



The Entrepreneurship Report

Mishcon de Reya

LONDON *of* CHAMBER
COMMERCE AND INDUSTRY

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Colin Stanbridge, Chief Executive, London Chamber of Commerce and Industry



The London Chamber of Commerce and Industry is delighted to be working with Mishcon de Reya, one of our Patron Members, on this important piece of research.

Some 490,000 private sector jobs must be created in the coming years to meet current economic forecasts. Therefore, entrepreneurship is critical to not only secure a sustained recovery, but also

to build the long term growth required for London to compete effectively with other international centres.

The Coalition Government has an opportunity to demonstrate its commitment to supporting entrepreneurs, and the dynamism and innovation they bring to the UK economy. I encourage policymakers to carefully consider the recommendations of this report, and invite them to work cooperatively with Mishcon de Reya, the London Chamber of Commerce, and the entire business community to ensure London's offer to entrepreneurs is unparalleled.

Nick Davis, Head of Corporate, Mishcon de Reya



We are proud to partner with the London Chamber of Commerce and Industry in investigating how we can best support entrepreneurs and, in turn, drive vital economic recovery.

At Mishcon de Reya we believe in the entrepreneurial mindset. Not only are many of our clients entrepreneurs or entrepreneurial in outlook, but we too strive to be innovative and brave in our

ways of working. This report shows how important it is to listen to this distinct community, to understand the challenges that they face and to support them in the best way that we can.

We have found that our axiom, "It's business. But it's personal", rings especially true for the entrepreneurial community: most are using their own money or approaching friends and family in financing their businesses. Furthermore, as their businesses change and grow, there is a perceived lack of support, information and funding options.

We hope that this report is able to provide entrepreneurs with a voice and a platform from which to galvanise the Government and the private sector to act, and we look forward to working closely with both the London Chamber and entrepreneurs themselves to achieve this.

I. EXECUTIVE SUMMARY

Everyone knows the importance of entrepreneurs in a successful economy and, even more importantly the part they can play in any economic recovery. The Government certainly does. Its recent Green Paper, “Financing a private sector recovery” has given the sector the not inconsiderable task of creating hundreds of thousands of new jobs. And that will not happen without a significant contribution from successful entrepreneurs. This has been reinforced post the recent Comprehensive Spending Review. But while everyone knows that the economy needs them, has anyone asked entrepreneurs what they actually need? Entrepreneurs are innovators, risk takers and the creators of businesses and jobs. They need to have their specific needs met.

Entrepreneurs need a voice and a platform. By the simple act of talking to entrepreneurs across London and the South-East, the report found it was providing this missing voice and platform. The positive response to this kind of dialogue points to the beginning of a bigger movement. One that, driven by Government, can significantly improve any entrepreneur’s chances of success in London and or elsewhere in the UK.

Mishcon de Reya and the London Chamber of Commerce co-authored “The Entrepreneurship Report” to give entrepreneurs a voice and a platform. With pollsters, ComRes, we talked to 170 entrepreneurs directly. To better understand them, to be absolutely clear about their particular needs and, finally, to make recommendations for change. How timely is the report? A recent study by the Business Finance Taskforce (a group comprising the chief executives of the UK’s six largest banks and the British Bankers’ Association) echoes many of the concerns raised here.

The report’s key findings offer five ways to start helping this vital community and London’s in particular.

I. Regulation

Somewhat unexpectedly, entrepreneurs’ views of tax and regulation systems were not explicitly negative. They recognise that fiscal and legal stability must take precedence. Their gripe is with how poorly information is presented; their plea is for more coherent, thought-through, comprehensible presentation. The one thing entrepreneurs really cannot afford to waste is time.

2. Funding

The pre-report assumption that bank lending is the primary way entrepreneurs raise finance needs a serious re-think. Of those we interviewed, 62 per cent had used self-financing or savings to fund their businesses rather than take on debt. Only 26 per cent had turned to the bank. Government initiatives that focus solely on incentivising banks are of limited value. Instead it is time to consider a wider, holistic range of options for those seeking finance, taking into account factors such as investment required and stage of the business’s lifecycle.

3. Information and Support

Just as with regulation, it is the organisation and presentation of information that is letting down entrepreneurs. Collating the available options in one place would surely tackle the prevailing anxiety and confusion. A strategic approach should be taken in streamlining information and support programmes to ensure that they are responsive to the specific needs of businesses and to market conditions.

4. Longer Term

30 per cent of entrepreneurs in the report have - post start-up - no plans to invest in growth over the next few years. Recession statistic? Perhaps, then again perhaps not. As many as 40 per cent of entrepreneurs said their decision not to invest had nothing to do with the recession. Instead could it be down to a lack of knowledge and support and consequently a lack of confidence? Is this because Government advice and information focuses on start-up financing? Is everything simply too start-up centric? The truth is Government input is essential at every stage of the business lifecycle through to potential exit. Entrepreneurship is not just about setting up businesses. It is about long-term growth and success, as is the economy's as a whole, and entrepreneurs need to be advised accordingly.

5. Public & Private Partnerships

Government may have the lead role to play in encouraging entrepreneurs, but fostering the right environment needs the right inspiration as well as the right incentives. And that is why public and private sector collaboration has such an important role to play. The private sector is the natural ally of the entrepreneur, filled with people and businesses who can be that inspiration and who can recognise a potential winner when they see one. The end result: better use of public sector funds, more successful projects, less bureaucracy, and less waste.

Entrepreneurs are a special breed. They will always dare to succeed - whatever the economic climate. What Government, public and private sector can do is to provide as much support as they can while entrepreneurs dare to take those risks. Clarity around tax and regulation. A coherent and realistic appraisal of funding options. A platform from which to articulate needs. A conducive environment in which to innovate. Why? Because in return for such support, all of us ultimately stand to benefit.

2. ENTREPRENEURS: GIVING THEM A VOICE

The current economic situation is a challenging one. The Government's forecast for recovery relies on the private sector to create some 490,000 new jobs in the next few years: no mean feat. A recent Green Paper from HM Treasury and Department for Business, Innovation and Skills (BIS)¹ stresses the importance of small and medium enterprises (SMEs) in securing the macro-economic recovery. Entrepreneurship will be a vital aspect of this revitalisation.

Political and economic leaders agree that the economy needs 'rebalancing', particularly with reference to the dominance of financial and business services. We believe that more important than a rebalance to the detriment of these two essential economic sectors, the national economy needs to expand and grow new specialisms with industries that complement existing ones. This will only be possible if entrepreneurs are free to conceive, produce and develop new services and products, and if innovative ideas are able to evolve into profitable businesses.

