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**SMALL BUSINESS AND GOVERNMENT:
THE RICHARD REPORT**

Submission to the Shadow Cabinet

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Small Business & Government: The Richard Report

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Foreword

As an entrepreneur, I believe strongly in the value of entrepreneurialism and innovation and the role they can play in improving the quality of all our lives.

As an American living and working in Britain, I believe this country has a significant role to play in the rapid globalisation of enterprise we are living through.

That is why I was delighted to be invited by David Cameron to Chair this Task Force to look at the way in which business support is delivered in the UK, and to suggest improvements.

This is a report commissioned by and written for the Conservatives, but written by independent business people of all political persuasions and none. Personally, I have no Party affiliation. For that matter I am not even entitled to vote in the UK. This is important because the members of this Task Force unanimously agree that our critique and recommendations are based on a combination of factual evidence, personal experience and advice from the business community, and are equally applicable whoever is in Government. This is not an ideological report rooted in any political philosophic tradition.

We hope it is read and - more importantly - acted upon in that spirit.

Douglas Richard
Chairman

The Big Numbers

4.4 million	Number of SMEs in the UK
99.7%	Proportion of all enterprises which are SMEs
47.5%	Proportion of UK workforce employed in SMEs
48.7%	Proportion of UK turnover generated by SMEs
66%	Proportion of all Business Link services which are 'signposting' to other support
3,000	Number of small business support schemes Gordon Brown estimates are operated by the Government
4.4%	Proportion of small businesses FSB survey shows use Government business support schemes
15%	Proportion of small businesses the CBI report use Government business support
0.5%	Proportion of small businesses who both use Government funded business support and say they are satisfied with it.
£2.4billion	Total amount spent by Government on direct business support schemes in 2003/4
2,900	Number of schemes Gordon Brown says he wants to abolish by 2010
2,000	Approximate number of public bodies offering small business support services
34%	Proportion of local business support schemes evaluated in any way
33.5	<i>Minimum</i> pence per pound of central Government spending on SMEs lost to administration

Executive Summary

This report sets out how we believe State business support should be reformed and improved. Further, it makes policy recommendations on other issues important to small businesses including access to finance, innovation and procurement and enterprise education.

Where We Are

The current Government is presiding over a system which is overly complex, ineffective and undirected. Some **3,000 business support schemes** are being run by over 2,000 public bodies and their contractors at a **direct cost of at least £2.5 billion**.

Total public expenditure spent on supporting small business is now more correctly estimated to be £10- £12 billion, and much is wasted. For example, at least a **third of the money spent on regional schemes is lost in administrative costs**.

Equally, **little is known about the effectiveness of existing programmes**. In the absence of Government evidence, we commissioned independent analysis on possible correlations between money spent and outcomes achieved. These included measures of growth, productivity, start-up and number of businesses registered. **No correlation** could be found on *any* of the 50 measures analysed.

Small business shows little support for the State-run service. A recent survey of SMEs showed that **less than one half of one percent (0.5%) of small businesses both used the Government for advice and were satisfied with the advice provided**.

The Government's own simplification programme is a sham. It decided in advance that there should be 100 schemes by 2010. It has spent the last two years unsuccessfully trying to work out how to reach that target. Just 10 of the 3,000 schemes have been scrapped and now DBERR is instead seeking to rename schemes 'products' and group them under 'portfolios' in order to get close to the 100 target. The whole exercise has cost £3m to date and DBERR expects to spend another £2m by 2010.

And Where We Should Go

Government should know its own limits. A Conservative Government should therefore provide a framework to support small businesses, but not seek to intervene itself, except where reasonable access to advice or support is not practically possible.

The next Conservative Government should **appoint an effective ministerial champion for small business and enterprise whose remit runs across the whole of Government and who reports directly to the Prime Minister.**

Unlike at present, business support policy needs to **clearly reflect the difference between providing information and expert advice or support.**

The Government has overly regionalised and politicised business support by making it a flagship responsibility of the new RDAs. The regionalisation of Business Link has removed both the advantage of local governance and the efficiency and impartiality of central Government.

We propose the whole regional business support apparatus of RDAs and Business Links should be replaced by a single, web-based Business Information Service.

This new portal would be an open exchange where businesses could find all the information available to them in one place offered impartially and independent of any provider of advice, grants or finance. An example of this approach is the *Venture Navigator* pilot project run by the University of Essex.

Every Government department, agency or regulator would be obliged by law to ensure that all relevant information and documents for new and established business are available through this Business Information Service (BIS).

Central to the BIS would be a **system of online customer feedback and Buyer and Seller grading and rating**, as used by millions of consumers every day on *e-bay*. Business support providers would be able to offer their services and stake their claims, and active buyer and seller feedback would be a condition of use, replacing unaccountable and intermittent accreditation by Government. This would directly empower small businesses.

The advantages would include:

- Increased choice of providers available to companies
- Greater accountability / transparency
- Less 'transactional distortion' through the political tender criterion process
- Significant cost savings
- Higher calibre of business advice
- Exposure of all providers to the same rigour of the market - driving up standards.

The in-depth information system behind the BIS should be modeled on the successful British Library Business and IP Centre, which is a substantive service provided by an institution with proven competence. **Similar centres should be rolled out across the country, delivered by major libraries and leading universities:** they are accessible organisations that have the proven competence to deliver expert information services, providing depth behind the web-based service.

Government should only intervene when reasonable access to appropriate business advice or support is not practically possible and any intervention must then satisfy key objective criteria.

We therefore propose that **the Audit Commission be empowered to undertake an audit of all national and regional Government schemes against these principles.** Those that do not satisfy these criteria should cease and all future schemes should be adjudged on the same objective basis.

Access to Finance

We propose an extension of the Enterprise Investment Scheme (EIS) to include loans as well as pure equity finance. Under current regulations the benefits of the EIS do not extend to Non Executive Directors who join the Boards of EIS qualifying companies to share with them their experience. **We should help businesses that want to align their advisors with the risks and rewards experienced by management.**

It is further proposed that the Conservative Party should **consult with other providers of capital** such as hedge funds, VCTs and individuals to determine structures that could **expand the pool and flexibility of small business loan provision and encourage these suppliers of capital to enter the Small Firm Loan Guarantee (SFLG) process.**

Banks. Further, the Task Force is disappointed with the low level of equity/quasi equity/subordinated debt engagement from the major banks. **We propose that the Conservative Party should establish a business finance group to work with the banks in recommending how greater involvement could be achieved.**

Alternative Investment Market. The success of AIM as an effective small cap market has been a major contributor to the UK's economic success and is attracting IPOs from around the world. The withdrawal of tax support for VCTs has made it harder for UK businesses to access AIM and the LSE as a source of major growth capital, and hit liquidity. The Task Force proposes that **the Conservative Party explore ways of engaging the power of the London market to aid UK small businesses.**

Innovation and procurement

We have identified and are concerned by a number of failures at the heart of the current Government's approach, concerning R&D tax credits, spin-outs and EU framework grants.

Procurement. Procurement is a major, but under-used, weapon in the Government's armoury of business support measures. We are particularly impressed by the US Small Business Innovation Research (SBIR) Programme under which \$2 billion a year is provided through a carefully structured, competitive programme for R&D projects for SMEs. **The Task Force now proposes the UK adopt a US style-SBIR programme as set out in detail in Chapter 4.**

Moreover, **the Treasury should establish and monitor targets for the percentage of each Department and major agency's direct procurement expenditure** spent with micro, small and medium sized businesses. To facilitate this monitoring, **standard data should routinely be collected by the Office for National Statistics on all Government contracts** and other expenditures over a minimum value in a form similar to the US "Individual Contract Action Report (ICAR)".

The transparency with which contracts are advertised and placed should be greatly improved by establishing **a UK web portal that covers all contracts, not just those worth less than £100k, allied to the BIS portal proposed above.**

Participation by Government departments and agencies in procurement policies should be made mandatory rather than voluntary, wherever possible.

Enterprise Education: a business in each school

Creating a more entrepreneurial culture in the UK is vital, both to our economy and to enabling millions of people to fulfill their personal potential. We propose a number of reforms which emphasise the primacy of **hands-on experience**. Enterprise and entrepreneurship are best understood when practised, not taught.

In Norway, this approach has proven highly successful, where **the proportion of school students setting up in business is double that of the general population**. We believe the UK can learn from the key elements of this programme, not least enabling there to be a business in every school. Working in partnership with teachers and business we would urge the Conservative Party to commit itself to overhaul Enterprise Education and now **establish a Working Party** to work out the practical details bringing together business, specialist providers and teacher and head teachers' representatives.

Chapter One: Attempting to Gain an Overview of Small Business Support

Since the Thatcher reforms of the 1980s, the UK has been a good place to do business. It may not remain so. The World Bank ranks the UK sixth in its International Ease of Doing Business Index, a fall of one place from the previous year. The Index of Economic Freedom ranks the UK 127th in the world in terms of freedom from Government. It takes less than half the time to start a new business in France than it does to open the doors of a new enterprise in the UK. Nine other European countries rank higher than the UK.

Yet, our 4.4m small and medium-sized businesses (SMEs) are the engine room of our economy, accounting for half of UK employment, 99.7 per cent of all enterprises and half of UK turnover. Importantly, small businesses are the primary vehicles for innovation which leads to new jobs, new industries and new wealth for the nation. Understandably, therefore, SMEs have featured prominently in the economic strategies of every Government since 1979.

The level of direct Government support for small business has increased more than five-fold between the early 1980s and the present day. While the number of small businesses has also increased, this has been at a much slower rate than the growth of Government support. Indeed, Business Support has become a booming business sector in its own right.

“Business Support has become a booming business in its own right.”

What has not been made clear, however, is to what extent – if indeed at all - the increase in numbers of small businesses can be attributed to Government intervention and support, nor the effect of Government support on business success. No one has asked the awkward question: to what extent is Government support for small business actually delivering value for money by improving business performance ?

The Task Force’s starting point was to try to build up a coherent picture of existing small business support. Because of the complexity of the sector, this was no straightforward task.

There are around 2,000 organisations in the UK delivering publicly-funded support services to small business. A 2004 DTI-backed study, which was based on heavy extrapolation, found that in 2003-04 the Government set aside £10.3 billion per year for small business support and, within that, spent £2.6 billion on direct support schemes for small business. These figures are the most widely quoted and have been broadly accepted though they actually represent at best a broad estimate. The Task Force conducted extensive research and, for the first time, took into account spending by the devolved administrations of Northern Ireland, Scotland and Wales, local authorities’ spending, and updated the figures to reflect policy and budget changes. We conclude that total public expenditure spent on small business support is now more correctly estimated to be over £12 billion, although we must stress

“Total public expenditure spent on small business support is ... over £12 billion. This accounts for over 2 per cent of all Government expenditure.”

that difficulty in obtaining accurate figures means that this is an estimate, not an audited figure.¹ This accounts for over 2 per cent of all Government expenditure.

Central Government Support

The £12 billion falls under three broad categories: Central Government, including direct support services (£5.5 billion), Tax Incentives (£4 billion) and CAP (£2.6 billion). In Central Government 14 Departments have between them 267 support services aimed at small business. The report attempts to break down the distribution of funds by Department and the types of services that these Departments purport to provide: prior to the efforts of this Task Force, it seems that little attempt had been made to understand or quantify the totality of Government support for small business.

In fact the Task Force found it exceedingly difficult to get information from the key Departments and quangos. The most common response was that the figures were not available and the resources did not exist to calculate them. It would be fair to say that this report could not even have been produced without the Freedom of Information Act. It also casts some doubt on the degree to which the funds which are ascribed to small business support are in fact spent in that pursuit. It is difficult to imagine how money could have been spent effectively in pursuit of an objective, when the measurement of the supposed activity had never before taken place and where the resources were not available to calculate or monitor that expenditure.

Regional Support

In the nine English regions there are three types of organisation which focus primarily on funding, and typically at least six types of organisation which deal primarily with delivery. No two regions have the same support structures. The Task Force devoted most of its attention to the Regional Development Agencies and the Business Link Providers which are intended to be the “*prime access channel*” for publicly-funded business support. Once again, the most striking findings are not the programmes but the organisations themselves. The Task Force has calculated that, in a basic scenario, for every pound coming from central Government for SME support, *at the very least*, 33.5 pence is lost to administration, i.e. a third. Therefore, at best, only 66.5 pence feeds directly into SMEs through advice and training or loans and grants. In practice, there are often more layers of administration, further reducing the number of pence per pound reaching SMEs.

The RDAs receive total funding of £2.44 billion, which is unequally divided across them with the most received by the London Development Agency (£446m) and the least received by the East of England Development Agency (£159m). They have great freedom to allocate monies as they see fit in individual pursuit of their common statutory goals, which is reflected in the different percentage of monies allocated to supporting SMEs. OneNorthEast spent the lowest proportion of income on SME support (14 per cent), with Yorkshire Forward spending the highest proportion (35 per cent). Given the disproportionate importance that small business formation and growth has for their mandated statutory purpose, such low percentages are noteworthy in and of themselves.

¹ The Task Force set out to find the total value of Government support for small business. Where possible, we have included data supplied to us by Government Departments. However, in many cases Departments were unwilling or unable to supply information. Where this information was not available, we used historic headline figures from published Government reports. In some cases these figures appeared flawed, but Government data were the only data available to us. These figures were then adjusted to take account of RPI inflation between the time that the Government-published figure was reported and January 2007. We believe that this is a cautious assumption to make, as increases in nominal total Government spending have been in excess of RPI in the time period measured. The accuracy of our figures is to a large degree dependent on the accuracy of historic Government data. However, we are confident that our methodology rests on cautious assumptions, and that the £12bn figure is the best estimate that we can give, taking into account the information available to us.

