A Fighting Chance

Avoiding a small business cashflow crunch and empowering a post-COVID recovery

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WHO WE ARE

The Federation of Small Businesses (FSB) is the UK's leading business organisation. Established over 40 years ago to help our members succeed in business, we are a non-profit making and non-party political organisation that's led by our members, for our members. Our mission is to help smaller businesses achieve their ambitions. As experts in business, we offer our members a wide range of vital business services, including legal advice, financial expertise, access to finance, support, and a powerful voice in government.

FSB is the UK's leading business campaigner, focused on delivering change which supports smaller businesses to grow and succeed. Our lobbying arm starts with the work of our team in Westminster, which focuses on UK and English policy issues. Further to this, our expert teams in Glasgow, Cardiff and Belfast work with governments, elected members and decision-makers in Scotland, Wales and Northern Ireland.

METHODOLOGY

This report draws from data collected from a survey of 1,306 FSB small business members between 24 July 2020 and 5 August 2020. The online survey was carried out by Verve on behalf of FSB, seeking views from businesses across the whole of the UK.

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Executive Summary

With the rapid development of viable vaccines appearing to now provide a light at the end of this dark tunnel, it would be easy to look ahead to 2021 with more optimism and a hope that conditions will gradually return to normality.

The COVID-19 crisis continues to have a huge impact on small firms, with lockdowns and restrictions to movement and trade affecting the UK economy for much of 2020.

Following lockdowns across all parts of the country, many areas in England, Scotland, Wales and Northern Ireland have moved into stringent local restrictions to movement and trade in the run up to the otherwise busy Christmas period. Despite the promise of vaccines now providing an eventual route out of the COVID-19 crisis, many smaller firms – particularly in retail, hospitality and entertainment sectors – will be entering the New Year under enormous financial pressures due to a perfect storm of:

- Poor Christmas trading due to local lockdown measures
- An end to Government's COVID business support schemes
- Carrying substantial and unsustainable debt
- Required repayments of emergency loans, due in April 2021
- Ongoing late payments and poor payment practices

The combination of these factors must be treated with the upmost urgency by Government, with many small businesses facing the real prospect of an impending cashflow crisis. There is a substantial risk that the first quarter of 2021 will herald a 'recapitalisation crunch' with business failures on an unprecedented scale.

FSB welcomed efforts by UK and devolved Government's to keep small firms afloat throughout the crisis, through a combination of job support payments, grants, loans and numerous other mechanisms. While we have frequently reminded Government that many businesses remained ineligible for some of these support schemes, it is clear that a vast number of small businesses would not have survived the crisis without them. However, in this regard, a failure to support small firms through the impending cashflow crisis of early 2021 would undo much of the good work carried out by Government throughout 2020. Small firms will play a vital role as the UK economy seeks to grow and recover following the crisis. But those small firms need to survive long enough to start paying back into the economy. Government must act now to put in place a coherent plan to support small firms in the transition to a post-COVID world. Government has invested a lot in small firms throughout the crisis, but to see a return on that investment it must enable these businesses to survive long enough to generate income.

The economic shadow cast by COVID-19 will be extensive, and the road to recovery will be long and dangerous. Many smaller firms begin that journey in poor health, having been battered and bruised by unprecedented turbulence over the last year. Many self-employed small business owners have been drawn in to increasingly unsustainable levels of debt, affecting both first-time and existing borrowers. Many will be re-emerging after an extended period of enforced dormancy, only to find that their customers – and the markets in which they operate – have changed.

They need time and space to understand their new environment, to invest in building their businesses back up to what they were, and adapt to the new normal. But to do this, they will need cashflow and capital, both of which are in tremendously short supply following an expensive and damaging world war on COVID-19. And as small firms take their first tentative steps towards rebuilding, they must do this knowing that much of the support they have been receiving from Government is due to come to an abrupt end and the loans that helped them survive the winter will soon need paying back.

The resulting debt overhang brings the need for a new attitude towards debt into sharp relief - one that will need to extend from existing debt arrangements, right through to the insolvency process, and restart. Similarly, as small firms seek to adjust to new operating conditions in volatile conditions, many small firms may need additional support with credit management and cash flow forecasting. Alongside support to manage existing debt and strengthen financial resilience, many small firms are likely to benefit from training and resources geared towards building fast, credible scenario-based cash-flow forecasts, and ensuring they have solid credit management tools in place to support decisions on staffing, growth, and to secure external finance.

Key Findings

Confidence

- Small business confidence has been in negative territory for 9 straight quarters.
- The 2020 Q3 UK SBI confidence figure stood at -32.6, down 28 points on last quarter.
- Only a third (34%) of businesses expect their performance to improve over the coming quarter. The significant majority (66%) expect performance to worsen.
- Almost half (49%) of small firms believe their revenue will still be down on pre-COVID levels this time next year, while only 29% think it will be up.
- A record one in four (25%) small firms said they reduced headcounts between Q2 and Q3 of 2020. An even higher proportion (29%) expected to make redundancies in Q4 – one in ten (12%) expected to let at least a quarter of their staff go.
- Widespread disruption has caused revenue growth to fall to its lowest recorded ebb, with more than half (56%) of small businesses reporting a drop. A similar proportion (50%) expect revenues to fall next quarter.
- 39% of small firms lack confidence in their longer-term survival (61% are confident their business will survive COVID).
- As a result of the COVID crisis, 29% of small firms have 'fundamentally changed' their business model.

Pre-COVID Debt

- Over half (56%) of small business owners had some form of debt prior to the COVID-19 crisis (i.e. 1st March).
- Of those small business owners that were carrying debt before the COVID-19 crisis, 46% were relying on their business bank overdraft, 38% on business credit cards, 30% on personal credit cards, and 27% on commercial loans.
- Of those small business owners that were carrying debt before the COVID-19 crisis, almost half (47%) were relying on personal finance (personal loans, personal credit cards, personal bank overdraft, personal mortgage).

COVID-related Debt

- As a result of the COVID-19 crisis, 34% of all small business owners have increased their levels of debt, either increasing the debt they already had before the crisis (20%) or taking on debt for the first time (15%).
- Of those small business owners that have taken on debt during the crisis, 77% say they have taken on more than £10,000. 60% have taken on more than £20,000. 45% have taken on more than £30,000. 21% have taken on more than £50,000.

- Of those small business owners that have taken on debt during the crisis, 64% have used the new BBLS support, 20% have increased their business bank overdraft, 17% have added to their personal credit card debt, and 14% have used CBILS.
- Small firms that accessed debt products during COVID-19 were more likely to be burdened by existing debt. Small firms carrying pre-existing debt into the COVID-19 crisis are more than twice as likely (48%) to have taken on additional/new debt as those with no pre-existing debt (23%). Those with pre-existing debt were also more than twice as likely (57%) to have taken on additional debt related to CBILS/BBLS, compared to those that had no existing debt (26%).
- Of those small business owners that have taken on debt as a result of the COVID-19 crisis, 29% have used personal finance (personal credit cards, personal loans, personal bank overdraft, personal mortgage) to support their business during this time.

Debt Burden

- As a result of the COVID-19 crisis, the proportion of small businesses carrying some form of debt has increased from 56% (pre-COVID) to 69% (post-COVID).
- The proportion of small firms using personal finance products for business purposes has also increased from 26% (pre-COVID) to 32% (post-COVID). This means that, of those businesses now carrying debt, just under half (47%) are using personal finance products to support their business.
- Small firms that have been required to fundamentally change their business model as a result of the COVID-19 crisis are more likely to have taken on additional or new debt (45%) compared to those that have not changed their business model (30%).
- Of those small businesses carrying debt, the proportion that describe their level of borrowing as 'unmanageable' rose from 13% (pre-COVID) to 40% (post-COVID). For those that borrowed for the first time due to COVID-19, this figure rises to 49%.
- Of those small businesses carrying debt, the proportion that describe their level of borrowing as 'significant' rose from 30% (pre-COVID) to 50% (post-COVID). For those that borrowed for the first time due to COVID-19, this figure is 42%.
- Of those small businesses carrying debt, one in six (16%) say more than 10% of their next year's turnover will go on debt repayment.

