

ENTERPRISE AND SOCIAL EXCLUSION

***National Strategy for Neighbourhood
Renewal: Policy Action Team 3***

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FOREWORD

There is a vital role that enterprise can play in helping to renew our poorest and most marginal communities. It helps to create jobs and stimulate activity in communities where crime and unemployment are high. It helps meet the basic needs of local people, by providing vital services like shops. Perhaps most fundamental, it helps develop self-confidence and determination in local people and communities - the real drivers of regeneration in the long run.

This report has been prepared in response to the Social Exclusion Unit's publication, *Bringing Britain Together*. It sets out an ambitious agenda for change - one that requires the participation and partnership of many different players. Government has a key role, in providing high quality leadership and acting as a catalyst of change. This needs to be recognised at each of its different levels - national, regional and local. Voluntary organisations have a vital part to play, by helping to shape the debate, and acting as links with communities themselves. The private sector's role too is pivotal: banks are the main source of outside finance for new and growing businesses, and other large firms are key players in the local community. But in the end nothing will work without the active engagement of communities themselves - and this report recognises that.

The proposals call for a new period of innovation and experimentation, both in Government policy and in the way that banks, business support agencies and others approach these markets. We will be reflecting closely on the recommendations as we take forward work both on the enterprise front and on neighbourhood renewal. Most of the implementation in Whitehall falls to DTI, and Patricia Hewitt - Champion Minister for PAT 3 until the summer - will be responsible for taking these elements forward. I know that she is very enthusiastic about the task in her new role as Minister for Small Business.

One final point needs emphasis. This report was prepared to contribute to work on neighbourhood renewal. But it should also be seen as a contribution to the Government's goal of helping to build an enterprise society. The proposals here are one facet of that broader task - alongside encouraging high growth businesses, and removing barriers to the success of all business. I see no tension between promoting enterprise in our worst estates and in, say, our leading universities. Both are needed if we want to build a society in which enterprise thrives.

I am very grateful to the Policy Action Team - particularly the external members - for producing such a useful and timely report, and also to all those from the wider community who helped the Team in its work.

STEPHEN TIMMS

OVERVIEW

The goal of this report is to identify how to generate more enterprise in deprived communities. That means getting more new businesses to start, and more businesses to grow and prosper.

Background

Policy Action Team 3 was set up in November 1998, with a mix of Whitehall civil servants and people drawn from business, banks, local government and the voluntary sector. We have worked by consulting widely, with people living and working in deprived areas, and with practitioners and researchers in fields like finance and business development. We have compared what we learned from them with what else we know about the present situation.

Some very clear and compelling messages have emerged from this work. We are convinced that these form a sound basis for deciding on further action.

Our single most important finding is simply that promoting enterprise in deprived communities does not get the attention it deserves - whether from the different parts of central government, or from the diversity of local and regional institutions, or from private sector banks and other firms. There is more that can be done by all these parties towards goals that should be common - building communities with stronger local markets, and giving everyone with the potential to succeed in business the opportunity to do so.

Specific problems

Our work identified three big obstacles to enterprise in poor communities:

- not enough accessible, high quality business support - like advice and training on marketing and money;**
- “market failures” in access to finance, which mean that not enough capital is available for projects with high returns to**

society;

- **a weak culture of support for enterprise, across the whole range of local and national institutions; the benefits and tax system is perceived as complex and difficult to understand.**

Actions

The PAT's recommendations are designed to address all three of these obstacles - to improve access to services so that more businesses succeed, and to remove barriers to enterprise so that more people take the opportunity.

We believe that a successful programme needs three things:

- **a national strategy, that conveys commitment and direction from central government, in all areas;**
- **strong links with regional and local organisations, and with the private sector, to translate that strategy into action;**
- **clear responsibility for who does what, and for who drives the overall programme forward.**

Our key recommendations have been framed on this basis, and they are as follows:

Business support

The Small Business Service (SBS) should, as part of its wider role to promote small business, have a clear remit to promote enterprise and business growth in deprived areas. To meet that remit, it should develop a strategy that aims to give a clear sense of direction to the many organisations involved in this area. It should identify and promote best practice and build its own expertise in the field. Regional Development Agencies should play their part in this too.

The SBS is a new organisation and its strategy will take time to develop and to be implemented. Action should also be taken on a shorter timescale - to engage Business Links in regeneration, to

develop a new national network of business mentors, and to look at more use of business incubation. In order to work well, business support services need to be developed so that they are seen as accessible and trusted by deprived communities, including ethnic minorities.

Finance

The Government should encourage an innovative and competitive banking market to serve poor areas - but in the end market mechanisms will not be enough. So the Government should also encourage new initiatives to provide finance for enterprise where justified by the high potential returns to society.

The Government's central task in this area is to act as a catalyst of change - encouraging innovation and galvanising other players into participation. But there is also a limited role at this stage for funding. We recommend opening two funding windows on an experimental basis - a national challenge fund for new financing initiatives, and a loan guarantee facility to support borrowing from banks.

The mainstream banks are the key players in this lending market. So their attitude towards the relatively fragile markets in deprived communities will be crucial. We recommend continued monitoring in this area, including perceptions of the banks among black and minority ethnic businesses, and other initiatives to recognise innovation.

Barriers to enterprise

The PAT welcomes the reforms made by the Government to increase the incentives to move from welfare to work, including self-employment. As the reform programme continues, it will be important to ensure that self-employment is clearly recognised and continues to be treated as a perfectly valid option that deserves support. The aim should be to make the move from "benefits to business" as natural and easy as the move from "welfare to work".

Self-employment has some unique features that need to be reflected in the benefits system. One of these is the uncertainty of income, particularly in early trading. We recommend looking at whether any changes are needed in this area, for example by building on the reforms of the tax and benefit system already introduced.

The culture of supporting enterprise needs to be spread more widely. We recommend building the interests of deprived communities into plans for raising awareness of enterprise in general; and a training plan for Benefits Agency and Employment Service staff.

Other issues

The PAT has made 24 recommendations in all. Some other key areas include:

- ***Social enterprises:*** need to be recognised and encouraged like other businesses, for the part they can play in renewal.
- ***Regeneration policies:*** more emphasis on enterprise is needed in DETR's regeneration programme, and closer and better working by local authorities.
- ***Larger firms:*** the private sector has a pivotal role in regeneration, and the Government should look at how to encourage their contribution.
- ***Loans, not grants:*** the public and voluntary sectors are too stuck in a culture of grants; we should have a presumption in favour of loans wherever there are positive financial returns.

Outcomes

If these recommendations are agreed, we should see:

By April 2000

- as part of its wider remit, the SBS to develop its strategy to support enterprise in deprived areas

- **launch of a challenge fund for new finance initiatives**
- **announcement of a new network of mentors**
- **more support for enterprise in the regeneration programme**

By April 2001

- **new programmes delivered on the ground by Business Links**
- **expanded reporting on activities of mainstream banks by Bank of England**
- **new or expanded community finance initiatives**
- **the foundations laid for a stronger social enterprise sector**
- **increase in commitment of larger firms**

April 2002 and beyond

- **clear signs of shift away from “grant culture”**
- **tangible benefits on the ground in rising economic activity**

EXECUTIVE SUMMARY

Policy Action Team 3's remit

This Policy Action Team was tasked to report on:

- C how successful business support organisations, such as Business Links, are in serving the most deprived communities;
- C how it can be made easier for people in poor neighbourhoods to get access to support to start a business or become self-employed;
- C how access to capital for small firms can be improved, especially for start-ups, including innovative approaches such as "microcredit";
- C what can be learnt from new ways of encouraging self-employment, building on the New Deal and Employment Zones and how access to capital can be tied into regeneration strategies more generally;

with a goal of:

- C drawing up an action plan with targets to encourage more successful business start-ups in poor neighbourhoods.

In practice, the PAT has seen its task, above all, as promoting more successful enterprise in deprived communities - that means both the creation of new businesses and the growth of existing ones.

The PAT was also asked to give specific consideration to black and minority ethnic (BME) issues. Our approach to this has been to build our analysis and conclusions very much into the mainstream of our work. So a discussion of the problems facing BME businesses will be found in each of the relevant sections of the report. In general, our recommendations are designed to have a positive impact on all businesses in deprived communities - whether BME-owned or not. But the PAT has also made specific recommendations on BME issues where necessary. Measurement of the success or otherwise of the recommendations will need to take explicit account of the effectiveness of promoting enterprise by BME groups.

An overview of the problem and our strategy

A shortage of jobs, local services and enterprise is one aspect of exclusion facing people in disadvantaged neighbourhoods. The challenge in economic terms is to rebuild livelihoods and restore robust local markets. Sustainable neighbourhood renewal will not happen without enterprise development. Conversely, enterprise development will be of only marginal relevance unless it is part of a wider strategy to develop people's skills and self-esteem and help them use mainstream services from which they feel excluded.

Promoting enterprise to expand employment opportunities can build confidence and capacity and offer a route out of exclusion through economic opportunity. Enterprise development should therefore be an important indicator of the success or failure of

neighbourhood renewal.

PAT 3's strategy has three elements :

- A. **Better access to services:** people in deprived areas need better access to services that will help businesses succeed. This means improving access to business support and finance.
- B. **Removing barriers to enterprise:** there are unnecessary barriers that stop people from moving into self-employment and prevent some types of business from succeeding. These need to be removed.
- C. **More effective institutions:** Central, regional and local government all have key roles to play in regeneration. So does the private sector in its own long term self-interest. These parties need to work better together and to have a stronger sense of shared objectives.

In each of these areas, the PAT has considered:

- C **The problem.** What is the current position and what evidence is there of a problem? What are the main issues to overcome?
- C **Strategies to address these problems.** What are the alternative options for dealing with these issues?
- C **Who should do what and when, and what are the desired outcomes?** Who needs to act, and what impact should these actions have?

PART A: BETTER ACCESS TO SERVICES

BUSINESS SUPPORT (CHAPTER 2)

The problems

There are a great many publicly funded or voluntary organisations which support enterprise in deprived areas. These include Enterprise Agencies, Business Links (BLs), Training and Enterprise Councils (TECs), local authorities, further education colleges, Regional Development Agencies (RDAs), and voluntary sector organisations such as the Prince's Trust (at national level) or Keighley Local Enterprise Agency (at local level).

Many of these organisations do excellent work, and some examples of best practice that we have encountered are identified in this report. But we have also found a number of serious problems:

- there is no national strategy or framework for providing support to enterprise in deprived communities in the same way that there is (for example) for businesses with high growth potential; by comparison, this area suffers from a lack of attention and clear responsibility at the heart of Government;
- the business support provided in these communities is too variable in its quality and

coverage; the quality of service depends too much on accidents of history and geography, and there is too little shared understanding of what works and what doesn't;

- too often, services are seen as inaccessible or unapproachable by people in deprived communities; provider agencies are often seen as part of the social mainstream, with little relevance to those who feel excluded; this is particularly true of Business Links;
- the number and variety of bodies active in this area causes confusion, and there is little understanding of their different roles.

Strategy

The PAT does not believe that in general there is any need for a new set of organisations delivering business support at local level. Rather, it believes that the right strategy is to encourage existing organisations to work better and to focus more clearly on deprived areas. In particular, there is a need for:

- systematic identification of best practice and the pursuit of higher standards
- more consistent coverage of deprived communities
- delivery channels that are trusted by deprived communities, and have the right technical skills.

The PAT believes that the new Small Business Service could play a pivotal role in this area, by providing a clear focus at the centre of Government for promoting enterprise in poor communities. The PAT recommends that as part of its wider remit to promote small business, **the SBS should encourage enterprise and business growth in disadvantaged communities. The SBS should develop a strategy to achieve this goal, and in particular it should:**

- **aim to give a clear sense of direction to the many organisations involved in business support in this area**
- **identify and promote best practice**
- **look at how to develop new services that add value**
- **increase its own capacity in the field by building a centre of expertise, and commissioning research into enterprise in deprived communities.**

The PAT believes that there is also an important role here for the RDAs and local SBS users' panels. In particular, it recommends that **these bodies should advise the SBS on the coverage of business support for disadvantaged communities at local level. The RDAs should also be encouraged to recognise the importance of enterprise in regeneration more generally, eg in their regional economic strategies and in operation of the Single Regeneration Budget (SRB).**

Business support services need to be delivered in a way that ensures deprived communities see them as accessible and trustworthy. To achieve this, **the PAT recommends that people with a background in deprived or marginalised communities (particularly those from a Black and Minority Ethnic background) are represented at every level in the system**, including the SBS national and local users' councils and management.

The approach proposed above will take some time to bear fruit. Action should also be taken in each of the following areas, with a more immediate impact:

- **Business Links.** BLs are the Government's primary mechanism for supporting business on the ground. BLs have strengths in terms of their relative expertise and links to the wider business community. Though some BLs already work closely with regeneration agencies, their focus is very much on businesses with high growth potential. It would be possible to ask the BLs to develop plans to support enterprise in deprived areas more actively from April 2000, and **the PAT recommends that, as a first step, the 29 BLs covering the 44 most deprived districts in England should be asked to do this.**
- **Mentors.** Volunteer advisers, or business mentors, play a key role in the success of initiatives like the Prince's Trust. **The PAT recommends the creation of a national network of mentors covering deprived areas.**
- **Business incubators.** These provide a combination of workspace and on-the-spot advice and support. They can add real value when operated effectively. **The PAT recommends that further work is done on how to increase the supply of incubators in deprived areas.**
- **Trade links.** British Trade International (BTI) is a new body set up by the Government to promote international trade. There is obvious potential for BME businesses, in particular, to build trading links. **The PAT recommends that BTI should have a strategy for serving firms in disadvantaged areas with the potential to import/export.**

Responsibility and desired outcomes

DTI and more specifically the Minister for Small Firms must take the lead in ensuring that this agenda is implemented by the SBS, RDAs and Business Links. The final outcome should be a higher rate of economic participation in deprived communities. More work is needed before judging whether it make sense to set intermediate targets in terms of business start-ups and failure rates.

FINANCE (CHAPTER 3)

The problems

People in deprived communities often find it difficult to find capital to start or grow businesses. The problem can be worse for certain groups within those communities.

There are several reasons why this is. One of the most important is that people in deprived areas are themselves capital poor, so that the most important source of finance for small firms in the rest of the economy is less available. External finance is therefore all the more important in ensuring efficient capital flows.

Small firms generally find it more difficult to access external finance than large firms. The general reasons for this are well known, and relate to the relative lack of information for potential creditors. In deprived communities, particularly for entrepreneurs who are looking to borrow small sums, these problems are often compounded by further factors:

- a scarcity of collateral, which supports most small firm lending in the UK;
- a more fragile local economy, which increases the risk of business failure;
- the high unit cost of making small loans, which makes them less profitable for lenders;
- problems of cultural separation, which mean that the banks can be seen as unapproachable and uninterested.

Women can face particular challenges, given their lower average income and assets.

Strategy

The PAT has considered carefully how to promote a more efficient market in capital in deprived communities, taking account of the potential social returns from stronger local communities. We have identified several key issues:

- i. UK commercial banks are plainly the major formal suppliers of external finance. Their policies towards operating in these neighbourhoods will therefore be key to the provision of sustainable finance.
- ii. But it is unlikely that market-based solutions alone will address all market failures, given the wider (non-commercial) benefits associated with regenerating deprived communities (eg people being involved in paid work rather than inactive and on benefits).
- iii. Loans have major incentive benefits compared to grants, as they can create a greater discipline to use resources productively. So lending is in general preferable to grant-giving, even if it is not on fully commercial terms. Support for loans can also be a more efficient use of limited public money, as it can be spread more widely. These facts are not sufficiently recognised in public policy.
- iv. New financial intermediaries, such as Community Finance Initiatives (CFIs), can play a valuable role, by acting as additional sources of credit in the community, focussed on market segments that are not commercial but which offer high social returns. CFIs can include schemes initiated by banks.

There have already been a number of moves by mainstream banks to address the perception that they are not interested in poor communities. The PAT welcomes these, and

encourages the banks to continue their initiatives in this area.

More generally, it is important that the banking sector should be as competitive, innovative and efficient as possible, so that deprived communities are served to the maximum extent by market means. **The PAT recommends that the Government should promote these goals**, and the Treasury should ensure that the Cruickshank review of the banking system takes into account the interests of deprived communities.

The PAT also believes that the Government should take an active role in promoting new initiatives providing finance for enterprise where market mechanisms will not suffice. The PAT recognises the potential value of CFIs and similar schemes, but there is a need to develop our understanding of how they can work best. **The PAT therefore recommends that the SBS should be responsible for developing the approach to community finance initiatives by identifying and spreading best practice.**

The PAT also considers that there is a good case for active intervention by Government in this area. The Prince's Trust Business Starts programme is one example of a CFI operating successfully in the UK, with an impressive track record of contributing to social inclusion. New Government initiatives should initially be on an experimental basis to support the development of best practice. **The PAT recommends that the Government should open experimental "funding windows" to strengthen the financial base of CFIs and similar initiatives:**

- i. **a national challenge fund to finance CFIs, and to evaluate the variety of approaches and distill best practices; and**
- ii. **loan guarantee support for CFIs borrowing from wholesale sources of finance, so that they can on-lend in deprived areas.**

The Government should also consider the case for tax relief on lending to/ investing in charitable community finance initiatives at sub-market rates.

Responsibility and desired outcomes

The Treasury and DTI are responsible for implementing different elements of this agenda. There is also scope for working with other organisations, such as the National Lottery Charities Board, and EU institutions such as the Commission and the European Investment Bank and European Investment Fund.

Increased economically viable lending in deprived communities is the desired outcome of these policies. This might be measured by surveying businesses on access to finance and tracking development of credit markets in deprived areas.

PART B: REMOVING BARRIERS TO ENTERPRISE

SELF-EMPLOYMENT (CHAPTER 4)

The problems

Self-employment is one avenue into work. It will not be the right option for everyone, but it can provide a good opportunity for people in deprived areas to move into productive activity. Larger private sector employers may not be present in these areas, and self-employment may be a more viable employment option as a result. In communities that feel excluded from much of society, self-employment can offer an effective route to economic independence.

The PAT identified three key problems which act as unnecessary barriers to people entering self-employment:

- i. **the perceived complexity of the tax and benefits regime** and lack of readily available information;
- ii. **the fact that income in the early stages of trading is uncertain**, and that time lags occur between investment and income;
- iii. **a relative lack of awareness and support for self-employment as an option.**

These problems - particularly the first - were identified time and again in the PAT's consultations with actual and potential entrepreneurs in deprived communities.

Strategy

There are presently a large number of different initiatives aimed at supporting those who wish to move into self-employment. These include:

- the Jobseeker's Allowance programme, which includes advice and training for people wishing to move into self-employment or start a business;
- the New Deal programmes, some of which have self-employment options;
- Work-Based Training for Adults and the Enterprise Rehearsal Scheme;
- Working Families Tax Credits, which support the self-employed as well as the employed;
- Employment Credits for the over-50s;
- organisations such as Enterprise Agencies and the Prince's Trust, discussed above;
- initiatives such as Employment Zones.

The PAT welcomes these measures, but it is concerned that many individuals in deprived communities do not seem to understand the range of support that is available to them.

There is also a clear perception that Government agencies, such as the Employment Service and Benefits Agency, are unenthusiastic about self-employment as an option. We need to make the move from “benefits into business” a central element of the whole welfare system.

The PAT recommends that, as part of its ongoing reforms, the Government should continue to review the effect of the tax and benefits system on people moving into business. The aim should be to create a tax and benefit system that is easy to understand and that supports and encourages people moving from benefits to self-employment. The move “from benefits to business” should be simple - as easy as moving into employment. **There should also be an urgent programme to make front-line staff in benefit offices and job centres more aware of self-employment as an option. Simple guidance / information should be available to inform clients about the benefit implications of self-employment.**

The PAT also recommends the Government considers:

- building on existing reforms of the tax and benefit system to **provide an "income bridge" for welfare recipients and their dependent partners who decide to enter self-employment.** Such an income bridge is already, or will soon be available, to many groups through the New Deal for 18-24s, the Working Families Tax Credit, and the Employment Credit for the over 50s. The PAT welcomes the Chancellor's announcement in the 1999 Budget that the Government sees a case for extending the principle of a guaranteed in-work income to all those in work, and that the Government will bring forward further proposals in due course;
- **making support for those moving into self-employment available to all irrespective of age,** in light of the New Deal pilots for 25 plus; and
- **improving the awareness of enterprise in deprived communities;** this needs to be built into the Government's public awareness strategy for enterprise.

More work is needed in each of these areas. The tax and benefit system is extremely complex and the PAT has not had the time or resources to investigate it in detail and to make specific recommendations for change. The design of the income bridge would be crucial to its success - for example, it would need to be linked to business start-up training, and some assessment to ensure that self-employment was an appropriate option for the individual and that their business case was of suitable quality. It would also need to take into account potential deadweight and displacement effects. The PAT recommends a limited number of pilots in deprived areas with evaluation.

Responsibility and desired outcomes

HM Treasury, DfEE and DSS need to work closely together to deliver this.

The PAT does not propose any specific targets for self-employment in deprived communities, which would risk distorting behaviour. The final outcome should be higher economic participation rates in deprived communities.

SOCIAL ENTERPRISE (CHAPTER 5)

The problems

Social enterprises are businesses run for a social objective, rather than for the sake of profits to be distributed to shareholders. At community level, social enterprises are a very diverse group, including financial services providers (eg credit unions), retailers and operators of childcare facilities. Social enterprises can strengthen the social and economic fabric of deprived communities, not least by providing services that are not profitable enough to attract private sector firms. They can also act as a bridge between a deprived community and the mainstream economy, eg by providing training and experience to people who might otherwise be unemployed.

Social enterprises merit support in much the same way as other businesses. They face business challenges such as marketing and financial management like other businesses. They also face some issues - like complex legal forms and mixes of funding - that are specific to the social economy. Social enterprises often see themselves as a distinct group. The PAT recognises that social enterprises have some particular needs, but thinks that it is important to emphasise the degree of commonality with other businesses.

The problems faced by social enterprises in deprived communities include: patchy availability of support services; a lack of understanding about how to measure “success” as a social enterprise; weak and fragmented markets for their products; and difficulties in accessing mainstream sources of finance.

Strategy

The PAT believes that the starting point must be to **recognise social enterprise as a group of businesses deserving support**, capable of making a contribution to economic and social renewal. The PAT recommends that the **Small Business Service should have a remit to understand and support social enterprises in the same way as other businesses. RDAs should be encouraged to include the sector in their regional economic strategies, and in the funding criteria for SRB.**

The PAT also recommends **further work on steps to build the capacity of the social economy**, such as a guide to evaluating community-based social enterprises, and a social labelling scheme for UK social enterprises analogous to the “Fair Trade” label for imported cocoa and coffee.

Responsibility and desired outcomes

The SBS and DETR should take forward the agenda. The outcome should be a stronger and better served social economy over the medium term, as measured by eg turnover and access to external finance.

PART C: MORE EFFECTIVE INSTITUTIONS

LOCAL AND REGIONAL GOVERNMENT (CHAPTER 6)

The problems

Local and regional government (local authorities, Government Offices, Regional Development Agencies) have a key role in the regeneration of deprived communities, including promoting enterprise. They are significant sources of strategic leadership, funding, information and advice. Housing associations are also major potential players.

The PAT has identified the following key issues:

- The SRB funds provide relatively little support for enterprise compared to its importance as a potential engine of renewal.
- There is too little collaboration between central, regional and local government in ensuring that strategies for supporting enterprise are effective.
- The potential of Housing Associations is not being exploited properly (though the risks of increasing their involvement also need to be understood).

Strategy

RDAs have a key role to play given their responsibility for the SRB and for regional economic strategies. There needs to be a step change in the importance given to enterprise within the SRB - RDAs will need to deliver this, working in conjunction with bid teams.

The PAT recommends that **RDAs should be rigorous in deciding which SRB bids to fund - ensuring they give enough weight to developing enterprise where there is need for this.** RDAs and DETR should also develop clear guidance for bid teams on promoting enterprise and identify good practice.

The PAT also considers that more should be done to increase the effectiveness of local authorities' work in this area. It recommends that **DETR and the LGA should work with the SBS and RDAs to develop and promote best practice in enterprise support as part of local regeneration and anti-poverty strategies.** Local authorities should also ensure that local planning and economic development regimes are properly linked to anti-poverty action plans, and vice versa.

Regeneration, including enterprise promotion, should be recognised as a legitimate activity of housing associations; and guidance should be provided on managing the financial implications and risks.

Responsibility and desired outcomes

DETR and SBS should take the lead here. The desired outcome is a higher quantity and quality of enterprise support at local and regional level.

MAINSTREAM BUSINESS (CHAPTER 7)

The problem

Larger, established firms have a vital role to play in local regeneration. They have an interest both as corporate citizens and for their own long-term commercial advantage, through the development of new products and more robust markets.

Many large firms presently make an outstanding contribution to their local communities. But behaviour seems to vary, both between different companies and across the different dimensions of social responsibility. The PAT believes that there is more that can be done to encourage mainstream business to play its full part in combatting social exclusion.

Strategy

It must be for business to decide what more to do, and how to promote this. No Government edict will produce a lasting change in behaviour. But the Government can play an active role as an advocate and catalyst - for example by promoting debate about the benefits of corporate social responsibility and by recognising success. Any fresh impetus given to the area should aim to build on existing organisations and initiatives, such as Business in the Community and plans for a Corporate Community Investment Index.

The PAT recommends that **DTI should take responsibility within Government for promoting business involvement in deprived communities**. Specific action might be taken as follows:

- C *Give a Minister a specific remit for Corporate Social Responsibility, to give focus and attention to this area*
- C *Promote a more systematic approach to Corporate Social Responsibility, through benchmarking and disclosure*
- C *Promote a better understanding of why it is in businesses' interest to be involved in deprived communities.*

Outcome

More involvement between mainstream businesses and deprived communities is the desired outcome from this work but this is difficult to measure. As a secondary indicator the DTI might track the attitude and perception of businesses, or deprived communities, towards corporate social responsibility.

Overall expenditure implications

Table 1 below summarises the full set of recommendations. The costings for recommendation 15 depends on the outcome of current evaluations. The cost of remaining recommendations should be able to be met within existing spending plans, although in some cases this may require some reallocation of resources from other areas.

The DTI have already announced that more than £3 million has been made available to develop a mentoring scheme.

Reporting

The PAT recommends that **the Government should report regularly on progress with implementing the agenda set out here**. The reporting arrangements will need to be consistent with any proposals set out in the forthcoming National Strategy for Neighbourhood Renewal. DTI and HMT should take the lead here.

Enquiries and comments

Comments on this report and its recommendations are welcome. For further information on the work of the PAT, and to pass on any comments, please contact:

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Table 1: Recommendations					
<i>Recommendation</i>	<i>Lead</i>	<i>Action</i>	<i>Timing and targets</i>	<i>Other comments (eg financial or legislative implications, local authority burdens, risks)</i>	
Business support (Chapter 2)			Overall aim is to increase economic activity in deprived communities.		
			Measure this using economic participation rates. Business start-up and survival rates can be useful pointers.		
1	As part of its wider role to promote enterprise, the Small Business Service should encourage enterprise and business growth in deprived areas.	DTI / SBS	<p>The Small Business Service should have an explicit remit to encourage enterprise and business growth in disadvantaged communities. It should take account of the needs of micro-businesses.</p> <p>The SBS should develop a strategy to meet this remit. It should:</p> <ul style="list-style-type: none"> - give a clear sense of direction to the many organisations involved in business support in this area - identify and promote best practice among these organisations - look at how to develop new services that add value - build its own capacity by recruiting experts in the field, with experience of regeneration and deprived areas. 	<p>Strategy to be devised as part of the process of creating and developing the SBS, and described in its first strategic plan.</p> <p>Implementation by end-2000.</p> <p>Recruitment of staff in this area should begin as soon as SBS CEO is in place.</p>	<p>SBS strategy in this area will have greatest impact in medium to long-term.</p> <p>There are other actions that can be taken in short term that will have a more immediate impact - see below (eg items 5, 6, and 12).</p>

Table 1: Recommendations					
Recommendation		Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
2	RDAs to ensure that their policies reflect the role that enterprise in deprived areas can play in contributing to neighbourhood renewal.	RDAs	RDAs should be encouraged to: a. examine the coverage of business support in deprived areas in preparing their Regional Economic Strategies; and advise the SBS on strengths and weaknesses. b. run regeneration strategies with the encouragement of enterprise as a core goal.	(a) - by end-1999, then ongoing (b) - ongoing. DTI & DETR to monitor business support funded via SRB for evidence of change. See also item 22.	
3	Get better understanding of enterprise in these communities, and across the different dimensions of society. Embed that understanding in Government to create a permanent source of expertise.	DTI/SBS	a. commission research into business start-up and survival in deprived communities and among different social groups (eg ethnic minorities, disabled). Research should examine drivers of behaviour. b. create centre of expertise in SBS on enterprise in disadvantaged groups and more generally in a diverse society.	Research programme to be commissioned by April 2000. Centre of expertise to be established as soon as possible in creation of SBS.	Research should inform local targets and contribute over time to SBS national strategy. PAT18 to consider research needs on local area basis - timing reflects that. There is a continuum between the activity suggested here and that needed to understand enterprise in society as whole (eg among women).

Table 1: Recommendations					
Recommendation		Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
4	Deliver business support services so that deprived communities see them as accessible and trustworthy	DTI	<p>This needs to be reflected in the business support system at every level, by including people with a background in deprived or marginalised communities, eg:</p> <ul style="list-style-type: none"> - in the SBS national council - in local SBS councils - in the management of SBS, Business Links, and Enterprise Agencies. <p>The best practice identified in item 1 should include how to reach out to deprived communities.</p>	Immediate - to be reflected in design of SBS and development of strategy.	
5	Business Links to have a role in providing business support services in deprived areas.	DTI / SBS	<p>As a first step, the 29 Business Link Partnerships covering the 44 most disadvantaged local authority districts should be asked to develop plans to support enterprise and business growth in deprived areas. These plans should look at how to promote: an entrepreneurial culture; creation of new businesses; growth of existing firms.</p> <p>DTI to initiate this request, and the SBS to follow it through.</p> <p>Longer term role of BLs to depend on SBS strategy.</p>	<p>DTI should make the request immediately.</p> <p>BL plans should be ready for implementation from April 2000.</p>	<p>Requires reallocation of resources from other areas - to be identified by DTI and/or BLs.</p> <p>Scope of new activity depends on what is achievable in this timescale.</p>

Table 1: Recommendations					
Recommendation		Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
6	Create a network of volunteer business advisers covering deprived areas.	DTI (with SBS & RDAs)	DTI (later SBS) to take the lead in creating a new national network of volunteer mentors, to include coverage of deprived areas. SCORE in the US is a precedent.	Operational by end-2000. Review its success by end-2003.	Patricia Hewitt, the Minister for Small Firms at the DTI, announced on 20 September that more than £3 million would be made available to the end of March 2001 to develop a mentoring scheme for people looking to start up their own business or running a new business.
7	Identify how to increase the supply of effective incubation units in deprived areas.	DETR / SBS	DETR to commission research evaluating the cost and benefits of support for incubators. The results of this research should feed into SBS strategy.	DETR to commission research. Implement the strategy by end-2000.	This work needs to involve SBS, DETR, RDAs, liaising with English Partnerships, local authorities and housing associations.