London requires special attention as a natural hub for entrepreneurs of all types in order to continue to succeed globally. Making the capital as entrepreneur-friendly as possible is an essential step towards growing London's economy, and, in turn, leading the UK's economic development as a whole.

In light of this, Mishcon de Reya and the London Chamber of Commerce and Industry (LCCI) have produced this report, the purpose of which is to understand entrepreneurs better; ascertaining their needs and making recommendations for change. Despite being the lifeblood of a successful economy, it appears that the entrepreneurial sector does not always have a voice: this report aims to provide them with one.

The findings in this report are drawn from both quantitative and qualitative research. The quantitative results are representative of 170 responses to an online survey conducted in July 2010 in partnership with pollsters ComRes.

This online survey examined companies' perceptions of the current business environment in London, the challenges faced and the opportunities available to entrepreneurs looking to set up and grow their business in the Capital. This questionnaire was conducted before the recent Comprehensive Spending Review, and focused on how these entrepreneurs financed the initial investment and subsequent growth and development of their company. Businesses were also asked about their growth and development plans for the coming years and how those plans had been affected by the recession. Additionally, the survey sought to analyse the effects that policies outlined in the 2010 Emergency Budget by the Coalition Government had on entrepreneurs.

Entrepreneurs also rated the growth and investment opportunities in London, as well as what features of the Capital had the most bearing on London's strength as a business location. Finally, business leaders were asked about the type of regulation they spent the most time dealing with.

The qualitative research aimed to complement the quantitative findings. We conducted 18 semi-structured interviews with entrepreneurs, owners and representatives of businesses of different sizes in a variety of sectors, from start-ups to more established businesses. These interviews sought to expand on entrepreneurs' views and experience on London's business environment, the accessibility of finance and the quality and extent of support available in the Capital.

¹ "Financing a private sector recovery", BIS, September 2010 at <http://www.bis.gov.uk/assets/biscore/corporate/docs/f/10-1081-financing-private-sector-recovery.pdf>

WHAT IS AN ENTREPRENEUR?

Quite conspicuously a loanword from French, the first use of the word entrepreneur is in fact credited to Irish economist Richard Cantillon, who wrote *Essai Sur La Nature Du Commerce En Général* (Essay on the Nature of Trade in General) in 1730. Cantillon's view of the entrepreneur was a positive one: he believed that they brought equilibrium to the market by understanding and predicting consumer preferences.

As is obvious from comments from our interviewees, today there is not one definition of an entrepreneur. Instead, what appears is a myriad of ideas linked to innovation, to taking risks, to coming up with ideas and/or to executing ideas for maximum success.

"I suppose I see myself as an entrepreneur because I keep having new ideas and coming up with innovations so we keep reinventing and we keep researching and relooking. It is more of a calling than just a business."
(Chairman of property management company)

"Entrepreneurship is about having a focused vision or idea, then proactively pursuing it." (Private bank executive)

"An entrepreneur is not necessarily someone who has great ideas; it is somebody who is able to make things happen, to create something out of nothing and make it successful." (Owner of a new strategy consultancy)

"It is to try and offer innovative products, to be flexible to client's needs, and to deliver our services in a convenient way." (Owner of a new communications start-up)

"An entrepreneur? It is not a term I use very often but I guess, you could put me down as that." (Professional in creative industries)

"A good entrepreneur can be spotted by their behaviours: to behave like an entrepreneur means always getting value. If you can get something for £50 you do not spend £500 just because the rules allow it. To behave like an entrepreneur also means that you pay your employees first; if there is no money in the kitty you do not take a salary. An outstanding quality of an entrepreneur is also the ability to think like a customer." (Venture capital and business funding expert)

"Being entrepreneurial is about generating ideas and success and making sure you're innovative in terms of doing things differently or doing something interesting for the client. You may not see yourself as entrepreneurial, but you are saying to yourself 'I have been working for other people but I can do this and I am going to do it.'" (CEO of established research firm)

Cantillon's positive view of entrepreneurs remains evident nearly three centuries later. Most notably, the significant impact SMEs, and in turn entrepreneurs, have on rebuilding the economy is acknowledged by the Government in its recent Green Paper "Financing a private sector recovery" which outlines: "A dynamic, growing SME sector has the potential to make a significant contribution to economic growth. SMEs are a vital part of the UK economy. There are around 4.8 million businesses in this category (99.9 per cent of all UK businesses), accounting for over half of private sector employment and turnover."

So, all good for entrepreneurs? Not quite.

SMEs make up 99.9 per cent of all UK businesses – a staggering figure. Consider the definition of the category as per the European Commission:

Enterprise category	Headcount	Turnover	Balance sheet total
medium-sized	< 250	≤ € 50 million	≤ € 43 million
small	< 50	≤ € 10 million	≤ € 10 million
micro	< 10	≤ € 2 million	≤ € 2 million

However, the issue that our respondents found was that the category of SME is so large that it is unwieldy and often unsuited to their particular needs. In fact, many entrepreneurs have different needs to small businesses. *“By always having the definition SME, the entrepreneurial sector gets lost which does not help as the needs of this sector are so different”* (Venture capital and business funding expert) Making this distinction is important in order to best serve the needs of this diverse community.

3. LONDON: THE GOOD AND THE NOT SO GOOD

London remains an international centre for business: this cannot be disputed. Speculation that bankers and business people would be crowding airports, clutching their briefcases and deserting the Capital has proven unfounded even in the current testing economic conditions. Our research has highlighted a number of reasons why this is the case, and why the business environment that is uniquely London's has been and still is a draw for businesses in general and entrepreneurs in particular.

This is no time to be complacent, however. Whilst we are a long way from 'scorched earth', there are factors that may make new businesses think twice about setting up in London, or encourage existing companies to reassess their presence in the Capital. To continue to be a hub for business and to encourage and attract entrepreneurial enterprise, London needs to maintain and build upon its strengths, although there is also work to be done in terms of logistics, regulatory certainty and stability.

THE GOOD

Our research found that, for now, London's position as a hub for global business remains strong. First and foremost is the fact the Capital is able to make the most of a confluence of natural advantages;

"businesses come to see London as a natural gateway to access the rest of Europe. Our time zone (favourable to conducting business with markets as diverse as New York and Tokyo) and the language put us in a good place as well" (manager at a direct investment agency)

These natural advantages underpin the existing reputation of the Capital, the importance of which is supported by our findings. Respondents to our survey were asked to rate the Capital as a business destination according to seven different elements, and its existing status comes out as one of its more powerful strengths.²

Our findings show that there are five other key areas supporting the Capital's existing reputation: connectivity; accessibility; professionals; networks and stability.

