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European Union Committee

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Kelly Tolhurst MP
Parliamentary Under Secretary of State
Department for Business, Energy and Industrial Strategy
1 Victoria Street
London

25 July 2018

Dear Ms Tolhurst,

Brexit: SMEs, including start-ups and scale-ups

1. Between 26 April and 5 July 2018, the EU Internal Market Sub-Committee held four evidence sessions and visited start-up communities in Cambridge to gather evidence on the potential implications of Brexit for UK SMEs, with a particular focus on start-ups and scale-ups. The Sub-Committee first heard from a roundtable of SME owners, representatives and experts, before looking in more detail at start-ups and scale-ups through a visit to Cambridge, an evidence session with experts and a roundtable with start-up founders. The previous Minister for Small Business, Andrew Griffiths MP, attended our final evidence session on the matter on 5 July.
2. This letter summarises the evidence and views put to us and our conclusions (in bold text). We would be grateful for a response to our findings, questions and substantive conclusions by **Monday 12 November 2018**.

Overview

3. We heard substantial evidence about Government engagement with smaller businesses about Brexit. When the previous Minister for Small Business gave evidence on 5 July, he spoke of preparing to “press the button” on widespread engagement once more information has emerged about the UK’s future economic partnership with the EU. We are concerned that by then it may be too late. Small businesses already have legitimate practical questions that are going unanswered. Smaller businesses do not have deep resources to engage proactively with Government, nor to spend time and resource conducting their own research and contingency planning. The onus is on Government to start a dialogue with smaller businesses and support them in planning for Brexit, both in mitigating potential risks and exploiting potential opportunities.
4. We take this opportunity to elaborate on some of the issues most frequently raised by SMEs, start-ups and scale-ups in the course of our evidence – notably on future access to European people and finance and potential alternatives, and new trade opportunities for SMEs after Brexit.

Engagement

5. Witnesses noted that while engagement with representative bodies at ministerial- and official-level had been regular and positive, Government, not SMEs, was setting the terms of that engagement. Adam Marshall, Director-General of the British Chambers of Commerce, asked: “Have the Government gone out and asked businesses what they are worried about, in order to formulate the questions they then try to give information about? They need to make it demand-led.”
6. Witnesses also told us that Government should be helping SMEs understand the implications of potential outcomes of the negotiations for their businesses. Mr Marshall stated: “The Government, having set out their position on what they want to achieve, need to link their preferred outcome to those practical questions. They have a responsibility to do that.”
7. Some witnesses raised limitations of the representative body model of engagement. Ian Cass, Managing Director of the Forum of Private Business, said: “With more than 5 million SMEs out there, if we represent 600,000 or 700,000, what is happening to the rest? They are in a void.” Mr Cass did not think that representative organisations like his own had been able to communicate messages about Brexit to SMEs as effectively as necessary, or that SMEs were yet sufficiently informed to ask the right questions about the implications of Brexit for their businesses.
8. John Foster, Head of Campaigns at the CBI, suggested as a solution “some kind of online portal, hotline or one-stop place where small businesses can get questions answered quickly”. Dom Hallas, Executive Director of the Coalition for a Digital Economy, suggested that one way that Government could communicate with early stage start-ups was through co-working spaces.
9. **We recognise that the Government cannot be expected to contact every SME directly, and SMEs will vary in the extent and nature of their exposure to Brexit risks and opportunities. We welcome the work undertaken so far by representative bodies to inform and prepare SMEs about Brexit. Nonetheless, we are concerned that relying solely on the traditional model of business engagement, using representative bodies to reach SMEs, is not providing sufficient breadth or depth of engagement to prepare SMEs for transition to post-Brexit arrangements.**
10. **Small businesses, start-ups and scale-ups need a place where their concerns can be answered as clarity begins to emerge on the final settlement. Witnesses have provided some ideas for solutions. We urge the Government to consider new and innovative methods of demand-led engagement with SMEs.**

