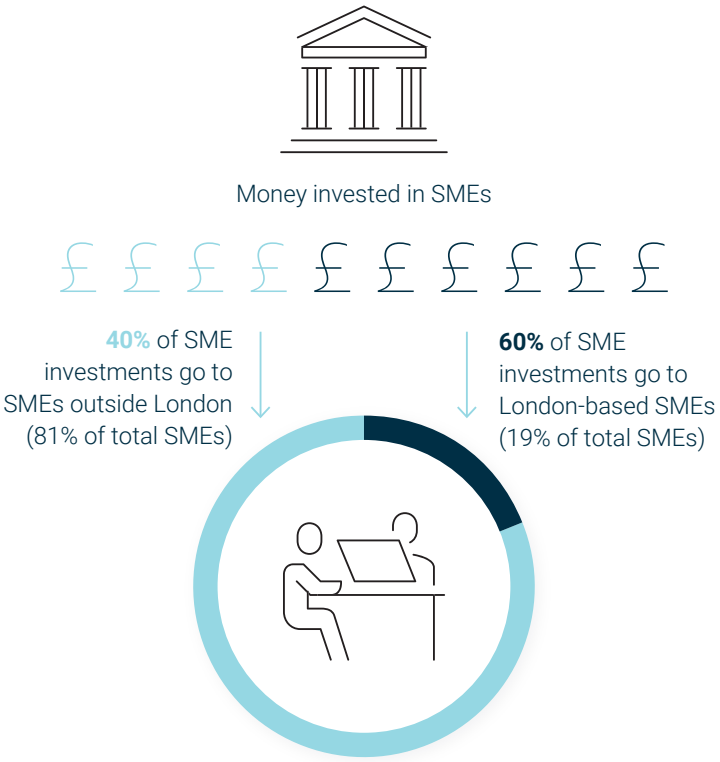
Swoop

The **One-stop** Money Shop for Business

What's driving the regional imbalance in UK SME funding?

Executive summary

UK SMEs may be facing a challenging environment, with Brexit uncertainty weighing on the domestic economy and business sentiment, but the value of investments into the sector hit record levels in 2018. The problem is small companies based in London are receiving a disproportionate amount of these investments. According to the British Business Bank (BBB), 60% of the money invested in SMEs goes to companies in London, even though the capital only hosts 19% of the country's SME population. That leaves 40% for the other 81% of companies outside London.

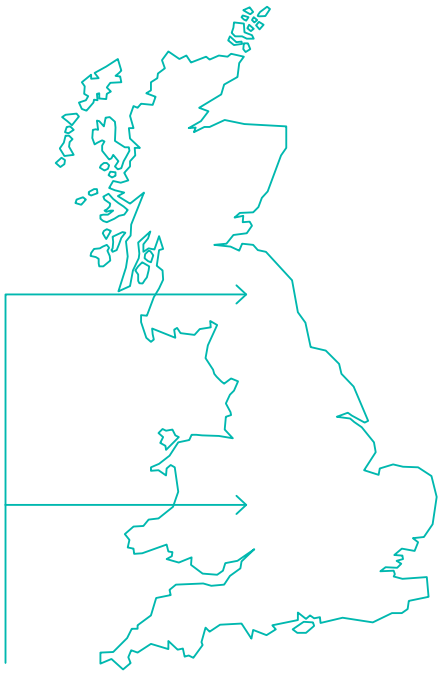


There are several possible explanations for this disparity, including a lack of awareness among SMEs in the regions, London's dominance as a global financial hub and the concentration of angel investors in the capital.

However, there are signs that the gap is narrowing. BBB research shows the amount invested in SMEs outside London increased by over £600 million in 2018. Firms in the West Midlands and the North East were beneficiaries of what are known as 'mega deals' worth more than £100 million, and some regions saw an increase in the volume of equity deals. Furthermore, the BBB recognises the imbalance and has launched several programmes to boost demand and build awareness in the regions.

Money invested in SMEs outside London

+ £600 million



Firms in the West Midlands and North East were beneficiaries of 'mega deals' worth £100 million

The SME finance ecosystem

While small businesses tend to be reluctant to take on external funding, data shows it can have a direct impact on the bottom line. According to the Scaleup Index 2018, published by research firm Beauhurst and the Scaleup Institute, 42% of high growth firms that increased their annual turnover by more than 100% used equity finance. In contrast, among companies that improved their turnover by between 20% and 40%, only 17% used equity finance[1]. A similar pattern emerged in employee growth rates.