The RDAs have six delivery organisations in common, although the most recent Government survey notes that a diverse range of “other” organisations can take up as much as 25% of the total budget. The primary conduit for small business support is expected to be the BLPs (Business Link Providers).

A DTI-backed case study of three English regions found that 66 per cent of Business Link services were ‘signposting’ (to other support) and that 60 per cent of spending on SMEs in the regions was under the control of BLPs. It is difficult to understand how so much funding can be spent on signposting. It is as though we have created a labyrinth of services that are so complex that we have had to create a further service whose primary unintentional remit is to decipher them.

The Need for Simplification

The Government acknowledges the complexity of its business support services and has set up a Business Support Simplification Programme (BSSP), which is implementing a framework for Government to reduce the number of direct support schemes from c3,000 to no more than 100 by 2010. On the evidence we have gathered - or rather failed to gather - we do not see how this target can be seen as anything other than arbitrary and knee-jerk, based on little or no evidence.

The Task Force shares the view of the Director General of the Institute of Directors (IoD) that simplifying and rationalising existing support *is not the central issue* which must be addressed in order for Government better to support SMEs. Issues such as tax, regulation, education and infrastructure are more likely to impact on small businesses. Equally, the Task Force recognises that there are too many schemes delivered in too complex a manner, that a great deal of money is spent on them, and that simplification of these schemes is where Government policy is currently focused. For these reasons it seems worth briefly considering the BSSP.

Margaret Hodge MP, the Minister then responsible for small business, made clear that she would not devote resources to compiling a list of existing - or what she called “*historic*” - schemes. This is curious given that many of the 3,000 programmes were created under the auspices of the current Government. It is disingenuous at best to consider them historic.

Further, simplification is a pointless goal if there is no clear understanding as to which programmes are effective in the first place. As is detailed in Chapter 2, there is little or no measurement of the impact or the outcomes of current programmes, so it is difficult to see how a rational simplification programme could be undertaken.

Finally, the number of programmes is a symptom of a deeper issue with business support intervention: that the process for creation of programmes is flawed and if nothing is done to remedy the manner by which they are created and measured then a periodic cull is only as effective as the PR it creates, without regard for the chaos and disruption it will engender.

The Restructuring of Business Link

Since taking responsibility for BLP funding in 2005, the RDAs have, for the most part, retained the structures that were in place. All RDAs, however, are reviewing the current model, which has been micromanaged at a 'sub-regional' level, often leading to unnecessary confusion, as well as duplication of services across individual regions. The majority of the RDAs seek to remove existing sub-regional structures which they believe are not acceptable.

As such, the primary national vehicle for delivering small business support has now devolved to the RDAs, who have each designed, or are in the process of designing, individual responses to their common purpose. Crucially, this has put business support firmly in the policy context – and political control – of regional economic development, which has given business support a very distinctive 'flavour', reflecting regional political priorities such as 'social enterprise' and 'regional capacity development' rather than pure business support. This state of permanent change also adds uncertainty to complexity: the two things all businesses wish to avoid.

Chapter Two: The Problems

Government Support for small business

Although the Task Force's remit was specifically to consider the programmes currently in place for direct support to business, we believe that this evaluation would be useful only if placed in the wider context of other challenges facing small business. The latter part of this chapter looks at some of those issues.

The Task Force agrees with the view of organisations such as the IoD, CBI and others, in their submissions to us, that action to tackle issues such as over-regulation, access to finance, and education will have a greater impact on small business than will any changes to the system of small business support schemes.

However, given that Government is spending significant sums on support for small business, the Task Force also took the view that it was important to attempt to assess the impact of this expenditure, and to make recommendations on how business support monies might be better channeled and targeted. It is our belief that there *is* a potential role for Government to support small business with programmes whose outcomes are monitored and shown to be effective. Our final recommendations reflect this belief.

The Task Force's starting point was to attempt not only to build a coherent picture of the current state of small business support in the UK, which we reported in Chapter 1, but also to review existing evidence about its effectiveness, with a view to informing our policy recommendations. An extensive literature review, coupled with the submissions made to the Task Force by key industry bodies, and specific research that we commissioned, led us to the following conclusions about the current system of Government support for small businesses.

It Lacks Rationale

Over the last 25 years, despite a consistent goal of job creation and the promotion of an enterprise culture, the plethora of piecemeal policies suggests that there has been no underlying rationale, objectives are poorly specified and often attempt to achieve multiple goals. In addition, a wide range of what has been labelled 'business support' probably more accurately falls under the title of social or regional policy, a point also acknowledged by the Tax Reform Commission.

This lack of rationale extends to the Government's current commitment to reduce the number of business support schemes from 3000 to no more than 100: it is not in a position to do so since little or no attempt has been made meaningfully to measure or monitor the effectiveness of the programmes in place.

It is Overly Complex

The complexity of the current system of small business support is a widespread criticism. Martin Wyn Griffith, Chief Executive of the SBS, himself admitted in recent evidence to the Public Accounts Committee that *"it is an incredibly complex system...an inaccessible business support system for customers that is inefficient and ineffective for Government"*. This view is echoed more strongly by the CBI, the NAO and the subsequent PAC report.

Awareness and Take-Up Are Low

Surveys by the FSB report low awareness levels and confusion. The CBI notes that only 15% of small businesses had any contact with the key business services detailed in Chapter 1. The IoD tellingly noted that a poll of their members suggested that the key issue was whether businesses were even aware of what was on offer. The FSB survey found that 4.4 per cent of small businesses use Government-funded support, compared with over half who consult accountants. The corresponding satisfaction rates show that 57 per cent of those using accountants for advice are satisfied compared with 9 per cent of those using Government support services. In short, less than one half of one percent (0.5%) of small businesses both used the Government for advice and were satisfied with the advice provided.

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Cambridge University research similarly shows that public sector sources of advice are far less important to small businesses than private sector advice such as from accountants, solicitors and banks, with private sector sources providing around 75% of all advice. The University’s figures show that almost all SMEs use business support and almost all find their most important source outside the public sector, with Business Links being rated as the single most important source by only 5% of respondents.

The frequent conclusion appears to be that the low take-up of Government-supplied business support services is due to low levels of awareness compounded by the confusion engendered by the sheer number of organisations providing such a large variety of programmes. But the conclusion does not clearly follow from the data.

When one looks across the sum of the studies, other more disturbing potential answers arise: that small business may simply not be interested in getting their support from Government in the first place or that small business may not have faith in those who are giving the advice. Which raises the question: should Government be giving small business advice for which there is potentially no demand or for which it is not the credible supplier?

Lack of Evaluation and Evidence of Impact

The Task Force found a general lack of evidence about the impact of different types of programmes and interventions. Our interim report highlighted the diversity of credible studies and sources which note that little or no attention has been paid to the measurement of the impact of significant expenditure of public money.

The Task Force asked almost all local authorities in Great Britain, through FOI requests, to provide their analysis of the effectiveness of the SME support schemes they operate. Of those that replied, only 34% were analysed in any way, and of these, two-thirds of analysis was based on customer satisfaction surveys. It is important to note that a customer satisfaction survey cannot substitute for an analytic measurement of effectiveness; thus in effect, nothing is known about the effectiveness of nearly all (c90 per cent) of the programmes currently in place.

Using the Freedom of Information Act, the Task Force also asked each of the nine RDAs to provide all documents evaluating the effectiveness of schemes operated by them. The quality of responses varied, from SWRDA which had evaluated the vast majority of its schemes to the Northwest RDA that said it could provide no analysis of any of the 21 schemes it operated in 2005-6.

Considering only information from the RDAs who did provide a full breakdown of schemes which had been individually assessed, however, it is possible to say that approximately 50% of those schemes which had not been assessed could easily have been assessed.

This does not even take into account whether the evaluations were of real merit. In many cases measures were made of how quickly telephones were answered or of customer satisfaction, rather than of effectiveness.

Taking a Different Tack: An Independent Analysis of Small Business Support

In an attempt to gain an evidence-based understanding of the impact of Government support for small business, the Task Force commissioned Boys Smith Consulting Ltd to examine what macro-economic effect, if any, publicly-funded regional support for SMEs is having. The main focus of this analysis was the £2.6 billion that the DTI estimates is spent on direct support schemes.

The most notable fact from the official breakdowns is that the expenditure is dramatically skewed between regions. Comparing total direct assistance (via RDAs, Business Links and LSCs) by region with the actual number of small businesses reveals that the direct support per small business in the North East (£1,068) is almost ten times what it is in the East of England (£109). Yorkshire & Humber, the North West and the Midlands all receive more assistance per business than London or the South. The five regions receiving the highest payments per business are all in the North. Those receiving the lowest are all in the South.

Given the stated goals of supporting small business across the country and, further, the fact that there is no correlation between the distribution of expenditure and any other measure, it is tempting to conclude that the expenditure is motivated primarily by social and political policies and not based on the needs of business. The Government is, in effect, operating a socially redistributive policy in the guise of small business assistance.

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The Evidence: No Impact

Genuine economic evidence of the impact (or otherwise) of assistance to small businesses is hard to find. The Government has been reluctant (or unable) to publish any and has restricted itself to anecdotal or survey-based data. These clearly *do* demonstrate that Government support does and can assist individual companies. But, given the scale of expenditure, does this add up to a real impact on regional economies?

In an attempt to answer these questions, Boys Smith Consulting Ltd conducted a series of 50 correlation analyses between Government expenditure per business (the *inputs*) and the evidence for regional business creation and entrepreneurialism (the *outputs*).

These show the following:

- There is no positive correlation between direct support per firm and **entrepreneurial activity**.
- There is no positive correlation between direct support per firm and **business registration**.

- There is no positive correlation between direct support per firm and **growth in self-employment** per region.
- There is no positive correlation between increased expenditure on support and **increased profitability**.
- There is no significant correlation between Government support and increases **in the number of firms** with fewer than 50 employees.
- There is no correlation at all between Government support and **survival rates** of small businesses.
- There is no correlation between increased expenditure on support and growth in **regional productivity**.

Thus, from the drivers of business success (business creation) through business growth and survival to regional productivity and economic size, the Government's expenditure on business support is not having any measurable impact whatsoever.

It is important to be clear about what this research does and does not show. The lack of any measurable macro-economic impact does not prove that Government intervention is not helpful in *any* individual instances. It almost certainly is. However, it does place the onus firmly on the Government either to prove more robustly that its expenditure is having impact or to consider scaling back surplus cost.

"The Government's expenditure on business support is not having any measurable impact whatsoever."

Chapter 3: Recommendations on Government support for small business

Key recommendations

Introduction

This Task Force starts from the premise that small businesses are the key ingredient of a successful modern economy and society. Economically, we know small businesses foster innovation, productivity and competition. We believe the social benefits of enterprise are just as important: small businesses help foster a sense of responsibility, community, and citizenship. This applies to small businesses that only support the proprietor, so-called “lifestyle” businesses, just as much as “scale” businesses - small businesses that have the intent and potential to grow and change their business sectors.

The obstacles that an entrepreneur faces when starting and growing a business are numerous. Some obstacles simply reflect the fact that starting a business is risky. Furthermore, an un-competitive idea will remain so regardless of the help on hand. Other obstacles relate to the lack of preparedness of the entrepreneur: they have not received the schooling or training in how a business operates or how to deal with the complexities of operating in the current environment. Obstacles also arise from marketplace distortions, such as the difficulties in getting access to finance. Others are bureaucratically driven: Government law and policy that has the consequence, intended or not, of making it more difficult to start and grow a business

What then should the role of Government be in supporting small business start-ups and growth?

Government and Enterprise

The Task Force believes that the aim of UK policy should be to make it easier to start and run a small business in the UK than anywhere else in the world.

We believe that the key role of Government is first, like doctors, to do no harm. It should make every effort not to create new obstacles. Additionally, and equally importantly, it should recognise its own limits. Governments cannot pick winners. The marketplace should be allowed to act to winnow out bad ideas and ineffective entrepreneurs. The Government must understand that in the realm of business it is not an expert, it is not a trusted advisor, and it cannot “create” entrepreneurs or businesses. With all of that in mind, we believe that its role should be:

- to celebrate entrepreneurial activity and help to stimulate an environment where entrepreneurship and business success is promoted in schools just as much as the traditional professions, especially in secondary schools and universities;
- to remove the key obstacles that small businesses face that are the direct or indirect result of law and government policy, such as over-burdensome regulation;
- to intervene as rarely and infrequently as reasonably possible;
- to focus its few direct interventions on clear marketplace distortions that affect all small business;
- when it does intervene, to have a clear rationale as to what proactive support it is appropriate for Government to facilitate or provide, and to make sure that the effect of support given is measurable – and is measured; and
- to support all small business equally, regardless of sector or geography.

There is therefore a special role for Government in addressing wider issues which present significant obstacles for small business: over-regulation, access to finance, Government procurement and helping the next generation of young entrepreneurs. We consider these issues in Chapter 4.

In this chapter, we consider the specific interventions and support that we consider it appropriate for Government itself to provide to small business.

We need to be explicit about the nature of support that is most useful for small business, and whether that support is best delivered by Government or other providers. In a wider context, the Conservative Party's Head of Policy, Oliver Letwin MP, recently spoke about the need for a shift from a "provision-based paradigm" to a "framework-based paradigm". We believe that this is a model which well describes the way in which Government should interact with small businesses: **to enable a framework for support, but not to seek to intervene itself, unless reasonable access to advice and support is not practically possible.** Further, any support that Government does offer must have a clear rationale, clear objectives and effective means of measurement.

Our interim report concluded that the current mechanisms for delivery of Government support to small businesses are complex, inefficient and largely ineffective.

We have not, in the time and with the resources available, been able to research every scheme and evaluate every agency and so determine what stays and what should be scrapped, or replaced. This top-down administrative approach has characterised the current Government's Business Support Simplification Programme. Rather, we have pursued a principles-based reform setting out the aims, functions and delivery of business support. These principles should provide the basis for a future Conservative Government determined to improve the competitiveness of the UK.