Connectivity

London's connectivity is key for businesses wanting to set up in the Capital: *"if you are serious about business, then you need to have a presence in London. Here you have access to lawyers, accountants, investors... All kind of industries are here"* (owner of a new strategy consultancy). This concept of clusters is particularly important in the financial sector and the support services that depend on it, and by extension for the national economy. The importance of clusters is not limited to finance, as a range of sectors are interlinked and dependent on each other.

Accessibility

Also critical is accessibility in terms of travel, information and communications. The ability to get to and from Europe quickly, because of the close proximity of Heathrow Airport, London City Airport and surrounding South-East airports, and the high speed rail link to Europe, facilitates setting up and conducting

"Nobody is saying that London is retiring from the global game. The challenge is whether the 'bad' things have the weight to offset the 'good' things."
Financial services expert

² "Existing reputation of the city" was rated 3.91, being 1 "key weakness" and 5 "key strength". This seemed to be particularly important for companies with 200 to 499 employees, within the retail/wholesale and manufacturing/transport/logistic sectors, and in Outer London; all of which rated the reputation of the city 4 or higher.

*“Why London?
It is the best place in the
world: English speaking,
it has easy access, time
zones work well, you can
easily get talent and it is
organised so you know
where things are and how
long it is going to take
compared to other countries.
I think the tax regime for
entrepreneurs is also very
good. London is a great
place for business.”*
Venture capital and
business funding expert

business in London. In terms of communications, speed of broadband internet can be the difference between a business deciding to set up in London or locate elsewhere. Yet, access to reliable communications in London is not limited to its electronic form; physical connections are equally important and successful in attracting new businesses. To maintain this competitive advantage and the economic opportunities it creates, the Government must continue to invest in connectivity of goods, service and people. This includes infrastructure investment such as Crossrail, Underground upgrades and broadband connectivity, as well as investment in skills' development. The good news from the recent Comprehensive Spending Review is that investment in both Crossrail and the Underground will continue.

Networks and Professionals

Networks and the professionals within them support London's authority on the global stage. The Capital has an ability to attract talent on an enviable scale. Quality professionals from across the world have and do come together in London across a range of sectors: finance, media, retail and pharmaceuticals to name a few. Business leaders consulted for this report rated "access to quality population" (i.e. contacts/networks, suppliers, skilled staff, etc.) as one of the strongest features of London as a business location.³ What these talented professionals bring with them, in turn, are further avenues for global connectivity since *"the ethnically diverse population (of London) often comes with supporting networks, encouraging business knowledge"*.

It is in this sense that London is described as *"a great place to network"*. These networks are both formal and informal ones. The latter can range from *"national, linguistic and/or ethnic networks"* to *"clubs where financial analysts get together"*, while networks of professionals are characterised by their quality and variety. The importance of these networks is not only their ability to connect people, but to act as relevant sources of information for entrepreneurs. Entrepreneurs do not always go to official advisory agencies for ideas and advice; this may be because they are not aware of their existence, or because they do not feel they are getting adequate support and information. Instead, entrepreneurs make use of their (often informal) personal contacts: *"I have built up a lot of good networks in the industry. I get a lot of guidance from people who have been in business on what to do"* (owner of a new strategy consultancy)

Political and Legal Systems

The Capital's and indeed the country's, political and legal systems were posited as another draw for businesses. Stability is at the core of the country's political system and we have a legal system which affords businesses and business owners an improved level of security and certainty. Thus, *"the regulatory and legal framework"* was rated 3.1 by the respondents to our survey,⁴ and seemed particularly relevant for those firms in the finance and business services sectors, as well as the professionals, and amongst those companies with 20 to 199 employees. The stability of the political system, on the other hand, was rated 3.8, and most valued by the retail and wholesale sector and amongst those firms with 1 to 19 employees and 200 to 499 members of staff.⁵

All these factors contribute to the fact that businesses are still choosing to locate in London rather than elsewhere. For the time being, our respondents believe that the good outweighs the bad. Welcome news? Of course. But challenges still exist, and must be addressed to ensure the Capital retains its privileged position.

³ "Access to quality population" was rated 3.9, being 1 "key weakness" and 5 "key strength" by those responding to our survey.

⁴ Being 1 a "key weakness" and 5 a "key strength" of London as a business location.

⁵ The levels of appreciation for the stability of the political system were significantly consistent amongst sectors and company's sizes. For example, while those in the retail sector rated it 4.1, the finance sector and professions rated it 3.8, and manufacturing and other sectors rated it 3.7. The numbers for the regulatory and legal framework varied more significantly.

THE NOT SO GOOD

The result of our survey showed that as a business destination London cannot afford to become complacent: 35 per cent of business owners rated current growth and investment opportunities in London as “poor” (29 per cent) or “very poor” (6 per cent), with only 20 per cent describing these opportunities as “good” (18 per cent) or “very good” (2 per cent).

There is also a perception that London is an expensive place to live and in which to do business. Cost of premises, especially in relation to other areas of the United Kingdom, was without doubt a thorn in the side of many of those interviewed for this research. There is little that we can say here that has not already been said about an inflated property market. The housing market crisis may have made properties more available throughout the Capital, but costly premises are detrimental to London businesses, as companies move backroom staff and certain parts of their operations to surrounding regions to escape the costs involved; “if we want to recruit staff who are going to have almost no client contact, it would be senseless for us to recruit those people in London because (...) the capacity we need to host those people in the office is more expensive” (owner of a new communication start-up).

Difficulties and costs associated with transport were also highlighted. This is not just about Tube delays, but more importantly the inaccessibility of the transport network itself and the viability of the infrastructure in the future. Infrastructure is critical to maintain and increase both national and international levels of commerce and to commuting. Years of under-investment have translated into a saturated and congested network, both road and rail. This makes it difficult for businesses to grow. Infrastructural and logistical issues cannot be underestimated.

Likewise, the importance of political stability in terms of business operations needs to be appreciated fully. The reputation of both London and the UK in this respect is broadly strong, as described above. However, a lack of consistency appeared to be a concern for our respondents, particularly in terms of taxation. While increasing levels of taxation will always ruffle feathers, recent and forthcoming changes in the tax system (e.g. 50p income tax, 20 per cent VAT or the taxation over bonuses) seem to have affected businesses’ perceptions of London’s tax structure. Thus, those asked considered the “tax structure and rates of taxation” in the Capital as a weakness.⁶ Companies of all sizes need certainty around the tax system and tax rates to be able to plan effectively and attract new companies and entrepreneurs to London and the UK. The Government’s direction on Corporation Tax is very welcome in this regard (see Emergency Budget section below).

