States of Jersey

Access to Finance Study

September 2015

Table of Contents

Executive Summary

Does Access to Finance constrain growth in Jersey?

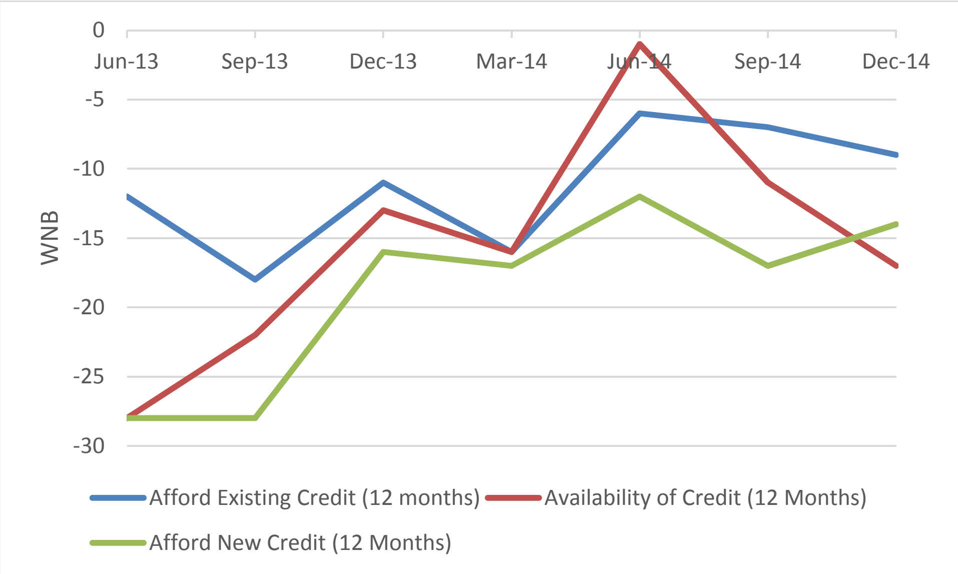
Jersey enjoys a relatively (by international standards) strong and stable economy with well-developed business links into international markets and a track record of attracting international business. Pro-business tax policies add to Jersey's reputation as a leading international offshore finance centre.

There is ambition and a requirement for more economic growth and diversifying the Jersey economy, with a focus on productivity improvements, job creation and skills development. As such, this study was commissioned to assess the extent to which 'Access to Finance' in the Island is potentially acting as a barrier to economic growth. The study draws on desk research and consultations with Government Bodies, Financers, HNWIs and business owners from a broad range of sectors currently operating across Jersey.

Demand, Supply and Confidence

Starting from a very negative position in 2013, the States of Jersey Business Tendency Survey notes that businesses' views on the availability of credit had improved markedly up to June 2014 where it came close to moving into positive territory. Since then, there has been a fall back towards strongly negative levels. Affordability of (both existing and new) credit did not come as close to positive territory as sentiments on availability but there has been a definite improvement away from Net Balances of close to -30 to -14 for affordability of new credit and a slight improvement in the sentiments on affordability of existing credit from -12 to -9.

Jersey businesses views on affordability and availability of credit



Source: SoJ Business Tendency Survey

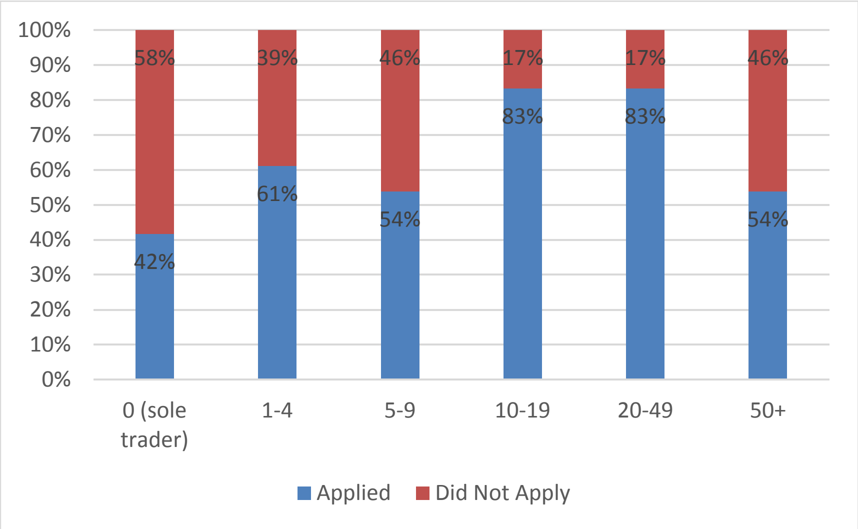
To supplement available data, awareness of and demand for finance has been tested through a broad range of consultations and an online survey that was distributed through Jersey Business, Digital Jersey and the Jersey Chamber of Commerce. The survey received 72 responses and OCO carried out approximately 50 face to face interviews with Financers, HNWIs and business owners from a broad range of sectors currently operating across Jersey.

The consultations were used to determine:

- **Awareness of finance availability in Jersey:** there were significant high levels of awareness of banking and secondary finance. Face to face conversations did however consistently raise a lack of competition in the banking sector. Peer to Peer lending, which is gaining considerable media attention and which is recording considerable growth in other markets only attracted a 44% awareness level among respondents to the survey.

- **Demand for finance:** the Business Tendency Survey notes that fewer than 20% of companies in their sample had applied for finance in the past three months. Extending this timescale out to three years in the OCO survey identified that just under 6 out of 10 survey respondents have applied for finance at least once during the past three years.

  Which of the following statements best describes your demand for finance in the last three years, size of firm?

  Source: OCO Access To Finance Online Survey (April 2015)

  Sole traders are least likely to have applied for finance within the last three years while c.80% of firms in the 10-50 employee size bracket have applied for finance at least once.

  During the consultations OCO undertook with small business operators in Jersey, a common opinion offered was that 'the banks don't want to know.' This might point towards a latent demand. Certainly, the insight from secondary finance providers was that there was a strong demand for business finance.

- **Accessing Finance/the extent to which finance is a barrier to growth:** Throughout the consultation exercise, several general perceptions emanated and can be summarised as:
  - There is an actual and latent demand for business finance. One bank viewed recent account openings in the previous 12 months as reasonably buoyant, having opened 160 new business accounts. Further, the extent to which survey respondents have noted a demand for finance over the past three years does not lend strong support to the view that there are few entrepreneurs on the island. Many consultees were also 'resigned' to the fact that the 'banks don't want to know' and so haven't even tried to access finance
  - There was a perception expressed that banks were unwilling to lend to smaller business, particularly start-ups as the level of risk was too high. This has been borne out in the survey analysis, where approval rates for sole traders were less than one in three. As noted this is not unique to Jersey and is symptomatic of a lack of trading

history and credit rating
- o Entrepreneurs express some frustration towards banks taking decisions off island through their centralised lending decision functions.
- o Consultees also suggested that banks do not always understand the business proposition and that having sector experts in the banks, or access to third party local advisers would remove this barrier
- o Consultees indicated that secondary providers were more willing to lend and offered a more personalised approach, but at a much higher interest rate
- o Entrepreneurs interviewed, viewed Peer to Peer as a strong potential funding stream. However, they viewed access to peer to peer lending as low in Jersey
- o HNW individuals are seen by many consultees as a strong potential source of business finance but were uncertain of how to access this potential funding source
- o Finally consultees suggested that Government Funding is targeted towards specific sectors or strategic priorities (i.e. innovative/ agricultural companies) and not available to every business

Based on survey responses, wide ranging consultations and Jersey's Business Tendency Survey, OCO has concluded the following two key points:

- **There is a range of and sufficient supply channels to meet local demand for business finance. The key issue identified on the supply side related to the alignment of the supply channels with demand.**

- **The key issue identified on the demand side is businesses could be better prepared to present their proposals to potential financiers.**

If the above two key findings are addressed businesses would be better informed of the options available and more likely to secure the type and amount of finance required.

In relation to the specific research objectives, OCO's conclusion is that, there is no evidence to suggest that costs are acting as a barrier to finance.

- Whilst there are non-cost challenges, including fewer market participants; a less diverse finance offer (i.e. invoice factoring isn't available and few peer to peer lenders) business with a good and well-presented proposition are securing business finance. A strong perception in the business community that banks aren't lending is discouraging businesses from applying for bank funding on an assumption that it is a pointless endeavour. This is not unique to Jersey and acts as one of the most common barriers to SME finance in other jurisdictions.

- There is no sense from the work undertaken of any sector specific issues or barriers, although several respondents did believe that sector specialists within the banks would result in a greater level of understanding of the businesses and therefore increased loan approvals. Unsurprisingly, smaller, younger firms did find accessing finance to be more difficult than larger firms with a longer track-record of successful trading. Further, throughout the course of the consultations, OCO heard nothing, or discovered no evidence to suggest that there are any specific or unique barriers facing high growth potential businesses.

- Throughout the consultation phase of this research several wider topics have been raised as a barrier to business development and growth and form the basis of a post script section of this report.

What should government do to address the findings

The core finding from OCO's analysis is that the supply from local financiers is able to service the local demand for business finance. In summary there is no 'gap' in the supply and demand for business finance that requires direct government intervention. Further the study produced no evidence to highlight any barrier for good propositions to access business finance.

Although the study concluded there are no gaps or barriers to business finance OCO concluded the following:

- After speaking to banks, secondary lenders and individual investors, businesses would be more likely to secure finance if their application was supported with a detailed business plan and financial forecast

- Entrepreneurs looking for business finance were not sure who to approach or where to go to apply for funding from private individuals

- Over the course of this research the scarcity of data on lending to small businesses was evident

Having considered the outcomes of the study OCO make the following recommendations

Table 5.1: Recommendations

Recommendation	Description	Rationale
Peer to Peer Portal	This portal would aim to bring together entrepreneurs with private individuals. It could be managed by government, an agency or a representative body, be self-funding and would require no government funding.	The non-traditional lending that has gained significant 'traction' in the UK and further afield is not accessible to Jersey businesses or investors. If promoted well, a portal 'would complement existing routes to finance, amplify supply and draw in any latent demand – thus addressing the identified misalignment of supply and demand on the island.
Better mentoring/softer support:	In order to offset the frequently repeated view that the standard of business plans coming forward for funding are weak, this mentoring scheme would provide a robust challenge and support function to new businesses.	While Jersey Business is well regarded, it is evident from consultations that there is a need for more targeted mentoring support, to mitigate the risks associated with operating a new business.
Bank liaison/ Data collation role	States of Jersey should continue to engage with the banks in a formal, regular format and enhance data collection on access to finance	Over the course of this research the scarcity of data on lending to small businesses was evident. States of Jersey should develop appropriate indicators on access to finance and ensure regular reporting. Further, Small businesses were citing a lack of sector specialists within the on island banks as a constraint to informed funding decisions. Continued, formalised and regular liaison between States of Jersey and the on island banks to give voice to these types of issues is recommended.

Access to Finance is part of a wider jigsaw…

The majority of one to one meetings highlighted a broader range of barriers to Jersey's economic performance. As recognised in the State's Economic Growth and Diversification Strategy and Enterprise Action Plan, there are a range of economic development and competitiveness challenges that the island continues to face.

The other key challenges that arose during the course of OCO's engagement encompassed:

- **Population Regulations:** The current population policy that helps control immigration levels have been cited as a major challenge.

- **Skills Shortages:** Consultees took a view that the 'skills mix' on the island is not sufficient to drive high value added growth.

- **Costs of doing business:** Business owners with operations in Jersey and the UK provided anecdotal evidence that the overall costs of operating a business in Jersey were higher on the island. Further research into the general cost competitiveness in Jersey may be warranted, to determine the extent of and reasons for operating cost differentials.

- **Corporate Governance:** The issue of company governance has been raised as a potential barrier in accessing finance with the view being offered that private companies are not disciplined in maintaining audited accounts and minutes of meetings and decisions etc. A lack of audited accounts and verified trading history would obviously impact on a bank's capability to assess a funding application.

- **Business Support required:** Businesses in Jersey need support, advice, mentoring, networks and partnerships. It became apparent during the consultation phase that Jersey Business is highly regarded by those that availed of support with business planning, but the majority of those that accessed support services appear to do so via word of mouth recommendations. Low awareness of available support and a lack of mentoring, networks and other 'softer' support was a common issue in consultations.

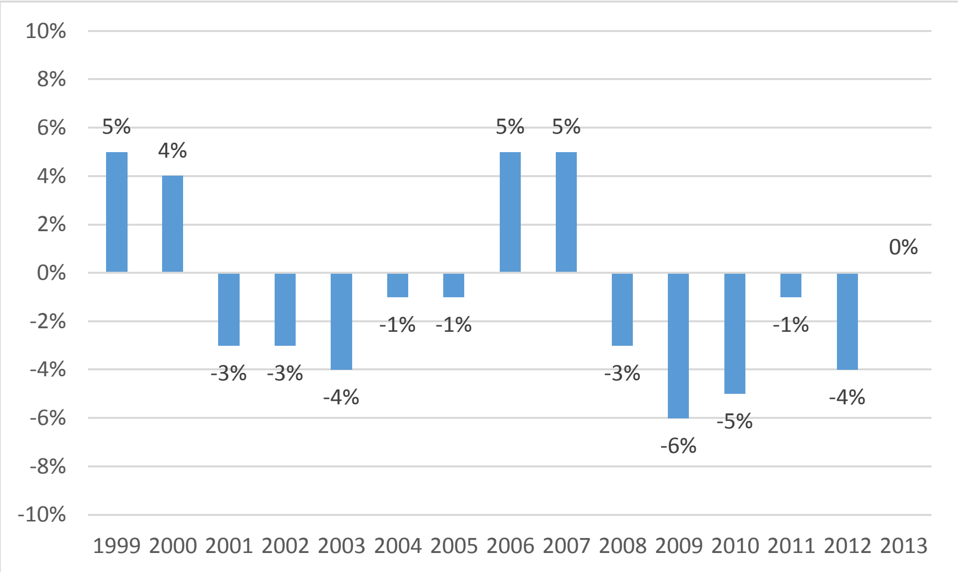
1. Introduction

Jersey enjoys a relatively (by international standards) strong and stable economy with well-developed business links into international markets and a track record of attracting international business. The Island's low tax environment adds to Jersey's competitiveness and to Jersey's reputation as a top offshore finance centre in the world.