Table 1: Recommendations					
Recommendation		Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
8	British Trade International to support trade activities in disadvantaged communities.	BTI	<p>BTI to ensure it has a strategy for serving firms in disadvantaged areas with the potential to import/export. Ethnic minority businesses are an obvious target group.</p> <p>The Export Development Counsellors in the 29 identified Business Link partnerships should be asked to work with businesses, particularly ethnic minority businesses, in disadvantaged areas to highlight the possibility of international trade as a mechanism for encouraging growth.</p>	By mid-2000	
9	Set targets for business start-up and survival rates in deprived communities.	DTI/SBS, RDAs	Set targets for local interventions to promote enterprise and business growth in deprived communities. Responsibility for this should rest with the party financing the intervention (eg SBS, BL, RDA etc).	Targets for local policies needed to accompany design of intervention.	

Table 1: Recommendations					
Recommendation	Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)	
Improving access to finance (Chapter 3)			<i>The aim is to ensure that more enterprises that can deliver high social or economic returns get the credit they can afford.</i>		
			Measure this by surveying businesses on access to finance, and tracking development of credit markets in deprived communities.		
10	Government to promote competition, innovation and efficiency in the banking sector to ensure that deprived communities are served to the maximum extent possible by market means.	HMT	HMT to ensure that the Cruickshank review takes into account the interest of deprived communities in a competitive banking sector.	Cruickshank due to report by end-1999	
11	Government to play an active role in promoting new initiatives providing finance for enterprise, where there are high social returns and where market mechanisms will not suffice.	DTI/SBS & HMT	SBS to develop HMG's approach to Community Finance Initiatives (CFIs) (which may include schemes initiated by banks).	Immediate & ongoing	HMT to work closely with DTI/SBS in this area. First steps do not need to wait for preparation of a formal SBS strategy - they can be based on this report. See item 12.

Table 1: Recommendations					
Recommendation		Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
12	The Government to open funding windows, on an experimental basis and subject to evaluation, to strengthen the financial base of CFIs and activities initiated by banks in this area.	HMT / DTI	<p>a. DTI/SBS to provide loan guarantees for CFIs borrowing from banks.</p> <p>b. DTI/SBS to establish a national challenge fund to resource CFIs.</p> <p>c. HMT/IR to consider case for tax relief on lending to/investing in charitable initiatives in this area, where investment is at sub-market rates.</p>	(a) and (b) should be operational by April 2000.	<p>Work on (a) and (b) should begin immediately.</p> <p>Costs of (a) and (b) depend on volume of activity and risk assumed.</p>
13	Monitor the character and volume of bank and CFI activity in deprived areas, to maintain pressure for change.	HMT / DTI Bank of England	<p>a. Government to invite the Bank of England to report regularly on finance for business in deprived groups and communities, perhaps as part of annual review of finance for SMEs.</p> <p>b. Government to run an award scheme for innovation and excellence in the banking sector in serving deprived communities.</p> <p>c. banks to be encouraged to work with interested parties on voluntary disclosure of activity in this area.</p>	<p>a. immediate</p> <p>b. first awards made in 2001</p> <p>c. request to be made in response to this report</p>	The Bank of England has agreed to implement (a).

Table 1: Recommendations				
Recommendation	Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
Promoting self-employment (Chapter 4)			<p><i>The aim is to ensure that people have every opportunity to develop and use their abilities. This means more people need to understand the potential of self-employment, and we must remove barriers in their way.</i></p> <p>We do not favour targets for self-employment as such, as they risk distorting behaviour. But changes in self-employment and attitudes to enterprise can be useful pointers to progress.</p>	
14	Create a tax and benefit system that is easy to understand and supports and encourages people moving from benefits to self-employment.	HMT DSS DfEE	<p>Two actions are needed:</p> <p>a. as part of the Government's on-going reforms, consideration should be given to the impact of the tax and benefits system on the propensity of people (especially those in deprived areas) to move into self-employment;</p> <p>b. Ensure that front-line staff in benefit offices and Job Centres are aware of self-employment as a viable option for clients and how the tax and benefit system will affect the move from "benefits to business". Simple guidance / information should be available to inform clients about the benefit implications of self-employment. A review of existing training is required and if necessary implement an urgent programme of training.</p>	<p>a. ongoing.</p> <p>b. in early 2000.</p>

Table 1: Recommendations					
Recommendation		Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
15	The Government considers extending greater support for those moving into self-employment irrespective of their age.	HMT / DfEE	The evaluation of the New Deal pilots for the 25 plus will be an essential element of this consideration.	By end-2000	The outcome of current evaluations should indicate the most effective intervention to reach disadvantaged groups.
16	Consider providing an income bridge to help the move from "benefits to business".	DSS/HMT/ DfEE	Consideration be given to providing an "income bridge" to the self- employed by building on current tax and benefit reforms - for example providing the Employment Credit for the over 50s or the Working Families Tax Credit to other groups, such as households without children.	Ongoing	
17	Improve awareness of self-employment and enterprise in deprived communities.	DTI/SBS DfEE	This needs to be built into the Government's public awareness strategy for enterprise, including: <ul style="list-style-type: none"> - the new National Campaign for Enterprise planned by BCC, DTI et al; - initiatives to improve links between education and enterprise; - Ministerial speeches. 	Immediate & ongoing	

Table 1: Recommendations					
Recommendation	Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)	
Social enterprises (Chapter 5)			<p><i>The aim is a socially and commercially successful social enterprise sector, that contributes positively to regeneration. Social enterprises should be served like other enterprises and, subject to their social goals, they should act like other businesses.</i></p> <p>Indicators could include activity levels (turnover, external finance), and use made of support services.</p>		
18	Social enterprises to be recognised as a group of businesses deserving support.	All parts of Government, especially DTI/SBS and DETR/RDAs	<p>The SBS should have a remit to support social enterprises in the same way as other businesses. It should:</p> <ul style="list-style-type: none"> - understand the sector's differences, but also its similarity to other firms. - help to build its potential. <p>RDAs should be encouraged to include the sector in their Regional Economic Strategies.</p>	Immediate & ongoing	
19	Enhance the potential of social enterprises.	DETR / SBS	<p>a. DETR to research evaluation - eg financial and social criteria.</p> <p>b. SBS to review legal/ regulatory framework to assess scope for simplification.</p> <p>c. DETR to research potential for "social labelling" - analogous to the Fair Trade label for coffee, cocoa etc -for UK social enterprises.</p>	<p>Commission research on (a) and (c) as soon as possible.</p> <p>Results to be available by mid-2000.</p> <p>(b) to be completed by mid-2000.</p>	Output of (a) should be an evaluation guide for social enterprises.

Table 1: Recommendations					
Recommendation		Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
20	Social enterprises to be recognised in national funding criteria.	DETR	The promotion of social enterprises should appear in the criteria for SRB and similar schemes.	Before the next funding round (ie SRB round 6).	
21	Drive change in culture of social enterprises and voluntary sector, away from grants towards loans.	HMT with DETR, DTI and other departments.	Systematic review of Government grant programmes, to identify potential for moving from grants to loans.	Complete review by mid 2000.	Loan financing should be a presumption where there is the potential for a positive financial return.
Regeneration strategies (Chapter 6)				<i>The aim is to ensure that the Government's strategies for enterprise and for regeneration reinforce each other and are closely linked.</i>	
22	Encourage more high quality activity to promote enterprise and business growth in regeneration strategies.	DETR with RDAs, LGA and SBS.	<p>a. Develop clear guidance on enterprise initiatives for SRB bid teams and identify good practice.</p> <p>b. RDAs to be rigorous in deciding which SRB bids to fund - ensuring that they give enough weight to developing enterprise where there is a need for this. DETR should commission analysis of the current proportion of SRB bids that develop enterprise.</p> <p>c. DETR & LGA, with SBS & RDAs, to develop and promote best practice in enterprise support as part of LAs' regeneration and anti-poverty strategies.</p>	<p>(a) and (c) by April 2000.</p> <p>(b) immediate & ongoing.</p>	RDAs should monitor progress in this area at a regional level, liaising closely with SBS and DETR.

Table 1: Recommendations					
Recommendation		Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)
23	Recognise regeneration formally as a legitimate activity of Housing Associations.	DETR	<p>a. Regeneration activities, in particular through supporting business and start-ups, to be formally identified as a legitimate activity of Housing Associations. This is PAT3's formal response to the current consultation exercise on the activities of HAs.</p> <p>b. Guidance to be provided to HAs on managing the financial and risk implications of engaging in regeneration activities. DETR, the National Housing Federation, The Housing Corporation and PAT7 should jointly prepare clear guidance.</p>	By end-1999	DETR have implemented the necessary statutory instrument.

Table 1: Recommendations					
Recommendation	Lead	Action	Timing and targets	Other comments (eg financial or legislative implications, local authority burdens, risks)	
Community involvement in promoting business (Chapter 7)					
24	Promote greater involvement in renewing deprived communities by 'mainstream' businesses	DTI with SEU	<p>DTI needs to have clear responsibility for this issue within Government. Possible actions include:</p> <ul style="list-style-type: none"> - Give a Minister a specific remit to promote Corporate Social Responsibility. - Promote a debate, and disseminate information, about why it is in businesses' interest to be involved in local / deprived communities. - Promote a clearer analytical framework for measuring businesses' contribution and its benefits. 	<p>A new strategy in this area should be put in place during 2000.</p>	<p>Greater business involvement in deprived communities goes beyond the scope of this PAT's work. So we recommend that this issue is taken forward on a cross-PAT basis.</p>

CHAPTER 1: INTRODUCTION

- 1.1 The pursuit of economic growth will be less successful if it neglects the need to develop and support an inclusive society. Product, labour and capital markets will be smaller, more fragmented and less efficient. The opportunities open to business - whether for recruiting employees, selling physical products or providing financial services - will be fewer. And the costs to society of supporting failed communities through taxation and public spending will be higher.
- 1.2 It is in the interest of many parties - both public and private sector - to support the regeneration of deprived areas by encouraging more enterprise within those communities. Government has a central role, in setting the framework, allocating resources, and catalysing activity. But it will only work effectively if it succeeds in doing two things:
- first, harnessing the self-interest of the private sector, and doing this in a way that encourages firms to be outward looking and innovative, and to focus on the potential for long-term gains (like developing new markets), not just short-term;
 - second, ensuring that the public sector itself pulls together and in the same direction; there are many different agencies funded by the public sector discussed in this report, and each has its own objectives and performance goals; the more the task described in this report can become a shared objective, the more coherent will become the practice of policy on the ground.
- 1.3 Government also has a role to play when there is market failure - for example where the wider costs (or benefits) to society are not taken into account in market outcomes.

The problem faced by enterprise in deprived communities

- 1.4 People in poor neighbourhoods face a number of obstacles when trying to start-up or grow a business or to move into self-employment. The most fundamental of these are intrinsic to the wider problem of social exclusion. They go beyond the remit of this report, and instead provide its context:
- *The local economic environment:* Low income levels result in low local demand for goods and services in poor communities, making it more difficult to start and grow successful businesses. Poor communities also often have high levels of crime, which can affect both the demand and supply side of the local economy, reducing consumer demand and increasing business costs.
 - *Local skill levels and labour markets:* Skill levels in poor communities may be low and poorly matched to the wider job market, with large amounts of unskilled or semi-skilled labour. Partly as a result, poor communities often have high levels of unemployment and weak local job markets. Prolonged periods of unemployment can lead to malaise and loss of commitment, further weakening the skill base.
- 1.5 These factors mean that enterprises in poor communities face a hard task -

supplying a weaker local economy, and recruiting employees from a weaker local labour force than in the rest of the economy. In addition, entrepreneurs running these businesses are themselves less likely to have the full range of financial and managerial skills needed to start and grow a business successfully.

- 1.6 But it is in the nature of entrepreneurs to overcome difficulties. And in other respects poor communities have some significant advantages, including: a large supply of individuals with entrepreneurial skills and talent (as shown by much of the evidence given to the PAT while working on this report); a still larger supply of individuals who are rich in time and some skills; and, in some cases, local networks that already support enterprise.
- 1.7 This report, in line with the PAT's remit (set out in Annex A), focusses on obstacles that are more specific to the encouragement of business start-ups and growth, and ways in which these obstacles can be removed. The strategy that the PAT has devised to achieve this aim has three elements:
 - A. **Better access to services:** people in deprived areas need better access to services that will help businesses succeed. This means improving access to business support and finance.
 - B. **Removing barriers to enterprise:** there are unnecessary barriers that stop people from moving into self-employment and prevent some types of business from succeeding. These need to be removed.
 - C. **More effective institutions:** Central, regional and local government all have key roles to play in regeneration. So does the private sector in its own long term self-interest. These parties need to work better together and to have a stronger sense of shared objectives.
- 1.8 But the PAT recognises that this strategy will only be effective if it is combined with a wider strategy to address other problems in deprived areas, such as addressing the skills gap and problems of crime.

The informal economy

- 1.9 The informal economy can play a significant factor in the lives of some people in poor communities, and in other areas. ("Informal" here is taken to mean enterprises whose business activity is in itself lawful, but is carried out without full compliance with the laws on taxes and benefits or some regulatory requirements.) The PAT has not looked at the policy issues surrounding the encouragement of people to move from the informal to formal economy, but there are numerous reasons why it is desirable to encourage that migration. Quite apart from the effects on society at large, remaining within the informal economy is likely to inhibit the long-term interests of the individuals concerned. For example, they might not be able to get business support services and finance for business expansion.

PART A: BETTER ACCESS TO SERVICES

Chapter 2: Access to Business Support

Introduction

- 2.1 This chapter considers how business support services address the needs of the most disadvantaged communities, and the different needs of groups within these communities (eg ethnic minorities, women, etc). It assesses the role that these organisations have so far played, and considers how that role might be developed, making it easier for people in poor neighbourhoods to access support to start or expand their business. In particular it considers and makes recommendations regarding:
- C the potential role of the Small Business Service;
 - C the role of Regional Development Agencies;
 - C Business Links;
 - C other support organisations (such as Prince's Trust) and the potential for a volunteer mentor network;
 - C other forms of business support - business incubation units; British Trade International.

The recommendations in this chapter (and elsewhere in the report) aim to support people trying to start up in business but, equally important, also aim to help existing businesses to expand and make the most of their potential.

Box 2.1: Range of possible business support services

- 2.2 The range of enterprise support that might be required by people looking to start up in business, or to expand an existing business, includes:
- C *awareness*: general awareness of the potential costs and benefits involved in starting up in business;
 - C *advice*: advice on the implications, risks and rewards from starting a business;
 - C *marketing*: understanding the potential market for new (and existing) businesses is crucial. Support agencies can help people who are not familiar with marketing techniques and approaches to undertake market research;
 - C *training*: training and support to develop the business skills needed before starting (eg business planning, marketing, financial control, taxation and dealing with regulatory authorities) and to sustain and expand a business;
 - C *access to finance*: signposting for sources of finance, and help with the process of

applying for finance (access to finance as an issue is dealt with in chapter 3);

C *mentoring*: ongoing support and guidance on a regular basis; and

C *help with bureaucracy and regulatory issues*: for example help with health and safety regulations, tax, payroll and trade issues.

The problem

Some facts

2.3 Statistics on business start-ups and failures (based on VAT registrations and de-registrations), which are subject to a number of caveats, suggest that in general (as one would expect) there is less enterprise activity in deprived areas - defined as one of the 44 most deprived local authorities districts according to the 1998 Index of Local Deprivation - than elsewhere. However, there are clear exceptions such as deprived areas in London which tend to have high levels of enterprise activity (both start-ups and failures).

2.4 Figures on business survival rates, also based on VAT data, show that business survival rates in deprived areas are lower at any duration than in non-deprived areas, though this difference is not very large.

Business start-ups and failures

2.5 Business start-up and failure figures are not readily available, but indicative figures can be derived from VAT registrations and de-registrations (though there are clear problems with using VAT figures - see below). VAT figures for 1997 (which though a snapshot should be indicative of the normal state of affairs) show:

C 6 of the 44 deprived areas feature among the areas with the *lowest* twenty VAT registration (business start-up) rates in England;

C A further 7 feature among the *highest* twenty registration rates - all in London, where registration rates are the highest in the country reflecting both high levels of enterprise and a tendency for companies to want a central London address;

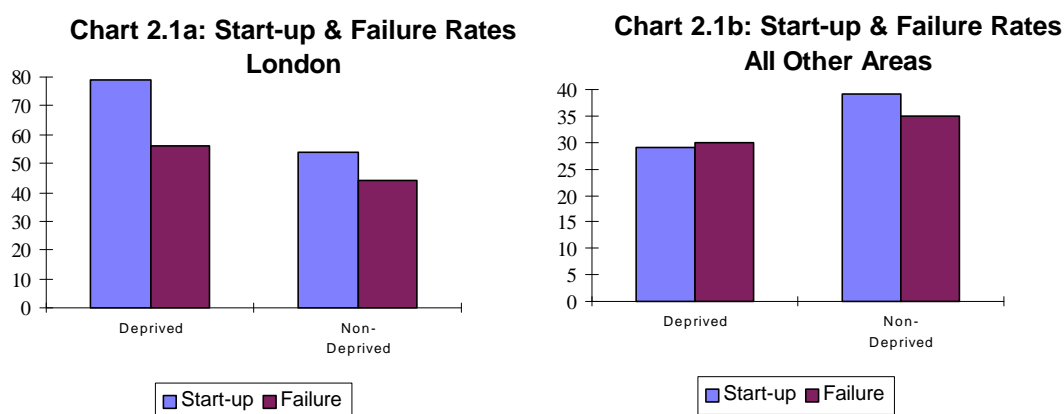
C Most of the remaining 31 deprived areas have a registration rate *below the England average*; and

C Low (high) de-registration rates go hand in hand with low (high) registration rates throughout the UK - including in deprived areas.

(Source: DTI SME Statistics Unit, note: the business start-up and failure rate is defined as number of businesses registering and de-registering for VAT per 10,000 resident adults)

2.6 These data on business start-ups and failures in deprived communities can be

difficult to interpret. Most simply, where people start or register their business need not be the same location as where they live. And within districts defined as 'deprived', there may be very prosperous neighbourhoods which makes comparisons of enterprise activity in different areas potentially misleading. An example is Kensington and Chelsea, which is included (at number 42) in the 44 most deprived local authority districts according to the 1998 Index of Local Deprivation. But this area has some extremely prosperous neighbourhoods. The impact of London on the figures is clearly illustrated in charts 2.1a and 2.1b. This shows that when London is excluded from the comparison both start-up and failure rates in deprived areas are lower than in non-deprived areas.



2.7 As noted above, the VAT statistics used be misleading. They do not accurately indicate business start-ups or failures, merely registering and de-registering for VAT. This will underestimate the true level of start-ups and failures because many small firms and self-employed people operate below the VAT threshold, notably sole traders, and are perhaps more likely to work in deprived areas. But subject to these heavy caveats, these statistics should provide an indicative picture of enterprise activity in deprived areas.

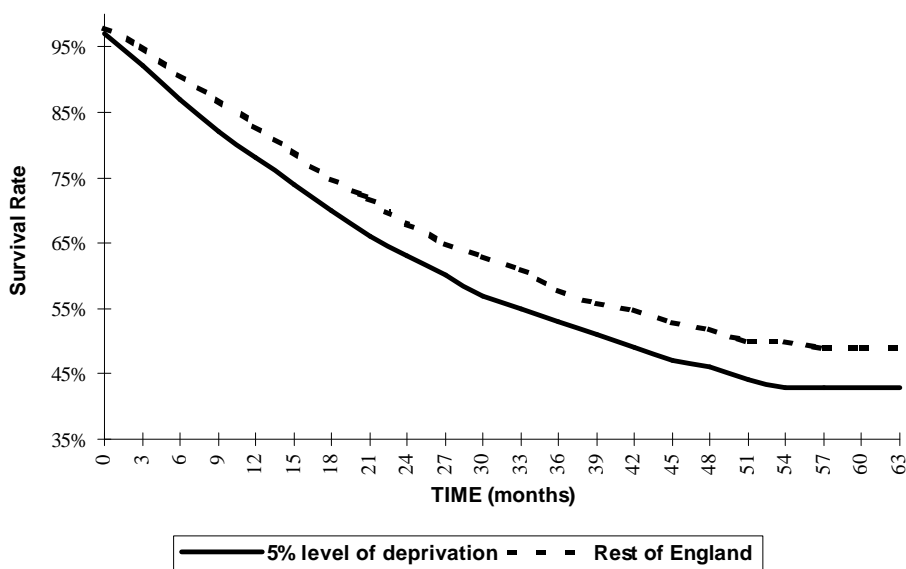
Survival rates

2.8 The PAT has looked at data on business survival rates from the ONS which show survival levels for businesses started in 1993 up to the present for areas of 5%, 7%, 10% levels of deprivation and for the rest of England. These show that, although business survival rates in deprived areas are lower at all durations, the difference is not large (see chart 2.2). Once again it is important to note that the data are for VAT registered businesses only and, therefore, misses out a large group of people.

2.9 As chart 2.2 suggests, at any time in their early-stage development, on average, businesses in deprived areas are more likely to fail than businesses elsewhere. The difference is not enormous. And without knowing the subsequent destination of the failed enterprises, it would be difficult to draw firm conclusions about the seriousness of any differences that might have been found on the basis of these data alone. (More in-depth analysis of these data are required, and in particular

analysis at more regional and local levels.) Nevertheless it is strongly indicative of the fact that businesses in deprived areas find it more difficult to start-up and expand than businesses elsewhere.

Chart 2.2: Survival Rates: proportion of businesses surviving



2.10 The PAT recognises the need for more in-depth research into this area. But from the observations above, the PAT's conclusion is that there is less enterprise activity in deprived areas than one might expect. And where there is enterprise activity, there is (marginally) more chance that this will fail. (Note that this offers no explanation for why the enterprises fail, and it is important to bear in mind that there are clear differences between London and elsewhere which can distort comparisons.)

The problems faced by businesses and potential entrepreneurs in deprived areas

2.11 Starting and growing a business requires a diverse mix of skills. Individual entrepreneurs rarely have the right mix. This is true for people in deprived areas as in other areas. But people in deprived areas may require more intensive pre- and post-start-up advice and counselling than people in other areas. This may be for a variety of reasons, including:

- C *lack of commercial experience*: people in deprived areas may have the ideas, skills and drive to run a business successfully but may be hindered in their attempts because of a lack of commercial background. As a result they may not speak in 'mainstream business jargon', and may not have the experience necessary to prepare a business plan. The flip-side of this is that the mainstream commercial

world may not be flexible enough in their approach in dealing with potential entrepreneurs who do not speak their jargon;

- C *trouble accessing finance* (this issue is covered in detail in chapter 3);
- C *motivation*: long periods of unemployment or inactivity may have resulted in a loss of motivation and relevant skills;
- C *training requirements*: due to a lack of skills and education they may have training requirements (these requirements may be different to training presently provided, for example the Employment Service may have provided training to the people in question, but this is likely to have been aimed at making them a good prospect as an employee rather than as a business person);
- C *lack of confidence*: starting up and expanding a business can be a daunting process, individuals may lack confidence in their own abilities and ideas;
- C *a lack of role models*: role models can act as an example, inspiration and motivational force;
- C *lack of contacts*: people in deprived areas may not know what products and services are available, or who to contact in order to gain access to them; and
- C *cultural barriers*: for ethnic minorities there may be cultural barriers, for example speaking English as a second language may be a significant barrier for those seeking advice.

2.12 Many of these problems and barriers may hinder people moving into salaried employment as well as those starting up in business. Furthermore some of these problems may be exacerbated for certain groups within deprived areas. For example, women may find it intimidating to walk into a male dominated support organisation, and can find it more difficult to gain access to finance due a lack of collateral. Women's earnings are generally less than men's earnings, hence they tend to have less collateral - see Women's Individual Income 1996/97 published by the Women's Unit, Cabinet Office.

2.13 In order to address these problems businesses and potential entrepreneurs in deprived areas need to have access to suitable business support services. But a strong message from our consultations was that these services were not readily available. There are a range of reasons why people in deprived areas often cannot access the advice and support they require:

- C *Support is not available, or patchy*: during the team's consultation exercise a familiar complaint was the lack of coherent business support available. Some business support agencies (eg Business Links) have a national coverage, but their remit may result in variable levels of enterprise support to deprived communities. Other agencies have a local basis (eg Enterprise Agencies), but can vary in strength and capability.

- C *Support that is available is perceived to be unapproachable:* a concern raised at consultations was that the providers of support (“men in suits”) were unlikely to empathise and understand the problems faced by people in deprived communities in starting up in business (this can apply to government and non-government organisations). This was perceived to be a particular issue for ethnic minorities - the desire to speak to ‘like-minded’ people was strong. One person cited an example of a black Prince’s Trust applicant faced with an all white assessment board. The applicant found this very off-putting and felt the board did not really understand her, or her values. This is backed up by academic research which suggests that official support agencies are not sufficiently tailored towards the needs of ethnic minority firms¹. Anecdotal evidence also suggests that women in deprived areas are reluctant to take up opportunities of support from male-dominated institutions.

- C *Poor signposting of support and potentially variable quality:* although support may be available people can find it difficult to know where to go to access this support, and the range of potential support organisations can be bewildering. Depending on where they lived, someone looking for advice on starting up or expanding a business might turn to an enterprise agency; Business Links; Training and Enterprise Councils; Prince’s Trust; their local Further Education college; Local Authority; or another organisation. Such organisations may or may not be readily available in poor neighbourhoods. Furthermore they may not have the necessary expertise, skills, and experience to provide the right support and advice, or the remit to do so. As a result the quality and availability of service provided can be variable.

The Policy Action Team on improving access shops in deprived neighbourhoods (PAT13) considered how business support for small retailers could be improved. Its findings were similar to these. While it argued that the needs of small retailers were rather different to other small businesses, it nevertheless found that these needs were not being met by existing business support services and particularly in the areas highlighted above.

2.14 PAT3 recognises that firms in deprived areas, as elsewhere, face other problems, including:

- C Problems of bureaucracy and regulatory burdens: the Government is committed to cutting the burden of unnecessary regulation on business and helping business comply with legislation. It announced a new, tougher approach to regulatory quality and control in the Modernising Government White Paper, published in March this year. One of the principal roles of the Small Business Service will be to work within Government to reduce the burden of regulation on SMEs as well as helping business comply with those regulations that are necessary.

- C Problems of late payments for small businesses: the Late Payment of Commercial

¹ Source: The Financing of Ethnic Minority Firms in the United Kingdom, published by the Bank of England, May 1999.

Debts (Interest) Act became effective from 1 November 1998. The first phase gives business with up to 50 employees a statutory right to claim interest on late paid bills from large businesses and the public sector. It is complemented by the work of the Better Payment Practice Group and other measures such as new targets for central Government and local authority payment performance.

- 2.15 These problems are more general to SMEs rather than businesses in deprived communities, and have therefore not been considered in detail by the PAT. But we welcome the initiatives in these areas noted above.

Strategies to address these problems

- 2.16 There are a diverse array of publicly funded or voluntary organisations which have a role in providing support for start-ups and small firms in deprived areas. The PAT's first key conclusion on how to improve support for small businesses in deprived areas is that, as a general rule there is no need for a new set of organisations delivering support at a local level. But there is a need for:

- i. **A systematic identification and promotion of best practice across the different organisations providing business support, and the aggressive pursuit of higher standards.** A much better understanding is required of what types of support work most effectively in different communities and for different groups within those communities (eg ethnic minorities, and women), and the development of that understanding over time. In order to achieve this there must be an engagement of existing experts and organisations in this area to ensure that the knowledge and expertise that currently exists is effectively utilised.
- ii. **More consistent coverage of the needs of deprived communities for business support,** as this is presently patchy in both volume and quality.
- iii. **The building of partnerships to ensure enterprise support reaches deprived communities effectively.** This means that business support needs to be delivered by institutions that both carry credibility in deprived communities, which are likely to differ widely in cultural terms, **and** have an excellent understanding of the technical skills required.

- 2.17 In order to achieve this the PAT has concluded that:

- a. ***There must be a strategic lead provided at a national level*** to ensure that quality business support services are delivered in deprived areas and best practice is disseminated widely;
- b. ***Suitable delivery mechanisms for business support must be available in all deprived neighbourhoods;***
- c. There is a need to ***develop new business support services that could add value in deprived areas.***

A) The Strategic Lead

2.18 The PAT believes that the **Small Business Service**, working with the Regional Development Agencies, is ideally positioned to take a strategic lead in this area. The Government has recognised the need to improve the quality and coherence of delivery of government support for small firms by setting up the Small Business Service. This need is even more apparent for people and businesses in deprived areas.

2.19 In his Budget statement of 10 March, the Chancellor of the Exchequer said:

"we will simplify help for small businesses and establish, for the first time in our country, a single Small Business Service, devoted entirely to the needs of small business. This one-stop, open-door service - the Small Business Service - will have new resources to offer loan guarantees, support innovation, advise on electronic commerce and deliver, for the first time, an automated payroll service to help new small companies starting out."

2.20 The Small Business Service (SBS) will have funds of over £100 million of new money to support this important work. It will report to the Secretary of State for Trade and Industry . The SBS will have 3 key responsibilities:

- i. Act as a strong voice for small business at the heart of Government;
- ii. To simplify and improve the quality and coherence of Government support for small businesses;
- iii. To help small firms deal with regulation and ensure that small firms' interests are properly considered in future regulation.

Within this second objective the Small Business Service should have a clear remit to provide suitable business support services in deprived areas, reflecting local needs.

2.21 The Small Business Service should be in a position to take a strategic view of the provision of business support, and help disseminate examples of best practice in order to improve the quality of support services. This has considerable potential benefit in deprived areas, where provision to date has been somewhat patchy, in part due to the remit of the Business Links, and perhaps also because enterprise support has not attracted significant attention within the SRB (this issue is considered in chapter 6).

Recommendation 1

2.22 Detailed proposals for the form of the Small Business Service are currently under consideration. There is therefore an excellent opportunity to influence the character and priorities of the organisation. The PAT recommends that:

As part of its wider remit to promote small business, the Small Business

Service should encourage enterprise and business growth in disadvantaged communities. In doing so, it should take account of the needs of micro-businesses.

2.23 The Small Business Service should develop a strategy to achieve this goal. It should:

C **give a clear sense of direction to the many organisations involved in business support in this area;**

C **identify and promote best practice among these organisations;**

C **look at how to develop new services that add value;** and

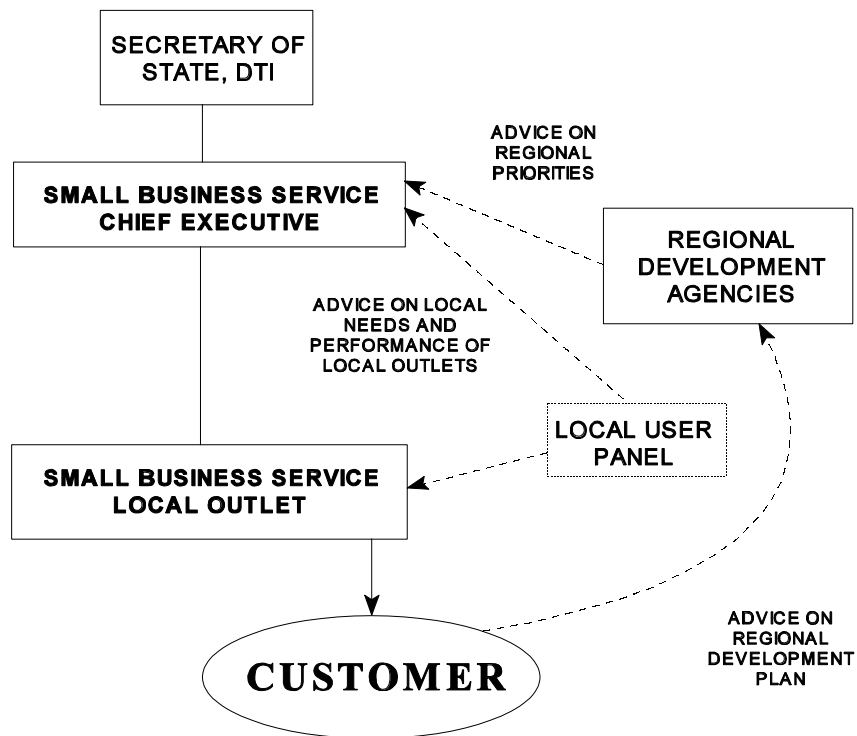
C **build its own capacity by recruiting experts in the field, with experience of regeneration and deprived areas.**

Timing: The SBS strategy should be devised as part of the process of creating and developing the SBS. It should be implemented by end-2000. Recruitment of specialised staff in this area should begin as soon as possible.

