

Escalate

THE INNOVATION & GROWTH FUND

ESCALATE: A PROSPECTUS FOR INVESTMENT

March 2013

EXECUTIVE SUMMARY

Escalate will unlock the potential of small and micro businesses with real potential and ambition for high growth by providing a package of targeted financial assistance integrated with the Government’s Growth Accelerator programme and locally-funded support for high growth businesses. Focused on the A21 Corridor, it will create or safeguard over 1,250 new jobs in the area’s most dynamic businesses.

We are seeking £5.5 million through the Regional Growth Fund to bring forward over £110 million in private sector investment over the next ten years. We anticipate business demand to be high – so 100% of the proposed RGF investment will go direct to final business beneficiaries, with all delivery costs funded locally.

This prospectus sets out the business case for Escalate. It explains why we need a new focus on high growth businesses, how the programme is integrated with existing support, how business is already driving forward the proposal and how we will deliver it.

A targeted focus to unlock growth

Small and medium enterprises with the potential and appetite for sustained growth will be the backbone of the UK’s economic recovery. The national Growth Accelerator programme recognises this, and the number of businesses benefiting from Growth Accelerator is growing fast. But many small businesses with real growth potential still find it hard to access commercial finance on viable terms, given the risks associated with new businesses and innovative projects.

Growth Accelerator business clients have said that a local, quickly-responsive access to finance scheme would help them to bring forward investment and unlock finance. So Escalate has been designed to offer targeted loan and grant support to small, dynamic businesses, linked with the Growth Accelerator and locally-funded High Growth Kent services.

Integrating new financial support with existing business coaching, Escalate is backed by a consortium of local businesses, banks, business organisations and local authorities, including:

Barclays Bank plc
 Beaming Ltd
 Bespoke Kitchens & Interiors Ltd
 Cohesion Design Services Ltd
 Component Force Ltd
 East Malling Research Ltd
 Federation of Small Business
 Garancie Ltd
 Hugh Lowe Farms Ltd
 Ideal Response Group Ltd
 Kent Invicta Chamber of Commerce
 Kit for Kids Ltd

Lloyds Banking Group
 Maidstone TV Studios Ltd
 Micralite Ltd
 Photek Ltd
 Pillory Barn Creative Ltd
 QinetiQ plc
 Red Brick Media Group Ltd
 Santander plc
 Strata Construction Group
 Torr Scientific Ltd
 Waste Oil Technology Ltd

THE CASE FOR INVESTMENT

The case for a focus on high-growth businesses

High growth businesses hold the key to future prosperity. The 6% of UK businesses with the highest growth rates generated half of all the new jobs created by existing businesses between 2002 and 2008 – with high growth associated with high levels of innovation¹.

National and local policy recognises the need to support high growth business. The Government funds the national **Growth Accelerator** programme to offer business coaching to firms with the ability to achieve 20% year-on-year growth. Locally, **High Growth Kent** offers a support package to businesses aspiring to reach Growth Accelerator criteria, creating an integrated business support escalator currently backing 1,250 businesses.

However, access to finance is a bigger obstacle for high growth SMEs than for most other businesses². This is because innovation is inherently risky – and at a time when banks remain risk-averse, the firms with the greatest potential often face the greatest barriers in securing debt finance on viable terms. Although the Funding for Lending scheme is increasing the size of the lending pool, centralised decision-making often leads to *“a collective inability to distinguish high growth businesses from bad credit risks in [banks’] lending decisions”*³.

Market failure in access to finance for high growth SMEs is a national and international issue – and we cannot entirely overcome it locally. However, there is a case for local action. We know our local base of potential high-growth businesses through Growth Accelerator and High Growth Kent. We already work closely with local bank branches. And in many cases, the finance gap is relatively small. Earlier this year, we carried out local research to consider what we could do locally to unlock finance for high-growth SMEs, adding value to national efforts⁴. This has led to the Escalate concept.

The case for a focus on the A21 Corridor

Escalate is especially focused on the A21 Corridor, which includes **West Kent** (Maidstone, Sevenoaks, Tunbridge and Malling and Tunbridge Wells) and part of **East Sussex** (Hastings, Rother and Wealden). There are three reasons for a focus on this area.