Repayment Options

- Whether they are carrying debt or not, many small firms are yet to utilise support through the taxation system, with just 16% saying they have used the Time to Pay service, 35% VAT payment deferral, and 11% self-assessment payment deferral. However, for those businesses that describe their current debt as 'worrying' or 'significant' these figures rise to 26%, 52% and 15%, respectively.
- Of those small businesses carrying debt, less than a two-fifths (39%) say they are confident that their lender would treat them fairly should a dispute arise and only 18%

felt confident that they would have fair redress through the Financial Ombudsman or other mechanisms.

- Of those small businesses carrying debt, only a fifth (21%) say they are aware of the role of the British Business Bank.
- Of those small businesses carrying debt, only a third (33%) believe the option of converting debt to equity would be a benefit to them. For those that describe their current debt as 'worrying' or 'significant' this figure rises to 38%.
- Of those small businesses carrying debt, more than half (56%) believe the option of converting debt to a tax liability would be a benefit to them. For those that describe their current debt as 'worrying' or 'significant' this figure rises to 63%.

Key Recommendations

IMMEDIATE SUPPORT FOR SMALL BUSINESS SURVIVAL

- The UK Government should take immediate action to provide debt-laden small firms with a reason to keep fighting. Many small business owners will worry about the imminent deadline for paying deferred VAT (31 march 2021). Government should give small businesses time to rebuild by extending this deadline until 31 March 2022.
- The UK Government should provide further breathing space to debt-laden small businesses by working with the Banking and Finance sector to push back the start of BBLS and CBILS repayments and increasing the length of time for which it covers interest rate payments on these loans (currently the first year).
- While *Pay As You Grow* is a step forward in management of BBLS debt, the UK Government must provide further clarity on the criteria that determine which firms have been 'heavily impacted'.

LONGER-TERM SUPPORT FOR SMALL BUSINESS RECOVERY

- The UK Government must take a holistic approach when assessing the needs of small firms and weighing options for targeted support based on comprehensive needs assessments.
- The UK Government should consider extending support for small businesses managing pre-existing debt, as well as debt accrued as a direct result of the COVID-19 crisis.
- In considering the totality of debt, the UK Government must examine how to formalise some of the flexibility offered by *Pay As You Grow* to cover other forms of debt, beyond the emergency BBILS support.
- The UK Government should consider the creation of a government run restructuring service, akin to the UK Recovery Corporation proposed by *TheCityUK.*
- The UK Government should consider the introduction of a new Successor Loan Scheme, which meets the needs of small firms.
- The UK Government should consider targeting specific aid at the most heavily impacted sectors, as well as local businesses that did not furlough or send staff on unpaid leave and acquired large debts as a result. This support could include tax reductions or loan write offs.
- Greater transparency is needed around contractual arrangements undertaken with finance providers.
- HMRC should recognise the impact that its move to preferential creditor and lender of last resort may have on small firms operating in supply chains, looking for opportunities to assist in areas like invoice financing and debt recovery.
- As a key pillar of Government's commitment to build a modern taxation system, the Making Tax Digital (MTD) platform must look to ensure small firms are alive to the various grants, reliefs and allowances they have not yet utilised.

- The UK Government should streamline the touchpoints small firms need to access in order to carry out taxation and debt repayment, and to access applicable financial support and services.

DISPUTE RESOLUTION

- The UK Government should provide small firms with clear pathways to dispute resolution, clearly articulating the breakdown of responsibility between the FCA, FOS and the newly created BBRS.
- HMRC should seek to utilise its move to preferential creditor in the spirit of rescue and recovery, and the provision of fair and reasonable redress. It should explore options for further simplifying the taxation system, incentivising small businesses to us the Making Tax Digital (MTD) platform.

RESILIENCE & LEVELLING UP

- The British Business Bank (BBB) should play a key role in improving the quality and reach of equity finance – including angel finance – in the nations and regions of the UK, especially outside of London and the Southeast.
- The UK Government should expand and build upon the British Business Bank (BBB) by strengthening its regional presence with empowered decision making deployed under a national framework, and continue the developments of its products along with Scottish Investment Bank (SIB), Development Bank of Wales and relevant bodies in Northern Ireland, including Invest NI.
- The UK Government should provide an ambitious, multi-year settlement for this Start-Up Loan Scheme. Alongside an increased financial commitment to the start-up loans scheme, Government should also seek to boost the New Enterprise Allowance (NEA), supporting the unemployed to start their own businesses.
- The UK Government must not lose sight of the objective of making investor tax reliefs, like the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS), more effective after Brexit, particularly for innovative businesses.
- The UK Government should consider how Employee Ownership Trust (EOT) structures may be adapted for COVID-related loans. EOTs provide a neat option to reduce debt and provide the scope for productive investment.
- Following Brexit, the UK Government must ensure there is no diminution in the amount of funding provided for small business access to finance purposes, compared to what is currently provided, for example through the European Investment Fund (EIF) and European Regional Development Fund (ERDF).
- The UK Government must take a ‘principles-led’ approach to Net Zero transition to help ensure the all businesses regardless of size and sector are able to help deliver and benefit from a just transition to a carbon neutral economy.

- To help combat small businesses late payment issues, the Small Business Commissioner must act to fine any company which fails to pay its SME suppliers.
- The UK Government must amend Financial Reporting Council (FRC) guidance and/or legislate at the earliest opportunity to force Audit Committees, led by a Non-Executive Director, to assess and report on payment practices in company annual reports, finally broadening accountability to whole company boards.
- The UK Government, working with the Bank of England, should urgently look to shore up supply chain finance.
- The UK Government should establish a centralised relief pot to ensure immediate payment where small businesses in government supply chains have already experienced frozen payments.
- Any large businesses receiving significant financial help (in the form of a government bailout or taking a shareholding in that company) should commit to a small business supplier charter with a clear obligation to make all payments within 30 days.

Introduction

The COVID-19 crisis has taken a huge toll on small businesses, across all sectors and geographical areas of the UK. Collectively, this group is estimated to employ almost 10 million people with a turnover in excess of £1.5 trillion.[1]

FSB has welcomed the package of support provided by UK and devolved governments throughout the pandemic, including grants, loans and the ability of small business owners to furlough staff and themselves. However, as the UK now looks to 2021 with increasing optimism that the pandemic can at last be brought under control by a combination of new vaccines and mass testing, the transition back to normality will be a period of unprecedented danger for small firms. The night is darkest just before the dawn. Many small firms will be entering the New Year not with optimism, but with a feeling of foreboding. Many will have suffered a difficult Christmas period, many will be carrying excessive levels of debt which is soon due for repayment. Much of the welcome government support – a lifeline for so many businesses throughout the pandemic – is due to come to and end. And many businesses will find themselves operating in significantly and permanently altered market places, to which they will need to adapt in the longer term. This perfect storm points to the real possibility of a small business cashflow crisis – a recapitalisation crunch. Without immediate interventions, the UK could face a wave of small business failures on an unprecedented level.

In the immediate sense, small businesses need a reason to keep fighting. Those burdened with debt, looking to stand on their own two feet again and take their first tentative steps, need to be protected from the immediate shock of debt and tax repayments. We are urging Government to work with the Banking and Finance sector to explore options to extend the breathing space for small firms, pushing back deadlines for VAT repayments and extending the interest free BBLS period.