1.1 Economic Performance Context

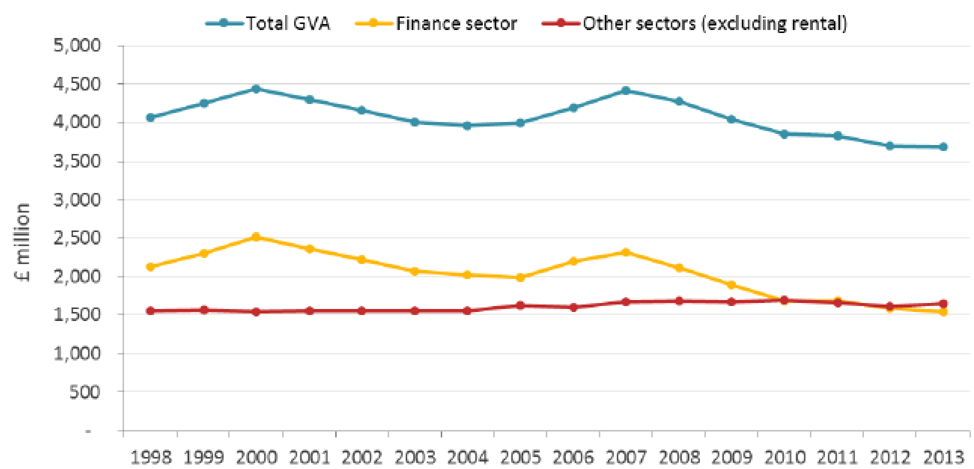
Jersey's global reputation as a financial services powerhouse does mask some challenges. While the strength of Jersey's economy owes much to financial services (it contributes c.42% to GVA). As Figures 1.1 and 1.2 bear out, the performance of the finance sector has resulted in a downward trend of GVA.

Figure 1.1: Annual percentage change in GVA (basic) in real terms



Source: Jersey Economic Trends

Figure 1.2: GVA (basic) at constant year (2013) values of income



Source: Jersey in Figures, 2014

While the latest Jersey Business Tendency Survey (April 2015) highlights a consistent level of optimism among finance industry leaders (the majority of indicators for the finance industry were either positive or strongly positive, whilst indicators for Business Activity, Profitability, Employment and Future

Business Activity improved) the downturn has brought the need to develop a more diversified economy into sharp focus.

Jersey's Fiscal Policy Panel have undertaken an analysis of trends in the Jersey economy and their January 2015 report concluded that there is no evidence to suggest that the trend rate of growth in Jersey will be significantly positive in the future. This is based on the Panel's assumption that there will be no growth in productivity. While the Panel anticipates some growth in the economy in the short-term, the underlying trend is likely to be broadly flat.

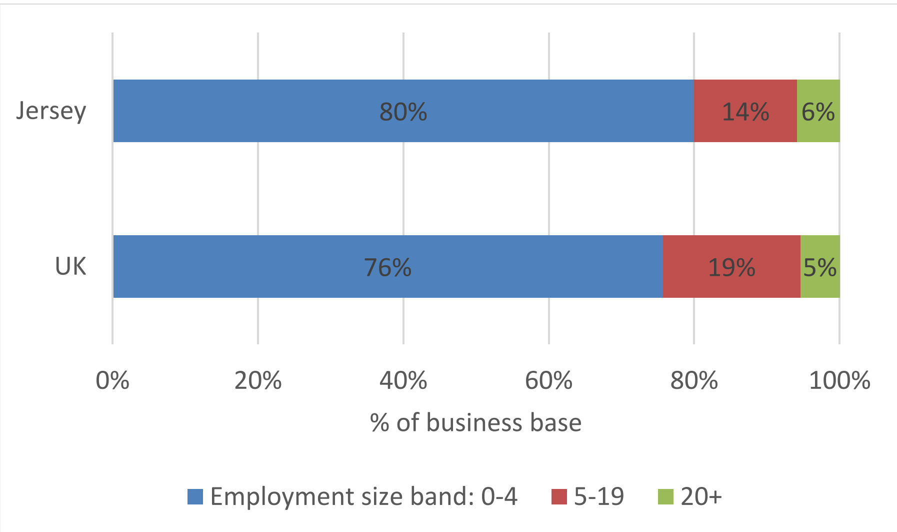
Despite signs of improvement in 2014, the States' 2015 Strategic Plan indicates that current economic trends are unlikely to generate sufficient growth in tax revenue for the States to balance its budget within the current structure of taxation and expenditure. Further, the impact of the ageing population will mean that further work will be needed in order to keep public finances in balance in the longer term.

This resulted in a recommendation that the States develop a clear strategy for raising productivity and competitiveness in order to secure the growth required to balance public finances and maintain current standards of living, despite the underlying demographic challenges of an ageing population.

1.2 Employment Context

Total employment in Jersey in December 2014 was 57,250 with 48,970 in the private sector. Jersey is heavily reliant on small businesses with fewer than 5 employees for private sector employment. According to the 'Jersey in Figures' statistical assessment of the island, there were 6,460 private sector firms in Jersey in December 2014. Of these, 80%, or 5,160 employed 5 or fewer people. This proportion is slightly higher than in the UK where 76% of the private business base employ 5 or fewer. This prevalence of firms with fewer than 5 employees is vitally important context for this study and may have a bearing on the Access to Finance environment as these 'micro' firms do typically find it more difficult to access finance in other jurisdictions. In fact, the Jersey business base broader economic context suggest three funding requirements: new business funding to grow and diversify the business base, growth funding to ensure companies in Jersey scale up and tailored funding to encourage beneficial behaviours such as innovation or exporting.

Figure 1.3: Private Sector Business Structure in Jersey and UK, 2014



Source: States of Jersey and ONS

1.3 Government Ambition

There are clearly defined strategic aims around growth, job creation and increased incomes. Much of the proposed solution to diversifying and maintaining a highly competitive and productive economy has been outlined across three key strategic Government documents – the Economic Growth and Diversification Strategy, the Enterprise Action Plan and the States of Jersey Strategic Plan 2015 to 2018 which was published on 30 April 2015.

Within the States of Jersey, the Economic Development Department[1] has the lead for the delivery of the Economic Growth and Diversification Strategy adopted by the States Assembly in July 2012.

The Strategy sets out the States' agenda for boosting economic growth and diversifying the Jersey economy, with a focus on job creation and skills development. This strategy outlines four key strategic aims:

1. Encourage innovation and improve Jersey's international competitiveness
2. Grow and diversify the financial services sector, capacity and profitability
3. Create new businesses and employment in high value sectors
4. Raise the productivity of the whole economy and reduce the reliance on inward migration

An Enterprise Action Plan was published in the summer of 2014 as the core delivery framework for many of the Growth Strategy priorities. It has been consulted upon widely with external partners, bodies and businesses in the Island. 23 core actions designed to address areas such as access to finance, innovation, skills and leadership and management have been identified and are in the course of being implemented by a combination of States Departments and external delivery partners.

The new Strategic Plan 2015-2018 outlines the goals that the island's Council of Ministers seeks to deliver. Contained within these social, environmental and economic goals is an ambition to 'achieve productivity-led economic growth, providing rewarding job opportunities and rising living standards across society.' Further, the strategy goes on to articulate a desire to support innovation, enterprise and inward investment across all sectors.

In respect of competitiveness the Department has embarked on a process of carrying out a number of short studies, supported by external consultants, to examine the impact of a number of key factors capable of impacting negatively upon economic growth and providing evidence and recommendations capable of informing policy development to minimise constraints.

This Study; Assessing Access to Finance, is the first of such exercises. The aims of this research, and where they are addressed in this report are presented in Table 1.1.

[1] Ministerial responsibility for key sectors may soon transfer within Government

Table 1.1: Outline of Aims and Addressing Sections

Study Aim	Addressed in…
Access to Finance • Are costs a barrier to accessing finance and how do costs in Jersey compare to costs in other jurisdictions? • Are there any other non- cost barriers that restrict access to business finance and do they differ to other jurisdictions? • What are the main reasons applications for business finance are rejected? • Does the stage (pre or post start-up), size of company or sector of business affect Access to Finance or the costs thereof? • Are there are any particular barriers affecting Access to Finance for firms with high growth potential?	**Section 2** places Access to Finance in a European and UK context while **Section 3** presents the findings from a wide ranging consultation exercise in which OCO met c.50 businesses, financiers, high net worth individuals and government representatives and issued a survey which was completed by 72 businesses.
To what extent does legislation, regulation or economic scale impact upon the ease of Access to Finance, determine the terms and conditions of access or deter providers from entering the market?	**Section 3** presents the findings from a wide ranging consultation exercise in which OCO met c.50 businesses, financiers, high net worth individuals and government representatives and issued a survey which was completed by 72 businesses.
To what extent does legislation, regulation or economic scale impact upon the ease of Access to Finance, determine the terms and conditions of access or deter providers from entering the market?	**Section 3** presents the findings from a wide ranging consultation exercise in which OCO met c.50 businesses, financiers, high net worth individuals and government representatives and issued a survey which was completed by 72 businesses.
Is there a role for the Jersey Government to play in making Access to Finance more effective for local companies as part of wider measures to boost growth, competitiveness or productivity? If so, what are likely to be the most appropriate steps to take to achieve this?	**Section 5** makes a series of recommendations, including possible roles for government
Is there a role for Jersey Government to facilitate and encourage private investment in local businesses? If so, what actions might be most appropriate for Jersey to consider?	**Section 5** makes a series of recommendations, including possible roles for government
Are there business funding options available elsewhere that would be of benefit to local would be entrepreneurs or established businesses?	**Section 4** profiles a selection of funding tools and policy levers used elsewhere

1.4 Approach & Report Structure

OCO's approach blended desk research with extensive consultations, as follows:

- Desk research on Access to Finance issues in Europe, the UK and Jersey was undertaken
- Face to face meetings were arranged on island with circa 50 Financiers, Businesses, Government officials, stakeholders, and High Net Worth Individuals
- An online survey was promoted by Jersey Business, Digital Jersey and the Chamber of Commerce
- OCO developed a draft report and recommendations and facilitated a round table discussion with EDD officials to present the findings
- To raise further awareness of the work and to test the thinking, OCO took part in a panel

discussion and networking event on 'The Brave New World of Business Funding' during Jersey Enterprise week.

The remainder of this report covers the following:

- **Access to Finance Context:** assessment of Access to Finance in Europe and the UK
- **Access to Finance in Jersey:** presentation of the survey results and consultation exercise.
- **Competitive Landscape:** Profile of Access to Finance vehicles and policy responses from elsewhere.
- **Recommendations:** OCO's proposed policy solutions.
- **Post Script:** This section reflect upon wider issues that were raised as barriers to enterprise development on the island.

2. The European Access to Finance Context

Access to Finance for SME businesses is a topic that occupies the minds of economic development practitioners across the globe. From the EU to local governments, policymakers are increasingly targeting new ways to foster Access to Finance for SMEs, a section of the economy that includes a large number of diverse businesses. While accessing finance has always been difficult for new business who typically have to bypass banks and rely on ‘friends and family’ for funding, the credit crunch and spate of banks that struggled to repair their balance sheets, led to Access to Finance problems across the whole business sector, not just start-ups.

This section assesses Access to Finance at a European and UK level.

2.1 Access to Finance in Europe

According to the European Commission, SMEs account for 99% of firms in the EU and provide some 67% of all jobs in the EU. SMEs play a vital role in job creation, but many of them struggle to obtain the finance they need to start-up, operate or grow. To place this in context, research by the European Commission and the European Central Bank in 2013 showed that one third of small firms across Europe failed to obtain the funding they applied for, which in turn could have negative effect on competitiveness, job creation and GDP growth throughout Europe.

Evidence consistently shows that SMEs face large and disproportionate obstacles to accessing the finance they need to survive and thrive. Identifying and overcoming these barriers has become a major task for organisations and economic development practitioners.

Further, the European commission’s Action plan to improve Access to Finance for SMEs (2011) outlines the following:

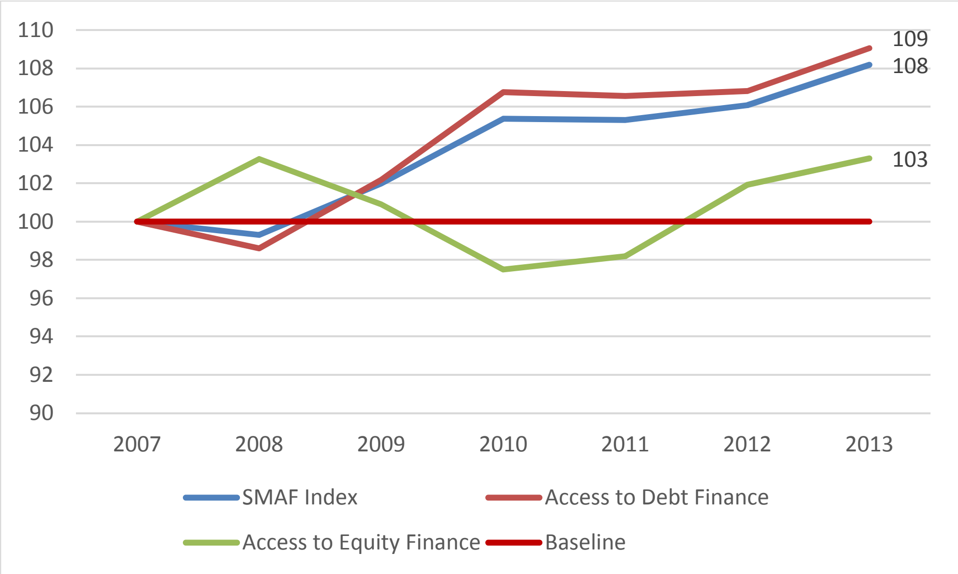
- Europe's economic success depends largely on the growth of Small and Medium sized Enterprises (SMEs) achieving their potential.
- SMEs contribute more than half of the total value added in the non-financial business economy and have provided 80% of all new jobs in Europe in the past five years (prior to 2011)
- SMEs often face significant difficulties in obtaining the financing they need in order to grow and innovate.
- One of the key priorities set out in Europe 2020, the EU's growth strategy for the coming decade, as well as in the Commission's Single Market Act and the Small Business Act is to facilitate Access to Finance for SMEs.
- The Annual Growth Survey has underlined the crucial role of a healthy financial system to support growth and set out priorities for action in the short-term perspective.

In order for SMEs to be a source for growth and jobs in Europe, the European Union (EU) and its member states must work together to improve the state of Access to Finance for SMEs.

The European Commission’s SME Access to Finance (SMAF) Index was developed to monitor SME’s access to financial resources, thus providing an indication of changing conditions of Access to Finance for SMEs over time (See appendix 1).

The index consists of two main sub-indices, Access to Debt Finance and Access to Equity Finance and is calculated using a baseline of EU 2007 = 100, allowing comparison between countries over time (the baseline of 2007 is implemented as it provides a baseline before the onset of the financial downturn).