2.24 The other key players at a strategic level are the Regional Development Agencies. Their role is considered in more detail in chapter 6, but they clearly have an important strategic lead to play in promoting enterprise in deprived communities as a way of regenerating deprived neighbourhoods.

2.25 The proposed relationship between Small Business Service Chief Executive, the local outlets, the RDAs and the Local User Panels is set out in Chart 2.3 below. More details can be found in the consultation document on the Small Business Service published in June.

Chart 2.3: Business Support Structure



Recommendation 2

2.26 The PAT recommends that:

Regional Development Agencies ensure that their policies reflect the role that enterprise in deprived areas can play in contributing to neighbourhood renewal.

2.27 The RDAs, working closely with local authorities, Enterprise Agencies and other players, should:

- i. ***examine the coverage of business support in deprived areas in preparing their Regional Economic Strategies; and advise the SBS on strengths and weaknesses;***

ii. ***run regeneration strategies with the encouragement of enterprise as a core goal.***

2.28 DTI and DETR should monitor business support funded via SRB for evidence of change in this area - see also recommendation 22.

Timing:

- i. By end-1999 then ongoing;
- ii. Ongoing.

Understanding the needs of entrepreneurs in deprived communities

2.29 To be effective, this strategy (and the delivery mechanisms) for business support will need a good understanding of the needs of deprived areas. Deprived communities represent a diverse set of areas and people, each with their own particular strengths, weaknesses, and needs. It is impossible (and wrong) to generalise about the problems and needs of people in deprived areas, although inevitably in putting together this report we have to a degree been forced to.

2.30 For example, different groups and communities will have different propensities to be self-employed or start up in business, and may face different barriers. Box 2.2 illustrates this point for ethnic minorities, where different groups have very different propensities to be self-employed. Similarly there will be differences between areas. These differences might reflect the availability and quality of local services, such as transport infrastructure, the effectiveness of local enterprises, external factors such as how near they are to areas of high economic activity, or simply ad hoc factors.

Box 2.2: Ethnicity and entrepreneurship

2.31 There are significant differences between the entrepreneurial behaviour of different ethnic minority groups. For example, Chinese, Indians and Pakistanis have a greater propensity to be self-employed than White Europeans; African-Caribbeans, however, have a lower propensity than Whites.

2.32 Different groups also appear to have different propensities to have employees. Data on the number of people who are self-employed and employ other people suggests that BME groups are more likely than Whites to have employees, but again this observation varies between groups, for example, African-Caribbeans are less likely to have employees than Whites (see charts 2.3a and 2.3b).

Chart 2.3a: Self-employed - % of all in work for SMEs (1987-90)

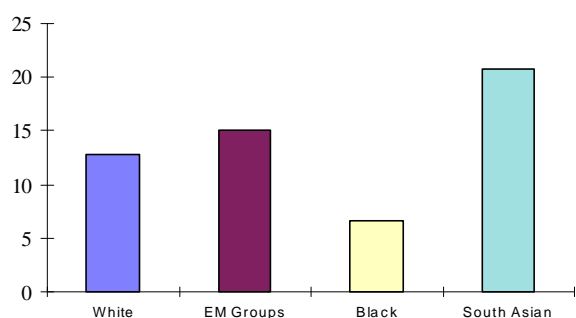
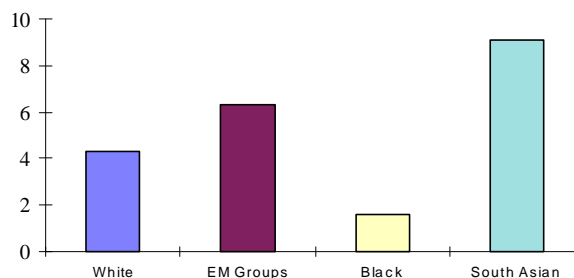


Chart 2.3b: Self-employed, with employees, % of all in work for SMEs (1987-90)



2.33 The low rates of self-employment amongst African-Caribbeans is clearly a concern. More needs to be done to understand why this group has such a low propensity for self-employment.

(Source: 1991 Census Local Base Statistics)

2.34 It is important that support organisations, from local business support organisations to RDAs and the Small Business Service have a good understanding of the needs of local areas and do not assume that what works in one deprived area will automatically work everywhere.

Recommendation 3

2.35 A better understanding of why different groups are more or less entrepreneurial is needed. The PAT recommends:

The DTI / SBS get a better understanding of enterprise in these communities, and across the different dimensions of society. And embed that understanding in Government to create a permanent source of expertise.

2.36 In order to achieve this DTI / SBS should:

- a. ***Commission research into business start-up and survival in deprived communities and among different social groups (eg ethnic minorities, disabled). Research should examine drivers of behaviour.***
- b. ***Create centre of expertise in SBS on enterprise in disadvantaged groups and more generally in a diverse society.***

Timing: (a) Research programme to be commissioned by April 2000. The outcome of this research, together with the recruitment of specialists recommended in Recommendation 1, should help create a centre of expertise (b) in the SBS on enterprise in disadvantaged groups, the particular problems they face, and how to address these problems. This centre of expertise should be established as soon as possible in creation of the SBS.

- 2.37 To build on this expertise within the SBS, there must be close co-operation with RDAs and local business support organisations, to ensure there is the right support available in all deprived areas and that this support reflects local needs. This support also needs to be credible with the target audience. This requires that people in deprived areas have a voice and are actively listened to.
- 2.38 With this in mind, the PAT welcomes the suggested setting up of **local user panels** by the Small Business Service. These would consist of independent businesses and would advise the SBS on quality, and the extent to which the services available match local customer needs. Such moves need to be reflected throughout the business support network.

Recommendation 4

2.39 The PAT recognises the importance of credibility and accessibility of business support. Therefore it recommends:

Business support services are delivered so that deprived communities see them as accessible and trustworthy.

2.40 This needs to be reflected in the business support system at every level, by including people with a background in deprived or marginalised communities, for example:

C in the SBS national users' (or enterprise) council;

C in local SBS councils;

C in the management of SBS, Business Links, and Enterprise Agencies.

2.41 The best practice identified in item 1 should include how to reach out to deprived communities.

Timing: Immediate. This should be reflected in the design of the SBS and its strategy development.

B) Business Support Delivery mechanisms

- 2.42 A key requirement for business support is that:
- C there is consistent coverage of the needs of deprived communities, in terms of both quality and volume; and
 - C support is provided by organisations that are both credible in deprived communities, taking account of cultural and gender differences, and have an excellent understanding of the technical skills required (in part this is covered above in recommendation 4).
- 2.43 It is with these points in mind that this section considers the existing delivery mechanisms for business support, and recommends ways in which this might be improved upon.

Coverage

- 2.44 There are a wide range of business support agencies and organisations, from the main Government delivery channel, Business Links, to localised provision. This section considers the different sources of business support.

Business Link Partnerships

- 2.45 Business Links are likely to be one of the delivery channels of the Small Business Service, alongside other forms of delivery like Enterprise Agencies, Prince's Trust, local community initiatives, and the Internet.
- 2.46 One of the key reasons for setting up Business Links was to address the issue of signposting (or previous lack of it) in the provision of advice and support to small businesses. Evidence² suggests that information and advice to small firms is vital to their sustained growth but that it is often not available in an accessible form. Business Links seek to remove confusion about different support services, and increase business awareness, take up and the quality of these services. Business Links aim to help businesses compete, develop and grow in an increasingly competitive world marketplace.

Box 2.3: Business Links

- 2.47 Business Links were established in 1993 to provide a local advice service for SMEs. They offer a basic service (information and seminars etc.) for all SMEs; but a much more intensive service (exports, technology, managerial development, manufacturing, design, marketing, financial advice etc.) for growth SMEs - those with the capacity and determination to grow quickly. Business Links employ their own advisers - primarily the Personal Business Advisor (PBA) - and also help their clients access specialist advice from both the public and private sector.

² "Business Links - Value for Money Evaluation", final report by PACEC, October 1998

2.48 A "Business Link" is not primarily an organisation (although it can be) but the unifying brand for a range of services provided by a local partnership. The partnerships consist of the TEC, the local Chamber of Commerce and the relevant Local Authorities and, usually, local Enterprise Agencies. The structure of Business Links differs between areas. For example, many institutes of higher education are also partners in Business Link. Note from April 2001, the 72 TECs will be replaced by 47 Local Learning and Skills Councils which will be responsible for coordinating all local training, including that provided by FE colleges.

2.49 There are currently 85 Business Link partnerships operating through over 200 outlets covering the whole of England. DTI provide funding - currently some £120m per annum - as part of the cost of the services they provide. Other sources of funding are European funds, sponsorship, partner contributions and charging. Business Links are expected to raise about 25% of their revenue from charging customers.

2.50 The target market for Business Links has evolved since they were established, from:

C concentration primarily on growth firms employing 10-200 people with limited provision for the broader market;

to:

C a service that is open to all firms regardless of size.

2.51 In the past the remit for Business Links - a bias towards promoting firms with high growth potential - has biased it away from supporting start-up and micro firms. Nevertheless around 50% of Business Links clients are firms with less than 10 employees (source: DTI). However, there is considerable variation between partnerships, reflecting differences in the business landscape.

2.52 Business Link Partnerships in areas that have suffered major industrial closures have usually been more active in supporting start-ups and microfirms. This has been a clear response to local need. It follows that those partnerships who cover the identified disadvantaged areas could also adapt to suit local circumstances if policy allowed their efforts to be rewarded.

2.53 The PAT recognises the efforts that local partnerships have put into activities such as New Deal, but support for start-up businesses in disadvantaged areas is still patchy. The network of Business Links provides an existing structure which should, in theory, be able to provide business support to people in all deprived areas. Table 2.1 below illustrates how 29 Business Link Partnerships cover the 44 most disadvantaged areas. These should be able to help to support the development of an entrepreneurial culture, start-ups or existing growing businesses in those areas.

Table 2.1: Matching Business Link Partnerships to Index of Deprived Local Authority Areas (DETR 1998)

Business Link Partnership	Deprived Local Authority Districts (1998 DETR Index)
Birmingham	Birmingham
Bolton & Bury	Bolton
Bradford & District	Bradford
Coventry & Warwickshire	Coventry
Doncaster	Doncaster
Greater Nottingham	Nottingham
Humberside	Hull
Lancashire East	Burnley
Lancashire East	Blackburn With Darwen
Lancashire West (Central Lancashire)	Preston
Lancashire West (Fylde Coast)	Blackpool
Leeds	Leeds
Leicestershire	Leicester
London Central	Southwark, Lambeth, Camden, Wandsworth, City Of Westminster, Kensington & Chelsea,
London City Partners	Hackney, Islington
London East	Newham, Tower Hamlets, Barking & Dagenham, Waltham Forest
London North	Haringey
London North West	Brent
London South	Greenwich, Lewisham
London West	Hammersmith & Fulham
Manchester	Manchester, Salford
Merseyside	Liverpool, Knowsley
Oldham	Oldham
Rochdale	Rochdale
Sandwell	Sandwell
Sheffield	Sheffield
Sunderland	Sunderland
Tees Valley	Hartlepool, Middlesborough
Tyneside	Newcastle Upon Tyne
Walsall	Walsall
Wolverhampton	Wolverhampton

Total 29 Business Link Partnerships	Total 44 Local Authority Areas
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Recommendation 5

2.54 Business Links have a major strength in terms of their relative expertise and their links with the wider communities. Therefore the PAT recommends that:

Business Links should have a role in providing business support services in deprived areas.

2.55 As a first step the DTI should ask the 29 Business Link Partnerships covering the 44 most disadvantaged local authority districts to develop plans to support enterprise and business growth in deprived areas. Taking account of local needs, these plans should look at how to promote:

- C an entrepreneurial culture;
- C creation of new businesses; and
- C growth of existing firms.

The SBS should ensure that these plans are implemented. This may require reallocation of resources from other areas. This should be identified by the DTI and / or the Business Links.

2.56 In the longer term, the role of Business Links will depend on SBS strategy.

Timing: DTI should request the Business Links to develop plans immediately, with plans to be implemented from April 2000.

Other business support organisations

2.57 There are a wide range of other organisations which provide valuable business support services in deprived areas. For example, Enterprise Agencies, Prince's Trust, TECs, Chambers of Commerce, National Training Organisations, Trade Associations, Local Authorities, and ad hoc local support organisations. Box 2.4 describes the Prince's Trust. (As noted earlier, from April 2001, the 72 TECs will be replaced by 47 Local Learning and Skills Councils which will be responsible for coordinating all local training, including that provided by FE colleges.)

Box 2.4: The Prince's Trust

2.58 PT (which is part funded by DfEE) invests in 18-30 year olds who wish to start up in business through mentoring and providing finance as a lender of last resort. Since 1986, they have helped over 42,000 young people; 60% of them are still trading after three years. Of the non-survivors, around half ceased trading as they were offered jobs or went into further training. The top ten businesses have a joint gross income in excess of £75m.

2.59 Help is delivered through 54 area offices and a network of local boards and panels who interview the applicants, approve the appropriate micro-finance and help provide local business support. Every applicant is given a mentor. There are 6,500 mentors who are local volunteer business people of all ages.

2.60 The help provided is:

C *Finance:* this is made up of loans (up to £5,000) and/or grants (up to £1,500) and pre-start-up test marketing grants (up to £250).

C *Mentoring:* this takes the form of pre-start counselling, identification and signposting of training needs and mentoring.

C *Business Support:* wide ranging support is provided to PT clients, including free legal, accounting and tax advice, subsidised exhibitions, incubation units, etc.

2.61 Prince's Trust believe the key success factors are:

C Easily available and objective counselling, mentoring and training during the six months before start-up and the first three years of trading.

C Easy access to flexible financing.

C Local delivery of and access to business support networks.

C The involvement of local business people to make winners out of people who otherwise might not succeed.

2.62 For many people looking to start their own business their first port of call (or second, if directed there by the local employment service) will be one of the various forms of local or regional Enterprise Agency. The existence and coverage of Enterprise Agencies is patchy - some agencies have metamorphosed into other organisations which have grown and developed into examples of best practice in the field (see box 2.5). In other parts of the country, such agencies became one of the Business Link partners (often with reduced funding), or closed when Business Links were established, leaving diverse other providers to fill in the gaps left by their demise.

Box 2.5: Keighley Local Enterprise Agency

2.63 Keighley Local Enterprise Agency (KLEA) is a voluntary sector organisation, in West Yorkshire, that promotes community-based enterprise and provides a wide range of business support services to new and existing micro-businesses. It was established in 1985, to provide business support to individuals considering self employment, existing small businesses and to the economic activities of voluntary groups. KLEA provides training and support to local businesses on a number of

levels. It also runs a "pathways to growth" mentoring scheme, a small business club, offers childcare facilities and a variety of other services to local business and people.

2.64 As part of its work promoting community enterprise, KLEA helped to establish Bracken Bank Community Enterprise (BBCE), an organisation which employs local people to carry out cleaning services for the elderly. They now have over 60 Social Services clients, 38 private clients, 2 local businesses and 4 community organisations. They employ a total of 14 people from the local community and provide a personal service, which they believe is one of the strengths of the community business. It is now an entirely self-financing business.

2.65 Funding for the core services of KLEA comes from Bradford Metropolitan District Council's Community Grants programme with some funding from the Single Regeneration Budget for Keighley. Training contracts from the local TEC and Business Link make up the remainder. Accommodation costs are subsidised through Keighley Business Forum and SRB funding. Funding is project based and varies from year to year, whilst core service funding from the Metropolitan Council is £28,000.

2.66 Enterprise Agencies often offer free and intensive training and support for the aspiring self-employed, covering: setting up businesses; planning; cash-flow management; finding premises; and marketing; combined with information on how to obtain grants or loans to start-up and advice on access to benefits in the initial lean period. They often have access to low-cost, short lease accommodation, which is sometimes made available through the local authority. These organisations market themselves through the local Employment Service and often target their advertising at the unemployed and other vulnerable groups through local community organisations.

2.67 Another example of a business support organisation is the Wellpark Business Centre, which provides business support in the Glasgow, and aims to help women in the local area start-up and expand their business. This organisation is described in more detail in box 2.6.

Box 2.6: Wellpark Enterprise Centre

2.68 Wellpark Enterprise Centre was established in June 1996 to provide information, advice and business counselling to women in business and those seeking to establish a new venture. It is a charitable company limited by guarantee and its funders include Strathclyde European Partnership, Glasgow City Council and Glasgow Development Agency. Both the public and private sectors are represented on its Board.

2.69 Located within the East End of the city, Wellpark operates from a refurbished 'B'

listed building with historical links to women's education and training. It provides a combination of products and services within a supportive environment.

Enterprise Development

2.70 The Enterprise Development team provides a comprehensive range of services aimed at supporting women into business. A significant part of its remit is to work in collaboration with Glasgow's network of Local Economic Development Companies (e.g. Drumchapel Opportunities) to provide women in the regeneration areas of Glasgow with an opportunity to consider self-employment as an option. Services provided are:

C Individual and group business counselling tailored to women's needs and held in a mutually convenient location.

C Advice on market research and business planning.

C Access to a £500 pre-start grant to assist with research and development of the business idea.

C Access to the Women's Start-Up Fund, a discretionary grant of up to £2,000 designed to help women start their own business. This grant can be used to obtain additional funding or to purchase equipment, promotional materials and childcare costs. All women establishing their businesses within Glasgow are eligible for the grant.

C Access to business start-up courses which are aimed at employed and unemployed women who wish to develop their business ideas and acquire the essential skills needed to run a business.

Business Development Team

2.71 The remit of the Business Development Team is to help existing female business owners with the problems they face in developing their enterprises. The main services offered are management growth training programmes, business health checks and assistance with development plans, developing networks through events and business mentoring schemes.

Resource Centre

2.72 Wellpark has a well-stocked Resource Centre where clients can access up-to-date information and research for their business ideas. It holds a range of Glasgow and Scottish business directories, plus factsheets, journals, management books, free leaflets and local information to help clients with their starting up or developing their businesses. Free Internet tutorials help new users search for information on the Web, and advice is available on going online and Internet marketing. Personal computers, scanners and printers can be booked for a small fee for office

applications and Internet surfing.

Microcredit

2.73 The Microcredit project is the first of its kind in Scotland and provides an innovative method of women accessing modest cash loans to help them to start or develop their own businesses. They may have been unable to secure funds from other sources due to the lack of collateral or security. Women who wish to benefit from this scheme form 'business credit groups' with each member vouching for each other and committing to repay the loans they receive as a group. The groups benefit from access to the full range of Wellpark's training and support services and this is an integral part of the project. The women also benefit from the strong mutual support network and peer encouragement which develops as part of the initiative.

Workspaces

2.74 Wellpark provides fully supported and serviced workspace facilities to small businesses on a short lease arrangement. Full conference and meeting facilities are also available.

Childcare Facilities

2.75 An on-site nursery provides childcare facilities to staff, tenants and visitors.

2.76 One key advantage that such localised organisations, and organisations that draw upon local knowledge and experience, may have over more mainstream business support is greater credibility. This might be because they draw on the expertise and experience of people who live in the area, or because the image of a local support service makes it more approachable.

2.77 The PAT recognises the need for credible and approachable business support, and where possible believes that these organisations should be encouraged, and their activities enhanced in order to provide the best possible advice and support to enterprises in deprived areas. The RDAs, SBS and Business Links have a role in promoting, encouraging, co-ordinating, and helping to fund such organisations (for example through SRB funding). In particular the SBS should be well placed to ensure that where possible this type of valuable expertise and advice is available in all deprived areas and open to all people in those areas.

2.78 But the PAT also believes more could be done to harness the expertise available in local areas to provide a mentor / business support service based on the human capital readily available in the locality. The SCORE Association in the US offers a possible model of how this might work. Box 2.7 briefly describes SCORE.

Box 2.7: SCORE in the US

2.79 The SCORE Association (Service Corps of Retired Executives) is a non-profit organisation dedicated to entrepreneur education and the formation, growth and success of small businesses across the US. SCORE was founded in 1964. Today it has over 12,000 volunteer members located across the US, and assists approximately 300,000 entrepreneurs annually. Some of the services SCORE provides (free of charge) include:

C counselling;

C workshops / seminars;

C e-mail counselling; and

C advice and information, for example on access to finance and starting up in business.

2.80 All SCORE business counsellors volunteer their time. Typically they have experience owning or operating a business. Counselling can be provided one-on-one or SCORE members may counsel in teams. Entrepreneurs seeking advice can choose from a range of counsellors in order to best match the counsellor's expertise with the entrepreneur's business needs. SCORE counsellors abide by a code of ethics and hold all client discussions confidential.

2.81 The type of support that might be provided can be bracketed into the following three categories:

- i. Pre-start counselling and advice (to ensure that only those for whom it is a suitable option chose to start up in business);
- ii. Mentoring, eg providing support and reassurance, rather than any specific expertise, in the start-up phase of a business; and
- iii. Specialist advice and training (eg legal and accountancy advice).

2.82 There is clearly an issue here about quality as well as the quantity and type of support provided. As the mentors would be volunteers, the PAT recognises that the administration systems put in place should not be too onerous and thus discouraging, but nevertheless be sufficient to ensure the quality of advice.

2.83 There are a number of ways for potential advisers to demonstrate that they are professionally competent and able to provide quality advice and support. These could include:

C assessment against standards of professional competence (eg those developed for Business Link Personal Business Advisers and Specialist Counsellors);

- C possession of a relevant National Vocational Qualification (NVQ), eg from the Management Charter Initiative (MCI);
- C membership of a recognised professional body or institution (eg accountant, banker, solicitor).

Recommendation 6

2.84 The PAT believes a network of volunteer business advisers could make a very positive contribution to successful enterprise in activity in deprived areas. The PAT recommends:

Create a network of volunteer business advisers covering deprived areas.

2.85 The DTI, and later, the SBS should take the lead in creating a new national network of volunteer mentors / business advisers, which includes coverage in deprived areas. One clear aim (and benefit) of this network should be that the mentors reflect the communities in which they work. As part of this process the DTI / SBS / Business Links should work with local businesses - large and small - to encourage mentoring activities by highlighting the benefits to businesses through staff development.

2.86 There are clear links here with the Prime Minister's active community initiative which aims to encourage and support all forms of community involvement including corporate community involvement and employer supported volunteering. The Home Office leads in this area and should be involved in this work.

Timing: Patricia Hewitt, the Minister for Small Firms at the DTI, announced on 20 September that more than £3 million would be made available to the end of March 2001 to develop a mentoring scheme for people looking to start up their own business or running a new business.

2.87 PAT3 is conscious that a number of other PATs are also likely to recommend greater volunteer involvement. The implications of the resulting burden on the voluntary sector needs to be carefully considered, and the broad approach towards voluntary work taken forward in a way that is sensitive to the demands placed on volunteers. The likely impact of the various PAT recommendations should be undertaken by the SEU as part of their national strategy.

C) Other forms of business support

Business Incubation Units

2.88 Although incubators are primarily associated with knowledge-based businesses, incubation units can make a valuable contribution to the successful start of a business in deprived areas. A business incubator is usually a property with small

work units which provide an instructive and supportive environment to entrepreneurs and investors at start-up and during the early stages of businesses. Its aim is to maximise the formulation and development of businesses and it achieves this through an active interest in the success of the firms (financial and non-financial) in the incubator. Against that, the provision of such services must be designed so as to ensure that it does not develop a 'dependency culture'. Ultimately the objective is to support and grow the business to the point where they can graduate successfully from the incubator.

- 2.89 Incubators have been used to combat specific economic problems of areas or communities. They can provide valuable focus to local initiatives to promote the creation of sustained indigenous businesses and to help diversify the local economy away from dependency on one particular industry or sector. The benefits that incubators offer deprived areas or communities are faster growth and higher survival rates for new companies. Incubators crucially offer businesses three key benefits:
- C a sharing and learning environment;
 - C ready access to mentors and investors; and
 - C visibility in markets.
- 2.90 An incubator typically has several key ingredients:
- C an appropriately specified building in a suitable location;
 - C an on-site manager with a strong business support role;
 - C an on-site support services appropriate to the nature of the businesses;
 - C is integrated with the area's/region's business, financial and technical networks; and
 - C a financing package that ensures the incubator is sustained as a viable proposition on a long-term basis
- 2.91 Incubators can provide a valuable business network for new and expanding businesses. These networks can be extremely beneficial. They can provide peer support and create points at which to access advice and support and gain information on, for example, potential finance.
- 2.92 The range and type of services available, and the importance of the need to graduate businesses, distinguish incubators from managed workspace (properties offering small units and shared central services where high occupancy is the key business aim).
- 2.93 In the UK there are few incubators aimed specifically at supporting disadvantaged groups or communities. In contrast, in the US, 5% of all incubators are classed as 'empowerment' incubators (described as focussing on ethnic minorities, women,

disadvantaged workers or residents of a neighbourhood in economic distress), and many more are used as an integral part of strategies to re-develop communities hit by industrial decline / closure (source: UK Business Incubation). In the UK, those incubators that are supporting deprived communities tend to have a much lower profile than technology incubators, for example. They also face considerable difficulties in finding the necessary funding to establish and run the incubator over the long term.

- 2.94 The nature of 'empowerment' incubators is that they provide support, training and access to office space to those businesses unable to pay full market rates, at least in the first few years. However, finding the necessary financial subsidy essential to establish and run the incubator before it can achieve self-sufficiency is very difficult. To create a step change in the perception and use of incubators in deprived areas needs financial support, active commitment from Government and development agencies, and effort to bring together existing good practice which exists here and overseas, in the US in particular.
- 2.95 Examples of incubation units in deprived areas in the UK are:
- C Wandsworth Youth Enterprise Centre, London - see box 2.8 for more details of this example;
 - C Project NE , Newcastle;
 - C TEDCO Business Centre, South Tyneside;
 - C Carrington Business Park, Trafford; and
 - C NE England BIC, Sunderland.

Box 2.8: Wandsworth Youth Enterprise Centre, Business Incubation Programme

- 2.96 Wandsworth Youth Enterprise Centre (WYEC), which is a registered Charity, was set up in 1988 in an area of high unemployment with a high ethnic minority population, in response to the growing problems of unemployment, social exclusion and lack of opportunities for young people.
- 2.97 WYEC has developed an integrated business incubation programme specifically designed to help young people aged 17 - 30 start up and run a successful enterprise. Since inception, the Centre has supported over 2,500 young people, and helped hundreds successfully set up and develop their own businesses (source: WYEC).
- 2.98 Central to the programme is an intensive one-to-one business counselling service inter-linked with business skills workshops, training courses and managed workspace, providing a flexible structure to allow the young entrepreneur to explore the self-employment route and, if appropriate, set up in business.

- 2.99 The programme attributes its success to a number of factors. A key feature is the client-led counselling service based on an underpinning philosophy of empowerment. This, combined with the range of supporting services, enables an appropriate blend of counselling, coaching, information giving, participative learning and practical support to be provided and tailored to meet the needs of each client.
- 2.100 Intensive support is provided at the pre-start-up stage with a series of progression points built into the programme. At each of these points, the client will have received the information and support necessary to enable them to make their own informed decision as to whether they wish to progress further.
- 2.101 On starting a business, post-start-up counselling and other practical support is provided for up to two years. This support is structured to help clients during the formative stages of business development while enabling them to gradually achieve full independence of the programme. For those who need it, a business unit is also provided on a reducing subsidy over two years. At the end of the two-year period the cost of the unit will be one step below local commercial rates, at which point the client moves out of the centre into fully commercial premises.
- 2.102 This model of a totally integrated youth enterprise incubation programme has been of considerable interest to the European Commission and organisations in various regions of Europe. WYEC has developed a service that facilitates the effective dissemination and transfer of this model of practice. For example, WYEC have, with EU funding, successfully adapted and transferred this model into Central and Eastern Europe, which resulted in the establishment of the first youth enterprise incubator centre in this area. WYEC is currently working with a number of organisations in the UK and mainland Europe which are aiming to develop youth enterprise incubator programmes tailored to their regions.

Recommendation 7

- 2.103 The PAT recognises the valuable contribution incubation units can make to the formative period of an enterprise but more understanding is needed of the costs and benefits of incubators in deprived areas. In recognition of this the PAT recommends:

The Government should identify how to increase the supply of effective incubation units in deprived areas. To achieve this DETR should commission research evaluating the costs and benefits of support for incubators, with the results to be fed into the SBS strategy.

- 2.104 This work needs to involve the SBS, DETR, RDAs, liaising with LAs, English Partnerships and Housing Associations.

<i>Timing:</i> DETR to commission research with an aim to implement the resulting strategy by the end of 2000.
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- 2.105 There are a number of ways in which this agenda might be taken forward, although these options are provided here only as illustrations and not recommendations:
- C Consider establishing a business incubator challenge fund run by the SBS. This would attract bids for part finance of new incubators or further development of existing ones with priority attached to the objectives, partnerships, extent of other finance and viability of projects proposed.
 - C Ensure it is a strategic requirement for RDAs and SBS to encourage and facilitate the establishment of incubators in deprived areas.
 - C Establish and spread existing good practice by using relevant existing organisations, e.g. UK Business Incubation, to pool knowledge/expertise and actively promote the incubator concept.
 - C Ensure that programmes run by TECs and Business Links aimed at deprived communities use new / existing incubators as a focus for these programmes and 'upgrade' managed workspace to incubator space.

Promoting International Trade

- 2.106 The Department of Trade and Industry (DTI) and the Foreign and Commonwealth Office (FCO) through British Trade International, provide a wide range of support to UK exporters. It has some 2,000 staff world-wide - it is a global network dedicated to helping UK business compete successfully throughout the world.
- 2.107 The network comprises Country Helpdesks and other teams providing export information services in DTI's London headquarters, the commercial sections at more than 200 FCO Diplomatic Posts overseas, more than 70 core Business Links throughout England, Scottish Trade International (STI), Welsh Office Overseas Trade Services (WO), and the industrial Development Board for Northern Ireland (IDB).
- 2.108 Working with the Regional Development Agencies, the network aims to help UK firms take full advantage of overseas business opportunities. They aim to achieve this by providing support, information, advice and assistance throughout the exporting process. The Government's trade promotion policy is guided by advice from 200 businessmen and women who serve on the British Trade International's Board and its Area Advisory Groups and Small Firms Committee.
- 2.109 There may be valuable overseas links not being fully utilised by businesses in deprived areas, not least by ethnic minority owned firms who may have family / friend ties overseas.

Recommendation 8

2.110 The PAT recommends:

British Trade International to support trade activities in disadvantaged communities.

2.111 British Trade International should ensure that it has a strategy for serving firms in disadvantaged area with the potential to import/export. Ethnic minority businesses are an obvious target group. The Export Development Counsellors in the 29 identified Business Link partnerships should be asked to work with businesses, particularly ethnic minority businesses, in disadvantaged areas to highlight the possibility of international trade as a mechanism for encouraging growth.

Timing: By mid-2000.