11. The SMEs and start-ups who spoke to us at roundtables on 26 April and 28 June, and on our visit to Cambridge on 14 June, all showed a willingness to adapt to Brexit. Francesca Hodgson, co-founder of Goodbox, said: “For us, Brexit is not a burning concern. We will work with whatever landscape we are given.” There was, however, some concern that they would not have sufficient time or information to do so. Martin McTague, National Policy Director of the Federation of Small Businesses, was concerned that if clarity is not forthcoming in sufficient time before the final settlement comes into force, small businesses might decide to scale back regardless: “They decide to scale back in most cases, unless there is a very clear indication that things have gone well.”
12. Ellenor McIntosh, co-founder of Twipes, told us that her minimum lead time for making decisions about how to adapt to Brexit would be six months to a year. Mr McTague echoed this, describing a typical lead time for SMEs as six months. Dr Radford, reflecting the pragmatic approach of the start-ups at our 28 June roundtable, said: “I understand that keeping your cards close to your chest in a negotiation process is important, but as soon as they are able to we want strong signals as to what is going to happen.”
13. In response to our questions about the lack of engagement to date, the previous Minister for Small Business said:

“It would be a mistake for us to go out now with a plethora of information when actually there is very little information to give. It is better to ensure that we have the channels ready ... Then, when we know the rules and the modus operandi that businesses will be facing, we can press the button and use the whole panoply of channels to get information across to SMEs up and down the country.”
14. **We recognise the importance of providing SMEs with clear and reliable information and we agree that the time to “press the button” on extensive engagement has not yet arrived.**
15. **However, witnesses have stated that SMEs will need between six months and a year to adapt to final Brexit arrangements, and we note that trade negotiations on the UK’s future relationship with the EU may continue into the transition period. We urge the Government to allow enough time within the transition period for SMEs to understand the implications of the final deal for their business, and to implement plans accordingly. How will the Government reassure SMEs before clarity has emerged from the negotiations?**

16. In focusing on start-ups and scale-ups, the Sub-Committee also heard evidence on sector-specific engagement. Notably, witnesses from the technology sector told us that Government engagement had focused too much on larger firms. Mr Hallas said: “The reality is that Government in general, Brexit or no Brexit, is much better at engaging with big companies than small companies ... at the moment we have too many meetings with the 10 biggest technology companies in the world and me sitting in a room.” None of the five founders at our start-up roundtable on 28 June had been given an opportunity to consult with Government about Brexit. Ms Hodgson stated: “[Government] will always go to the bigger companies first; those companies have the biggest voice.”

17. How is BEIS working with other departments, particularly DCMS, to ensure that SMEs, start-ups and scale-ups are engaged on specific sectoral issues as well as larger stakeholders?

Access to talent

18. As for many other areas of industry the Sub-Committee has heard from since the referendum, there was consensus among our witnesses that access to talent was a key issue for SMEs, and particularly for start-ups and scale-ups.¹ Mr Hallas described it as “top of the list for every start-up and scale-up company that I liaise with”, while Philip Salter, founder of Entrepreneurs Network, called it a “critical issue”. A recent Institute for Public Policy Research (IPPR) report, based on interviews with a number of start-ups, also cited access to people as the most common concern of start-ups.²

19. For start-ups, the impact is already apparent. Founders in Cambridge told the Sub-Committee that in recent recruitment exercises they had seen a significant drop in applications from EU citizens. Witnesses attributed this decline to both uncertainty over the status of EU citizens in the UK after Brexit, and to perceptions about the atmosphere in the UK towards migration following the referendum result. Start-ups in Cambridge, which had high proportions of EU staff, also described a significant impact on staff morale. At our roundtable on 28 June, Ellenor McIntosh, co-founder of Twipes, illustrated with reference to her Estonian manufacturing partners: “After Brexit, I think Estonians would be a bit scared. Coming to the UK and working in the UK is always a bit of a dream ... Brexit is now making it not impossible but uncertain.” Steven Hunter, CEO of 9Fin, noted:

“For me, it is as much a question of perception as anything. Whether or not it was intended that way, some of our employees and some of the people we speak to perceived the Brexit vote as, ‘You’re less welcome here than you were previously’. Whether that is the case or not is a different question, but that is sometimes their perception, so for us it is about reassuring our employees and encouraging them still to come to London as a great place to work.”

