

OCTOPUS HIGH GROWTH SMALL BUSINESS REPORT 2015

How Britain's fastest growing smaller companies
can be a force for regional revival

Follow the conversation: **#hgsbreport**





What are high growth small businesses?

High growth small businesses (HGSBs) are companies achieving more than 20% average annual growth in turnover over a three-year period and with an annual turnover between £1 million and £20 million.



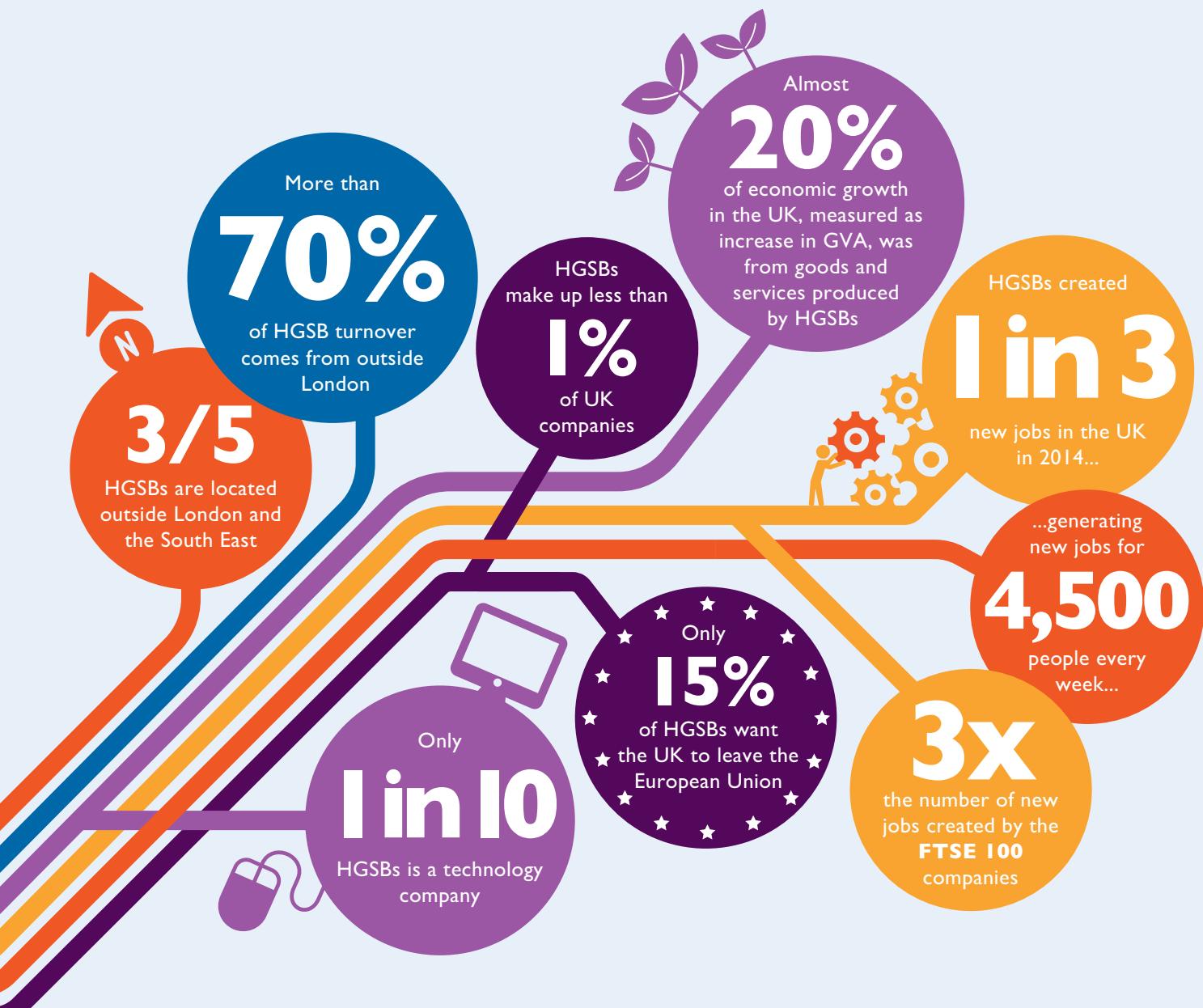
Out of the 5.3 million companies that exist in the UK only 22,470 of them are HGSBs. They can be found in every region of the UK.

Executive summary

The UK's high growth small businesses (HGSBs) have the power to drive a regional economic revival. They make up less than 1% of UK companies, yet last year created one in every three new jobs in the UK.

Three out of five HGSBs are outside London and the South East. They create growth wherever they're found, and given the right skills, funding and connectivity, they can turn our regions into economic powerhouses, bringing new hope, purpose and prosperity to people across the UK.

We therefore call on Government to take the practical steps set out in this report, and target a 25% increase in HGSBs in every region of the UK within the next five years.



Endorsements



Rt Hon Sajid Javid MP
Secretary of State for
Business, Innovation and Skills



Chuka Umunna MP
Labour Party



Tom Thackray
Head of Enterprise at
Confederation of British Industry



Philip Salter
Director of The
Entrepreneurs Network



Raising our economy's productivity depends on supporting the growth of new and existing businesses. Government provides access to finance, it is making it easier to start a business and building a strong enterprise culture. The Octopus High Growth Small Business Report 2015 gives us valuable insight into many SMEs' growth potential.



The Octopus High Growth Small Business Report provides a fantastic showcase of the best of British entrepreneurship. We should do all we can to shine a spotlight on their success. The report finds that high growth small firms are creating jobs at a faster rate than the FTSE 100, and are based right across the country, in every major industry sector - they are driving forward innovation and helping to rebalance Britain's economy. It is also right to highlight the challenges they face such as the need for better infrastructure, in particular superfast broadband.



High growth small businesses have a disproportionate effect on both the economy and community around them. There is a lot of growth coming from these companies, so it's really important to give them a voice. We need to encourage more businesses to grow and create the right ecosystem across the country in which both current and future high growth small businesses can reach their potential.



Once again, Octopus Investments has shown how high growth small businesses are the lynchpin of Britain's economy. We know this Government recognises the importance of them, but if we want to support these vital businesses – not just in London, but throughout the country – we need to ensure that the policy suggestions outlined in this report are put into force.

Contents

Foreword Simon Rogerson, CEO of Octopus	4
About the research: an economist's view Graham Brough, CEO of Centre for Economics and Business Research	6
Hidden potential: a snapshot of HGSBs in the UK	8
Opportunity everywhere: the geography of HGSBs in the UK	10
The high growth effect: how HGSBs can drive regional growth	14
Unlocking the powerhouse: what HGSBs need to succeed	16
Policy recommendations	22
Contact us	36

Foreword

Last year a tiny number of companies created one in every three new jobs in the UK. These are the high growth small businesses. These companies are impacting millions of lives and are changing the way the world works.



Simon
Rogerson
CEO of
Octopus

HGSBs
make up less than

1%

of UK
companies...

...yet created

34%

of new jobs in the
UK in 2014

High growth small businesses (HGSBs) have been a constant engine of economic growth in recent years. And they continue to lead the way when it comes to job creation and economic prosperity. They make up less than 1% of the firms registered in the UK, yet they've been generating around 4,500 new jobs every week. To put this contribution into perspective, it is three times the number of jobs created by the entire FTSE 100 in the same period. When it comes to making a positive impact, bigger is not necessarily better.

Last year's report was the first of its kind to give a voice to HGSBs. It acknowledged the economic role such businesses play, but it also gave the people who've built these companies the much-needed opportunity to make themselves heard. It offered a forum to talk about the challenges they face and the obstacles they overcome. And the results got people talking. Our report prompted questions in Parliament and led to policymakers and a wide range of stakeholders joining the call to champion HGSBs.

“This report highlights the role HGSBs can play in driving regional growth, addressing the North-South divide and rebalancing our economy”

This year's report goes a step further. As well as reinforcing some of the key findings from last year's report, it highlights the role HGSBs can play in driving regional growth, addressing the North-South divide and rebalancing our economy. Around three of every five HGSBs are located outside London and the South East and they have a disproportionate impact on weaker performing local economies. This report explores some of the regional imbalances that exist and makes the case for increasing the number of HGSBs in every region.

We've surveyed some of the UK's most entrepreneurial small companies, and they've shared with us their ambitions, their frustrations and what they need to give their business a competitive edge and a fighting chance to succeed. The issues we've raised in this report have never been more relevant. In this, a General Election year, the Government pledged to create a Northern Powerhouse and announced

measures that will devolve economic decisions to Northern cities. We welcome this, and we see some of our policy recommendations as a natural extension of these plans. Government has been doing a great job getting behind entrepreneurs. Schemes such as London's Tech City show what the right kind of support can achieve.

“HGSBs are proving that what works in London can happen in every part of the UK”

But HGSBs are proving that what works in London can happen in every part of the UK. The firms featured in last year's report now employ one in every 40 workers in the UK, providing 768,000 people with jobs and generating £118 billion in turnover during the past year. If we could increase the presence of HGSBs by 25% in each region it would create hundreds of thousands of new jobs across the country. It's an ambitious target, but every single HGSB was built on ambition and the determination to challenge conventional thinking. We know this because here at Octopus we see such ambition and determination every day through the companies we back.

Octopus is one of the most active investors in HGSBs in the UK. This means we have first-hand experience of the economic and social difference such companies are making. We have supported more than 500 smaller UK companies over the past 15 years – including Zoopla Property Group, Secret Escapes, graze.com and Majestic Wine plc. We're proud that some of the companies we've backed, and continue to back, feature in this report.

It's time to get behind our high growth small businesses. They're thriving already, but with the right framework they can become a force for regional revival, rebalancing our national economy, and bringing new prosperity and optimism to every part of the UK.

About the research: an economist's view

The Centre for Economics and Business Research (Cebr) is delighted to present the 2015 Octopus High Growth Small Business Report – an update of last year's insightful and thought-provoking publication, which demonstrated the crucial role a small number of fast-growing businesses play in driving the economy forward.



Graham
Brough
CEO of Cebr

25%

increase in the number
of HGSBs in the North
of England...

...could see
almost
20k

new jobs

Last year's report set out our evidence that high growth small businesses (HGSBs) are driving a significant portion of the UK's economic growth. The findings brought well-deserved attention to this tiny proportion of our UK companies – less than 1% – and we've carried on tracking the progress of the companies we surveyed.

HGSBs continue to make a substantial contribution, accounting for almost a fifth of UK economic growth and more than a third of jobs created in 2014. In addition, our research shows that they are more confident in future economic prospects than other types of business. With confidence a key determinant of capital spending, we can also expect HGSBs to punch above their weight when it comes to investing in the UK.

"There is a clear link between the number of HGSBs and economic growth"

But the most compelling findings of this year's research relate to the regional effect. This year, we have worked with Octopus to examine the substantial divides in economic performance across the UK, and to consider how HGSBs can narrow the gap between London and other regions. There is a clear link between the number of HGSBs and economic growth; London has over ten times as many HGSBs as the North East of England.