2.112 The PAT has also considered various other forms of business support. These may well be useful to businesses in deprived communities and more might be done to make use of them. For example:

C *Regional Supply Offices:* these were established in 1993 to promote the development of local supply chains. It operates through 10 regional offices and works closely with Business Links and Regional Development Organisations to open up new sales opportunities for SMEs. Existing businesses in disadvantaged areas currently face no barriers, other than awareness, to matching their goods and services to the needs of larger companies. More could be done to promote awareness of this service, eg through the network of business advisers.

C *The potential role of the Internet:* One possibility for overcoming the problem of nationwide coverage (ie reaching all areas including poor neighbourhoods) and accessibility (although this may still be a barrier) is the Internet. Much of the business support literature and signposting to other information and advice that is provided by, for example, Business Links, could be made available on the Internet. This should help businesses in deprived communities gain access more readily to this information, as well as mainstream businesses more generally. This is something that the Small Business Service should look into.

C *Innovation and technology transfer:* there are a number of areas where DTI schemes could be used to aid innovation and technology transfer into disadvantaged areas. These are not considered here.

Responsibility and desired outcomes

2.113 The DTI must take the lead in ensuring that this agenda is implemented by the SBS, RDAs and Business Links. The PAT is conscious that a number of recommendations relate to the Small Business Service, which will not be

operational until later in the year. Nevertheless most recommendations can be initiated and there are actions that can be taken in the short-term that will have a more immediate impact, for example recommendations 5 and 6 (and recommendation 12 in chapter 3 which also recommends action for the SBS).

2.114 The overall goal of this intervention is higher economic participation. Indicators for this are business start-up and survival rates, although the key outcome is higher employment whether it is self-employment or salaried employment. Setting a target for business start-up and survival rates is made difficult by the lack of data at a sufficiently disaggregated level (ie data on business start-up and survival rates are not available to the PAT's knowledge at, for example, ward level).

Recommendation 9

2.115 Therefore the PAT recommends:

Targets are set for business start-up and survival rates in deprived communities.

2.116 Targets should be set for all interventions to promote enterprise and business growth in deprived communities. Responsibility for this should rest with the party financing the intervention (eg SBS, BL, RDA etc).

Timing: Ongoing.

Chapter 3: Access to Finance

Introduction

- 3.1 External finance can make all the difference to the successful growth of small firms, especially start-ups, and can equally importantly help sustain fundamentally sound enterprises (and the jobs they provide) through rocky patches. It is therefore important that firms in deprived areas are not excluded from adequate provision of finance.
- 3.2 This chapter:
- C considers the problems faced by small and medium sized enterprises (SMEs), and people trying to start-up a business or move into self-employment, in gaining access to finance.
 - C assesses the role which mainstream commercial banks and other financial institutions can play in serving this market in the UK's most deprived areas, in particular through micro-finance and other innovative financing methods.
 - C reviews the evidence on existing community finance initiatives in the UK, and some of the aspects of the US experience of community finance.
 - C concludes with a discussion of the relative merits of a range of potential policy levers which might be used to enhance the provision of finance for enterprise in deprived areas.
- 3.3 A key theme of the PAT's work has been the importance of combining help with access to finance with suitable training, advice and support. Therefore, as with much of this report, the recommendations in this chapter complement those made elsewhere, especially in Chapter 2.

Definition and analysis of access to finance problem

- 3.4 The "gap" between the demand for finance from small businesses and the supply from banks and other financial intermediaries is a long standing policy concern in the UK and other developed economies. The nature and extent of any financing gap that may exist for smaller enterprises in deprived areas is an important subset of this wider question of financing for small and medium enterprises. This is currently the subject of several Government initiatives (such as the Cruickshank review for the Treasury of the UK market for banking services, and DTI's Enterprise Fund).
- 3.5 The Cruickshank review (due to report to the Chancellor in early 2000) is likely to be particularly relevant to the work of this PAT. Its remit is to examine the level of innovation, competition and efficiency in the provision of UK banking services, including banks' relationships with SMEs. Any general conclusions in the SME area could have important specific implications for the relationships between banks and small firms operating in the most deprived areas.

- 3.6 In theory, SMEs may face barriers to external finance for several reasons:
- C asymmetric information: the owner/manager of the small business has better information about the firm's prospects than the lending institution. This advantage matters less for large firms, particularly those on the stock market, where there is a free market in information and analysis about the company.
 - C costly monitoring: monitoring and assessment costs (in order to ensure repayment for the lender) are proportionately greater for smaller loans, so reducing supply/raising the price of SME lending.
 - C higher objective risk in SME lending: smaller businesses are less robust and diversified in general than large, and so present greater risks to lenders.
- 3.7 The normal market response to the extra cost of SME lending would be to raise interest rates to compensate, but this would have the effect of pricing out the "good" lower risk borrowers and leaving an unprofitable subset of higher risks. To avoid this, banks appear to set an effective ceiling on lending rates, so rationing credit to SMEs perceived as a higher risk. Credit rationing may be said to occur where a project which would yield positive private financial returns, after paying for the costs of funding, fails to attract sufficient external finance.
- 3.8 In addition to the general factors which may create a "funding gap", there are also specific factors which could further increase the gap for SME lending in deprived areas:
- C higher objective lending risk: SMEs operating here are likely to face more fragile demand, be less well capitalised and are less likely to have sufficient collateral against which to mortgage the loan. For women, for example, this can be a particular problem as they are less likely than men to have collateral with which to raise finance (women's pay is on average lower than that of men - see for example the Cabinet Office publication, Women's Individual Income 1996/97 - and they are therefore likely to have less capital). For the very smallest loans, which may be appropriate for micro-businesses, it is usually administratively inefficient for banks to take collateral.
 - C greater information asymmetries: with fewer successful SMEs operating in deprived areas, lenders may have less experience to draw on of such firms' borrowing needs and performance. Owner/managers are likely to have less formal experience in business and be less able to present financial information credibly to a lending institution. Different ethnic backgrounds of borrower and lender may also hinder effective communication.
 - C more costly monitoring: small scale loans by less robust businesses are likely to cost more, proportionately, to monitor. These diseconomies of scale may be exacerbated by the withdrawal of business lending officers from deprived areas.
- 3.9 Even if this classic "market failure" were rectified, there may nevertheless be a shortfall in commercial funding for enterprises compared to the socially optimal

level. Commercial lending decisions will not take account of the “social returns” from the lending - for example the positive externalities of wealth creation; high economic participation; and the fact that the success of enterprise growth in deprived areas can spill over between firms, for example in the form of better trained and work-ready local workforces, and mutually reinforcing demand for business support services. This external social benefit will not be fully recognised by commercial lenders.

- 3.10 On the question of credit rationing for SME lending in general, the recent evaluation by KPMG Management Consulting of the DTI’s Small Firms Loan Guarantee Scheme (SFLGS) concludes that credit rationing does exist in the UK market. This is based on evidence that lending rates are “sticky”, ie they do not respond rapidly to changes in the official interest rates which determine the costs to banks of supplying the loans. The evaluation concludes that the continuing evidence of SME credit rationing in general is central to the rationale for the SFLGS.
- 3.11 At present, it is not possible to quantify or delineate precisely the bounds of the additional financing difficulties faced by enterprise in deprived areas. There are however reasonably good grounds, as set out above, for concluding that enterprises in deprived areas face markedly greater financing problems than small firms in general. There is also more survey evidence from several recent reports on financing current community finance practice in the UK: these are summarised in the annex to this chapter.
- 3.12 The key points which emerge are that:
- C UK commercial banks remain by far and away the major suppliers of SME finance across the UK as a whole, lending nearly £35bn to small firms in general. Contributory factors to this have been: the branch networks which have been key in a market environment where face-to-face contact has hitherto been very important; and access to key information on the borrower, such as their current account details. Thus lending by these institutions dwarf all alternative sources of finance for SMEs in deprived areas, and their policies towards operating in these neighbourhoods is therefore key to the provision of sustainable finance over the long term;
 - C certain trends in banking to date, such as the rationalisation of branch networks, and the specific needs of small firms in deprived areas, are perceived by SMEs to have widened the gap between the lending supply and the borrowing demand. Countervailing trends, such as electronic banking, have not yet offset the rationalisation trend. While the funding gap is well documented in general terms, there is no comprehensive UK-wide analysis which quantifies the problem and assesses its impact on business enterprise in deprived areas;
 - C ethnic minority businesses, which are an important element of the business community in many deprived areas, face many of the same financing challenges as SMEs in general. There is evidence though that many *perceive* themselves to be treated adversely in obtaining finance, feeling that they have to prove their business

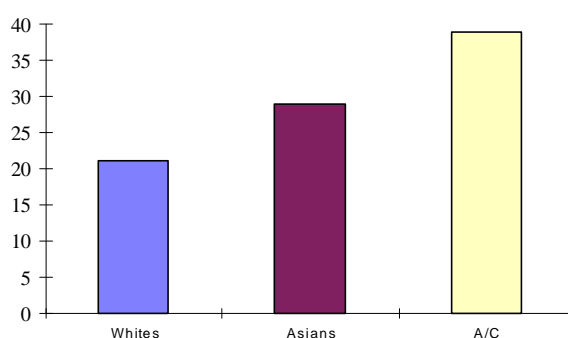
case to much higher standards than apply normally. Women have a similar perception that they have little credibility with banks. This perception alone, even if not borne out in practice, can itself act as a further barrier to raising loans from commercial banks - see box 3.1 for a discussion of this issue;

- C recognising the wider benefits to the neighbourhood from successful enterprise development, local organisations have created a wide range of community finance initiatives to fill the financing gap by providing loans (often combined with training or mentoring) to SMEs. These initiatives are often in partnership with one or more commercial banks based in or around the area;
- C the coverage of such intermediary organisations, which can help bridge the gap between business needs in deprived areas and commercial requirements of bank lending, is at present patchy. These community finance initiatives tend to be thinly capitalised. They also operate a wide variety of different business models.

Box 3.1: The financing of ethnic minority firms³

3.13 The perception that ethnic minority owned firms found it more difficult than other firms to gain access to finance was a strong message from the PAT consultations. Some other evidence also suggests such a problem. For example, a study by Jones, McEvoy and Barrett (1994) found that almost one in three Asian loan applicants and almost two in five African-Caribbean loan applicants encountered some resistance, either leading to their application being turned down or to conditions being imposed which they thought were unjustifiably stringent. These compare with around one in five problems encountered by white applicants (see chart 3.1 below).

Chart 3.1: Problems Obtaining Bank Loans - problems as % of applicants



3.14 However, recent evidence in this area is somewhat mixed. For example, recent

³This box draws heavily on the report published by the Bank of England on 20 May 1999, "The Financing of Ethnic Minority Firms in the United Kingdom".

surveys undertaken for NatWest Bank found that more Asian business customers borrow from their bank than is the market norm (80% vs 47%), and African-Caribbean businesses borrow in line with the market norm (46%).

3.15 Overall it probably cannot be definitively concluded that there is discrimination on the part of banks, but there is clearly a perception among BME groups that they are likely to face discrimination from banks. In recent years the banks have taken steps to improve their business relations with ethnic minority firms. Examples of steps taken include:

C issuing internal guides on ethnicity;

C seconding managers to small businesses;

C running ethnic minority business awareness schemes; and

C developing specific strategies towards ethnic minority business customers (eg creating cultural business centres).

3.16 The PAT welcomes such initiatives. Nevertheless, feedback from consultations suggest that more needs to be done. The PAT believes that ***banks should work just as hard to reduce the perception of discrimination, as to stamp out any actual discrimination.***

3.17 The consultations conducted by the Policy Action Team with business and finance providers confirmed and exemplified many of these conclusions emerging from the more formal studies.

3.18 In the field of microfinance for small firms, the PAT's seminar with UK and US practitioners from both banks and community initiatives highlighted some important issues:

C The growth in micro finance initiatives is finely balanced at present, and momentum is not yet self-sustaining. There are heroic examples of success, however these are masked in a difficult and fraught process of institutional development.

C While funds in the public and charitable sector are scarce, initiatives should draw on the private sector. The issue is therefore how to make community development a bankable proposition, and how commercial institutions can be persuaded to invest.

C Initiatives need local ownership, but they also need the scale that can be derived from a national framework.

C There needs to be partnership between players with social and commercial objectives as the costs are high (loan, mentoring, support and management of the portfolio)

- C If senior banking people with influence are involved then they can deploy the commitment, the people and the skills required. It is in the banks' long term interests to do this.

Box 3.2: Centre for Employment and Enterprise Development (CEED) Charity

3.19 CEED is a leading example of a black and ethnic minority led social business. It was founded in 1988 as a 'positive action training organisation'. It has since developed and diversified into a highly successful community-based economic and social regeneration agency. Its work with the NatWest Charitable Trust Fund is an example of a mainstream bank helping to provide financial backing for regeneration.

CEED Young Entrepreneurs Development Fund (YEDF)

3.20 The YEDF was established in 1996, also through the NatWest Charitable Trust Fund. The NatWest Charitable Trust was established in 1994 as a grant making charity. Funds are allocated to support communities on issues of importance to the Nat West Group. The funding package for CEED was for £95,000 per calendar year for a total of three years.

3.21 The objectives of the YEDF are:

C To create new opportunities for young people and inner city residents, and business to shape the future.

C To create new business opportunities and jobs for young people at risk.

C To ensure that young people presently excluded from the labour market have the opportunity to establish business to enhance their employment prospects.

C To encourage and enable young people to contribute to and benefit from improved quality of life.

C To encourage young people to contribute to the social, community and family life of the city.

C To encourage inward investments from mainstream businesses.

What does CEED do?

3.22 CEED is responsible for managing the YEDF and providing loans for small and existing businesses set up or owned by young people mostly in the inner city areas and Bristol generally. Managing the fund requires CEED to be responsible for the following tasks and activities:

i. Provide business advice and counseling to new and existing businesses.

- ii. Provide business training courses and seminars.
 - iii. Assess and evaluate business plans and cash flow forecasts of all applicants.
 - iv. Award loans
 - v. Review, monitor and provide support for businesses.
 - vi. Provide annual progress reports to the Trust.
 - vii. Attend the annual Trust conference.
- 3.23 The fund is now in its third year and has created opportunities for many young people and the community in Bristol. It has helped business start-ups and training for this among young people; increase new business development throughout inner city areas; and provide access for young people running existing businesses to funds for growth and expansion. Over 42 new businesses (c.55 jobs) have been established with assistance from the YEDF so far.

European experience of community finance

- 3.24 Most other European countries have a far more localised and less nationally concentrated provision of small business banking services than in the UK. Although this is changing somewhat with rationalisation induced by the single European market and the advent of the single currency, there is nevertheless a substantial legacy of regionally-focussed mutual and cooperative banks, mutual guarantee societies, and social banking. There has been greater involvement of local and regional authorities and local chambers of commerce as partners in bank ownership and bank lending policies. In addition, in France and Germany there are specialist state-backed banks whose remit is to lend to small businesses.
- 3.25 The most comprehensive recent survey of European micro-finance (*The Social Responsibility of Credit Institutions in the EU, Reifner and Evers report for European Commission DG XXIII*) draws the following conclusions for Germany and France:

Germany

- 3.26 In general, the German banking system has traditionally well served the SME lending market through an extensive network of national and regional banks. These include both purely commercial banks as well as "ländesbanks" benefiting from state guarantees and public refinance banks. German entrepreneurs are able to access publicly-funded programmes through their main "house bank". This means that the problems caused by micro loans in general (eg absence of well developed business plans, lack of collateral, higher proportional overheads in managing the lending book) tend to restrict micro-lending in Germany. House banks receive a

small fixed percentage remuneration for handling guaranteed loans, so face little incentive to serve the smallest loans.

France

3.27 The French provision for SMEs is similar in some respects to that in Germany: a well functioning regime for medium sized enterprises, involving programmes of publicly-funded guarantees, does not cater very well for micro enterprises. The state loan guarantee scheme SOFARIS is generally well regarded: although less generous in support for each individual loan than comparable schemes in the UK or Germany, it has a much wider reach (25,000 beneficiary firms per year, of which 5,000 are start-ups, versus around 7,000 in Germany and UK).

US experience of community finance

3.28 The US market for community finance is somewhat more developed than in the UK. This springs from a wide range of factors, including:

- C a tradition of local banking and local bank regulation, which gives banks a greater stake in their local economy and offers a geographically-focussed policy lever to bank regulators;
- C more widespread and active participation of community organisations in urban regeneration, with a more entrepreneurial and commercial attitude to seeking finance;
- C greater partnership between community financiers and commercial banks to provide “patchwork finance” for such schemes;
- C a challenging approach from the Federal government, involving both prescriptive legislation (Community Reinvestment Act 1977) placing obligations on US banks, as well as incentives for commercial lenders to become involved (eg Small Business Administration loan guarantee schemes, Bank Enterprise Award scheme) and publicly-funded support for community organisations (eg Community Development Finance Institutions Fund).

3.29 The scale of community finance is correspondingly greater than in the UK. According to the National Community Capital Association, there are around 350 community development finance initiatives across the US, with \$2-3 billion available for lending. The US initiatives can be categorised roughly as:

- C community development banks (about 10);
- C credit unions (130+);
- C loan funds (46);
- C micro finance funds (50+);
- C neighbourhood equity funds.

- 3.30 Compared to the £34 trillion assets of the mainstream financial services industry in the US, the activities of community finance initiatives are however still marginal. As an indicator of market development, scaling these figures for the relative sizes of the UK and US economies would give £200-300 million for lending in the UK, if community finance were as developed as in the US. This range compares to the estimate of £170m of capital available for enterprise lending by community finance initiatives in the UK.
- 3.31 In addition to specific community finance organisations, US banks are also involved in direct lending to small businesses in deprived areas. Much of this marginal commercial lending will be supported by the Small Business Administration's generic loan guarantee scheme, or the specific microloan sub-programme. In the early 1990s, when the average loan size under the mainstream SBA programme had reached \$200k, the SBA began to develop separate microlending facilities, available to entrepreneurs traditionally considered "unbankable", largely due to inexperience with credit, credit problems, or lack of assets. SBA's refocusing on smaller businesses included:
- C direct loans administered through private non-profit organisations, for loans of \$100-25,000, on condition that the non-profits provide adequate loan loss reserves from local capital sources, eg commercial banks;
 - C streamlined handling for SBA guarantees on bank loans under \$50k, with more responsibility placed on banks to assess applications; and
 - C technical assistance grants to non-profit organisations, for training potential loan applicants, business management counseling, and direct training of the staff of non-profits.
- 3.32 The result of SBA's evolution is that over half of the loans supported by their programmes are now for amounts under \$100k, and its overall default rate is 15 per cent. Since the inception of the microloan scheme in 1992, this programme has made \$66 million in microloans to more than 6,000 small businesses, with no losses to date.
- 3.33 The unifying theme of most of the US initiatives is that they are able to exploit public and charitable funding in order to lever in commercial lending, thus scaling up their operations significantly. In part this is driven by the banks' needs to demonstrate a minimum level of community investment, which they are able to do either via direct lending themselves or by providing wholesale finance for community finance initiatives. But it is sustained by the fact that banks have been able to make a commercial return from such activity. The gap between the needs of the borrowing business enterprise and the commercial returns required by banks has been narrowed or eliminated by:
- C *reducing risk*: technical assistance to borrowers in developing business plans, post-loans monitoring, helping to create self-supporting networks of businesses in deprived areas, can all reduce the likelihood of default;

- C *enhancing reward*: patient capital to community finance initiatives (eg from socially minded investors) requires sub-market rates of return. This, along with public subsidy, enables community finance initiatives to bridge the gap between commercial rates of return to banks and the price paid by enterprises in deprived areas for their borrowing.

Rationale and scope for policy action in the UK

- 3.34 Private sector high street banks *do* provide access to finance for commercially-viable young and growing enterprises across the UK, including to those operating in deprived areas. Some examples of their activity in this area are set out in box 3.3. But the presence of a variety of publicly-funded local enterprise finance schemes indicates that in certain locations, and for certain businesses, there *is* a gap between the provision of bank finance and the needs of enterprises, especially taking into account the positive benefits to the wider neighbourhood of enterprise development in deprived areas. This is therefore a legitimate area for Government to consider policy interventions designed to improve access to business finance (as it has done more widely in the field of SME finance through tax and public spending measures, such as Venture Capital Trusts and the Small Firms Loan Guarantee Scheme respectively). The important questions for government are which, if any, market failures are susceptible to government action, and if so what sort of government action; and how to design and implement policies which work with the grain of the market, nationally and locally, to reduce the barriers to finance for soundly-based small firms operating in the UK's most deprived areas.

Box 3.3: Activities undertaken by High Street banks in deprived areas

- 3.35 High Street banks are active in providing finance to enterprises in deprived areas generally through building links with local business communities and support agencies. Some examples of these activities are:
- C Helping to fund Community Finance Initiatives (CFIs);
 - C Running business clubs;
 - C Providing volunteer business advisers / mentors to PT;
 - C Undertaking seminars in local communities on a range of topics, such as Starting up in business, Marketing and Internet Banking;
 - C Hiring local ethnic minority people to act as conduits between the banks and local communities, and to increase their understanding of the market.

- 3.36 There are two routes to closing the gap: either greater bank financing, or greater provision from local enterprise/community finance schemes. The two are not mutually exclusive: in many cases, small firms will graduate from the latter to the former and banks may be involved as partners in community finance initiatives. So it is clear that in both their core business and in their interactions with local

economic partners, banks have a key role to play in providing appropriate SME finance.

- 3.37 Enterprises in deprived areas, just like other SMEs, may also seek non-bank finance, such as leasing and factoring. They may also seek to access finance through new communications technology rather than face-to-face, which could help reduce some of the disadvantages of operating in a deprived area with few local bank outlets. Competition and diversity among sources of finance is to be encouraged, and if one source (eg bank financing) is not readily accessible in certain areas then there may be market opportunities for others to exploit. The economies of scale in establishing viable finance institutions mean that it is unlikely that fully commercial local finance providers would emerge aimed exclusively at deprived areas. Commercial competition to traditional bank lending is more likely to come from other types of finance which have a wider geographical spread.
- 3.38 The strongest impetus for the involvement of commercial financiers will be their identification of a sustained business interest in this sector of the market. The other recommendations of this report are aimed at enhancing the capacity of SMEs in deprived areas to start up and manage their businesses. More capable firms are easier to lend to, so concerted progress on the provision of business support should reap dividends for bank financing as well.
- 3.39 Strong competition between banks should also drive them towards more innovative ways of serving this market, which may otherwise become marginal to their core business. As major UK corporates with a presence in many communities and strong brands to protect, their visible involvement in SME lending here may also help bolster their corporate image with wider competitive benefits from brand enhancement. As noted above, Don Cruickshank is currently conducting an independent review for the Treasury of competition and innovation in UK banking services, including small firm lending. The PAT is encouraged by this development, which offers the prospect of greater innovation in commercially-driven lending by banks beyond the bounds of their current practice.

Recommendation 10

- 3.40 It is important that the banking sector should be as competitive, innovative and efficient as possible in order to ensure that enterprises in deprived communities are served as well as possible. The PAT recommends that:

the Government promotes competition, innovation and efficiency in the banking sector to ensure that deprived communities are served to the maximum extent possible by market means.

- 3.41 HMT should ensure that the Cruickshank review takes into account the interest of deprived communities in a competitive banking sector.

Timing: The Cruickshank review is to report to the Chancellor in early 2000.

Strengthening Community Finance Initiatives

- 3.42 The rest of this chapter focuses on the second route for closing the “funding gap” strengthening local community finance initiatives to provide a complementary and alternative channel through which more SMEs in deprived areas could access appropriate finance.
- 3.43 The UK community finance market is already partly served by a wide range of local initiatives which developed to meet specific local needs. These have attracted mixed funding from local authorities, lending or grants from banks, and charitable investments from individuals and organisations. They provide non-standard finance packages (including technical assistance as well as capital) to a wide range of small businesses operating in deprived areas. Where successful, they have the potential to provide an opportunity to small businesses which might otherwise be closed off as a result of background. The challenge for the Government now is to explore how best to extend nationwide the best practice of the most successful community finance initiatives, while at the same time enabling local partnerships to devise the most appropriate forms of financial support for the enterprises operating in their areas.

Box 3.4: Glasgow Regeneration Fund

- 3.44 The Glasgow Regeneration Fund (GRF) provides lender of last resort financing (loans, equity and guarantees) to support the creation and survival of small businesses in Glasgow’s eight regeneration areas. It forms part of the City Council’s and Development Agency’s regeneration strategies, and has raised funds from them as well as the European Regional Development Fund and private sponsors (eg Body Shop, Royal Bank of Scotland, BP). Since 1993, over £3 million has been raised and over £2 million invested. Some 230 companies have been assisted and over 1,500 jobs have been created, with a further 400 or so saved. GRF places particular importance on aftercare as way of helping their Micro and VSE clients to sustain success: guidance and support is available to all firms which GRF fund.
- 3.45 Some examples of the enterprises which GRF has supported include:
- C CF Services: in the Castlemilk area GRF contributed to the finance package which enabled the management buy-out of this community business employing 50 people in landscaping, ground maintenance and security services;
 - C Alba Adventures: in Glasgow North, GRF provided expansion finance for this outdoors education centre;
 - C PACE Printing and Design: in Gorbals, GRF funded this business start-up which evolved from a community printing project to a fully commercial operation.

GRF provides the loan capital element of the Glasgow Women's Microcredit Project, based at the Wellpark Enterprise Centre, which is the first of its kind in the UK.

Objectives

- 3.46 Before considering specific policy levers, it is important to clarify the objectives and ambitions of any additional Government action in this area. The overall aim of any Government intervention should be to facilitate access to finance and thus encourage sustainable smaller enterprise in deprived areas. It is important to recognise though that better terms of access to finance for businesses will not lead to full employment in deprived areas, and propping up fundamentally unsound enterprises will deliver only temporary economic activity with potentially debilitating longer term consequences. Access to finance on its own may also not be sufficient if enterprise growth is held back by a lack of appropriate business mentoring and support services, so policies on finance need to be closely linked to those on business support in deprived areas. Finally, any intervention should meet the standard tests of working with the grain of the market, maximising the additional impact of policy, reducing the displacement of activity, as well as focussing specifically on the areas of most acute need.
- 3.47 Given this, the following are suggested as broad parameters for community finance initiatives which might be supported by public policy.

Target enterprises

- 3.48 Each initiative should have a clear understanding and definition of the business sector at which it is aimed. There is a wide spectrum, from those firms on the margin of purely commercial lending, for whom the standard Small Firms Loan Guarantee Scheme may be relevant, to those long way from being bankable, such as Prince's Trust's client group of unemployed young people. Within this spectrum, community finance initiatives could aim to cover one, two or all of the following targets:
- i. start-up businesses (whether initiated by the employed or those coming out of employment) which demonstrate the potential to become self-sustaining and graduate to standard commercial lending in the medium term;
 - ii. existing businesses which are employers within the deprived area with a proven track record of trading and which also demonstrate the potential to graduate to commercial lending; and
 - iii. Social enterprises (which are discussed in chapter 5).
- 3.49 In each case, provision of support from the community finance initiative should be conditional on inability to access commercial lending on reasonable terms. Service sector businesses should not necessarily be excluded from access to this funding (as retail and catering are under the SFLGS), since there are fewer concerns about

such funding displacing other economic activities in these sectors within deprived areas (cf report of PAT 13 on shops).

Financing intervention

- 3.50 The initiative should aim to structure the debt or equity finance provision in such a way as to:
- i. reduce risk to the lender: eg through staged financing, scaling down or phasing investment plans, delegating loan performance monitoring and enforcement to peer enterprises through group lending;
 - ii. aim for sustainability of the borrower: initial lending should be made with a view to graduating the borrower onto fully commercial lending within a period of time. CFIs may have a role to play in providing background record information for commercial lenders (CFIs would therefore need to collect this information in a form which is acceptable to a commercial lender). The rate of graduation should take into account the need for the CFI to develop a balanced portfolio of risks;
 - iii. aim for sustainability of the community finance initiative, taking into account the various funding sources of the community finance initiative and the different rates of return required by the public, commercial and charitable investors;
 - iv. add value to the borrowers' business: particularly for start-ups, external finance should be provided in conjunction with tailored advice on the finance needs of the business and the requirements of fully commercial funders. The aim would be to equip enterprises with the skills better to graduate onto bank finance within a clear time period;
 - v. maximise leverage of private sector commercial capital, given the objectives of the specific initiative.

Community development and partnership

- 3.51 The community finance initiative should be organised in such a way as to:
- i. strengthen practical links to the local communities, to understand the business finance needs of local community-based enterprises;
 - ii. sustain the financial support of local lending institutions, in order to import external lending discipline and capital;
 - iii. integrate with other local community finance initiatives, in order to minimise the scope for wasteful duplication, overlap and confusion on the part of the applicant businesses, and maximise the benefits of scale economies;
 - iv. integrate with local and regional economic development agencies' other regeneration activities, eg by substituting loan finance and technical assistance in place of local authority grant funding for business development.

Strategy for developing access to enterprise finance in deprived areas

3.52 The UK already has the makings of a national network of community finance initiatives which are emerging in partnership between various combinations of local groups, commercial banks and local government. Given this background, there are three broad strategies which might be adopted now to develop access to enterprise finance:

C ***evolutionary and catalytic approach:*** the Government would aim to foster and incubate community finance, with the aim of seeing best practice adopted nationwide. Government would aim to bridge the information gap, raise the public profile, and in doing so encourage potential commercial partners to become more involved in community finance. Local initiatives would continue to obtain capital from a variety of private charitable, commercial and local government sources.

C ***accelerated interventionist approach:*** this would build on the measures to bridge the information gap under the evolutionary approach. The Government would, in addition, aim to enhance the scope and sustainability of community finance initiatives through interventions involving public resources (possible policy levers discussed below). This could have the direct benefit of capitalising the more effective initiatives, and encouraging others to improve their performance in order to secure central funding. It would have the potential disadvantage of centralising to some degree the development of what are primarily locally inspired initiatives. There are also questions about how best to target new resources

C ***mixed approach:*** this would involve adopting the various activities envisaged under the evolutionary approach, along with some experimentation via pilot projects of the potential benefits of the more interventionist policies under the second approach. This strategy would tend to migrate towards one of the two extreme approaches over time, in light of the response to initial Government interventions.

3.53 At this stage in the development of the UK market, there is broad consensus in favour of a mixed approach to future policy, involving dissemination of best practice, funding for experimentation in the use of new policy tools, and evaluation of local impacts. Given the patchy geographical nature of development to date, there is also agreement that central Government could play a useful catalytic role with banks, community finance initiatives and local and regional public bodies in coordinating this strategy.

3.54 In taking forward this strategy, it would also be important for central Government to develop and articulate at the outset clear measures to determine the impact of policy initiatives. These should identify the outcomes which are desired, and should ideally have the support of both local communities and the public sector partner. Measures could include both short run indicators of the effect on individual business start-ups and the survival of existing businesses, as well as more comprehensive measures of the enterprise environment stimulated by the policy interventions.

Potential policy levers

- 3.55 The PAT considered a wide range of potential policy levers which the Government could consider experimenting with in developing community finance provision. The following is a brief summary of the pros and cons of the main options.

National challenge fund for community finance initiatives

- 3.56 This might provide a “funding window” for such initiatives to bid for Government funding to finance the capitalisation of the local fund, or to finance capacity building within the initiative. (The US Treasury’s Community Development Finance Institutions Fund provides a conceptual model for such a scheme.) Centralisation of funding in this way might create a pool of experience within Government which over time could be well placed to direct funding to community finance initiatives which demonstrated best practice. There would also be the scope for the central agency acting as an advocate, profile raiser and source of technical assistance for community finance initiative development nationwide. If set up as a one off, it could act as a catalyst for the development of local funds. Against that, creation of a central bureaucracy may add rigidity, administrative overhead and distance from the environment in which community finance initiatives operate. A central ring fenced source of funding aimed at this specific aspect of local regeneration could also be seen as going against the grain of recent developments which have led to the establishment of the Single Regeneration Budget (SRB) and the devolution of discretion on allocation to local authorities.