Record breaking year for SME investment

Investment values hit record levels in 2018, according to the BBB's Small Business Equity Tracker 2019[2]. The figure increased by 5% to £6.7 billion, suggesting the UK equity ecosystem has matured and can now support growing companies. Meanwhile, the number of deals fell 6% to just over 1,600 and have remained flat since 2015. The trend towards fewer but larger equity deals reflects the global venture capital (VC) markets.

The BBB identifies two factors it believes are driving investment values. VC funds are growing, and bigger funds make larger investments. And as the UK equity market continues to mature, demand is rising among SMEs that have previously raised finance. The data backs this up- deal numbers increased in more advanced growth companies.

The gap in regional financing

Investment values may be at a record high, but they aren't evenly spread across the UK. Figures published in the BBB's Small Business Equity Tracker show 59% of investment value went to SMEs based in London even though it only hosts 19% of the UK SME population. That means the rest of the country, which is home to 81% of small companies, shared just 41%.

In terms of the number of deals, London received almost half. To put these figures in perspective, in 2018 London got 6.8 deals per 10,000 SMEs, compared with 1.9 in the regions. Further proof of the imbalance can be seen in a list of the 25 Local Authority Districts (LADs) with the highest number of equity deals in 2018. Eleven of the top 25 and eight of the top ten LADs were in London (Edinburgh ranked fifth and Cambridge ninth).

However, there were signs that the gaps are narrowing.

London was still the largest market in 2018 but saw investment values fall, while the rest of the country experienced an increase of £616 million (29%) to £2.8 billion. This rise was driven by bigger deal sizes, particularly at the growth stage, especially in the East of England, the North East and the West Midlands. For example, one company in the North East received what the BBB classifies a 'mega deal' of £149 million and another in the West Midlands secured £100 million. The national average was £4.5 million.

Overall deal volume fell in the UK in 2018, although some regions experienced an increase- the North East grew by 65%, Yorkshire and the Humber by 15% and Wales by 11%. The East of England and East Midlands also saw small increases.

The equity finance gap

According to the Equity Finance and the UK Regions report published by the Department for Business, Energy and Industrial Strategy in July 2019, there is demand for equity- what it calls the equity finance gap- among SMEs in the regions[3]. The East Midlands has the biggest gap in relative terms- for every £1 of investment received in 2017, it could absorb £9 more, followed by Yorkshire and the Humberside and the West Midlands. The North East was the only region outside the capital without an equity gap.

Why the disparity?

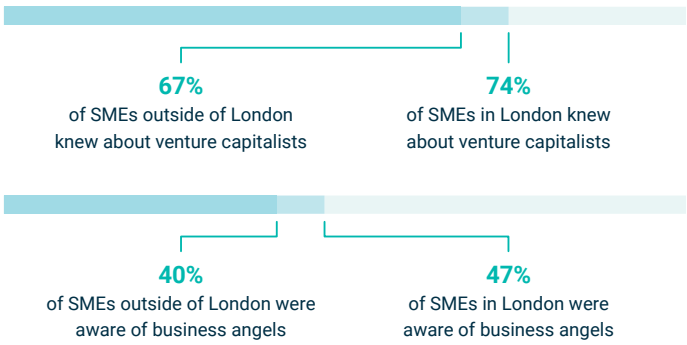
So, what's behind the imbalance in regional financing?

Lack of awareness

According to the latest version of the BBB's Finance Survey, awareness of the different sources of external funding varies by region[4]. While 74% of SMEs in London knew about venture capitalists, that figure fell to 67% elsewhere in the country. Likewise, only 40% of small companies outside London were aware of business angels compared to 47% in the capital. However, the good news is awareness in both categories in increasing in the regions.

A possible explanation for this disparity is that sources of funding tend to locate in the capital, and investors prefer to work with local companies.

According to private market data provider Pitchbook, 75% of investors who list VC as one of their strategies are based in London. VC firms are extending their reach though. Eight of the 11 regions outside London saw an increase in the presence of active VC investors between 2017 (the last time this data was collected) and 2019 with Wales, Yorkshire and the Humberside and the South West enjoying the fastest growth[5].



[1] http://about.beauhurst.com/wp-content/uploads/2018/11/ScaleUp-Index-2018-WEB-5_11_18.pdf
[2] https://www.british-business-bank.co.uk/wp-content/uploads/2019/06/Small-Business-Equity-Tracker-2019.pdf
[3] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/821902/sme-equity-finance-regions-research-2019-012.pdf
[4] https://www.british-business-bank.co.uk/wp-content/uploads/2019/02/Business-Finance-Survey-Report-Final.pptx
[5] https://www.british-business-bank.co.uk/wp-content/uploads/2019/06/Small-Business-Equity-Tracker-2019.pdf

London's financial might

London attracted a disproportionate share of equity investment and deals in SMEs in 2018 thanks to its mature financial sector, its reputation as a global finance hub and the concentration of sectors that rely most on this form of financing, such as technology and professional services. However, the volume of deals in the capital fell slightly from 51% in 2017 to 48% in 2018, while several other regions- the North West, East of England, Scotland, the South West and Wales- experienced growth over the same period.