Firstly, the A21 Corridor has a **high concentration of businesses with growth potential**. Good connections to London make the area an attractive place to do business, and there are especially strong opportunities for growth in a small number of highly innovative sectors. The **software, digital and ICT** sector around Tunbridge Wells is one of the strongest creative sectors in the South. A growing **bioscience research** base is developing, based on the expanding health science sector (such as the new Kent Institute of Medicine and Surgery at Maidstone) and the established national presence in agricultural R&D at East Malling Research Centre. The **defence technologies** sector is also nationally significant, building on the presence of QinetiQ at Sevenoaks and General Dynamics at Hastings. This means that a targeted effort at unlocking finance for high growth firms in this area

¹ NESTA (2009), *The Vital 6 per cent: How high-growth innovative businesses generate prosperity and jobs*, p.3

² BIS Economics Paper 16 (2012), *SME Access to External Finance*, p.12

³ John Fingleton (2013), ‘When Banks Fail Small Businesses’, *Financial Times*, 21 February

⁴ Kent County Council/ Wessex Economics (2013) – Market Analysis

will yield positive returns for both the national and local economy. But given our overwhelmingly SME-dominated economy, the risks of failing to support small business growth are high.

Secondly, high-growth businesses in the A21 Corridor support **economic activity across a much wider area**. For example, some 17,700 people commute daily from the Medway Towns and Swale into Maidstone and Tonbridge & Malling⁵, and supply chain links are intense – so growth in the A21 Corridor is a motor for job creation across Kent and East Sussex.

Thirdly, we want to **avoid duplication**. There are already successful local RGF programmes in East and North Kent, and these can provide a solution to high-growth businesses in these areas. So we have focused Escalate on those places where local RGF is not available.

What businesses are saying

In designing Escalate, we have asked businesses, business organisations and banks what would help to open up finance for small, high-growth companies⁶. The key messages included:

- Targeted financial assistance would help drive growth. However, public sector schemes are complex and it is often difficult to understand what is available. So any new approach must have clear criteria and processes and is linked to business support.
- Some businesses are reporting signs of a return to growth, but with bank lending still limited, the ability to increase capacity to respond to rising orders is constrained.

*“We have become increasingly competitive in the last eight months and want this to continue...
The order book is just beginning to turn into an increase in production demands”*

Manufacturing business (10-20 employees), Tunbridge Wells

- While grant finance can be useful, repayable finance is equally welcome and can often be preferable, as it demonstrates a clear stake by the business in the success of the project and proves to private sector investors that another lender is willing to invest.
- Despite pockets of disadvantage, the economy of the A21 Corridor is relatively strong. So there isn't a need for a large-scale grants scheme – what local businesses with growth potential need is a smarter programme of targeted assistance to help increase the willingness of the private sector to invest in firms with growth potential.
- Support in accessing private sector finance and in building business networks is important alongside financial assistance, so the role of services such as Growth Accelerator and High Growth Kent will be an important part of the package.
- Supply chain and labour market links stretch beyond the A21 Corridor – so some flexibility needs to be built into the scheme to take account of benefits beyond fixed boundaries.

⁵ KCC Research and Evaluation

⁶ Consultation with individual businesses, Growth Accelerator and High Growth Kent coaches, Kent Business Advisory Board, West Kent Partnership, Kent Invicta Chamber of Commerce and banks.

THE ESCALATE PROPOSITION

The key principles

Listening to business and building on research into the finance gap for high-growth SMEs, we have designed Escalate as an innovation and growth fund, which will:

- Offer targeted financial support to businesses with high growth potential, where this will unlock private sector debt and equity finance;
- Be directly linked to the wider support offer provided to high growth businesses through Growth Accelerator and High Growth Kent; and
- Focus on the long term growth of the economy as well as the growth of individual businesses, by targeting support to those businesses with the strongest net added value and the strongest supply chain multipliers.

Our proposals

Based on these principles, Escalate will offer a **targeted financial assistance package** linked with the **high growth support services** backed by national and local government.

The financial assistance package

The Escalate innovation and growth fund will offer a combination of loan and grant finance to high growth businesses, where this will help to unlock private finance and where it will deliver a project that will create sustained employment.