Figure 2.1: European Union SMAF Index, 2007 - 2013



Note: the debt finance sub-index represents 85% of the SMAF weighting and the equity finance sub-index was represent 15% of the SMAF weighting.
Source: SMAF Index

Debt Finance, which is more typically associated with more mature businesses has increased by 9 points since the 2007. There was a dip below 100 in 2008 during the worst of the crisis followed by a surge until 2010 when the index flat lined during the Euro crisis. The Access to Debt Finance sub-index is comprised of indicators based on the take-up of different sources of debt finance, SME perceptions of loan finance and actual data on interest rates. Confidence does appear to be returning, with the index increasing to 109 over the year to 2013 (see Figure 2.1).

Equity Finance, more commonly associated with early stage businesses has improved since 2007, but at a slower rate than the index for Debt finance. The Access to Equity Finance sub-index is calculated with data from the European Venture Capital Association and the European Business Angel Network reflecting investment volumes and numbers of deals/beneficiaries. The EU sub-index value is 103 for 2013, indicating a slight improvement since 2007. However, the index fell considerably between 2008 and 2010, with values falling below the baseline level between 2010 and 2011, suggesting the onset of the financial crisis had a more adverse effect on access to equity finance than access to debt finance. Given Jersey's aim to improve entrepreneurship and new business starts, the equity finance issues across Europe are particularly relevant and this study will, where possible, draw out this same distinction between debt and equity finance.

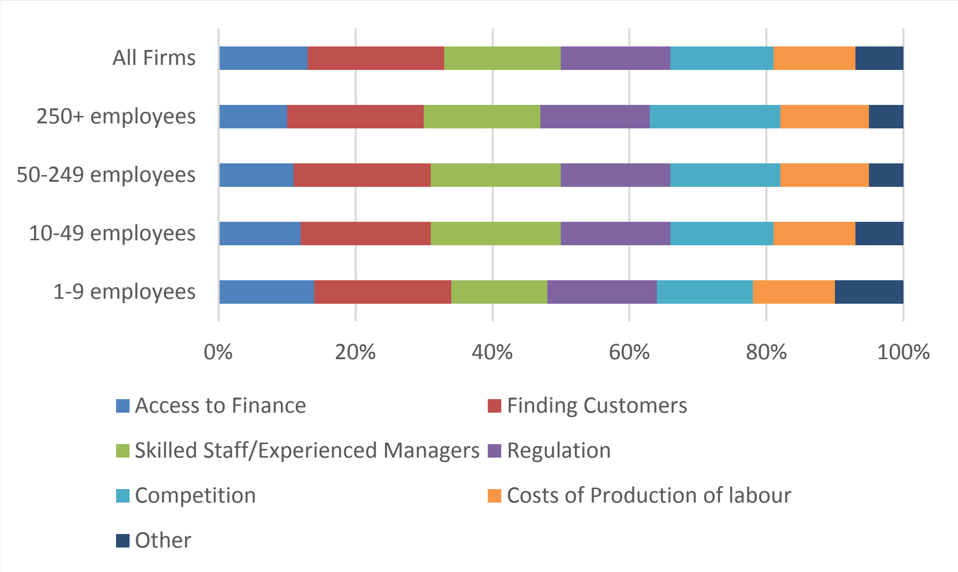
The 2013 SMAF index is a weighted mean of both sub-indices for the European Union. Following the onset of the financial crisis in 2008, the index dropped somewhat before gaining constant positive momentum between 2008 and 2013. The EU Index score for 2013 is 108, representing an improvement of 8 points from 2007.

Whilst the growing SMAF Index suggests that Access to Finance has generally improved somewhat for SMEs, it is still a consistent problem. Since 2008, the European Central Bank (ECB) in collaboration with the European Commission have carried out the survey on the Access to Finance of enterprises (SAFE), covering all EU countries. The 2014 edition of the study provides an up to date view of accessing finance from an enterprise perspective.

The study found that in 2014, the two most common purposes for external financing by SMEs in the EU were "Fixed Investment" and "Inventory and working capital". With more than half (58%) of respondents referencing these as the purpose of external finance, it highlights the extent to which accessing finance plays a pivotal role in the day to day running of SMEs.

While access to finance is undoubtedly a pressing concern amongst businesses, Figure 2.2 shows that in 2014 it ranked fifth amongst companies. 13% of companies cited it as their most pressing concern, behind 'finding customers'; 'skilled staff'; 'regulation' and 'competition' in order of importance.

Figure 2.2: Most urgent problems enterprises in EU are facing

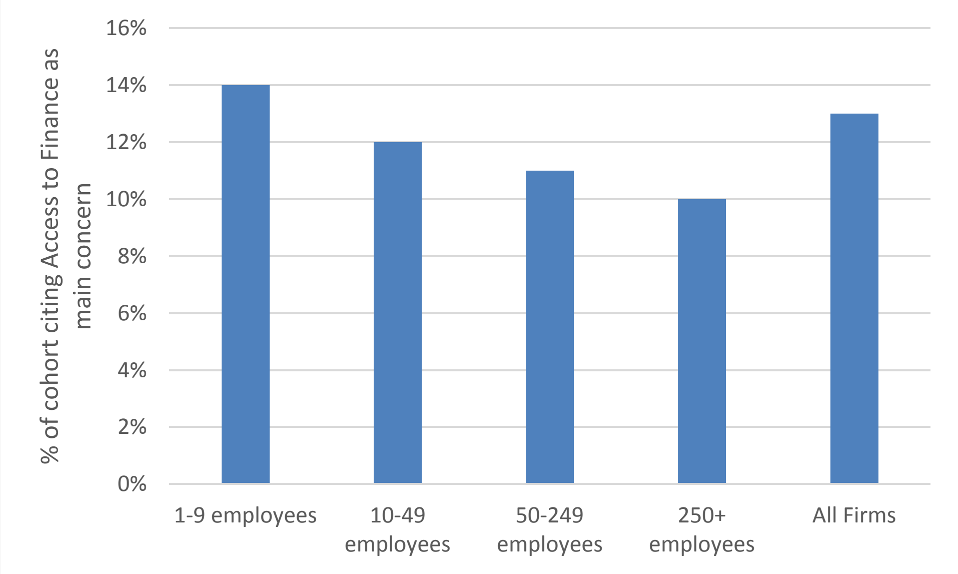


Source: EU Access to Finance survey 2014

These EU wide issues are consistent with OCO's assessment of issues in Jersey. Access to skilled staff and regulation issues were particularly prevalent throughout the consultation phase. The 'finding customers' challenge, which is cited by one in four companies is relevant in the context of wider business support through mentoring and business angels who offer to play an important role in supporting business plan development and networking/market entry initiatives.

The extent to which enterprises considered the problem of Access to Finance to be of particular importance decreases across the enterprise size spectrum. More Micro enterprises (1-9 employees) rated the problem as their highest concern (14%) than any other cohort. Figure 2.3 draws this statistic out.

Figure 2.3: Proportion of Companies Citing Access to Finance as their most pressing Issue

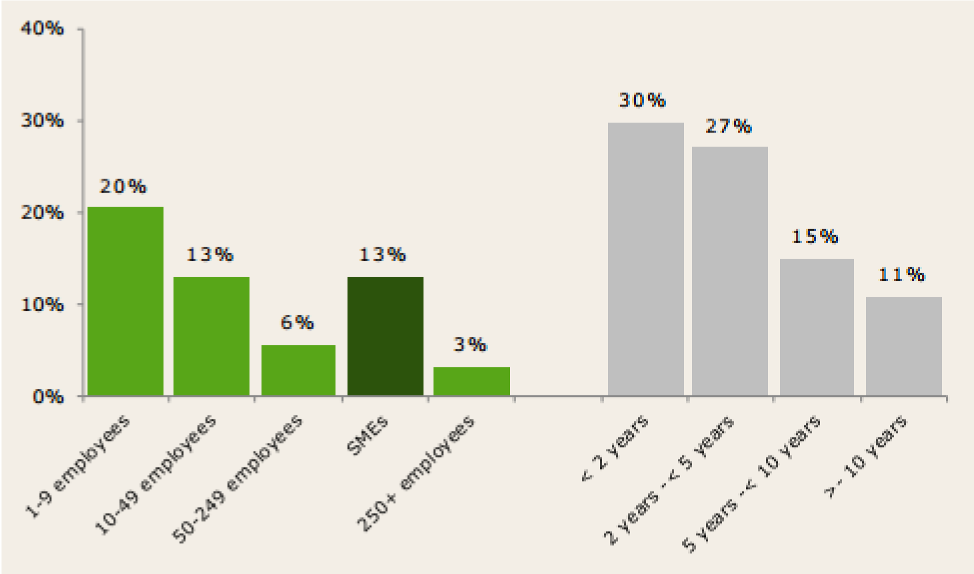


Source: EU Access to Finance survey 2014

With business confidence surveys across much of Europe showing increasing confidence amongst businesses, it is a fair assumption that the demand for finance will increase in order to achieve growth ambitions. As such, it is no surprise that 20% of all small businesses in the 28 Member States of the European Union indicated that in the half year between April and September 2014, their needs for external financing using bank loans (the preferential method of external financing for firms looking to realise growth) had increased. Subsequently, businesses perceived bank loans to be largely available, although the size of the company again correlated with the perceived difficulty of obtaining bank loans.

Drawing on the importance of bank loans as an external source of finance, Figure 2.4 shows bank loan rejection rates. 13% of applications from small businesses were rejected between April and September 2014. The problems of obtaining bank loan finance are particularly prevalent for micro companies and those that have been in operation for less than five years. One in five applications were rejected form companies with fewer than 10 employees and for companies younger than two years old, the rejection rate was close to one in three. Given Jersey's business structure, these statistics are particularly important in contextualising what appears to be a significant macro-economic issue across multiple markets.

Figure 2.4 Bank loan rejection rate (April to September 2014)



Source: EU Access to Finance survey 2014

Whilst the parameters surrounding Access to Finance have gradually improved throughout Europe, it is evident there is still a significant level of volatility surrounding the issue, with perceptions and the reality of obtaining finance not always aligning. The issue has been recognised through the EU's core economic development and competitiveness strategy – Europe 2020. Within this Strategy, the European Commission is committing ***"****To improve the business environment, especially for SMEs, including through reducing the transaction costs of doing business in Europe, the promotion of clusters and improving affordable Access to Finance****"***

2.2 Access to Finance in the UK

Similarly to Europe, small businesses are crucial to economic growth and stability in the UK. In fact, small firms (fewer than 250 employees) account for 99.3% of all private sector business in the UK, and contribute 48% of the economy's private sector employment and 33% of turnover[2]. Small and medium sized business collectively accounted for the employment of 15.2 million people and a combined turnover of £1.6 trillion. More pertinent to a Jersey context is that 76% of UK private sector businesses have fewer than 5 employees, a slightly smaller proportion than Jersey at 80%.

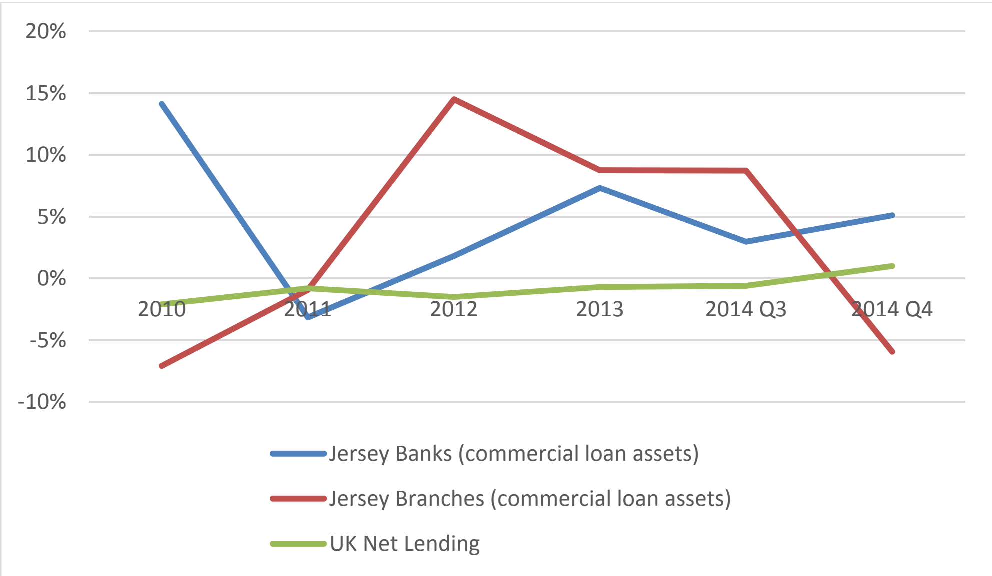
The ability of SMEs to access finance is important for funding business investment, ensuring businesses reach their growth potential, and for facilitating new business start-ups. However, a lack of finance can constrain cash flow and hamper businesses' survival prospects. Although the UK economy is expanding and employment rates are rising, business investment remains relatively static, due in part to business uncertainty over future economic conditions and funding constraints affecting smaller businesses, as such the growth rate of lending to businesses has been largely negative since 2010, as illustrated in Figure 2.5.

Accepting that the UK and Jersey data are not wholly comparable due to their different sources and definitions, figure 2.5 also presents the change in commercial lending levels by Jersey Banks and

[2] House of Commons SN/EP/6078, December 2014

Jersey Branches by way of contextualising the recent operating context. The volatility is clear and it is difficult to draw any clear patterns from the data. Jersey branch lending had emerged reasonably strongly from the downturn by 2011. With no obvious reason for the sharp decline in Q4 2014 it would be prudent to treat this data with caution until a full 2014 calendar year statistics are available. It is also the case that this data does not permit an assessment of the extent to which this lending is to small businesses, or indeed the number of businesses that have been lent to.

Figure 2.5: Annual change in commercial lending, UK and Jersey



Source Bank of England Trends in Lending, January 2015, Jersey Financial Services Commission
Note: 2014 Average to November 2014

Many SMEs seeking growth will succeed, many will not - 40% of new businesses in the UK close within three years of starting up. For some of those with the potential to succeed, traditional loans and overdrafts are not suitable for their financing needs. This again highlights the importance of well-functioning finance markets and the need for diversification in the range of financial products used by SMEs.