Regional challenge funds for community finance initiatives

- 3.57 The funding window concept would be retained, but the public funds would be administered at local level, either at the city authority level or by the newly-formed regional development agencies. Local authorities may themselves bid in to the SRB for specific funds to support local community finance initiatives. Central policy direction and influence could be maintained through guidance notes and information exchange provided by DETR.

National challenge fund for banks involved in community finance initiatives

- 3.58 The two policy options above would deliver financial support directly to the non-commercial community finance initiative. Although this would address the problems of capitalisation and capacity faced by many community finance initiatives, and might thus indirectly attract commercial bank capital, it would not do so directly. A separate challenge fund could be created to provide financial incentives directly for banks to increase the scale of their activities in deprived areas. (The model for this is the US Treasury Bank Enterprise Award scheme.)
- 3.59 Banks’ involvement in order to be eligible for such a reward could be either financial support for community finance initiatives, or their own direct provision of lending and business advisory services in these areas. The fund could focus resources with the aim of kick-starting initiatives and activities by rewarding expansion of activities, with the award calculated as a variable percentage of the financial involvement of the bank. There would be a policy choice about when to deliver funding: *ex ante* on

the promise of investment (perhaps with a clawback mechanism for failure to deliver), or *ex post* reward after successful implementation. The former might provide greater incentives for *additional* bank investment. Given the relatively small sums which would probably be involved, any such scheme would need to be structured to extract the maximum reputational benefit to the winning banks, in order to create the strongest incentives to invest in community finance.

Targeted loan guarantee scheme

- 3.60 The three previous policy options would help to provide initial capital for community finance initiatives. Inevitably, mentoring and business support notwithstanding, some lending from such schemes will suffer defaults. Loan guarantee schemes could help mitigate the loss of such defaults, thus increasing the sustainability.
- 3.61 At present, the DTI's Small Firms Loan Guarantee Scheme (SFLGS) is operated through the banks and other lending institutions. The Government provides a guarantee of 70 or 85 per cent (the latter for firms with 2 years trading or more) on loans to firms with viable business proposals but which have been unable to obtain a conventional loan because of lack of security. Certain sectors are excluded from the Scheme on the grounds of displacement, including retailing, hairdressing, motor repair, taxi and cab hire. A premium is paid by the borrower to the DTI of 0.5 per cent for fixed and 1.5 per cent for floating rate loans.
- 3.62 The SFLGS has been evaluated on a number of occasions since it was introduced in 1981. The most recent evaluation was completed in December 1998. With recommendations for some minor modifications, the evaluation found that the Scheme provides value for money and that the lenders, including the banks, continue to support it. The evaluators also found a number of market segments, including the very low end of the employment spectrum, which did not draw significantly on the scheme. However, their analysis of loan guarantee schemes in other countries showed that similarly they tended not to operate at the extremes of the market segments, particularly at the single self employed and micro firm level. This led them to conclude that such segments require other financial instruments to be employed or that financial packages using loan guarantee schemes have not been innovative enough.
- 3.63 In this community finance field, it might be helpful to open up a different form of loan guarantee support which would be accessible to community finance initiatives directly or via the banks, as well as to banks which were directing lending to the target enterprises and areas. (This model has been applied in the USA under the US Small Business Administration's loan guarantee scheme, in which non-bank institutions have been registered to lend guaranteed funds to smaller firms in competition with the banks.) Community finance initiatives might find such support particularly valuable given their objectives of reaching out to enterprises which are typically perceived as higher risk by commercial lenders. This approach would probably require an additional level of administration somewhere to accredit community finance initiatives as being competent and aimed at the right target enterprises and areas. If guarantees were provided for bank lending to community

finance initiatives, then the banks themselves would have commercial incentives to ensure a minimum quality of CFI.

Securitisation of community finance initiative loan portfolios

- 3.64 Another policy option for enhancing the longer term sustainability of community finance initiatives might be to assist these schemes to securitise their loan portfolios. This could help recycle capital for new lending by the community finance initiative, enabling them to expand the scale of the activities where they offer some comparative advantage (early stage finance and mentoring of enterprises). Local schemes might sell portfolios of loans of a certain maturity to their local authority or to a central agency. In the former case, the authority could finance this acquisition through increased general borrowing, or package several community finance loan portfolios and issue a specific community finance instrument. There would be scope for the authority to credit enhance the instrument by subsidising some or all of the default risk from the underlying loans. Debt instruments which specifically represented underlying lending by community finance initiatives might be treated as eligible investments for special investment incentives (eg the national challenge fund for banks, option c above).
- 3.65 The viability of such an approach would depend in large part on the depth and liquidity of the market for public sector debt instruments. The UK market already supports an outstanding stock of some £700m of long term bonds issued by individual local authorities. The larger the organisation which was doing the securitisation, the greater the potential for risk pooling and administrative economies of scale in issuing debt. To create a separate market in community finance-based instruments, it may be necessary to securitise at a level higher than the local authority; Regional Development Agency may be a more appropriate level. In sum, though, this option is unlikely to be relevant in the short term in raising the level of community finance activity in the UK.

Tax incentives for banks' support for community finance initiatives

- 3.66 As an alternative to the public spending approaches outlined above, the corporation tax system might be used to create incentives for banks to provide capital to community finance initiatives. There are two possible mechanisms:
- c investments (debt or equity) in accredited community finance initiatives could be made tax deductible, providing an up front incentive at the bank's marginal corporation tax rate;
 - c the revenue from such investments (in the form of interest or dividends) could be exempted from tax on receipt by the bank, providing an ongoing incentive to those banks seeking a quasi-commercial return from their community finance investments.
- 3.67 The potential advantages of such a scheme are that it would operate in an automatic manner. There would be minimal bureaucratic interference in allocation of public resources, beyond establishing the initial parameters and definition for the

scheme and maintaining an accreditation process for community finance initiatives. The disadvantages are that it cannot easily be tailored to direct resources to the areas of greatest need nor to those schemes which offer the best potential. There is also a potential disconnect between local bank decision makers involved in specific community finance initiatives, and those in head office concerned with the bank's tax affairs, which might dilute the incentive effect in practice of a tax incentive.

- 3.68 Tax may however have a role in relation to individual social investors in community finance initiatives. Such investors are often closely involved in the wider life of the community and their active involvement in the CFI can help strengthen the organisation. Lending rather than giving may help engage the social investor in the work of the CFI. At present, outright donations to *charitable* social enterprises which engage in regeneration activities, including SME development and finance, can attract tax reliefs. Lending or investment to such charities at below commercial rates does not attract tax enhancements on the element of donation, the gap between commercial rates and the return offered by the CFI (ie the interest subsidy, not the value of the principal). By extending tax relief in this way, CFIs' fund-raising ability should be strengthened.
- 3.69 In seeking investment from private individuals, community finance initiatives should clearly be mindful of the need to comply with financial services legislation and best practice.
- 3.70 A number of CFIs are registered as Industrial and Provident Societies (I&Ps). HMT issued a consultation document in May 1999 about the exemption from the Banking Act for Withdrawable Share Capital (WSC). The document said that it seemed likely that most (if not all) issuance of WSC would fall under the definition of deposit. As a result of the consultation, it has become clear that the terms on which WSC is issued varies considerably, and does not necessarily always involve the issuance of deposits. For the avoidance of doubt, HMT, having consulted the FSA, wishes to make it clear that withdrawable shares will represent deposits only if the sums involved are paid on terms which provide for their repayment in full. Where withdrawable shares do not constitute deposits, societies will not be affected by the changes proposed, since they have no need to rely on the exemption.

Recommendation 11

3.71 In order to strengthen the role of Community Finance Initiatives the PAT recommends that:

the Government to play an active role in promoting new initiatives providing finance for enterprise, where there are high social returns and where market mechanisms will not suffice.

3.72 The Small Business Service, working with the DTI and HMT should develop the

Government's approach to Community Finance Initiatives (which may include schemes initiated by banks).

Timing: Immediate and ongoing. The first steps in taking forward this agenda need not wait for preparation of a formal SBS strategy - they can be based on this report (see recommendation 12).

Recommendation 12

3.73 In order to improve the financing available to CFIs the PAT recommends:

The Government to open funding windows, on an experimental basis and subject to evaluation, to strengthen the financial base of CFIs and activities initiated by banks in this area. It should achieve this by:

- a. DTI/SBS to provide loan guarantees for CFIs borrowing from banks;***
- b. DTI/SBS to establish a national challenge fund to resource CFIs (CFIs, perhaps in partnership with mainstream banks, would bid for these funds to provide a capital base for their lending activities);***
- c. To strengthen the ability of CFIs to raise finance from private investors, the Government (Treasury/Inland Revenue) should also consider the case for introducing tax relief on loans to charities at below market rates.***

Timing: Work should begin on (a) and (b) immediately and should be operational by April 2000.

3.74 The Small Business Service should also explore possible loan guarantees being provided by other organisations. For example, the SBS should discuss with the European Commissions their approach to funding. Some existing European funding could go towards loan guarantees. The European Investment Fund runs the SME guarantee facility (SMEGF) - a programme with a subsidy from the European Union budget to support lending to SMEs. Roughly £20m of subsidy is earmarked for the UK - which would guarantee lending of a much larger amount. Any support routed via EIF needs to be matched by the national authorities. This could be used to guarantee lending by CFIs and banks to businesses in deprived areas. Another example, might be the National Lottery Charities Board, which provides grants for regeneration activities. If this were in the form of loan guarantees to CFIs or banks lending to businesses in deprived areas this might provide a significant boost to lending in deprived areas.

Recommendation 13

3.75 An important means of strengthening the market for SME finance in deprived areas will be a greater awareness among banks, CFIs and others of how this market is developing across the UK. In part this function should be performed by the SBS in taking forward the recommended action to spread best practice across areas. But the PAT considers there may also be a useful additional role for an informed independent body not directly connected with policy delivery to monitor the character and volume of bank and CFI activity in deprived areas. This extra information should provide a stimulus for continuous improvement. The PAT therefore recommends that:

the Government monitor the character and volume of bank and CFI activity in deprived areas, to maintain pressure for change.

3.76 The PAT recommends that:

a. the Government should invite the Bank of England to report regularly on finance for business in deprived areas (and for groups within deprived communities), perhaps as part of their annual review of finance for SMEs.

3.77 As well as providing financial support for CFIs and promulgating best practice, the SBS may also be able to use its developing role and standing in this market to encourage good practice by the banks and other commercial finance suppliers. Dissemination of such examples could help stimulate competitive activity to the benefit of enterprises in deprived areas. The PAT therefore recommends that:

b. Government (SBS) should run an award scheme for innovation and excellence in the banking sector in serving deprived communities.

3.78 Aside from Government and the Bank of England, outside researchers and local groups will be interested in assessing how banks and other commercial financiers are performing. The PAT recommends that:

c. Banks should be encouraged to work with interested parties on voluntary disclosure of activity in this area.

Timing: (a) immediate. (b) first awards to be made in 2001. (c) request to be made in response to this report.

Responsibility and desired outcomes

3.79 The Treasury and DTI are responsible for implementing different elements of this agenda. There is also scope for working with other organisations, such as the National Lottery Charities Board, and EU institutions such as the Commission and

the European Investment Bank/Fund.

- 3.80 But the DTI should be responsible for ensuring that the Small Business Service implements the bulk of this agenda. The formulation of policy must take account of the inherent risks involved in any institution that borrows and lends.
- 3.81 The aim is to ensure that more enterprises that can deliver high social or economic returns get the capital they can afford. This can be measured through surveys of businesses on access to finance, and tracking development of credit markets in deprived communities.

Annex to Chapter 3: Evidence on access to finance problems

Small is bankable: Community reinvestment in the UK, Mayo, Fisher, Conaty, Doling and Mullineux, Joseph Rowntree Foundation, 1998

Surveying the current provision of community finance initiatives in the UK, the report finds that:

- C there are currently eleven community loan funds with assets of over £75 million, about half of which is available for lending (the rest being equity). These funds have helped lever in additional commercial lending (in ratios of up to 1:10). Several community loan funds have now formed a UK association, the Rebuilding Society Network;
- C microfinance funds are less well established, although the largest of them, the Prince's Trust with assets of £21 million, is by far the largest and most prominent community finance initiative in the UK to date;
- C there are eight mutual guarantee societies which have developed in the UK in the last four years. These have yet to start lending, in large part because their regulatory status is still uncertain;
- C there are three social banks, run as for-profit organisations dedicated to social or environmental objectives in addition to their commercial aims. Triodos Bank, the largest of these, has £52 million assets in the UK;
- C credit unions serve around 200,000 people in Great Britain, and another 200,000 people in Northern Ireland. They are primarily geared towards personal finance, although a few are beginning to provide loans for self-employment and microfinance;
- C around one quarter of local authorities have established loan funds for small businesses (a 1994 survey found 84). However, their overall quality is poor: few reach sustainability and management of fund and loan portfolio is generally weak.

In summary, UK community finance initiatives aimed at enterprise serve directly or indirectly around 100,000 people, and control around £170 million of capital (£96 million with loan and micro-finance funds, £74 million with social banks).

The report assesses that these initiatives only partially fill the financing gap created between the demand for small business finance in deprived areas and the current state of supply from fully commercial lenders. The key reasons for this mismatch are identified as:

- C branch closures distancing micro-entrepreneurs from local bank staff with lending discretion;
- C micro and small businesses in deprived areas are more likely to suffer credit rationing, as a result of the greater perceived risks from their local economic environment, small size of loan requests and greater investment of time required to assess less conventional business plans;

- C potential for lack of understanding between ethnic minority borrowers and suppliers of commercial lending or technical assistance.

These conclusions are not universally accepted. The counter arguments (as advanced by the banking industry) are that banks can and do reach enterprises operating in deprived areas. Any perceived credit rationing may be the result of poor local demand affecting the viability of the business and hence the lending decision, and the greater need for business support and advice for small firms operating in a less favourable economic climate.

Benchmarking in Micro-Lending: UK Country Report, Kempson and Whyley, for European Commission DG XXIII, 1998

Micro-entrepreneurs face well-documented problems in trying to access commercial funding. Personal wealth and savings are the most important sources of start-up finance, followed by bank lending and then support from family and friends. This suggests that enterprise may be held back in poorer areas where individuals and their immediate personal contacts have fewer personal financial resources to deploy and thus place greater reliance on external funding.

While many micro-entrepreneurs are able to access bank lending on purely commercial terms, there are certain aspects of bank lending which tend to operate against certain types of borrowers who may be more heavily concentrated in deprived areas. The relevant factors include:

- C rigid lending criteria: bank requirements' for business experience, savings to invest in the business, assets for security, and professional presentation of the business case can all operate against micro-entrepreneurs without the track record, personal wealth or formal approach to business required to satisfy lending officers;
- C micro-entrepreneurs' feelings of fear and alienation: those who are economically disadvantaged may be reluctant to approach traditional banks;
- C centralisation of bank decision-making has worked against the creation of personal relationships between micro-entrepreneurs and their lending managers;
- C there have been (unproven) allegations of discrimination (racial and sexual) against traditional banks in their lending decisions;
- C micro-entrepreneurs face disincentives to bank borrowing, in the form of minimum arrangement fees, higher interest rates, difficulties in changing lending terms, and serious penalties for default;
- C poor attitude towards banks, leading entrepreneurs to resort to bank financing as a last resort.

Again, some of these conclusions are not fully accepted by the banking industry.

The survey of 15 micro-lenders identified several themes:

- C UK micro-lenders operate along a continuum ranging from the quasi-commercial

to those very socially-oriented organisations;

- C many micro-lenders are focussed on wider community regeneration rather than supporting small businesses per se. Consequently, many micro-lenders have a very strong local emphasis;
- C micro-lenders differ in their own objectives for self-sustainability: most are charitable organisations and only a small minority have reached or are close to self-sustainability. All, however, are committed to sustainable developments of those to whom they lend;
- C UK micro-lenders tend to lend to individual businesses, rather than to mutually guaranteeing groups of small firms, as is the practice of several foreign micro-lenders;
- C finance is only one part of the business support package. There is typically intense pre-loan contact between lender and borrower and a continuing after-loan personal relationship. Monitoring and mentoring are often part of the loan conditions;
- C default rates are typically 20-25 per cent, within a full range of 1-40 per cent. Micro-lenders are significantly more lenient post default than commercial lenders.

Micro Credit in the UK: British Bankers Association survey of members' involvement in micro-finance schemes, 1999

This survey, conducted in 1998, has identified 60 or so community finance initiatives involving members of the BBA. The key points emerging from this survey include:

- C the banks have provided at least £8 million of identified capital to set up the majority of such loan funds, which have total identified funding of £24 million. Both figures almost certainly underestimate the extent of this activity and banks' involvement. Their contribution to the other schemes is not separately identified;
- C most of the schemes date from the first half of the 1990s or earlier and have no set finishing date;
- C maximum loan available is typically in the £5,000-10,000 range;
- C target borrowers include both start-ups and existing businesses within the geographical scope of the fund, with a slightly greater emphasis on the former;
- C interest rate policy varies widely, including both fixed rates and variable rates (50% of base rate to base +3%);
- C lending decisions are most made by the bank and other partners in the scheme;
- C active monitoring of borrowers is very often compulsory as a loan condition, and advice is also usually offered in conjunction with finance.

At present, the inventory provides simply a quantitative description of the range of initiatives in the UK. The next step would be to analyse in more depth the success or

otherwise of these schemes and to identify the key factors determining the performance of initiatives.

This community finance involvement by UK banks should be seen in the context of their general lending to small businesses. The following table summarises the latest BBA data:

Major British banks' finance to small businesses*

	1992	1993	1994	1995	1996	1997	June 1998
No. of small business current accounts (m)	2.9	2.7	2.6	2.6	2.6	2.6	
No. of current accounts overdrawn (m)	0.70	0.69	0.67	0.67	
Overdraft borrowing (£bn)	19.4	16.6	13.9	12.8	11.7	11.4	11.2
Term lending (£bn)	20.1	21.6	22.4	22.9	22.4	22.7	24.8
Deposits (£bn)	22.3	23.5	24.8	26.1	27.6	31.6	30.9

* debit turnover of up to £1 million per annum

Unfortunately, there is no comprehensive data on the geographical distribution of the lending activity.

The Financing of Ethnic Minority Firms in the United Kingdom, A Special Report, Bank of England, 1999

The Bank of England's report seeks to compare the experience of ethnic minority small firms with that of small firms in general, or non-ethnic businesses in particular. This is directly relevant to the work of PAT 3 given the over-representation of ethnic minorities in deprived areas. The key results of the Bank's report include:

- C ethnic minority businesses (as defined by the cultural background of the owner) are estimated to make up almost 7 per cent of the total small business stock (compared to 6.4 per cent in the population as a whole). Chinese, Indians and Pakistanis have a greater representation in self-employment than whites, while Afro-Caribbeans have a lower representation;
- C financing problems faced by ethnic minority businesses are similar in nature to

those encountered by small business generally, although some studies suggest that they encounter them in a more acute form at both the start-up and the growth stages;

- C there is little documented evidence of ethnic minority businesses suffering discrimination by finance providers in the UK, but there is evidence that some ethnic minority businesses perceive that they are treated adversely. Whether or not this discrimination exists, the steps that need to be taken by banks and other finance providers to counteract either actual or perceived discrimination are the same in both cases;
- C banks have recognised that ethnic minority businesses are a significant, and growing, sector of the small business market, and in recent years have taken a number of active steps to improve their business relations with ethnic minority businesses. On the whole, this has been noted positively by their ethnic minority business customers, and the diversity of the banks' approach is encouraging;
- C take up of official business support among ethnic businesses appears to be low. The Government is looking actively at ways of improving this.

PART B: REMOVING BARRIERS TO ENTERPRISE

Chapter 4: Self-employment

Introduction

- 4.1 This chapter considers the role of self-employment in providing employment opportunities in deprived communities, and how this might be enhanced. The PAT's goal is to remove the barriers preventing people (for whom it is a suitable option) from moving into self-employment. The key issues that the PAT have highlighted, and made recommendations on, are:
- C the perceived complexity of the tax and benefit system, and lack of readily available information;
 - C income uncertainty in the early stages of self-employment; and
 - C awareness of self-employment.
- 4.2 It is important to stress the PAT's view that self-employment will not be right for everyone. Individuals should make a balanced choice between self-employment (starting a business) and entering salaried employment (working for someone else). Government intervention should not distort this decision one way or the other. But self-employment does provide a good opportunity for many people in deprived areas where mainstream businesses have moved out of these areas. And in communities that feel excluded from much of society, self-employment provides some with an attractive route to economic independence.
- 4.3 The PAT recognises the importance of advice and training for people making the decision as to whether self-employment is right for them, and to help businesses expand and fulfill their potential. This is particularly the case for people who are unfamiliar with self-employment. Pre-start (and ongoing) training and advice can help ensure commitment and provide the required business skills. So the recommendations in this chapter need to be considered in parallel with those in chapter 2 to ensure that appropriate training, advice and support is available (and with those in chapter 3 so that people can gain access to finance). The new National and Local Learning and Skills Councils will also be key providers of such advice and training.
- 4.4 This chapter ties in closely with the work of other policy action teams looking at promoting employment opportunities in deprived areas. In particular Policy Action team 1 (Jobs) is looking at reducing the level of worklessness and unemployment in deprived communities generally; and Policy Action team 2 is looking at skills.

Definition of problem and analysis

Some facts about self-employment

- 4.5 The data PAT3 have collated on self-employment in deprived areas suggest that

self-employment may not be as effective a source of employment for people in deprived areas as it might be. However, it is difficult to determine to what degree self-employment is low in deprived areas due to the characteristics of people in these areas (for example, poor skills resulting in self-employment not being a viable option); or whether there are specific problems related to deprived areas which result in there being barriers to the move into self-employment (for example due to a particular lack of awareness of self-employment, or lack of enterprise culture in these areas). As a result many of our recommendations relate to promoting self-employment as one avenue out of poverty rather than being specific to deprived areas.

- 4.6 In deprived areas (defined as the 44 most deprived local authority districts according to the 1998 Index of Deprivation) self-employment represents a smaller proportion of the economically active population than in other areas. This is also true for salaried employment rates. But there is a greater proportionate difference between self-employment rates, when comparing deprived and non-deprived areas, than between salaried employment rates. Furthermore, those that are self-employed in deprived areas are less likely to employ someone else than in other areas. These facts are illustrated in table 4.1. (Note a similar picture is seen whether London is included or excluded in this comparison. There are relatively higher rates of self-employment in London than elsewhere, mirroring the higher levels of business start-up rates discussed in chapter 3. But the proportionate difference in self-employment rates between deprived and non-deprived areas in London are still greater than the proportionate difference in employment rates.)

Table 4.1: Self-employment in deprived areas (self-employment as a % of working population)			
	Self-employment:	Self-employment:	Employment
	All	No employees	Full time and part time
10% level of deprivation	8.1	6.0	75.7
Remaining population (90%)	12.4	8.2	78.4
7% level of deprivation	7.8	5.9	74.6
Remaining population (93%)	12.2	8.1	78.4
5% level of deprivation	7.8	5.9	73.0
Remaining population (95%)	12.1	8.0	78.4

Source: 1991 Census of Population, Local Base Statistics

- 4.7 Certain social, economic, ethnic and other demographic characteristics appear to impact on individual's propensity to be self-employed - and to succeed. Box 2.2 in chapter 2 considers ethnicity and the propensity to be self-employed.
- 4.8 Research carried out for DfEE (see Kellard and Middleton 1998) has identified the following sub-groups as being more likely to be successful in moving out of unemployment into self-employment:

- C those with past experience of self-employment;
 - C people coming from families with a tradition of self-employment;
 - C those with modest capital reserves, often in equity tied up in owner occupied property;
 - C stable relationships, especially in two income households, often provides the financial resources and personal support needed for successful entry into self employment.
 - C men (although the number of female entrepreneurs is increasing); and
 - C those with higher educational qualifications or significant amounts of practical experience (evidence here is contradictory: both academic and vocational qualifications are important, but there exists a large number of self-employed people with no qualifications at all).
- 4.9 Age is important too, the prime age for entering self employment is between 35 and 50 - the point in many people's careers where they have gained a solid experience of work in a particular field; associated business and technical skills; and sufficient financial resources to sustain themselves through the initial teething problems.
- 4.10 It can be seen that many of these factors (poor skills, relative lack of experience of enterprise, and poor capital reserves) may help explain why self-employment is lower in deprived areas. Table 4.2 shows that there is a lower incidence of marriage, and (unsurprisingly) home ownership in deprived areas. These characteristics may contribute to the lower incidence of self-employment.

Table 4.2: Characteristics of those in deprived areas (%)					
	Males aged 16-64	Residents aged 16-24	Residents aged 25-44	Residents who are married	Households owner occupied
10% level of deprivation	31.1	14.4	29.7	37.4	43.6
Remaining population (90%)	31.9	12.4	29.2	48.6	73.1
7% level of deprivation	31.0	14.6	29.8	36.2	40.8
Remaining population (93%)	31.9	12.5	29.2	48.2	71.8
5% level of deprivation	31.1	14.8	29.9	35.0	38.3
Remaining population (95%)	31.8	12.5	29.2	47.9	70.8

Source: 1991 Census of Population, Local Base Statistics

- 4.11 Lower levels of self-employment in deprived areas may simply reflect these and other characteristics of people in deprived areas. And to fully understand whether there are specific problems related to deprived areas we would have to control for all these characteristics. Nevertheless PAT3 believes it is important, as part of any strategy to improve employment opportunities in deprived areas, that self-employment is made a viable option for those for whom it is suitable.

Self-employment as a route out of poverty

- 4.12 Studies show that self-employment can be an effective route out of unemployment and exclusion for many people, see for example Metcalf 1997, Gavron, Cowlin, Holtham and Westfall 1998. Each year about 270,000 or (9%) of people leaving Job Seekers Allowance (JSA) move into self-employment. Until recently people moving from unemployment accounted for roughly half of all people entering self-employment in Britain. Not everyone becoming self-employed from unemployment has been out of work for a long time. Nor have they necessarily faced extensive periods of chronic employment instability, unemployment or poverty. But some have.
- 4.13 The evidence on the motivation for becoming self-employed is mixed, see for example Bryson and White 1997, and Metcalf 1997. For many self-employment is a planned and positive career enhancing move, particularly those working in occupations and sectors where self-employment is a conventional working pattern. And self-employment can be a flexible form of working. So, for example, women (and men) may find self-employment an attractive option in order to achieve a desirable balance between work and family life. Disabled people can also benefit from the flexibility of self-employment. But some people try self-employment as a last resort when faced by the prospect of lengthy unemployment and low family incomes. Others move towards self-employment from unemployment in a totally unplanned way, for example through the gradual build up of casual work for friends and neighbours.
- 4.14 Evaluations of business support programmes show the benefits of people being helped into self-employment through Training for Work or by the Princes' Trust (see for example, "Evaluation of the Self-Employment Option within Training for Work", CRG, 1996 or "Review of Business Start Up Activities under the SRB", by York Consulting); between 70% and 90% are still trading after a year, which compares with around 50% of all JSA claimants who return to unemployment within a year of leaving the unemployment register. (There may be problems with such comparisons however. For example, due to the selection programme undertaken by PT there may be selection bias which make self-employment appear a more successful option than it is in reality.) Sustained trading is one measure of the impact of self-employment on the prospects of unemployed people.
- 4.15 That said, the possibility of a business venture not succeeding must be recognised, as must the potential consequence of this for an individual's financial position - including the risk of bankruptcy. On the other hand, people who experience self-employment may improve their general employability (essentially their attractiveness to employers) through demonstrating their motivation and giving them a current work record.

Problems faced by those moving into self-employment

- 4.16 There are a number of factors that may prevent people from moving into self-employment which reduces the contribution made by self-employment to reducing

exclusion and poverty. Access to business support services and access to finance are discussed elsewhere in this report (in chapters 2 and 3 respectively). But there are other factors that can be just as important. These include:

- C *The impact of the tax and benefit system:* the factors cited here tie in closely with the issues raised by PAT1 considering the problems faced by people generally in moving from welfare to work. This chapter should be read in conjunction with their report when it is published. The key tax and benefit issues in the move from “benefits to business” are:
 - i. *Uncertainty regarding the impact of moving into self-employment on benefits which reflects a lack of readily available or digestible information:* people find it difficult to access information on whether they can continue to claim benefits when self-employed, and if so, at what level. This uncertainty is a barrier to the move from “benefits to business”.
 - ii. *Revealing income in order to qualify for benefits:* in order to qualify for in-work benefits the self-employed must be able to demonstrate their level of income. This (necessary) requirement can be a disincentive to moving into self-employment if people think it will be an onerous task or if uncertainty over their initial income will adversely affect their benefit claim.
 - iii. *The risk of losing existing benefit entitlement* if their business venture did not work out.

- C *Uncertainty over income:* especially in the initial phase of the business’ life, income can be extremely uncertain. Recent reforms of the tax and benefit system (in particular the Employment Credit for over 50s and the Working Families Tax Credit), and the self-employment option in the New Deal for 18-24s, provide more income certainty for people moving into self-employment. But for those groups not covered by these (welcome) initiatives, income uncertainty remains a problem and a potential disincentive to start up in business. This problem is exacerbated by the fact that people in deprived areas often find it difficult to borrow to fund their income during this initial phase.

- C *Awareness:* people may not see self-employment as a viable option for them, and may not be aware of help that might be available should they want to move into self-employment.

Some of these factors can prevent people from moving into salaried employment as well. But they can be exacerbated for the self-employed. For example income uncertainty is a greater problem for the self-employed.

- 4.17 Concerns regarding completing tax returns were also a feature of feedback from the PAT’s consultations. In particular: the necessity to complete complex tax returns; fear of innocently falling foul of the system due to genuine mistakes; and more generally dealing with what is sometimes seen as “a monolithic institution” (the tax office) which can be inaccessible to people in deprived areas - this can be

a daunting task for the self-employed, especially for people without experience in this area.

- 4.18 Box 4.1 provides an example of the difficulties faced by those wishing to move off benefits into self-employment.

**Box 4.1: Difficulties faced by those moving off benefit into self-employment:
A lone parent**

4.19 A lone parent in Brighton had done a course in aromatherapy and massage, registered as a childminder. She wished to explore the possibility of becoming self-employed whilst claiming family credit and housing benefit to supplement her income.

4.20 Employment Service Advisers, for the New Deal for Lone Parents, were not able to give her any information about self-employment, and specifically how it affects benefit levels and future entitlement to benefits. When asked for advice about these issues they could give no help other than to say “it would be less complicated if you were to get a salaried job” (in this example, the claimant was not given any information about who would be able to provide the information she sought).

4.21 As it happens income from child-minding is actually treated much more favourably under the present housing benefit arrangements than income from other sources, but as the claimant was not made aware of this she did not start her business for fear of being worse off.

Strategies to address these problems

The tax and benefit system

- 4.22 The Government has implemented a number of measures in recent Budgets to improve the tax and benefit system - see box 4.2.

Box 4.2: Reforms to the tax and benefit system

4.23 The Government has introduced a number of reforms to the tax and benefit system in order to make work pay. It has introduced:

C A new **10 pence rate of income tax** (which significantly reduces the tax bill for the low paid).

C **A cut in the basic rate of income tax to 22 pence** to reward work and ensure families are better off.