¹ Noted in oral evidence by Martin McTague, Philip Salter, Adam Marshall, John Foster, founders in Cambridge, Dom Hallas, Irene Graham, Carlos Eduardo Espinal, Steven Hunter, Francesca Hodgson, Ian Jones, and Dr Sean Radford.

² Sarah Longlands, Anna Round and Tom Kibasi, [‘Charting a course for the future: how London’s startup scene can survive and thrive in the age of Brexit’](#), Institute for Public Policy Research, June 2018

20. **Witnesses agreed that it has become harder for start-ups to recruit EU citizens since the referendum result, and that perceptions of the UK's openness to EU migration have been a contributory factor. We welcome recent progress on the future status of EU citizens in the UK, and we encourage BEIS to work with the Home Office to ensure that any final deal for EU citizens in the UK is effectively communicated.**
21. Our evidence supports that taken last session by the EU Home Affairs Sub-Committee, who heard from the Chambers of Commerce and the IPPR that SMEs would struggle with a non-EU work permit system for EU citizens after Brexit.³ Witnesses to this inquiry confirmed that any barriers to UK-EU labour mobility after Brexit would disproportionately affect SMEs. Mr Foster argued that replicating the Tier 2 visa system for EEA citizens after Brexit would be “deeply burdensome” for SMEs, and that the Government should therefore seek to negotiate preferential mobility status for EU citizens.
22. Witnesses were, once again, particularly concerned from the perspective of start-ups. Mr Hallas noted that for seven out of 10 of his member companies (technology start-ups), bureaucracy was the biggest problem of the visa system. He described the challenges of the Tier 2 visa application process for start-ups:
- “The Tier 2 system at the moment requires 80-page forms and is completely unviable for most start-ups. You get this bizarre situation, which is unviable for the vast majority of start-ups but is perfectly fine for large corporates who can afford the lawyers who fill in forms.”
23. Mr Hunter noted that in a competitive market for talent, increased bureaucracy for migration to the UK compared to another EU Member State might be enough to encourage EU citizens to opt against UK jobs. Mr Jones added that, when interviewing a candidate from Australia recently, his start-up had considered the costs and delay of obtaining a visa potentially obstructive. He also suggested that strong EU talent networks channelled start-ups towards recruiting from the EU, and that Brexit “should open our talent pool for recruiting from outside the EU.” Several start-ups told the Sub-Committee on our visit to Cambridge that they found the Tier 2 visa system burdensome and unclear.
24. Mr Hallas also highlighted the importance of being able to recruit quickly for fast-growing firms: “At the moment, a start-up can sign someone up from Berlin on a Friday and they can be working at their desk in London on a Monday ... This is just as important as the volume [of migration].”

³ European Union Committee, [Brexit: UK-EU movement of people](#) (14th Report, Session 2016-17, HL Paper 121), p.42

25. Witnesses called for visa reform in response to this challenge. Mr Hallas and Ms Graham welcomed recent announcements on the 'Start-up Visa' and removal of medical professionals from the Tier 2 visa cap, but both called for further reform. Mr Hallas described Brexit as an opportunity to simplify the visa system. He also requested that criteria consider equity involvement in businesses as well as salary, and that Tier 1 (Exceptional Talent) visas be rebranded to encourage more applications from women. Ms Graham argued for a fast track scale-up visa, which she said would "have a knock-on effect" on export opportunities.
26. At our session on 5 July, the previous Minister for Small Business said: "I can, I hope, reassure the Committee that there are, at all levels of Government, ongoing representations and negotiations on the way a future visa system will operate. The voice of business is clearly being heard."
27. **We were encouraged to hear that the visa system is subject to further discussions between BEIS and the Home Office. We would be grateful for an update on measures to improve the visa system for SMEs as this work progresses.**
28. **We note the Government's intention for a UK-EU mobility framework. This is a valuable opportunity to design a process that works for SMEs, start-ups and scale-ups for both recruitment and mobility of existing staff between the UK and the EU, and we urge the Government to consult them closely in its development.**
29. **SMEs also wish to be able to more easily recruit from outside of the EU. However, the visa system remains prohibitively bureaucratic for small businesses. We strongly urge the Government, notwithstanding the UK-EU mobility framework, to ensure that barriers to recruitment from outside the EU are reduced.**