Principles of reform

Our key principles of reform relate to the issues of provision of business information, advice, specific support schemes and related business finance. We believe that:

- initial business information should be separated from advice, with the former provided as a single, web-based exchange replacing the existing regional information and advice services;
- this portal should be funded by Government and that it should operate as an open exchange able to sign-post enquirers to the advice and support they need;
- most business advice and support services are offered by private sector experts, business organisations or conventional sources of expertise such as reference libraries or universities, and that Government should not seek to replicate or compete with these;
- quality advice and support will best be achieved by enabling small businesses to rank the service they received using the web-based exchange, rather than Government trying to establish new quality standards;
- Government's principal role should be to provide the information exchange, not to seek to provide advice directly; and
- Government should only intervene where reasonable access to advice or support is not practically possible.

We expand on these points below. However, first and foremost, we believe that a pre-requisite for success is an **effective Ministerial champion for small business and enterprise whose remit runs across the whole of Government**, and who reports directly to the Prime Minister. Neither the Small Business Service nor previous small firms Ministers have been effective in co-ordinating policy and delivery across the whole of Government. We regard this as critical.

Regional Business Links: neither local, nor efficient.

The case for the Regional Development Agencies will not be made in these pages. The underlying rationale for the RDAs has been the oft-stated mantra that government is best delivered locally; that the closer government is to the governed the more effective it will be. Unfortunately, the imposition of a mezzanine layer of government between local and central government is a sure recipe for additional bureaucracy. The fact that this mezzanine authority is not elected, and thus is not directly accountable to the regions it supports, further undermines the supposed advantage of closer, more local government. And the fact that these authorities govern heterogeneous, disparate regions makes them unable to act in anything approaching a local manner. In short, they provide neither the advantage of local governance nor the efficiency and impartiality of central Government. Thus, the devolution of power from Whitehall has, paradoxically, made services more remote from the people.

This paradox is highlighted in the case of advice for small business. The current Government devolved the nationally-organised Business Link system to the RDAs, which had the effect of amalgamating locally-based Business Links into regional activities. There seems to have been no particular rationale for this except the blind support for regionalisation.

Separating information from quality advice

In addition, the RDAs have adopted a model of business support known as IDB-Information, Diagnosis and Brokerage. Whilst this may be an appropriate approach for providing specialist support to scale businesses, it is unnecessarily bureaucratic and complex for most start-up and small businesses. Further, it has been open to widely varying interpretation.

The actual challenge of Business Links is to provide information for businesses facing everyday pedestrian challenges and questions. There is a place for this type of help, as we suggest below. But the existing variety of approaches, policies, systems and business models across and within the nine regions, when the issues facing small business and the questions that need to be answered are virtually identical, is absurd. The issues on which small business owners regularly seek advice are generally similar, regardless of geographical location. We believe that this points towards a single **system of information, rather than a variety of different, regional systems.**

We also take the view that this information should be made available via the shortest route possible; should leverage existing infrastructure and expertise and that as a general rule Government should not provide business advice.

A single business information service

Taking these recommendations together, the Task Force advocates the reform of the existing regional Business Links into a **single information service**, as the first port of call for small business owners and aspiring entrepreneurs.

Unlike the existing regional Business Links this service would only provide information, not subsequent advice. Indeed, it should be impartial and independent of any subsequent provider of business advice, grants or finance schemes.

CASE STUDY: *VentureNavigator*

The *VentureNavigator* is a web service created by The Business Edge Consortium, a consortium led by the University of Essex, comprising Cambridge, Glasgow, Liverpool, Open and Warwick Universities and key commercial providers. The project is funded from the Higher Education Innovation Fund (HEIF) until 31 July 2008. *VentureNavigator* is currently free for anyone to use.

VentureNavigator is an online resource to help entrepreneurs, start-ups and growing businesses. It offers the following facilities:

- **Assessment** – tests on a variety of topics to improve business ideas and performance.
- **Resources** – a searchable library of thousands of impartial business resources ranging from case studies to videos.
- **Community**– a simple forum for entrepreneurs to ask questions, offer answers, and share ideas.
- **Signpost** – direction to further resources, guidance and help available from other agencies, tailored to the specific needs of the business.
- **Data** – collation of real time data for policymakers on business activity and needs by area and sector.

VentureNavigator is designed to be, and is, as applicable to a start up a plumbing business as a spin-out biotechnology business. What makes it so relevant to this report is that it improves the efficiency, effectiveness and outcomes of other interventions by Government by ensuring that those interventions can be targeted on the basis of need, objective diagnosis and probable returns. To quote from the Business Edge Consortium,

“VentureNavigator can, if deployed and sustained nationally, significantly enhance the rate of new business formation, survivability and longevity within the United Kingdom, contributing to wealth creation and general well being. Essex University envisages development of the platform so that it becomes “industry standard architecture” for all early stage business support interventions by government and other agencies.

We envisage its use by all University technology transfer offices and as part of all HEIs engagement with entrepreneurship, business and the community. HEIs will be a key delivery channel alongside Business Link where VentureNavigator can act as a complementary channel to increase deal flow, reduce cost and improve the effectiveness of Business Link mediated interventions. Properly deployed VentureNavigator can over time change the face of business in the United Kingdom”

Creating an information exchange that lets experts from the private sector provide support either commercially or in return for exposure to their expertise, would have the dual effect of having the experts that entrepreneurs already trust provide the material, and reducing the burden on Government to support small business in an area where it is neither trusted nor expert. We remind the reader that less than one half of one percent (0.5%) of small businesses both used the Government for advice and were satisfied with the advice provided. A national business information service that provided information and a marketplace for private provider advice would directly address the weaknesses of the current system.

Further, **every Government department, agency or regulator should be obliged, by law, to ensure that all relevant information and documents for new and established business should be available through this business information service.** Thus, for example, the rules, procedures and application forms for R&D tax credits would have to be online from the Treasury, whilst DBERR would be responsible for providing all the relevant employment rules, forms and initial guidance. **Government departments would be far more mindful of the regulations they imposed, if they were required to pay for the customer service enquiries they generated.**

Because the service would be web-based with telephone support, it would ensure the best possible access for everyone and it would enable direct access to the latest online business tools, such as *VentureNavigator*, a free online resource for entrepreneurs, start-ups and growing businesses.

Tailored, quality advice

Beyond the initial information, businesses need advice which is founded on clear principles. In many ways the quality of this advice is as important as the provision of any subsequent scheme or grant.

Business advice needs to be tailored to each business person's own needs and that of their local market. It needs to be delivered by credible, qualified advisors, preferably face to face in an ongoing relationship. To quote George Derbyshire, CEO of the National Federation of Enterprise Agencies, "*This ought to be the Gold Standard to which all policy makers should aspire*".

There is already a variety of well-established support services run by organisations such as Local Enterprise Agencies and Chambers of Commerce, which bring together qualified advisers with a business background, an established local reputation, and support from the local business community and local authorities. National business organisations also offer valued advice and support.

CASE STUDY: The British Library Business and IP Centre

The Centre supports small businesses and entrepreneurs from inspiration to successfully launching and developing a business: approximately 50% of its users are start-ups or aspiring entrepreneurs.

The Centre is unique in offering free access to business and intellectual property information in one place in London, with impartial experts to guide people to the information that they need; the Centre's skills are complemented by around 50 partners who help people make the most of the information in the Centre.

Its accomplishments are impressive:

- Since it opened officially in March 2006, the centre has supported over 30,000 small businesses and aspiring entrepreneurs by providing them with up-to-date business and IP information to help them e.g. protect their novel idea, assess a market, pinpoint customers, develop a mailing list and write a business plan.
- In a recent independent e-survey (based on 230 respondents), over two-fifths said that the Centre had helped them to launch their business, a quarter that it had helped them to expand their business and 35% that it had helped them safeguard their business.
- Nearly two-thirds of respondents had developed or were in the process of developing a new product or service, of which a third had taken measures to protect it via a patent, trademark or registered design and another third were planning to; overall, over half the respondents said that the Centre had increased their awareness of the importance of intellectual property.
- The Centre has delivered, with its partners, over 250 workshops, 1:1 advice and mentoring sessions (either free or highly subsidised) since it opened. There is a very high degree of loyalty with people attending 2.5 events on average and two-thirds saying that they were of immediate practical use.

The strength of the British Library's approach is that it has focused on providing access to key information supported by expertise. Entrepreneurs can access a wealth of other relevant information for their business from the 150 million items at the Library, such as arts and science information and content, newspapers, and images and sound.

They can also gain inspiration from exhibitions and events. One entrepreneur has described it as a space that helps her think creatively. It is a substantive service provided by an institution that has proven competence. This task force advocates for the British Library's Centre to serve as a model for other similar centres to be rolled out across the country.

The **British Library Business & IP Centre** is an example of an established institution which has developed a centre of recognised business expertise. It has created a world-class facility, with public funding, which is accessible, expert and tailored to the needs of each business. We believe it serves as an excellent example of quality advice and support.

Most existing and aspiring small businesses use these private and third sector services.

However, Government Business Links (BL) have sought to provide competing services and the regionalisation of BL has also fostered a subsidiary system of Government-awarded local monopolies on business advice. The authors of this report make no judgement on the private companies that have won the tenders on a region by region basis.

To the contrary, we believe that they are potentially the best providers as they are in the business of providing such support.

We feel, though, that the best mechanism to determine who provides the advice that the small business owners desire is the customers themselves. Placing these providers in competition with all other advisors and making the small business owner pay for the advice will immediately create a marketplace that will survive or fail based solely on its value.

Given this, we believe that a Conservative Government should focus its efforts on enabling the provision of information, not advice. There is no need for Government advisors to try and compete with private and third sector agencies. Government should instead work through business experts, existing institutions and current programmes that could be reinforced rather than being reinvented.

As for ensuring quality advice and service, we believe this will best be achieved by enabling small businesses to rank the service they received using the web-based exchange, rather than Government trying to establish new quality standards. The best example of a web ranking system is the vendor ranking system on *e-bay* which permits buyers and sellers both to rank each other and to provide commentary in their own defence. This customer-led approach is the right way to raise standards.

The advantage of creating a marketplace for advice provision is not only that it is being provided by a trusted and competent party, but also that it is inherently led by business need and not political policy. Priorities must not be chosen within Whitehall. Businesses must be free to seek out what they need.

An important benefit of this market-led approach is that it provides a much clearer and more measurable basis for justifying Government intervention.

Future Government intervention

Clearly, we need a system of transparent criteria for determining the basis on which future advice and new business support initiatives are assessed.

The Task Force proposes a set of rules against which the effectiveness of interventions should be measured.

First, the Government should only consider intervening when there is clear evidence that reasonable access to appropriate advice or support is not practically possible. The most obvious example might be a remote location, such as the Isles of Scilly.

If the above pre-condition is satisfied any Government intervention must satisfy the following three standards:

1. *Fitness for purpose*: does the scheme/intervention have a clear business goal and to what extent does it meet that goal?

The underlying philosophy of Government intervention should be that small business support programmes should not be burdened with secondary political goals, regardless of their merit. It is difficult enough for programmes to succeed without the additional burden of regeneration or social policy goals, which should be driven by programmes framed for that purpose.

The principle should be to develop the programmes that have the most defined endpoints, rather than the broadest social and political benefit. *'The smallest intervention over the shortest period needed to meet the goal'* should be the approach.

2. Measurability: does the scheme/intervention add substantive value or positively affect outcomes and is this measurable?

Current policy does not promote evidence-based intervention. Too many programmes are based on self-audit surveys, anecdotal evidence or subjective and so questionable data. Yet, of all forms of Government involvement, business support is one of the most amenable to measurement. There is simply no excuse for the conditions that this Task Force found when it tried to discover the effectiveness of programmes nationally. It is perfectly clear that we do not have a culture of effectiveness.

We must weave into the conditions of the programmes mechanisms to determine how well they are working and adapt and modify them to ensure that they do work. And, in those circumstances where they are clearly ineffective, we must stop them. We propose that a requirement must be built into programmes that they stop automatically if measurable milestones aren't met.

3. Existing providers: Does an appropriate institution, organisation or programme already exist that could be leveraged, as opposed to creating a new one?

This Task Force encountered many instances where the current Government's magpie-like affection for the new and shiny meant that a new programme was created to solve an issue where multiple overlapping organisations already existed to solve the same problem. Instead of asking the responsible question: "Can we make what we have already invested the taxpayer's money in work?", they fell prey to the desire of being able to announce yet one more new initiative.

Going forward, a key condition must be whether or not there exist current organisations that reach the target audience, that are effective, that have the resources and track record and that could be tasked with the additional responsibility instead of creating yet another purpose built, stand-alone, disjointed, new programme to sit on top of the pile that already exists.

The Task Force recommends these criteria as fundamental cornerstones of a new approach to business support.

They would underpin an approach which would be in direct contrast to that adopted by the current Government, which has led to a proliferation of over 3,000 programmes of Byzantine complexity and cost in less than 10 years, followed by a knee-jerk 'slash and burn' reform based on arbitrary political targets.

Evaluating current schemes

How to evaluate existing advice and schemes? The Government's consultation on its Business Support Simplification Programme (BSSP), whilst agreeing with our analysis that the system has proliferated wildly and needs rationalising, has arbitrarily chosen in advance a target of reducing the number of programmes from 3,000 to 100.

And, as this Task Force detailed in its interim findings, despite the Government's assertions to the contrary, there has been little or no measurement of the effectiveness of these programmes, even where it is clear that the programmes' outcomes could be effectively measured.

This approach of arbitrary political target-setting must be replaced by a more rational system, based on customer satisfaction and performance monitoring against clear criteria for intervention.

We believe that the rules set out above should form the core of an independent audit of all national and regional Government schemes, current and future.