C The **Working Families Tax Credit (WFTC)** which will boost the incomes of low income working families with children, combined with the National minimum Wage,

it offers a household with dependent children a guaranteed minimum income (roughly around £200 per week). This provides an income bridge for those moving into work.

C **Cuts in National Insurance Contribution Liabilities for low earning self-employed people.**

C An **Employment Credit for over 50s** was announced in the 1999 Budget. People over 50 who return to full-time work after 6 months or more on benefits will be eligible for £60 per week for the first year back in work (£40 for part-time work - 16 to 30 hours a week).

4.24 As noted above despite these (positive) moves the tax and benefit system is still perceived as a barrier to people moving into self-employment.

Recommendation 14

4.25 The PAT welcomes the reforms introduced to increase the incentives to move from welfare to work, including self-employment. As the reform continues it will be important to ensure that within the tax and benefit system self-employment is treated as a perfectly valid option that deserves support. The PAT recommends:

a. As part of the ongoing review and reform of the tax and benefit system, the Government should consider how the system interacts with people moving into self-employment. The move from “benefits to business” should be as easy as moving into salaried employment.

And in order to provide readily available information on the system:

b. Ensure that front-line staff in benefit offices and Job Centres are aware of self-employment as a viable option for clients, and how the tax and benefit system will affect the move from “benefits to business”. Simple guidance / information should be available to inform clients about the benefit implications of self-employment. A review of existing training is required and if necessary an urgent programme of training should be implemented.

Timing: (a) ongoing; and (b) the review of training to be completed by end 1999 and revised / new training (as necessary) to be provide in early 2000.

Support for people moving into self-employment

4.26 Box 4.3 sets out the various forms of support for self-employment currently provided by the government. There are of course many local initiatives as well which are

extremely valuable, but these are too numerous to list here.

Box 4.3: Government support for self-employment

4.27 This box outlines a number of government programmes and initiatives which currently, or in the near future, will help unemployed people moving into self-employment.

C The **New Deal for 18-24s** (available to those unemployed for over six months) has a self-employment option, involving training, counselling, and a period of up to six months test trading. As part of the six months of test trading there is effectively an income bridge offered, whereby the participant continues to claim an allowance but cannot whilst doing so draw profits from the enterprise. Profits can only be drawn once they stop claiming JSA, or after six months.

C The **New Deal 25 plus pilots** (launched at the end of November 1998) target those people aged 25 or over who have been unemployed for over 18 months, or over 12 months in some areas. Based on the intensive approach pioneered for 18-24 year olds, they also include support for self-employment. Partnerships have been asked to develop innovative proposals to help unemployed people into self-employment.

C The **New Deal 50 plus** provides a Personal Adviser, financial support and in-work training grants to people over 50 moving into self-employment after 6 months or more on benefit. The Employment Credit pays £60 pw for full-time work (£40 pw for part-time work) for the first 52 weeks back in work, for those with an income of less than £15,000. This offers support during the crucial early months of trading when self-employed earnings are often low.

C The **New Deal for Disabled People** offers support for people on incapacity benefits moving into self-employment. Currently personal adviser support is available in 12 areas - covering some 250,000 clients.

C Under existing rules people can continue to claim their **Jobseeker's Allowance** for up to 8 weeks while they are preparing a business plan. Therefore unemployed people, at the discretion of Employment Service Advisers, can be relieved of the requirement to actively seek work for 8 weeks whilst starting in self-employment.

C DfEE provide matched funding to the **Prince's Trust (PT)**. PT is targeted on people aged 18-30 (mostly unemployed) disadvantaged people. (See box 2.4 on PT for a fuller explanation of their services.)

C The aim of **Work Based Learning for Adults** is to help long-term unemployed adults (aged over 25 and unemployed for more than 6 months) into secure and sustained employment or self-employment. The self-employment route involves business support and training. Often participants have the opportunity of test trading. In the year to November 1998 WBTA helped around 3,500 people into self-employment.

- C The 15 **Employment Zones**, which should be up and running from April 2000, will offer help to long-term unemployed people aged 25 and over seeking to become self-employed. Although prototypes and the new Zones are encouraged to find innovative methods of support for unemployed people, participants seeking help to become self-employed should at least receive training to do so.
- C The **New Deal for Communities (NDC)** provides funding for the intensive regeneration of poor areas, which is discussed in chapter 6. Its key aims are increased employment, higher educational attainment, reduced crime and improved health. The choice of what programmes are run in each area depends largely on the local community - however, it is likely that many of the partnerships will have schemes that encourage people to move from unemployment to self-employment as part of their overall strategy.
- C The **Jobfinder's Grant** is designed to reduce the transitional costs jobseeker's incur when moving from benefit into work. This grant is now available to those moving into self-employment.
- C The **Back to Work Bonus** is a payment of up to £1000 which provides an incentive for claimants to move into work from benefits. It is open to claimants of Income Support and JSA who have been entitled to these benefits for 3 months or longer. If they move into work (including self-employment) which takes them completely off benefit, they can claim a Back to Work Bonus.

4.28 It is clear that there are a lot of programmes and initiatives which offer a variety of help to unemployed people seeking to become self-employed. These are welcome. But the work of the PAT and feedback from consultations suggest two significant problems:

- C a relative lack of help for those aged 25 to 49 (though those aged under 30 are eligible for support from the Prince's Trust, and people aged 25 to 49 are eligible for Work Based Learning for Adults and some will be eligible for the Working Families Tax Credit and the New Deal pilots for 25 plus);
- C a lack of an income bridge (for those people not eligible for the Working Families Tax Credit or Employment Credit for the over 50s) to address the uncertainty of income, the disincentive of leaving the benefit system, and the problem that people in deprived areas are often capital constrained and hence cannot borrow to provide an income in the initial stages of their business start-up.

Support for those aged 25 to 49

4.29 The PAT recognises the concerns expressed during our consultations regarding help for those aged 25 to 49, and in particular for the age group 30 to 50 who are not eligible for support from the Prince's Trust. As noted above help is available to this group of people, for example through Work Based Learning for Adults; Working

Families Tax Credit; and the New Deal pilots for 25 plus. But there may be a case for additional support to be provided.

- 4.30 The PAT recognises that there are particular reasons for wishing to help the young and those aged over 50. The young tend to have higher unemployment rates than those aged 25 to 50, and evidence suggests that long periods of unemployment and inactivity at an early age can have scarring effects which result in poorer job prospects in later life (see for example, "The Modernisation of Britain's Tax and Benefit System: Employment Opportunity in a Changing Labour Market", published by HM Treasury 1997). And trends in participation over recent years suggest that older workers are moving out of the jobs market, and a lot of productive potential is being lost unnecessarily (see for example "The decline of employment among older people in Britain", Nigel Campbell 1999).

Recommendation 15

- 4.31 In recognition of the concerns expressed regarding the availability of help to all irrespective of their age, the PAT recommends that:

The Government considers extending greater support for those moving into self-employment irrespective of their age. The evaluation of the New Deal pilots for the 25 plus will be an essential element of this consideration.

- 4.32 Evaluation of current initiatives - such as the New Deal pilots for the 25 plus - is required to judge the most efficient intervention to reach disadvantaged groups.

Timing: By end-2000.

An Income Bridge

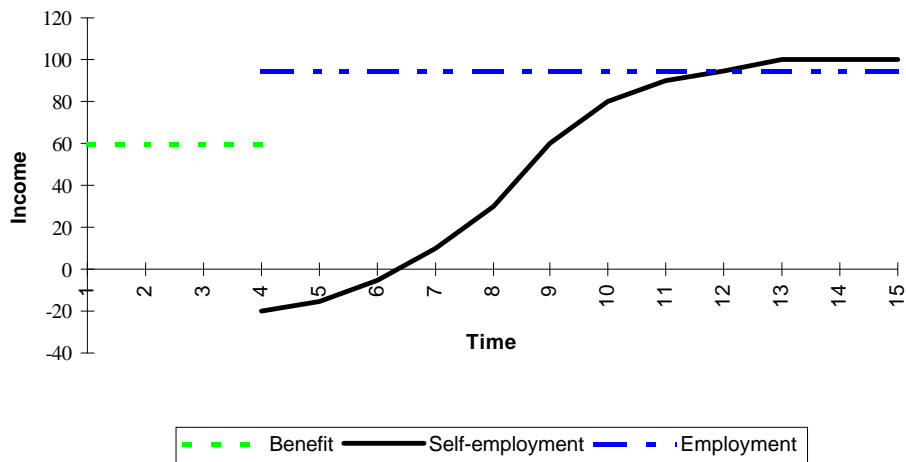
- 4.33 A regular feature of feedback from consultations was the need for an income bridge, ie a guaranteed level of income either (and most importantly) for the initial start-up phase of self-employment, or permanently. (A minimum guaranteed level of income is provided to those in salaried employment through the National Minimum Wage, but there is no equivalent for the self-employed.) An income bridge for the self-employed would help alleviate:

- i. the disincentive of giving up benefits (and a regular income); and
- ii. concerns regarding income uncertainty - "where will I get the money to feed my family?"

- 4.34 An income bridge is particularly relevant for people in deprived areas because they are typically capital constrained. They frequently do not have savings upon which they can draw, and cannot borrow funds - banks will often not be prepared to lend funds due to a lack of collateral which can make such lending very risky from their

perspective. This can result in many people not wanting to start a business. As chart 4.1 illustrates, in the start-up phase the cessation of benefits (in full or in part) can leave an individual with little or no income for a period of time, as it will take time for the business to establish itself and provide a sufficient income.

Chart 4.1: Illustrative example of income paths from unemployment into work



4.35 The PAT has considered a number of ways in which an income bridge might be provided:

A) *Subsidising lending in people starting up in business, or reducing the risk of lending through loan guarantees*

4.36 Helping people moving into self-employment to borrow is one option for an income bridge. Banks do not take account of the social benefit of moving someone off benefit and into work⁴ they may lend less (or lend at a higher rate) than is socially optimal. To remedy this the government could act as guarantor on, or actively encourage through subsidies, loans to those seeking to set up in self-employment. At the moment this provision is not met by the Small Firms Loan Guarantee Scheme (SFLGS) which focusses on loans to larger businesses, and which lends a minimum of £5,000 - higher than the typical sums people in deprived areas need to borrow. Chapter 3 discusses the scope for reforms to SFLGS.

4.37 The potential advantage of a loan, over an income bridge such as a benefit run-on is that from the outset individuals will rigorously assess whether or not self-

⁴ The bank will set the borrowing rate, or make the decision as to whether to lend or not, based on the riskiness of the lending. Though this may be the correct response by banks, which must aim to maximise profits for their shareholders, this ignores the social return, or positive externalities, associated with the lending. Most obviously it ignores the saving to the exchequer of not paying benefit to the person starting their business. Thus the bank is underestimating the actual (social plus private) return from the lending. Hence it will lend at a socially sub-optimal rate, or provide fewer funds than is socially optimal.

employment is viable for them⁵. The main, and the PAT believes very significant, drawback from this suggestion is the perception by people in deprived areas that taking on high levels of debt entails too much risk for them should the venture fail.

B) Extending the principle of a guaranteed minimum level of in-work income (such as that provided by the Working Families Tax Credit)

4.38 The Working Families Tax Credit, Employment Credit for the over 50s and the self-employment option in the New Deal for 18-24s all provide an income bridge for people moving into self-employment. The Working Families Tax Credit acts as an effective buffer to those struggling in self-employment not only in the start-up phase but throughout the business's life. Extending the principle of a tax credit to working people / households without dependent children would cover all those looking to set up in self-employment and therefore would overcome the problem of the uncertain periods of income for the self-employed in general.

4.39 The Government has stated that it is attracted to the principle of extending the principle of the working tax credit to low income households (ie include those without children) through an Employment Tax credit. The Employment Credit for the over 50s is the first step in this process and its experience will be important.

C) Reform or change eligibility requirements to existing programme

4.40 The government could consider changing the eligibility requirements of Jobfinder's Grant (or other similar programmes) to help more unemployed people into self employment. Whilst this might act to reduce the uncertainty of the start-up phase it is subject to a number of concerns – deadweight (people taking advantage of the income bridge who would have successfully moved into self-employment even if it hadn't been there) and displacement effects (through the income bridge these firms may be able to compete with lower prices taking business away from other firms) and fraud. In addition the amount of the Jobfinder's Grant, at £200 is unlikely to be a significant help to many of those setting up in self-employment.

D) Revive the Enterprise Allowance Scheme or introduce something similar

4.41 The government could simply extend an allowance to unemployed people on moving into self-employment. However the problems with this type of scheme are considerable: deadweight, displacement, the possibility of fraud, and inflexible time limits. A scheme along the lines of the New Deal would be better where participants are informed and trained in self-employment before they decide to become fully self-employed.

4.42 Such an income bridge has been used in the past. The Enterprise Allowance

⁵ Research suggests that one of the main elements in a successful cost effective self-employment program is self-screening, for instance through developing a business plan. The loan need not be time limited and so should offer more effective financial help to start-ups, especially those from which revenue streams may take longer to accrue.

Scheme (EAS) helped to provide a minimum level of income during this initial period. The EAS gave participants an allowance of £40 per week (equivalent to the average unemployment benefit payment at the time of introduction) for a year on moving into self-employment. Only the very short-term unemployed, those unemployed for less than 13 weeks (although this was later reduced), were excluded from the programme.

- 4.43 By the late 1980s it was clear that EAS was most effective when combined with formal business skills training. In 1991 responsibility for EAS was devolved to TECs to sit alongside their responsibility for business skills training. At the time the emphasis was very much on local business-led partners taking the lead in devising local solutions within a broad national framework known as the Business Start-Up Scheme. Subsequently in 1994 this process was taken a step further when the Business Start Up Scheme was absorbed into the Single Regeneration Programme. This led to the current arrangements in which the emphasis has been on general business start-ups rather than self-employment as a way out of welfare dependency.
- 4.44 The structure and benefit of the EAS has been criticised. For instance one piece of research showed displacement as high as 100% in some sectors⁶. But displacement and deadweight effects may be less of an issue in deprived areas where there is a lack of enterprise.

Recommendation 16

- 4.45 The PAT welcomes the Chancellor's announcement in the 1999 Budget that the Government sees a case for extending the principle of a guaranteed minimum level of in-work income for all those in work, and notes that the Government will bring forward further proposals in due course. The PAT recommends:

As part of the ongoing reform of the tax and benefit system, consideration should be given to providing an "income bridge" to the self-employed. Current reforms - the Employment Credit for the over 50s and the Working Families Tax Credit and the New Deal for 18-24s- provide such an income bridge for some groups. The PAT would like to see this extended to other groups.

- 4.46 As noted earlier, self-employment will not be right for everyone. For this reason pre- (and post-) start-up advice and training is crucial. The PAT believe that provision of an income bridge for the self-employed through the tax and benefit system should be linked to a requirement that suitable pre start-up advice and training is obtained.

⁶ C.Hasluck (1990) The Displacement Effects of the Enterprise Allowance Scheme: A Local Labour Market Study. IER

Timing: Consideration to be given as part of the ongoing reforms.

Awareness of self-employment as an option

- 4.47 Anecdotal evidence and feedback from the PATs consultations suggests that starting up in business is often not perceived by people in deprived areas to be an option. This might be for a variety of reasons, for example: they might not believe that they have the skills; consider it too risky; do not have the confidence to set up in business; or simply have not thought of starting a business as an option. During PAT consultations, people commented that they only considered self-employment because there were no other options. Furthermore feedback from suggested that self-employment is often not signposted as an option for people looking to move into employment, for example by Job Centres or benefit offices.
- 4.48 Earlier chapters in this report have focussed on the help that people might be able to receive, either through support and training (chapter 2) or in gaining access to finance (chapter 3). And Policy Action Team 2 is considering the issue of skills. But equally important is simply that people are aware of self-employment as an option.
- 4.49 Although the PAT believes more should be done to encourage people to consider it as a viable option, it also recognises the importance of setting out the disadvantages as well as the advantages. Self-employment is not right for everyone, and it does entail risks, eg financial risks. At the same time it can provide valuable experience, offers a particularly flexible form of employment, and for groups which may perceive themselves to be, or are, discriminated against, for example ethnic minorities and ex-offenders, it can provide an important employment option.
- 4.50 There are a number of ways in which awareness of self-employment and enterprise more generally might be promoted:
- C Schools and further education - making awareness of enterprise a more integral part of education;
 - C Careers' advisers providing information on self-employment as an option;
 - C Employment service and benefit offices;
 - C Trade organisations and industry groups (such as the CBI and BCC) promoting enterprise and an entrepreneurial culture more generally;
 - C Local community and voluntary organisations (for example PYBT through promoting self-employment and awareness of enterprise more generally); and
 - C Ministerial speeches, eg promoting role models which should be accessible figures at the community level.

4.51 A number of these elements can be (and are being) pursued by Government and non-governmental bodies.

Recommendation 17

4.52 The PAT recommends:

the Government (DTI / SBS / HMT / DfEE / DSS), and other interested parties, improve awareness of self-employment.

4.53 This needs to be built into the Government's public awareness strategy for enterprise including:

C improving education and business links, by encouraging schools to link up with the world of work and local businesses. As announced in the Budget, companies seconding staff to schools and colleges will qualify for tax relief. This will help promote an enterprise culture amongst the young, and equally importantly, companies will gain from such secondments through developing their staff's key skills - such as communications and teamwork - but also to develop positive social and community attitudes.

C the National Campaign for Enterprise. The British Chambers of Commerce are coordinating a large scale national campaign to encourage entrepreneurship over a period of several years. They are doing this in combination with a large number of organisations, including the DTI, the CBI and the IOD. This is intended as a strategic partnership which could embrace all other initiatives on this subject, and covers older people as well as the young.

C through greater awareness and promotion at Job Centres and Benefit offices;

C through Ministerial speeches, for example by highlighting examples of successful entrepreneurs from deprived communities.

4.54 There should be particular focus on groups for whom self-employment might be an appropriate form of employment, such as some ethnic minorities and ex-offenders (the latter can often be discriminated against in standard forms of employment making self-employment an attractive option). Highlighting success stories by people from deprived communities and from these groups would be one way of achieving this aim.

Timing: Immediate and ongoing.

Responsibility and desired outcomes

4.55 HMT / DSS / IR should take the lead in the ongoing reform of the tax and benefit system. DTI / SBS / DfEE should take the lead in promoting self-employment as

part of the drive to increase employment opportunities in deprived areas.

- 4.56 The aim of these measures is to increase economic participation through making self-employment a viable option for those for whom it is appropriate. We do not favour targets for self-employment as such, as they risk distorting behaviour. But alongside economic participation, changes in self-employment and attitudes to enterprise can be useful pointers to progress.

Chapter 5: Social Enterprise

Introduction

- 5.1 This chapter considers the role, and potential contribution of social enterprises in the regeneration of deprived areas, and what the Government might be able to do to promote this sector.

Definition of problem and analysis

What is the social economy?

- 5.2 The social economy is an imprecise term, but in general can be thought of as those organisations who are independent of the state and provide services, goods, and trade for a social purpose and are non-profit distributing. The sector is funded, and achieves viability, through a mix of trade, income generation and grants. The sector needs to make profits (or at least avoid losses) to be viable, but profits are not sought for distribution to shareholders.
- 5.3 The social economy can be effective at developing services which may be unattractive or inappropriate for the private sector, or cannot be delivered effectively by the public sector. It can be also be valuable in engaging local people in economic activities in ways that public agencies have found difficult. The social economy does not simply provide substitutes for real jobs and services where there has been market failure. It also helps develop a stronger sense of community.
- 5.4 Social enterprises, which together make up the social economy, are in most ways like any other private sector businesses, but they are geared towards social regeneration and help, rather than simply the generation of profits. As such social enterprises do not fall within the standard definitions of private or public sector enterprises.
- 5.5 This broad definition focuses on institutional forms. It is also possible to distinguish between social economy initiatives operating at the national level, such as large insurance mutuals and retail co-operatives, from those engaged in aspects of community economic development, such as smaller co-operatives, employee owned businesses, intermediate labour market projects, social firms (eg for production by people with disabilities), or social housing. PAT3's work has focussed on social enterprises which are engaged in community economic development.
- 5.6 Social enterprises at community level are a very diverse group, ranging from financial services providers (such as CFIs and credit unions) to retailers to operators of childcare facilities. They are often part of partnerships with both public and private sectors, for example through stake-holding and joint venturing, as well as through complex trading and contracting relationships.
- 5.7 Some examples of social enterprises are provided in box 5.1.

Box 5.1: Case studies of Social Enterprises

Grenwich Leisure Ltd

5.8 With the likelihood of cuts in leisure services by the London Borough of Greenwich in 1992, the Members and Officers of the Leisure Services Department sought a solution, which would avoid the closure of leisure centres, and the loss of jobs. The leisure centre staff created Greenwich Leisure Ltd, a “not-for-profit” Industrial and Provident Society structured as a workers’ co-operative. Closures and job losses were avoided. Now seven years later it is an expanding sustainable social enterprise.

5.9 Peter Kellner (1998) noted when describing Greenwich Leisure Ltd:

“Staff feel a real sense of ownership of their business. Their enthusiasm has led to lower absentee rates, lower staff turnover and a real boost in morale. Employee pride means that ownership of problems is also improved, ensuring a responsive customer service.”

5.10 He also comments:

“Costs to the council have been reduced on an annual basis. From 1992 to 1998 the cost of providing the leisure centres has been reduced from £2,497,000 to £1,400,000, a saving of over 40%!”

Kennington Office Cleaners Co-operative

5.11 Ten cleaners living on a Kennington estate, tired of working for what they felt were exploitative low wages, started a social enterprise as a co-operative in 1978 with a £1,000 loan and the support of a community worker. Working as a co-operative enabled them to work flexible hours to suit their children, obtain reasonable wages and more generally feel better about their lives:

“you feel like you are part of society - it’s a good feeling”.

5.12 After 2 years it had a turnover of £18,000. Today its turnover is £70,000 and there are 28 employees.

5.13 Initially the company was set up as an Industrial and Provident Society. In 1993 the structure was changed to a company limited by guarantee, which enabled management responsibilities to be spread more widely.

Tara Fruit and Veg

5.14 In 1997, residents of The Woolwich Common Estate, a disadvantaged neighbourhood with a largely black and ethnic minority community, set up a social enterprise selling fruit and veg to answer pressing local needs. Previous attempts

had failed, but on this occasion, the decision by the council to charge a peppercorn rent for a closed local shop enabled the enterprise to flourish – on start-up costs of just £1,200.

- 5.15 The shop is not-for-profit and is staffed by volunteers from the estate. Consequently the shop is able to keep prices very low.
- 5.16 Benefits to the community are enormous: a good diet and better health, reduced transport and pollution, and volunteer experience in retailing, shop management, marketing and financial skills. Vulnerable older people are assisted greatly by a free delivery service.

The Social Entrepreneurs of Blaengwnfi

- 5.17 An ex-mining village of 2000 people, in economic decline, was faced with the closure of its only shop for 12 miles. The concerned Senior Citizen's Group enlisted the help of what is now Business Link, obtained a bank loan and raised the deposit money for the building from selling shares in the village.
- 5.18 After a year of successful trading they obtained grant finance from the council to renovate the shop and convert the rest of the building into retail units. By keeping money spent locally and supporting local enterprise, the neighbourhood benefited from a stronger local economy.
- 5.19 In 10 years the co-operative paid off the shop mortgage and now feeds its profits back into new community projects. The retail units house several businesses, some of which have moved out into their own premises. Future plans include starting a new social enterprise, a leisure and tourism co-op.

The role of social enterprises in economic regeneration

- 5.20 Support for social enterprises must be seen as part of a wider aim to engage communities in regeneration projects. Building human and social capital is necessary to strengthen local communities which is essential if there is to be successful regeneration.
- 5.21 Social capital is the value created by the whole range of social institutions from informal and family networks to more formal institutions such as religious and political groups. These bring people together to create resources and assets for social renewal and development and hence increase the quality of life for people in the local community. Economic regeneration and the development of social capital are mutually re-enforcing objectives.
- 5.22 The social economy can make a significant and valuable contribution to the building of social capital and the economic regeneration of deprived communities. This can be achieved by:

- C providing services, such as intermediate labour markets (eg helping match local people to jobs);
- C helping to develop the skills of local people, by providing training and work experience; and
- C creating employment opportunities.

In all of these activities social enterprises help to foster pathways to 'integration' for socially excluded people.

Data on the social economy

5.23 Information about the social economy is at best partial. What data exists, however, does indicate that it is a growing body of practice. For example:

- C the New Economics Foundation estimates that around 1.5 million people are regularly engaged in community economic initiatives;
- C a 1997 report "Valuing the Social Economy" for Community Enterprise Strathclyde estimated that 42,000 people were employed in the social economy in lowland Scotland (around the same as the Scottish electronics sector), with a further 60,000 people volunteering;

5.24 A study for the UK Social Investment Forum indicated major growth areas such as care services, energy and the environment. And through Local Development Employment Initiatives the European Commission has identified 19 discrete "fields" in which social enterprises might open up new job sources for the unemployed. They include home-help and child care services, security, housing and neighbourhood improvements, local shops, cultural and leisure activities, audio-visual services, new information technologies and waste disposal and recycling activities.

The problems faced by the social economy

5.25 Many of the problems faced by social enterprises are much like those of any other business (as discussed in Chapter 2). But in addition they are faced by further problems more specific to this sector:

- C *Little or no support services available:* It is far from straightforward for local residents to start a social enterprises. These organisations are less understood and rarely promoted in a consistent way by the existing infrastructure for business support. A specialist framework of technical assistance and start-up providers has operated in a number of areas, with local authority support, but have arguably suffered from being a separate service, rather than an option on a mainstream menu from business support agencies.

Support for social enterprises is provided by a range of voluntary organisations and local authorities, often acting effectively as "social enterprise incubators". An example of such "nurturing" is the Environment Trust in East London which has been

supporting a social enterprise in St Lukes in Canning Town. Local people campaigned to acquire a church, which has been converted into an enterprise centre, a health centre and a community café.

- C *Lack of demand for goods and services*: in order to be sustainable social enterprises must be able to sell their goods and services. How to promote demand is a problem faced by all businesses, but this is exacerbated by the fact that social enterprises are typically based in deprived communities where there is a general lack of demand. A number of social enterprises have begun to tackle this by marketing their activities to niche consumers outside the target group. A well-known example is The Big Issue. Box 5.2 considers labelling as a possible solution to this problem.
- C *Lack of appropriate models of evaluation (ie difficulties in assessing successful outcomes)*: all social enterprises face the challenge of balancing financial and social performance in terms of their evaluation, eg how efficient they are. Social enterprises are not driven by a profit motive, and value social benefits as well as financial benefits. This makes “successful outcomes” (defined in these two dimensions) difficult to assess.
- C *Over complex and varied legal structures hinder start-ups, act as an on-going burden and complicate governance*: recent changes proposed by the Charity Commission to extend the scope of charitable status to agencies that meet certain criteria, and are associated with relief of unemployment, is a good building block here (although eligibility is limited and complex rules on trading remain an obstacle).
- C *The structure of funding*: the structure of funding for social enterprises is currently very complex. Much of the energy of organisations in the UK goes into competitive bidding as forever vulnerable groups struggle to draw down grant aid for their members and clients. In this, the local and community oriented organisations often see themselves as being in conflict with the largest “brand name” charities. A history of bid and challenge grant funding (City Challenge, SRB, ESF, ERDF) has spawned both a bewildering array of providers and clients, networks and umbrella bodies and has forced relations between them into a narrow and often destructive competitive context. More might be done to rationalise the process of bidding for funding.
- C *Inability to access mainstream finance*: due to their typically unorthodox structures, and non-profit orientated approach, banks can be reluctant to lend to social enterprises, despite the fact that they are often a lower credit risk than businesses generally.

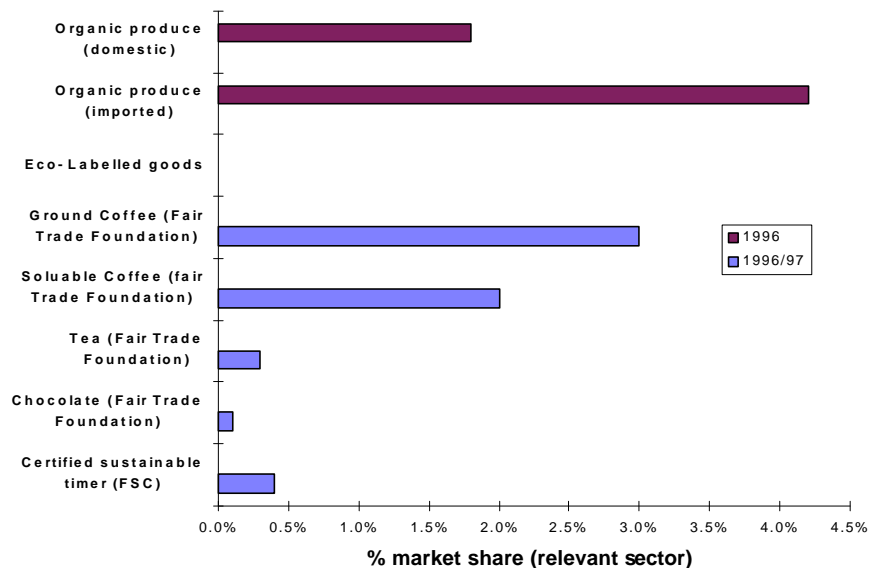
Box 5.2: Social Labelling

5.26 Social labels aim to increase demand for certain goods through changing consumption patterns. A range of enterprises (such as social firms) produce goods and services by people in exclusion for wider sale.

5.27 Social enterprises operating overseas have introduced a highly effective programme of marketing under the concept of “fair trade” which has significantly extended sales and promoted livelihoods and enterprise overseas. The global value of fair trade is around £270 million per annum. A number of the techniques used, such as social labelling, are of potential relevance for the development of a homegrown initiative designed to promote demand for social enterprise products from the UK.

5.28 Table 5.1 below shows the different ways in which labelled products have penetrated the UK market. Further evidence is provided in an opinion poll carried out for DG VI of the European Commission which indicated that 29% of the EU population had heard of fair trade products and at least 11 % had previously bought at least one such product.

Chart 5.1: Penetration of Fair and environmentally labeled goods'



Source: New Economics Foundation

5.29 Consumers also indicate that ethical considerations can influence their purchasing. Ethical Consumer Magazine has highlighted a range of market research that has occurred between 1989 and 1997, nearly all of which points to consumers making, or being willing to make, purchasing decisions based on ethics. For example, according to a survey by Ogilvy and Mather in 1996, “67% of adults claim to consider a company’s ethical stance when buying a product”.

What makes an effective Social Label?

5.30 Social labels operate through both “window” and “mirror” effects. The most obvious fact is that they inform the consumer about how the product was or was not

produced – the “window” effect. Less obvious perhaps, but equally if not more important is their function as a “mirror” for the consumer in securing the benefits of self-expression and positive social identity.

- 5.31 Several characteristics of labels tend to determine their effectiveness, in particular relevance, clarity, trust, accessibility, accuracy, financial and legal viability, and impact - see table 5.2.