Most financial assistance will be offered as ‘repayable finance’ – i.e. an interest-free, normally unsecured loan offered on grant conditions with the requirement to meet job creation and other targets. The length of repayments will vary according to project, but based on previous schemes and for forecasting purposes, we have assumed that most loans will be repaid over five years.

However, there may be circumstances in which a job-creating and high-value project could not viably be delivered through a loan agreement, so Escalate will also be able to offer grant support if required. We have estimated that 75% of the value of the fund will be offered in loans, with the remaining 25% offered as grant.

Focusing on high growth businesses

We want to ensure that Escalate is targeted towards those businesses that offer the strongest prospects for growth. We also want to ensure that it is fully integrated with existing support.

For that reason, the route to accessing Escalate will be via the Growth Accelerator and High Growth Kent services. Growth Accelerator and High Growth Kent business coaches will promote the fund to their clients and will offer support in applying, with all applications to the fund signed off by the applicant’s business advisor.

This approach will ensure that we offer a coherent package of support and make sure that scheme criteria and eligibility are fully explained to prospective applicants. It also means that access to the fund will be limited to those businesses which are **scaleable** and have the capacity for sustained growth, and which have the **ambition** to grow.

However, Escalate will not be restricted to *existing* Growth Accelerator and High Growth Kent clients, and we anticipate that Escalate will be important in expanding the client base of both services to businesses that have the potential, but with which we have not yet engaged.

Focusing on high value added businesses

High growth businesses can be found in any sector. But Escalate aims to increase net employment and value-added in the local economy as well as individual businesses. So we will put in place criteria which **promote** access to Escalate in key sectors with long-term growth potential, and we will link these with the links that Growth Accelerator and High Growth Kent can provide with organisations such as the Technology Strategy Board and the Manufacturing Advisory Service.

Building on the A21 Corridor's key opportunities for growth, we will focus on the potential of:

- **Health science** - Linking local business with the Academic Health Science Network to help them respond to demands for innovation and new services in healthcare;
- **Defence technologies** - Building on our established presence in this valuable part of the UK's manufacturing sector and linking businesses in the local supply chain with the Centre for Defence Enterprise;
- **ICT and software** – Supporting new products and ideas from the A21 Corridor's strong business base in this rapidly growing market.

At the same time, we will **restrict** access for activities that only operate in local, saturated markets (for example, retailing and parts of the food and drink sector), ensuring that displacement is avoided and that limited funding is targeted to those activities that will yield the greatest long term growth.

At the launch of the programme, we will publish an **Investment Strategy** clearly setting out sectoral priorities and restrictions. This will be reviewed in the light of the market and the performance of the programme and will be regularly updated based on local economic and business need.

Focusing on unlocking private finance

Escalate is not a substitute for commercial finance, and businesses will need to demonstrate that financial assistance cannot be secured from the private sector. However, a decision to award Escalate grant or loan support can help increase the ability of the bank to lend, within the constraints of its existing lending policies.

“We welcome the Escalate proposal. Businesses in Mid and West Kent tend to have higher demand for debt for their higher growth aspirations and although this sometimes means higher credit risk, this could be mitigated by the involvement of another lender.”

Barry Spicer, Area Commercial Director, HSBC

Recycling Escalate

Because most Escalate support will be made in the form of interest-free loans, the fund will be partly recyclable. Assuming the closure of the scheme to new loans and grants after ten years, there will be around £1.46 million following receipt of all repayments by Year 15⁷.

⁷ This assumes: a) Initial investment of all RGF by March 2015; b) 75% of funds distributed as interest-free loans, with the remainder as grant; b) The closure of the scheme after ten years; and c) a default rate of 10% (a pessimistic assumption given experience of previous repayable finance schemes).

This will allow us to make the Escalate fund work harder, supporting additional businesses. However, as Escalate is a response to current market failure, the need for the fund will hopefully diminish over time. So after Year 10, **all repayments will return to Government**, unless there is a strong case at that time for continuing the operation of the programme.

Measuring the cost

We have considered how much RGF investment Escalate will need based on the number of high-growth businesses that could potentially benefit from the scheme and evaluations of earlier grant and loan schemes.

