Small businesses are finding that the decision to leave the EU has created more questions than answers, **Ian Harper** reports

SHOW ME THE BREXIT

THERE IS life beyond the European Union for Britain's small businesses. That's the message from Tim Wright, co-founder and director of Twintangibles, the leading crowdfunding consultancy. Wright is one of the few people we spoke to who is, in his own words "an avid exponent of Brexit".

He says: "I think SMEs [small and medium-sized enterprises] could have huge opportunities to open up into new markets and in particular the growing parts of the global economy. But this is entirely dependent on the government putting together the necessary bilateral trade agreements."

Wright's optimism stems from his focus on the alternative finance market, which includes crowdfunding, invoice financing and peer-to-peer lending. The UK commands 74 per cent of the European alternative funding market, he points out, and there are good reasons for that dominance that won't change after Brexit. These include, Wright says: "People like doing business in London because of linguistic, legal and regulatory frameworks."

Future potential aside, the largely unexpected referendum result is having significant short-term repercussions for business.

Mike Cherry, national chairman of the Federation of Small Businesses, says: "It remains to be seen if the fall in the pound will have a net positive or negative effect on small firms. While the fall should help exporters as it reduces the relative cost for foreign consumers buying UK goods, it also increases the cost of imports, which will increase costs for many businesses."

How important is exporting to the UK's small businesses? According to Colin McLean, CEO of SVM Asset Management: "Fewer SMEs and business start-ups are targeting exports or import substitution, so the currency effects will take time and be limited. The financing environment will become more difficult... IPOs have stopped. For SMEs in financial services, there is probably little benefit from EU membership, so possibly not a lot of change. However, talk of a second [Scottish] independence referendum may delay some inward investment until things are resolved. Overall, in the short term, Brexit and the political turmoil are not helpful."

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Keith Morgan

Chris Fletcher CA, a member of ICAS' Business Policy Committee and a non-executive director of Spark Energy, agrees: "Clearly some factors may be helpful, for example a lower pound for exporters, but not many SMEs export and many provide local services, which are probably unaffected."

Robert Pattullo CA, a member of the same ICAS committee as Fletcher and a former non-executive director with tech companies Touch Bionics and Arrayjet, says: "I believe that the fall in confidence could be a big factor. This is likely to affect SMEs and banks."

PwC predicts a slowdown in UK growth as a result of uncertainty, and senior finance partner Peter Kelly says: "While the falling value of the pound offers a chance to benefit in terms of exports, a large number of UK SMEs still have a predominately domestic focus."

UK consumer spending is expected to hold up reasonably well, Kelly believes, but those companies that don't pass on rising prices to their customers may need to find efficiency savings.

Gillian MacAulay, managing director of Strathclyde University Incubator and founder of the Gabriel Investments syndicate, says: "I think in the longer term, economic advisers are indicating that [the economy] will probably shake out to be approximately the same. But 40 per cent of our market is the EU. Why would we cut ourselves off from that collaborative market right now when things are still quite tough? I just think the timing is ill conceived."

WHITHER EU FUNDING?

One thing looks certain – Brexit means the end of EU funding. But is this significant for SMEs and, if so, will government make good any loss?

The European Investment Bank (EIB) estimates that by March 2016, the European Fund for Strategic Investments had triggered around €76bn (£63bn) of investment in Europe, part of supporting smaller businesses and midcap companies. European structural and investment funds are also used to help fund SMEs.

The FSB's Cherry says: "There are many small businesses that could lose out if EU funding is withdrawn, which is why the FSB is calling on the government to guarantee this funding is preserved when we leave the EU. EU funding has been used across the UK to support the provision of superfast broadband, infrastructure improvements including rail, apprenticeships and business support to small firms. It also plays a role in supporting the rural economy by direct payments to farmers. In 2014 the UK received £4.5bn from EU programmes. It is also clear that many of the areas that receive the most EU funding are also the most economically vulnerable."

Gareth Magee CA, a partner with Scott-Moncrieff, says: "Funds such as the Scottish Co-investment Fund originate from Europe and, with match funding from the angel network, have significantly boosted the fortunes of high-growth SMEs."

Speaking to *The Guardian* newspaper in April, Swati Dhingra, assistant professor of economics at the London School of Economics and co-author of *Life after Brexit: What are the UK's options outside the European Union?*, said: "The EIB plans to lend £100m to SMEs in the UK. If this funding dries up after Brexit, domestic sources such as the British Business Bank would need to find the funds to make up for these shortfalls."