Longer term, as the UK looks towards a post-COVID recovery, further intervention will be required to enable small firms to survive and play their critical role. As part of this, small firms will need support to manage and/or restructure their debts, along with a coherent and holistic assessment of their pressure points. Small firms will also need support to strengthen their financial, digital, operating and environmental resilience.

Smaller firms have disproportionately driven job creation in the UK since 2010.[2] However, the COVID-19 crisis has placed an unprecedented economic burden on the small business community, negatively affecting their confidence and economic outlook. FSB's Small Business Index for Q3 2020 showed that small business confidence has been in negative territory for 9 straight quarters. And between Q2 and Q3, the confidence figure had dropped again from 28 points to 32.6, as a result of a rise in the number of COVID-19 cases and the announcement/expectation of further lockdown measures in different parts of the UK.

Small firms will require an extended period of convalescence, aided by significant government intervention to help them to manage debt and support economic recovery. FSB research shows increasing concern amongst small firms on their ability to meet their debt obligations. Many of these small firms took on additional debt facilities in a

[1] BEIS, 2019, Business population estimates for the UK
[2] Nesta/Sage, 2017, The State of Small Business: Putting UK entrepreneurs on the map

responsible way, prior to COVID-19, on the basis of sound economic forecasting. However, the unprecedented crisis has made it harder for small businesses to service both their existing debt and any additional debt taken to weather the crisis or restart their business. FSB research indicates that almost half of small firms had pre-existing arrangements in place prior to the start of the COVID-19 pandemic, and that the confidence of small firms to manage their debt has also dropped in the same period.

With COVID-19 economic disruption set to drive up unemployment rates, SMEs are a key route to employment, providing 60% of all UK jobs. Nine in ten people who moved from unemployment back into the workplace after the 2008 financial crash did so through a small firm or self-employment.[3] This emphasises the criticality of small firms to the UK's long-term recovery. Small forms will need a suite of measures to support recapitalisation and recovery, underpinned by a new attitude to debt. Small firms have the potential to spearhead the UK's economic recovery. But in order to do so, Government must provide them with breathing room and a clear pathway out of debt, coupled with a clear customer journey to dispute resolution.

[3] TheCityUK, 2020, Supporting UK economic recovery: recapitalising businesses post Covid-19

Short-term Recapitalisation Challenge - Debt and Confidence

FSB data shows that more than half (56%) of small firms had some form of existing debt before the COVID-19 crisis. Since the start of the pandemic, this figure has risen to 69% (Figure 1).

Figure 1: Proportion of small businesses carrying debt – Before COVID-19, Due to COVID-19, Overall
Source: FSB Finance Survey, 2020

Debt immediately before COVID-19	*Additional or new debt since the start of COVID-19*	**Current debt (before and additional combined)**
56%	*(34%)*	**69%**

Unsurprisingly the volume of debt held by small firms has also increased since the start of the pandemic. FSB research suggests that around a third (34%) of small businesses had taken on more debt, including those taking on debt for the first time (15%).

Of those small business owners that have taken on debt during the crisis, 77% say they have taken on more than £10,000. 60% have taken on more than £20,000. 45% have taken on more than £30,000. 21% have taken on more than £50,000 (Figure 2).

Figure 2: Amount of debt taken on by small businesses during the COVID-19 crisis
Source: FSB Finance Survey, 2020

More than £10,000	77%
More than £20,000	60%
More than £30,000	45%
More than £50,000	21%

Recent research by TheCityUK estimated that, by the end of March 2021, Government loan schemes may incur £35billion in unsustainable debt.[4] TheCityUK identified unlisted SMEs as the cohort in need of the most significant support as a result of the economic impact of COVID-19. By the first quarter of 2021, around £100 billion could arise in unsustainable lending volumes, with SMEs predicted to incur just over half of total unsustainable lending (amounting to around £50-56 billion). Furthermore, higher volumes of unsustainable loans are estimated in the property, construction, and accommodation and food sectors, representing around 50% of total unsustainable lending.

[4] TheCityUK, 2020, Supporting UK economic recovery: recapitalising businesses post Covid-19

Of those small business owners that were carrying debt before the COVID-19 crisis, 46% were relying on their business bank overdraft, 38% on business credit cards, 30% on personal credit cards, and 27% on commercial loans (Figure 3). Since the start of the crisis, the positive impact of BBLS and CBILS can be seen, both in the high level of take-up of the service and the reduced rate at which COVID-related borrowing is loaded towards less sustainable sources of finance, like credit cards. Of those small business owners that have taken on debt during the crisis, 64% have used the new BBLS support[5], 20% have increased their business bank overdraft, 17% have added to their personal credit card debt, and 14% have used CBILS. The rates of uptake for BBLS (64%) and CBILS (14%) are consistent, regardless of whether or not a small business had pre-existing debt before COVID-19.

Of those small business owners that were carrying debt before the COVID-19 crisis, almost half (47%) were using personal finance (personal loans, personal credit cards, personal bank overdraft, personal mortgage) to support their business. Again, the popularity and positive impact of BBILS and CBILS can be seen, with small business owners that have taken on debt as a result of the COVID-19 crisis less likely to have used personal finance (29% compared to 47% pre-COVID).

Figure 3: Distribution of primary sources of small business debt – Before COVID-19, Due to COVID-19, Overall
Source: FSB Finance Survey, 2020

	Debt immediately before COVID-19	*Debt since the start of COVID-19*	Current debt (before and additional combined)
Bounce Back Loan Scheme (BBLS)	**-**	***64%***	**49%**
Coronavirus Business Interruption Loan Scheme (CBILS)	**-**	***14%***	**10%**
Business Bank Overdraft	46%	*20%*	40%
Personal Credit Card	*30%*	*17%*	29%
Business Credit Card	38%	*13%*	32%
Personal Bank Overdraft	*13%*	*10%*	15%
Personal Loan	*15%*	*7%*	15%
Personal Mortgage	*16%*	*6%*	15%
Commercial Loan	27%	*4%*	23%
Business Mortgage	13%	*2%*	11%
Asset Finance	10%	*1%*	8%
Invoice Finance	7%	*1%*	6%
Peer-to-Peer Finance	5%	*1%*	5%
Debt Finance	5%	*0%*	5%
OTHER	11%	*9%*	14%
PERSONAL FINANCE	***47%***	***29%***	**47%**

[5] This estimate correlates with Government's own data for BBLS take up of 1.4 million by November 2020, available at: https://www.gov.uk/government/collections/hm-treasury-coronavirus-covid-19-business-loan-scheme-statistics

FSB's recent SBI data shows that much of the debt being taken on by small businesses during the Covid crisis is related to their short-term survival, rather than strategic growth (Figure 4). Data for Q2 2020 shows that, of those small firms that successfully applied for credit for business purposes within the previous 3 months, 61% reported that this was to help manage their cashflow. This is a marked increase on previous quarters and, indeed, represents the highest figure in the history of the SBI.

Figure 4: Purpose of small business credit applications in previous three months
Source: FSB SBI tracking data

	Q2 2018	Q4 2018	Q2 2019	Q4 2019	Q2 2020
Purpose: to help manage cashflow	39%	47%	45%	37%	62%

FSB data also suggests that the COVID-19 crisis has had a negative impact in the confidence of small firms in their ability to repay their debts. Small business confidence has been in negative territory for 9 straight quarters and in Q3 2020 stands at -32.6 (down 28 points on the previous quarter).[6] Only a third (34%) of businesses expect their performance to improve over the coming quarter. The significant majority (66%) expect performance to worsen. And almost half (49%) of small firms believe their revenue will still be down on pre-COVID levels this time next year, while only 29% think it will be up.