Also of note was a thornier issue: that the pursuit of a stable and reliable political, legal and tax system can lead to over-regulation. Whilst the overall regulatory and legal framework was positively regarded due to the stability it brings (as seen above), many of our respondents considered adhering to the range of regulations to be a barrier to setting up and, more particularly, growing their businesses. Small firms simply do not have the time or resources to devote to the onerous number of requirements surrounding employment, tax and accounting and health and safety, to name but a few. “There is too much paperwork and they are not easy to understand. It is the words that they use that make it very complex. For example, they talk about “the key return of investment”, but entrepreneurs want to hear “value for money” (Owner of a new strategic consultancy).

I think the two biggest risks to London’s competitiveness are the cost of actually being here, and the other is accessing the city - in terms of ‘physically’; it is the ease with which you can bring up the whole team to central London”

Owner of a new communications start-up

⁶ The tax structure and rates of taxation were rated 2.5 by the respondents to our questionnaire, the lowest of all the elements asked about. This low rating was consistent amongst sectors and company’s sizes.

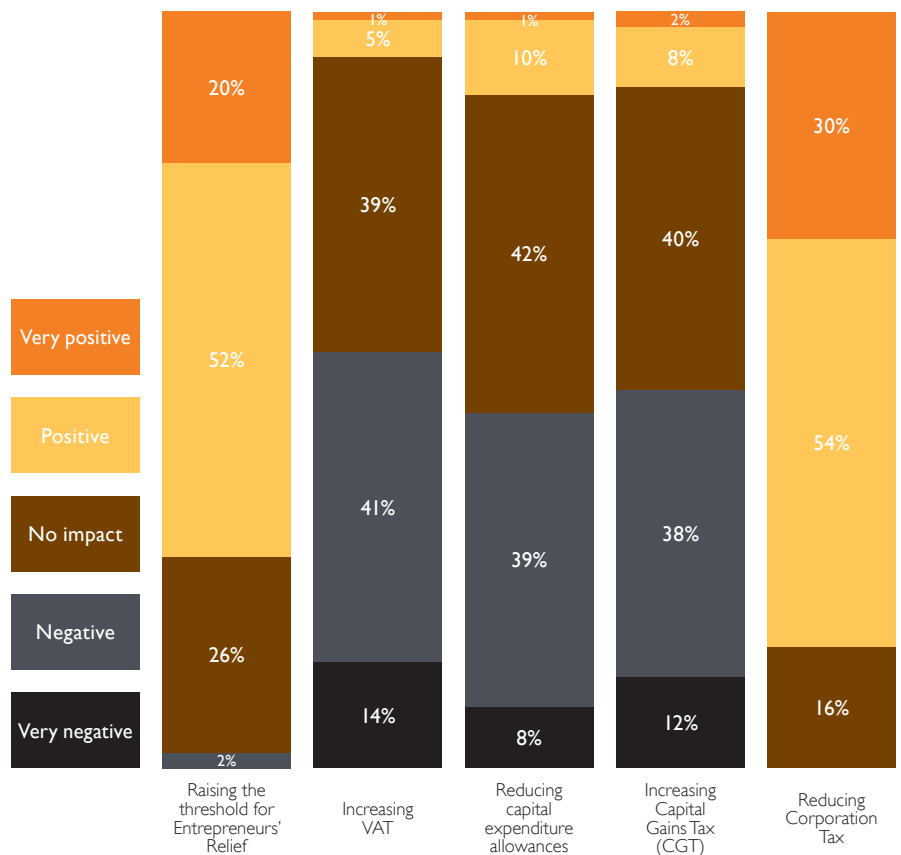
We support the Government's efforts towards improving regulation. Our research, however, shows that these improvements have not gone far enough. The new "regulatory architecture should not have too many blank pages, too much 'start again'" because good regulation can encourage business, but only if the unintended consequences are thought about properly, as pointed out by an entrepreneur. Moreover, the costs associated with taking professional advice can be too burdensome for those entrepreneurs trying to grow and expand their businesses.

EMERGENCY BUDGET

The Emergency Budget, announced in late June 2010, gave us an opportunity to gauge the ways in which the Government is showing support for entrepreneurs and, crucially, how entrepreneurs themselves rate measures taken in terms of having a positive or negative impact on their business.

Our survey showed that 84 per cent of business owners felt reducing the rate of Corporation Tax, as outlined in the Emergency Budget, would have a "positive" (54 per cent) or "very positive" (30 per cent) impact on entrepreneurship in London. Likewise, raising the threshold for Entrepreneurs' Relief had a warm reception, with 72 per cent of those asked rating it as having a "very positive" (20 per cent) or "positive" (52 per cent) impact. Increasing rates in Capital Gains Tax were, by contrast, generally unpopular, with 50 per cent rating its impact on entrepreneurship as "negative" (38 per cent) or "very negative" (12 per cent).

Figure 1: Business leaders' views on how policies outlined in the Emergency Budget will affect entrepreneurship in London.



4. FUNDING AND SUPPORT: THE REALITY

A key finding in our research around funding and support is, we believe, a positive one. Our respondents did not complain about the amount of information available to them, particularly at the initial stages. However, they believed what is available must be clear, better organised and proactive. Their requirements should also be met in a way that is not overly protracted: for many, time is the most valuable commodity they have in terms of making their businesses a success. The internet has indeed been a great liberator and levelled the playing field in many ways, but, without clear structured information, the time it takes to find what you need can be a major hindrance. Where to go to find the information required is another concern for entrepreneurs. Because there are a great number of organisations providing help and information, there is at times the risk of duplication. The result is confusion and the tendency to go to informal networks and people they know for advice and information, as mentioned above.

Concerns extended to the type of advice and those persons granting the advice at both the entrepreneurial and governmental level. On the one hand, entrepreneurs do not always feel confident on the quality of advice given by official programmes and agencies. As one venture capital and business funding expert put it, *“in my experience people that are setting up businesses have done their research and understand their market. The problem people sometimes have is the plethora of poor quality advice often delivered by someone that has never run a business themselves.”* There is a gap therefore in the understanding of what is on offer and what is needed by entrepreneurs. On the other hand, those offering advice to the Government on how to promote entrepreneurship *“tend to be those that are well-known or ‘famous’ or the FTSE-type people. But you actually need to make sure that smaller businesses and entrepreneurs’ needs are properly represented”*, as the same expert explained.

Our research also found that, if businesses were able to access, understand and benefit from support as a start-up, as they grew this became trickier to find. The amount of support available for companies at the beginning of their lifecycle appears to tail off as they look to expansion, a time at which businesses are most fragile and support is arguably most crucial: *“The Government should support start-ups, there is no doubt about that, but there is a need to be more strategic about that support and to recognise there is not a lot of support for those who want to accelerate”* (Owner of a new strategy consultancy).