This report reveals both the extent of current regional divides, and the potential for HGSBs to narrow the gap between them. The Chancellor's ambitions of generating a Northern Powerhouse will never be realised if there is no increase in the number of successful entrepreneurs basing themselves in the North of England. With 25% more HGSBs the North of England could see almost 20,000 new jobs – a forecast that's highly pertinent to Government plans for regeneration in the regions.

So what do HGSBs need in order to grow? Our analysis includes a survey of 500 HGSBs across the UK conducted by ICM Unlimited. The results show that skilled workers, access to funding and good communication links are essential, and become obstacles to growth in regions that lack them. HGSBs

also need a stable business and policy environment and are overwhelmingly opposed to a UK exit from the European Union.

While the Conservative majority at the General Election has eliminated some causes for concern – for example around higher rates of income tax – the promised vote on UK membership of the European Union raises others. A clear majority of the HGSBs we surveyed were against UK exit from the EU – unsurprising given the major short-term shock this would bring to the UK economy. Yet, despite the effects of a General Election and world economic slowdown, HGSBs remain relatively confident about the future.

The Government needs to ensure that the UK is an increasingly desirable place for HGSBs to be established and to thrive. The Summer Budget announcement to cut Corporation Tax to 18% is a welcome step towards this, but more can be done and this report provides a series of policy measures that would ensure HGSBs make an even stronger contribution to the economy in the future. Without continued progressive change, the UK risks being overtaken by super-competitive and dynamic economies elsewhere in the world – from the Middle East to the Far East.

This is the basis of our joint call, with Octopus, for policies that enable HGSBs to thrive in all regions of the UK.

"Should the economy start to stumble, the role of HGSBs in supporting jobs and growth will be even more important"

The global economic outlook remains highly uncertain and there are a wide range of risks to the UK over the coming years. Should the economy start to stumble, the role of HGSBs in supporting jobs and growth will be even more important. This small group of companies have shown they are constant engines of growth through the good times and the bad. Let's see all regions of the country realising the full potential of these dynamic high growth small businesses.

Hidden potential: a snapshot of HGSBs in the UK

We define HGSBs as those with more than 20% average annual growth in turnover over a three-year period and with an annual turnover between £1 million and £20 million.

They're a small group...

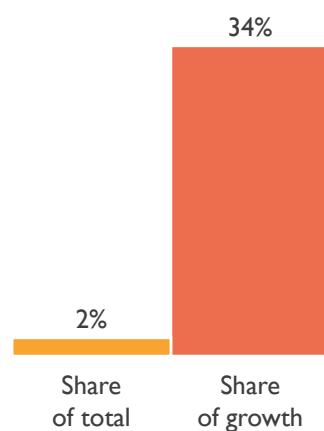
As well as being small in size, HGSBs are few in number, representing a tiny proportion of all UK business. Out of the 5.3 million companies in the UK, only 22,470 are HGSBs, which is less than 1% of UK companies.

...but they punch well above their weight

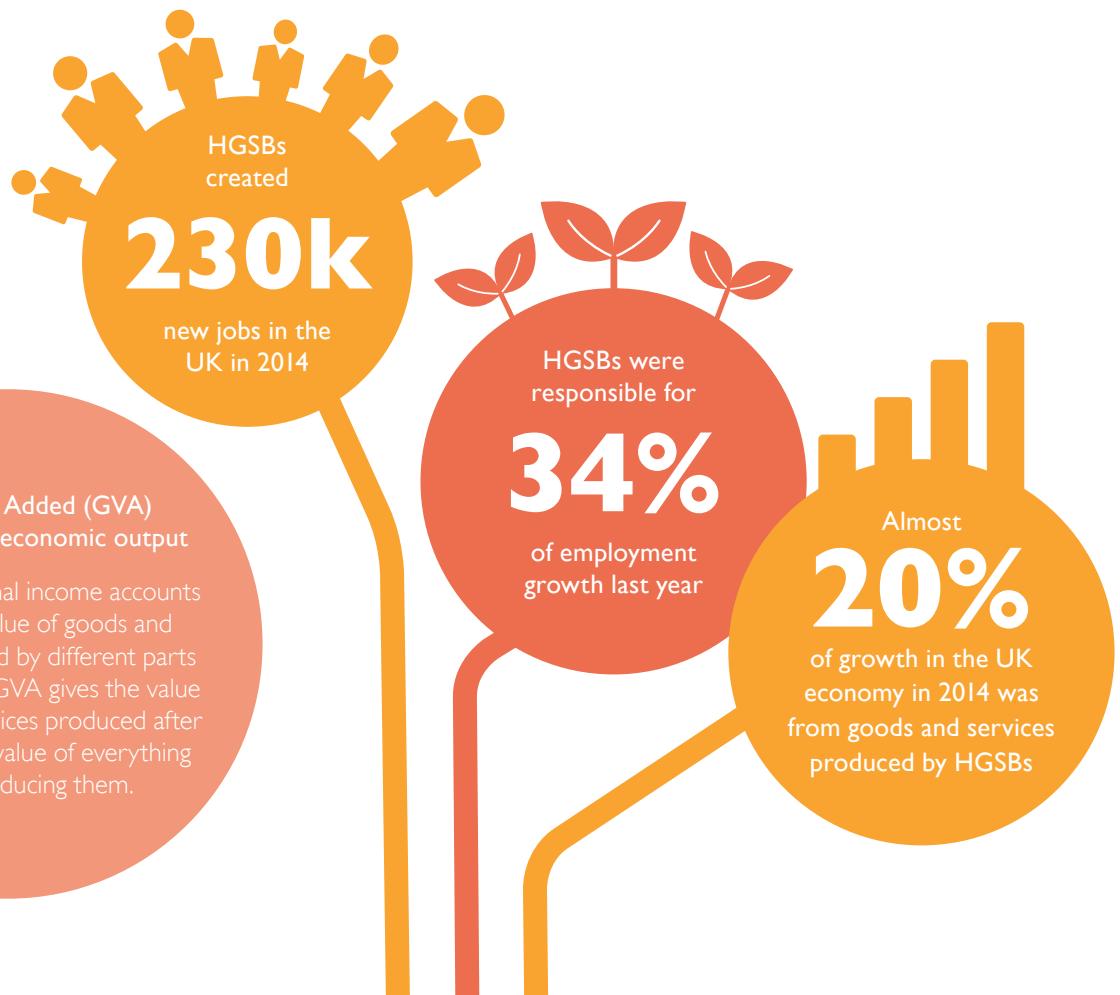
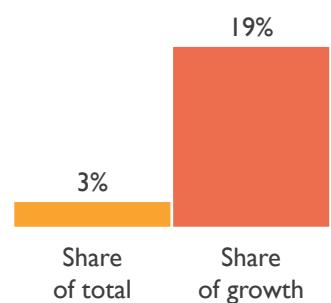
HGSBs make a disproportionately large contribution to our economic wellbeing, creating jobs and driving growth at an exceptional rate.

HGSBs accounted for just 2% of total employment in the UK, but created over a third of new jobs in the UK in 2014. Similarly they contributed almost 20% of growth to the UK economy, measured as increase in GVA, despite accounting for less than 3% of total GVA.

HGSB employment,
2014



HGSB economic output (GVA),
2014



They're growing in every business sector...

65% of HGSBs are in the service sector – particularly in administration and support, which together account for 15% of all HGSBs in the UK. Contrary to what many assume, less than one in ten HGSBs is a technology company.

...bringing new business to every region...

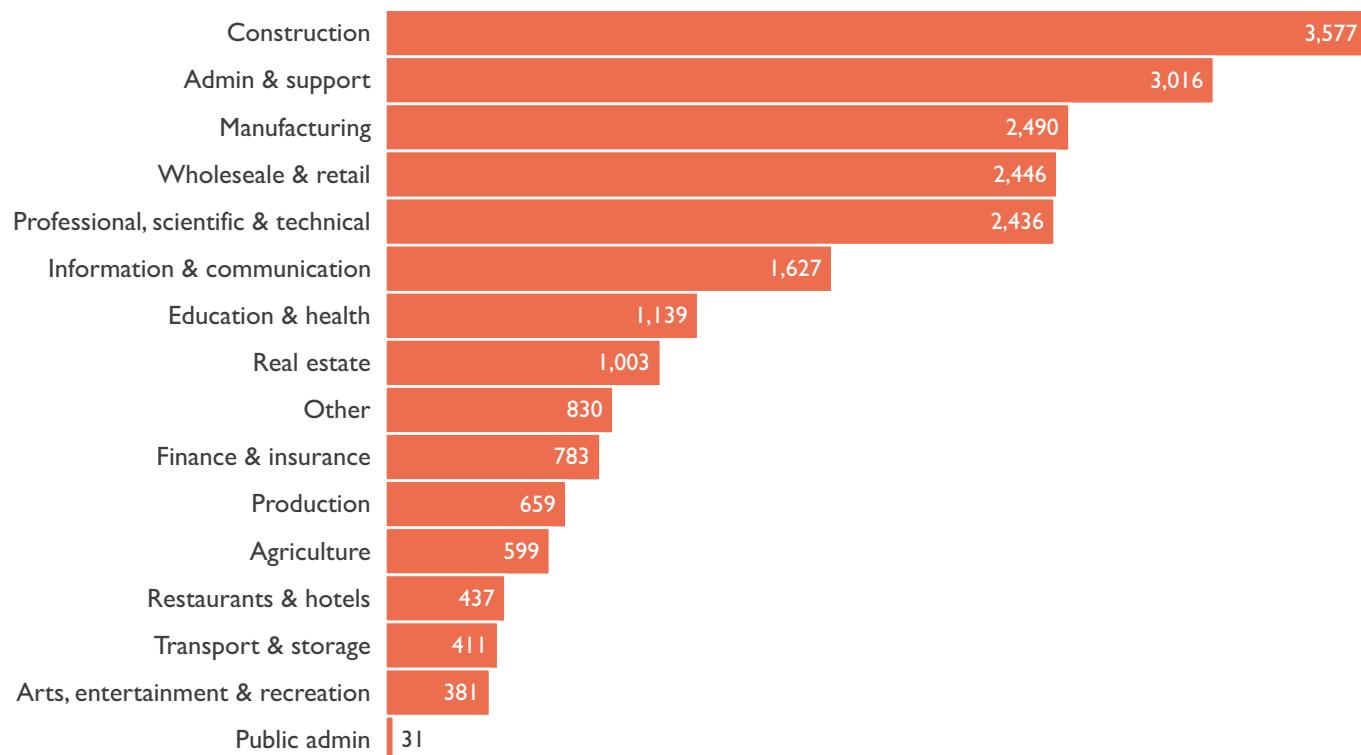
Significantly, HGSBs are found in every part of the UK. In the next section we explore this regional pattern.

...but they still struggle to be seen and heard

The HGSB segment comprises businesses spread across a broad range of industries, which doesn't make for a cohesive group. This and their small size help explain why they're easy for policymakers to miss within the wider SME (Small and Medium-sized Enterprise) sector.



