 2010 to £8.5m in 2012. We talked to the company’s Chairman and CEO, Dr Neville Prior, who has combined his research interests in organometallic chemistry with a business career.

As a successful and long-established company (it was founded in 1935), Dr Prior has no issues in accessing finance. Given the company’s strong cash flow position it could self-finance and if necessary, access additional funds from banks without difficulty. Dr Prior thinks the idea of British Business Bank is a good one. While companies like Cornelius Group do have good access to bank funding, he acknowledges that many smaller business entrepreneurs can experience difficulties in gaining financing, especially new start-ups without a track record of success or easy access to ‘angel’ investors. In his view, the British Business Bank is certainly ‘supportable’ if it has a clear mission to fund entrepreneurs.

Expanding on these thoughts, Dr Prior is very clear about where the proposed British Business Bank should focus its attention. Firstly, the bank should be created with an emphasis on new businesses and start-ups, including graduates ‘fresh out of university’ who want to commercialise their research but have no track record. It is important to fund these new ventures because they create jobs and wealth for the country. Importantly, the interest charged on its loans should not be set at what Dr Prior describes as, ‘penury rates’. He thinks that the main focus should be on manufacturing businesses but recognises that this is a very large undertaking as, ‘our manufacturing base has been so hollowed out it’s almost a case of starting from scratch’. There should also be a focus on export-oriented SMEs as they create a flow of new resources and wealth into the country. Lastly, he suggests there is still a huge gap between those firms who can access funds and newer entrants. This funding gap is not healthy for the British economy since it creates a barrier to competition, stifles innovation and preserves the ‘status quo’.

Turning to the wider role of the Government in encouraging SMEs and enterprise, Dr Prior’s views are very clear and succinct. The government needs to be more proactive in ‘singing the value’ of entrepreneurs and small business to Britain. They are an important contributor to Britain, creating jobs and wealth, yet it often feels as if ‘entrepreneur’ and ‘making money’ are dirty words. Government can play a role in changing these perceptions, so a high priority needs to be placed on promoting the value of small business to local communities and the wider British economy. Dr Prior also feels that the Government is not communicating a sufficiently coherent growth strategy. Finance is only one part of this strategy and it needs to be combined with ‘sensible’ policies to deliver other things, such as specialist consultancy advice and help for start-ups. ‘Red tape’ also needs to be reduced as it is still too complex and costly. There are examples of where things are being done very well, such as a recent course on starting a new business, but these initiatives often ‘sit in isolation’ from one another. For Dr Prior, the real need is for better integration with, ‘all the policies, nuts and bolts, strategy, and support’ properly aligned.

Company website: www.cornelius.co.uk
Case study B: The fashion designer and retailer

Antonia Pugh-Thomas is a London-based dress designer who creates bespoke haute couture womenswear for private clients. In the eighteen years since she founded the business, Antonia has established a reputation for designing imaginative and elegant clothes, made from the finest fabrics by highly skilled technicians. She has four full-time employees at her shop in Fulham, and takes on additional staff on a seasonal basis. Antonia’s business is completely self-funded. She recalls attempting to secure financing early in her businesses career but was unsuccessful. Although she always had a clear view of herself as a businessperson working in the fashion industry, she discovered that potential funders often saw her as ‘artsy’ and tended to take the view that artist-run businesses were inherently high risk and therefore unattractive investments.

Though she considers herself to be quite well informed about national and local politics and current economic issues, Antonia has no prior knowledge of the British Business Bank proposals. She sees this as highlighting a wider need for the Government to improve its communication with small businesses. Would Antonia consider using the kinds of services that the BBB is intending to offer in order to expand her business? Perhaps, though she is not entirely convinced that perceptions of her own industry have moved on enough to support a major financial investment. As we turn to discussing the priorities of banks in general, Antonia is adamant that they should look at the person and what they are trying to achieve, rather than lumping them into a ‘one size fits all’ category. The key questions are: is the business viable?; does the person have the necessary skills and an appropriate business plan?; and are they serious? Funders need to avoid pre-conceived notions, such as that of the ‘flaky artiste’ and see the business for what it really is, which in her case is an attractive and profitable niche market.