Though 30 per cent of business owners had no plans for growth or change for the next two to five years, the majority do have plans to either grow or exit in the set time-frame (see Figure 2 overleaf).

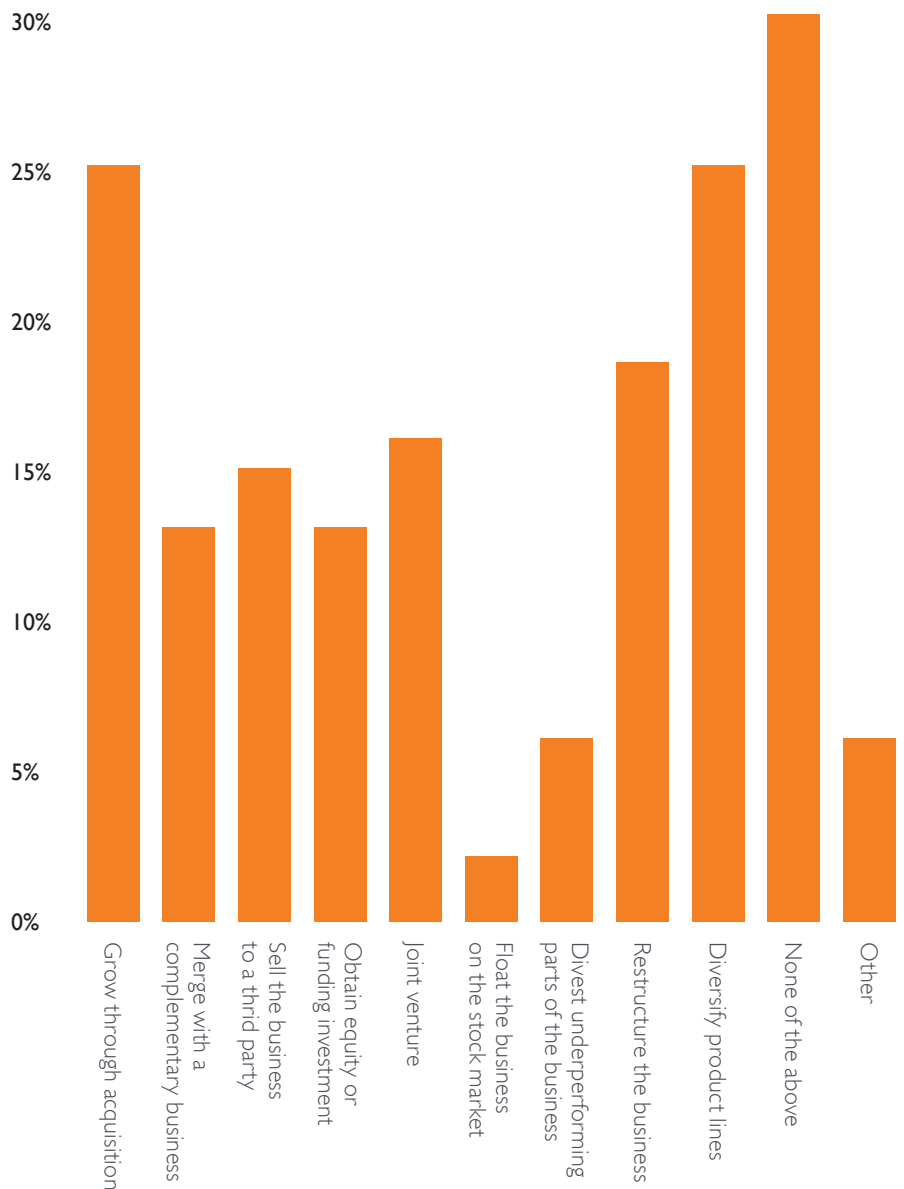
“If you and I were both qualified doctors we would be seen as experts and command immediate respect and immediate buy-in. But some of these people advising businesses have never run a business themselves and tend to rely on standard responses and tick boxes.”

Venture capital and business funding expert

So, businesses continue to have ambitions, and this is not surprising, given what has already been said about the entrepreneurial mindset. However, a number of the growth options provided in our survey, such as joint ventures (see Figure 2), are not even addressed in the Government consultation as funding options.

Partnerships between private and public sectors should be also encouraged. Businesses working together is a commonplace practice and an important way of sharing funding and opportunity. Again, joint venture and other opportunities depend on information, connectivity and the chance for businesses to find a meeting of minds. In the context that only 20 per cent of businesses rated current growth and investment opportunities in London as “good” or “very good”, it is vital that the right types of businesses and individuals are connected with entrepreneurs. Finding ways to promote industry contact can only be welcomed.