Access to funding and business support programmes

30. Several witnesses highlighted the importance of the EU's role providing financial and non-financial support to UK SMEs through the European Structural Funds, and in particular the European Regional Development Fund. Mr McTague stated that the north-east, Wales and the south-west have become "very dependent on business support funded through structural funds", and Ms Graham raised its importance in non-financial support for start-ups and scale-ups.
31. Some witnesses were uneasy about the lack of detail released on the Government's proposed replacement for the Structural Funds, the Shared Prosperity Fund (SPF). Mr Marshall said:

“There has been significant delay in the Government coming forward with their proposals as to how that replacement fund could work. That causes concern. Any delay that causes the ramp-up of the fund to happen later than expected would mean a gap between the end of the European funds and the availability of future funds for regional development. That would have an impact on SMEs.”

32. When questioned about the timing of the SPF, the previous Minister for Small Business said: “We hope that later this year we will launch a full public consultation on the rules and the way the shared prosperity fund will operate.” When questioned about the levels and distribution of funding, he said:

“We recognise that ensuring a similar level of funding [to European Structural Funds] would be preferable. Of course, we have a budget, and a Chancellor who makes these decisions, but it is our intention as a Government, certainly within BEIS, to make sure that the very real benefits of this kind of funding ... continue to operate at a level that allows them to be as effective as possible.”

33. Witnesses also emphasised the importance of the European Investment Fund (EIF) for SMEs, start-ups and scale-ups, in forming a substantial part of the UK’s pool of Limited Partners for venture capital funds. Between 2011 and 2015, the EIF committed €2.8bn to the UK, and was the source of more than a third of funding for UK venture capital.⁴ Mark Brownridge, Director-General of the Enterprise Investment Scheme Association, noted that the EIF “has helped to bring about £400 million every year to UK SMEs”. Ms Graham described it as “a cornerstone of a range of funding”.
34. Mr Hallas reported that the EIF had already “turned off the taps” on funding to the UK. Mr Hunter, whose start-up was funded by an EIF-backed venture capital firm, echoed Mr Hallas’s statement. He described the impact on start-ups: “If [venture capital firms] have difficulty raising money, it takes a little longer for it to trickle down to us.” We noted with concern reports earlier this year that EIF investment in the UK had fallen by 91% in 2017.⁵
35. Mr Hallas saw “no rules-based reason” for the cessation of EIF funding to the UK, describing it as “a political process”. He added that the European Investment Bank (EIB) had not been willing to engage on the issue, because the UK Government did not yet have a formal position on their continued participation with the Bank.
36. Mr Hallas, Ms Graham, and Mr Brownridge all welcomed the outcome of last year’s Patient Capital Review, which resulted in a £2.5bn patient capital facility launched by the British Business Bank (BBB) on 13 June 2018. Mr Hallas noted that there remained a question of similar longer-term funding. He also raised the issue of the BBB’s relative inexperience: “The EIB is an organisation that has been set up at this scale for a long time and the BBB is being scaled up to that level ... My main concern is that, as we transition from one system to another, things slip through the cracks.”