Number of HGSBs in the UK by sector, 2014



Opportunity everywhere: the geography of HGSBs in the UK

HGSBs thrive wherever opportunity lies. Almost three in every five HGSBs are outside London and the South East, and every region of the UK has a high growth success story to shout about. While this is encouraging, we need to get more HGSBs into the regions to unlock further growth.

HGSBs are flourishing right across the UK

HGSBs are to be found in every part of the UK, and significantly, almost three in every five HGSBs are outside London and the South East.

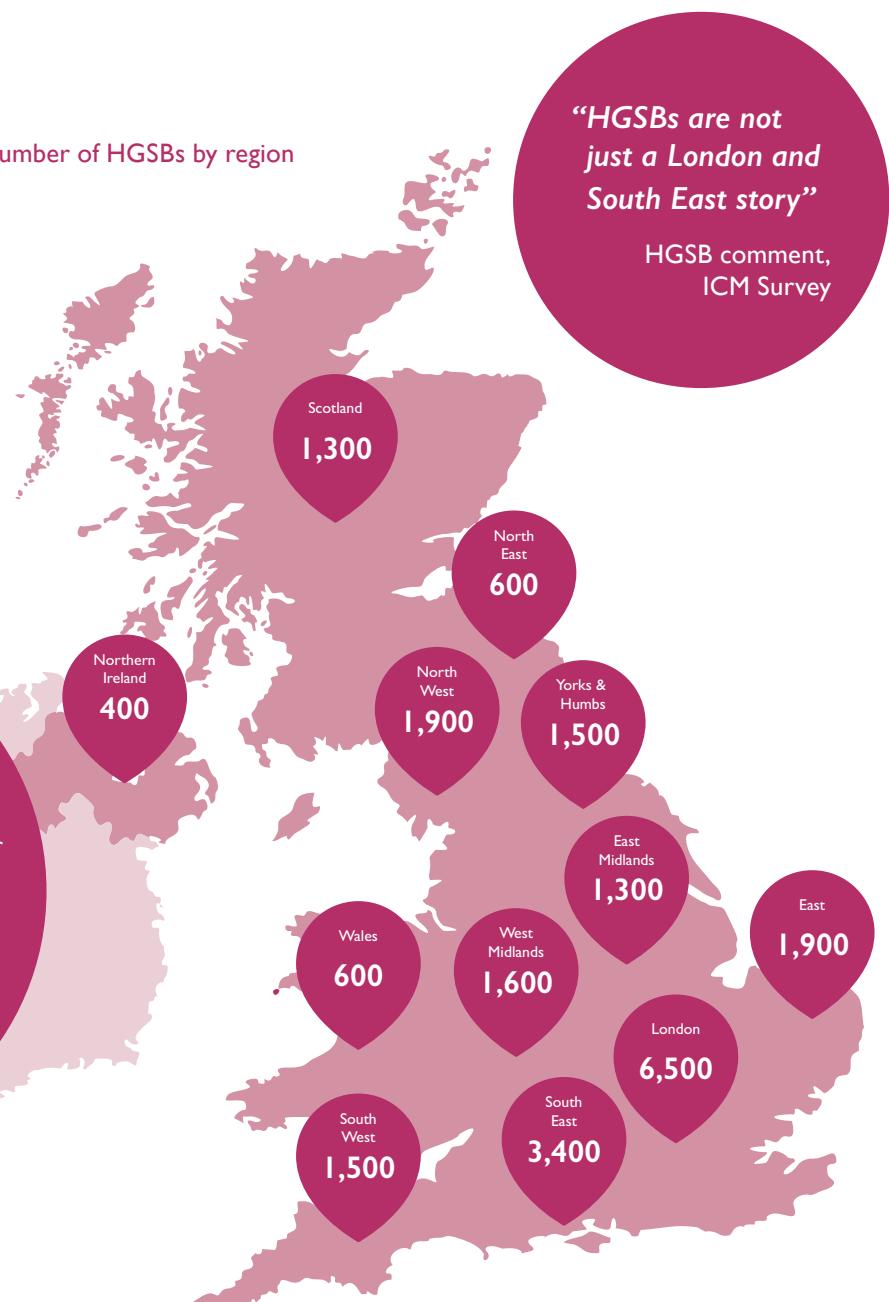
Some regions are lagging behind

Although HGSBs are succeeding in every region, some parts of the UK have relatively few. The devolved nations of Wales and Northern Ireland, and the North East of England count the fewest HGSBs, with less than 1,000 each.

"There is a huge amount of growth coming from these businesses and you can see it in the development of clusters across the country, whether it is Tech City in London, medical technology in Cambridge or creative industries in the North West."

Tom Thackray
Head of Enterprise
at CBI

Number of HGSBs by region



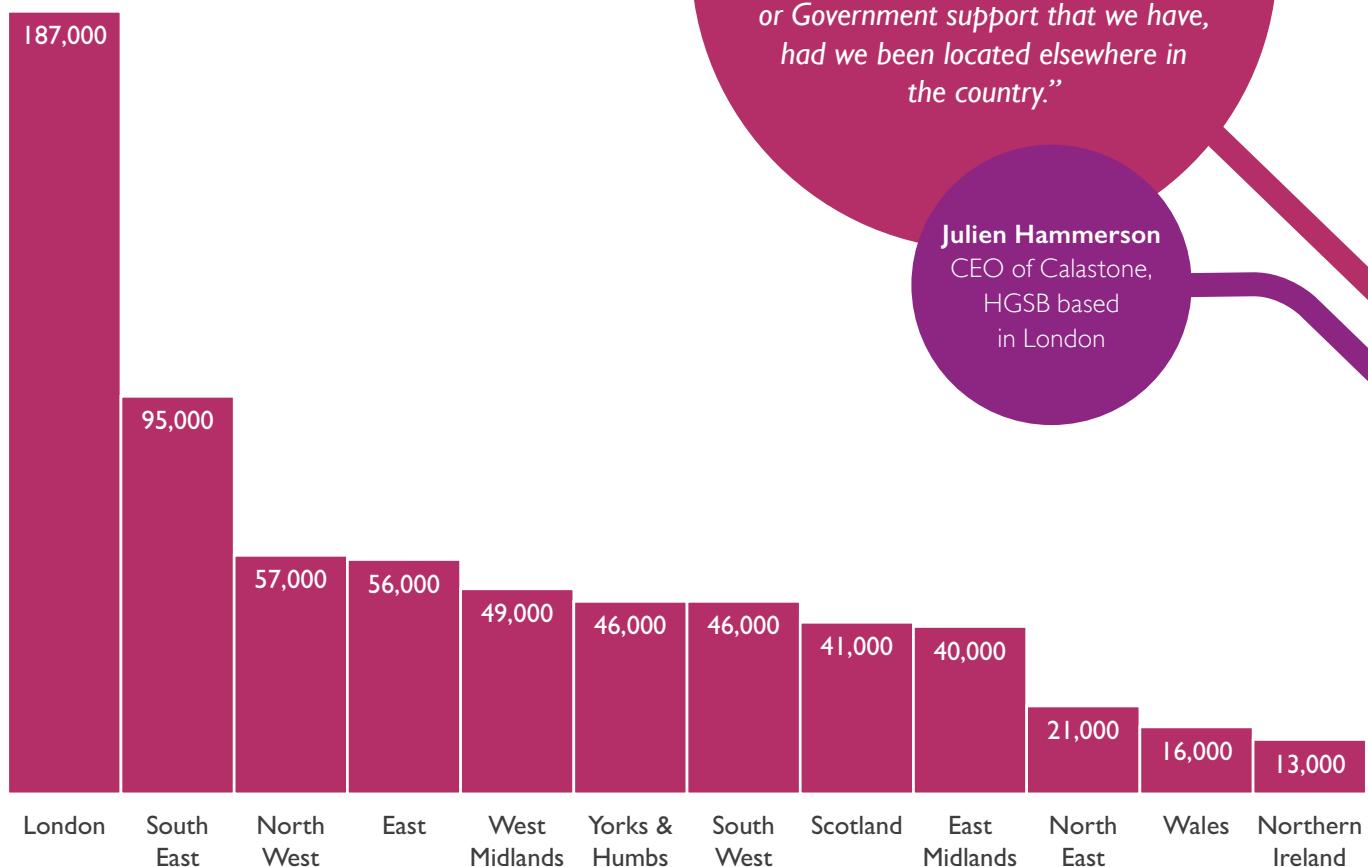
"HGSBs are not just a London and South East story"

HGSB comment,
ICM Survey

London has the highest share of HGSB employment

Perhaps inevitably, most HGSB jobs are in London – around 187,000 last year. People in London are also much more likely to be working for HGSBs than they would be anywhere else. In 2014 more than one in 25 working Londoners was employed by HGSBs, compared with a rate of one in 90 in Wales.

Number of people employed by HGSBs by region, 2014



“Calastone was founded eight years ago in London and our location has been key to the development of the business. I do not believe we could have attracted the talent, expertise or Government support that we have, had we been located elsewhere in the country.”

Julien Hammerson
CEO of Calastone,
HGSB based
in London



"This report from Octopus is a welcome contribution to gathering evidence on the ideal conditions for growth and shows you don't have to be in London to grow!"

Emma Jones
Founder of
Enterprise Nation

...but more than two thirds of HGSB turnover comes from other regions

Despite London's pre-eminence, the remaining majority of turnover comes from HGSBs located across the rest of the UK. HGSBs are not just a London and South East story.

In the North East and North West of England, which has a below-average share of HGSBs, these businesses generated £10 billion in turnover in 2014, providing 11% of the total HGSB contribution to UK GVA.

"We need to ensure that the hugely exciting and vibrant entrepreneurial scene that we see in pockets, such as gaming in Brighton and FinTech in Nottingham, is helped to thrive right across the UK."

Dan Cobley
Co-founder and
CEO of Brightbridge
Ventures. Former MD
of Google UK

HGSBs in London add the most to UK economic output...

The financial turnover of HGSBs helps drive the UK's economic output, measured as GVA. In 2014 HGSBs in London generated turnover of £28 billion. That's more than a third of the turnover for all HGSBs across the UK.