Table 5.2: Characteristics of an Effective Label	
Relevance	<i>Is the issue important to the consumers and intended beneficiaries?</i>
Clarity	<i>Do consumers understand the label?</i>
Trust	<i>Do consumers, businesses and beneficiaries believe in the legitimacy of the label and the way it operates?</i>
Accessibility	<i>Can consumers buy labelled products? Can willing businesses participate in the initiative?</i>
Accuracy	<i>Can businesses participating in the initiative be assured that the label's claims are verified?</i>
Financial viability	<i>Is the label consistent with the financial goals of participating businesses? Does it add additional assurance to that contained in the brand? Are consumers able to afford labelled products?</i>

- 5.32 Social labels can require a minimum level of resources to set up and promote. The most effective labels seem often to be operated by representative groups in civil society with the direct support of, or within a framework backed by, the public sector. In the Netherlands, for example, this approach has meant that 89% of consumers have heard of the fair trade label, “Max Havelaar”, compared to the EU Eco-label, which has had little associated civil action, and has a consumer recognition of only 11-12% in the UK.

- 5.33 The PAT believes that demand for the goods and services provided by social enterprises might be enhanced through social labelling. However more work needs to be done to investigate how relevant and practical this is, the best way in which it might be done, and how best practice might be disseminated (see recommendation 19).

- 5.34 Ultimately the main problem, and challenge, to social enterprises is sustainability. Developing the capacity and sustainability of social enterprise is a challenge to the

overall policy regime that relates to the sector (from public sector contracting through to business advice). Social enterprises whether serving the local community, or the interests of a particular group nationally or regionally will not necessarily thrive naturally – they need structures to nurture and support them. As with any other form of government spending, the rationale for providing such support must be based on an assessment of the costs and benefits.

Strategies to address these problems

- 5.35 Government intervention to promote social enterprises must be based on the same criteria as intervention elsewhere. In the case of social enterprises this largely rests on the fact that the provision of support services and finance by the private sector may be sub-optimal as it is based only on private returns. The social returns to promoting social enterprises can be significant. As discussed above, social enterprises can make a positive contribution to the regeneration of deprived areas by helping to provide employment, goods, services and more generally build social capital. But this does not mean that Government should act to support inefficient social enterprises. They are businesses just like any other, and some will fail - which should be expected. The Government also has to consider the opportunity costs of any resources to support this area compared with other uses of the resource.
- 5.36 The development of the social economy has already been recognised as a live issue. For example, in December 1997 the Council of the European Union adopted a series of Employment Guidelines following discussions at the Amsterdam summit and the Luxembourg Jobs Summit (European Commission, 1998). Among the anticipated measures to bolster employability, flexibility and adaptability pressed for by the British presidency, the guidelines adopted by all the member states specifically recognised for the first time the potential for job creation in the social economy.
- 5.37 Indeed, governments, including that of the UK, have formally signed up in their National Action Plans to bringing forward measures both for the promotion of the social economy and local development initiatives. Commenting on these, the EU Commission asserts that:
- “the social economy and the activities oriented to meet the needs unsatisfied by the market can lead to the development of a new sense of entrepreneurship particularly valuable for economic and social development at the local level. This sense of entrepreneurship is closer to the aspirations and values of people that do not seek profit making but rather the development of socially useful activities or jobs. These forms of entrepreneurship have a useful role in promoting social cohesion and economic local (sic) performance”.*
- 5.38 To date the public sector has played an important enabling role in relation to these initiatives. The grant regime of UK and European funds for regeneration has been the prime source of capital and revenue for those local institutions engaging in local area regeneration. But more could be done to address the various problems

highlighted earlier.

Support for social enterprises

- 5.39 Social enterprises are faced by very similar problems to mainstream businesses. Hence just like mainstream businesses, social enterprises will benefit from support from organisations such as Business Links. However such support for social enterprises is at present patchy. The sector is generally poorly understood and is typically not seen as deserving support when compared with mainstream businesses.
- 5.40 The PAT believes a significant boost to the social economy could be achieved simply by utilising the services of existing business support services.

Recommendation 18

5.41 The PAT recommends that:

social enterprises are recognised as a group of businesses deserving support - the Small Business Service should have a remit to support social enterprises in the same way as other businesses.

5.42 The SBS should:

- C ***understand the sector's differences, but also its similarity to other firms; and***
- C ***help to build its potential (for example, review how to address issues such as complex legal structures).***

5.43 Furthermore, RDAs should be encouraged to include the sector in their Regional Economic Strategies.

5.44 See also PAT 16's discussion and recommendations on social and civic entrepreneurs.

Timing: Immediate and ongoing.

5.45 As with small businesses more generally, the SBS is well positioned to provide a strategic lead in supporting and developing social enterprises. But there are many other key players that need to be engaged in order to build a better understanding of the sector and to make the most of the opportunities for economic regeneration that social enterprises offer.

Recommendation 19

5.46 The PAT recommends that:

the Government and other interested organisations work together to enhance the potential of social enterprises.

5.47 This should be achieved by:

- a. DETR to research evaluation models - based on both financial and social criteria - and produce an evaluation guide to be disseminated by the SBS.
- b. SBS to review legal / regulatory framework to assess scope for simplification.
- c. DETR to research potential for "social labelling" - analogous to the Fair Trade label for coffee, cocoa etc - for UK social enterprises.

Timing: Commission research on (a) and (c) as soon as possible with the results to be available by mid- 2000. (b) to be completed by mid-2000.

Access to finance

5.48 The recommendations set out in chapter 3 should make a significant difference in the provision of finance to social enterprises. Community Finance Initiatives should be well placed to understand the problems faced by social enterprises. Box 5.3 considers Regional Community Investment Partnerships, which offers one possible approach to increase social enterprise activity in the UK through partnerships between public, private and non-profit sectors.

Box 5.4: Regional Community Investment Partnerships

5.49 A series of expert workshops in 1999, including practitioners and observers from the European Commission has met to consider how to scale up social economy activity at the regional level. One answer suggested is the development of Regional Community Investment Partnerships.

5.50 These are a strategic consortium of public, private and non-profit actors. A good example is the emerging London Community Reinvestment Partnership, which brings together a wide range of banks and Community Finance Initiatives. The aim is to act as a secondary provider, to provide support and bring resources for social enterprises without drawing them into rigid institutional structures which might destroy their essential properties. It would provide a wide range of integrated financial technical support and brokerage activities and would require pump-priming resources to get off the ground.

5.51 Regional Development Agencies are well-positioned to act as the potential

facilitating agency for the development of Regional Community Investment Partnerships.

Funding

- 5.52 Ideally social enterprises will be able to obtain mainstream commercial funding. But the PAT recognises that there is still a role for grant finance. Grants must, of course, be linked to the delivery of specific outputs that merit taxpayer funding. Social enterprises often find grant funding is key in their start-ups phase.
- 5.53 The PAT believes that the sector should be recognised as having the potential for making a significant contribution to economic regeneration and hence included explicitly in funding regimes.

Recommendation 20

5.54 The PAT recommends:

Social enterprises are recognised in national funding criteria, for example in SRB and similar schemes.

Timing: Before the next funding round - SRB round 6 criteria will be announced shortly.

- 5.55 While the state can have a powerful influence on the creation of social enterprises through grant aid, and subsidies, their long run sustainability demands self-sufficiency. One element of sustainability will be a judicious use of, but not over-reliance, on grants. The use of loans rather than grants is something that should be considered to ensure that a “grant-dependent” culture does not exist. Social enterprises will often be able to gain access to mainstream sources of finance once they have a track record. This will be considerably enhanced if they can also demonstrate that they are able to service debts.
- 5.56 There are a number of other potential benefits from the use of loans rather than pure grant funding, for example it:
- c allows the funding to be spread more widely;
 - c creates the right incentives to avoid a culture of grant dependency; and
 - c should encourage greater efficiency through better management, eg through the discipline of keeping up loan repayments.
- 5.57 The Local Investment Fund, which is described in more detail in box 5.5, is a Community Finance Initiative that lends to social enterprise. Their experience

illustrates the opportunities for loan finance in this sector.

Box 5.5: The Local Investment Fund

- 5.58 The Local Investment Fund (LIF) is a registered charity within Business in the Community. It provides loans and technical expertise (free of charge) to not-for-profit organisations - social enterprises - in the UK. These organisations are typically charities or companies limited by guarantee or similar.
- 5.59 LIF is a partnership between DETR, BitC (whose offices it uses), and the private sector, led by NatWest. Its £3m pool of lending funds are derived from a DETR grant of £1 million; a loan from NatWest of £½ million; and private sector money of about £1.5 million. It is also supported by the National Lottery who fund its national loans manager.
- 5.60 The criteria on which LIF will provide finance are:
- C the organisation is not-for-profit;
 - C the organisation is economically viable;
 - C the application cannot be handled by the mainstream funders; and
 - C the organisation is rooted in the local community, with measurable benefits in economic regeneration terms:- job creation or preservation, training, and building renewal.
- 5.61 LIF was set up in 1994. Since then £1.5 million of loans have been agreed. These loans, varying in size from £25,000 to £250,000, have leveraged £6.6m into community regeneration. LIF estimate that loans to clients have generated over 300 new full time jobs and more than 550 training places.
- 5.62 Examples of organisations LIF have lent to include:
- C **The Bibini Centre**, which is a multi-purpose residential centre in Manchester offering long-term care and services such as counselling, and respite accommodation. It is geared towards children of African, Asian and Caribbean origins who are in need or are socially disadvantaged;
 - C **First Data Training**, a training agency in an inner city area of Nottingham, established by local residents to provide instruction in IT for the long-term unemployed, ethnic minorities and parent returners to work; and
 - C **Leicester Social Economy (LSE)** which is regenerating three blocks of Victorian Mill buildings in the centre of Leicester. These will be used for a wide range of community orientated projects such as an arts centre and a cafe. The funding of LSE is discussed in box 6.3.

5.63 LIF is now establishing community loan funds in the regions. LIF are working closely with the RDAs and the Government Offices in each region to ensure that it qualifies for appropriate public sector funding, so that loans and donations from local businesses are matched by funding from the European Union, the National Lottery and other public sector sources.

5.64 The desire to see greater use of loan finance in is not to say that grant funding will not remain important for the successful development of social enterprises, especially in their start-up phase. Assets and strong balance sheets are also an important prerequisite for growth and sustainability. But it is important to use funding as efficiently as possible and to create the right incentives.

Recommendation 21

5.65 A key factor for the long-term sustainability of this sector is self-reliance. The PAT recommends that all interested parties attempt to:

achieve a change in culture of social enterprises and voluntary sector, away from grants towards loans.

5.66 Public sector organisations should be informed of the most effective use of public sector funds, for example by considering loans rather than grants, and how private sector funds can be most effectively leveraged in to projects. A systematic review of Government grant programmes is required to identify the potential of moving from grants to loans. This should include Local Authorities, who play a critical role in enabling financing for deprived areas (see also chapter 6 which considers the role of Local Authorities).

Timing: Complete review by mid 2000.

Responsibility and desired outcomes

5.67 The Small Business Service should be responsible for this agenda, with DETR and others.

5.68 The aim is a socially and commercially successful social enterprise sector, that contributes positively to regeneration. Social enterprises should be served like other enterprises and, subject to their social goals, they should act like other businesses. It must also be recognised that social enterprises can be risky, just like any other form of business. Thus we should expect that some social enterprises will fail, and this should not be seen as indicative of a problem with the sector.

5.69 Indicators that should be used to gauge success include activity levels (turnover, external finance), and use made of support services. Indices of social enterprise

activity, such as that provided by MORI should also be used.

PART C: MORE EFFECTIVE INSTITUTIONS

Chapter 6: Local and Regional government

Introduction

- 6.1 This Chapter outlines the present structures within regional and local agencies which can support start-up and ongoing businesses in areas of deprivation, and considers the potential for improving co-ordination, and building upon this structure.

Problem Analysis

- 6.2 The work of this team suggests that there are two key issues in the area of local and regional government, and its associated activities, that need to be addressed:
- i. Different parts of government need to work effectively together, with knowledge and expertise being fully shared and utilised; and
 - ii. The importance of enterprise in regeneration activities needs to be recognised, and due weight be given to its promotion in policies and interventions.

Working effectively together

- 6.3 Local and regional government (eg local authorities, Government Offices and Regional Development Agencies) all have key roles to play in the regeneration of deprived communities, including the promotion of enterprise. They are significant sources of strategic leadership, funding, information and advice. And it is important that they all work effectively together, making full use of their combined experience and expertise. Housing Associations are also well placed to make a significant contribution.
- 6.4 The desirability of co-ordination of government functions at regional level has already been recognised in the establishment of the Government Offices. The development of RDAs, whose role spans regeneration and competitiveness, should offer a new opportunity to consider and develop the agenda. But the PAT believes that more should be done to ensure that different parts of government, and non-government organisations, work together to regenerate deprived areas.

Promoting enterprise in regeneration policies

- 6.5 The PAT believes that there should be greater promotion of enterprise as a central element of any regeneration policy. The regeneration of deprived communities will not succeed in the long term unless local economies thrive. The work of the PAT suggests that there has not been sufficient recognition of the importance of regenerating local economies as well as the local infrastructure. A recent review of the SRB's promotion of business start up activities, with particular reference to the introduction of a challenge funding approach to the SRB, was commissioned by DfEE from York Consulting. It concluded amongst other things that:

- C other regeneration activities have tended to crowd out support for business start-ups, which as a result has become somewhat fragmented;
- C there has been a move in focus from promoting start-ups, to promoting start-ups with a significant chance of survival;
- C while most start-ups supported would have occurred without the SRB, SRB help has enhanced their chances of survival;
- C the extent to which SRB money has operated through the medium of what could loosely be termed business support has fallen. However the York work focussed solely on start-up activity, rather than the considerable body of SRB support for wider economic and business goals). There may be scope for examining this in more detail.

6.6 It should be stressed however that:

- a. funding granted from the SRB reflects local/community priorities. Imposing national priorities would be unwise, and indeed the central bidding guidance did not change between the fourth and fifth SRB rounds, when the York research was conducted. Some local authority commentators, however, feel that local bidders are mindful of central government priorities and try to frame bids in those terms, since to reflect these is seen as increasing the chance of success. If Government let it be known that they wanted more enterprise support projects, such schemes would soon emerge.
- b. the SRB is a competitive bidding process, allocating a fixed pot of funds. If business directed schemes have not been receiving funding this will be because bids with other focuses - at least as valuable in terms of the output measures, and bringing in at least as much private money - have benefited.
- c. The SRB is an ongoing scheme, but the York project only looked at the later rounds. For example, in Wigan there was substantial funding for all their business support from SRB round 1 which is set to continue to 2001. So there was no need for them to bid in subsequent rounds.
- d. The York project looked at start-ups, but not support for existing small firms (which is equally important).

6.7 That said, the PAT does take seriously a perception, supported by the York work, that SRB projects can tend to underplay the potential role of business support and enterprise promotion in achieving regeneration aims.

Strategies to address these problems

6.8 There are a number of different local and regional government agencies working to increase the possibilities for business start-ups and to try to ensure their survival and successful growth. The main players are:

- C Government Offices;

- C Regional Development Agencies;
- C Local Authorities; and
- C Housing Associations.

6.9 The PAT has considered the roles of each of these players, and where necessary has recommended ways in which their contribution to the promotion of enterprise activities in deprived communities might be improved.

6.10 There are of course other (important) regional and local organisations that support enterprise. For example, regional development organisations assist with the promotion of inward investment and help investors to establish themselves. Inward investment is important as it has long been recognised as a significant way of diversifying an economy and a speedy way of delivering jobs. However the PAT has focussed on the regional and local bodies which are more directly related to economic regeneration.

Government Offices (GOs)

6.11 At present the main regional mechanism for supporting new and ongoing businesses use the Government Offices. These offices were formed in 1994 by the amalgamation of the Regional Offices of the Department of the Environment, Department of Transport, DfEE and DTI.

6.12 The range and quality of business support regionally is largely determined by national policy and programmes, and the Government Offices have made a good start in bringing together the work of government departments at the regional level. This will be developed further by the Regional Development Agencies (RDAs).

6.13 Government Offices are at present responsible for administering the New Deal for Communities at a local level - box 6.1 provides more details. They remain responsible for administering the Single Regeneration Budget in London, although outside London this role has transferred to the RDAs.

Box 6.1: The New Deal for Communities

6.14 The New Deal for Communities (NDC) was launched in 1998, with £800m of funding available. Its primary objective is to secure holistic, focussed and intensive regeneration in the most deprived neighbourhoods (of 1,000-4,000 households) in the country. The NDC grant programme will meet all of the additional costs of good and sustainable regeneration so, while drawing in private and other monies is welcome, it is not the prime rationale. Moves are afoot to draw in the expertise of existing businesses to work with, and within, regeneration partnerships running the programme. And Ministers have already made it clear that enterprise support would be a welcome element in holistic regeneration schemes.

6.15 The PAT believes that there is a need for greater clarity on the role of Government

Offices in relation to enterprise given the new role of RDAs and chambers. A key role for them in the future in this area should be to ensure that there are clear links between enterprise and other parts of the central Government agenda, and that other parts of government are fully supporting this in their region. RDAs will cover some of the wider links between regional economic strategies and other issues; but in doing so they cannot speak for central Government in the way that Government Offices can. The PAT notes that the role of Government Offices more broadly is being addressed in the study by the Performance and Innovation Unit on the role of central Government at regional and local level.

Regional Development Agencies (RDAs)

6.16 The role of regional government has developed with the introduction of RDAs in April 1999. These agencies are genuinely region-wide bodies, able to take a comprehensive view of the problems of their areas and to make the necessary connection between urban and rural communities. They have taken on responsibility for administering the Single Regeneration Budget (SRB), as well as most of the work of English Partnerships and the rural regeneration programmes of the Rural Development Commission.

6.17 One of the RDAs' first tasks is to prepare regional strategies covering all five of their statutory purposes. These are to:

- C promote economic development and regeneration;
- C promote business efficiency, investment and competitiveness;
- C promote employment;
- C enhance the development and application of skills; and
- C contribute to the achievement of sustainable development.

6.18 The regional strategies will encourage and strengthen the formation of local partnerships and improve the co-ordination of approaches. They will be used in a number of ways. For example, they will form a framework against which Business Links will prepare business plans so that their services can match more closely the needs of each region. The RDAs will also work with Business Links to develop a regional dimension to the network. They will help to develop Centres of Expertise whereby one Business Link provides specialist services for customers from several Business Links. They will also have scope to facilitate networks and exchanges of best practice amongst the region's business community.

6.19 The regional strategies will also be taken into consideration in the advice provided to the Secretary of State for Trade and Industry by the RDAs in the processing of individual Regional Selective Assistance cases. This is a discretionary grant which is only available in the UK Assisted Areas.

6.20 There are a number of areas in which the work of RDAs will impact on economic development in deprived areas by:

- C working closely with TECs (and from April 2001 Learning and Skills Councils) and National Training Organisations to pool information and develop strategies which take account of national, regional and local objectives. They will co-ordinate action to improve the local supply of skills.
- C having a leading role on the handling of significant internationally-mobile investment projects within their regions. They will assemble the package of support offered to qualifying firms whether new to the region or already based there.
- C having the power to support special initiatives similar to the Coalfield Enterprise Fund created by English Partnerships if they consider that they are needed in their regions (this fund will provide new public and private sector investment to support small firms with high growth potential in the former coalfield areas).

6.21 Government Offices will work with RDAs to monitor the effectiveness of business support and to ensure continuing improvements are being introduced that meet evolving customer needs. They will take account of the Regional Innovation Strategies prepared by the RDAs when administering the Smart programme. This is aimed at helping individuals and SMEs to improve their competitiveness by developing new products and processes to the benefit of the national economy.

6.22 Co-operation with regional, local and neighbourhood partners is a vital part of the RDA's work in furthering economic development. Achieving one of the key objectives - to support and promote growth in local economies and businesses - will involve the promotion of self-employment, improving the survival of new businesses, the provision of business advice, and improving the confidence of local people and local businesses.

6.23 The Government wants partnerships to be the main method of delivery for many of its initiatives. It is an absolute requirement of NDC partnerships that they should involve and gain the support of the local community and local businesses from the outset. Other regeneration partnerships will also be expected to demonstrate the support of local businesses, including small firms.

6.24 Chairs/CEOs of the RDAs fully support the need for community involvement. Partly in response to the PAT's input, DETR have arranged for training for the new RDA boards to include explicit sessions led by 'Business in the Community', so spreading commitment and understanding of the community aspect of policy delivery.

6.25 DETR has issued guidance to the RDAs in a number of areas, to ensure that RDAs as a whole, and their staff across the board, are aware of these points. Text has been inserted into the guidance on regeneration, largely as a result of activity by the PAT, on the need to work with and foster business. References include:

- C defining one of the 5 key national policy objectives as the need to

"support and promote growth in local economies and businesses - through

the creation of self-employment, improved survival of new businesses, provision of business advice and improved confidence of local people and local businesses".

C noting, with regard to partnership working, that the Government has:

"made it an absolute requirement that NDC partnerships should involve and gain the support of the local community and local businesses from the outset. Other regeneration partnerships will also be expected to demonstrate the support of local businesses, including small firms, and encourage and facilitate the involvement of the community ...".

C stressing, again, that RDAs need to work closely with, amongst others, Employment Zones, community representatives, TECs, businesses and major employers.

C explicitly detailing the 5 aims of the SRB, one of which is the need to support and promote growth in local economies and businesses.

6.26 The PAT endorses the changes DETR have made to the RDA's regeneration guidance and recommends that future RDA training exercises continue and develop the practice of input such as that from 'Business in the Community'.

6.27 A further policy development has been the announcement in the Competitiveness White Paper (December 1998) of new regional venture capital funds, which will specialise in providing small scale equity to businesses with growth potential, drawing in local expertise. The Government will work with RDAs on how to take this forward. While the prime focus will not be regeneration, the PAT stresses that it cannot be assumed that such businesses are irrelevant in the more deprived areas. There is also scope for RDAs to support the development of community finance initiatives in their area, for example through regional community investment partnerships (see Chapter 5).

6.28 The PAT recognises that RDAs are key players in the promotion of enterprise in deprived areas. Its main recommendation with regards to RDAs is set out in Recommendation 2 in chapter 3, which is that:

C ***Regional Development Agencies ensure that their policies reflect the role that enterprise in deprived areas can play in contributing to neighbourhood renewal.***

6.29 And that the RDAs, working closely with local authorities, Enterprise Agencies and other players, should:

i. ***examine the coverage of business support in deprived areas in preparing their Regional Economic Strategies; and advise the SBS on strengths and weaknesses;***

ii. ***run regeneration strategies with the encouragement of enterprise as a core goal.***

6.30 DTI and DETR should monitor business support funded via SRB for evidence of change in this area - see also recommendation 22.

Single Regeneration Budget (SRB)

6.31 One of the RDA's key policy levers in the area of regeneration and economic development is the administration of the Single Regeneration Budget (SRB). The SRB is a flexible programme designed to enhance quality of life in areas of need. Last year's Comprehensive Spending Review allocated £2.4 billion to the SRB over a three year period, with 80% of new funding set aside for the most deprived areas. It provides resources to support regeneration initiatives in England carried out by local partnerships, working with other programmes and initiatives (public and private sector). An explicit rationale is to act as 'catalyst funding', drawing in and supplementing private sector and European funding. Community involvement is seen as key.

6.32 SRB schemes can have a mixture of objectives including:

- C enhancing employment prospects, skills and education;
- C addressing social exclusion, and enhancing opportunities for the disadvantaged;
- C improving the environment and infrastructure, including housing;
- C supporting and promoting growth in local economies and business; and
- C tackling crime/drug abuse and enhancing community safety.

6.33 For the purposes of this report, the most relevant of these is supporting and promoting the growth of local economies and businesses. Box 6.2 recounts the experience of Aim for Business, an organisation in Deptford, London, which is part funded by SRB money, and discusses some of the issues surrounding funding that they have highlighted.

Box 6.2: Aim for Business (A4B), Deptford

6.34 A4B offers a customised training programme enabling young, unemployed people to access training that allows them to explore, set up and manage their own businesses. Training is supported by one-to-one counselling whereby individual needs are addressed, including business plan formulation, funding and benefit issues. They also offer specialist training in Book-keeping, Time Management, Financial Management etc, and make available resources such as fax, photocopier, and computers. Existing businesses can also access support from the service.

6.35 A4B's success rate is admirable, with 73% of businesses surviving at least 18 months and averaging 2 employees (source: A4B). They have successfully targeted ethnic minority and female entrepreneurs for their activities.

6.36 A4B have many problems accessing funding because self-employment/ business start-up support does not have a 'stand alone' pot of funding. In danger of closure last year,

some creativity enabled them to redefine their activities to 'fit in' with initiatives on offer, and they survived by accessing 6 different pots - three different SRB rounds, European Social Funds (ESF), some Local Authority funding from Lewisham, and Hyde Plus (see box 6.6 for a description of Hyde Plus). Each contract is for a particular area within the borough, and are such small pockets of money that alone they would almost not be worth having, given the paperwork and monitoring involved. Funding is only secure for one year which creates unnecessary pressure and uncertainty. In spite of this A4B has retained its emphasis on its core values, and its belief in the service it offers which has been fine tuned over 14 years. They ask that Funders recognise quality programmes and place less emphasis on the "new and innovative", when something is already clearly working - it is impossible to be "new and innovative" every year!

"...The ideal would be the recognition that business start-up should stand alone and have its own forum and funding services."

Source: Cindie Hitchings, Project Co-ordinator, Aim for Business

6.37 SRB bidding guidance gives explicit encouragement to consideration of business objectives. Specifically, projects are evaluated against a number of output measures. These include measurements of:

- C number of people entering self-employment (and number previously unemployed);
- C the number of new business start-ups in the area (not including relocations);
- C the survival rate of new businesses: numbers of businesses supported, and those surviving 52/78 weeks;
- C the number of businesses receiving advice as a result of SRB assisted activities;
- C the value of other public and private funding attracted; and
- C the number of new community facilities provided by the scheme (siting businesses in the locale may have benefits in terms of facilities for the local people as well as bringing employment to an area).

6.38 Less direct measures include:

- C jobs created, preserved;
- C number of people trained obtaining qualifications;
- C new or improved business/commercial floorspace;
- C hectares of land improved/reclaimed for development.

6.39 The PAT believe that these output measures fully reflect the priorities of PAT3, and judge that change, if needed, is best directed other than through the output measures.

6.40 But as noted earlier, and indicated by the work of York Consulting, the PAT believes more weight should be placed on the promotion of enterprise when considering SRB funding. A particular concern here is the development of SRB bids. There are a number of possible reasons why enterprise is not given the prominence it deserves in bids:

- C it may be harder to factor in private money in this area than others (eg because other sources of money are more interested in 'softer' projects). This may be a legitimate reason for not giving money through the SRB, and it may be that other sources of support would be better used, or it may be a reason to seek to bolster the monies, eg by linking to other sources of business support. The PAT would strongly caution against overturning the principle that the SRB should seek to factor in private money.
- C the potential beneficiaries do not yet exist (in the case of new firms), or do not have the time to co-ordinate bids. Both of these points are almost certainly the case, and this is most unlikely to change whatever the PAT recommends - one LGA adviser summarised it by saying that where SMEs are starting up, or begin to thrive their priorities are growth and survival; helping with medium term SRB bids of uncertain success is not high on their list of priorities. But it may point to explicit recognition in SRB guidance and procedures that bids should instead consider promoting intermediaries - such as enterprise agencies.
- C the nature of bid teams, and the perceived leading role of local authorities, may mitigate against projects which are outside the expertise and interest of at least some of those involved. Bid teams are generally partnerships which are brought together by local authorities, rather than dominated by them. And the bids are heavily advised by GOs, as regards their content. It is notable that the Housing Associations the PAT consulted felt that local authorities were indeed best placed to fulfil this role. But it is undoubtedly true that experience and enthusiasm for this part of the agenda varies markedly across local authorities - this was something which came out repeatedly in the PAT's discussions. (Those with experience of working with enterprise agencies seemed best equipped.) There must be a strong case for spreading good practice - mirroring the similar guidance which DfEE have provided for educational projects - and for encouraging training and intake of wider experience.

6.41 This is of course an area which is the responsibility of the RDAs. With their business focus, the RDAs will be well placed to ensure that the support and advice for business (defined to include for-profit, and social enterprises, including start-ups) is fully acknowledged as an important part of regeneration, and that it operates on a level playing field within the bidding process. They will also be able proactively to engage business, through the identification of the benefits to business of active participation in bid partnerships.

6.42 It is recognised that local partnerships will be best qualified to identify local needs for SRB, and the next round will likely have more focus on local/regionally defined priorities. However, there is still a need to spread good practice, encourage relevant training, and develop outreach, within bid teams, notably those led by local authorities, so as to ensure

they are all fully up to speed on the options for business related bids, and the role of community enterprises - and ways of factoring in support from the private sector from the outset, through marketing plans which clearly make the case for private sector involvement.

6.43 The PAT's work on business support and finance also emphasises the need for these policies to go hand in hand if they are to be successful. Proposals for providing financial support to businesses (whether as grants or loans) are likely to be far more successful if they are associated with business support services (pre- and post- start-up support). Likewise providing support services in communities where access to finance is a serious hindrance to successful enterprise development will only be partially successful.

6.44 The PAT has made a number of recommendations related to SRB funding. Recommendations 20 and 21 in chapter 5 recommend that:

C Social enterprises are recognised in national funding criteria, for example in SRB and similar schemes; and

C all interested parties attempt to achieve a change in culture of social enterprises and voluntary sector, away from grants towards loans.

6.45 And Recommendation 22 - see later on in this chapter - recommends that:

C there is clear guidance on enterprise initiatives for SRB bid teams identifying good practice; and

C RDAs to be rigorous in deciding which SRB bids to fund - ensuring that they give enough weight to developing enterprise where there is a need for this. DETR should commission analysis of the current proportion of SRB bids that develop enterprise.

Local Authorities

6.46 The other key organisations involved in supporting businesses are local authorities, which are already increasingly looking to form partnerships with other organisations to support initiatives spanning authority boundaries. Local authorities have the power to promote economic development by providing financial or other assistance to set up or support the expansion of businesses in their area or which will improve the employment opportunities of people in their area. This assistance can take the form of grants, loans, guarantees, indemnities, investment, or the provision of property services or other benefits. They can also create or protect opportunities for employment in such businesses.

6.47 It is important that public sector players are suitably flexible in their approach to partnerships. Box 6.3 is a good example of such flexibility, and considers a loan provided by the Local Investment Fund and Leicester City Council.

Box 6.3: The Local Investment Fund and Leicester City Council: Phoenix Yard Development, LSE Consortium
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6.48 Community finance organisations can experience difficulties in working on
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regeneration schemes with the public sector: for example, the slow payment of grants from public sector agencies can threaten the follow-on funding from the private sector and the very viability of the regeneration project. Public sector grants may also carry "clawback" clauses or restrict the community enterprise from pledging the asset under development to other parties as security for loans.

6.49 However innovative ways around such barriers can be found, as in the case of a loan involving the Local Investment Fund and Leicester City Council, along with European funding, English Partnerships and Triodos Bank.

6.50 Leicester City Council provided £275,000 in City Challenge funding to enable the purchase of a group of buildings by a consortium of 3 social economy organisations.

6.51 In return for funding 100% of the purchase price, City Challenge took the first charge on the property. This became a problem when bringing in a range of other financial players. Triodos Bank agreed a loan of £600,000, but without a first charge on the property they would not have been able to lend at all.

6.52 The solution was an agreement to lease part of one of the buildings, which was entered into by a voluntary group, the Leicestershire Centre for Integrated Living, who were entitled to City Challenge financial support of £275,000 for a new centre within the development at Phoenix Yard. LIF lent £230,000 against a second mortgage so that the building for this voluntary group could be completed. Once this was ready for occupation, the existing charge on the property was released. This enabled Triodos to take the first charge and lend into the project.

6.53 LIF said the attitude of the Council was critical in this process: in this case, a way had been found of handing over ownership of the project to the community consortium group and of providing the initial finance, so that the complete funding package for this £1.8M project could be released .