⁴ House of Commons Library, ‘[UK Funding from the EU](#)’, 10 January 2018

⁵ ‘[EU investment fund closes door on UK tech start-ups](#)’, *The Telegraph* (21 April 2018): (Accessed 9 July 2018)

37. Mr Brownridge suggested that the BBB should use this fund to address historical regional funding disparities: “Traditionally, a lot of money has gone to the London region, and other regions in the UK have been left behind. We hope that the Midlands Engine investment fund and the Northern Powerhouse funds will see some of that money and help to grow businesses outside London.”
38. Mr Hallas reinforced this point, stating that out of £2.9 billion of UK venture capital investment in 2017, £2.5 billion was directed at London-based firms. Ms Graham called this a “regional disparity”, and suggested it was often “easier to invest in London and south-east businesses”. Founders at our roundtable on 28 June agreed. Dr Sean Radford, CEO of TrainAsONE, joined Ms McIntosh in remarking that promising start-ups existed outside of London, but lacked equivalent marketing to London start-ups. Mr Jones added that there was very little business support available in rural areas.
39. **When he gave evidence on 5 July, the previous Minister for Small Business was unable to guarantee that the SPF would provide the same level of funding to UK SMEs as the European Structural Funds, nor did he provide reassurance on the expected geographic distribution of the SPF compared to the Structural Funds. We will be monitoring developments in this area, including the consultation later this year.**
40. **We are concerned by reports that the EIF has “turned off the taps” on UK funding without a regulatory or legal basis. Can you confirm these reports, and has the EIF recommenced investment in the UK? What representations has the Government made to the EIB and the EIF on this issue?**
41. **As the UK takes back control of investment funds, there is an invaluable opportunity to address regional disparities in venture capital funding in the UK. We welcome the announcement that the British Business Bank will now consider ‘regional imbalances in access to finance for smaller business’ as part of its remit. We hope this will be reinforced with significant funding commitments to develop start-up and scale-up ecosystems outside London, including through the Midlands Engine and Northern Powerhouse funds.**
42. **We noted with interest the points made about the marketing of non-London start-ups, and new initiatives by the British Business Bank to establish clusters of business angels outside London and a network of regional relationship managers. We would be interested to hear more about these initiatives, and other action the Government is taking to help non-London start-ups attract the attention of venture capital firms, angel investors, and other funding opportunities.**

43. Neither EU nor UK funding application processes appear to be working well for UK start-ups currently. Dr Radford described EU funding opportunities as “difficult to find, particularly for a start-up, and ... quite onerous and lengthy”. Mr Jones added that his firm opted against applying for European funding for the same reasons.
44. There was widespread criticism among start-up founders of Innovate UK’s application process. Mr Jones said: “We have given up bothering with Innovate UK. You apply for a grant and you have to work up the application yourself, you submit it and three to six months later you might get some feedback, and it is binary: yes or no.” Ms Hodgson explained that some companies offered to make grant applications on start-ups’ behalfs for a commission, claiming an 80% success rate, compared to 5% for start-ups applying alone. Ms McIntosh called for Innovate UK to “streamline its process, be more transparent and provide detailed feedback.”
45. Mr Jones cited the Welsh Government as a positive example of developing a supportive environment for start-ups: “The Welsh Government have been fantastically proactive in getting ahead of the curve for positioning post Brexit ... It has created a very good template from which the rest of the UK could learn.” He added that SMARTCymru, the Welsh Government’s closest equivalent to Innovate UK, provided support for start-ups submitting grant applications, gave detailed feedback, and came to decisions quickly.
46. **Both EU and UK application processes for research grants appear, from the evidence presented to us, ill-suited for fast-growing companies. Brexit thus presents an opportunity for UK funding bodies to redesign their processes to be more effective for start-ups and scale-ups. Does the Government recognise this opportunity, and what steps is it taking to improve Innovate UK’s application processes?**

Export Opportunities

47. SMEs currently focus heavily on the domestic market; of the 20% who export, Mr McTague told us that 90% trade exclusively within the EU. Witnesses therefore saw Brexit as an opportunity to diversify trading opportunities for SMEs, start-ups and scale-ups. Mr Cass noted that significantly more of his members were interested in exporting than before the referendum result. Ms Graham suggested that, as part of the forthcoming export strategy, Government should use data to “fast track scale-ups into export opportunities”. She added that scale-ups “see huge opportunities in Canada, the US, India, Latin America, Asia and China”. Mr Hallas agreed there were opportunities to “strike out in the world”, but noted that accessing technology markets in the US and China might involve subscription to different models of technology regulation, particularly with reference to data ethics and artificial intelligence.