Turnover of HGSBs in 2014 by region



HGSBs are concentrated in economically successful areas

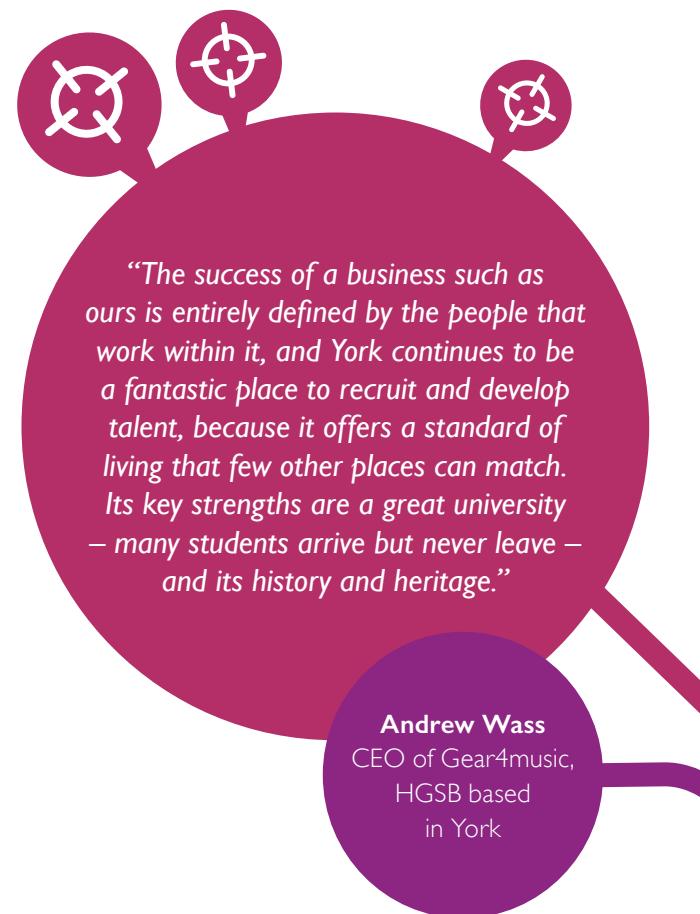
HGSBs are drawn to high-performing economic regions and, in turn, bring further growth, vigour and competitiveness. Conversely, parts of the country where economic conditions are less favourable tend to attract fewer HGSBs and consequently fall further behind. These contrasting cycles of growth and decline serve to increase the imbalance between regions over time.

The quality of the local business environment is the most important factor for HGSBs when they are deciding where to locate. This is closely followed by the strength of the local infrastructure and how well connected the area is. One in every two HGSBs surveyed also said that access to talent was a deciding factor.

The main deciding factors that determine where HGSBs are located



NOTE: ICM SURVEY OF 500 HGSBS WHO WERE ASKED 'WHAT ARE THE MAIN DECIDING FACTORS DETERMINING WHERE YOUR BUSINESS IS LOCATED?' 12% ANSWERED 'DON'T KNOW'



The high growth effect: how HGSBs can drive regional growth

HGSBs create growth wherever they're found, but the impact is strongest in exactly the places that most need a boost. With regional inequality high on the policy agenda, these companies offer a clear, strong and viable force for rebalancing the economy. How exactly could they make the difference?

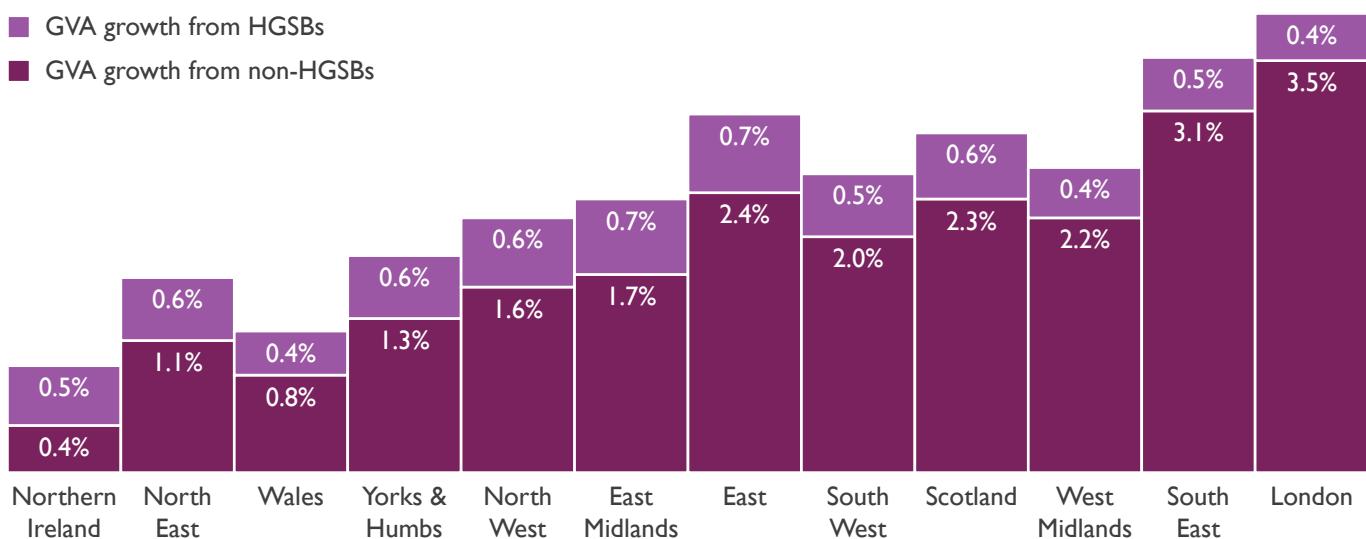
Wherever they spring up, high growth small businesses cause a rush of energy and confidence. They bring new activity, commerce and employment; they create demand for services and infrastructure; they set off new cycles of innovation and opportunity; and, they spawn or draw in other enterprises like them.

HGSBs have more impact in regions with less growth

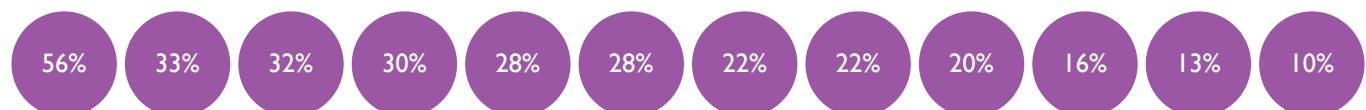
Regions with fewer HGSBs are also the places that need these businesses most. London has the most HGSBs but is less dependent on them. Meanwhile, HGSBs are a lifeline for growth and job creation in Northern Ireland, Wales and the North East. Cities such as Belfast, Newcastle upon Tyne, Sunderland, Durham, Cardiff and Swansea have the greatest reliance on HGSBs for local economic growth.

This effect becomes clear if we look at the contribution HGSBs make to economic growth in each region.

GVA growth by region, 2014



Share of GVA growth coming from HGSBs



Narrowing the growth gap

An increase in the number of HGSBs in each region would have the greatest impact in regions where growth is currently slower. The chart below shows that if the North West had 25% more HGSBs last year, its GVA growth would have increased by 20%. This would have created an additional £606 million of GVA for the region and provided more than 14,000 new jobs.

Bringing new employment to every region

An increase in the number of HGSBs in each region could generate thousands of jobs across the country. If the North of England had 25% more HGSBs last year, it would have created almost 20,000 new jobs.

If there were as many HGSBs in the North East last year, as there are in the South East (a rise of 2,700 businesses), then the North East would have benefited from an additional 99,800 jobs – which would significantly contribute to reducing unemployment in the region.

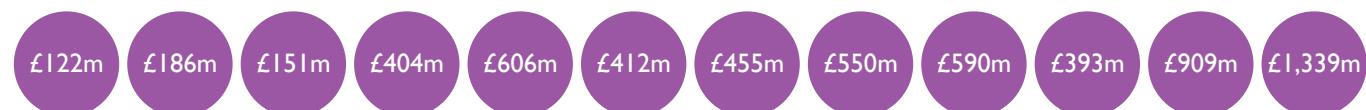
Increase in GVA, as a percentage of GVA growth, if each region had 25% more HGSBs in 2014



Jobs created if the region had a 25% increase in HGSBs in 2014



Additional GVA generated if the region had a 25% increase in HGSBs in 2014



Unlocking the powerhouse: what HGSBs need to succeed

High growth small businesses have common needs: finance, talent and connectivity. These are readily available in London and the South East, but much needed in other UK regions.

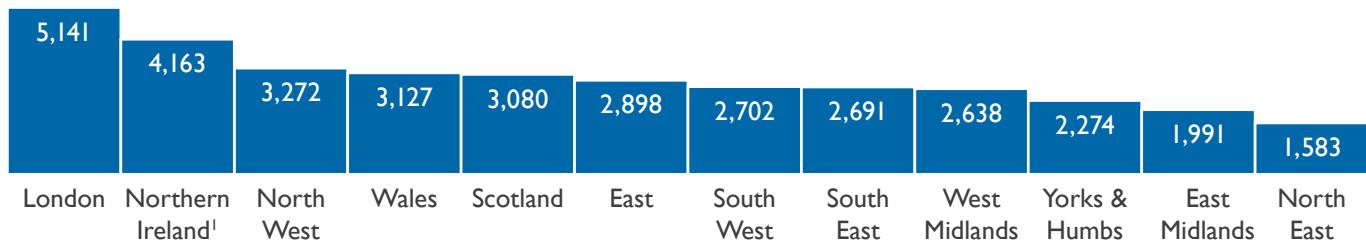
Access to finance

Difficulty accessing finance continues to hold back the growth of HGSBs and last year the problem intensified. Almost one in four HGSBs found it difficult to secure the funding they needed on acceptable terms. Of these firms, 75% said this was a significant barrier to their growth. Across the broader SME sector lending has been in decline since the financial crisis of 2008.

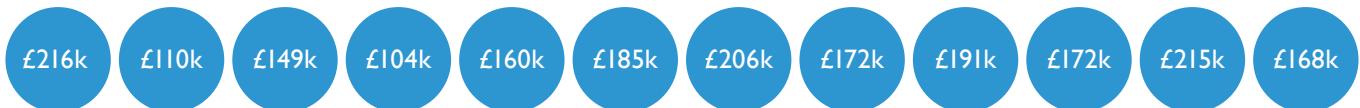
Regionally, postcode data show lending is heavily concentrated in London, which accounts for eight out of the top ten postcodes for value of outstanding SME loans. The number of SME loan approvals in London is three times that of the North East, and according to British Bankers' Association data, the average value of loan facilities granted to SMEs in London and the Midlands is much higher than in the North of England, Scotland, and Wales – which has the lowest average value of loan facilities.

Outside London and the South East, postcode data show lending to be concentrated in the North of England and in cities such as Edinburgh, Manchester, Bristol and York.