Figure 2: London business growth plans for the next two to five years⁷



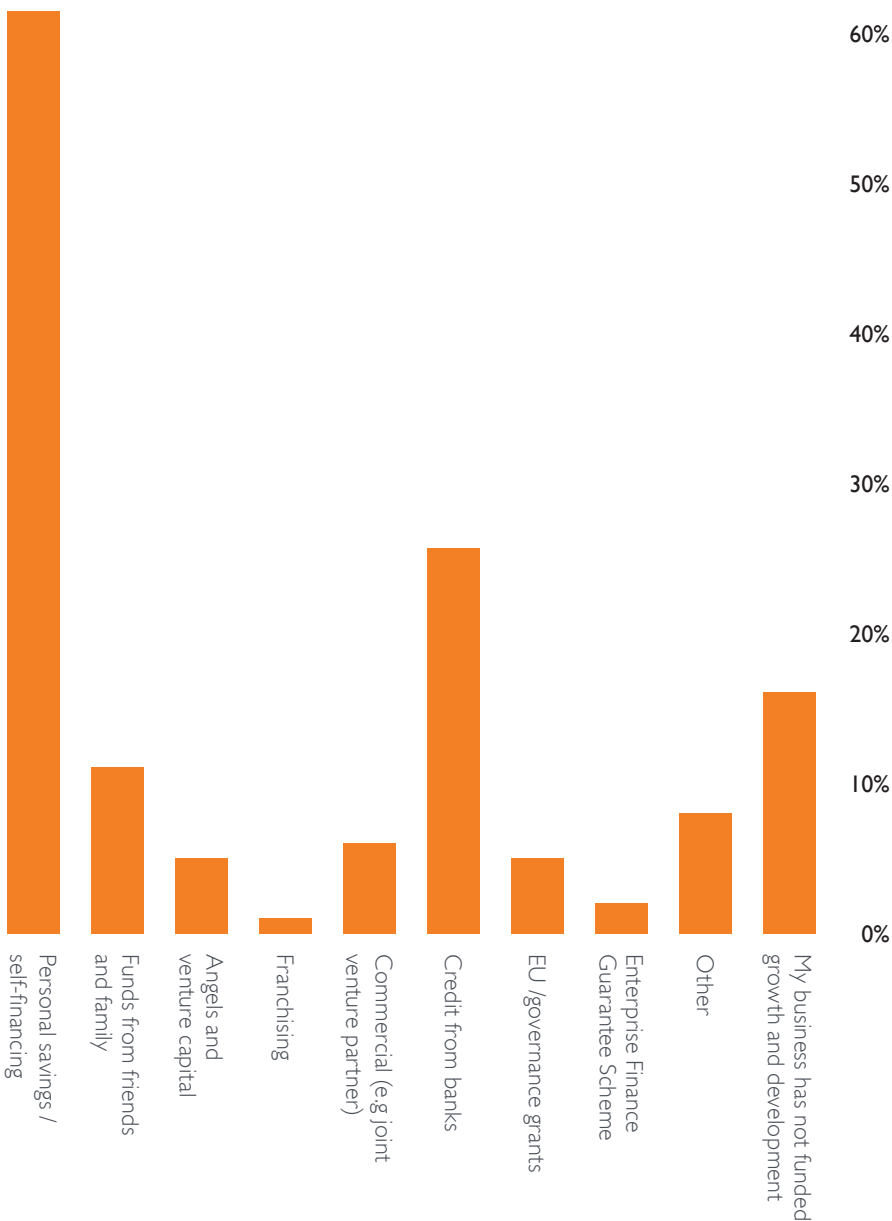
⁷ Respondents were asked to tick as many options as applied to them. As a result the percentages do not add up to 100%.

ACCESS TO FINANCE

Accessing finance was, unequivocally, the biggest anxiety faced by our respondents. Support for agencies and programmes that may need further organisation to be at their most effective was matched by gloominess in terms of finance.

Our survey showed that, in terms of growth and development, vital to a business's success, self-financing far outweighed any other form of funding at 62 per cent. Credit from banks was the second most used option in terms of funding growth and development according to our survey, at 26 per cent, still completely overshadowed by personal savings/self-financing (see Figure 3). This finding was also supported by our interviewees, most of whom had started their businesses on savings. However, self-financing does not stop once the firms had been established. As one entrepreneur explained it, *"there have been times when as well as not getting a salary, I had to put my own money into the business."*

Figure 3: London business financing mechanisms for growth and development in the last two years



One might jump to the easy conclusion that this gap between self-financing and bank lending is recession-related. Our research shows that this is not strictly the case: some 40 per cent of businesses reported their lack of investment was not due to the recession. What this shows is that there are underlying factors for not funding growth and development beyond current market conditions. The Government must, therefore, find ways to further incentivise business investment, as the economic recovery does not guarantee it. Businesses, for example, should be allowed to combine four years of capital allowances into one investment, as a one-time spend of £100,000 may meet business needs more effectively than a limit of £25,000 per year. Start-ups could also benefit from simple and targeted initiatives such as reductions in their phone and internet bills over the crucial first year.

In short, many of the smaller entrepreneurial businesses do not rely on a debt finance model, and were reluctant to seek credit even before the recession. Banks, therefore, are only a part of the solution to funding entrepreneurs,⁸ and policies focused on getting banks to lend do not fully recognise the nature of the situation. What is needed is a combination of options that are as creative or as innovative as the entrepreneurs and businesses which they are funding.

FUNDING OPTIONS

Choosing the right type of funding will be the most important decision that entrepreneurs will have to face, and at each stage of the business lifecycle. It is important, therefore, to have adequate information, as well as a clear idea of why they want that type of funding and what they will do with it. A recent LCCI publication in conjunction with TiE highlighted the funding options available.⁹ Here we outline those most commented upon by our respondents, and their advantages and disadvantages.

Venture Capital/Private Equity

The UK venture capital and private equity market is second only to the US in terms of size, representing almost 51 per cent of the total European market. Venture capitalists will be looking to invest large sums of money in return for an equity stake in the business. The typical minimum that they would be interested in investing is £2million. They will also be looking for an ambitious but realistic business plan, a product or service with a unique selling point, a high return on investment over a short time, sound management expertise and a proven track record.

For many of our respondents, some of these conditions rule out their approach to venture capitalists. For one, the sheer quantity of investment will, more often than not, not be required by start-up companies. Furthermore, someone who has decided to start their own company may not have the proven track record required. Venture capital also appears to have an association with an established business rather than one seeking start-up support: *“we will go to venture capital when we’re making profits – and then bring in the banks when we’re bigger”* (Creator of media and recycling unit). Only 5 per cent of those asked have funded growth and development in the last two years through angels and venture capital (see Figure 3).

The biggest criticism of venture capital, however, is their lack of appetite for risk, or as one entrepreneur explained it, *“this country, this city does not do venture capital. It does growth capital, i.e. you have got one data centre and you want to buy three data centres; they look at the expenses of one data*

⁸ An interesting document on the future of banks is “Supporting UK business. The report of the Business Finance Taskforce”, October 2010; published shortly before this report.

⁹ ‘Funding Guide for Entrepreneurs’, July 2010, www.londonchamber.co.uk/DocImages/7545.pdf

centre and they say “ok, if we added three more, what may we have?” So what you are financing is growth capital. What you are not financing is “I do not know what a data centre is but I think that if I were to build one I may have a business.” In other words, “what happens in this place is actually you have effectively growth capital. That is where the banks will not lend because the certainty is not there, but fundamentally you have proven the model and you are looking for the capital to take the model and make it 3x. That is the space where venture capital invests today in London.”

Business Angels

Business angels, if Dragons’ Den is anything to go by, seem the most glamorous of funding options available to entrepreneurs at the beginning of their lifecycle. In reality, securing funding from a business angel is a very different prospect from the one shown on the BBC, particularly as non-TV angels often request anonymity to avoid unwanted approaches. *“They are a really important strata of funding, and networks are a useful way of accessing them. But the best angels are probably met through people you already know. Ultimately the angel is a person – someone you can trust and work with”* (Private bank executive).

Their investment will typically range between £25,000 and £750,000 and they will often be successful business people in their own right with both capital and business acumen to offer the start-up. Investment by the estimated 18,000 business angels operating in the UK is a high-risk venture for the donor: 40 per cent of all investments made by them are lost.