Although Antonia’s haute couture dress shop has been very successful, she is concerned about the impact of local government policies on the business community. Over the past year Antonia has witnessed the closure of many previously successful small businesses that employed people and contributed to the community. She attributes these failures directly to high business rates and council taxes, coupled with a lack of local services. Income tax rates are ‘not an issue’ because you only pay them if you are profitable. However, the problem with business rates is that you have to pay them regardless of whether you make money or not, and no allowance is made for the difficulty of trading during the recession. Antonia says that a story circulating recently in the media, suggesting that the Government may increase business rates in the Spring, ‘makes me despair’. As businesses have closed down, or left the neighbourhood, the local environment has started to deteriorate, with empty boarded-up buildings becoming a magnet for graffiti and vandalism. This has created a negative cycle with fewer people visiting the area, leading to yet more shops closing or relocating. High local taxation rates are therefore having a perverse effect, creating an overall decrease in tax revenues. Antonia is adamant that lower business rates would help to refill the empty buildings and rejuvenate the area. At the heart of her exasperation is this simple question: ‘why won’t the politicians listen to me and my colleagues?’ Small businesses like hers have demonstrated a long-term commitment to the local community and should not be seen as, ‘a golden calf to milk’.

As we conclude our discussion, I ask Antonia if she faces any additional challenges as a female entrepreneur. The reply is an emphatic, ‘no’. However, she does recall finding it harder to run a business in the early years. And why was that? Probably a case of the ‘hubris of youth’ as compared to the more mature (chastened?) approach of a business professional who has overcome a decade and a half of challenges – and learned a thing or two along the way.

Company website: www.antoniapugh-thomas.co.uk
Case study C: The design and manufacturing firm

Ron Gretton is the Managing Director of Call Aid UK Ltd, a small design and manufacturing company that provides a range of innovative electronic products for the healthcare market and other specialist applications. Their wired and wireless call systems have been installed in a wide range of institutions including NHS hospitals, international hotels, high street bank branches, and military establishments – including a NATO base in Afghanistan. Ron is an electronic/mechanical engineer with more than 30 years’ experience of designing and marketing low voltage electronic systems. His Nottingham-based firm has been operating since 2002.

Ron is looking to expand his business and hire one or two more engineers, but despite repeated attempts over the past year, he has been unable to secure the necessary funding. Ron wants more money for product development and acknowledges that the funds would be unsecured. As we talk, Ron describes what he sees as a ‘crazy’ situation, in which those businesses that are short of money and are looking for funding, but financiers only want to lend to businesses who already have overcome the period struggle of establishing their company/product. He points out that much of the finance currently on offer is matched funding (i.e. 50% grant against 50% from the company). This type of funding does not help in situations where small businesses have already ploughed almost all of their resources into the business: ‘If the money has run out how can they find matched funding? It has already been spent on the very project for which they were seeking assistance.’ Given these challenges, why does he continue with the business? Ron reflects on the question. After all, he is now 70 years old and most of his friends have already retired. The real reason is because, ‘I am still passionate about my business and inventing’.

Ron thinks that the small business finance world could learn a lot from the traditional lending practices that are still used by some ethnic groups. For example, a person who needs to raise money for a project or a new product might seek out wealthier members of the extended family. These relatives have an obligation to lend, as a result of their family ties, but the borrower also has a moral responsibility to repay that money. Ron also suggests that the banks need to, ‘look forwards’ at the potential of a business, rather than concentrating on the past. He feels that many people working in finance and government do not have practical, hands-on experience in running a business. ‘At best’ they have been to a university business school, but this is not sufficient because, ‘a business is much more than a balance sheet or cash projections based on a formula’.