Based on current and forecast Growth Accelerator and High Growth Kent client numbers, Escalate aims to benefit 158 businesses by March 2015. Looking at the number of jobs created in earlier schemes focused on high-growth businesses, we estimate an overall cost per job of **£5,511**. It should be noted that this cost is based only on the number of businesses we aim to support with the initial allocation of RGF funding – as loan repayments are recycled, the overall cost per job over the lifetime of the scheme will fall to around £2,450 per direct job created or safeguarded).

Hitting the ground running: An early start for Escalate

With demand from business clear, and a need to invest all RGF funds by March 2015, it is vital that Escalate makes a quick and effective start.

So Kent County Council has approved £150,000 to start delivery of a small '**vanguard**' Escalate **scheme**, which will be available to businesses from April 2013. Delivered through Growth Accelerator and High Growth Kent, this aims to support up to ten businesses in accessing private finance.

Because this initial scheme is small, we will only make it available through very targeted marketing by business coaches. However, it will ensure that all the processes we need to run Escalate are in place in the event that we secure RGF – and it will give us an early pipeline of projects so that we can launch the full Escalate scheme on schedule in September 2013.

Delivery strategy

Escalate will be delivered through a partnership involving the Growth Accelerator and High Growth Kent services and Kent County Council as accountable body, alongside local businesses and all the local authorities in the A21 Corridor. To ensure that the programme runs efficiently, we have clearly defined roles and responsibilities for delivery.

Governance

At the start, we will appoint an **Escalate Approvals Panel**. This body will consider all applications for loan or grant support (following independent appraisal) and will determine the allocation of funds. The Approvals Panel will include a representative of the accountable body, as well as representation from the private/ public **West Kent Partnership**, and will have a majority of private sector members offering a range of expertise. To ensure transparency and avoid conflicts of interest, the Growth Accelerator and High Growth Kent teams will not be represented on the Approvals Panel.

The **accountable body** for Escalate will be Kent County Council (KCC). KCC already acts as accountable body for two RGF-funded schemes (Expansion East Kent and TIGER) and has substantial

experience in administering grant and loan programmes. KCC will be responsible to Government for the use of all RGF funds and for ensuring that the systems are in place to deliver effective appraisal, monitoring, financial control and compliance with all state aid and other regulations.

Management

All management costs will be paid for by local partners. Escalate will be promoted to business through services that are already funded and there are economies of scale from which the accountable body can gain in its management of existing schemes elsewhere in Kent. This means that the costs of managing Escalate will be low – about £180k to March 2015 (or about 3% of programme value). These costs will cover independent project appraisals and additional contract and monitoring officer support to ensure that Escalate is delivered effectively.

How it works in practice: the customer journey

Escalate has been designed to give genuinely **integrated support** to high-growth businesses, alongside a **transparent, business-led approvals** process with a focus on backing businesses with the **greatest potential** for growth and job creation. This is how the programme will work in practice:

- When Escalate is launched, a **Delivery Plan** and **Investment Strategy** will be published, setting out the application criteria, state aid and other rules, and sectoral priorities. The Investment Strategy will be regularly reviewed in the light of the market, and updated as appropriate.
- Escalate will be **promoted** to businesses with growth potential via the High Growth Kent and Growth Accelerator teams. Other business organisations and intermediaries (such as banks and accountants) will also be able to signpost to Growth Accelerator and HGK.
- To apply for support, applicants will contact their business coach and complete a standard **application form**, which should be countersigned by their business coach – ensuring that the business is supported, and that inappropriate or ineligible applications are minimised.
- Once completed, the application is submitted by the business to the Programme Management Team at Kent County Council. This will then be **appraised** by an independent appraiser (contracted through competitive tender).
- Once appraised, applications will be considered by the **Escalate Approvals Panel**. The Panel will decide whether or not to allocate funding.
- **Contracts** for approved applications will then be drawn up between Kent County Council and the business, and funding will be drawn down. Grant and loan agreements will specify the profile of drawdown linked to delivery milestones, as well as the repayment schedule where appropriate
- Once the project is underway, KCC will be responsible for **monitoring** delivery and the use of the funding, reporting progress back to the Approvals Panel at each Panel meeting.

Throughout the process, businesses will retain their relationship with their Growth Accelerator or High Growth Kent business coach, although to ensure clear governance, business coaches will support applications, but will not be part of the decision-making process.