Figure 5: Small business perceptions of their debt levels before and after COVID-19 outbreak
Source: FSB Finance Survey, 2020

	Views on Pre-COVID Debt	**Views on Current Debt**	*Views on Current Debt (pre-COVID borrowers only)*	*Views on Current Debt (first time borrowers only)*
Significant	30%	50%	*52%*	*42%*
Unmanageable	13%	40%	*37%*	*42%*

Unsurprisingly, Figure 5 shows that the proportion of in-debt small businesses that describe their level of borrowing as 'unmanageable' rose from 13% (pre-COVID) to 40% (post-COVID). For those that borrowed for the first time due to COVID, this figure rises to 49%. At the same time, the proportion of in-debt small businesses that describe their level

[6] FSB, 2020, Small Business Index (SBI) Q3, available at: https://www.fsb.org.uk/resource-report/fsb-q3-20220-small.html

of borrowing as 'significant' rose from 30% (pre-COVID) to 50% (post-COVID). Even for those borrowing for the first time due to COVID-19, with no pre-existing burden, this figure is 42%.

Of those small businesses carrying debt, one in six (16%) say more than 10% of their next year's turnover will go on debt repayment.

Recent research by the Money Advice Trust suggested that one in three (29%) self-employed business owners had fallen behind on one or more household bill, business bill or credit commitments, as a direct result of the financial impact of the coronavirus outbreak. More than half (55%) said the financial worries caused by COVID-19 had a negative impact on their mental health and more than two in five (43%) had been regularly losing sleep as a result.[7] In this context, it is particularly concerning that almost half (47%) of in-debt small businesses continue to use personal debt products for business purposes.

In terms of the small business response to the COVID-19 crisis, there is a clear correlation between the necessity to adapt, the need to take on more debt, and business confidence. Figure 6 shows businesses that lack confidence in their survival are more likely to have taken on more debt (45%) than those that are confident (27%). Similarly, those that lack confidence in their survival are more likely to have taken on debt for the first time (21%) than those that are confident of survival (12%).

Figure 6: Proportion of small businesses that increased their debt (including new debt) as a result of COVID-19
Source: FSB Finance Survey, 2020

	All small businesses	Not confident of survival	Confident of survival
Increased overall debt as a result of COVID-19	34%	45%	27%
Taken on debt for the first time	15%	21%	12%
Taken up CBILS/BBLS as a result of COVID-19	40%	46%	35%

Figure 7 shows that those that have had to fundamentally change their business model are also more likely to have taken on more debt (45%) compared to those that have made no fundamental changes to their business model (30%). Similarly, those who have fundamentally changed their business model are more likely to have taken on debt for the

[7] Money Advice Trust, 2020, Back to Business: Supporting people in self-employment to bounce back from Covid-19

first time (20%) compared to those who have not had to change their business model (13%).

Figure 7: Proportion of small businesses that increased their debt (including new debt) as a result of COVID-19
Source: FSB Finance Survey, 2020

	All small businesses	Fundamentally altered business model as a result of COVID-19	No alterations to business model
Increased overall debt as a result of COVID-19	34%	45%	30%
Taken on debt for the first time	15%	20%	13%
Taken up CBILS/BBLS as a result of COVID-19	40%	46%	37%

The Coronavirus Business Interruption Loan Scheme (CBILS) and Bounce Back Loan Scheme (BBLS) have been an incredibly valuable sources of emergency funding for many smaller businesses during the COVID-19 pandemic. Of those small businesses that took on debt during the crisis, two thirds (64%) accessed CBILS or BBLS. These schemes appear to have reduced the likelihood of businesses owners relying on personal finance to support their business activities.

FSB welcomed the extension of BBLS to the end of January 2021, as well as the additional time and increased flexibility for repayments under the new Pay As You Grow scheme. However, this additional flexibility has not been automatically extended to CBILS. While BBLS borrowers have the option to increase their loan repayment period from 6 to 10 years, for CBILS the decision to extend is at the discretion of the lender. It is clear that many lenders, including some major banks, currently have little interest in taking up this opportunity.

Recommendations

- **The UK Government should take immediate action to provide debt-laden small firms with a reason to keep fighting.** Many small business owners will worry about the imminent deadline for paying deferred VAT (31 march 2021). Government should give small businesses time to rebuild by extending this deadline until 31 March 2022.
- **The UK Government should provide further breathing space to debt-laden small businesses by working with the Banking and Finance sector to push back the start of BBLS and CBILS repayments and increasing the length of**

time for which it covers interest rate payments on these loans (currently the first year).

- **While *Pay As You Grow* is a step forward in management of BBLS debt, the UK Government must provide further clarity on the criteria that determine which firms have been 'heavily impacted'**, particularly given that repayments are not contingent on the profit-making level and turnover of businesses.

Longer-term Debt Management and the Role of HMRC

Small firms will need support to manage their debt, with substantial measures required to handle debt restructuring at scale. Transparency is also needed around the extent to which credit files have been negatively impacted since the start of the COVID-19 pandemic. This must be coupled with a government directive to the finance system to adhere to commonly agreed standards. Broadly speaking, a new attitude to debt is required in order to prevent a small business credit crunch.

The economic impact of COVID-19 has brought the need for a new attitude towards debt into sharp relief - this includes the way in which we treat insolvency and bankruptcy going forward. Recent research by TheCityUK warns that up to 3 million jobs across the UK and 780,000 SMEs are at risk if urgent action isn't taken to tackle the projected £35bn of unsustainable debt from COVID-19 loans.[8] Many small firms will need support to repay debt accrued through the government backed coronavirus loan schemes.

There will be no silver bullet towards recapitalisation and the management of pre-existing debt, as well as debt taken on as a result of COVID-19 crisis and measures imposed to contain the spread of the virus. A suite of measures will be needed. The scale of unsustainable debt will require government intervention geared to support small firms to reduce and repay their debt, whether existing or newly taken on as a result of the pandemic. Leaving small firms to struggle under the weight of debt not only risks jobs and our economic recovery, but the health of the SME sector we rely on to spur future growth. Solutions that fail to take regional, sectoral and growth factors into account risk overlooking those firms who have been most impacted by the pandemic, and thus more likely to seek external finance.

Without direct support, small firms suffering under the burden of debt have, in theory, a number of options open to them, depending on their circumstances. For example, they could decide to convert part of their debt to equity – i.e. effectively selling off a stake in the business to release cash. However, of those small businesses carrying debt, only a third (33%) believe the option of converting debt to equity would be of benefit to them (Figure 8). For those that describe their current debt as 'worrying' or 'significant' this figure rises to 38%.

Selling equity to raise funds – whether it's to pay off debt or provide capital for investment – is not a popular choice for most small business owners. Many small and self-employed business owners – e.g. plumbers, hairdressers, small shopkeepers – have relatively few assets, meaning that the option of converting debt-to-equity would not be viable. Recent research recognises both the 'low volume of equity finance raised by SMEs and their limited access to professional investors'. According to TheCityUK, equity finance raised by UK SMEs remains under £10bn per annum, with less than 5% of this flowing to rescue/distress equity.[9] This falls significantly short of the potential demand for capital.

[8] TheCityUK, 2020, Supporting UK economic recovery: recapitalising businesses post Covid-19
[9] TheCityUK, 2020, Supporting UK economic recovery: recapitalising businesses post Covid-19

Figure 8: Proportion of in-debt small businesses that see the potential benefit of converting debt to equity
Source: FSB Finance Survey, 2020

	All in-debt small businesses	In-debt small businesses that describe their debt as significant or worrying
Converting debt to equity would be beneficial	33%	38%
Converting debt to a tax liability would be beneficial	56%	63%

For small businesses carrying debt, a far more popular option would be to convert outstanding debt to a tax liability, to be paid off over a longer period, with repayments based on profits, and with some controls built-in. Such a scenario would require Government to step in and nationalise a portion of small business debt, perhaps through the creation of a bad bank like the 'UK Recovery Corporation' proposed by TheCityUK. More than half (56%) of in-debt small businesses say they would see the benefit of converting their debt to a tax liability to be paid off over a longer period of time to HMRC through the tax system. For those that describe their debt as worrying or significant, this figure rises to 63%.