According to the British Business Bank's CEO, Keith Morgan: "The Bank currently supports over £3.1bn of finance to more than 48,000 smaller businesses and participates in a further £4.4bn of finance to small midcap businesses. Some of our programmes do have an element of EU funding involved, but the vast majority don't. We are in frequent communication

“Banks have recently made greater efforts to create financing opportunities for SMEs”

Neil Norman

with HM Treasury, the Department for Business, Energy and Industrial Strategy and the Department for Communities and Local Government, and are monitoring the situation carefully in case some of our funding arrangements have to change.”

Fletcher says: “It’s extremely important for HMG [Her Majesty’s Government] to plug gaps in the short term to maintain confidence and momentum. There may be a disruption to the EU funding commitment in the short term, but that is mere speculation. It’s quite likely that HMG will re-prioritise spending to suit the UK when it gets into control, but we have no idea how this will work, especially since we have no idea what the cost of remaining in the EU trading bloc will be.”

STATE SUPPORT – OR NOT?

Post-Brexit, it is likely that EU rules limiting government support for business will no longer apply – unless, of course, they form part of a new agreement on access to the single market.

Morgan says: “No-one can really predict at this stage what might result from any exit negotiations. If the UK leaving the EU led to greater flexibility in how we could improve finance markets for smaller businesses we would, of course, want to explore how we could make best use of that new flexibility.”

However, McLean points out: “Brexit may well be followed by EEA [European Economic Area] membership or some variant of that with special terms for the UK. On, say, a Norwegian basis, there would be no more than 15 per cent of the UK budget contribution to be rebated. There will likely be a fight for how that is spent in the UK. The UK is likely to have to compete with Europe on tax incentives and with lower revenues there will be limits on what aid might be available.”

Some argue that retaining access to the single EU market will be a priority of negotiations, not least because it influences inward investment.

Cherry says: “It’s too early to say how inward investment in the UK will be affected by Brexit, but the thing that most interests investors is whether you can show a clear business plan which will deliver a good return. In or out of the EU, the UK has some of the most innovative and exciting entrepreneurs in the world and that is not going to change. Small firms will want to see steps taken to encourage inward investment to the UK moving forward, bolstering its investment in critical departments such as the Department for International Trade. Continued access to the single market will ensure the UK continues to offer such investors access to European markets.”

BANKING ON THE BANKS?

There has long been a debate over whether UK banks provide enough support for small business. Will Brexit influence bank lending to SMEs and start-ups?

Cherry says: “The Bank of England has been quick to shore up the UK banking system and has relaxed capital requirements on banks, allowing them to lend up to £150bn more to businesses and consumers. Recent stress testing of the UK banking system showed the sector to be resilient, and we don’t expect the drop in some banks’ share prices to have too much of an impact on lending. Our most recent data, taken before the referendum, shows small firms reporting an improvement in credit availability and affordability.”

Neil Norman, entrepreneurial tax partner with Chiene + Tait, says: “Banks have recently made greater efforts to create financing opportunities for SMEs.”

He adds, however, that the sort of products offered by Virgin StartUp, Barclays and others to provide SMEs with accessible funding on a debt rather than equity basis may not reach their full potential.

Chris Fletcher says: “The problem is that funds come from Westminster government decisions, which are often not sensible. For instance, the push to get banks to lend does not solve the problem that it is equity funding that SMEs generally need, and banks are anyway being told to reduce the risk in their lending. One large bank tells us that only 4 per cent of its balance sheet is in any event lent to SMEs.”

McLean adds: “Given that the banking mechanism is broken, there may be more politicians arguing for some form of national investment bank.”

Neil Davidson CA, managing director with P2P specialist Alderburn Finance, comments: “P2P investors providing loans are not constrained by capital regulation, sector concentrations or policies based on multi-billion pound portfolios. They make their decisions based on the individual case in hand and make their own personal judgement on risk. Regardless as to how the large UK banks react to Brexit, P2P investors remain ‘open for business’ for good lending propositions. SMEs should take comfort from this.”

THE LONG VIEW

In the longer term, for SMEs – while there may indeed be new opportunities – life post-Brexit is one big unknown.

Brian Aitken CA, partner with private equity firm Nevis Capital, sums it up: “There will be winners and losers and there is a good opportunity for those SMEs who are able to spot the right opportunities to thrive. Those who don’t make any plans could find things tough. The big killer is uncertainty, which funders don’t like. Until there’s clarity, it’s difficult to know what the impact on SMEs will be.”

He adds: “The good opportunities will get backing, potentially at better valuations as venture capitalists will favour lower risk deals, but the bar will be higher for more mediocre opportunities. I think it will be tough for start-ups – with too much risk around. However, there will be plenty of venture capital and private equity keen to back more established businesses. Private investors like Nevis Capital will be keen to invest as we can take a long-term view. The government will likely make up any shortfall in lending left by the EU to the SME market as it is critical to economic growth.” CA

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