We therefore recommend that the Audit Commission be required to undertake a complete audit of all such schemes, based primarily on the pre-condition that there is clear evidence that reasonable access to appropriate advice or support is not practically possible.

Where a scheme satisfies that pre-condition it should then be assessed on the basis of fitness for purpose, measurability and existing provision, as set out above. Where a scheme fails that pre-condition it should cease.

Such an audit should include not just Business Link and Regional Development Agency business support activities, but also those other governmental schemes aimed at directly supporting business, including the Local Enterprise Growth Initiative.

Further, we take the view that the allocation of any Government funding for business support should be on a national, not a regional, basis. We believe that this will help to:

- avoid duplication, waste and inefficiency;
- prevent regional bias and a situation where deserving businesses in one region are left unsupported while less deserving businesses in another region are given assistance;
- facilitate the measurement of interventions' effectiveness.

As we have made clear, however, we are firmly of the view that the presumption should be in favour of business-led support for small business, with Government intervention minimal and measurable. In terms of financial support for business, we want to see a move away from what has been described as “grantpreneurship”, whereby businesses are incentivised by Government grants, rather than customer demand.

However, we do believe that Government has other key roles to play in terms of facilitating financial support for small businesses, and we address these in Chapter Four.

A 'customer' approach to business support - how would it work in practice?

We believe the approach we advocate here will deliver two major benefits:

- Significant improvements in the effectiveness and cost efficiency of Government business support, and
- Significant improvements for both the customers and providers of business support in the convenience, cost-efficiency and effectiveness of the actual provision of business advice to target companies.

Although this Report has focused on setting out our critique of the current system of business support as a method of Government intervention, and the background analysis behind our recommendations for an alternative approach, our thinking has been driven in large part by the need to improve the 'customer experience' for both providers and service users.

The need for an urgent review of business support has been painfully obvious to all of us on the Task Force, both from the evidence we heard during our consultations, and the direct experience of a number of Task Force members of Government business support schemes.

Appendix B looks in detail at the difficulties of the current system for both providers and customers of business support. It then sets out practical case studies of how the new system would work for three very different enterprises: someone starting up their own hairdressing salon; an entrepreneur with an idea for a new type of toothbrush; and an owner manager of an established small business looking for advice and support on strategic business development and succession planning.

Conclusion

This Task Force believes that all small businesses, *lifestyle* and *scalable*, are key to a successful economy. The obstacles that entrepreneurs face arise both from the inherently risky nature of the enterprise as well as from inadequate training, market place distortions and from Government policy.

The goal we set for UK policy is that it should be easier to start and run a small business in the UK than anywhere else in the world. But we remind ourselves and the Government that its first goal, in trying to support small business, is not to create additional obstacles. The Government cannot solve all problems nor pick winners. Rather the Government should enable a framework for support, but not seek to intervene itself, unless there is clear evidence that reasonable access to appropriate advice is not practically possible.

Chapter 4: Wider Policy Recommendations

As we noted in the last chapter, we believe that there is a special and critical role for Government in addressing a range of wider issues that present significant obstacles for small business: over-regulation, access to finance, taxation; and in providing particular support in areas such as procurement and education.

Both taxation and the issue of over-regulation are under close scrutiny by other working groups which will report in due course. Therefore, whilst they are both matters of great import to small businesses, we felt we should not duplicate work in hand.

However, the remaining issues – access to finance, procurement and education – merit comment and our recommendations.

Access to Finance

We recorded in Chapter 3 of this report our concerns that some of the current Government effort to help with small business financing is either misdirected, unmeasured or both. We believe that this is a crucial area, and we make a number of specific recommendations:

- **Extension of EIS**

The Enterprise Investment Scheme has in many ways been a success, providing tax incentives to individual investors in a way that has encouraged them to invest in private businesses and at the same time keep their investments ‘on shore’ and in their own name. More importantly for small businesses, the EIS has provided an important source of early-stage capital. As a result there has been a significant increase in direct investment by high net worth individuals into small businesses, and this has not only provided them with access to much-needed capital but has also provided, for many businesses, direct links to successful business angels and entrepreneurs. This has helped with the recycling of entrepreneurial skills in the small business community.

We propose an **extension of this scheme to include loans as well as pure equity finance**. For many businesses, especially smaller service and family-owned enterprises, equity finance alone may not be appropriate and in many cases will not provide an obvious exit route for investors. In addition, there are many business communities (particularly amongst ethnic minorities) where loan finance is the norm. The extension of EIS tax incentives to cover convertible loans would greatly extend both the types of small business that would benefit from EIS and the pool of high net worth individuals able to support the small business community. In addition it would allow existing EIS investors to provide bridging finance into an intended future investment round. This type of investment is conventional within the venture community and this extension of the EIS scheme would benefit many existing small businesses that have been supported by EIS investors.

Many of the same conditions that apply to the current EIS would also apply to a convertible loan i.e. the size and type of business and the investment coming from an individual rather than a corporate vehicle. The loan would have to be within a defined size band, with an upper and lower interest rate band and would have to have defined terms for conversion into equity, should it not be repaid within the agreed time span.

The UK has a wealth of expertise in successful business enterprises which is potentially available to mentor and guide new start-up and growing businesses.

Under current regulations the benefits of the EIS do not extend to Non Executive Directors (NEDs) who join the Boards of EIS qualifying companies to share with them their experience. Frequently these companies are cashflow light in early years and prefer to reward NEDs through equity rather than fees. We **believe that there is much to be gained from encouraging successful entrepreneurs' involvement as NEDs in new and growing companies and that the best way to incentivise success is through equity rewards.** For those companies therefore, who prefer to remunerate NEDs through equity rather than fees, we propose that the extension of the benefits of the EIS to such situations.

- **Extension of SFLGS providers**

The concentrated nature of UK business banking provides limited competition for small business loans such as those within the Small Firms Loan Guarantee Scheme (SFLGS). It is proposed that **the Conservative Party should consult with other providers of capital such as hedge funds, VCTs and individuals to determine structures that could expand the pool and flexibility of small business loan provision and encourage these suppliers of capital to enter the SFLGS process.**

Further, the Task Force is disappointed with the low level of equity/quasi equity/subordinated debt engagement from the major banks. Their involvement in private equity is recognised but this is very much at the top end of the scale, and not in any way aimed at fledgling businesses with potential. We propose that **the Conservative Party should initiate a task force to work with the banks in recommending how a greater involvement could be achieved.**

- **Small businesses and the City**

The City of London has been one of this country's great success stories. It is rapidly becoming the favoured public market for many businesses throughout the world. The success of AIM as an effective small cap market has been a major contributor to this growth and success and is attracting IPOs from around the world. The overregulation (Sarbanes Oxley) of US markets such as NASDAQ has further encouraged the growth of London as an international market. AIM has been particularly important for small businesses and the tax benefits for VCTs that were recently withdrawn have been a significant factor towards the support of UK small businesses leading up to and through AIM IPO. The withdrawal of this support has made it harder for UK businesses to access AIM and the LSE as a source of major growth capital. This has also made the chances of liquidity for investors less likely where investors have invested in UK private companies, making them less favourable investments. The Task Force proposes that the Conservative Party explore ways of **engaging the power of the London market to aid UK small businesses. Such encouragement should be in the form of incentives to support UK businesses and should in no way act to erect barriers to foreign companies wishing to list on the London market.**

Innovation and procurement

We have noted the crucial role played by small businesses in innovation and the development of new sectors of the economy. However, we have also taken the view that none of the 4 principal policy measures in place directly to fund R&D in small firms is currently relevant to start-ups and early-stage companies. Instead, we are much more attracted by the procurement model for funding innovation, as practised very successfully in the US.

We are indebted to David Connell for his detailed and expert work in this area, and his fuller analysis of the issues of innovation and procurement, and Government's role in relation to them, is attached as an appendix to this report. Here, we summarise our key recommendations in these areas:

- The Taskforce fully endorses proposals for the introduction of a **US style-SBIR programme**. The detailed elements of this important proposal are summarised in Appendix C.
- The Treasury should **establish and monitor targets** for the percentage of each Department and major agency's direct procurement expenditure spent with micro, small and medium sized businesses.
- To facilitate this monitoring, **standard data should routinely be collected** by the Office for National Statistics on all Government contracts and other expenditures over a minimum value in a form similar to the US "Individual Contract Action Report (ICAR)". This would permit the analysis of SME contracting performance against targets and remove the need for unreliable ad hoc surveys. It would also enable a range of other analyses and reports in support of procurement policy.
- The transparency with which contracts are advertised and placed should be greatly improved by establishing a **UK web portal that covers all contracts**, not just those worth less than £100k. Full information should be available directly through this web site, rather than requiring further searches of individual department web sites as is often necessary with supply2gov.uk. Full details should also be published of the organisations to which contracts have been awarded and their value.
- **Participation by Government departments and agencies in procurement policies should be made mandatory** rather than voluntary wherever possible (e.g. Small Business Friendly Concordat: participation in SBRI web portal)

Enterprise Education

Creating a more entrepreneurial culture in the UK is recognised as being vital, both to our economy and to enabling millions of people to fulfill their own potential.

There are many different, local initiatives in this field. It is not the intention of the Task Force to try and map every activity and propose wholesale change. Indeed, good local schemes should be allowed to flourish. However, too many school students are entering the world of work without any understanding of what working for themselves could mean.

The current Government has made positive noises about the need for business and enterprise education. Yet its actions to date have been piecemeal and not thought through. For example, the Government has provided schools with funds for enterprise training at Key Stage 4, but then failed to ring-fence that money. The result is that much of the money has been switched to other projects, by hard-pressed head teachers.

Equally, the requirement that pupils spend five days in business, financial and enterprise education has not been matched by clear educational objectives, guidance and training. This has made it harder for schools to provide what their pupils really need, with a huge variance in opportunities between schools.

Thirdly, to date enterprise has been regarded by many as another subject to be taught by some teachers. But to effect real change enterprise education needs to be embedded across the curriculum. All teachers need to understand it, value it and promote it.

So we believe the existing approach needs radical reform.

First, the emphasis must be on providing **hands-on experience**. Enterprise and entrepreneurship are best understood when practised, not taught.

In Norway, this approach has proven highly successful, where the proportion of school students setting up in business is double that of the general population. We believe the UK can learn from the key elements of the Norwegian programme.

These include :

- Enterprise is treated as **inter-disciplinary and cross-curricula**, in both teacher training, and every school. It is not a separate subject.
- **School-based businesses** run by teachers and students have proven highly popular and successful.
- Practical experience leads the learning, both in and outside the school. **Partnerships with local businesses** are vital to provide outside know-how and to help establish enterprises within the school.
- **Schools are free** to decide how to incorporate enterprise into their programme, aided by leading outside specialists.
- Local and regional state agencies spend ten percent of their economic development budgets on the training and support of enterprise education. This was matched in value by the support of business through local and national partnerships.

We support this practical approach and would urge that the Conservative Party commit itself to overhaul enterprise education and now **establish a Working Party** to work out the practical details, bringing together business, specialist providers and teacher and head teachers' representatives.

Vital to this task will be the need to **simplify the process** for overstretched schools and provide a single national accreditation process for providers, to make it easier for schools to select the right scheme and provider for their needs.

We recognise that there are many initiatives in this area and that some schools run excellent entrepreneurial competitions and schemes. We believe the approach outlined above would provide a meaningful framework for these activities, while avoiding change for change's sake.

However, in those areas lacking an entrepreneurial culture we believe that this hands-on, local approach could make a real difference. The best way to develop the next generation of entrepreneurs will be by giving them hands-on experience.

Conclusion

Governments do not create wealth, start businesses, or invent products. Individuals and businesses do. But Government can help. We believe that much can be done to provide better support for entrepreneurialism and small business in the United Kingdom.

This report has detailed the size of the Government's role, the shortcomings and failures of the current system, principles for reform, examples of reform, highlights of programmes that are successful and wider policy areas where Government can play a role.

But if the reader takes only one thing away from this report, they should take away the authors' fundamental optimism about the state of entrepreneurialism and enterprise in Great Britain today. We live in a vibrant, open and pluralistic society that can and should be one of the most admired, innovative and welcoming countries in the world.

As we enter the 21st century the United Kingdom has a unique opportunity to place itself at the centre of enterprise and innovation and to become a role model for the emerging and mature economies of the world.

Appendix A

The Task Force

Douglas Richard (Chairman)

Having appeared in the second series of BBC's Dragons' Den, Doug is the founder and Chairman of Library House (www.libraryhouse.net), founder and Vice-Chairman of the Cambridge Angels, and co-founder and Chairman of Hotxt (www.hotxt.net). Doug is a successful entrepreneur with 20 years' experience in the development and leadership of technology and software ventures, both in the US and in the UK. Between 1996 and 2000 he was President and CEO of Micrografx, a US publicly quoted software company which he sold to Corel Corp.

Prior to that he also founded and subsequently sold two other companies: Visual Software and ITAL Computers. Doug holds a BA in Psychology from University of California at Berkeley and a Juris Doctor at the School of Law, University of California at Los Angeles. In 2006 Doug was an Honorary Recipient of The Queen's Award for Enterprise Promotion.

David Connell

David Connell was co-founder of TTP Ventures, an early stage science and technology focused venture capital fund based in Cambridge with funding from Siemens, Boeing and financial investors. As CEO and Executive Chairman he was responsible for investments including Cognima, Element 14 (a spin out from Acorn), Alphamosaic (a spin out from Cambridge Consultants), Oxford Diffraction (a spin out from Oxford Instruments), Argenta (a spin out from Aventis), ZBD-Displays (a spin out from QinetiQ), and university spin outs such as Cambridge Semiconductor and Azuro. Today he combines non executive roles with the fund and a number of small technology companies with a research position at the Centre for Business Research at Cambridge University where he specialises in procurement and innovation policy.