48. Several witnesses proposed further trade missions for SMEs. Mr Marshall noted that in other countries, Ministers go on “market-making missions” with SMEs, designed to “open doors” for them in new markets. Ms Graham raised London’s ‘Go to Grow’ programme, a trade mission designed specifically to help businesses scale up, and suggested this should be replicated elsewhere in the country. Mr Jones suggested that Innovate UK could build “a team of companies” who could pitch on each other’s behalf.
49. The previous Minister for Small Business told us that BEIS are currently using data to “identify, focus and target our messages on SMEs that are currently exporting”. He also described forthcoming engagement with SMEs as “an opportunity to kick-start and further engage with businesses that are not currently exporting”. Dr Rannia Leontaridi, Director of Business Growth at the Department for Business, Energy and Industrial Strategy (BEIS), also mentioned that the Department for International Trade (DIT) have run more than 1,000 trade missions over the last two years.
50. **We welcome BEIS’s approach of targeted engagement for those SMEs currently exporting to the EU, who will be most affected by a transition to new arrangements. What support, if any, has been provided to these companies about Brexit to date, and what further support is planned?**
51. **What is your assessment of the demand from SMEs for Government assistance in accessing new export opportunities, and what proportion of businesses involved in DIT’s trade missions in the past two years have been SMEs, start-ups and scale-ups respectively?**
52. **Brexit could be an opportunity to challenge SMEs to export more, including outside the EU. However, to do so, SMEs will need Government support. We encourage you to continue working closely with DIT to ensure the specific needs of SMEs, start-ups and scale-ups are considered in the development of the Government’s export strategy.**



Lord Whitty, Chairman of the EU Internal Market Sub-Committee

Appendix: Witnesses to the Sub-Committee's work examining the implications of Brexit for SMEs, including start-ups and scale-ups

SMEs roundtable: 26 April 2018

Martin McTague, National Policy Director, Federation of Small Businesses
Mark Brownridge, Director-General, Enterprise Investment Scheme Association
John Foster, Director of Campaigns, Confederation of British Industry
Adam Marshall, Director-General, British Chambers of Commerce
Irene Graham, CEO, ScaleUp Institute
Ian Cass, Managing Director, Forum of Private Business
Professor John Wilson, Professor of Banking & Finance and Director of Research at the School of Management, University of St Andrews
Rob Vivian, CEO, PureComms
Philip Salter, Director, The Entrepreneurs Network
Simon Hansford, CEO, UKCloud.

Start-ups and scale-ups evidence session: 21 June 2018

Dom Hallas, Executive Director, Coalition for a Digital Economy (Coadec)
Carlos Eduardo Espinal, Managing Partner, Seedcamp
Irene Graham, CEO, ScaleUp Institute

Start-ups roundtable: 28 June 2018

Dr Sean Radford, Founder and Chief Executive Officer, TrainAsONE
Ian Jones, Co-Founder and Chief Strategy Officer, AMPLYFI
Ellenor McIntosh, Co-Founder and Director of Operations, Twipes
Steven Hunter, Co-Founder and Chief Executive Officer, 9fin
Francesca Hodgson, Co-Founder and Chief Operating Officer, GoodBox

Ministerial evidence session: 5 July 2018

Andrew Griffiths MP, previously Parliamentary Under Secretary of State, Minister for Small Business, Consumers and Corporate Responsibility, BEIS
Dr Rannia Leontaridi, Director of Business Growth, BEIS