The response of our interviewees to business angels ranged from fairly non-committal: *“if you are doing something that can start trading at a relatively small investment (less than half a million) they can be incredibly good,”* to unfavourable: *“they are not sophisticated investors and do not actually understand private equity investment.”* Moreover, *“the quality of investors and the quality of deals in a typical business angels’ network was quite low because, what we found is that people with significant capital were not making use of them but they were primarily using their own private networks to make private investments; and people who did that (use business angels’ networks), did not have the capital to invest.”* (Creator of media and recycling unit).

The prevailing fact is that a business angel’s suitability will always be deeply dependent on individual circumstances, if one is able to find one of these elusive creatures at all.

Government Loans and Schemes

As we have mentioned previously, respondents felt the organisation of support programmes available to them needed to be better organised and streamlined.

Entrepreneurs’ Relief, the Enterprise Investment Scheme (EIS) and the Enterprise Guarantee Scheme were addressed in our survey and our interviewees gave them as examples of positive Government initiatives, though were keen to highlight where they might not be as effective as they could be. As they are quite different, it is important to address them separately.

a) Entrepreneurs' Relief

*"Entrepreneurs' Relief reduces the amount of the capital gain to be taxed on a disposal of qualifying business assets on or after 6 April 2008, as long as you have met the qualifying conditions throughout a one year qualifying period either up to the date of disposal or the date the business ceased. The relief is subject to a lifetime limit of £5,000,000 of qualifying capital gains for each individual."*¹⁰

While it is true that respondents broadly saw Entrepreneurs' Relief as having a positive effect on entrepreneurship in London (72 per cent of businesses felt raising the threshold for Entrepreneurs' Relief would have a "very positive" or "positive" effect on entrepreneurship in London - see Figure 1), they also stressed that those who want to or can become entrepreneurs will do so anyway. That is to say, the policy will not affect those hitherto unresponsive to entrepreneurship and setting up a business. It will act as a reward for those who have already thought of entrepreneurship: *"Relating it to my personal experience, when I first started I did not spend much time looking around as to what tax relief was available to entrepreneurs in making my decision whether to do it"* said one successful entrepreneur. Also, Entrepreneurs' Relief is beneficial for those who are established and have already grown their business, but not for those who are starting up or need to expand their business. Notwithstanding, and as the CEO of an established research firm explained, ***"Entrepreneurs' Relief is a good thing because more people will go out and invest that money into something else."***

b) Enterprise Investment Scheme (EIS)

*"The Enterprise Investment Scheme (EIS) is designed to help smaller higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies."*¹¹

The key features in the EIS include:

- Income Tax relief up to 20 per cent
- Capital Gains Tax deferral up to 40 per cent for the life of the investment
- Capital Gains Tax freedom on profit made when disposing of the investment (after 3 years, and provided that the investment has remained an EIS qualifying company for the full three year period)
- Inheritance Tax exemption
- Loss Relief up to 50 per cent¹²

EIS is a very welcome initiative and received praise from our interviewees: *"The Enterprise Investment Scheme is excellent and should be promoted more"* (Venture capital and business funding expert). However, since it is high-risk (and therefore best-suited to high-net-worth individuals), it cannot be heralded as the solution to most entrepreneurs' difficulties when raising funding. Only 2 per cent of our respondents had used it as a funding mechanism, while 5 per cent of our respondents use business angels or venture capital, and 12 per cent used funds from family and friends, meaning a total of 17 per cent are excluded from the EIS scheme (see Figure 3). Furthermore, its rules are complex and because it overlaps with other regulation, more information and support should be given on how the Scheme works. Limiting investment to £500,000 may also be a problem for expanding companies.

¹⁰ <http://www.hmrc.gov.uk/helpsheets/hs275.pdf>

¹¹ <http://www.hmrc.gov.uk/eis/>

¹² Trapezia EIS II Fund leaflet

c) Enterprise Finance Guarantee Scheme (EFG)

Whilst it has been a major Government programme to support lending to small businesses, EFG has been described as bureaucratic and there is evidence to show not many firms have benefited given the substantial investment.¹³

As the Green Paper, "Financing a private sector recovery", proposes to continue EFG and possibly extend to medium-sized firms, it is important to address its link to the banks. The Department for Business, Innovation and Skills suggests the role of EFG is "*facilitating additional bank lending to viable SMEs with no or insufficient security to secure a normal commercial loan*". Our research however shows that most SMEs/entrepreneurs do not rely on banks for growth (see Figure 3) so we believe it should be expanded to other ways of funding to help firms to grow.

In delivering funding and loan programmes for SMEs, the Government must develop partnerships with organisations who best understand business needs, and diverse ones at that. These partnerships across sectors will not only ensure the delivery of the projects to the intended recipients, but also reduce the bureaucracy and cost. Furthermore, it will make it easier to communicate to businesses whether they are eligible and why through established and respected channels, as well as ensuring the quality of information provided. Moreover, it will make it easier for entrepreneurs to know where to go for funding.

Apart from the limitations of the different types of funding options, our research shows that businesses were open to a range of options. The Government must, therefore, take a holistic approach when developing policies around access to finance for businesses. Encouraging bank lending to SMEs is not sufficient, as firms are using more than one source of funding, as shown above. It is, therefore, essential that Government policy looks at how a range of finance approaches fit together, taking into consideration the advantages and disadvantages related to amount of money required, stage of the lifecycle and other factors outlined in this report. The varying goals and needs of businesses must also be recognised, as a "one size fits all" approach will not drive entrepreneurship forward in a way that will assist economic recovery.

Grants and Awards

Grants and awards are typically used alongside other forms of finance and will be unlikely to cover more than 50 per cent of the total finance costs. Local and central Government provide grants, which, by their very nature, do not need to be repaid. Awards, by the same token, do not need to be repaid and are often offered by private companies as well as governmental organisations. While both of these number in their hundreds, our respondents pointed out that applying for grants or awards is no easy task. Only 6 per cent of our respondents had used Government grants to finance their growth and development in the last two years (see Figure 3), and their attitudes towards them ranged from ambivalent to disparaging: "*I feel there are a lot of strings attached in getting Government help. "If we give you money you must do A-B-C and D", which then changes the direction of my business because I do not want to and did not set out to do A-B-C and D*" (Owner of a new strategy consultancy).

¹³ According to a survey done by the LCCL in July 2010, only 2 per cent of the companies asked had received help through the EFG scheme.