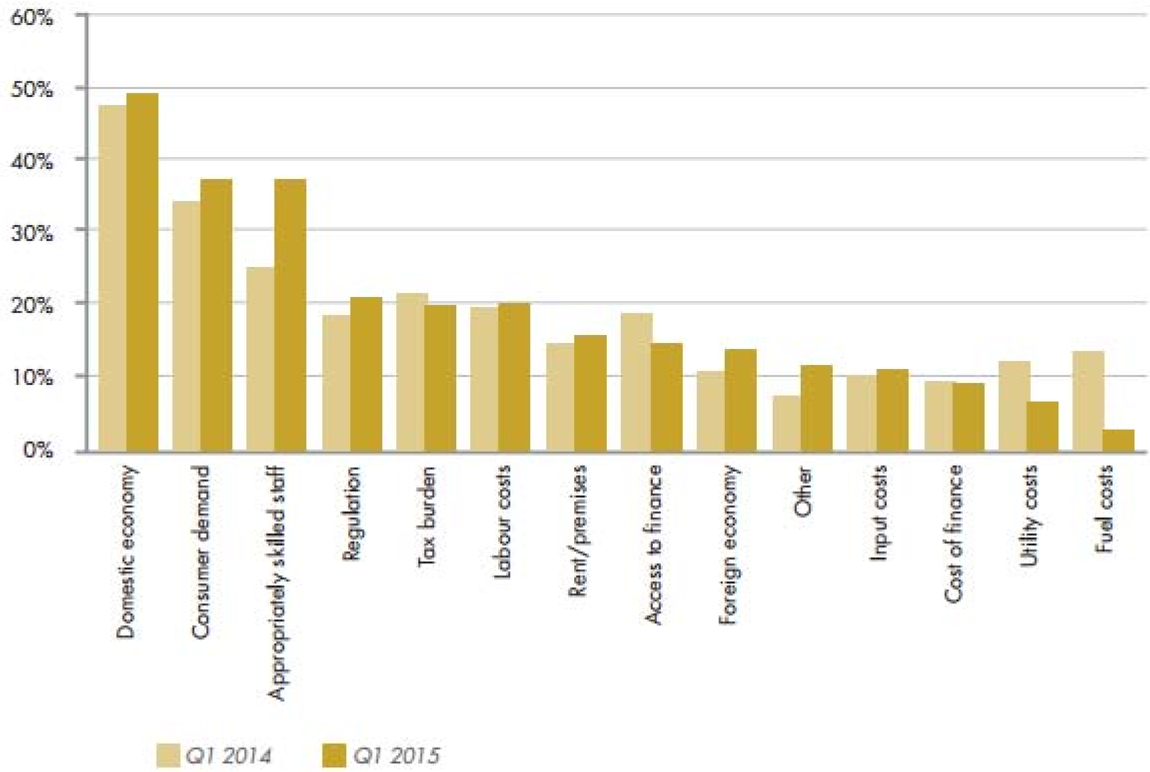
The SME Finance Monitor is a quarterly study of 5,000 UK businesses with up to 249 employees investigating the attitudes and experiences regarding finance for SMEs. A key finding in the Q4 2014 iteration of the study is that almost eight in ten businesses have been given Access to Finance in the past 18 months and confidence among SMEs is at the highest levels since the Finance Monitor began in 2011. UK SMEs are becoming more positive about their future and are seeing Access to Finance as less of a barrier. Key themes drawn from the report include:

- **Businesses are more likely to get funding than they think** – Confidence that the bank would lend remained below the actual levels of success reported to date. 54% were confident that their renewal would be successful, compared to current success rates of 99%, while 33% were confident about a new facility, compared to a 79% success rate.
- **Approval rates** – To Q4 2014 over eight out of 10 loan and overdraft applications resulted in finance. This rises to 87% in Q3 2014.
- **Most discouragement indirect** – 5% of SMEs met the definition of a 'would-be seeker' of external finance, who had wanted to apply for a loan or overdraft but felt that something had stopped them. This proportion has slightly fallen over recent quarters. The main reason cited for not seeking borrowing was discouragement – an indirect assumption they would be turned down.

- **Risk profile of businesses** – the proportion of SMEs rated a worse than average risk currently stands at 43%, down from 45% in Q2 2014.
- **Three quarters of all SMEs don't want finance** – 79% of SMEs interviewed said they did not seek external finance, nor did anything stop them from doing so.
- **Access to Finance becoming less of a barrier to growth** – amongst all SMEs 6% rated Access to Finance as a major obstacle to their business, down from 7% in Q3 2014. This comes behind the current economic climate (14%), legislation and regulation (11%), political uncertainty/future government policy (9%) and cash flow/late payment (8%).
- **Businesses aiming to be debt free** – seven out of 10 SMEs are looking to pay down debt and remain debt free. This rises to 79% for those currently using external finance.

Further, the Federation of Small Businesses produces the Voice of Small Business Index to provide a macro-economic picture of the UK economy from the point of view of small business owners. Figure 2.5 shows that Access to Finance in Q1 2015 is viewed by small businesses as less of a barrier to achieving growth than a year before. The Q1 2015 FSB Voice of Small Business Index also recorded the highest number of firms to date reporting that overdrafts and loans are more available. This, combined with credit becoming more affordable is somewhat easing the burden and gradually making Access to Finance less of a pertinent issue for small businesses in the UK. Access and cost of finance also appear to be significantly less important as constraining factors as issues such as general economic performance, skills an regulation. Although this study focusses on Access to Finance in Jersey, the vast majority of consultees cited other issues around skills, operating costs and regulation in Jersey as being bigger issues. We return to this topic later.

Figure 2.6: Possible barriers to achieving growth aspirations



Source: FSB Voice of Small Business Index, Q1 2015

In general, UK SMEs appear to be becoming more positive about the current state of financial availability and the finance market is evolving with new products and new entrants, however there is still an evident funding gap. The British Business Bank's Small Business Finance Markets 2014 report summarises the following as the key issues surrounding SMEs in the UK accessing finance in the near future:

- More SMEs will seek finance for growth as the economy recovers. Demand will grow and gaps remain in the supply of finance
- A more diverse and vibrant supply of finance is needed – offering more choice of suppliers and products to small businesses. This includes peer to peer and crowd funding as well as greater choice and flexibility in the traditional banking space
- Awareness and understanding of the range of finance options is patchy with some small businesses discouraged from applying. Most smaller businesses, according to the British Business Bank Survey are not aware of the full range of external finance options available to them, and are instead reliant on finance provided by banks. For instance, 93% of smaller businesses are aware of credit cards and 85% are aware of leasing or hire purchase as types of finance available. The figures are much lower for alternative funding sources, with 32% aware of crowdfunding and 35% aware of peer-to-peer lending, but they are increasing over time

3. Access to Finance in Jersey

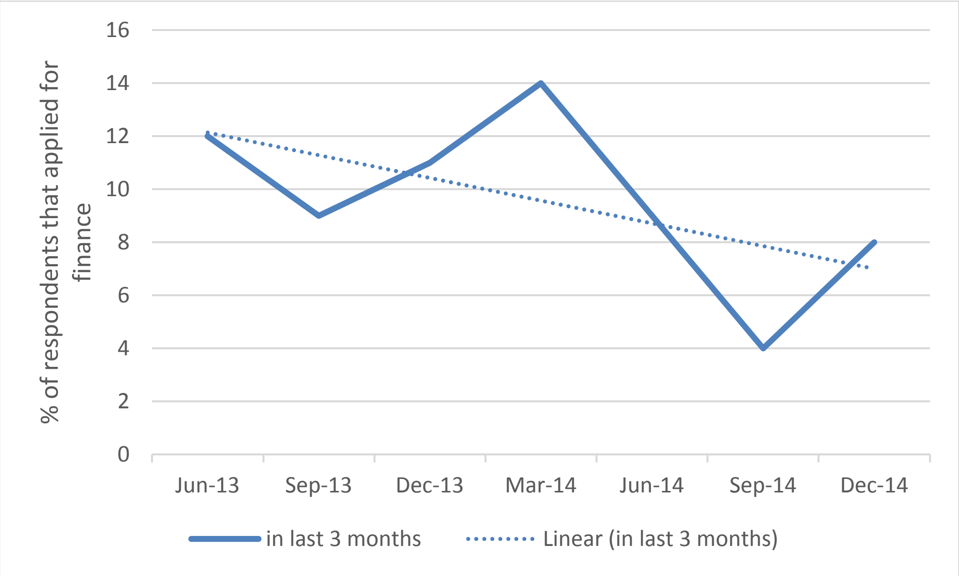
The States of Jersey Business Tendency Survey (BTS) is a quarterly survey which samples private sector businesses on the island. The survey asks the Chief Executive or Managing Director of sampled businesses for their opinions on the current situation of their business compared to three and twelve months previous and also for their expectations for the next three and twelve months. Typically 300 completed questionnaires are returned, constituting an overall response rate of 60%. The respondents account for two-fifths (40%) of total private sector employment in the Island.

Each indicator is presented as a Weighted Net Balance. Essentially the net balance is obtained by taking the difference between the weighted percentages of respondents giving positive (such as "increase" or "higher") and negative responses (such as "decrease" or "lower"). The net balance is given as a difference measured in percentage points (pp).

OCO are grateful to Jersey's Statistics Unit for providing a data feed from the Business Tendency Survey in relation to credit applications and views on affordability and availability.

Less than one in ten respondents applied for finance within the previous three months in December 2014. This is not surprising over a three month period and is broadly consistent with OCO's survey findings which considers the same question over a 3 years period. Although the December 2014 figure is lower than all previous data points (with the exception of September 2014) and the trend is downwards, the proportion of businesses applying for finance has not surpassed 15% at any point over the past two years. This poses several questions as to whether awareness, lack of availability, affordability or the nature of business funding on the island (is it friends/private investors) is dampening demand for finance or whether demand and supply are aligned?

Figure 3.1: Percentage of BTS respondents that have applied for funding, all sectors

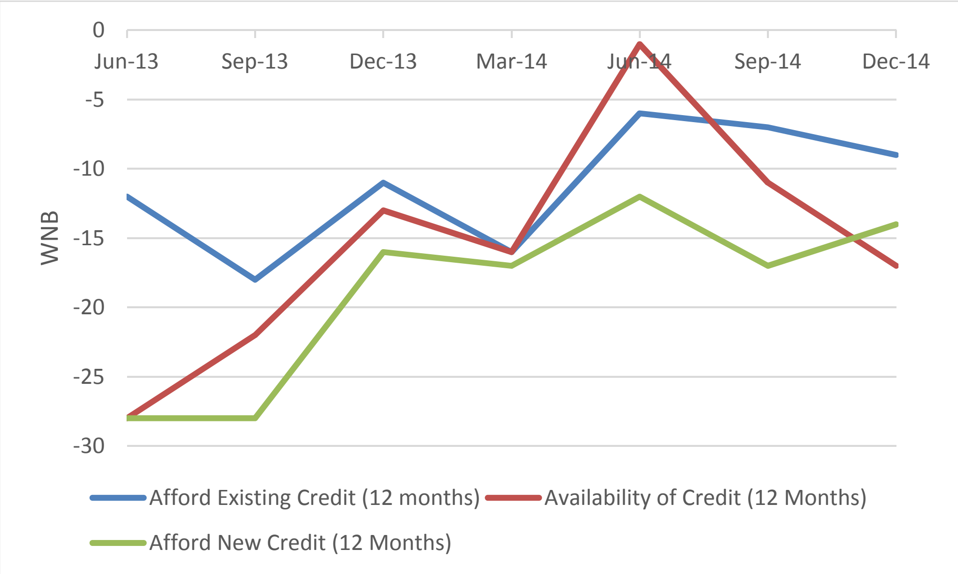


Source: Business Tendency Survey

The BTS facilitates some additional analysis in relation to affordability and availability of credit. Recall that negative numbers in the following figure mean that more respondents have a negative opinion (worse/lower) than positive (better/increased).

Starting from a very negative position in 2013, businesses' views on the availability of credit had improved markedly up to June 2014 where it came close to moving into positive territory. Since then, there has been a fall back towards strongly negative levels. Affordability (both existing and new) of credit did not come as close to positive territory as sentiments on availability but there has been a definite improvement away from Net Balances of close to -30 to -15 for affordability of new credit and a slight improvement in sentiments on existing credit from -12 to -9 for affordability of existing credit.

Figure 3.2: Business views on affordability and availability of credit



Source: Business Tendency Survey

To supplement available data, awareness of and demand for finance has been tested through a broad range of consultations and an online survey that was distributed through Jersey Business, Digital Jersey and the Jersey Chamber of Commerce. The survey received 72 responses. To place this in context, this is c.25% of the size of sample that the BTS works with. It is important to note that a convenience sampling method was applied to gaining survey completions with the sample selected to ensure whole sector representation. It is not intended to draw strong statistically significant inferences or direct comparisons from the survey as its primary function was always to supplement and support the detailed face-to-face consultation phase.

OCO carried out approximately 50 face to face interviews with Financers, HNWIs and SMEs from a broad range of sectors currently operating across Jersey. (Please see Appendix 1 for a list of interviewees).

In broad terms, the consultations were used to determine:

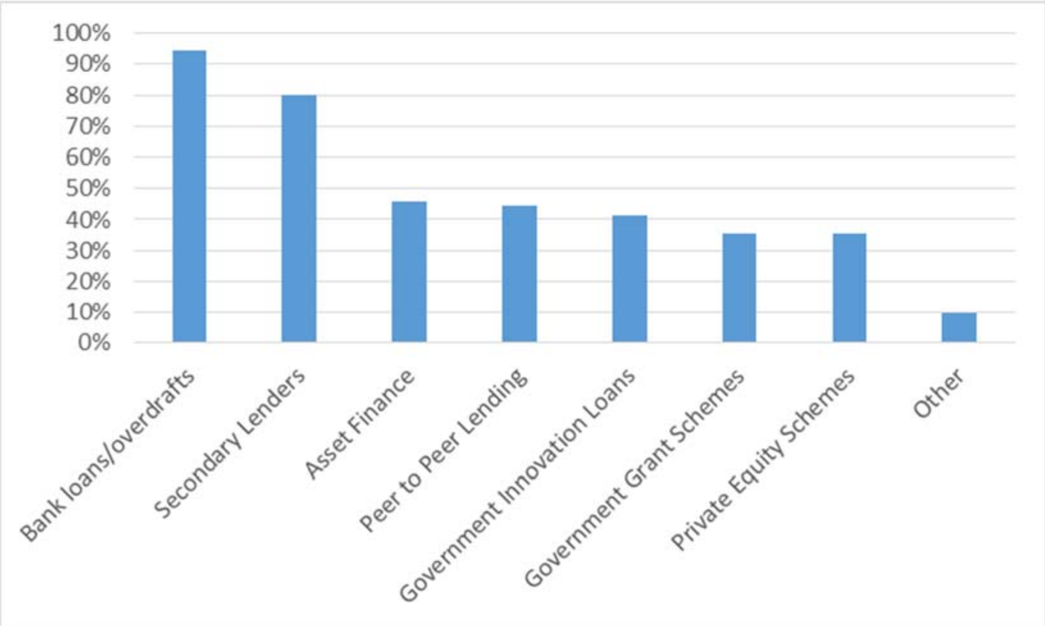
- Awareness of finance availability in Jersey,
- Demand for finance from SME's,
- Accessing Finance
- Broader issues relating to enterprise formation and growth

3.1 Awareness of Finance Availability

When asked to indicate their level of awareness of finance providers in Jersey, there was significant high levels of awareness of banking and secondary finance. Face to face conversations did however consistently raise a lack of competition in the banking sector as a constraining factor. One consultee pointed out that when dealing in the UK, there are considerably more financial products on offer from significantly more providers compared to the banking sector in Jersey, with 4 key players (RBSI/NatWest, Lloyds, HSBC and Barclays) and a narrower product line. While pricing appears to be undertaken on a UK basis and while there is no evidence from this study to suggest higher pricing in Jersey as a result of reduced competition, the impact of fewer providers and products is an obvious reduction in consumer choice in areas such as customer service, approval speeds, length of loans, redemption fees etc. In addition, newer forms of finance such as invoice factoring are not available on the island,

Peer to Peer lending, which is gaining considerable media attention and which is recording considerable growth in other markets attracted a 44% awareness level among respondents to the survey. Interestingly, a peer to peer lending vehicle or HNWI/SME matching service has been consistently offered in face to face consultations as a potentially significant addition to support business funding. Section 4 looks at a selection of these schemes from elsewhere. Awareness of Government schemes and support (such as the Rural Initiative Scheme) were also relatively low. This is somewhat surprising as face to face consultees were all aware of the Innovation Fund.