Number of SME loan facilities approved, Q2 2015



Average loan size by region, Q2 2015



NOTE: ¹DATA FOR NORTHERN IRELAND RELATES TO Q1 2015
SOURCE: BRITISH BANKERS' ASSOCIATION



The voice of HGSBs

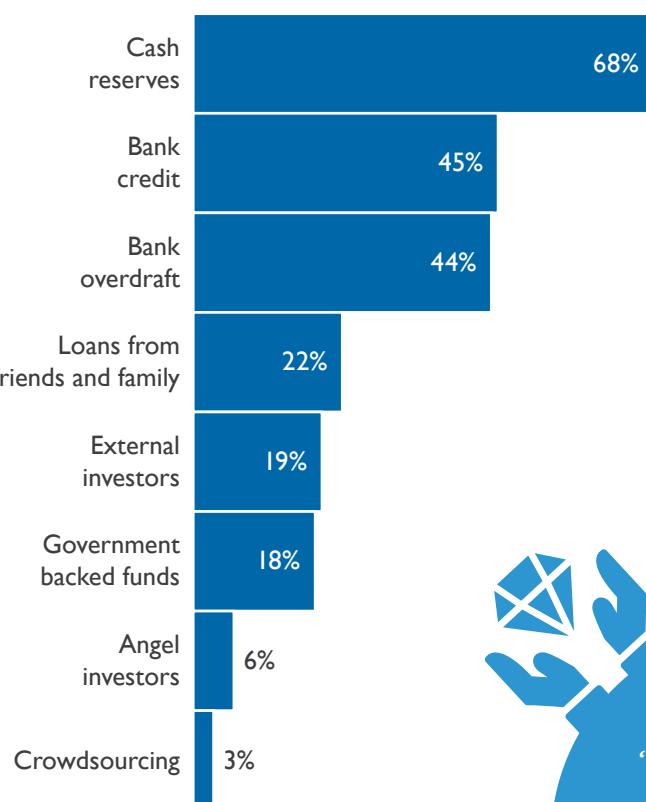
We asked ICM Unlimited to conduct a survey of 500 HGSBs. The results give a clear picture of the needs, challenges and opportunities these businesses share, as well as providing insight into their economic outlook and the impact of the General Election.

The survey revealed that finding people with the right skills was the number one concern for HGSBs. But other factors count: the quality of the local business environment and infrastructure can be decisive when choosing where to locate. And in every region, access to finance remains key.

Debt versus equity

One of the biggest funding obstacles for HGSBs is securing equity finance, and these companies continue to rely heavily on debt rather than equity as an external funding source. HGSBs have an average gearing ratio of 29%, which is higher than the current 22% average for small businesses. This suggests HGSBs are more willing and perhaps under more pressure to take on debt than other businesses of their size.

Most critical sources of funding for HGSBs in the early stages of business growth



Gearing ratio

This shows the balance between funds a company owns (its equity or capital) and funds it is borrowing. The average gearing ratio for a business sector gives a picture of the level of debt risk companies are generally willing to take on in their sector.

Funding sources

Cash reserves remain the most important sources of funding at the early stages of business growth, with entrepreneurs leaning more on bank overdrafts and loans from friends and family than from funding via Government or external investors.

And the pattern of debt dependency doesn't change much for established businesses seeking funding for further growth. Cash reserves along with the traditional channels of bank credit and overdrafts remain the most important sources of funding. External investors take on a greater role as loans from friends and family join angel investors and crowdsourcing as the least important sources of funding.

Government backed funding sources are available, but they're currently under-used: four out of five businesses surveyed weren't making use of funds such as Venture Capital Trusts and Enterprise Investment Schemes.

“Funding is absolutely critical – it's your lifeblood when you're trying to rapidly scale a business.”

Richard Gibson
Director at
SwiftKey, HGSB
based in London



Talent: a workforce with the necessary skills

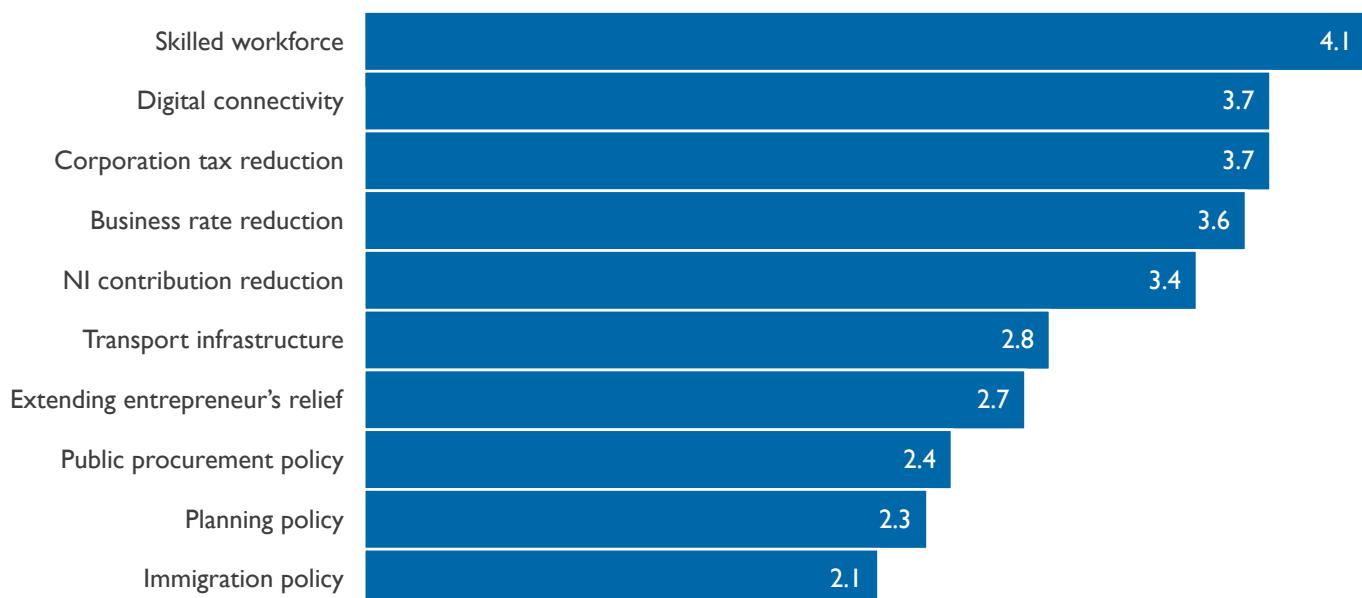
Will we be able to find people with the skills and talent we need? This is the most pressing question of all for HGSBs when choosing a location, according to the survey, and the most significant reason why weaker economic regions often fail to make the shortlist.

64% of respondents agreed that a skilled workforce was a driver of growth for their business, with half citing it as a significant location factor.

HGSBs move quickly and they need to be able to attract the right skills to help them expand. They often need to look overseas to find the talent to achieve this. The introduction of mandatory coding lessons across the UK is an excellent investment in future skills, but meanwhile, for perhaps the next 15 years, immigration will play a crucial role in providing HGSBs with the talent they need.

The UK remains an attractive destination for international talent, but immigration policy could hamper HGSBs looking to hire talent from abroad.

The importance of different policies to HGSBs where 1 is not at all important and 5 is very important (average scores)

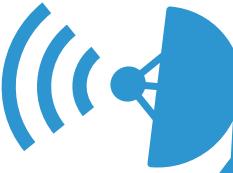


Strong digital connectivity

Half of the businesses surveyed depend heavily on their online presence to drive growth, while 62% pointed to technology upgrades and 58% attributed their growth to innovation.

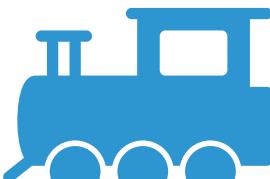
Digital connectivity is therefore inevitably high on the wish list for HGSBs choosing a location, and over the last year it has become a greater concern. A significant number of HGSBs cited inadequate broadband as a major obstacle to growth.

As well as being an absolute priority, improving access to fast broadband is also a relatively clear-cut and concrete way to improve regional prospects for HGSBs, particularly in areas struggling to keep up with this predominantly urban technology boom.



"Poor digital connectivity is a huge issue and cost to small businesses all over the country, including parts of London. The Government can help the market through regulation."

Ben Marks
MD of YouthSight,
HGSB based
in London



"Although York is well connected by train (less than two hours to London), it needs more investment into road transport and commercial property if it's really going to create the right environment to develop more fast growing businesses like ours."

Andrew Wass
CEO of Gear4music,
HGSB based
in York

High-speed transport connections

HGSBs need efficient local transport infrastructure and rapid access to other parts of the UK.

In Scotland, 38% of HGSBs cited poor transport links within cities and with the rest of the UK as an obstacle to growth.

For England and Wales, transport tends to be a bigger worry in the regions where growth is concentrated. In London, 25% of HGSBs find getting about the city to be a problem, and 21% say they're being held back by poor transport links with other regions.

So while the digital challenge is to bring less developed regions up to speed with busy urban centres, the transport challenge is to connect the busy centres more effectively with less developed regions.

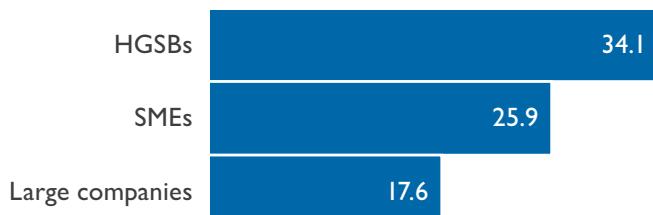
Economic outlook

Many HGSBs think growth depends on how they perform, and above all how they serve customers. But an equal number see their growth prospects as tied up with wider economic conditions.

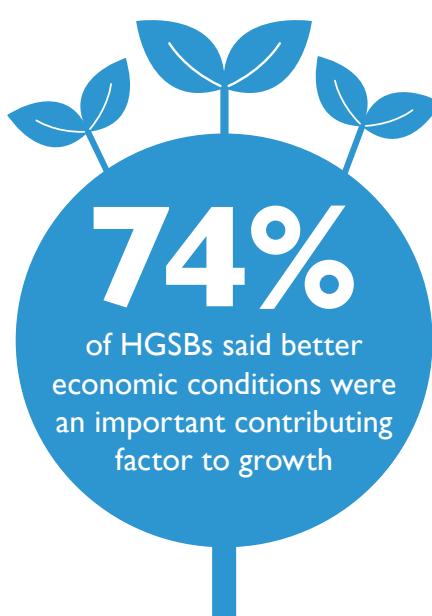
HGSBs are optimistic about the next 12 months

Despite being slightly more cautious in their overall economic outlook during this General Election year, HGSBs remain relatively confident about the future. Compared with other types of business, HGSBs are more optimistic about the next 12 months, with the vast majority of respondents expecting to see their turnover increase. If these expectations are accurate turnover for all HGSBs could rise by 15%, adding around £13 billion to the economy.