Solutions to help firms manage debt must be tailored to the needs of small businesses, considering their scale, size and prospects. FSB welcomed Government's 'Pay as you Grow' scheme, allowing all businesses that borrowed under the Bounce Back Loan Scheme (BBLS) to repay their loan over a period of up to ten years, reducing their average monthly repayments. And the further option for businesses to move temporarily to interest-only payments – or pause payments altogether – for periods of up to six months was also welcome. Although Government has announced its intention to allow CBILS lenders to also extend the term of a loan up to ten years, neither initiative deals with the substantial debt burden carried by businesses related to debt accrued before COVID-19, or non-BBLS/CBILS related debt accrued during the crisis.

It will be tempting to focus remedies solely on new debt, accrued as a result of the pandemic via the coronavirus loan schemes. However, many small firms will have carried pre-existing debt into the COVID-19 crisis, and others will have accrued debt during the pandemic through non-Government supported mechanisms. Excluding these firms from interventions to support debt repayment during the UK's economic recovery, would fail to address the wider, underlying problem.

For example, Figure 9 shows that small firms carrying pre-existing debt into the COVID-19 crisis were more than twice as likely (48%) to have taken on additional/new debt as those with no pre-existing debt (23%). And those carrying pre-existing debt were also more than twice as likely (57%) to have then taken on additional debt related to CBILS/BBLS, compared to those that had no existing debt (26%). In other words, small firms that accessed debt products during COVID-19 were more likely to already be burdened by existing debt.

Figure 9: Proportion of small businesses that increased their debt (including new debt) as a result of COVID-19
Source: FSB Finance Survey, 2020

	No debt pre-COVID	Existing debt pre-COVID
Increased debt as a result of COVID-19	23%	48%
Taken up CBILS/BBLS as a result of COVID-19	26%	57%

FSB welcomed Government's recent VAT deferral 'New Payment Scheme', which allows those businesses that deferred VAT due in March to June 2020 the option to spread their payments over the financial year 2021-2022. And, following the Self-Assessment deferral scheme announced in July 2020, we also welcome the additional time provided to self-assessment tax payers (with less than £30,000 tax liability) to pay taxes that would otherwise be due in 2021, through the enhanced 'Time to Pay' scheme. However, we urge Government to monitor the use of these schemes and go further. According to FSB research, around half (48%) of in-debt small firms have made use of the VAT deferral scheme.

While the New Payment Scheme will provide much needed temporary relief to half a million businesses carrying debt into the COVID-19 crisis, FSB research suggested that almost half of small firms had entered into external financing arrangements prior to the outbreak. These arrangements would have been undertaken by lenders and small firms in good faith on the basis of sound forecasting. However, the subsequent unprecedented impact of COVID-19 on business operations – and the pressure to adapt to rapidly changing market conditions – means that the burden of this debt has become increasingly unmanageable for many.

Some small firms may find themselves open to a breach of covenant with their creditors, based on the necessary action or enforced inaction they took as a result of the crisis. Given the risks that debt overhang and insolvency pose to the UK's employment, recovery, and growth prospects, Government should support small firms to refinance and relieve their debt burden. Such measures must not be focussed solely on those that debt accrued through the crisis, but also pre-existing debt.

It must also be noted that debt arrangements taken out by small businesses before the COVID-19 crisis are likely to have higher interest rates attached to them. If these rates were fixed, then they are unaffected by the subsequent lowering of interest rates by the Bank of England.

Measures to support small firms with their debt-burden and cashflow problems must be holistic, acknowledging wider crunch points that businesses face throughout their financial year. More generally through taxation, HMRC has the power to ease the overall burden on small businesses by simplifying the system, easing the move to Making Tax Digital, allowing deferrals and payments by instalment, streamlining the various touchpoints for small firms (and aligning them with the *Pay As You Grow* service), and alerting small firms to specific reliefs, allowances and training.

Following the Finance Act 2020, HMRC has regained its status as a preferential creditor for any insolvencies that take place after 1 December 2020. Recent research by TheCityUK suggested this role may provide HMRC with an opportunity to administer longer-term debt repayment through the taxation system.[10] However, FSB believes further work is required to understand how HMRC's role as preferential creditor would impact on small firms in reality, particularly with regard to mechanisms like invoice financing and peer-to-peer lending.

Further incentives are also needed to support the survival and growth of small firms as they look to attract private sector equity investment. In certain circumstances, HMRC should consider debt forgiveness in the form of grants and targeted support. This might include generous liability tax arrangements, the introduction of a bad bank model and restructuring service, supporting debt to equity swaps etc. Small firms play a vital role as employers and in providing pathways to re-employment, so all options should be considered carefully to ensure they continue to play this role fully. As the Job Retention Scheme ends, Government must explore innovative solutions geared towards job retention, such as Employee Ownership Trusts.

Employee Ownership Trusts (EOTs) provide a neat option to reduce debt and provide the scope for productive investment.[11] The EOT model ensures that business owners who sell their shares in a firm to a new-style EOT, as part of an employee ownership conversion, are exempt from capital gains tax. It also provides the means to give income tax free bonuses to employees. Government should consider how EOT structures may be adapted for COVID-related loans. Such loans could be assigned to a new EOT in consideration for the EOT receiving preference shares in the company of the same value, plus an option to acquire 10% of the firm when there is a future change of control. With the government guarantee already in place, the bank does not need an additional guarantee from the firm, thereby creating new borrowing capacity in the company if needed. Importantly, the bank loan is taken off the firm's balance sheet.

In such a scenario, the flow of payments to the bank would be the same as for a standard EOT transaction, including contributions to the EOT that are profit related and a 10-year sunset clause. When the loan has been repaid, the EOT would have an unencumbered shareholding in the company, for the benefit of its employees. In practice, it is unlikely that this would be distributed to beneficiaries until an exit event. The EOT is the natural exit route for the company's shareholders when they are ready to sell.

The COVID-19 crisis highlights the need for agile and responsive support from financial institutions, as well as Government. For example, the role of the British Business Bank

[10] TheCityUK, 2020, Supporting UK economic recovery: recapitalising businesses post Covid-19
[11] EOA, Guide to Structuring Employee Ownership

should be further bolstered to ensure that money is deployed to where it is needed as quickly as possible, across all regions of the UK. The Government's commitments to Levelling-up and Zero Carbon are both welcome, providing an opportunity to build a more balanced and more sustainable economy as we recover from the COVID-19 crisis. Support for debt repayment should reflect this agenda, providing small firms with an opportunity to play their part through their investments and recapitalisation efforts throughout the course of their recovery and growth.

The burden of debt is likely to push many businesses to the brink of closure. However, even at this stage, many can be saved with the right support and guidance. Business owners faced with closure and insolvency must be supported in re-starting, rather than penalised. Government must cushion the blow for those businesses that decide insolvency is their best option. In principle, there is likely to be a competitive advantage in providing a high degree of flexibility within the insolvency process, allowing for last minute rescue. Those seeking to access external finance for restart should be supported to do so, whether through traditional or non-traditional lenders. For those facing closure due to financial difficulty as a result of the COVID-19 crisis, there may be a role for targeted grants in encouraging otherwise well-managed firms with solid businesses plans and enduring markets.