He is a strong advocate of the role of Government procurement in sponsoring innovation in small firms and has written extensively on US policies. David's early career was with British Steel and NEDO and he went on to lead the Deloitte Haskins and Sells High Technology Group. In 1989 he joined a newly formed firm, The Technology Partnership, later TTP Group plc, to head up its Strategy Group, and later start TTP Ventures. TTP Group has become one of the UK's most successful contract R&D companies which, when combined with a number of product spin out companies incubated within the Group, has created well over 1,000 jobs. David has degrees in Physics, Operational Research and Economics.

Peter Ibbetson

Peter Ibbetson has been associated with the SME sector for many years. Between 1996 and 2003 he was Head of Business Banking at NatWest which has responsibility for over a quarter of the country's SME clients. He was also the Chairman of the British Bankers Association Small Firms Panel, and for five years he was an independent member of the Small Business Investment Task Force. He is now an Executive Director of Lenlyn Holdings plc, Chairman of Bioprogress plc, a Non Executive Director of Utiylix Limited, and Regional Chairman (East Anglia) of Coutts and Co.

He has a strong association with the Princes Trust, chairing the Cambridgeshire Board and sitting on the East of England Council, is a Trustee and Director of The Local Investment Fund (the largest CDFI in the country), and is an independent council member of Central London Learning and Skills Council.

Jonathan Kestenbaum

Jonathan Kestenbaum is Chief Executive of Nesta, The National Endowment for Science, Technology and the Arts. With assets under management of £350 million, Nesta is the largest single endowment in the UK exclusively dedicated to fostering innovation. He previously worked as Chief-of-Staff to Sir Ronald Cohen, the Chairman of Apax Partners. Together with Sir Ronald, Jonathan built The Portland Trust, which most recently developed a \$500 million fund for small and medium sized businesses in the Middle East. Jonathan graduated from the LSE and Cambridge. He completed an MBA with distinction from the Cass Business School. Before becoming active in business, Jonathan started his career in education, building an international training programme for promising young educators. He also completed an MA in Education with distinction.

He subsequently helped establish and build a large family commodity trading business, which was a ring dealing member of the London Metal Exchange. The company was successfully sold in a management buy-out. Jonathan is a trustee of a number of foundations. He is a board member of the Design Council and Enterprise Insight. Jonathan is also a tutor at the Cass Business School and on the planning group of the World Economic Forum. He is a graduate of the Cabinet Office Top Management Programme and was until this year Non- Executive Chairman of Quest, a large financial services business.

Dr Andy Richards

Dr Andy Richards is an entrepreneur and business angel who specialises in building healthcare and life-science companies. A Cambridge graduate with a PhD in chemistry, Andy spent his early career with ICI (now AstraZeneca) and with PA Technology. He has broad experience of the medical sector in research, drug development and in executing commercial deals. In 1992, Andy co-founded Chiroscience and was Business Development Director through to the merger in 1999 with Celltech. Since 1999 Andy has been founding and growing companies including Arakis Ltd and Cambridge Biotechnology Ltd, both of which were recently sold, as well as others that are still in their growth phases.

Andy Richards is currently a director of Vectura Group plc, Biowisdom Ltd, Daniolabs Ltd Theradeas Ltd, Cancer Research Technology Ltd (commercial arm of CR-UK), Babraham Bioscience Technology Ltd, Babraham Bioconcepts Ltd and is Chairman of Geneservice Ltd Altacor Ltd and Pharmakodex Ltd. He is a founder member of the Cambridge Angels a member of the Council of UEA, a director of the Bioindustry Association (BIA) and an advisor to Toscana Life Sciences. In addition, he advises several specialist venture capital funds.

The Task Force is grateful to all those who provided evidence to its enquiry, whether orally or in writing.

Appendix B

A 'customer' approach to business support - how would it work in practice?

We believe the approach we advocate here will deliver two major benefits:

- Significant improvements in the effectiveness and cost efficiency of Government business support, and
- Significant improvements for both the customers and providers of business support in the convenience, cost-efficiency and effectiveness of the actual provision of business advice to target companies.

Although this Report has focused on setting out our critique of the current system of business support as a method of Government intervention, and the background analysis behind our recommendations for an alternative approach, our thinking has been driven in large part by the need to improve the 'customer experience' for both providers and service users.

The need for an urgent review of business support has been painfully obvious to all of us on the Review, both from the evidence we heard during our consultations, and the direct experience of a number of us of Government business support schemes.

Providers

Whilst there are examples of excellent schemes and providers offering an excellent service, it is also true that the recent expansion of Government business support schemes has led to something of a 'feeding frenzy' amongst the big public sector consultancies, and an explosion in new providers of business support, many of them focusing exclusively or largely on public sector work, in many cases providing services which have not been properly tested or verified in the market. There is a widespread sense amongst commercial business support providers, who make their living selling and refining their services to companies direct in the competitive free market, that a 'parallel' public sector 'market' has been sponsored by the Government, in which quite substantial multi-million pound contracts are awarded for business support services - often over fixed terms of a number of years - in public sector bidding processes which, whilst complying with the letter of the tender regulations, are far from transparent.

Often the bids appear to be granted to providers whose credentials in the free market are questionable at best, and sometimes non-existent. Sometimes the problem appears to be that the people allocating the tenders are not properly qualified. Often there are local (or regional) political imperatives which manifest in criteria that effectively 'close' the tender process, leading to suspicions about the process itself. In some cases bidders have been told that, despite lengthy tendering processes, a particular tender 'will be going to a local provider'. Companies who have been awarded work on one project which is then renewed describe being told that the job will have to be tendered 'but you will win it', which can only mean hundreds of hours of time wasted by other bidders in a sham bid designed only to comply with tender regulations. Whilst stimulating local economic activity is a quite legitimate objective of RDAs, it is questionable whether skewing the qualifying criteria for business support providers is a sensible or acceptable way of achieving it.

The effect of the creation of this 'parallel' political market for business support is that the best providers of market support services (accountants, corporate finance houses, brokerages, mentors, training companies etc) who are good enough to sell their services direct to companies in the free market do so, and tend to avoid the political market with its bureaucratic systems and political imperatives which lead to delay and cost.

This often creates a 'two tier' market in which the best advisers concentrate on selling direct to private sector clients, and the rest - many who would struggle in the commercial market - concentrate on winning tenders in the public sector. So the current system appears to be having an unexpected side effect of concentrating the poorest quality business support services on some of the most important public policy priorities - fostering enterprise as part of the drive against deprivation in the inner cities, BME communities and key sectors, undermining the central objective of the whole project.

This situation is not healthy for Government, local businesses, or the wider economy.

Ultimately, a system based on Government intermediaries selecting which business support providers should provide services on behalf of companies cannot be as efficient or demanding as one in which the companies choose for themselves.

The approach we are advocating would increase the choice, competitiveness and accountability of business support providers, to the benefit of all.

Advantages would include:

- Increased choice of providers available to companies
- Greater accountability / transparency
- Less 'transactional distortion' through the political tender criterion process
- Huge cost savings
- Higher calibre of business advice
- Exposure of all providers to the same rigour of the market - driving up standards

The danger with any system in which Government intervenes between customer and provider to pay the bill for a service is that the accountability inherent in the transaction between purchaser and provider is blurred, with the risk of the provider offering a service that may not be in the best interests of the actual customer, but in the best interests of the provider's relationship with the Government. In business support this can lead to the provision of advisory services which are tailored to the needs of Government not business, and in which the provider is not 'at risk' from the success or failure of the business. In a free market, a business advisor will look very hard at a company's prospects before even taking on basic fee-paid work, because for any real business the investment of time in a client, even paid time, represents a significant investment of itself.

Removing the public sector intermediary role as purchaser of services is a first step. Potentially, we would like to see the system evolve even further to promote business support advisors being encouraged and helped to share some of the risk and reward in the businesses they advise, to promote a genuinely long term relationship based on real commitment and partnership.

We would recommend that further work be done to look at the possibility of generating some simple, transparent EIS-based incentive scheme to help companies develop such relationships with business support providers.

Customers

For the ultimate customer of all this activity - the entrepreneur or business requiring business advice and support services - whilst there are of course good advisors and good stories, especially in regard to basic start-up advice, we have all heard and experienced the standard concerns about business support services. The most common concerns are:

"I don't know where to find the help or information on the help. There are so many schemes. Why cant we just have a Business Information Service?"

"I wouldn't trust a Government appointee to tell me how to run my business. If I need professional help I need the best and I'll go where I can be sure of the quality."

"Government schemes tend to be very bureaucratic. Entrepreneurs don't have time to sit around filling in forms and being politically correct. You don't have to do it in the private sector. I just want to be able to pick up the phone and talk to someone and start getting advice."

"They were fine for basic information - but when it came to the specifics of my business sector I needed to talk to an expert and highly qualified experts do not work for the local RDA or Business Link."

The central themes of the feedback we have received and of our own experience of business support are the need for:

- A 'menu' system which makes clear a cascade of services from the most general to the more sophisticated
- a Business Information Service for access to all Government business support services
- rapid telephone business information services to deal with basic enquiries
- access to sector and market specialists when required.

An important principle of the Business Information Service and online business information service is that those companies who have benefited be required to consent to making themselves available to future customers for reference and/or advice.

Case Studies

We have set out below some case studies of how the new system would work in practice, covering three different business scenarios:

1. Someone who wants to start a hairdressing salon
2. An inventor / technology entrepreneur with an idea for a new type of toothbrush
3. An owner manager of an established small business looking for advice and support on strategic business development and succession planning.

The Hairdresser

The hairdresser has always dreamt of having his/her own salon and wants to know:

- What do I have to do to start my own salon ?
- Can I do it ?
- Do I need to register a new Ltd company ? How do I do that ?

- How does VAT work ?
- What sort of accounts do I need to provide ?
- Where can I access development capital or a bank loan ?

This person needs basic information, communicated clearly and simply, with someone on the end of a telephone 24/7 to answer any questions. Every question they are likely to have will already have been asked, and answered, many times.

This information can be provided wholly by a national helpline and website.

This is how it would work:

1. Google 'business support'
2. Visit www.nationalbusinesssupport.com
3. Use search engine to navigate
4. Take simple assessment tool / test
5. Click on links to see local banks / hairdressers / trade associations / business advisors etc in your area
6. Call National Business Support Business information service

The Entrepreneur

The entrepreneur has developed or acquired the rights to a potentially very powerful new technology or business idea that could be very valuable. He / she wants to know:

- How can I protect my idea (without giving it away)?
- Has someone else already done something like this?
- Where can I access specialist help with developing the product concept?
- What might it be worth?
- How best to exploit it?

Suppose the invention was for a novel toothbrush design. This person needs a combination of

- Venture capital basics (how you get an idea patented and commercialised)
- Specialist knowledge and advice on the dental devices market.

This could potentially be provided by any one of:

- An angel investor
- A mentor
- An accountancy or brokerage house specialising in the field
- A patent agent or IP lawyer

This person needs to understand the pros and cons of talking to each of these different sort of advisor, and be empowered to make their own choice.

This is how it would work:

1. National business information service and website would provide basic information on technology venturing, including a description of the key considerations any entrepreneur or inventor should be considering, and the different types of advisor he could consider, with the pros and cons of each.
2. The Business Information Service would provide up to date databases of approved suppliers of each type of service, with direct links to their website.

3. As with e-bay, the Business Information Service would show customer ratings of each provider, with direct feedback from past customers, so that at a glance it would be possible to know how active an advisor this is, how recently it has provided services, to what sort of companies, and how the customers themselves rated them.
4. The website would make available a number of online assessments, which would both help to educate the inventor in the sort of issues he/she needs to be thinking about, and help profile the company.
5. The inventor could then send their profile to a number of listed companies for an initial consultation. This would be part of the contract of provision entered into by all providers.
6. The scheme would then provide the inventor with entitlement to a series of stages of support with participating providers.
7. Importantly, the national Business Information Service would be able to put a business like this in direct contact with an appropriate sector specialist. The dental device business is a specialist business - even within healthcare - and needs a specialist to advise on it. The chances of there being a dental device specialist within any of the RDA networks, let alone available and signed up to an RDA local business support service, are slim. But finding an appropriately qualified advisor for a national scheme would not be difficult.
8. Initial advice would be fully funded, but if/as the concept develops, the scheme would gradually require the inventor to make some contribution themselves (on the principle that free advice is never as valued as that which you have had to pay something for).
9. Ultimately, if/as a project develops, suppliers could earn 'points' which could be part payable as fees and part converted into equity in a venture via a simple, Government-backed EIS-based scheme to incentivise partnerships between fledgling companies and high quality business support partners.

The established business proprietor MD

The established business MD wants to explore strategic options for growing and developing his/her business, including the possibility of a corporate transaction or a strategic investment, perhaps as part of succession or retirement planning or strategic business development.

Assume for example, the MD of a family manufacturing business making travel luggage, with no family members to take on the business, looking to explore options for succession planning and growth.

This person needs an experienced business advisor who can meet and talk to him/her, understand their personal ambitions and profile, talk through the pros and cons of various options, assess outline options, and help identify other people and businesses, possibly target businesses, he/she might talk to, and ideally help effect an introduction.

This is how it would work:

1. The proprietor would contact the Business Information Service and access basic guidelines and top 20 'Dos and Donts' and advice on issues around growing, partnering, selling and succession planning within an owner managed business.