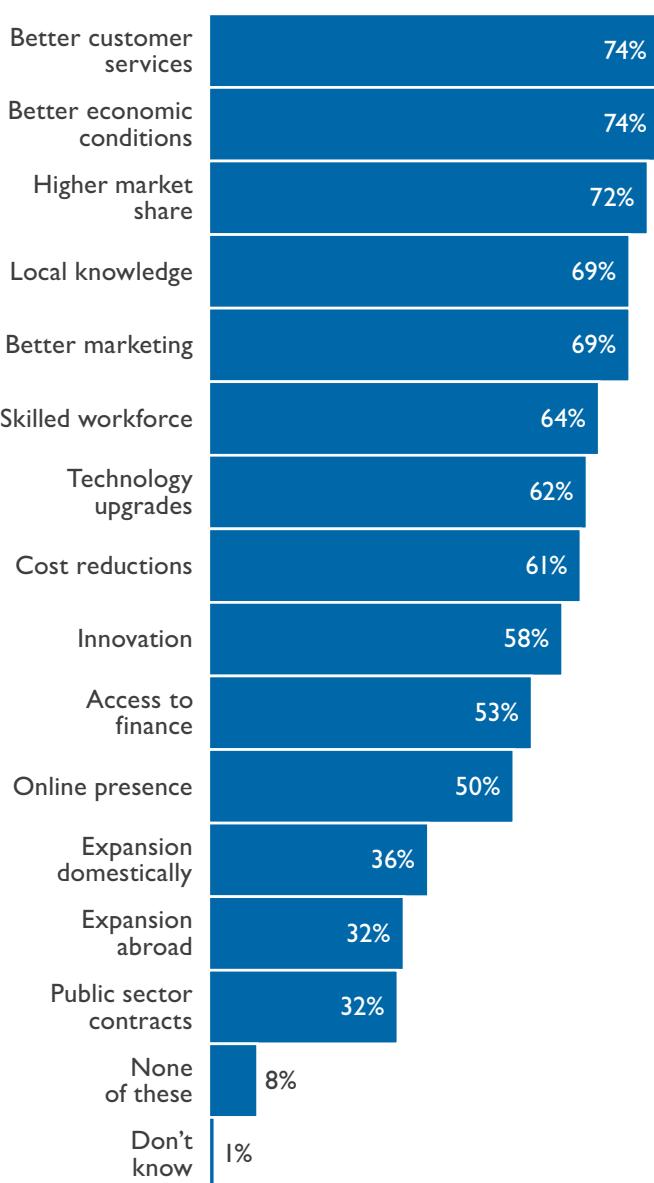
Index value of business confidence in economic prospects over the next 12 months



SOURCE: ICM SURVEY, ICAEW/GRAANT THORNTON BUSINESS CONFIDENCE MONITOR Q3 2015, CEBR ANALYSIS



Drivers of growth for HGSBs over the last 12 months



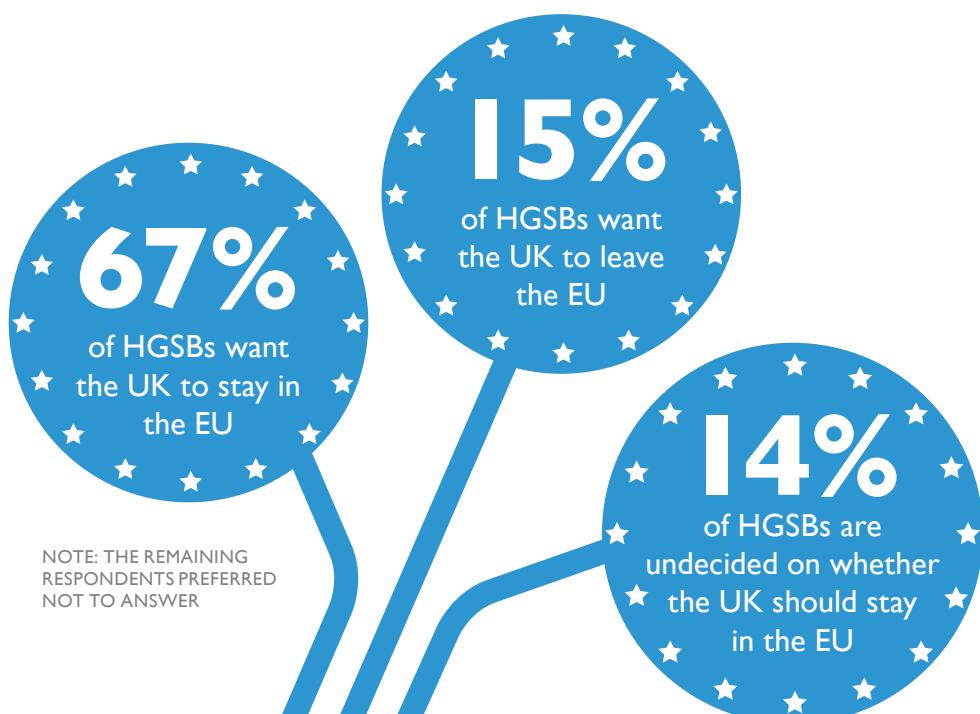
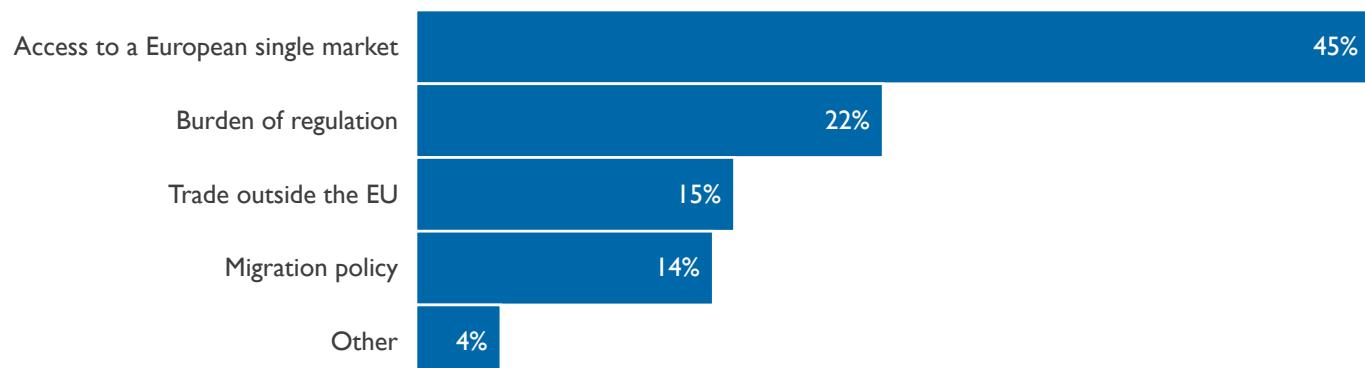
The importance of a stable policy environment and remaining in the European Union

HGSBs like a stable policy environment. They are overwhelmingly against a UK exit from the EU, mainly because they value access to the single market. Trade and migration policy are secondary reasons for wanting to remain in.

Exporting and expanding into new markets is not a strategic priority for many HGSBs

Not many HGSBs see overseas expansion as a priority, despite one third of respondents citing it as a key driver of growth. In the coming year only 18% of HGSBs expect to increase the number of countries they export to. With the right support, there is an opportunity to get more HGSBs exporting and expanding overseas to address global markets.

The most important deciding factors for HGSBs' vote on the EU referendum



High growth for every region: our policy recommendations for empowering HGSBs to drive growth and create a more balanced economy

Regions outside London and the South East have a surprisingly large number of HGSBs and huge potential for further growth, but are being held back due to the lack of the connections and resources that HGSBs need.

We call on Government to extend the full benefits of HGSBs to all regions of the UK, helping rebalance the economy and address the North-South divide.

Government has made great progress in fostering smaller company growth and backing UK entrepreneurs. In fact all political parties have been thoroughly supportive of HGSBs.

But this report gives a compelling case for doing more. The challenges HGSBs face and the potential they have to unlock regional growth have clear implications for policymakers.

Geographical inequalities will always exist, and the UK's regional diversity is a great asset. But by narrowing the gaps – creating the right conditions for HGSBs across every region – we can enable a more balanced and prosperous economy, getting behind our high growth success stories while creating many new ones. This is the big idea that shapes our policy recommendations.



25%

more HGSBs in every region in the next five years would create...



170k

new jobs across the country



...approximately

£22.5 billion

in additional turnover...

Make sure HGSBs get the support they need wherever they are by expanding the role of Local Enterprise Partnerships in all parts of the UK

At present the quality of support available for HGSBs varies greatly across the UK, and many regions looking to attract HGSBs are not yet equipped to match the fantastic business experience that London and the South East offer. The new devolution deals offer a unique opportunity for integrating business services within local authorities, through the use of the Local Enterprise Partnership (LEP) network.

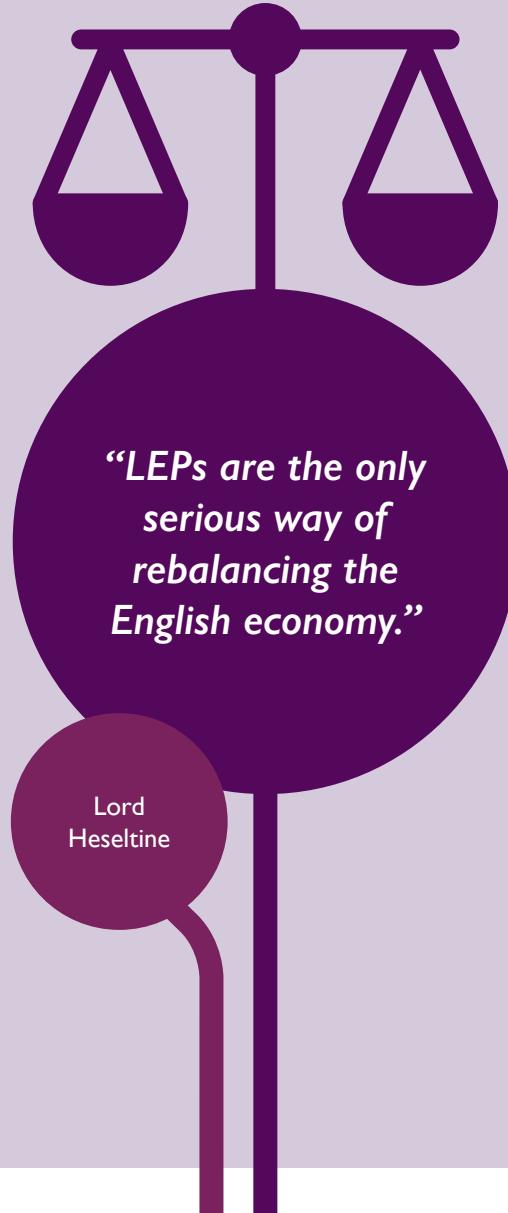
We recommend:

I. Developing the LEP network to create a dedicated 'one-stop shop' service for HGSBs in each region

LEPs offer a great existing structure for supporting local business. We propose that the current framework of LEPs in England, and their equivalent bodies in Scotland and Wales, are developed (and in some cases reformed) to create a 'one-stop shop' service that gives HGSBs a single point of contact for advice and funding as they grow.

Current schemes such as the Growth Accelerator Programme and business support are often difficult for HGSBs to access, or unknown resources for entrepreneurs. But with the local authority landscape changing and devolution deals giving opportunity to new combined authorities, now is the time to connect HGSBs with the support they need, by consolidating and devolving such schemes to a local level.

LEPs provide an ideal structure for achieving this, enabling combined authorities to use existing networks to administer devolved and integrated skills, funding, business support and mentoring as a single, comprehensive service, focused on local business needs while conforming to national standards.



"LEPs are the only serious way of rebalancing the English economy."

Lord
Heseltine

2. Making sure LEPs demonstrate a clear strategy for supporting HGSBs, including continued expansion of the enterprise zone model

To support this strategy, we recommend that LEPs are required to record data on HGSBs on an annual basis. This can be fed back to policy makers to make sure that the right measures are put in place.