Recommendations

- **The UK Government must take a holistic approach when assessing the needs of small firms and weighing options for targeted support based on comprehensive needs assessments**.
- **The UK Government should consider extending support for small businesses managing pre-existing debt, as well as debt accrued as a direct result of the COVID-19 crisis.** While Government has acknowledged the difficulties that many small firms will have in paying back emergency BBLS and CBILS loans, the COVID-19 crisis has also exacerbated the burden of debt that many smaller firms carried into the pandemic.
- **Looking beyond BBLS debt and protections offered under Pay As You Grow, transparency is required on the extent to which credit files have been negatively impacted since the start of the COVID-19 crisis.** This must be coupled with a Government directive to the finance system to adhere to commonly agreed standards in order to prevent a small business credit crunch.
- **In considering the totality of debt, the UK Government must examine how to formalise some of the flexibility offered by *Pay As You Grow* to cover other forms of debt**, beyond the emergency BBILS support. This may include the creation of a government run entity to assist small firms to restructure their debt through differing mechanisms.
- **The UK Government should consider the creation of a government run restructuring service, akin to the UK Recovery Corporation proposed by *TheCityUK.*** Such an organisation would take decisions on debt management options for small firms, effectively managing the portfolio using major restructuring firms as agents, to manage businesses return to profitability. As with existing debt

arrangements, lenders are likely to be eyeing the risk tolerances of portfolios and may seek to exit debt arrangements. This new organisation could also take oversight of the CBILS scheme to help mitigate the risk of small business debt being sold to the highest bidder. In addition to issuing, holding and administering new instruments created through the conversion of the guarantee on CBILS loans, the new organisations should look to establish eligibility criteria for small firms seeking to manage debt facilities outside of the coronavirus loan schemes. Given that this organisation would essentially be mandated to operate in the spirit of rescue and recovery, it would need to be run and seed funded by government, with private sector investment as conditions improve.

- **The UK Government should consider the introduction of a new Successor Loan Scheme**, which meets the needs of small firms. The new scheme would need to be open to investment capital, enabling small firms to use it for capital investment purposes. It should refrain from seeking Personal Guarantees, particularly against primary residences.

- **The UK Government should consider how Employee Ownership Trust (EOT) structures may be adapted for COVID-related loans.** EOTs provide a neat option to reduce debt and provide the scope for productive investment. The EOT model ensures that business owners who sell their shares in a firm to a new-style EOT, as part of an employee ownership conversion, are exempt from capital gains tax. It also provides the means to give income tax free bonuses to employees. With the government guarantee already in place, the bank does not need an additional guarantee from the firm, thereby creating new borrowing capacity in the company if needed. Importantly, the bank loan is taken off the firm's balance sheet.

- **The UK Government should consider targeting specific aid at the most heavily impacted sectors, as well as local businesses that did not furlough or send staff on unpaid leave and acquired large debts as a result.** This support could include tax reductions or loan write offs. Debt forgiveness in the form of grants may also be a useful incentive against individuals weighing the benefit of becoming insolvent, particularly when linked to 'green investments' in assets, R&D, skills and training, or to supporting skills transition in construction, social care and digital.

- **Greater transparency is needed around contractual arrangements undertaken with finance providers.** When entering into external finance arrangements, it is essential that small firms, including new borrowers, are aware that loans taken out may be reassigned by lenders to other financial entities. Given the associated risks involved in defaulting on agreements, a minimum standard is required across lenders to ensure firms are fully apprised of the consequences of breaching their covenant arrangements. This must also include firm guidance on what constitutes a reasonable grace period under their agreement.

- **HMRC should recognise the impact that its move to preferential creditor and lender of last resort may have on small firms operating in supply chains, looking for opportunities to assist in areas like invoice financing and debt recovery.** Small businesses should be given the ability to assign late invoices to HMRC as payment of tax, particularly VAT (as VAT is payable regardless of whether payment has been received) allowing HMRC to manage the relationship directly. For those facing closure due to financial difficulty as a result of the COVID-19 crisis, there may be a role for targeted grants in encouraging otherwise well-managed firms with solid businesses plans and enduring markets.

- **As a key pillar of Government's commitment to build a modern taxation system, the Making Tax Digital (MTD) platform must look to ensure small firms are alive to the various grants, reliefs and allowances they have not yet utilised.** The platforms success will rely on its ability to meet the needs of small firms and remain user-centric. Beyond collecting tax, MTD could have a critical role to play in alerting small businesses to relief and allowances, streamlined applications, tax off-sets for training/upskilling, and signposting to accredited debt and credit management training bodies. Management of debt repayments through the suggested Business Repayment Plan would be beneficial in ensuring small firms can access a coordinated hub. A user-centric, modern, digital taxation system must contain fair adjustments for users with seasonal or uneven income, the taxpayer should not be expected to pay as if receiving a regular known salary.

- **The UK Government should streamline the touchpoints small firms need to access in order to carry out taxation and debt repayment, and to access applicable financial support and services.** There may be value in aligning any debt repayment mechanism (such as *Pay As You Grow*) to existing online taxation platforms. In this way, emphasis on incentives rather than compulsion to extend the scope of MTD is essential.

Dispute Resolution

Small business banking remains concentrated with the 'Big 4' banks. Where disputes occur, access to resolution mechanisms must not become a bottle neck for small firms in need of mediation and redress. Small firms will need timely routes to dispute resolution with a clear customer journey.

Of those small businesses carrying debt, less than a two-fifths (39%) say they are confident that their lender would treat them fairly should a dispute arise and only 18% felt confident that they would have fair redress through the Financial Ombudsman or other mechanisms.

There has been a sharp rise in inexperienced first-time borrowers who will need to manage their debt in an environment of volatility and uncertainty. With 15 per cent of small firms saying they have taken on debt for the first time during the COVID-19 crisis, there may be challenges related to how effectively these firms are able to manage their debt in a volatile environment including uncertain demand and cash-flow forecasting.

Given the scale of unstainable debt across the small business community, policymakers must not underestimate the demand for dispute resolution. Small firms are likely to pay the price for any delays in these processes, which have the potential to set them further down the path of default. Undue delays place small firms at greater risk of default, with increased pressure from lenders to initiate insolvency proceeding, recapping assets themselves or selling off debt to other unregulated lenders. The Financial Ombudsman Service (FOS) will continue to provide an important dispute resolution mechanism for those businesses below the £6.5m turnover eligibility threshold. For businesses with a turnover between £6.5m and £10m, the Business Banking Resolution Scheme (BBRS) will be an important initiative for resolving disputes between smaller firms and their banks.

Both of these services are likely to see a high volume of contacts in the coming months and years. Therefore, it is critical that those using the services are provided with a clear customer journey when seeking access to resolution, including initial signposting to these services by Government.

Recommendations

- **The UK Government should provide small firms with clear pathways to dispute resolution, clearly articulating the breakdown of responsibility between the FCA, FOS and the newly created BBRS.** Businesses with the smallest resources must not be left behind. As a consequence of the COVID-19 crisis, many small businesses have taken on external finance arrangements for the first time in a volatile environment and may have no prior experience of dispute resolution services.

- **HMRC should seek to utilise its move to preferential creditor in the spirit of rescue and recovery, and the provision of fair and reasonable redress.** It should explore options for further simplifying the taxation system, incentivising small businesses to us the Making Tax Digital (MTD) platform. These incentives could include tailored alerts about reliefs and allowances, streamlined applications, tax off-sets for training/upskilling, signposting to accredited debt and credit management training bodies, and management of CTL payments. There may be a role for HMRC to support awareness raising and signposting of dispute resolution support services to small firms.

Improving Resilience & Levelling Up (Skills, Sustainability and Inclusivity)

Business resilience is vital to the UK's long-term economic recovery. There is a clear need to support small firms to rebuild and grow their long-term resilience to support their own recovery and enable them to meet current and future challenges. The OECD has called for public investment in recovery to support progress in digitalisation, sustainability and inclusiveness.[12] UK recovery plans will need to be designed to help mitigate the looming unemployment crisis by stimulating activities that 'generate high quality jobs in the growing net-zero economy, improving the quality of all jobs and revitalising communities across the country'.