2. Most helpfully, the website could have online feedback from people who have been through the process, describing in their own words the main pitfalls, challenges and lessons they have learned. (The system could usefully mirror the sort of feedback systems used increasingly over the last few years by online patient groups in the healthcare sector, which has been a very powerful driver of patient advocacy around treatment regimes and issues associated with medicines evaluation and prescription).
3. Through the website and business information service, the proprietor could access people who have been in a similar position to him/herself, and have the chance to contact them directly to ask questions about the process. (Provided the contact is from genuine business people genuinely seeking advice, most small business people are only too pleased to share their experience with others facing the same challenges).
4. With the help of the Business Information Service the proprietor could be put in touch with a shortlist of people who best fit the profile - people who have sold or successfully developed previously owner -run businesses, and/or people in the luggage business.
5. Finally, the proprietor could be put in touch with an experienced business mentor who has the skill both to advise and potentially assist in finding and completing a transaction.
6. In this scenario, it is possible that the most valuable advice may actually be provided without recourse to any professional advisor at all. Simply by harnessing the power of really well managed networking technology such as that behind Facebook, Youtube and other online communities, first class business advice can be made available to people who wouldn't otherwise know how to access it.
7. What would be the incentive for people to be part of this network ? Pure, unambiguous self interest. Running a small business is often a lonely pastime. Networks are everything. Most small business people would be only too glad to provide advice on issues they have dealt with in the past to fellow entrepreneurs. The key is that the system is clever enough to connect only people whose profiles really 'fit'. On that basis, who knows what might come of it?

Appendix C

Government funding for research and development in SMEs²

Introduction

The crucial role played by small businesses in innovation and the development of new sectors of the economy is widely recognised. The Small Business Administration points out that in the United States, small businesses³ are responsible for 13-14 times as many patents per employee as larger firms and 60-80% of all new US jobs over the last decade. In the UK they account for 59% of total private sector employment. Large companies nearly all start as small firms⁴ and the growth of major companies is fuelled by the acquisition of more innovative smaller ones.

The costs and risks associated with technological innovation through research and development are high. And only a fraction of potentially viable propositions fit the demanding criteria of venture capital investors used to dealing with this situation. However, there are important “spill over” benefits to customers, suppliers, competitors, employees and the economy as a whole, sometimes even if the company making the innovation fails to turn it into commercial success.

Potential customers also find it hard to evaluate innovative new products and services offered by suppliers, and the personal risk to buyers of trying something new may outweigh the potential benefits to their employer.

The resultant difficulties experienced by innovative companies in securing investment and early customers can amount to “market failure”.

For all these reasons, governments have long regarded it as a legitimate part of their role to provide funding for research and development in private sector companies, especially in smaller firms.

The Task Force strongly supports this position and is particularly concerned about the relevance and effectiveness of measures currently in place in the UK to support R&D in start ups and early-stage science and technology based companies.

Despite the considerable attention given by the Government to this topic over the last decade, we believe that policy thinking has been too focused on university spin-outs and the role of venture capital in financing. University spin-outs will only ever represent a small percentage of new start-ups. Successful science and technology entrepreneurs are, we believe, far more likely to have worked for another commercial organisation first. And many early-stage science and technology based firms are not appropriate for venture capital investment, even if they have the potential to make an important contribution to the economy. This may be because their initial markets are too small or timescales too long to justify the risk to an external investor, or because they are not yet “venture ready”.

The public sector has a critical role to play here and we believe it could do more.

² This Appendix has been written by David Connell at the Centre for Business Research at Cambridge University

³The US definition of a small business extends to firms employing up to 500 people.

⁴ Demergers and buyouts excepted

Current Policies to Directly Fund R&D in Small Firms

There are currently four principal policy measures in place to directly fund R&D in small firms and we comment on each of these below. A fifth, procurement-based initiative, the Small Business Research Initiative is not currently functioning, and is discussed in more detail in the section on procurement (Appendix D).

R&D Tax Credits

Around 5000 small firms benefit from R&D tax credits each year. They give R&D based firms a relatively simple and efficient way of reducing their tax bills or, if loss making, extracting cash from the Treasury. In money terms, this is by far the largest source of Government funding for R&D in small firms, worth around £200m per annum. Three quarters of this takes the form of cash payments.

The scheme's introduction in 2000, just before the end of the technology boom, helped many firms in financial difficulty. Government is regularly lobbied on ways in which the scheme could be extended or made more generous and the rate of relief for SMEs was increased from 150% to 175% of qualifying revenue in the 2007 Budget.

However, it should be noted that R&D tax credits are incapable of having any significant impact on the financing of start-ups and other early-stage, pre-revenue companies. Even after enhancements due to come into effect in 2008, R&D tax credits will only cover 19% of eligible expenditure. The other 81% of R&D costs must have already been found from elsewhere.

So, as a policy to encourage increased R&D amongst small businesses, we strongly question the whole R&D tax credit concept. Our experience as founders, directors and investors in small companies suggests that R&D tax credits are rarely, if ever, taken into account by boards when deciding how much to spend on R&D or which projects to undertake. Rather, they are seen as a windfall financial benefit at the financial year end.

This perception, that R&D tax credits provide little or no additionality, is reinforced by independent studies.⁵

In essence, therefore, though very effectively implemented, the R&D tax credit is a very blunt-edged form of blanket subsidy. Its popularity with Ministers and companies probably reflects the restrictions placed on innovation policy by EU State Aids rules and the resulting imperfections of **other** policies, rather than its potential to boost the economy.

We would not, however, question the overall magnitude of this support; the key question is whether this money could be used more effectively to encourage R&D in small firms.

⁵ Research by the Centre for Business Research at Cambridge University indicates that R&D tax credits had increased R&D expenditures "not at all" or "to a limited extent" in between 80 and 90% of SMEs.; "Innovation Activity and Technology Intensive Firms", Andy Cosh and Alan Hughes, in British Enterprise; thriving or surviving, CBR, 2007.

Grants for Research and Development

The old DTI developed a family of grants for research and development aimed at SMEs, ranging from £20,000 at the low end to a theoretical maximum of £500k. Government covers between 35% and 60% of project costs depending on project size. Grants for Research and Development are now administered by the RDAs, and the total amount provided in England and Wales was £29m in 2006, over 60% of it in the form of "Development Grants", those in the range up to £200k (since increased to £250k). "Exceptional Grants" can be up to £500k, but only £718k was awarded in this category in 2006, 2.5% of the total. There are similar schemes for Scotland and Northern Ireland.

R&D grants have been in existence in one form or another for many years, but because companies cannot count R&D expenditure against both R&D tax credits and R&D grants, the latter – slightly more generous, but more uncertain from the applicant's point of view – have become less popular. The total has been running at about £30m per annum in recent years.

As with R&D tax credits, companies must generally fund the majority of project costs themselves and, as the cost of developing innovative new technology products usually runs into millions of pounds, the impact of the £250k provided under the key Development Project category is often limited. As with R&D tax credits, the problem is particularly acute for start-ups and other early-stage companies with limited finances, which is where the requirement for Government support is greatest.

We are also concerned that overall budget allocations are made first on a regional basis. Apart from the issue of duplication of specialist resources to administer the scheme, we believe that a policy of this kind should be focused on funding the best projects nationally, selected on a competitive basis, rather than having its aims muddled by regional policy objectives.

Technology Strategy Board Collaborative Programmes

The Technology Programme is DIUS' flagship programme for funding innovative technology projects. Its importance is planned to increase with the strengthening in the role of the Technology Strategy Board which is responsible for the programme. The TSB became an independent executive Non-Departmental Public Body in 2007, charged with managing the Technology Programme and other programmes at arm's length from Government. It has recruited a new cadre of directors and managers from the private sector to run these programmes.

We strongly support the changes that have been made in the TSB's status and organisation, though it is too early to assess the impact. The key issue we would highlight is the design of its flagship delivery mechanism, collaborative R&D programmes, particularly in as far as they are relevant to SMEs.

In essence, the "Innovation Platforms" funded through the TSB's Technology Programme are just a continuation of a range of mechanisms to encourage collaborative R&D, starting with the Alvey programme set up in 1983 to reinvigorate the UK IT industry. The names and themes have varied over the years, but the architecture has been largely unchanged. The new TSB has inherited £1.1 billion in ongoing programmes from the DTI and the collaborative approach continues to dominate planned future expenditures

There are three important features of this funding mechanism which make it inherently unsuitable for small businesses.

- (i) It is focused on precompetitive, longer-term R&D

Small firms rarely have the luxury of operating at this distance from the market. Their R&D must be focused on near-term customer requirements

- (ii) Projects must involve collaboration between academia and industry

Between 2004 and 2006, only 18% of total Technology Programme funding went to SMEs, an average of £25m per annum over each of the last three years. The remainder was split roughly 2:1 between large firms and universities

Collaborative projects of this kind inevitably defocus project objectives as each participant's aims and timescales may be different. Agendas are almost inevitably driven by the longer term R&D objectives of large company and university participants. Intellectual property issues can also restrict the topics which can be addressed.

- (iii) Companies must make significant financial contributions to projects alongside Government funding.

This is fair and reasonable for large firms, especially those which in any case have large ongoing R&D budgets. But it is much more problematic for small firms, especially start-ups and early-stage companies. Over the last three years, the average minimum contribution for small firm participants has been 60%.

We recognise that efforts are being made by the TSB to design collaborative programmes which are more appropriate to SMEs. However we believe much more needs to be done here, starting with a fundamental analysis of past collaborative programmes and leading to the design of new project architectures that can have the biggest economic impact. For the reasons described below, we believe that a more procurement orientated approach, based on development "contracts" between customers and suppliers, rather than loose "collaboration", has an important role to play.

EU Framework Grants

The 7th EU Framework Programme has a budget of Euro 51 billion to be spent on a wide range of technologies between 2007 and 2013, the bulk of it through collaborative R&D programmes.

Successive EU Framework programmes have all suffered from the same weaknesses as the UK's collaborative R&D programmes, with the added complexity that partners from different EU countries must be involved, further diminishing their relevance to SMEs. FP7 tries to increase SME participation by raising funding support from 50% to 75% of costs and by some dedicated SME measures. However, all projects suffer from the requirement for collaboration.

For those of us with a background in small business – as founders, managers, investors and advisors, our experience has led us to the conclusion that Government-funded collaborative R&D projects are almost invariably a distraction from the real business of getting new products to market quickly and winning customers, which is the priority for small innovative firms. Although we recognise that the collaborative R&D approach has a role to play in the overall innovation process, we believe that the shoe horning of the majority of UK Government grant and EU-supported R&D projects into this model undermines their impact on the SME sector, perhaps the key player in the exploitation

of the UK's science base. Part of the reason for this failure is the restrictions placed on national government innovation policies by EU State Aids Regulations, and the dominance since the 1980s, for largely political reasons, of the collaborative model in EU policies for research and development.

In summary, we believe that all of the current mechanisms for directly funding R&D in small firms have major weaknesses as mechanisms for supporting start ups and early stage companies. We are instead much more attracted by the Procurement Model for funding innovation, which sits at the centre of US policies, and other customer led mechanisms. We discuss this below.

Customer Led Innovation and the Role of Government Procurement Policy

In business, innovation is essentially about problem solving, and customers have a critical role to play in defining problems and testing solutions from potential suppliers.⁶ The early development of many of the UK's most successful new companies in the science and technology sector was based to a significant extent on developing innovative solutions under contract for large corporate customers.⁷

Besides the immediate revenue generated, R&D contracts to develop demonstrators and prototypes for customers to evaluate against their requirements provide two important direct benefits to start-ups and other innovative SMEs:

- they provide insight into wider market requirements and a mechanism for evaluating new technologies and product ideas
- they provide a reference site for subsequent customers.

Many new companies go through a "soft" stage in their development in which much of their revenue comes from "bespoke" contracts of this kind, based on their specialised expertise, before transitioning into a "harder" form of business, selling their own "standard" products. The exploratory development and testing of possible applications for customers in different sectors through R&D contracts is also an important early stage in the commercialisation of new technology.⁸

So we believe that measures to support this "natural process" of innovation should play a key part in any Government's policy to support start-ups and early-stage companies.

Proposals for Improved SME Innovation Policies

A US Style SBIR Programme

We are particularly impressed by the US Small Business Innovation Research Programme (SBIR) under which \$2 billion a year is provided through a carefully structured competitive programme for R&D projects aimed at meeting Federal Agencies' requirements for new technology as customers. The SBIR programme is described in more detail in Appendix D.

⁶ See "Demanding Innovation, Lead Markets, Public Procurement and Innovation, Professor Luke Giorghiou, NESTA February 2007, for a good summary of the academic research and wider discussion.

⁷ "Secrets of the World's Largest Seed Capital Fund: How the United States Government Uses its Small Business Innovation Research (SBIR) Programme and Procurement Budgets to Support Small Technology Firms; David Connell, Centre for Business Research, University of Cambridge 2006

⁸ See "Secrets..." op. cit. for a fuller discussion

The Task Force believes that something similar needs to be established in the UK and fully endorses the detailed proposals for doing so made in the “Secrets..” report by David Connell published by the Centre for Business Research at Cambridge University.⁹ The initial budget for this programme should be £100m a year.¹⁰

How a US style programme could be established in the UK

Programme Aims

- Facilitate identification of government departments’, and other agencies’, requirements for innovative new technologies
- Facilitate the advertising and commissioning of “Innovation Contracts” with industry to develop and trial technologies and solutions capable of meeting these requirements

Key Programme Features

- Annual budget of £100m split down by department
- Topics advertised in detail twice per annum
- Contracts awarded solely for technical feasibility studies, technology demonstrators, prototypes and technology trials
- Any size company may apply, but selection focused strongly on level of innovation, enabling SMEs to compete on an equal footing irrespective of size¹¹
- 100% funding with no requirement for collaboration
- Complete transparency of topics, amounts and awards
- Intellectual property resides with supplier
- Contracts awarded in two phases to manage risks:
 - Phase 1 typically £75k for a feasibility study (success rate for applicants 15-30%)
 - Phase 2 typically £500k for a development project (success rate typically 50%)

⁹ “Secrets....” Op. cit.