We also recommend that LEPs are encouraged to promote the top 50 HGSBs in their area. We need to get better at celebrating our successes and inspiring regions to champion HGSBs that are making a difference on their doorstep. This programme could be extended to create a national index of the top-1000 HGSBs in the country, led and promoted by LEPs in conjunction with the enterprise and business community in their area.

Enterprise zones have been created on the right principles, with the potential to provide effective regional growth points where like-minded, mutually supportive businesses are clustered. We call for a clear strategy and a programme of measures that enable LEPs to replicate this model across the UK.

3. Requiring LEPs to have strong business representation at board level

To achieve a consistent standard and become a leading force in unlocking the HGSB potential across the country, LEPs need to understand the needs of these businesses and have strong business representation on LEP boards.

LEPs should be built into emerging local partnerships, and we also recommend that local business ratepayers elect a business representative to sit on the combined authority boards.

To make sure that devolved budgets are managed and spent in a way that maximises benefit for both the taxpayer and business, local integrated partnerships should also have people with relevant business experience involved at senior decision-making level. In light of the role that they may have in setting business rates in areas with elected mayors from 2020 onwards, this will be even more crucial.

LEPs should also recruit business angels to champion the development of a strategy for supporting HGSBs and mentoring entrepreneurs in their area.



"We are seeing enterprise zones across the country create thousands of jobs and billions of pounds of investment, boosting the local and national economy."



James Wharton MP
Minister for Local Growth and the Northern Powerhouse



"Local Enterprise Partnerships are an essential requirement in driving local devolution arrangements."



Rt Hon Greg Clark MP
Secretary of State for Communities and Local Government

Solve the missing links in infrastructure and create a better connected economy

To participate in the growth that HGSBs can drive, all parts of the UK must be digitally and physically accessible to business. Urbanised areas will inevitably be better connected, but there is enormous scope to create new growth potential by targeting parts of the country that have yet to be effectively linked into the high growth opportunity.

We recommend:

I. Accelerating the spread of effective mobile and broadband connections to all regions

Digital connectivity is key to the UK's economic future, yet according to Ofcom, 15% of UK business premises can't receive 10Mbps - the usual requirement for a typical household. Areas with inadequate broadband are often more remote and so have poorer mobile services too. These tend to be the areas with a low number of HGSBs. Technology can transform the connectivity of these areas, encouraging local entrepreneurs and opening up new economic horizons for communities.

Government is making good progress towards its goal of having 95% of UK premises online by 2017, but challenges such as a lack of competition are slowing down the process. We therefore propose that Government:

- Provides the business community with a forecast of broadband infrastructure projects so that investment decisions can take account of future connectivity.
- Opens up competition for broadband provision, working with smaller, local businesses while encouraging BT and other communication companies to invest in harder-to-reach areas of the UK.
- Expands the procurement process, with incentives for smaller tech companies to tackle specific regional digital connectivity issues.

The Government has made good progress rolling out free public WiFi. The Superconnected Cities programme has seen free public WiFi installed in more than 1,000 buildings in 22 cities across the UK. Leeds, Bradford, Oxford, Manchester, Salford, York, Edinburgh, Cardiff and Newport all now have public transport WiFi. The findings of this report provide a strong case for continuing to drive forward with these programmes as quickly as possible.



Ed Vaizey MP
Minister for the
Digital Economy

2. Investing in transport infrastructure to connect business hubs

This report shows that in regions with higher growth one of the main concerns is inadequate transport links, both locally and with the rest of the country. We therefore need to improve connections between the busy centres and the less developed regions.

HS2 and rail electrification will address North-South connectivity in line with Government ambitions for a Northern Powerhouse, but other areas of the country remain in need of better transport links.

We propose that Government establishes a Commission on Cities and Transport, to examine which leading regional cities most need improved transport links in order to achieve growth. This could be part of the Government's development of the new National Infrastructure Commission. Improving accessibility to the regions and enabling people to feel connected to big hubs and cities will help more HGSBs to flourish outside of London and the South East.

To reduce dependence on a few large national investments, the Commission should set civic leaders the task of finding innovative ways to finance new urban transport infrastructure. Creating an environment of civic entrepreneurship should provide a stimulus for more effective private-public collaboration on infrastructure projects.

"The Government could do more to encourage businesses to set up outside London, which is full to bursting anyway, to help address the North-South divide. If the Government gets the right infrastructure in place and supports regional activity and connectivity then there is no reason why you can't be based outside of London. Leeds, for example, is accessible by train in just over an hour from London."

Nigel Hart, Operations Manager of Atwell International,
HGSB based in Worcestershire

"The Northern Powerhouse is never going to happen unless the Government invests into the infrastructure up here. The roads are terrible. People feel that all the money is invested in infrastructure in the South. I think they're investing money in the wrong place, which is a shame as there is lots of potential for growth companies to be successful here if they have the right support."

Lisa Pogson, Director of Airmaster Air Conditioning, HGSB based in South Yorkshire

Reduce the risk finance gap by connecting HGSBs with the funding they need

Securing funding to launch, live and grow is the biggest challenge HGSBs face in all regions of the UK. London's global status makes it relatively easy for HGSBs to attract finance, showing the difference that viable funding options can make.

We recommend:

I. Raising the profile of existing finance initiatives

A prudent first step is to promote proven schemes that are not yet being fully used. These include the Angel CoFund, the British Business Bank, Catapult Centres, Venture Capital Trusts, Enterprise Investment Schemes, Seed Enterprise Investment Schemes, entrepreneurs' relief and start-up loans. LEPs can play a role (if developed into a one-stop shop for HGSBs as recommended on pages 24 and 25) in raising awareness and signposting HGSBs to the various funding options available to them – at a local, regional and national level.

1 in 4

HGSBs finds
it difficult to get
the funding they
need...



The VCT sector raised £429 million in the 2014/2015 tax year for UK smaller companies¹

...of these

75%
said it was a
significant barrier
to growth

2. Using tax incentives to channel money to the HGSB sector

Creating tax incentives to attract investment into certain areas of the economy is a well-trodden path. We propose the following steps, using existing tax efficient frameworks, to increase investment into HGSBs:

I. Continuing to promote Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EIS)

These offer a tax advantage on investments in HGSBs. Launched over two decades ago, these government approved initiatives have been a brilliant success for the UK. Over the years successive governments have shown their commitment to ensuring these schemes remain effective champions of UK enterprise and smaller companies. They now have a long established and proven track record of supporting HGSBs, and are the envy of many entrepreneurs in other countries. We welcome the Government's work to date in this area and recommend policies that continue to protect and promote these products. A large number of HGSBs are still unaware of these funds and with two decades of success behind them more needs to be done to raise awareness and promote them.

II. Encouraging more corporates to invest into HGSBs and our entrepreneurial ecosystem

Corporations have significant excess cash and would be ready to respond to incentives for investing in entrepreneurial business, thereby gaining access to the growth these businesses are creating by disrupting existing markets. A previous UK scheme failed in 2010 because the investment incentives were insufficient, but a similar scheme in the US has proved that, with the right incentives, the approach can be effective. We recommend introducing a new, simplified scheme based on the existing VCT structure, with incentives geared to attract corporate investment. We propose that companies investing in VCTs can claim a 30% rebate on the cost of investment (as individual investors currently do), thereby creating an entirely new pool of funding for HGSBs.

"If I were in Government, tax breaks for high growth small business would be top of the agenda. I would also ensure these types of businesses have better access to investment and growth funding."

Nigel Hart, Operations Manager of Atwell International, HGSB based in Worcestershire

III. Tax incentives for UK pension funds that invest in Venture Capital Trusts (VCTs) and Enterprise Investment Schemes (EIS)

Venture capital investment can complement pension funds, with their long-term investment horizons and focus on creating a stable savings base. But investment in venture capital by UK pension funds has declined sharply in recent years, largely due to lack of understanding of the asset class.

We propose that UK pension funds be allowed to claim 30% of the amount they invest in venture capital (accredited through either the VCT or EIS regimes) from HRMC. This is the same level of tax incentive currently available to retail VCT and EIS investors and would provide pension funds with a level of protection against such investments not being successful – something that compensates investors for the higher risk and encourages investment. Pension funds would be required to hold shares in VCTs or EIS for a minimum of five and three years respectively in order to be eligible to claim this tax relief.

3. Changing the Tier 1 (Investor) visa requirements to channel the investment towards beneficial small business growth

Under the current Tier 1 (Investor) visa requirements, a migrant can invest in UK gilts, as well as certain unlisted trading companies.

We recommend that Tier 1 (Investor) visa revenues are channelled solely into UK trading companies, as defined by the current legislation, and the legislation is amended to enable investment into listed Venture Capital Trusts, which are already subject to strict investment criteria as set out by Government.

A change in the rules to this effect would ensure revenues from Tier 1 (Investor) visas are being invested in UK companies that have a direct link to UK job creation and economic growth. This would be more beneficial to the UK economy than the current policy, which often results in migrants investing in UK gilts.

The change would require very little additional oversight and the route is already regularly reviewed by HM Treasury.

“The opportunities of the digital economy and of ‘knowledge intensive’ jobs must be seized by both our Government and businesses. Britain is in a strong place to do that, but without new skills, investment and dynamism we are going to get left behind.”

Rt Hon
Yvette Cooper MP

4. Opening up the individual savings account (ISA) investment market to give HGSBs better access to capital

We propose allowing private shares to be held in ISAs, to improve access to capital for fast-growing businesses and to give savers greater choice. The new higher ISA allowance and Peer-to-Peer ISAs have increased interest in ISA investing, making this a good time to act. The changes would not require significant legislation and are likely to get the support of businesses and investors.

At present, people will only be able provide debt to unquoted companies through Peer-to-Peer ISAs, preventing them from accessing the potential growth and upside that can come with early stage equity investing. Debt in smaller companies is often as risky as equity as there is no equity buffer, which doesn't seem fair on investors. Opening up the ISA market to unquoted trading companies will enable investors to have the choice to access the growth of HGSBs through either equity in a traditional ISA or debt through a Peer-to-Peer ISA.

5. Making sure that Peer-to-Peer ISA investments benefit HGSBs

The recent changes will allow peer-to-peer investments to count towards ISA allowances, with any interest received free from income tax. This change was made to create an innovative way of funding growth for small businesses.

We propose that Government adds conditions to prevent large, established corporates from using this platform to raise debt, which could crowd out HGSBs from this valuable source of funding.

6. Supporting AIM, the world's most successful growth market

Listing on AIM is an excellent strategy for smaller companies to fund their growth. The market is one of the UK's most important assets, and where AIM flourishes, the UK reaps the benefit in terms of tax receipts and employment growth. We propose that Government dedicates resources towards ensuring that the regulatory and tax environment encourages UK businesses to list on AIM, and encourages both UK and overseas investors to invest in smaller companies. AIM celebrated its 20th birthday in June this year and over the last two decades has proved a valuable platform for growth for many high growth small businesses. More than 3,500 companies have joined AIM and it has raised over £90 billion to support their development. It is the world's most successful growth market – no other country has a market like it.



“AIM is responsible for a £25bn contribution to UK GDP and almost three-quarters of a million jobs in Britain alone.”