Turning to the proposed British Business Bank, Ron is adamant that that the organisation, ‘should NOT be called a bank; rather it should be called an Innovation Fund.’ Why? Because he thinks the term ‘bank’ has psychological connotations that will lead to particular kinds of behaviour, i.e. they will apply the same risk criteria as traditional banks which has always shut out small innovative businesses. Banking in the UK revolves around a ‘no risk’ mentality. In fact, he feels so passionately about this point that he has already written to the Prime Minister.

Ron’s view is that many small businesses either do not have collateral or are already fully extended with available security. He comments that, ‘Asking for a personal guarantee is also off-putting, as apart from the effort, risk and finance they have already invested, they are now being asked to pledge home and hearth. Is this the reward for all the effort they have and will be investing in this venture? The level of worry getting a business off the ground is more than enough to be going on with without the nagging worry that their entire world could come crashing down if they fail.’ Potential negative impacts on the owner’s family can also be a major barrier to making new investments. Ron comments that, ‘From a male perspective, wives in general are not supportive of husbands risking their homes and the future security
of the family unit. This is a burden on top of all the other considerations that businessmen have to consider when the decisions of risk are being made. Many marriages break down because of this issue. I have also known a number of people with good product ideas, but they did not pursue them as they would not like to get into the bank security issues.'

Ron has a very detailed set of ideas about how his Innovation Fund should operate. Funding for the bank will come from both business and government. The most important criterion should be that these funds are offered unsecured. When a business secures funding, a percentage of the resulting revenues will return to the Innovation Fund to be reinvested in other ventures. It will also be important to keep track of the ideas, or clusters of ideas, that prove successful in order to identify future prudent investments. In other words, the organisation will feature some of the rules that are used by existing financial institutions, but it would operate in different ways. For example, there would still be bad loans, just as there are now, but the new innovation fund would be more flexible, recognising that small businesses go through cycles and ensuring that its own processes were ‘in tune’ with these cycles. This would be encouraged by creating an effective management structure to oversee the fund, including people from ‘outside the establishment’ who have ‘hands-on’ experience, especially in small businesses.

What particularly concerns Ron is that the country has, ‘a massive skill base and innovation capability’ but it is mostly to be found in very small (4 or 5 person) enterprises: ‘This is where the action and real passion is; this is where the innovation is occurring’. He thinks that many such micro-businesses are generating real revenues and are extremely professionally run. And based on his experience, these are the types of businesses that the innovation fund should be geared towards.

As we discuss the role of government in more general terms, Ron expresses his frustration. He is adamant that government bodies are making decisions with no thought or worry about the consequences for SMEs: ‘Governments change and the previous government’s policies are reversed. Businesses are started or restructured on the strength of these policies and rules, so when policies are changed overnight, businesses fail, but politicians are not affected by the changes they make.’ Ron also sees bureaucracy as a major obstacle. Although health and safety is an important factor in business, he thinks it has sometimes been taken to extreme levels: ‘For example, in the building and construction sector the amount of administration work that has to be completed prior to starting work on a building site is enough to dissuade any small business from applying.’ Ron sees many regulatory regimes, such as health and safety, as being based on large multinational enterprises with ‘deep pockets’. In effect, they become a barrier to keep out the competition. For him it is a case of, ‘the establishment wanting to maintain the status quo’. His solution is to, ‘simplify the laws and reduce the bureaucracy’.

For Ron, the ‘big issue’ is that profit and success are being ‘run down’. He feels that UK engineering has been particularly hard done by, in comparison with some other areas of business. Yet we should really be celebrating engineers, because, ‘everything that we use, drive, live in and consume’ has required the skills of engineers at every stage. Ron concludes our discussion with a simple message. In his view, success is devalued in the UK; out-dated entrenched traditions are too strong and they are destroying the country.

Company website: www.callaiduk.com