The COVID-19 crisis has exacerbated existing inequalities within the UK. Government intervention has been necessary to protect those most at risk in our communities, but further intervention is now required to ensure that the UK recovery is inclusive, robust, well-informed and long-term. Investment in a skills, regions and job creation (particularly if prioritising sector support) will be essential for a 'just transition' so nobody is left behind.

To support the operating and financial resilience of smaller firms, investment in both credit and debt management skills is vital. When assessing upcoming pressure points, small businesses will need support to build comprehensive scenario-based cashflow forecasting and greater understanding of their balance sheets in order to inform decisions on redundancies or closure.

A vital part of the economic recovery and ongoing resilience of small firms will be to understand alternative forms of finance, alongside more traditional routes, like equity finance (which remains underused in the UK compared to nations like the US). Given the perennial negative impact of late payment on the health of small firms, invoice finance may be a suitable route to finance for many. Policymakers must prioritise support for non-traditional and peer-to-peer lending so that they can play a part in the UK's economic recovery. Efforts should be made to promote and enhance the various Enterprise Investment Schemes on offer. In this regard, the British Business Bank – or a potential British Development Bank in future – would have a vital role to play.

The introduction of CBILS and BBILS may have elevated visibility of the British Business Bank since the start of the pandemic, as it continues to play an important role in clarifying eligibility requirements and identifying accredited lenders. However, FSB data indicates a low level of awareness among small firms, with only 17% reporting that they were aware of the role of the British Business Bank (BBB). In contrast, Welsh based respondents reported higher rates of awareness (42%) when asked whether they were aware of the role of the Welsh Development Bank.

To date, one of the few ways in which the BBB has intervened directly in finance markets is through one of its subsidiaries, the Start Up Loans Company. This provides a vital service to around 10,000 new businesses a year. FSB welcomed the Chancellor's Budget announcement that funding for the Start-up Loans Company (SULC) will be extended by a year to 2021. Recent data released by the British Business Bank suggests that more than 75,000 start-up loans have been provided since 2012, marking more than £623 million invested in small businesses. These loans were not specifically designed in response to COVID-19, pre-dating the pandemic by eight years. However, according to the BBB,

[12] OECD, 2020, Building Back Better: A sustainable, resilient recovery after COVID-19

these loans have significantly increased in popularity since the start of the COVID-19 pandemic as entrepreneurs use the time to develop new ideas and seek to understand how the markets in which they operate have changed.[13]

There is a clear value to start-up loans and, while the 2020 Spending Review announcement of funding for an additional 1000 loans (over what was originally funded in the March 2020 Budget) was welcome, FSB believes Government should go further, providing an ambitious, multi-year settlement for this scheme. Alongside an increased financial commitment to the start-up loans scheme, Government should also seek to boost the New Enterprise Allowance (NEA), supporting the unemployed to start their own businesses. With unemployment figures expected to be extremely high as a result of COVID-19, this scheme could provide a significant route to economic recovery. Government should seek to increase the value and accessibility of this support, which is currently worth up to £1,274 over 26 weeks.

Finally, while supporting and empowering small businesses to modernise and improve their resilience, it must be acknowledged that their opportunities for face-to-face contact with trusted advice about finance have diminished. For example, the COVID-19 crisis appears to have accelerated a shift away from cash at a time when physical bank branches continue to close across the UK. The pandemic has seen an unprecedented rise in the volume of customer contacts at bank branches, demonstrating that online support doesn't meet the needs of all customers. Small firms are less likely to have access to relationship managers when making decisions on accessing or extending debt arrangements, and FSB data suggests there has been rise in new inexperienced borrowers. As the impact of CBILS/BBLS on competition and small business banking emerges, policymakers should explore the potential of multi-lender shared banking infrastructure, including the option to re-assign loans.

Recent research by FSB and the Centre for Research in Ethnic Minority Entrepreneurship (CRÈME) demonstrated the brutal way in which the pandemic has exacerbated existing inequalities.[14] Government intervention has been necessary to protect those most at risk in our communities. It must also intervene to help ensure that our recovery is inclusive. A purely market led approach to recovery is unlikely to provide an adequate remedy to the scale of unsustainable debt small businesses face, nor will it ensure a just transition to a resilience and sustainable economy. Small businesses cannot be hammered on both fronts. Instead, Government must think holistically around investment in skills, regions, and job creation (particularly if prioritising sector support), ensuring nobody is left behind. The right financial structures are essential for incentivising this.

Recommendations

- **The British Business Bank (BBB) should play a key role in improving the quality and reach of equity finance – including angel finance – in the nations and regions of the UK, especially outside of London and the Southeast.** The strong focus on the supply of equity finance outside of London, through both the Northern Powerhouse Investment Fund and the Midlands Engine Investment Fund, is

[13] British Business Bank Press Release, available at: www.startuploans.co.uk/media-centre/75000-loan-milestone/

[14] FSB/CREME, 2020, Unlocking Opportunity: The value of ethnic minority firms to UK economic activity and enterprise, available at: https://www.fsb.org.uk/resource-report/unlock.html

welcome, but should go further. BBB regional advisors should utilise cluster theory to support the development of angel clusters across the UK, working closely with wider private sector institutions and LEPs in England (and the relevant organisations and structures in Scotland, Wales and Northern Ireland). The skills base of investors could also be further developed through a programme of knowledge sharing between well-established angel networks and areas that otherwise lack a strong angel pool. The BBB's recently launched 'request for proposals' (seeking new ideas from the market on how, for example, to innovate and develop angel clusters) is a welcome step forward and needs to be built upon. The Angel Co Fund model could also be expanded.

- **The UK Government should expand and build upon the British Business Bank (BBB) by strengthening its regional presence with empowered decision making deployed under a national framework,** and continue the developments of its products along with Scottish Investment Bank (SIB), Development Bank of Wales and relevant bodies in Northern Ireland including Invest NI. This in line with the Future of Growth Capital Report: https://growthcapital.report/
- **The UK Government should provide an ambitious, multi-year settlement for this Start-Up Loan Scheme.** Alongside an increased financial commitment to the start-up loans scheme, Government should also seek to boost the New Enterprise Allowance (NEA), supporting the unemployed to start their own businesses. With unemployment figures expected to be extremely high as a result of COVID-19, start u loans and NEA will provide significant routes to economic recovery.
- **The UK Government must not lose sight of the objective of making investor tax reliefs, like the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS), more effective after Brexit, particularly for innovative businesses.** The experiences of FSB members underscore the importance of SEIS and EIS for equity investors. Many small firms find the current system too administratively arduous and slow. For relatively small initial investments (e.g. such as those that may be needed for knowledge intensive firms at the very start of their life cycles) it is possible that the complexity of the relief schemes presents a barrier. The UK Government should expedite efforts to digitise the advance assurance process in order to make both EIS and SEIS more attractive for investors and easier for businesses to use.
- **Following Brexit, the UK Government must ensure there is no diminution in the amount of funding provided for small business access to finance purposes, compared to what is currently provided, for example through the European Investment Fund (EIF) and European Regional Development Fund (ERDF).** Brexit means that EU funding – at least in its present format – will soon come to an end. This will have significant implications for smaller businesses, particularly in relation to their ability to access finance. Post-Brexit, the way that access to finance funding is distributed throughout the UK will also change, potentially via the Shared Prosperity Fund and potentially with a greater role for the BBB as a key managing agent or fund of funds manager. By managing and consolidating a number of funding sources, the BBB has already demonstrated success in leveraging funding for access to finance at a pan-regional/pan-LEP level through both the Northern Powerhouse Investment Fund and Midlands Engine Investment Fund. In future, there may be further opportunities to replicate these kinds of projects across the UK in areas where

there is a recognised clear market failure, with the BBB facilitating the distribution of new, post-Brexit sources of funding. This would enable local areas or regions to draw on the commercial expertise of the BBB, which may be particularly important if there is a shift away from the provision of grants and towards the provision of loans. This approach also increases the 'size of the prize' by empowering regional bodies to access multiple funding pots. More broadly, there must be a debate on the future role of the BBB, and the extent to which it intervenes directly in finance markets, perhaps through a development bank model (like the Development Bank of Wales). As an example of success, the UK Government should look to the German development bank, KfW, which has been instrumental in creating world-leading SMEs.