¹⁰ The existing UK Small Business Research Initiative, which was established in 2001 with the aim of emulating the US SBIR, in fact bears no relation to it and is widely recognised as having failed to deliver.

¹¹ The US SBIR Programme is open to companies with up to 500 employees, but 70% of awards go to companies employing 25 people or less. So it is to be expected that SMEs will win the great majority of contracts under a UK scheme, operating fully within EU procurement regulations.

The key principle of SBIR is that *public sector agencies* should sometimes fund developments, prototypes and trials of new technology that they require as customers. Besides ensuring that innovation is demand led, it would also provide reference sites for subsequent sales, speeding the penetration of wider markets at home and abroad.

The operation of this programme is described in more detail in the Panel on page X. It could in principle be seen as a relaunch of the existing DBERR Small Business Research Initiative (SBRI). However, SBRI is effectively a non functioning programme today, so the changes required are transformational.

Once implemented, this programme should be closely monitored with a review to expanding its scope and budget, providing it delivers the anticipated benefits.

Funding for Prototype Evaluation in the Private Sector

We also propose an initiative to encourage the extension of the SBIR approach into the *private sector*.

Collaborations between customers and suppliers are already a feature of some projects funded by the Technology Strategy Board. However, the distinction between “a collaborative research project” and a “technology development or prototype supply **contract**” is a fine, but important one and we believe that this approach could be used to make some of the Technology Programme more relevant to SMEs.

We have in mind a mechanism which reimburses, say, 75 per cent of a customer’s costs of purchasing and evaluating prototypes or demonstrators of innovative technologies, particularly those supplied by SMEs. The approach envisaged would involve setting aside an annual budget, of say £20m, with projects selected on a competitive basis twice yearly.

The “time to first customer” has a critical impact on the **longer term** ability of a company offering an innovative new product to maintain its competitive position as its market matures. Competitors, and peer group companies in related product markets, that access early customers and grow faster will inevitably be able to spend more on R&D and marketing and ultimately make acquisitions to consolidate their position.

So a policy of this kind, alongside a US style SBIR programme, could materially affect the UK’s ability to grow independent “gorillas”.

The DTI operated a very well regarded prototype funding programme of this kind, actually reimbursing 100% of customers’ purchase costs, 25 years ago¹².

¹² The Pre Production Order Scheme

General Policy Principles

We believe that all forms of public sector R&D grant or contract should be subject to the following basic principles:

- contracts and grants should wherever possible be awarded using a timetable driven, competitive process against a fixed total budget to ensure efficiency and reduce the administrative delays for recipients
- there should be complete transparency in terms of the names of awardees and the amounts of awards and matching contributions
- there should be regular independent reviews of the impact of all programmes covering inputs, outputs and medium and longer term outcomes.

EU Policy Framework

The restrictions imposed by EU Regulations are frequently cited as a barrier to changes in UK innovation policy. However we believe that it should be perfectly feasible to reconcile the purpose of these changes within the broader EU regulatory framework.

Appendix D

Procurement - Lessons from US Policies to Support Small Businesses and Progress in Implementing UK Policies¹³

Introduction

The UK public sector represents nearly 50% of the economy. For example, it is responsible for the purchase of 55% of all IT products and services and the majority of medical equipment and consumables.

For our small firms to thrive in national and international markets it is important that they have effective access to the public sector market, and are not excluded from bidding for contracts purely because of their size or short track record.

Government Departments also have significant potential to stimulate innovation by funding feasibility studies, prototypes and trials of technology they will need in the future, and by acting as “first customer” for new products. SMEs can play a vital role in this process.

It is inevitable that those responsible for procurement will tend to play safe in making decisions. There are no bonuses for novelty or buying from companies who cannot tick all the boxes or have a short track record. But there are a whole range of personal penalties for those associated with procurements that go wrong. Better always “to stick with IBM”.

So there are sound reasons for putting in place policies that try to counter these natural tendencies.

These principles have been accepted by the Government for some years now and policy statements and good practice announcements have been made at regular intervals. The most comprehensive to date was published jointly by DIUS and the OGC in August 2007 and runs to nearly 80 pages¹⁴. However, policy is still essentially based on exhortation and a desire for cultural change; there is still very little evidence that this intent is being translated into practice.

We believe that the other pressures on departmental officials – to spend money wisely and avoid embarrassing failures – are simply too great for buyers to become more receptive to innovative new solutions and untested suppliers. “Cultural change”, though highly desirable, will only come about when those responsible for spending departmental budgets, and the specialist procurement staff who work with them, are given the tools to deal with the natural aversion to risk that their roles inevitably entail.

We believe that specific departmental innovation programmes, with separate spending budgets to fund the development and testing of new technologies **prior to full scale operational deployment**, are needed to legitimise the experimentation required. A US-style Small Business Innovation Research (SBIR) programme could a key role here, bringing both improvements in effectiveness to Government departments and giving a boost to the UK's more innovative SMEs.

¹³ This Appendix was written by David Connell at the Centre for Business Research at Cambridge University

¹⁴ Finding and Procuring Innovative Solutions – Evidence-based practical approaches; DIUS/OGC August 2007.

When it comes to the wider issue of SME participation in Government purchases of **all** goods and services, we believe there is also much we can learn from US policy. This is summarised below.

Overview of US Small Business Procurement Policies

Policies to encourage small firm participation in US federal government procurement date to the Small Business Act of 1953, and we have examined these policies in depth.

The aim of the 1953 Act was to help small firms compete for contracts as effectively as larger companies. An amendment in 1978 introduced mandatory targets for small business participation in federal procurement and subcontracting commitments, and these targets still remain at the heart of policy today. Since then the legislation has been further amended a number of times and today is highly complex.¹⁵

The Small Business Innovation Research Programme was established under separate legislation in 1982 and is covered later in this Appendix.

Policies to help small businesses access US federal procurement budgets today include the following elements:

(i) Set Asides for Small Businesses

Each acquisition of supplies or services with an anticipated value of between \$3000 and \$100,000 is automatically reserved for US small businesses unless the contracting officer can justify otherwise. Simplified procurement processes apply.

Other procurements can be set aside for small businesses under certain circumstances.

(ii) Agency Small Business Goals

All agencies are required to negotiate annual goals with the Small Business Administration for the percentage of procurement expenditure **directly** contracted with small businesses as prime contractors. The federal target was increased from 20 to 23 per cent in 1997.¹⁶

There are also targets for the percentage of agencies' **total** (prime and subcontracted) procurement expenditure awarded to small disadvantaged businesses (5%), women-owned firms (5%) and other sub-groups.

(iii) Small Business Subcontracting Programme

The aim of this policy is to promote maximum possible use of small businesses as **subcontractors** on federal contracts. It does so by requiring "other than small businesses" (OTSBs) that are awarded prime contracts to submit a "subcontracting plan" for each project worth more than \$550k (\$1 million for construction projects).

¹⁵ It is encapsulated in Part 19 of the Federal Acquisition Regulations which alone runs to 78 pages.

¹⁶ The Future of Small Businesses in the U.S. Federal Government Marketplace; Major Clark and Chad Moutray; Office of Advocacy, U.S. Small Business Administration.

Subcontracting plans must include:

- goals for small business (and other sub-group) participation in dollar and percentage terms
- types of supplies and services to be subcontracted
- description of methods used to develop goals and identify sources
- name and duties of plan coordinator
- assurances with regard to flow down through larger subcontractors to smaller firms
- record keeping and reporting procedures.

Bundling of contracts is allowable in certain circumstances, as is reporting of subcontracting achievement on an overall reporting unit (e.g. Boeing Chicago) basis.

OTSBs must report against their subcontracting plans twice yearly.

The contracting officer at an awarding agency can take account of a firm's subcontracting plan, and its performance in meeting previous subcontracting goals, in deciding whether to award it a contract.

Once a contract has been awarded, a financial incentive may be offered for exceeding agreed targets. The incentive may be up to 10% of the dollar value of any excess.

The SBA may review and advise on subcontracting plans prior to a contract being placed and is involved with the awarding agency in monitoring performance against plans.

(iv) Transparency and Internet Tools

All federal government procurement opportunities worth over \$25,000 are supposed to be listed on the FedBizOpps.gov web site. The SBA's SUB-Net web site is aimed at helping small businesses find subcontracting announcements.

A new government-wide internet tool - the Subcontracting Reporting System - has been put in place to reduce paperwork for prime contractors.

(v) Office of Advocacy

In 1976, the U.S. Congress created the Office of Advocacy within the U.S Small Business Administration to protect, strengthen and effectively represent the nation's small businesses within the federal government's legislative and rule-making processes. The Office of Advocacy works to reduce the burdens that federal policies impose on small firms and maximise the benefits that small businesses receive from the Government.

Its team of lawyers and economists is headed by a political appointee, giving it a quasi-independent perspective in relation to agency officials.

Impact of US Small Business Procurement Policies

Achievement against agency and overall federal targets is reported annually in the SBA's Report to the President. The numbers for 2005 are:

	\$ Billion	Per Cent
Total federal government expenditure	314	100.0%
Prime contracts to small businesses ¹⁷	80	25.5%
Subcontracts to small businesses from primes (estimate by SBA based on 2003 actual)	60	19.1%
Total procurement from small businesses	140	44.6%

Figures are also available by agency and additional data are sometimes included in the SBA annual report, such as the percentage of federal R&D contracts awarded to small firms (13% in 2003).

Data are also publicly available for named prime contractors or contractor reporting units (e.g. Boeing Chicago), through the Defense Contract Management Agency.

An important feature of the subcontracting rules is the behaviour they have induced in large companies. Many maintain some form of "Supplier Diversity" or Small Business Office to help search out and engage small businesses to meet their subcontracting targets. Many also comment on their small business programmes on web sites and annual reports. For example 3m states that "it is committed to proactively identifying small, minority owned and women owned sources for the goods and services 3m needs". In 2004 it sourced 34% of subcontracted business from small US firms.

Subcontracting targets also provide an incentive for large companies to collaborate with small firms that have SBIR projects.

Definitional and Reporting Issues

It should be noted that the US definition of small business appears to be rather flexible for procurement (though not SBIR) purposes. The norm is up to 500 employees (c.f. 250 for EU SMEs). However, the ceiling depends on the sector. For example, it is increased to 1000 for computer suppliers and 1500 for aircraft industry firms.

A significant feature of the US system is the comprehensive reporting of contracts through the Federal Procurement Data System. This enables regular and up-to-date statistics to be produced showing performance against targets and other economic analyses. This contrasts with the UK approach which relies on ad hoc sample surveys and is subject to severe definitional and reporting problems (see below).

US Small Business Innovation (SBIR) Programme

¹⁷ The percentage increased steadily from 15 per cent in the mid eighties, suggesting that the US policy had some measure of success. See The Small Business Economy, SBA Report to the President, 2004.

The SBIR programme was established in 1982 and was expanded in scope through subsequent legislation in 1988 and 1992. It plays a major role in funding early stage US science and technology companies.¹⁸

The SBIR legislation requires that all larger federal agencies spend 2.5% of their external R&D budgets with small businesses through the SBIR process. Only majority US-owned businesses are eligible and the R&D must be undertaken in the US.

The way in which the SBIR programme is structured and managed is an important reason for its success. Key elements of this process are as follows:

- (i) Agencies advertise topics ("solicitations") in groups, typically twice a year; each topic relates to an agency's requirements for new technology
- (ii) "Contracts" and "grants" are awarded on a competitive basis in two phases:
 - i. Phase I, typically \$100k for a feasibility study
 - ii. Phase II, typically \$750k for development of a demonstrator

SBIR projects that subsequently receive follow-on Government funding from non-SBIR budgets are defined as entering "Phase III".

- (iii) Awards cover 100% of firms' project costs plus a profit element; there is no requirement for collaboration with any other organisation.
- (iv) The company owns any IP generated.
- (v) Companies can apply for and win multiple awards for different projects in parallel. This is common practice.
- (vi) There is complete transparency in terms of solicitations, timescales, award winners and contract amounts. The legislation requires that the process is timely and efficient.

Today, Phases I and II of the SBIR programmes are worth around \$2 billion per annum with a further \$230m from the closely allied STTR programme which requires academic collaboration. Phase III funding adds perhaps another \$2 billion.

Firms that obtain Phase III funding from mainstream agency budgets also derive significant commercial benefits, including an expectation that they will become a designated "sole supplier" of the technology to the Government. The higher margins that this usually leads to makes them highly desirable partners and acquisition targets for large firms. This, and their potential contribution to small firm subcontracting targets, means that large firms are encouraged to monitor the SBIR community closely. Some large defence contractors have established dedicated SBIR Officers.

The majority of SBIR award winners employ fewer than 25 people, though there are also a few firms with hundreds of employees for whom SBIR is essentially a core business. Measures have been put in place to prevent abuse in these cases.

The SBIR programme is just the first step on the procurement ladder for small science and technology based firms. Larger contracts, particularly from the Department of Defense, are available through Broad Area Announcements (BAAs) and other mechanisms

¹⁸ "Secrets" of the World's Largest Seed Capital Fund: How the United States Government Uses its Small Business Innovation Research (SBIR) Programme and Procurement Budgets to Support Small Technology Firms; David Connell, Centre for Business Research, University of Cambridge, July 2006.

and there are significant opportunities for small businesses to participate, either directly or as a subcontractor to a larger firm.¹⁹ Through these mechanisms, early-stage US firms receive significantly more financial support from the Government per company than their UK counterparts.²⁰

Each agency operates SBIR in a slightly different way, and the National Institutes of Health and National Science Foundation designate awards as “grants”, rather than “contracts”. This reflects greater openness to company ideas and the fact that the term “grant” does not carry the same connotations as it would in the UK. (Under EU State Aids rules, a “grant” to fund 100% of a firm’s project costs would be illegal).