Angel activity concentrated in the capital

High Net Worth Individuals who make direct equity investments are an important source of funding for small companies- even more popular than VC. But 57% of business angels are located in London and the South East according to the latest version of the UK Business Angel Market Report, alongside some of their favoured sectors such as Fintech (80% of London-based angels invested locally). That explains why SMEs in London and the South East received the bulk of their investments at 47%[6].

Redressing the balance

The BBB has taken several steps to narrow the gap between London and the regions.

Regional investment programmes

The BBB runs three regional investment funds in an effort to increase the availability of finance for SMEs around the country.

Launched in 2017, the Northern Powerhouse Investment Fund (NPIF) was given a pot of £400 million to back microfinance (£25k to £100k), business loans (£100k to £750k) and equity finance (up to £2m) in small companies in cities like Manchester, Liverpool and Leeds.

The NPIF is currently in the second year of its ten-year programme, and the BBB published an early assessment report In July 2019 . The report indicates that the NPIF has been successful in achieving its goals to date, with some of the highlights including:

- The fund received 3,764 inquiries and 820 applications from SMEs
- It exceeded its targets by making 419 investments with a total value of £86 million
- 60% of SMEs reported they wouldn't have secured equity investment without the help of the NPIF
- 85% of respondents who received funding claimed they feel more confident about securing finance in the future
- More than 60% of businesses who received funding through the NPIF reported an increase in turnover

The BBB also launched the Midlands Engine Investment Fund (MEIF) and the Cornwall and Isles of Scilly Fund (CIOSIF) in 2018. The MEIF has £250 million to back small business loans (£25k to £150k), equity finance (£50k to £2m), debt finance (£100k to £1.5m) and proof of concept (up to £750k) for SMEs based in the Midlands region. The CIOSIF has been allocated £40 million to provide debt (£25k to £1m) and equity (£50k to £2m) finance to SMEs in the South West

Building awareness

The BBB has introduced several schemes to build awareness of the different sources of funding in regions outside the capital:

- The Demand Development Unit (DDU) is responsible for helping SMEs understand what financing options are available and which are most suitable for them and for reducing regional imbalances
- The Finance Hub is an online resource launched by the DDU to provide independent advice about the debt and equity finance options available to SMEs
- The UK Network has employed regional representatives to engage stakeholders and develop a thorough understanding of finance ecosystems to improve collaboration and coordination
- The Regional Angels Programme has a budget of £100 million to increase the awareness and availability of angel investments in parts of the UK that are under served by this form of finance

[6] https://www.british-business-bank.co.uk/wp-content/uploads/2018/06/Business-Angel-Reportweb.pdf

nimble

PLANT BASED CLEANING PRODUCTS

The Swoop effect – Nimble Babies

The challenge

Professional chemist Von Sy founded Nimble Babies after his sister complained about how hard it was to clean her daughter's milk bottles. Von launched his solution, which he called Milk Buster, in 2015.

Von wanted to expand his business by bringing more plant-based cleaning products to the market. However, he had invested all his money in the launch of his first product, so he needed to source additional funds.

The solution

Swoop helped Von navigate the daunting process of securing external funding and introduced him to potential sources, ranging from tier one to invoice finance. Our team explored the various options with Von, and he decided equity finance was the best solution for his business. Not only would this provide solid cash flow and working capital to fulfil large orders, but he'd also benefit from the advice of experienced mentors.

The results

Thanks to the funding Von secured through Swoop, Nimble Babies now has 10 products in its portfolio and has won multiple awards. The products are available in 87 Boots stores around the country and online via Boots, Ocado and Amazon. The company also exports overseas and hopes to be stocked in more Boots stores as well as other high street retailers.

"The Swoop team was great in teaching me about the whole funding process, which was very confusing and daunting for someone who's never done it before. They suggested funding sources that I'd never even heard of, and it was like having my own internal fundraising team who did all the research and contacting for me! All I needed to do was to turn up to the meetings and dial in for the phone calls they arranged, which was so helpful given that I was having to run the business at the same time"

Von Sy, Founder,
Nimble Babies

Swoop

Get in touch

To find out how Swoop can help your business grow,
visit swoopfunding.com
or email hello@swoopfunding.com