HYMANS ROBERTSON

Unwrapping productive finance

How do we make productive finance a success?

In our opening **article** in this new series, we introduced the concept of productive finance and explored the role it could play in the UK economy. In this publication, we explore the factors at play and the actions that need to happen if productive finance is to succeed and be a force of good in the UK.

Attracting capital: government and business, pulling together

Success requires us to marry the UK's existing resources with new funding and expertise to create and grow companies with an international competitive advantage. But making the most of the specialisms within our industries requires coordination and support, including affordable capital backing.

That means ***business and government must work together, through shared priorities and supportive policy, to ensure that money is invested in a purposeful way*** and that companies see the UK as a positive place in which to do business.

The main sources of capital

To be successful in attracting providers of capital, productive finance needs to be accessible from the widest range of capital sources. Those include established markets and sources of capital, including equity and debt (both public and private). Productive finance opportunities can also attract capital from both domestic and international sources, thereby bringing fresh investment into the UK.

In the spirit of not breaking what is already working, ***successful productive finance would ideally complement existing private sector capital sources.*** It's the totality of the finance from all sources that can best accelerate growth.

The challenges facing government

1. To attract sufficient levels of investment, government should ensure its offer is appealing to various providers of capital. Typical investor preferences include levels of risk tolerance, appetite for return, liquidity needs and time horizon.

   The UK government is currently exploring the role of alternative providers of capital, such as insurers and international investors. They're also considering how capital residing in pension schemes might be deployed to support productive finance.

2. Another challenge facing government is the one on their own doorstep, which is timely given the budget. Government too will be a key investor in growth and as the recent Budget and Mansion House Statement outlined they will raise finances from both issuing more debt and raising more revenue from tax sources.

The government changed its debt target at the October budget to take account of more 'certain' long-term assets. This is a sensible change that ultimately allows the government to borrow more to invest. However, there's also an onus on the government to maintain market confidence in the supply of new gilts. Part of the reason why gilt yields rose in response to the budget was because almost a third of the new borrowing is to be used to fund day-to-day spending, as opposed to investment. Moreover, the government used almost all of the additional headroom created, raising the risk that it will have to issue more gilts in the future if there is any slippage against forecasts. Indeed, the Office for Budget Responsibility (OBR) has forecast that higher government investment is likely to lead to some crowding out of private investment.

What are the historic challenges?

Investors have typically seen productive finance opportunities as:

- **complex, with high barriers to entry** – in part due to the number of stakeholders on any one investment.
- **uncertain** – investments will often be higher risk, with uncertainty over available returns.
- **longer term** – capital, when invested in a productive finance project, has to be patient, requiring a longer-term commitment from the investor.

These challenges have tended to limit the investor pool to large, specialist institutions and those with deep pockets. Companies and government will have to work hard to mitigate these historic challenges of productive finance investment.

More bang for your buck

Of course, the largest investors will not just bring capital. Through their broader resources and networks, investors can bring opportunities for partnerships and joint ventures, intellectual assets, and access to innovative technologies. These investors also bring introductions to markets and networks that would otherwise be out of the reach of smaller/new start companies in the UK today. By attracting larger investors that can offer more than just capital, from across the spectrum of different capital sources and locations, a project can deliver more for the same capital investment.

In this context, ***the risk for productive finance in the UK is that we are not ambitious enough at the outset***. It would be a missed opportunity to focus on smaller initial steps (ie a narrower range of capital sources, smaller projects, more modest investors, domestic rather than international sources of capital). The government has to create the right environment to ensure that there's a universally positive case for investing in the UK. This would unlock the full potential of productive finance.

Ultimately, productive finance has the capacity to unite private sector industry and government with private capital behind a common purpose, thereby benefiting all stakeholders. When delivered at a significant scale, the first productive finance initiatives will create the momentum that attracts and retains further investment and talent in the UK.

In summary

These are the key things that need to happen to make productive finance a success:

- Businesses and government need to work together
- Opportunities should appeal to a range of investors and capital sources
- Barriers for entry should be removed
- It's important to leverage the influence and skills of larger investors

We'll be exploring more aspects of productive finance in our ongoing series – stay tuned for more. Alternatively, reach out to your usual Hymans consultant.

Contact us

If you want to discuss anything further, or have any questions, please get in touch.

Elaine Torry
Co-head of
Trustee DB Investment
elaine.torry@hymans.co.uk
0141 566 7952