Figure 3.3: Awareness of Finance Providers in Jersey

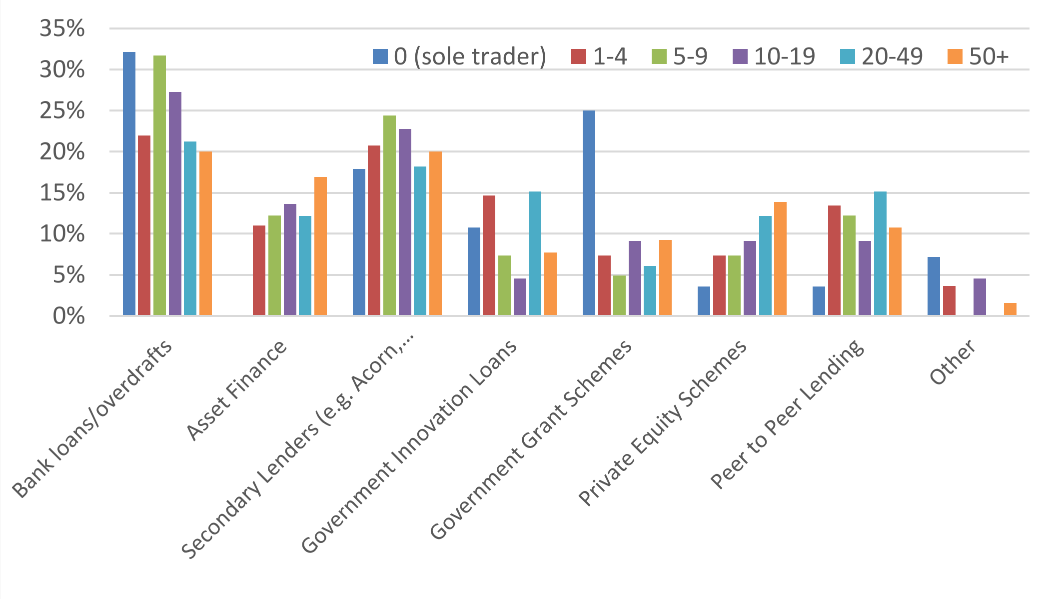


Source: OCO Online Survey

Although somewhat constrained by sample sizes, the data has been assessed by the size of the business (as measured by number of employees).[3] There appear to be some examples of increased awareness amongst larger businesses, specifically in areas such as asset finance and secondary lenders and private equity schemes. For sole traders, awareness was particularly high for the traditional bank loans and overdrafts and government schemes.

[3] Appendix 2 presents further analysis by turnover bands and age of business

Figure 3.4: Awareness of Finance Providers in Jersey by size of business



Source: OCO Online Survey

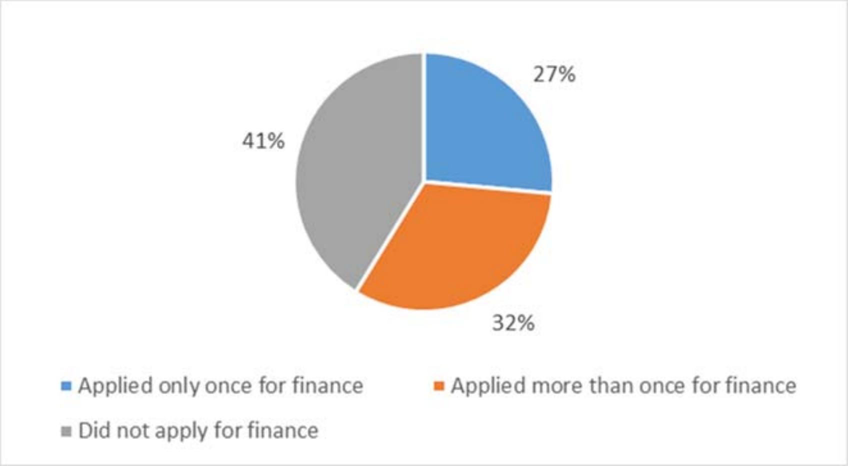
3.2 Demand for Finance in Jersey

The consultation process delivered diverging views on the demand for finance. Several consultees noted that there is a lack of entrepreneurship on the island. Reasons offered for this view were that the lure of a well-paying salaried job in the financial services sector was providing too great a disincentive to start a business and that many of the NHWIs that have moved to Jersey are ‘post entrepreneurs’, having taken the risk many years previously.

However, the counter view was received from the banks interviewed and a secondary finance provider was confident that there was significant demand for finance. Of course, a study such as this is limited by not being able to identify latent entrepreneurship (e.g. those people that wanted to start a business but subsequently chose not to in instances where the costs of finance have proven prohibitive).

In terms of recent demand, the Business Tendency Survey did note that fewer than 20% of companies in their sample had applied for finance. Bearing in mind that the BTS survey question asks about the previous three months, the OCO survey captured information that just under 6 out of 10 survey respondents have applied for finance at least once during the past three years. One third of the sample have applied more than once (figure 3.5).

Figure 3.5: Which of the following statements best describes your demand for finance in the last three years?

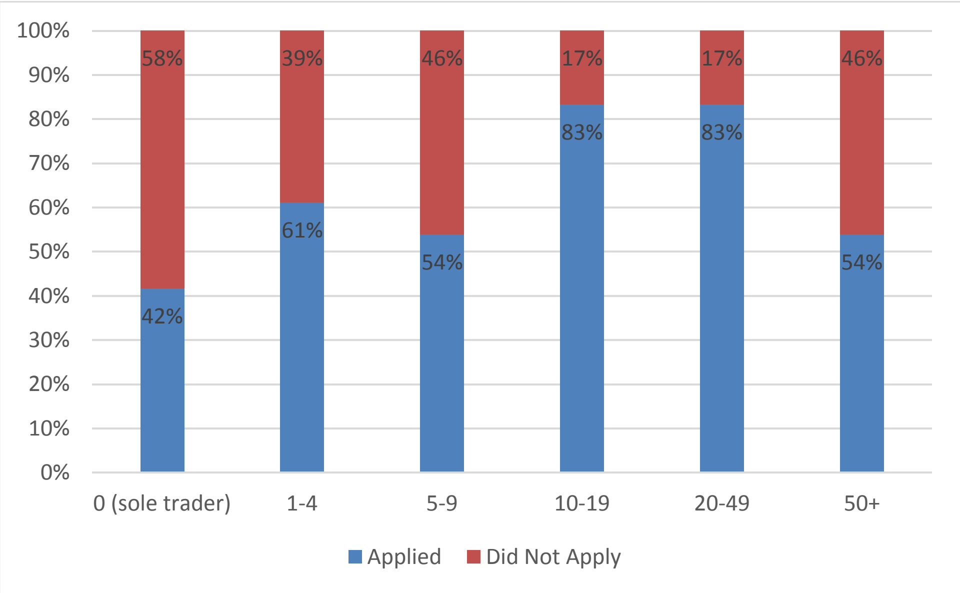


Source: OCO Online Survey

There are some significant differences in the extent to which firms have applied for finance when disaggregating by size of firm. Sole traders are least likely to have applied for finance within the last three years while c80% of firms in the 10-50 employee size bracket have applied for finance at least once.

Based on the consultations OCO undertook with small business operators in Jersey, a common opinion expressed by the business owners, was that 'the banks don't want to know.' Those that offered this view have proceeded to borrow through 'family and friends' or secondary finance routes without trying the banks. This may point towards the emergence of an information gap between banks and potential lenders. Certainly, the insight from secondary finance providers was that they had a strong loan book and strong current demand, demand that is outstripping their capacity to lend.

Figure 3.6: Which of the following statements best describes your demand for finance in the last three years, size of firm?



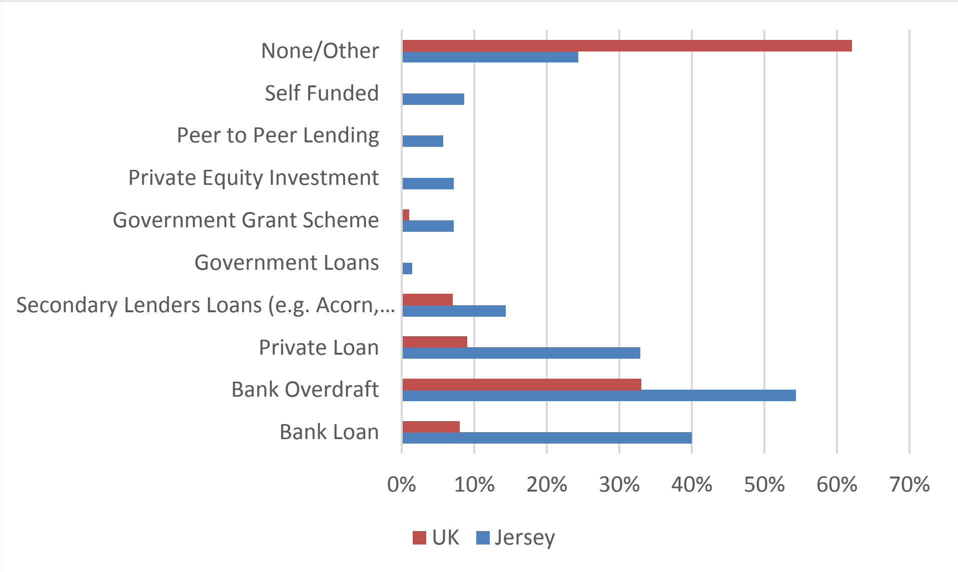
Source: OCO Online Survey

While there is a definite demand for finance (with 60% of respondents having applied at least once in the past three years) more than a third (34%) have either self-funded or required no funding. Figure 3.7 outlines where the finance is coming from. Where possible, data for the UK has been included, based on the 2014 SME Finance Monitor. Again, it must be noted that the different sources and methods used prevent meaningful comparison between the jurisdictions. As such, the UK figures are presented for context.

Jersey businesses that responded to the OCO survey appear particularly wedded to the traditional route of bank overdraft and bank/private loan. Perhaps reflective of the Jersey 'small island' characteristics, the popularity of private loans for finance is interesting.

The juxtaposition of the UK data is an interesting one. The requirement for funding appears much lower in the UK context but where there was a demand, the most popular mode of access was bank overdraft. Noticeably, there is also a much lower call on 'private loan' and 'secondary lenders' in the UK, perhaps a reflection of the much greater choice of banking product available in the UK.

Figure 3.7: What sources of finance do you or have you used to operate your business (select all that apply)

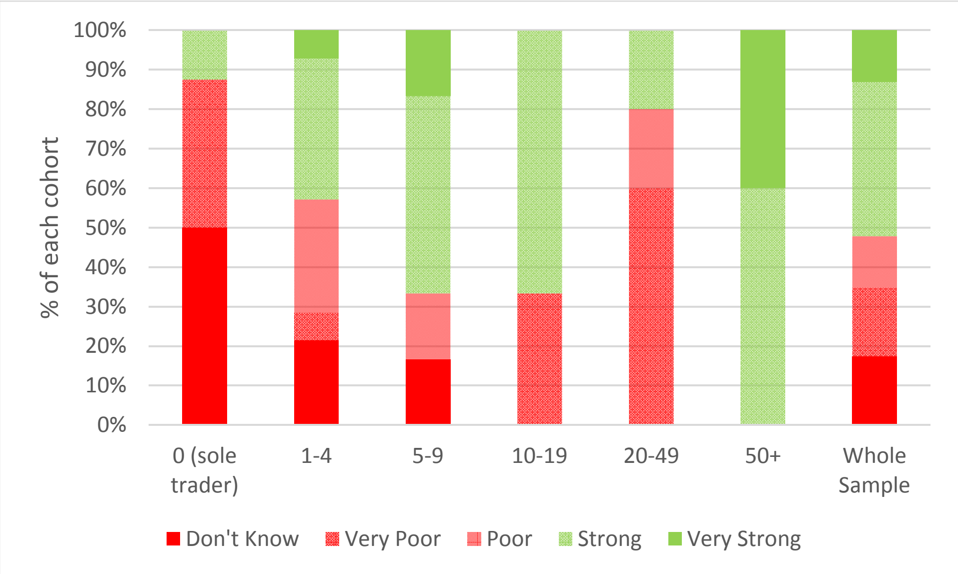


Source: OCO Online Survey and SME Finance Monitor 2014

3.3 Accessing Finance

As noted above, approximately six out of ten survey respondents had required some element of finance in the past three years. Of these, companies have graded their own capability to access external finance (i.e. their own judgement of their credit rating and skill at completing the required application forms and business plans) (Figure 3.8).

Figure 3.8: How capable is your business at accessing external finance?



Source: OCO Online Survey

A third of respondents consider themselves as better than average at being able to access funding. For those that did, this belief is based on having a successful track record, profitability and a strong reputation. Owning assets and being able to offer security against the loans was also cited as a reason for funding success. Conversely, for those that considered their capability to access funding as below average the following were typical responses as to why:

- 'Unable to offer security to back loans'.
- 'Being a start-up'
- 'Tech industry not understood at all by usual lenders or Government departments when applying for grants.'
- 'Don't know the people with access to proper Angel funds'
- 'Everyone is far too slow to act on funding requests'

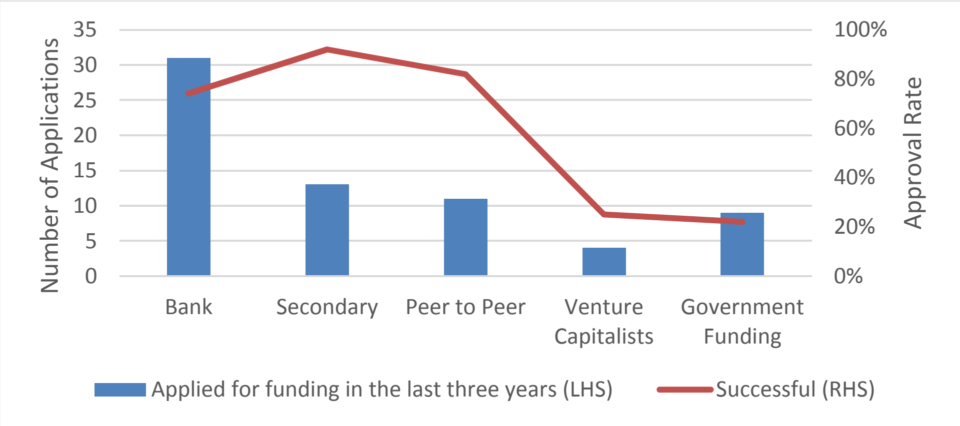
The last statement requires some explanation as it can be interpreted several ways. It was offered in the context of a business owner frustrated at the speed of an application process rather than a criticism of their own speed to apply.