Promoting enterprise

6.54 Local Authorities have great potential to encourage business start-ups and to support existing businesses in regeneration areas. They own much of the property in such areas, and have a direct landlord-tenant relationship which makes them a familiar and potentially trusted intermediary. They are important employers and consumers. And they have relevant direct responsibilities: for education; in drawing up poverty action plans; with regard to planning; in controlling tenancy agreements; and in working with TECs, Business Links, Chambers of Commerce etc.

6.55 Local authorities have developed closer relationships with business following their increased interdependence in encouraging the economic development of the community including the introduction of the SRB and ERDF. The Government plans to develop these relationships further by placing a duty on authorities to promote the economic, environmental and social well-being of their areas. This manifesto commitment may be

accompanied by legislation on community planning. Although it is not clear to what extent the new duty will extend local authorities' powers on economic development, the duty, together with the increased ability to form partnerships with other public and private sector organisations, ought to increase links with the business community and stimulate economic development activity.

6.56 The LGA are clear that this is a two way process: thriving businesses are vital to local councils. A recent publication: 'Listening to Business' details how and why local authorities are building on their contacts. Regeneration is singled out as a key area.

6.57 In the PAT's discussions with the LGA and their regeneration advisers it became clear that there are some excellent examples of good practice. In particular, many local authorities work with enterprise agencies directly to promote business start-ups and foster existing business in regeneration areas. Community enterprise agencies have long existed in many areas, but funding for them has in many cases been rechannelled to other organisations such as Business Links. Some local authorities continue to fund them, and there is potential to get other partners involved, such as the banks. Some enterprise agencies form part of wider networks of business support, whereas others stand alone.

6.58 Provision of business support services is patchy, in part depending on LA priorities. Funding and permissible activities controls (eg stemming from S137 of LGA 1972 and S33 of LGHA 1989) may also play a part, although the funding at least may be augmented by the prospective introduction of powers for supplementary business rates. A message which has come consistently out of the PAT's discussions is that the extent and quality of what is done depends in large part on the enthusiasm and expertise of local personnel. More could be done to foster both of these:

- C Enthusiasm cannot be imposed from above. But benchmarking; circulation of good practice; and word of mouth contact are all important. The LGA regeneration committee will have an important potential role as disseminators.
- C Experience is something which can be fostered, but it is getting harder to obtain such experience given the greater demands upon local authorities, and the apparent reduction in interchange opportunities - for example Community Enterprise agencies used to benefit from exchange with and secondment from clearing banks: but very few banks now get involved in this.

6.59 It has been suggested that Small Business Development Centres, along the lines of those found in the US, could be a useful tool for encouraging confidence and providing accessible advice centres for new businesses. Local authorities will usually have access to the kind of accommodation needed for such centres, as well as having the contacts with Business Links, enterprise agencies, TECs and businesses, which would make them well placed to set up such programmes. The LGA suggested that libraries could have a particular role in this, and in other provision of information/non financial assistance. However, expanding existing provision where it exists, in the form of community enterprise agencies, and building on the expertise and goodwill of those already working in the field will be as likely to produce results.

Housing and regeneration policies

6.60 Local authorities are increasingly producing anti-poverty strategies which are used as a backdrop for their role in housing management amongst other purposes. Housing may, the PAT suspects, be particularly important for business start-ups in deprived areas, since local office/factory accommodation may be unavailable, or extremely prone to crime, and in any case finance for forms of access to property other than that provided by local authorities will be very hard to obtain without collateral.

6.61 The LGA are very aware of possible concerns that tenancy agreements might inhibit business start-ups. Most local authorities are prepared to allow a low level of business to be carried out in residential dwellings, both council and privately owned, but accommodation can be a big barrier to establishing a business. Obviously, noisy polluting businesses which generate lots of traffic are unsuitable for residential areas. But residential areas might benefit from certain kinds of light industrial or commercial development, because they may provide nearby workplaces and commercial facilities (shops etc) and enhance safety through more people traffic moving through the area. One particular problem may be space: local authority rented housing tends to be allocated on the basis of required living space, without reference to business needs. Another problem is soundproofing.

6.62 Many councils have redundant office space which is between being sold/ redeveloped etc. There is a possibility that newly forming enterprises could use these spaces, on a low-cost short-life basis, similar to the residential tenancies given to short-life housing groups. The facilities may not be ideal, but could provide a useful resource in the short term. Other options include underused assets such as underground garages - which has a parallel in the successful use in many areas of railway arches. The LGA support this idea, and note that while many authorities have such assets, they may not be able to find the resources to effectively utilise them. There may also be problems with vires - eg Pt V of the Local Government Act.

6.63 A vital preliminary step in respect of this kind of supporting capacity development appears to be the requirement for some management from the start - without this, access to such centres is jeopardised, and local support undermined - eg through noise, generated traffic, rubbish. Such management could be combined with an advisory role for the businesses which become based in the centres.

6.64 Despite some hopeful signs, there is more that could be done in this area. While good local authorities, along with other landlords of social housing, would be expected not to place unnecessary barriers in the way of tenants' operating businesses from their homes, most of them - even the better ones - still have more or less onerous provisions in their tenancy agreements for tenants to seek their permission before setting up businesses. It might be a good idea for landlords of social housing to have an agreed procedure for giving permission based on realistic reasons such as the neighbours are not affected and the property is not damaged. (This would also apply to the installation of telecommunication equipment which may be necessary for business start-ups, although this is only likely to be a problem in properties where there are common parts.) More could be done to:

- C amend good practice so that it pays sufficient account to the benefits to the community of business start-ups;
- C ensure such good practice is copied across the diffuse housing association and LA housing sector.

6.65 If local housing policy is now becoming linked to anti-poverty and regeneration, local planning regimes can remain largely separate entities. Planners are usually included in the formulation of poverty action plans, but may not see such issues as a vital part of their remit. A lack of communication between different interested parties within local government, anecdotally at least, is a pervasive issue. But good practice does exist - DETR can for example make available an excellent guide from Wigan's planning department. Planning Departments do have a potentially important part to play in business start-ups, eg with regard to changes to property required to underpin change of use. And local development plans can provide for essential infrastructure support to business development and start-ups.

Other issues

6.66 Local authorities have a distinct perspective on other barriers to enterprise in their areas. In the PAT's discussions local authorities saw a need for more intensive support for some clients in the first stages of setting up businesses, and also see lack of access to finance, at the start and at certain critical points as being the crucial factor in the failure of some small businesses.

6.67 Councils also have a wider responsibility to make their local areas attractive to new businesses. This includes a role in making the local environment attractive and ensuring that an appropriately-trained workforce exists. Councils can facilitate contact with new businesses by participating in the Business Link partnerships providing business services for local employers, and by having helpful front line staff with wide knowledge of the interaction with business for enquiries about planning permission, building regulation approval, business rates etc.

6.68 Whatever is done at this level in terms of new initiatives, the PAT would strongly caution against creating yet more 'action zones' or partnerships. Targeting within existing frameworks such as the New Deal for Communities or Employment Zones seems to us more sensible.

Recommendation 22

6.69 The PAT recommends that:

more high quality activity to promote enterprise and business growth in regeneration strategies is encouraged.

6.70 All parties - DETR with RDAs, LGA and SBS - should work together to achieve this goal. This means:

- a. ***Developing clear guidance on enterprise initiatives for SRB bid teams and identify good practice.***
 - b. ***RDAs to be rigorous in deciding which SRB bids to fund - ensuring that they give enough weight to developing enterprise where there is a need for this. DETR should commission analysis of the current proportion of SRB bids that develop enterprise;***
 - c. ***DETR & LGA, with SBS & RDAs, to develop and promote best practice in enterprise support as part of local authorities' regeneration and anti-poverty strategies.*** Box 6.4 describes an examples of best practice in this area.
- 6.71 RDAs should monitor progress in this area at a regional level, liaising closely with SBS and DETR.

Timing: (a) and (c) by April 2000. (b) immediate & ongoing.

6.72 Note that the DETR already publishes a number of good practice guides for regeneration, including 'Community Enterprise: Good Practice Guide' which gives advice for potential funders and partners. These are available from Phil Budgen, Regeneration Division, 4/G5 Eland House, Bressenden Place, London, SW1E 5DU. Alternatively they can be found on the DETR's website at: <http://www.regeneration.detr.gov.uk/info/gp/index.htm>. Dingle Opportunities, described in box 6.4, is an example of good practice in this area.

Box 6.4: Dingle Opportunities

6.73 Dingle Opportunities in Liverpool, set up in 1994 as a partnership between Granby Toxteth Task Force, Dingle 2000 Development Trust and Liverpool City Council. Dingle Opportunities is a one-stop shop which deals with employment and training generally, but offers particular support to community business. It combines the accessibility of a drop-in centre with professional service provision. It has the staff and funding to devote resources to identifying possible ideas for businesses, bringing together people who may be interested and working up the ideas with them. It also has the advantage of being a one-stop shop for training and business so that a person enquiring about training courses may end up in a group considering setting up a community business.

6.74 Dingle Opportunities start businesses off as training schemes with European Social Fund or Employment Zone funding with the intention that they should develop until they are viable businesses. At this point some may become community businesses with a board drawn from the local community, while others may remain owned by Dingle Opportunities as a source of income after the SRB funding has ended.

6.75 The activities of recent and emerging start-ups include computer services, cleaning and local arts collective. Many start-ups developed from non-commercial projects such as

Intermediate Labour Markets and training schemes. In the long term the project will continue under the umbrella of the local development trust, Dingle 2000.

6.76 Funding Partners include: Government Office Merseyside; Dingle Single Regeneration Budget; European Social Funds; European Regional Development Funds; Liverpool City Council (CBED); Merseyside Development Corporation; Donations; Income generation.

Housing Associations

6.77 The PAT held very productive discussions with some of the more go-ahead Housing Associations, and visited some Hyde Plus projects to look at the activities of one of the more pro-active associations - see box 6.6. Some of the main points arising are set out below. As with Local Authorities experience is mixed, and much could be done to spread best practice and benchmarking. Some notably different perspectives to local authorities emerged, and in general rather more of a can do approach - in part because they are much more concentrated organisations.

6.78 Housing Association activities are becoming more significant in economic development. They often have property in regeneration areas but not usually on the very worst estates. In the south-east, they are more likely to have resources available to pursue economic development projects but elsewhere, there are less funds available because of the generic problem of low demand (the subject of PAT7). Government guidance has recently been relaxed enabling HAs to get involved in more varied activities - but these must, of course, remain subject to checks on propriety.

6.79 HA employees are often in a better position to interact with tenants because they have more direct contact with them - and a relationship of trust. The trust aspect they view as essential in developing support for business in regeneration areas. A lot of the enterprises they become involved in are not necessarily profit-making, but represent good value-for-money because they help to develop motivation and skills in the community - social capital (see reference to Squirrels Cafe, Dartford, in box 6.6). The PAT judge this to be a very important point. Benchmarking has been successfully used to improve such enterprises.

6.80 Box 6.5, which describes YouthBuild, a Bradford and Northern Housing Association scheme, and box 6.6, which describes Hyde Plus regeneration projects, are examples of what might be done in this area.

Box 6.5: YouthBuild

6.81 YouthBuild is a scheme which Bradford and Northern Housing Association have adapted from a US model. It delivers a number of related benefits for regeneration, most notably training and business start-up, and is a good example of the way in which multiple funding schemes and co-operation between quasi-governmental bodies on the ground can produce real benefits for the community.

6.82 Under YouthBuild teams of young men from ethnic minority communities are recruited to put together unwanted sets of small flats into high demand five bedroom houses. Overseen by a local contractor they are trained up to the necessary construction skills, in the process attaining NVQ2 by day and block release. This helps form an important source of new self-employed small building firms in this area, where traditionally young men from ethnic minority communities have not entered this type of employment.

6.83 The finance originally came from SRB round 4, and future funding has been obtained from the European Social Fund and ERDF (the European Regional Development Fund) sources. Training funding came from the local TEC, and the operation on the ground was supervised both by the local contractor and by the local authority. The Housing Association has been able to re-circulate the enhanced value into a Community Development Trust thus further benefiting the local community.

6.84 A first scheme has successfully been completed with 10 trainees; and funding has now been achieved for a further 31 trainees.

6.85 Relationships between HAs and other agencies are variable. With TECs relationships have tended to be good, but much less so with Business Links - who were disparaged by some during consultations as not interested in regeneration areas. Working with local authorities is vital, because HA coverage is patchy, and geographically dispersed. Good local authorities are a source of fruitful relationships, and many are happy to have HAs active in their areas, recognising the mutual benefits to be gained from their work. There are some local authorities however who are frustrated because they cannot be as proactive as they would like as they simply do not have the resources - their staff will often be stretched to the limit just ensuring that housing is managed, rents collected etc., with no time for exploring funding opportunities for innovative regeneration work. This frustration may manifest itself in the relationships with HAs. But so much of this depends on personalities. Improving the contact between all these agencies will be an important factor in the success of some regeneration initiatives.

Box 6.6: Hyde Plus regeneration projects

6.86 Hyde Plus is a separate arm of Hyde Housing Association which concentrates on community and economic regeneration work. They are involved in a number of innovative activities especially with young people in both socially excluded areas where they have properties, and in other parts of London and the home counties.

6.87 Examples of their work include:

C *Squirrels Café, Dartford:* a work experience project for socially excluded youngsters, the café won the "Good Café Guide's Best Café in the South East" prize in 1998. The project manager emphasises that the youngsters involved tend to have emerged from local authority care, and/or exclusion from school and the cafe enables them to develop the kind of life skills - timekeeping, social interaction,

money handling, personal hygiene etc - which they will need if they are to maintain a working life in the future, rather than actually teaching them catering skills (although obviously they pick some of these up, as well as learning basic cooking techniques) The project has an overall manager, a catering manager for the cafe and two other high quality workers who give the young people the support and confidence they need to work in the cafe successfully. After periods ranging from 12 weeks to a year, the young people are encouraged to move on and take work elsewhere. A partner to this project is the nearby Furniture recycling project, a similar scheme in that it concentrates on the development of social and life skills rather than carpentry or woodworking. The project also provides low cost furniture for new Hyde tenants.

C *Careers Café*: Upstairs from Squirrels Café is the Careers Café, an innovative resource centre with support and advice available on finding work, self-employment and CV writing combined with a comprehensive advice service covering such areas as housing and benefits, to provide a holistic service. The atmosphere is very relaxed and inviting, with soft sofas and armchairs, tea and coffee available (the opposite of a job centre!) and with a drop in service or appointments available.

C *Creekside Foyer, Learning and Employment centre*: is due to open in Deptford very soon. This will bring together accommodation for 40 young homeless people; employment resources, help and advice; a CV service; training courses; a gym and fitness centre and help for business start-ups from Aim for Business (see box 6.2).

C *Community Centres*: Hyde Plus are planning to regenerate two community centres in Stockwell, where Hyde HA have recently taken over the management of a large number of council owned properties.

6.88 HAs see the main barriers to development are their debt overhang - which leaves them little left to pursue such activities; and childcare - both its availability and its affordability. There are some very good examples of their work however, and there are housing associations active in many of the NDC neighbourhoods. Unlike the local authorities, the Housing Associations do not view tenancy agreements as a major constraint: they take the view that these are often flouted and that blind eyes would be turned in many cases (assuming the landlord ever found out), unless some significant nuisance was being caused.

6.89 A further idea is to involve HA tenants in helping to run the association. HAs say they would be willing to employ their tenants but mostly they lack the appropriate skills. They are looking at ways to enable HA employees to pass skills on to tenants.

6.90 The PAT recognises that because HAs only own a limited amount of stock and relatively few of the worst estates, there has to remain a significant onus on local authorities to take the lead in these kind of regeneration activities. Nevertheless recent trends suggest that HAs will be taking over ownership and / or management of an increasing amount of housing stock in deprived areas, for example as part of the Large Scale

Voluntary Transfer Programme. And a number of HAs already have innovative and exciting projects helping to provide employment skills and business start-up opportunities in deprived areas, for example those described in the boxes above.

Recommendation 23

6.91 The PAT recommends:

Recognise regeneration formally as a legitimate activity of Housing Associations.

6.92 In order to achieve this aim:

- a. Regeneration activities, in particular through supporting business and start-ups, should be formally identified as a legitimate activity of Housing Associations. This is PAT3's response to the current consultation exercise on the activities of HAs.
- b. Guidance to be provided to HAs on managing the financial and risk implications of engaging in regeneration activities. DETR, the National Housing Federation, The Housing Corporation and PAT7 should jointly prepare clear guidance.

Timing: By end-1999.

Responsibility and desired outcomes

6.93 DETR should take the lead in ensuring that this agenda is actively pursued. The aim is to ensure that the Government's strategies for enterprise and for regeneration reinforce each other and are closely linked.

Chapter 7: The Role of Mainstream Business

Introduction

- 7.1 The importance of Corporate Social Responsibility is clearly recognised by the Government:

“The 21st century company will be different. Many of Britain’s best-known companies are already re-defining traditional perceptions of the role of the corporation. They are recognising that every customer is part of a community and that social responsibility is not an optional extra.” The Rt Hon Tony Blair MP, Prime Minister, 24 February 1998.

- 7.2 This chapter considers what role the business community might play in helping to promote the regeneration of deprived neighbourhoods. The PAT recognises that this goes beyond the strict scope of PAT3’s remit, which is to promote enterprise activities in deprived neighbourhoods which is only one area of possible business involvement in deprived communities. Therefore this issue is considered relatively briefly here, and the PAT recommends that the promotion of greater Corporate Social Responsibility is taken up as cross-cutting issue by the DTI rather than by any particular PAT.

The problem

- 7.3 Business involvement in local communities can be vital to successful regeneration. Businesses themselves have an interest in this area both as “corporate citizens” but also for their long-term commercial advantage through the development of new products and more robust markets.
- 7.4 Organisations such as Business in the Community do an excellent job encouraging greater business involvement in communities. And many large firms make an outstanding contribution to their local communities. There are many examples of mainstream businesses getting involved in deprived communities to promote regeneration activities, whether this be through employee development programmes or through supply chain initiatives. The PAT welcomes such examples, but believes more might still be done by mainstream businesses - large as well as small and medium sized enterprises. But in order to achieve this businesses need to:
- i. Understand why it is in their interest to be “socially responsible”;
 - ii. Be able to measure and demonstrate the impact of their activities both on the business itself and on the wider community.

Strategies for addressing this problem

Understanding the benefits of being socially responsible

- 7.5 Clearly it is not for Government to prescribe to business how they should be

involved in the wider community. It is for business to decide. But the Government should play a stronger role in promoting the benefits to business of such an approach, and in highlighting examples of best practice.

- 7.6 The Competitiveness White Paper *Our Competitive Future: Building the knowledge driven economy* highlighted research by the Centre for Tomorrow's Company which suggested that a successful business will better serve its shareholders by focussing on the needs of its customers, employees, suppliers and the wider community. Commitment to the local economy and its economic, social and environmental concerns builds reputation. It is not altruism: it brings business benefits and improves their competitive position. Wealth creation and social justice are two sides of the same coin.
- 7.7 One element of getting businesses to understand the benefits to themselves and the communities of getting involved in their local areas is simply awareness. Many case studies of best practice already exist, for example Business in the Community's Awards for Excellence, and these need to be made more easily accessible to the business community and should be linked into other best practice databases. The PAT welcomes Business in the Community's intention to develop a database of best practice in their member companies. This will be accessible through a new web site which will also give businesses advice on how to develop policies to increase their positive impact on society.

Box 7.1: Holly Street estate, Hackney, London

- 7.8 An example of business involvement in neighbourhood renewal is Laing Partnership Housing's (LPH) work in the Holly Street estate. For LPH social and economic considerations, and the wider concerns of the community, must be part of house-building programmes if they are to help revitalise inner cities. LPH's regeneration programme on the Holly Street estate in Hackney, London, is a partnership with local residents, schools, community organisations, local authorities, housing associations and agencies.
- 7.9 Alongside physical regeneration of the local area, their aim has been to engender a sense of inclusion and ownership through initiatives to promote the active participation of local people and thus achieve an increased sense of well-being in the areas of:
- C Training and employment;
 - C Community development;
 - C Tenant liaison and involvement; and
 - C Education and the arts.
- 7.10 In 1992 the Holly Street estate suffered from multiple deprivation, high unemployment, crime and poor health. The work of LPH has helped turn this around

so today the community has been rebuilt not only in the short-term but also to be self-sustaining for the future. In 1992 less than 10% of residents expressed any desire to stay; currently 93% want to stay in the area long-term

Source: "The 1999 Examples of Excellence", Business in the Community.

- 7.11 An example of businesses benefiting directly from close links with the local community are partnerships between businesses and arts organisations. The vast majority of businesses in the arts and other creative industries are SMEs. Their success depends on a combination of business acumen, enterprise and creativity. Partnerships between businesses and arts organisations can be mutually beneficial, and can also have a positive effect on the communities in which they exist. In deprived communities they often provide employment opportunities which simultaneously allow people (who might not otherwise have had the chance) to vent their energy and creativity, as well as effecting other educational and social benefits, such as crime reduction. Such benefits are already recognised by the Government through Support for Arts and Businesses (formerly the Association for Business Sponsorship of the Arts).

Measuring a business' impact on their local community

- 7.12 A growing number of companies are now reporting on their social performance and relations with a wide range of stakeholders, including employees, suppliers, customers and the community. Such social auditing and reporting, pioneered in the early 1990s by organisations such as the New Economics Foundation, has emerged as both a management tool and a mechanism for improving corporate social responsibility and a company's accountability for its actions. Examples of 'Blue Chip' social reporting companies include Diageo, BP Amoco, British Telecom, Shell International, Camelot and United Utilities.
- 7.13 A common international framework for social and environmental reporting is being developed through the Global Reporting Initiative (GRI). The GRI includes the active participation of companies, non-profit organisations, accountancy bodies and business associations from around the world. Around twenty companies will have completed a pilot phase of this reporting framework by early 2000.
- 7.14 Other companies have focussed on specialised areas, such as the recent attention paid by food and textile retail companies to ethical sourcing, an approach of potential relevance for regeneration in the UK. A range of companies including Asda, Littlewoods, Marks & Spencer, Monsoon, Tesco and J Sainsbury have joined the government-backed Ethical Trading Initiative.
- 7.15 There are many other awards and indexes which have been developed to reflect the growing interest of the business community in corporate social responsibility, for example the Dragon Awards and Bruce Naughton Wade's Corporate Community Investment Index. Other schemes, such as Race for Opportunity seek to promote activity on a specific theme rather than a holistic approach.

- 7.16 There is much to recommend all of these schemes but the PAT believes to achieve greater business participation, they must make clear the links between competitiveness and social inclusion. Business in the Community is developing this link, using the British Quality Foundation's (BQF) Business Excellence Model as the framework and criteria for their awards, which are kitemarked by BQF. The Government has a role to play in helping to take this agenda forward.
- 7.17 It is also important that where firms participate in such schemes their involvement is genuine. And from businesses' perspective, they will want to be able to demonstrate this fact. During a consultation with ethnic minority entrepreneurs in Bristol there was a discussion of *Race for Opportunities*, a national scheme run by Business in the Community to promote large businesses to help black and ethnic minority groups. Everyone felt the concept was good, but there was a perception that in practice some large businesses were simply paying lip service to the scheme. A more systematic approach to measuring business involvement in the community was felt needed.
- 7.18 The PAT welcomes the Business in the Community's Impact Taskforce, which brings together business and the British Quality Foundation (BQF). It is to report by end 2000 on mechanisms and approaches to encourage more business involvement in communities. These should help businesses measure what they are doing and what impact they are having, in particular to see the benefits for their many stakeholders - including employees, suppliers, customers and the community - and the health of the business.

Recommendation 24

- 7.19 The PAT believes more business involvement in deprived communities would greatly benefit the neighbourhoods as well as the businesses themselves. The PAT recommends:

The DTI promote greater involvement in renewing deprived communities by 'mainstream' businesses.

- 7.20 Greater business involvement in deprived communities goes beyond the scope of this PAT's work. So we recommend that this issue is taken forward on a cross-PAT basis. At the same time the PAT has considered a number of ways in which greater business involvement in deprived communities might be achieved:

C *Give a Minister a specific remit to promote Corporate Social Responsibility - by both small and large businesses;*

C *Promote a more systematic approach to Corporate Social Responsibility, for example through benchmarking; and*

C *Promote a debate, and disseminate information, about why it is in businesses' interest to be involved in local / deprived communities.*

Timing: A new strategy in this area should be put in place during 2000.

7.21 The team also considered whether a new standard recognising businesses' work with their wider stakeholders should be established. The PAT are conscious, however, that businesses generally already feel that there is a plethora of standards and may be reluctant to see the introduction of any more. Therefore more work should be undertaken to consider whether this would be the most appropriate action.

Responsibility and desired outcomes

7.22 The Department of Trade and Industry should be responsible for taking forward this agenda. More involvement between business and deprived communities is the desired outcome from this work, but this may be difficult to measure. As a secondary indicator the DTI might track the attitude and perception of businesses, or deprived communities, towards Corporate Social Responsibility.

ANNEX A: PAT3'S REMIT

As set out in “Bringing Britain together: a national strategy for neighbourhood renewal” (report by the Social Exclusion Unit), this Policy Action Team (PAT) was tasked to report on:

- C how successful business support organisations, such as Business Links are in serving the most deprived communities;
- C how it can be made easier for people in poor neighbourhoods to get access to support to start a business or become self-employed;
- C how access to capital for small firms can be improved, especially for start-ups, including innovative approaches such as ‘microcredit’;
- C what can be learnt from new ways of encouraging self-employment, building on the New Deal and Employment Zones and how access to capital can be tied into regeneration strategies more generally.

With a goal of:

- C drawing up an action plan with targets to encourage more successful business start-ups in poor neighbourhoods.

The PAT was also asked to give specific consideration to black and minority ethnic (BME) issues. Our approach to this has been to build our analysis and conclusions very much into the main stream of our work. So a discussion of the problems facing BME businesses will be found in the report where relevant. In general, our recommendations are designed to have a positive impact on all businesses in deprived communities - whether BME-owned or not. But the PAT has also made specific recommendations on BME issues where necessary.

ANNEX B: MEMBERSHIP OF ACTION TEAM 3: BUSINESS

Champion Minister

September 1998-July 1999	Patricia Hewitt MP Secretary to the Treasury	Economic
August 1999 onwards	Stephen Timms MP, Financial Secretary to the Treasury	

Policy Action Team

Philip Rutnam (Chair)	Head of Enterprise Team, HM Treasury
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External Members

Amanda Jordan	Head of Corporate Affairs, NatWest Group, and Adviser Social Exclusion Unit
Ed Mayo	Executive Director, New Economics Foundation
Andrew Robinson	Manager, Community Enterprise, NatWest Group
Caroline Shah	Business Analyst and Consultant
Richard Street	Princes Youth Business Trust
Museji Takolia	Management Consultant and Chairman, Centre for Employment and Enterprise Development (The CEED Charity)
Sue Walsh	Watford Borough Council

Officials

Atul Patel	Social Exclusion Unit
Geoff Mulgan	No.10 Policy Unit
Martin Hurst	Department for the Environment, Transport and the Regions

Amanda Brooks	Department of Trade and Industry
Maria Kenyon	Department of Trade and Industry
Mark Smith	Department of Trade and Industry
Julie Braithwaite	Department of Trade and Industry
Eric Galvin	Department for Education and Employment
David Alexander	HM Treasury
Daniel Storey	HM Treasury
Ben Gales	HM Treasury (Secretary
Tim Sharp	HM Treasury (Secretary

Other officials also attended some meeting, including:

David Smith	Department of Trade and Industry
Sue Robinson	Department for Education and Employment
Gavin Bowen	Department of Social Security
David Reardon	Social Exclusion Unit
Matthew Waite	HM Treasury

ANNEX C: RESEARCH AND REPORTS

“Bringing Britain together: a national strategy for neighbourhood renewal”, report by the Social Exclusion Unit, September 1998.

“The 1999 Examples of Excellence”, Business in the Community, 1999.

“New Mutualism - The Third Way”, Peter Kellner, 1998

“Social Enterprise, Social Inclusion Conference Report”, Social Enterprise London, 1999.

“The Financing of Ethnic Minority Firms in the United Kingdom”, The Bank of England, May 1999.

“Evaluation of the Self Employment Option within Training for Work”, CRG, 1996.

“Review of Business Start Up Activities under the SRB”, York Consulting, June 1998.

“Self-Employment for the Unemployed: the Role of Public Policy”, Hilary Metcalf, Policy Studies Institute (1997).

“The Entrepreneurial Society”, Robert Gavron, Marc Cowling, Gerald Holtham and Andrea Westall, Institute of Public Policy Research (1998).

“Moving In and Out of Self-Employment”, London Policy Studies Institute (1997).

“Youth Enterprise Initiative Output Related Funding Scheme Report”, BRMB International, Department for Employment and Education Research Report No5, May 1997.

“Women's Individual Income 1996/97” published by the Women's Unit, Cabinet Office.

"Business Links - Value for Money Evaluation", final report by PACEC, October 1998.

"Raising capital for the ethnic minority small firm", Jones, McEvoy and Barrett, 1994.

"Small is bankable: Community reinvestment in the UK", Mayo, Fisher, Conaty, Doling and Mullineux, Joseph Rowntree Foundation, 1998.

"Benchmarking in Micro-Lending: UK Country Report", Kempson and Whyley, for European Commission DG XXIII, 1998.

Micro Credit in the UK: British Bankers Association survey of members' involvement in micro-finance schemes, 1999.

"Moving In and Out Of Self-Employment", Bryson, A. and White, M. (1997) London: Policy Studies Institute.

"Helping Unemployed People into Self-Employment", Kellard and Middleton (1998).

"The Modernisation of Britain's Tax and Benefit System: Employment Opportunity in a Changing Labour Market", published by HM Treasury 1997.

"The decline of employment among older people in Britain", Nigel Campbell 1999.

"The Displacement effects of the Enterprise Allowance Scheme: A Local Labour Market Study", C Hasluck, 1990.

"Proposed Changes To The Banking Act Exemption For Withdrawable Share Capital For Industrial and Provident Societies", published by HM Treasury, May 1999.

ANNEX D: The consultation process

The PAT carried out an extensive programme of visits and meetings in different parts of the country in order to prepare this report. From December 1998 to March 1999, the then Champion Minister, Patricia Hewitt MP, led a programme of regional roadshows to meet interested groups and individuals. These meetings took place in

- C Newcastle;
- C Birmingham;
- C Liverpool; and
- C Edinburgh.

The PAT also held a high-level seminar on community banking seminar, at No11 Downing Street in April 1999, with around 25 participants actively interested in community finance.

Later in the spring, we undertook consultation exercises on the emerging findings of the report with local business representatives, and potential entrepreneurs in:

- C Lewisham;
- C Bristol;
- C Norwich; and
- C Central London.

These groups included discussions particularly about the problems faced by black and minority ethnic groups, by women and by potential entrepreneurs over-50. Many thanks to the Prince's Trust, Lewisham FE College, the CEED Charity in Bristol, and to the Women's Enterprise Employment and Training Unit in Norwich, for helping to arrange each of these events.

The PAT also held around 30 smaller-scale meetings and discussions with people active in this area, including meetings with representatives from voluntary sector groups, banks, community finance initiatives, business support organisations, housing associations, and local government. The PAT is grateful to all these groups and individuals for sparing the time to contribute to this work.

Finally, many thanks go to Andrea Westall, Research Fellow, Institute of Public Policy Research, Professor John R Presley, University of Loughborough, and Professor Andrew Mullineux, University of Birmingham for providing feedback on the report in draft.