Harnessing a green recovery

As the UK seeks to achieve Net Zero by 2050, the ability of smaller firms to small firms to demonstrate their 'green credentials' will be seen increasingly important to their long-term viability as they seek to take advantage of investment opportunities, support and finance packages, new and emerging markets, and supply chain opportunities. Small firms that fail to take steps to decarbonise risk becoming uncompetitive as they come under increasing scrutiny from insurers, lenders and larger businesses alike, all of which will be making assessments about the resilience of their own insurance cover, lending and investment opportunities, and supply chains. It is reasonable to assume that government support in future will be increasingly conditional on action to limit harmful emissions.

This will have implications for firms looking to diversify or secure new supply chains, take green growth opportunities and to secure onward funding and investment from lenders. The need to rebuild both the UK economy post-COVID cannot be decoupled from the need to also build towards a zero carbon and sustainable economy. So, measures to support businesses through this recovery must reflect this binary pressure.

The COVID-19 crisis has demonstrated the creative and innovative power of small firms.[15] In meeting the UK's Net Zero commitments, Government must harness these qualities by supporting business-led solutions, recognising that many small firms will need tailored advice and support to finding their own individual pathways to Net Zero. Exploring ways to align the overarching goals to support recovery, resilience and decarbonisation does not mean forgetting about the sectors/businesses who need it most – including those with pre-existing debt taken out in good faith based on solid economic projections. Policymakers must provide clear, predictable and joined-up policy and regulatory frameworks to provide long-term line of sight to small firms, guiding their forward planning and investment while, at the same time, allowing them time and space to adapt and upskill. This should include the development of detailed sector plans to enable businesses of all sizes and sectors to deliver, and benefit from, the UK's Net Zero transition and clean growth opportunities.

In November, FSB joined forces with the UK's top five business groups – the Confederation of British Industries (CBI), Make UK, the British Chambers of Commerce (BCC) and the Institute of Directors (IoD) to highlight its commitment into helping the UK achieve its goal of becoming net-zero by 2050. This commitment proposes a 'just transition' to net

[15] FSB, 2020, New Horizons: How small firms are navigating the COVID-19 crisis

zero and highlights five core principles needed to achieve this goal. This fairness test gives government and businesses the opportunity to work together to delivery viable, long-term measures to encourage sustainability, protect society and grow a resilient economy.

1. **Ambition** – ensuring we hit our targets, led by evidence
2. **Accountability** – providing coordinated and coherent leadership
3. **Delivery** – empowering businesses to find their own paths
4. **Opportunity** – not leaving any sectors or regions behind
5. **Cost** - affordable and achievable, based on impact,

A recent report led by UK Finance outlines how the banking and finance sector can support the delivery of the UK Net Zero economy.[16] Financial networks across the UK, in a regionally inclusive programme incorporating 'corporates, SMEs, local authorities and other sources of enterprise', can be supported by a strong and forward-thinking banking and financial sector. Addressing the needs of small businesses, workers and communities in the transition to Net Zero is increasingly material to value creation in the banking sector by, for example, impacting the ability of customers to pay loans as technology changes. Over the next decade, banks and the financial sector will need to show how they are aligning balance sheets with the UK's Net Zero target. This includes demonstrating how they are enabling households and companies to become resilient to climate change impacts, and how the process of often disruptive transition can be steered so that it is fair and inclusive. These goals combine to form the challenge of the just transition, a task that has become even more important following the shock of the COVID-19 pandemic.

Recommendations

- **The UK Government must take a 'principles-led' approach to Net Zero transition to help ensure the all businesses regardless of size and sector are able to help deliver and benefit from a just transition to a carbon neutral economy.** To do this, policymakers should follow the five fairness tests covering Ambition, Accountability, Delivery, Opportunity and Cost.

Tackling late payment

A year and a half on from announcing reforms to tackle late payments, Government has still not tackled this problem. Before COVID-19, poor payment practice was already embedded as one of the most serious impediments to small business growth and survival, a problem that has been exacerbated since the start of the pandemic. Recent research by the Money Advice Trust suggests that over a third (38%) of self-employed business owners had experienced an increase in late payments since the coronavirus outbreak began, with almost three quarters (72%) saying it was making the financial problems caused by the pandemic worse.[17]

[16] UK Finance/LSE/Grantham Research Institute on Climate Change and the Environment/University of Leeds, 2020, Financing Climate Action with Positive Social Impact: How banking can support a just transition in the UK
[17] Money Advice Trust, 2020, Back to Business: Supporting people in self-employment to bounce back from Covid-19

FSB's previous report – Late Again – explained why small businesses and the self-employed depend on cashflow for their very existence – 'cash is king'.[18] Today, unless we can successfully tackle the scourge of late payments and, more generally, poor payment practice, many small businesses will be forced to close their doors for good and will be unable to play their part in spearheading the UK's economic recovery.

FSB previously called on Government to mandate that any large businesses receiving significant financial help (in the form of a government-backed bailout or taking a shareholding in that company) should commit to a small business supplier charter, including making all payments within 30 days. The report argued that the Small Business Commissioner should be given the power to fine businesses up to a maximum of £30,000 in cases where systematic and chronic late payment has been proven, and Duty to Report data spot checked by independent auditors and published as part of annual reports. The Government should also commit to moving the target for prompt payment down from 60 days to 30 days, along with a toughening of the Prompt Payment Code.

Set against a backdrop of increasing levels of late and frozen payment, the current pandemic has also seen examples of large businesses going the extra mile to support smaller businesses in their supply chains. Good supply chain practice leading to a robust and sustainable supply chain is one of the major competitive advantages that one large business can have over another.

FSB has recognised and welcomed the good work that has already taken place to tackle late payment, but there is a lot more to do if public sector procurement is to genuinely be used to support small businesses and the self-employed through an economic recovery.

Recommendations

- **To help combat small businesses late payment issues, the Small Business Commissioner must act to fine any company which fails to pay its SME suppliers.** FSB supports moves to make the prompt payment code mandatory and to bolster the role of the Small Business Commissioner to provide powers to investigate and fine repeat late payment offenders and make 30 days the standard definition of prompt payment as set out in the Prompt Payment Code.
- **The UK Government must amend Financial Reporting Council (FRC) guidance and/or legislate at the earliest opportunity to force Audit Committees, led by a Non-Executive Director, to assess and report on payment practices in company annual reports,** finally broadening accountability to whole company boards.
- **The UK Government, working with the Bank of England, should urgently look to shore up supply chain finance.** Any large company that benefits from shored-up supply chain finance must commit to using that finance to pay their SME suppliers, pay any outstanding invoices within 14 days, be a signatory of the PPC, and agree not to lengthen their payment terms for their SME provider.

[18] FSB, 2020, Late Again: How the coronavirus pandemic is impacting payment terms for small firms, available at: www.fsb.org.uk/resources-page/late-again--how-the-coronavirus-pandemic-is-impacting-payment-terms-for-small-firms--.html

- **The UK Government should establish a centralised relief pot to ensure immediate payment where small businesses in government supply chains have already experienced frozen payments.**
- **Any large businesses receiving significant financial help (in the form of a government bailout or taking a shareholding in that company) should commit to a small business supplier charter with a clear obligation to make all payments within 30 days.**