Xavier Rolet
CEO, London Stock Exchange

7. Reducing tax burdens on HGSBs where possible during their growth phase

Tax cuts remain high on HGSBs' wish list. We propose:

I. Deferring Corporation Tax

HGSBs often face large Corporation Tax bills within the first few years of operation, drawing off money that could be better spent on growth. We welcome the Government's commitment to maintaining the most competitive business tax regime in the G20 and believe that one way of achieving this is through a Corporation Tax regime that supports HGSBs. We therefore ask Government to permit fast growing companies to defer their payment of Corporation Tax while in early growth. By allowing this money to be invested rather than paid out immediately in tax, the Exchequer is likely to get higher returns from these companies in the medium term. HM Treasury could set interest payments at higher levels than gilt yields, and such a policy shift could even add an interest charge to the original tax bill in return for the deferral of payment.

“All Corporation Tax does is cause businesses to act in suboptimal ways. Reduce Corporation Tax for the businesses that are most important to the economy’s growth and allow SMEs to celebrate their success.”

Ben Marks, MD of YouthSight,
HGSB in London

II. Enabling small companies with cash accounting to offset losses against previous employment income

Liberalised rules introduced in 2013 allow the smallest companies to account for income and expenses on a cash basis. This should make it easier to set up businesses – but at present, anyone wanting to offset losses against previous PAYE income needs to prepare accounts on a GAAP basis, limiting the effectiveness of cash accounting. To realise the benefits of cash accounting for encouraging entrepreneurship, we propose that HMRC recognises cash accounting losses and allows them to be offset against PAYE.

Tackle the shortfall in talent by bringing in the brightest and best from around the world

HGSBs surveyed in this report told us that they regularly rely on skilled migrant labour but have found that recent visa restrictions make it harder to access such talent. The relative abundance of skilled labour in London and the South East is another reason why HGSBs are concentrated here, indicating the difference talent could make to growth across the UK.

HGSBs are overwhelmingly in favour of policies that would enable highly skilled workers from overseas to come and work in the UK. We have confidence that the Government is building a skills base for the next generation (for example by being the first country in the world to make coding lessons mandatory). But for the short term, we would welcome measures to make overseas talent more immediately available to HGSBs in every region.

We recommend:

- Making it easier for venture capital firms to act as sponsors for the migrant talent their investee companies need, for example by creating a talented migrant worker bond.
- Creating new visas aimed specifically at recruiting talented graduates with specific degrees and skills, for example coding.
- Using the LEP network to help businesses find the right talent, for example by creating collaborations between business and universities.

“We have regularly had to attract talent from around the world. Finding people with the right skills was incredibly challenging.”

Richard Gibson, Director at SwiftKey,
HGSB based in London



Lessen the uncertainty and keep full access to European Union trading and skills

HGSBs need a stable policy environment in order to plan and execute strategy. The General Election and wider economic slow-down have led to a slight fall in confidence among HGSBs during the last year, and the question of UK membership of the European Union (EU) has further compounded uncertainties about the future.

We recommend:

Campaigning for continued UK membership of a reformed EU

We urge Government to push for continued EU membership, while at the same time calling for regulatory reform, to cut red tape and make it easier to employ skilled migrant workers.

Only 15% of HGSBs surveyed for this report said they wanted to leave the EU. The overwhelming majority wants to stay, and more than half oppose leaving because they value access to the single market. Trade and migration policy are secondary reasons for wanting to remain in. Almost two thirds of those wanting to leave the EU cited the regulatory burden as an important factor in their decision, with migration policy the next most important reason.

“The UK is the European destination to launch innovative new businesses. It is the natural gateway to a market of 500 million European consumers and a natural bridge to the US. This global outlook, and a dynamic entrepreneurial economy, make it the natural choice to start, run and grow your business.”

The Innovation Nation Report,
British Venture Capital Association, October 2015



Narrow the trade gap by helping HGSBs export more

We also call on Government to encourage HGSBs across all regions of the UK to export more. Only half of the companies surveyed in this report sell their products or services outside the UK, and these are only to a small number of countries.

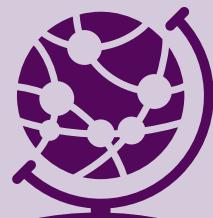
UKTI (UK Trade & Investment) will have a key role to play in helping small businesses export their activity. It already provides excellent opportunities for HGSBs and has a good track record of promoting businesses abroad. Our report shows, however, that many companies that could benefit are not accessing support from UKTI.

We recommend that UKTI:

- Carries out research to identify companies that could benefit from help, and pro-actively engages with them.
- Creates dedicated HGSB international trade envoys to ensure these businesses are well represented overseas.
- Works with Local Enterprise Partnerships to make expert guidance on international expansion accessible to HGSBs in all regions of the UK.

“Our international expansion, especially in the US, has been fundamental to our success – it’s vital that the framework and support is in place for other high growth small businesses to follow this path should they wish to.”

Joshua March, Founder and CEO of Conversocial,
HGSB based in London



“Those companies that have access to agencies like UKTI find it extremely useful when looking to expand internationally. However we need to raise awareness about the services and help that they can offer.”

Tom Thackray
Head of Enterprise
at CBI

HGSBs have shown their power to create jobs, wealth and confidence in every corner of the UK.

Now they have a bigger role to play, in shaping a new geography of regional economic powerhouses. We call on Government to target a 25% increase in HGSBs in every region within the next five years, through the practical steps we've described:

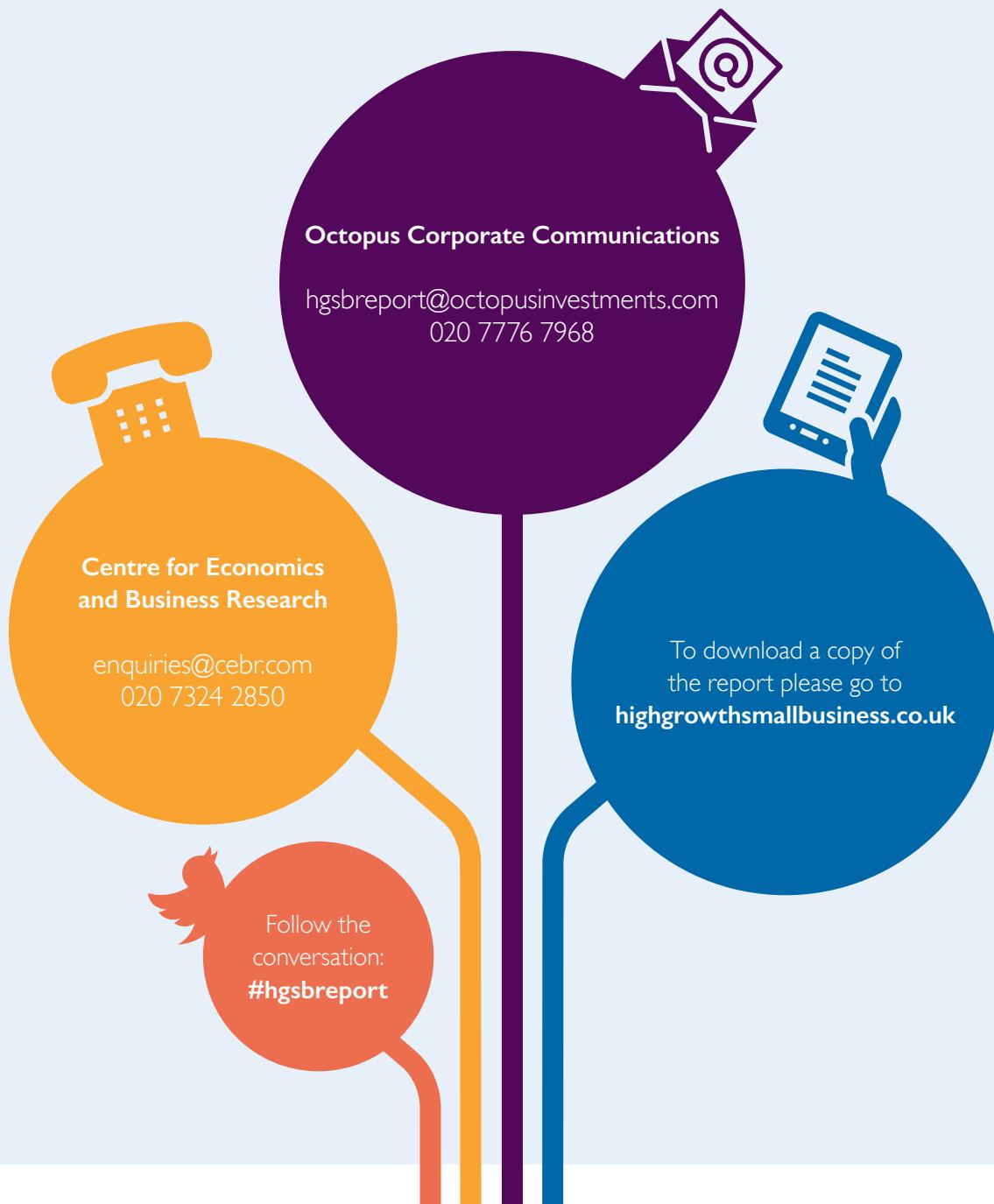


Contact us

If you would like to talk to Octopus about this report or our support for UK smaller companies, please contact our Corporate Communications team.

For further information about the methodology and research data included in this report please contact the Centre for Economics and Business Research (Cebr).

All data and graphs are prepared by Cebr and ICM Unlimited.



About the contributors

Octopus

Octopus transforms the industries that really matter – like investments, healthcare and energy. We do extraordinary things so that our customers see change for the better. Octopus is a fast-growing UK fund management business with leading positions in several specialist sectors including smaller company investing, healthcare property, energy and property finance.

Founded in 2000, Octopus manages more than £5 billion of funds on behalf of 50,000 investors – both retail and institutional. Over the years we have invested in more than 500 SMEs including household names such as LOVEFiLM, graze.com and Zoopla Property Group. Our investments have helped these businesses to create thousands of new jobs.

octopusinvestments.com

Centre for Economics and Business Research (Cebr)

Cebr is an independent consultancy which advises some of the world's largest companies. Cebr's reputation for insightful economic analysis, award-winning forecasting and decisive business advice is based on innovative research by a renowned team of macro and micro-economists.

Since its foundation in 1993 by former CBI and IBM Chief Economist, Professor Douglas McWilliams, Cebr has been 'making business sense' by applying theoretical economics backed by quantitative evidence to real world decisions for companies. It provides analysis, forecasts and strategic advice to major multinationals, financial institutions, government departments, charities and trade bodies.

cebr.com

ICM Unlimited (ICM)

ICM's clients act with confidence. They have a research partner that brings clear-cut insight to the table. A full service agency that works fast. With imagination. With rigour. One that works with brands like the BBC, Aviva, Sainsbury's, The Guardian and Vodafone. One that wants to work with you. Take a look at our work to find out what we can do for you. Part of Creston Unlimited.

icmunlimited.com