In fact, even where SBIR “grants” are awarded, they are for directed research and development (usually highly specified by the agency concerned) and therefore represent procurement contracts in all but name.

UK Policy on Procurement from SMEs

The potential role that UK government procurement could play in stimulating innovation and small firm growth has been regularly highlighted for at least 20 years.

The Government has been very receptive to lobbying for reductions in the barriers that prevent SMEs from participating fully in the government procurement of goods and services generally. Recent documents include *Government: Supporter and Customer (Better Regulation Task Force, May 2003)* and *Government Action Plan for Small Business (DTI, SBS January 2004)*.

The latter identified “*the need to create an environment in which small businesses are able to compete effectively for a bigger proportion of government contracts*”. However, policies which might favour small firms are in general prohibited by EU Procurement Regulations, so US policies cannot simply be replicated.

The role of procurement in innovation was a key theme of the DTI “Innovation Report” in 2003 and this theme was rapidly picked up by the Office of Government Commerce.²¹ It is also a key theme in recent work of the Council for Science and Technology which advises the Prime Minister.

An important report, *Transforming Government Procurement (Treasury, January 2007)* sets out Government’s policies to bring about major improvements in this area. It reflects a desire to avoid big-ticket disasters like the NHS electronic care records system and to reduce resources through efficiency savings identified in the Gershon Review. Policies to increase small firm participation and innovation are also discussed, but in practice they have to compete for management attention with these financially much more significant goals. *Transforming Government Procurement* focuses on making the Office of Government Commerce smaller, stronger and more capable. Additional OGC guidance on innovation was published in August 2007.²²

The most visible sign of Government policy to encourage small firm participation in procurement is the Supply2.gov.uk web portal, launched in March 2006. It aims to give

¹⁹ There are typically some 50 pages of BAA announcements on the FedBizOpps.gov website, representing around 500 separate R&D opportunities.

²⁰ “Secrets...”; op. cit.

²¹ Capturing Innovation, OGC, April 2004

²² Finding and Procuring Innovative Solutions; op. cit.

companies access to contracts worth up to £100k and in a sense complements the EU requirement for higher value contracts to be published in the Official Journal of the European Union. Basic access to Supply2.gov.uk is free. More detailed or specific information requires payment of an annual subscription.

It is not mandatory for Departments to publish contracts on the website and we are not aware of any analysis of how effective it has been so far. However, an analysis of SBRI “opportunities” published on the Supply2Gov website, and which is reported below, suggests that there may be more general coverage and definitional problems.

Progress on initiatives to improve SME access to central Government procurement generally was summarised in a report by Small Business Service in December 2005²³.

An update, based on data for 2005/6 was published in March 2007²⁴. The 2005/6 report included survey data showing that the proportion of central Government procurement expenditure reported to have been awarded to small businesses increased from 18% in 2003/4 to 22% in 2004/5.

This is remarkably close to the US figure for direct procurement from small firms although, to get a clear picture of how well UK SMEs are doing overall in obtaining Government procurement contracts, a figure for their participation as subcontractors is also required. No information appears to be available on this part of the picture.

However, further examination of this document, and the full survey report which underpins it, underscores the unreliability of these figures:

- Health Service and MOD expenditure (64% of total central Government expenditure) was excluded from the main survey
- The sample covered 41% of the remaining expenditure, but with wide variations between departments (only 1% for DES)
- The survey report states that, due to changes in the methods used to compile the data, it was “*difficult to make any direct meaningful comparisons (between the 2003/4 and 2004/5 surveys) or draw conclusions*”
- Data nevertheless provided for the MOD show that in 2004/5 only 8% by value of MOD contracts went to SMEs (based on a 56% sample). The figure for NHS PASA was 41% (39% sample).

The later 2007 report in fact indicated that, by value, the percentage of central Government expenditure on goods and services spent with SMEs declined from 22% in 2004/5 to 16% in 2005/6. The figure for NHS PASA was also down – from 41% to 27%, whilst the MOD figure was stable, though relatively low at 8%.

Though apparently disappointing for policy makers, we believe the real problem here lies with the accuracy of the data. As the authors of the 2007 report point out; “*There is however no legal requirement for respondents to supply this information, and no standard methodology by which respondents collected it.....It remains very difficult to make any meaningful comparisons between the surveys or draw conclusions from the response as a result of limitations in data quality*”.

²³ Access to Public Procurement for Small and Medium Sized Enterprises – A Progress Report; DTI, SBS, December 2005.

²⁴ Progress on Improving Access to Public Procurement; DTI, March 2007

We believe that any policy on encouraging procurement from SMEs will continue to be problematic until accurate data on its effectiveness are collected.

UK Small Business Research Initiative (SBRI)

Inspired by the SBIR, the SBRI was launched in 2001 with a similar 2.5% target. The initial objective was to place £50m of Government R&D contracts per annum with SMEs through the SBRI web site. However, by 2004, contracts worth only £2m per year were being advertised and none of the key departments participated.

Following a campaign led by David Connell and Anne Campbell (MP for Cambridge until 2005), a mandatory 2.5% target (worth around £100m per annum) was introduced by Gordon Brown for all departments in the March 2005 budget.

There have been two main components of the implementation of this announcement: incorporation of SBRI opportunities within the supply2gov.uk web portal and publication of statistics aimed at measuring performance against “targets” for individual departments.

By February 2008, nearly two years after the relaunch of SBRI through the supply2.gov.uk web portal, it was clear that the scheme still bears no real resemblance to the US SBIR. Key differences are summarised below:

- **Few, if any, of the circa 200 opportunities advertised to date are legitimate contracts within the scope of the initiative.** The majority are not even for projects involving technological R&D at all. An analysis of the 51 separate opportunities advertised over a recent 6 month period²⁵ showed that:
 - 25 were not for R&D projects (examples include contracts for the supply of Chinese books to a local authority library, the provision of an IT disaster recovery plan and maintenance services)
 - 19 were calls from Research Councils seeking grant proposals from academic researchers, and for which businesses are ineligible to apply (although they may in some cases participate in academically led collaborations)
 - 3 were for policy research studies for Government Departments (for example, a call from DBERR for a study of the UK’s comparative advantage in “green business”)
 - 1 was for academic scientific research for DEFRA
 - 3 were calls for collaborative projects (in which businesses must participate) under one of the TSB’s grant-based innovation platforms, including a provision for direct funding at a very small scale (up to £50k per project) for SME feasibility studies²⁶
- The maximum size of contracts typically covered by the Supply2Gov database is £100k, compared with a typical size of \$850k under US SBIR.
- Opportunities are advertised on an ad hoc basis, rather than in batches two or three times per annum, with defined award processes and timetables, as in the US.

²⁵ The six months to 14th February 2008

²⁶ The inclusion of the feasibility study element is a welcome addition to TSB programmes, but it should be noted that a 2006 DTI policy framework document specifically emphasised the role of SBRI as a procurement measure. Grants, which would normally attract state aid considerations, were excluded.

- Participation of key departments is small (e.g. NHS) or non-existent (e.g. MOD).
- The Research Councils have opted out of SBRI in favour of policies based on collaborative R&D programmes involving universities. Selling products originally developed for UK customers into the global market for innovative research tools is one of the most straightforward ways of exploiting the UK science base. So the unwillingness of the Research Councils to support small businesses in the same way as their US equivalents puts the UK at a competitive disadvantage. The Small Business Research “Scheme”, the mechanism by which the Research Councils claim to play this role, is undefined on any web site. A well regarded, but small scale SBRI programme operated by BBSRC was discontinued 2 years ago.
- The information provided on individual opportunities is sparse, difficult to use and costs £180 per annum. No information is available on successful bidders. In contrast, information on US SBIR opportunities is highly detailed, very accessible, and free. The names and addresses of awardees and the value of awards are all published on the web.
- The IP picture is unclear but, in at least some cases, IP generated resides with the funding department rather than the awardee. It is a basic principle of the US SBIR programme that IP remains with the contractor. Unlike in the US, there are no standard contracts.

DBERR SBRI Statistics: Why they are misleading

There is widespread frustration amongst small businesses, industry associations, academic entrepreneurs and venture capitalists with the Government’s failure to deliver an SBRI programme that works. However, departmental and political perceptions are influenced by statistics published by DBERR (and previously the DTI) which claim to show that the 2.5% of “target” for the percentage of extramural R&D spent with SMEs is being easily met. The reported 2006/7 figure is 5.9% (7.9% excluding the MOD and 5.4% for the MOD).

The DBERR numbers are largely departmental estimates and are misleading in several important respects:

- It is inappropriate to use 2.5% as a target for the proportion of **total** departmental extramural R&D procurement expenditure which goes to SMEs. The figure of 2.5% used for the US SBIR is simply the proportion awarded through the tightly managed SBIR process **to help firms get on the first rung of the R&D (and technology) procurement ladder**. A target for the total percentage would need to be very much higher than 2.5% - between 10 and 15% - to have any realistic value.
- It is difficult to establish how individual departments’ returns have been compiled or what has been included. However, they seem, in at least some cases, to have included all R&D expenditure with SMEs, including non-procurement expenditures through academically-led collaborative R&D programmes. Indirect expenditures through prime contractors may also have been included in some departments’ estimates.
- As a result mainly of progressive exclusions by MOD, the total “baseline” departmental R&D figures to which the 2.5% is applied have been steadily reduced each year – from £3.6 billion in 2003/4 to £2.3 billion in 2006/7. The baseline for 2007/8 is £1.1 billion.

- The “baseline extramural R&D” expenditure to which the 2.5% “target” has been applied reported by the MOD has fallen from £3.18 billion in 2003/4 to £1.87 billion in 2006/7. The reported value of MOD “R&D contracts won by SMEs under SBRI” fell from £458 million (14.4%) to £99 million (5.4%) over the same period. The proposed MOD baseline for 2007/8 indicates a further significant fall, to £530 million, roughly a quarter of the previous year’s figure. With such large changes from year to year, and a complete lack of transparency over what has been included, it is difficult to attach credence to any of these figures.
- The Department of Health has a very low baseline²⁷ (£60m) yet is officially the second largest spender on R&D after the MOD. It reflects the fact that most of the £500m in R&D funding allocated to NHS providers has historically been absorbed into general expenditure at regional and hospital level. The amount actually spent on R&D is problematic. As a result, the DoH’s current £1.9m SBRI “target” is quite inconsistent with the role of medical technology in the economy.
- The Research Councils are excluded, so that after MOD, by far the largest departmental R&D spenders included in the SBRI scheme are DEFRA and DFID.

Perhaps as important, the analysis of SBRI opportunities actually published suggests that most departments, with the possible exception of MOD which does not participate in SBRI, may have very little involvement in “hard R&D” aimed at developing innovative technological solutions to meet perceived needs. Departmental R&D in the UK seems to be much more orientated to policy studies and quasi-academic research. Innovation and the funding of technology development are seen as the responsibility of private sector suppliers and the DIUS, in stark contrast to US federal government agencies.

The innovative customer is an essential driver of economic development, and it is essential that Government departments pull their weight in this process alongside large companies if we are to build a modern “Innovation Economy” in the UK. The role that Government departments should play in this process through procurement was strongly emphasised in John Denham’s first major speech as Secretary of State for Universities, Industry and Skills and we believe that a US-style SBIR programme could play a catalytic role in bringing about this change.

In his Review of Science and Innovation Policy published in October 2007²⁸, Lord Sainsbury also called for establishment of a US-style SBIR programme to replace the existing SBRI. Responsibility for implementing his recommendation now rests with the DIUS and TSB.

However, putting this into practice is no easy task. We believe that to set up an effective programme the Treasury must take a lead, alongside DIUS, in defining and enforcing it through the budgeting process. Departments must have strategies and resources in place to define their future technology needs, and separate budgets to spend with suppliers. Furthermore, R&D expenditures must be much more carefully monitored to ensure they are “real”.

We believe that all future governments, of whatever colour, will need to take this difficult issue seriously. The devil really is in the detail.

²⁷ The “baseline” is estimated extramural R&D expenditure to which the 2.5% “target” relates.

²⁸ The Race to the Top; a Review of Government’s Science and Innovation Policies; Lord Sainsbury of Turville, HM Treasury, October 2007

Policy Proposals

Small business procurement policy is heavily constrained by EU regulations. Many US policies, if replicated in the UK, would be illegal under EU law. Some also appear to entail high levels of bureaucracy and the risk of economic inefficiencies.

However, we believe the following new procurement policies are both desirable and practical within the UK context. Indeed, we believe they are essential if the nation is to take full economic advantage of the talents that reside in our small businesses.

US Style SBIR Programme

As discussed in the Appendix on Innovation, we fully endorse the detailed proposals for introduction of a US style SBIR programme in the “Secrets” paper²⁹. The key elements of this proposal are summarised in the Panel in Appendix C.

Overall SME Procurement Targets and Statistics

The Treasury should establish and monitor targets for the percentage of each department and major agency’s direct procurement expenditure spent with micro, small and medium sized businesses.

To facilitate this monitoring, standard data should automatically be collected by the Office for National Statistics on all Government contracts and other expenditures over a minimum value in a form similar to the US “Individual Contract Action Report (ICAR)”. This would permit the analysis of SME contracting performance against targets and remove the need for unreliable ad hoc surveys. It would also enable a range of other analyses and reports in support of procurement policy.

Transparency

The transparency with which contracts are advertised and placed should be greatly improved by establishing a UK web portal that covers **all** contracts, not just those worth less than £100k. Full information should be available directly through this website, rather than requiring further searches of individual department websites as is often necessary with supply2gov.uk. Full details should also be published of the organisations to which contracts have been awarded and their value.

Mandatory Participation

Participation in procurement policies should be made mandatory rather than advisory wherever possible (e.g. Small Business Friendly Concordat, participation in SBRI web portal).

²⁹ These are designed to enable a programme very similar to the US SBIR without breaching EU regulations.