The costs of finance were tested as a barrier to finance during the consultations. No evidence was forthcoming to suggest that the pricing of loans is a barrier. Equally, it is OCO's assessment based on conversations with banks and desk research that commercial loan rates on the island are aligned with UK rates. Rather, the poor quality of proposal coming forward (i.e. poorly presented/ill thought through business plans, from the funders perspective) and the risk profile of businesses coming forward for funding (given their size, age turnover etc.) were seen as the barriers.

The difference in self-recorded ability to access finance is stark in the context of business size. The vast majority of sole traders either didn't have a view or rated themselves as very poor. Significant doubt in their own ability to access finance creeps into the respondent's from the 10-19 and 20-49 cohort. The confidence that comes with being a 50+ person organisation is evident in the results, with this cohort rating its' ability to access finance as strong or very strong. This is unsurprising, as 50+ organisations typically have a longer trading history and reduced risk profile.

The following chart reiterates the popularity of the traditional route to finance (i.e. banks) and also draws out varying approval rates across the various modes. The banks have approved fewer than 70% of the applications noted in the survey while secondary finance and peer to peer lending, although less popular, do have higher approval rates. This is not atypical across the globe. New businesses, without a trading history and credit rating are not typically strong candidates for bank finance.

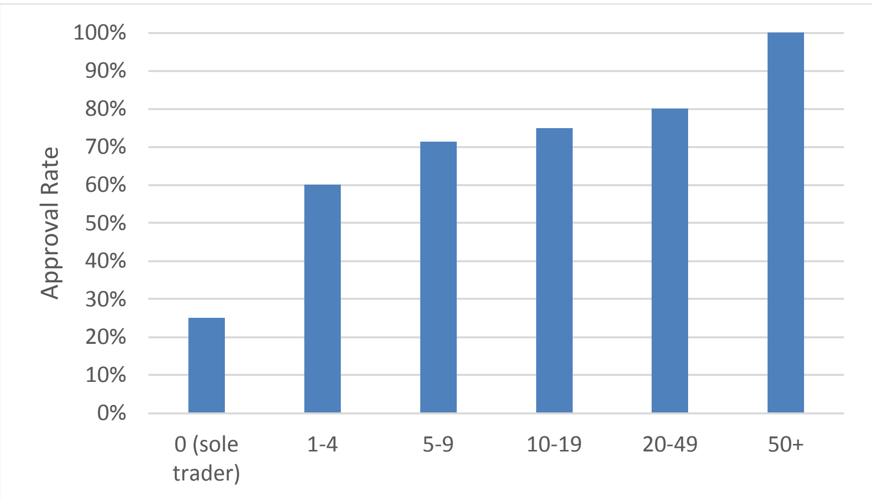
Figure 3.9: Applications for Finance and Approval Rates



Source: OCO Online Survey

The sample size does not support much disaggregation but Figure 3.10 below does present the Bank approvals by company size. Further disaggregation (by turnover and age of business) is presented in the appendices. It is hardly surprising that the noted approval rates for sole traders are significantly lower than other cohorts, given the risk levels associated with a sole trader. When asked why loans are typically turned down, finance providers cited the level of risk being too great but also noted that the standard of application and business plan often hinders applicants.

Figure 3.10: Bank Approval Rates by firm size



Source: OCO Online Survey

Throughout the consultation exercise, several general perceptions emanated from the business and financiers interviewed. These can be summarised as:

- There is an actual and latent demand for funding. Evidence such as the number of new business accounts opened in the previous 12 months by one bank (160) and the extent to which survey respondents have noted a demand for finance over the past three years does not lend strong support to the view that there are few entrepreneurs on the island. Many consultees were also 'resigned' to the fact that the 'banks don't want to know' and so haven't even tried to access bank finance, relying instead on family, friends or secondary finance.
- Consulted businesses consistently perceive that Banks were unwilling to lend to smaller business, particularly start-ups as the level of risk was too high. This has been borne out in the survey analysis, where approval rates for sole traders were less than one in three. As noted this is not unique to Jersey and is symptomatic of a lack of trading history and credit rating
- Banks have adopted an off island centralised decision making process. This is leading to some frustration with businesses that would prefer a more personalised service but there is no evidence that this 'off island' approach to lending decisions is hindering sound business ideas.
- There is nothing to suggest that high growth potential businesses are more or less disadvantaged in being granted finance in Jersey than in other jurisdictions. Lenders are basing decisions based on the risk profile of business and quality of application. As such, more established, larger businesses present a 'safer' proposition to lenders.
- Consultees also suggested that banks do not always understand the business proposition and suggested that having sector experts in the banks may be beneficial.
- Secondary Providers were perceived by consultees as more willing to lend than banks and offered a more personalised approach, but at a much higher interest rate
- Peer to Peer is seen as a strong potential funding stream but provision is low on the island as the main UK provider's coverage does not include the Channel Islands
- Government Funding was targeted at specific activities on the basis of recognised market failures/wider benefits (i.e. innovative/ agricultural companies).

3.4 Broader issues

The face to face consultations drew out more nuanced views than a survey is capable of but did converge across several key themes. **The following points merely reflect consultees' views and are not offered as solutions at this stage**:

- **The concentration of HNWIs on the island is not being effectively engaged to invest in Start Ups:** There is a strong sense that there are many HNWIs that would be willing to invest in SMEs but two issues were offered during consultations as preventing this. Firstly, there is currently no tax incentive to do so, such as a Seed Enterprise Investment Scheme or Enterprise Investment Scheme. While demand exists for such a scheme, the market failure to justify such a scheme is not proven. Secondly, there is no 'matching service' whereby business plans can get sighted by potential investors.

- **There is a potential role for government to align supply and demand for finance:** A strong majority of survey respondents (70%) and consultees support a role for government in improving Access to Finance. The specifics of such a role are not unanimous and range from providing an enhanced innovation fund to acting as a match making service. Other suggestions include forming a start-up loan fund with a secondary finance provider or changing the income tax rules to facilitate an SEIS scheme. Those that oppose a role for government cited the overly bureaucratic nature of government schemes and a perceived lack of understanding about business. Obviously any government role would require proof of market failure in order to justify government involvement. We return to the market failure topic in the recommendations section.

3.5 Summary

As a high level summary of the core issues, the following table provides a useful synopsis of the funding ecosystem in Jersey.

Table 3.1: Summary of Core Issues

Source	Awareness	Availability of Funds	Appetite to lend	Key Jersey Players	Type & Style	Lead Time	Indicative Pricing	Issues
Banks	High	Medium/ High	Medium	RBS Lloyds HSBC Barclays	Type: Term Debt Finance Style : Mature / Recurring finance	Medium	Lowest from c.5.5%	• Less competition and choice of products in Jersey than other jurisdictions • Perception from SMEs that the bank decision process is impersonal and undertaken off island • Perception that banks lack specialist sector knowledge
Secondary Finance	High	Medium	High	Acorn Future Finance Close Finance	Type: Personal Loan / Equity Style: Debt Finance	Short	c.+5% above Banks	• Approval Rating higher than banks • Higher cost of borrowing which may prove to be a deterrent to potential entrepreneurs • Funding capacity limited by availability of funds to lend
Peer to peer	Low	Untapped	Potentially Strong	Sancus Envestors	Type: Equity Style: Early Stage	Short	c.+5% above Banks	• Indications are that there is a strong appetite to lend but awareness of current offers are low • Current offer on island has higher costs of entry to partake than more generic 'open to all' crowd funding/p-2-p offer. Sancus (a HNW peer to peer lending company) lenders require £250,000 to partake and businesses require to pay a fee to enter the Envestors process
Government	Medium	Medium	Medium			Long	Comparable to bank rates	• The Innovation Fund has been cited as a noble idea in theory but over bureaucratic and slow to react in practice
HNWIs	Low	Potentially High	Potentially Strong			Untested	Variable	• There is a high level of HNW capital on the island • Sense is that there are HNWIs who are willing to lend • Current p-2-p offer perceived to be based on word of mouth and 'who you know' with relatively high costs of entry

Based on OCO's survey responses, wide ranging consultations and Jersey's Business Tendency Survey, it is not unreasonable to conclude that the demand for finance on the island can be serviced by the supply of business finance available from a range of banks, secondary lenders and private investors.
.

In relation to the specific research objectives, OCO's conclusion is that there is no evidence to suggest that costs are acting as a barrier to finance. However the study did identify some non-cost barriers that reduce the likely success of securing business finance. Non cost challenges to securing finance include fewer market participants; a less diverse finance offer (i.e. invoice factoring isn't available and few peer to peer lenders) and a relatively weak standard of business plan. A strong perception that banks aren't lending is not helping, as businesses are ruling themselves out of applying for bank funding on an assumption that it is a pointless endeavour. This is not unique to Jersey and acts as one of the most common barriers to SME finance in other jurisdictions.

There is no sense from the work undertaken of any sector specific issues or barriers, although several respondents did believe that sector specialists within the banks would result in a greater level of understanding of the businesses and therefore increased loan approvals. Unsurprisingly, smaller, younger firms did find accessing finance to be more difficult than larger firms with a longer track-record of successful trading. OCO found no evidence to suggest particular barriers facing high growth potential businesses.

However, there is definitely no sense of Access to Finance being *the* issue that, once addressed, will unlock the gate to significant new, high growth potential companies. Wider topics that have been raised consistently throughout the consultation phase of this research form the basis of a 'post script' section. That said, there is significant merit in seeking to enhance Access to Finance for small businesses.

It is unlikely that the banks will change their behaviours, due to the risky nature of new businesses. Secondary finance providers are an obvious destination for business owners that have been turned down by the bank but these providers typically offer finance as a personal loan and charge a higher rate of interest that may be prohibitive to potential entrepreneurs. There does therefore appear to be a need for government to help improve Access to Finance. Two obvious avenues to explore are:

1. Assist local business seeking finance prepare detailed business plans and financial forecasts to present to financiers; and
2. Given the concentration of HNWIs on the island, one potential solution involves HNWIs in a peer to peer lending type model. We return to this in section 5.

Before that, the following chapter provides an overview of some funding models and policy tools being used elsewhere.

4 Competitive Landscape

Throughout the course of the research, schemes and policy levers from other jurisdictions have been cited as worthy of consideration for Jersey in the context of increasing the supply of finance and choice available. This section profiles a range of these schemes that were considered during the desktop research undertaken during the study. The inclusion in this report is for information purposes and OCO found no evidence of a market failure that any would be needed.

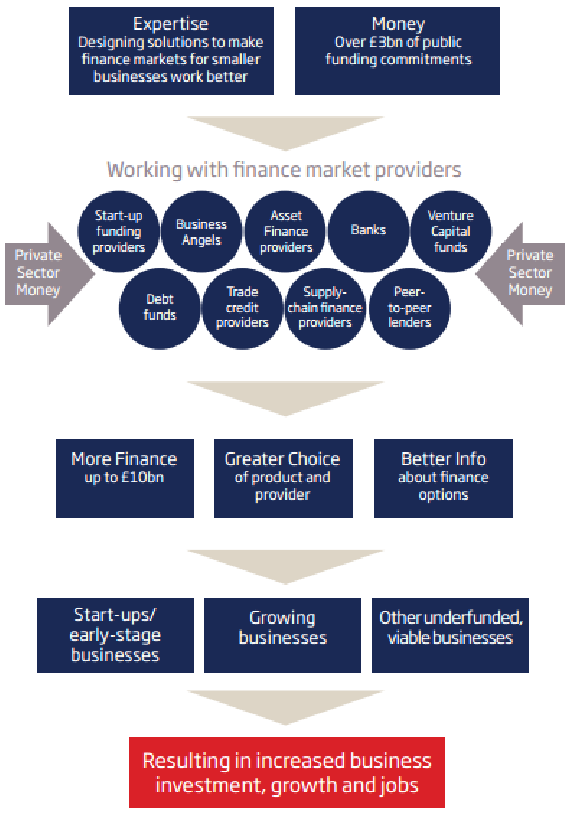
4.1 British Business Bank

The British Business Bank is a 100% Government-owned institution that operates to fulfil a public policy objective. Unlike most banks, its impact is not measured in terms of profits generated but rather by the benefit of increased economic activity it creates.

In an effort to help businesses prosper and build economic activity in the UK, the goal of the British Business Bank is to change the structure of finance markets for smaller businesses, so these markets work more effectively and dynamically. The British Business Bank brings expertise and Government money to the smaller business finance markets.

The objectives of the British Business Bank are:

- To increase the supply of finance available to smaller businesses where markets don't work well.
- Create a more diverse and vibrant finance market for smaller businesses, with a greater choice of options and providers.
- Build confidence in the market by increasing smaller businesses' understanding of the options available to them.
- Manage taxpayer resources efficiently and within a robust risk management framework.



Whilst British Business Bank does not provide funding directly to smaller businesses, it works in conjunction with private sector partners to enable businesses access to more finance, from a greater number of providers, through a wider range of products.

Understanding markets and smaller businesses' finance needs enables the bank to design programmes to make finance markets work better, and investing alongside private sector investors maximises impact and allows reach to the full range of finance providers such as banks, leasing companies, venture capital funds and web-based platforms.

In addition to finance, the British Business Bank also uses guarantees to share risk with the private sector and so creating stronger incentives for lenders to extend credit to smaller or growing companies. Programmes are designed to bring benefits to smaller businesses that are start-ups, high growth, or simply viable but underfunded.