5. FINDINGS AND RECOMMENDATIONS: THE WAY FORWARD

The Government has acknowledged that entrepreneurs will be a vital engine of growth for economic recovery. Yet, in this acknowledgement, they have also subsumed them into the vast category of SME which does not do justice to their particular and distinct needs. Entrepreneurs do not have a voice, or a platform with which to express themselves. In talking to entrepreneurs across London and the South-East, we are able to provide the voice and potentially a platform. We believe that this could be the beginning of a bigger movement, and that there are key areas in which the Government can act now to improve significantly the chances of success for entrepreneurs in London and beyond.

We have identified five key findings and recommendations that, if addressed by Government, would have a meaningful and positive impact on the entrepreneurial community.

Regulation and tax systems are not looked at as negatively as one might think

Much talked about, our findings showed that feelings toward these two issues were not as unfavourable as expected. Our respondents were tolerant of certain necessary levels of tax and regulation, noting that stability in terms of fiscal and legal environment takes precedence. However, regulatory requirements on businesses are often unclear, burdensome and time-consuming. More coherence of thinking and presentation, where possible, is vital to ensure time and resources are not diverted from the entrepreneurs' business of business.

RECOMMENDATION 1

There is a critical need for certainty around the tax and legal systems to enable firms to plan effectively. The Government's direction on Corporation Tax is very welcome in this regard. Future policies should follow a similar, clearly defined path.

The reality of how entrepreneurs fund their businesses does not focus on bank lending alone

- 62 per cent of respondents use self-financing or savings to fund their businesses
- 26 per cent of respondents borrow from banks to fund their businesses
- 40 per cent of respondents reported their lack of investment was not due to the recession

Our findings showed that entrepreneurs use personal savings or other forms of self-financing rather than going to banks and taking on debt. Government initiatives that focus solely on incentivising banks to lend could be, therefore, of limited value, particularly in terms of our recession findings.

RECOMMENDATION 2

A holistic range of options must be available to best serve those seeking finance, taking into account factors such as the amount of money required and the stage at which the business finds itself.

Similarly, Government must find ways to incentivise further business investment, as the economic recovery does not guarantee it. An example would be allowing businesses to combine four years of capital allowances into one investment, as a one-time spend of £100,000 may meet business needs more effectively than a limit of £25,000 per year.

The biggest problem with information and support is the way in which it is organised

The production of documents such as the funding options guide¹⁴ produced by the London Chamber of Commerce and Industry in conjunction with TiE, have hitherto been necessary due to the complexity and range of existing support programmes for business, which often overlap and are badly sign-posted.

Designing support programmes that are planned strategically and organised in a coherent way that meets the needs of time-pressured businesses would enhance take up of these resources, enabling companies to grow more quickly and effectively and reducing the anxiety and confusion.

RECOMMENDATION 3

Existing sources of business advice, including those funded by Government, need to be streamlined and given sufficient resource. They also need to be able to develop programmes to respond to the specific needs of growing firms and market conditions.

The focus of support is on start-ups; further on in the lifecycle this becomes scarce

– 30 per cent of respondents have no plans for growth in the next few years

Our findings highlighted the need for input at each stage of the lifecycle of a business: to provide advice and information on start-up financing should not signal the end of any governmental input. Not only do we need entrepreneurs to set up businesses, but to fuel economic recovery, businesses must also grow and succeed in the long term. That close to a third of respondents were not looking towards growth may be related to the economy, but there is also the distinct possibility this lack of confidence comes from a lack of support and advice on how to grow. Entrepreneurs should be advised on how best to make themselves attractive to investors from day one through to growth and potential exit.

RECOMMENDATION 4


Support for start-ups is widely available, although not always maximised and well organised; problems arise when a business is growing yet is not big enough to invest further without substantial risk. Resources should be spread more widely to ensure that businesses at every stage of the lifecycle will benefit, especially those trying to grow.

There is work to be done in matching the right kinds of people and businesses together to incentivise entrepreneurship

- Only 20 per cent of respondents rate current growth and investment opportunities in London as “good” or “very good”

In this context, it is vital that the right types of businesses and individuals are connected with entrepreneurs to provide opportunity and cement the Capital's reputation as an attractive business destination. Creative and innovative mechanisms must be developed to bring interested parties together: working together, organisations such as the London Chamber for Commerce and Industry, The Institute of Entrepreneurs and Government can engage these

¹⁴ The “Funding Guide for Entrepreneurs” (July 2010) can be found at <http://www.londonchamber.co.uk/DocImages/7545.pdf>.



parties. There is a need for open dialogue which can be achieved through lobbying, events and literature such as this report. It may be true that capital will find ideas, but without the requisite incentivisation of those companies or individuals in a position to offer support, financial or otherwise, finding ideas becomes a more taxing process than it needs to be.

RECOMMENDATION 5

In delivering funding and loan programmes for SMEs, Government should develop partnerships with businesses who best understand business needs and can reach those companies who will most benefit from the programmes. This will not only ensure delivery of the projects, but also reduce bureaucracy and cost.

Finally...

To be an entrepreneur, as we have discussed, means many things to many different types of businesspeople. Yet, we think it is clear that the creative, innovative and gutsy spirit of the entrepreneur will always be the driving force behind the success of their business. This pioneering mindset does not exist in a vacuum. Support from the Government and the private sector is needed to provide solid foundations allowing creativity to flourish: certainty around tax and regulation; a realistic appraisal of funding options; and a platform from which to articulate their needs. It is from these foundations that entrepreneurs will grow and thrive, driving economic recovery and building confidence in London and the UK: of ultimate benefit to us all.

WHO WE TALKED TO

The tables below show the responses to questions that we asked of our survey participants about their businesses, revealing the following:

- Sectors include: finance and business services; retail and wholesale; manufacturing, transport and logistics; professions; and other services;

Table 1: In which sector do you operate?

Finance / Business Services	Retail / Wholesale	Manufacturing / Transport / Logistics	Professions	Other services
30%	7%	8%	19%	34%

- 65 per cent of the businesses surveyed had fewer than 20 employees (see Table 2);

Table 2: What is the size of your business?

1-19 employees	20-199	200-499	500+
65%	22%	6%	5%

- Over 50 per cent have been established for more than ten years (see Table 3);

Table 3: How long has your business been established for?

Less than a year	2-5 years	5-10 years	Over 10 years
5%	20%	22%	54%

- 66 per cent conduct most of their business in the UK (see Table 4);

Table 4: In which of the following markets do you conduct most of your business?

UK	Europe	Middle East	Americas	Africa	Asia
66%	18%	4%	4%	4%	5%

- More than a third estimated 25 per cent or less of their customers were based in London (see Table 5).

Table 5: Approximately, what percentage of your customers is based in London?

0-25%	26-50%	51-65%	66-80%	81-100%
36%	25%	12%	12%	15%

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