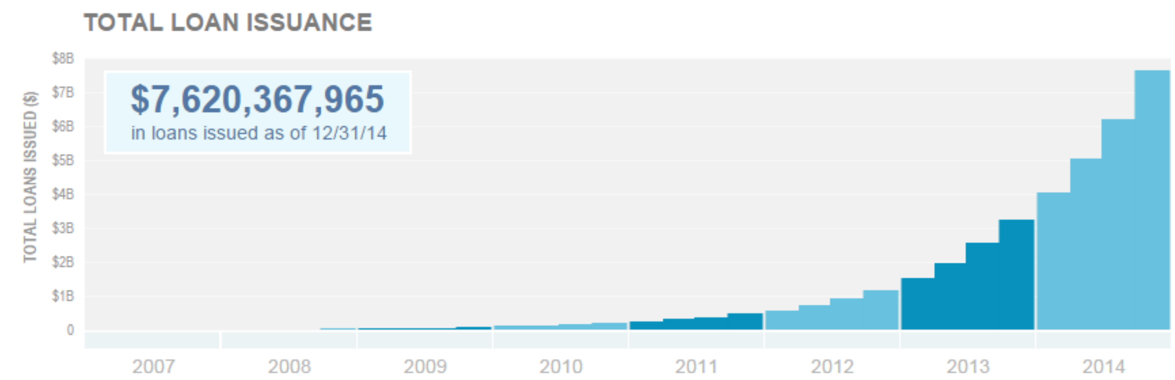
4.2 Lending Club

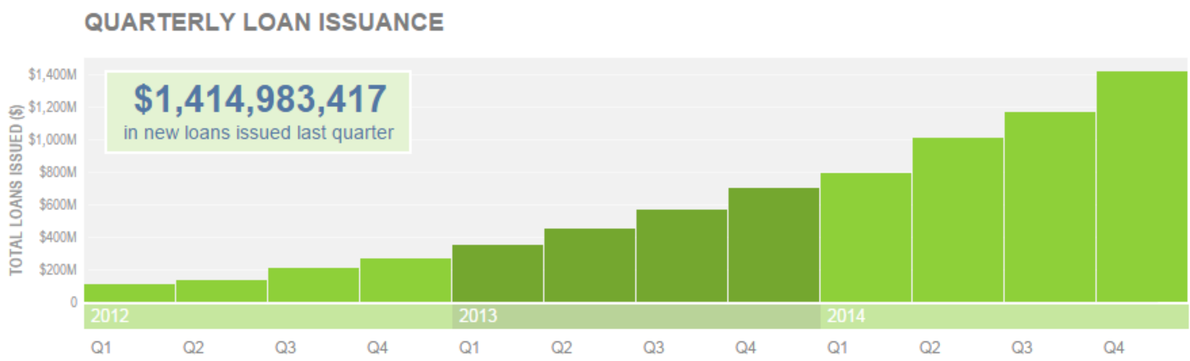
Founded in 2006 Lending Club is the world's largest online credit marketplace, offering personal loans, **business loans**, and financing for elective medical procedures. Lending Club aims to make credit both more affordable and more available. Investors (any US resident adult with a bank account) provide capital injections to enable many of the loans in exchange for earning interest.

According to Lending Club, prior to the formation of the company, the $3 trillion US consumer lending market was largely untouched by technological innovation, and most people and businesses received their credit via traditional financing institutions including banks, credit card companies, and credit unions, whilst investors also invested in more typical means such as bonds and stocks.

Lending Club operates entirely online and as such has no branch structure, enabling the Club to operate at a lower cost than traditional bank lending, Lending Club passes these savings on to borrower through lower interest rates and to investors through 'solid returns'. Lending Club's innovation was designed to offer a simple, low cost, convenient and beneficial alternative to both borrowers and investors.

Lending Club's aim is to transform the banking system into a frictionless, transparent ad highly efficient online marketplace. As of the 31 December 2014 Lending Club had issued a total of $7,620,367,965. Further, in Q4 of 2014, Lending Club issued almost $1.5 million in loans.





The following outlines the different services offered by Lending Club:

- As a personal loan or **business loan** borrower, you can get an instant quote in minutes with no impact to your credit score. Once you select an offer, you can watch as funds are committed by investors who are choosing to invest in you and your success.
- If you're investing, you can open an account in minutes and build a portfolio of hundreds or thousands of loans made to quality borrowers. You'll receive monthly payments of principal and interest, which you can withdraw or reinvest.
- All loans facilitated by Lending Club are issued by a bank and subject to the same consumer protection, fair lending, and disclosure requirements as any other bank loan.

4.3 Funding Circle

Founded in 2010, Funding Circle is an online marketplace which can help UK businesses access fast and simple finance, whilst investors have the potential to earn returns by lending to them.

Funding Circle connects people and organisations who want to lend with established businesses who want to borrow.

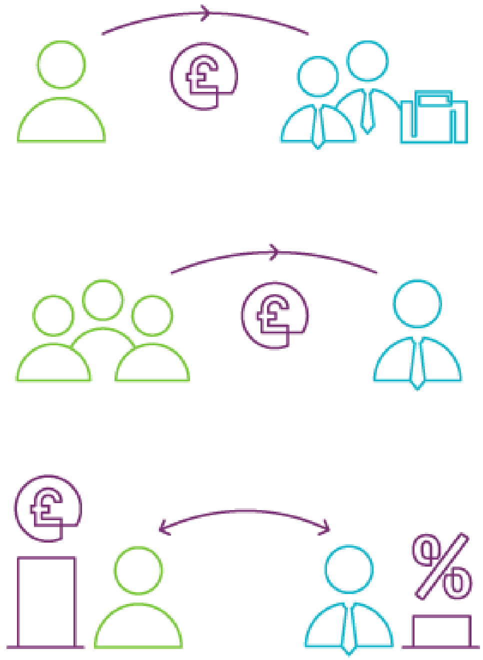
Through Funding Circle, businesses borrow directly from more than 30,000 people, the **UK Government**, local councils, a university and numerous financial organisations. The funding circle rules currently exclude Channel Island/Isle of Man companies or residents from taking part.

The UK Government alone is lending £60 million to businesses through Funding Circle - In March 2013, the Government began **lending £20m to small UK businesses** through Funding Circle, as part of its Business Finance Partnership scheme[4]. In early 2014, the Government-backed British Business Bank Investment Programme decided to **invest a further £40 million** to support economic growth by providing more efficient finance to small businesses.

To date Funding Circle has facilitated loans of £586,748,820 to 7,200 British Businesses through 38,750 investors in the UK.

The Figure below outlines how the process of Funding Circle works:

[4] The Business Finance Partnership was a UK Coalition Government scheme to increase the supply of capital to business through non-bank lending channels. The Government invested £1.2bn in through fund managers and 'non-traditional lenders'



1. One investor can lend to a number of creditworthy businesses to spread their risk and at interest rates they choose.
2. One business typically borrows from lots of different investors, with only the lowest interest rates being accepted on their loan (subject to minimum bid rates).
3. Once accepted, the business makes monthly repayments back to the investors who lent to them.

4.4 Government Tax Incentives

Enterprise and Seed Enterprise Investment Scheme

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.

The Seed Enterprise Investment Scheme (SEIS) is designed to help small, early-stage companies raise equity finance by offering tax reliefs to individual investors who purchase new shares in those companies. It complements the existing Enterprise Investment Scheme (EIS) which offers tax reliefs to investors in higher-risk small companies. SEIS is intended to recognise the particular difficulties which very early stage companies face in attracting investment, by offering tax relief at a higher rate.

Income Tax relief is available to individuals who subscribe for qualifying shares in a company which meets the SEIS requirements, and who have UK tax liability against which to set the relief. Investors don’t need to be UK resident.

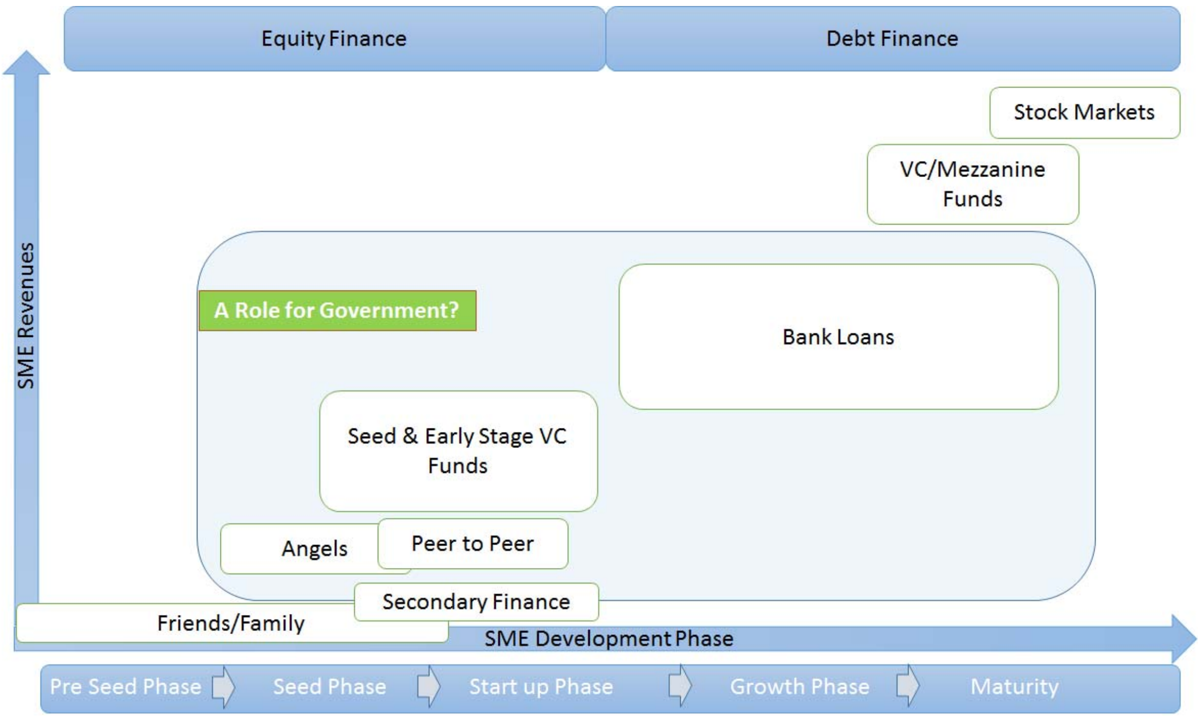
The shares must be held for a period of 3 years, from date of issue, for relief to be retained. If they are disposed of within that 3 year period, or if any of the qualifying conditions cease to be met during that period, relief will be withdrawn or reduced.

Relief is available at 50% of the cost of the shares, on a maximum annual investment of £100,000. The relief is given by way of a reduction of tax liability, providing there is sufficient tax liability against which to set it. A claim to relief can be made up to 5 years after the 31 January following the tax year in which the investment was made.

5 Recommendations

The diversity of small business characteristics leads to a requirement for different funding needs, depending on the stage of their development. In the broadest sense (and perhaps overly simplistically), these can be summarised in a 'funding escalator' style diagram (figure 5.1). Within this diagram, a possible role for government is suggested across a reasonably broad spectrum. Given that any potential role for government requires a market failure rationale to be proven, the market failure arguments that have justified government intervention in the UK have not been identified in the Jersey Study.

Figure 5.1: Stylised Example of Small Business Funding Continuum



Source: OCO, based on NESTA (2009) Reshaping the UK Economy

5.1 Market Failures in SME Finance

The UK Treasury defines a market failure as 'an imperfection in the market mechanism that prevents the achievement of economic efficiency'. While many businesses can access the finance they require, there are several generally accepted structural barriers that affect the supply and demand of debt and equity finance. These market failures mainly relate to 'imperfect or asymmetric information'. In addition, there are information market failures affecting the demand side for businesses seeking finance. SMEs may not fully understand the potential benefits to their business of raising finance or their likely chance of success in gaining finance, which ultimately means they do not apply.

A 2011 SME Access to External Finance paper from UK BIS provides a comprehensive assessment of the various market failures that exist in small business finance. It is worth citing these here:

- **Debt financing gap businesses lacking track record and collateral:** A structural market failure exists in the provision of debt finance to SMEs due to asymmetric information between the lender and the business. It is difficult for the lender to distinguish between high and low risk entrepreneurs without incurring significant costs. To avoid the costs associated with gathering this information, lenders often require borrowers to provide evidence of a financial track record and/or collateral as security for the finance. Therefore, a market failure exists because the financial institution's decision to lend is based on collateral and track record, rather than the economic viability of the business. This means, some young businesses with viable business propositions that lack a track record or collateral are prevented from raising the finance they need.

- **Equity Gap for high growth potential small businesses:** It is widely recognised that an 'equity gap' exists in the provision of modest amounts of equity finance to smaller businesses. This is also due to asymmetric information between the investor and the business on the likely viability and profitability of the business. Assessing the quality of SME proposals and associated risks is difficult and leads to the investor to incur transaction costs of undertaking due diligence. These transaction costs are generally fixed and do not vary greatly with the size of investment. For instance, typical due diligence costs are generally between £20,000- £50,000. They are therefore higher as a proportion of the investment deal size for smaller investments, and for a small investment in a technically complex company, the costs can easily account for 10% or more of the investment. This results in a structural gap in the market where investors and risk capital fund managers focus on fewer, larger investments in more established (lower risk) businesses at the expense of early stage venture capital.

- **Financing gap in supply of growth capital:** The Rolands review of the provision of growth capital to UK SMEs (2009) found a gap in the provision of growth capital for viable SMEs. The market failure comes about by asymmetric information which leads to investor favouring larger deals in more established businesses. This market failure has been exacerbated by the retreat of banks into more traditional lending practices since 2007/08.

- **Demand side market failure:** There are information market failures affecting the demand side for businesses seeking finance. SMEs may not fully understand the potential benefits to their business of raising finance or their likely chance of success in gaining finance, which ultimately means they do not apply for finance. This may restrict the growth of businesses. A lack of investment readiness also leads to SMEs lacking the ability to present themselves as investable opportunities, for instance due to inadequate management skills or poor business plans.

- **Positive externalities:** The BIS paper also points to a number of positive externalities that exist and provide further rationale for government intervention. Investing in early stage innovative businesses can lead to a number of positive spill-over effects known as externalities through innovation and knowledge transfers to other parts of the economy, which private investors do not take into account when making their decision to invest in venture capital. This divergence between private and social benefits results in a sub-optimal level of investment in equity finance to young high growth potential businesses.

5.2 Recommendations

Based on the analysis undertaken and presented in the preceding sections, the following recommendations are presented for consideration in no order of priority.

Table 5.1: Recommendations

Recommendation	Description	Rationale
Peer to Peer Portal	This portal would aim to bring together entrepreneurs with private individuals. It could be managed by government, an agency or a representative body, be self-funding and would require no government funding.	The non-traditional lending that has gained significant 'traction' in the UK and further afield is not accessible to Jersey businesses or investors. If promoted well, a Peer to Peer Portal 'may complement existing routes to finance, amplify supply and draw in any latent demand – thus addressing the identified misalignment of supply and demand on the island.
Better mentoring/softer support:	In order to offset the frequently repeated view that the standard of business plans coming forward for funding are weak, this mentoring scheme would provide a robust challenge and support function to new businesses.	While Jersey business is well regarded by the consultees, it is evident that there is a need for a focused mentoring support, to mitigate the risks associated with operating a new business.
Bank liaison/ Data collation role	States of Jersey should continue to engage with the banks in a formal, regular format and enhance data collection on access to finance	Over the course of this research the scarcity of data on lending to small businesses was evident. States of Jersey should develop appropriate indicators on access to finance and ensure regular reporting. Further, Small businesses were citing a lack of sector specialists within the on island banks as a constraint to informed funding decisions. Continued, formalised and regular liaison between States of Jersey and the on island banks to give voice to these types of issues is recommended.

6 Post Script: Access to Finance is part of a wider Jigsaw

This study was commissioned with a clear remit to assess the issue of Access to Finance and the impact that this is having on Jersey's economic performance and ambitions to create a more diversified, high value added economy. During the course of the assignment it became evident that the overwhelming majority of consultees did not view demand for finance or Access to Finance as *the* major issue of concern. A range of other issues were consistently raised as constraints in economic performance. These will not come as a surprise. Indeed, the State's Economic Growth and Diversification Strategy and Enterprise Action Plan notes that there are a range of economic development and competitiveness issues that could be addressed to support Government growth aims.

The issues that arose during the course of OCO's engagement are:

- **Population Regulations:** The growth limitations that the current population rules impose on business have been cited as a major constraint. There are two strands to this issue. The first is a frustration with burdensome bureaucracy. One consultee had calculated that at their 'chargeable rate', they had invested c. £40,000 of their time in one year dealing with employment licenses. The second issue is the permitted level of population growth. Current regulations that constrain population growth have been regularly cited as a constraint on growth and feed into skills shortages…
- **Skills Shortages:** Linked to population rules, consultees took a view that the 'skills mix' on the island is not sufficient to drive high value added growth. With no obvious way to address skills issues in the short term (without population rule changes), there was a sense of pessimism from many consultees that the hoped for boost to economic performance is a realistic aim
- **Costs of doing business:** Business owners with operations in Jersey and the UK provided anecdotal evidence that the costs of operating a business in Jersey were significantly higher on the island. One retailer noted that salaries in the UK are between 15% and 20% lower than in Jersey and that rental costs are also significantly lower in the UK. While this is but one opinion, many consultees noted the view that Broadband/Telecoms pricing was considerably more expensive that elsewhere. Further research into the general cost competitiveness is Jersey is warranted, to determine the extent of and reasons for operating cost differentials.
- **Corporate Governance:** The issue of company governance has been raised as a potentially significant barrier in accessing finance with the view being offered that private companies do not disciplined in maintaining audited accounts and minutes of meetings and decisions etc. It is OCO's understanding that private companies may elect to prepare audited accounts, either by including such provision in their Articles or by passing a resolution at a general meeting, but are not legally obliged to do so. A private company which has elected to appoint an auditor can, at any time, elect not to provide audited accounts by passing a special resolution. A lack of audited accounts and verified trading history would obviously impact on a bank's capability to assess a funding application.
- **Business Support required:** Businesses in Jersey need support, advice, mentoring, networks and partnerships. It became apparent during the consultation phase that Jersey Business is highly regarded by those that availed of support with business planning but the majority of those that accessed support services appear to do so via word of mouth recommendations. Low awareness of available support and a lack of mentoring, networks and other 'softer' support was a common issue in consultations.

  Linked to this business support issue was the fact that European programmes such as the Regional Development Fund Social Fund and Rural support are providing massive support mechanisms to competitor companies in other jurisdictions.

Appendices

Appendix 1: Interviewees

Financiers/Stakeholders:

Denny Lane, Future Finance
Martin Bralsford
Alistair Blair, JIF
Paul Masterton, Digital Jersey Hub
James Naish, Jersey Construction Council
Richard Harrop, Acorn Finance
Neil McCluskey, Barclays Bank
Lloyds Bank
Jersey Business, Graeme Smith
Robin Clayton, Director, Lombard Finance
Jersey Bankers Assoc.
Envestors, Ed Daubeney
James Morris, Chamber of Commerce
Russell Dutch - RBS Int

Business Operators

Alex Langley, Director, Grant Thornton
Kerwin Mohun, Pimata
Richard Stevens, Seafaris
Cheryl Kenealy, Palm Springs Nursing Home
Kirsty McGregor, Jersey Dairy
Andrew Lucas, La Haule Farm
Andrew Marolia, Fabriah
Andrew Scott-Miller, Race Nation
Lucy Falle, Muddy Paws
Darren Malorey, DB Malorey Plumbing Ltd
Dale Broadhead, Light & Furniture
Roland Blampied, blockcraft.je
Steve Hickson, E-scape
Sam Pinto, Sams Bakery
Jon Hackwood, Sycamore Financial
David Cullen, Roulette Clothing
Laurent Coenen, Potage Farm
Charles Gallichan, Woodside Farms
Catherine Curtis, Baby Hub
John Vautier, Jersey Oyster
Tim Crowley, La Mare Wine Estate
Gerald Voisin, Voisins
Cali De La Haye, Yoga Box
Andy Horsfall, green Beans.je
Daisy Barnard, Photography
Alison Fox, Alison Fox Counseling
Lelde Broma, Beirao Bistro
Mark Brandon, Sunworks
Richard Clews, Collections Group
Ed Prow - The Potting Shed
Karl Moss
Jeff McGarry, Where-r-u
Kate (tot.com)
Loftor Loftsson
Jodie Morgan
Rupert Langley-Smith, Proviz
Frank de Jesus, Seafish Cafe
Karen Smith, Karen Carers
Zac Harbison, E Denis & Co - Tobacconist
Aaron Labey, Happy Events
Healthhaus
Hans Van Hoot
Tina Child-Villiers, TLC Salon

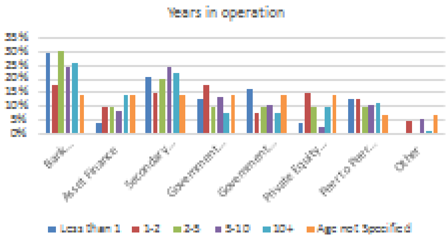
Appendix 2: Survey Analysis

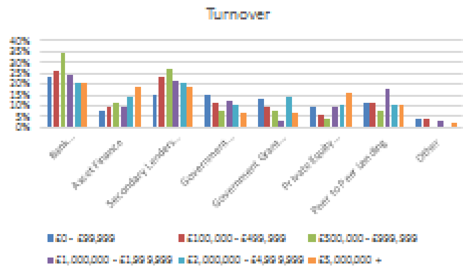
What sources of business finance are you aware of that are available on the island? - Sector

	Bank loans/overdrafts	Asset Finance	Secondary Lenders (e.g. Acorn, Future, Close)	Government Innovation Loans	Government Grant Schemes	Private Equity Schemes	Peer to Peer Lending	Other
Agriculture and Fisheries	50%	0%	25%	0%	25%	0%	0%	0%
Business Services	21%	13%	18%	10%	13%	10%	13%	3%
Construction	44%	11%	33%	0%	0%	0%	11%	0%
Digital/Technology	26%	12%	18%	18%	6%	12%	9%	0%
Financial Services	20%	16%	20%	11%	7%	14%	10%	1%
Manufacturing	20%	0%	20%	20%	0%	0%	20%	20%
Other Services	24%	9%	21%	12%	12%	7%	12%	4%
Retail	29%	14%	24%	0%	5%	5%	19%	5%
Tourism and Hospitality	29%	0%	29%	14%	14%	0%	14%	0%
Transport and Distribution	33%	17%	17%	0%	17%	17%	0%	0%

Whilst almost all sources are recognisable to all sectors, traditional financing methods (i.e. Bank loans/Overdraft remain the most commonly recognised source of finance across all sectors. However, Secondary lenders appears to be another widely recognised source.

What sources of business finance are you aware of that are available on the island? – Age, Turnover, Employees





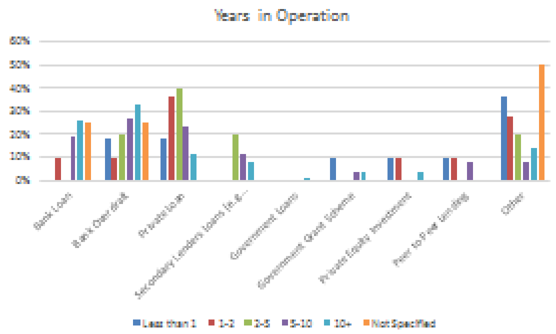
Bank loans/overdrafts and secondary providers remained the most popular despite the age, turnover or number of employees within a business

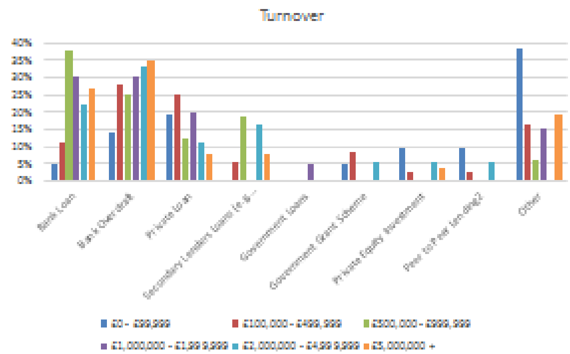
What sources of finance do you or have you used to operate your business?

	Bank Loan	Bank Overdraft	Private Loan	Secondary Lenders Loans)	Government Loans	Government Grant Scheme	Private Equity Investment	Peer to Peer Lending2	Other
Agriculture and Fisheries	33%	0%	0%	0%	0%	33%	0%	0%	33%
Business Services	13%	27%	27%	13%	0%	0%	0%	0%	20%
Construction	43%	29%	0%	29%	0%	0%	0%	0%	0%
Digital/Technology	6%	28%	28%	6%	6%	6%	11%	6%	6%
Financial Services	32%	32%	0%	8%	0%	0%	4%	0%	24%
Manufacturing	17%	17%	33%	0%	0%	0%	0%	17%	17%
Other Services	21%	24%	21%	0%	0%	7%	5%	2%	19%
Retail	18%	45%	9%	18%	0%	0%	0%	0%	9%
Tourism and Hospitality	14%	29%	29%	14%	0%	0%	0%	14%	0%
Transport and Distribution	0%	33%	0%	0%	0%	0%	0%	0%	67%

Similarly to awareness of business finance, bank loans and overdrafts are common across almost all sectors. However, private loans are just a commonly used in many cases

What sources of finance do you or have you used to operate your business? Age, turnover



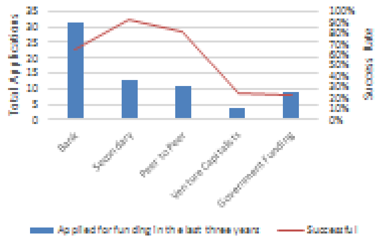


Older companies appear more likely to have used bank loans and bank overdrafts, whilst younger companies appear more open to alternative forms of finance. Similarly, companies with lower turnover were less likely to use bank loans and overdrafts, but were more likely to use secondary lenders and private loans.

'Other' sources of finance was commonly cited by businesses of all ages and size, this is typically through self/family funding.

Have you used any of the following methods to apply for external business finance in the last three years and were you successful?

Q15	Bank		Secondary		Peer to Peer		Venture Capitalists		Government Funding	
	Applied	Successful	Applied	Successful	Applied	Successful	Applied	Successful	Applied	Successful
£0 - £99,999	2	50%	3	33%	5	60%	2	0%	5	0%
£100,000 - £499,999	10	50%	4	100%	0	0	1	0%	2	50%
£500,000 - £999,999	4	75%	2	100%	1	100%	0	0	0	0
£1,000,000 - £1,999,999	4	50%	1	100%	4	100%		0	2	50%
£2,000,000 - £4,999,999	5	40%	3	100%	1	100%	1	100%	0	0
£5,000,000 +	6	100%	0	0	0	0	0	0	0	0
Grand Total	31	20 (65%)	13	12 (92%)	11	9 (82%)	4	1 (25%)	9	2 (22%)



Bank lending was the most common type of finance applied for, with two thirds of respondents successful in receiving finance. It appears larger businesses have a better chance of being successful in bank lending.

With a 92% success rate across 13 applications, secondary finance was the most commonly successful type of finance applied for. Success appears to be less dependent on size, however the smallest turnover band (£0-99,999) had a lower success rate of 33%.

Companies with high levels of turnover also appear less likely to apply for finance from sources other than banks.

If your company was not approved for any finance applied for in the last three years, why?

Key Themes:

Terms

"The overdraft facility we requested was approved but we decided against it as we no longer needed it by the time it was approved and the fee was too high."

"It was approved, but the terms were unacceptable and it was far cheaper to borrow money at a commercial interest rate from a family member"

Lack of understanding

"Those evaluating the applications did not have the right level of industry experience to be able to understand and correctly assess the quality of the proposals, so declined because they could not judge the risk."

"Lack of understanding of the industry. Project fell into 'blacklisted' area for banks. Govt funding failed due to JIF process being too slow for actual innovation."

Unwillingness to lend

"existing bank unwilling to extend existing loans"

"banks are lending to virtually no businesses in the start up or commercial categories in Jersey over the last few years."

"As a start up, banks and secondary lenders were not willing to lend without huge rates and security."

Appendix 3: SMAF Sub-Indices

These sub-indices are calculated using data from the following sources: European Central Bank (ECB) for debt; European Venture Capital Association (EVCA) and European Business Angel Network (EBAN) for equity; and the EC and ECB's Survey on the Access to Finance of SMEs (SAFE), for both sub-indices.

The index is a weighted mean of the sub-indices. The sub-indices themselves are weighted means of the indicators that comprise them, with the indicators 'normalised'[1]. Appropriate values for the weights are defined based on actual volumes[2], the nature of indicators[3] and the coverage of indicators[4]. In general the index largely reflects the importance of debt finance in the area of Access to Finance: the debt finance sub-index was set to represent 85% of the SMAF weighting. The equity finance sub-index was set to represent 15% of the SMAF weighting.

The composition of the two sub-indices is set out in the diagram below. This sets out the 14 indicators that cover the index, with nine included in the debt finance sub-index and five in the equity finance sub-index.

Debt finance sub-index

- % of firms using bank loans
- Interest rates on loans up to 250 thousand €
- Interest rates for overdrafts
- % of firms using bank overdraft, credit line or credit cards overdraft
- % of firms using leasing or hire purchase or factoring
- % of companies not applying for bank loan because of possible rejection
- % of firms "applied but did not get everything requested "
- Rejected loan applications and unacceptable loan offers
- Willingness of banks to provide a loan (% of respondents who indicated a deterioration)

Equity finance sub-index

- Total venture capital investment in thousands of € (% of GDP)
- Number of venture capital beneficiary SMEs (scaled by GDP)
- Total volumes invested by business angels in thousands of € (% of GDP)
- Number of deals where business angels invested (% of GDP)
- % of firms feeling confident to talk about financing with equity investors/ venture capital firms