Swapping Debt-for-Equity

Transforming ownership to ease the Covid SME debt burden, protect jobs and create an inclusive economy.

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Social Investment Business

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Executive Summary

Social Investment Business has been running a campaign to explore ambitious solutions to the unmanageable levels of debt facing SMEs as a result of Covid-19. Businesses have taken on a huge amount of debt since the onset of the pandemic, much of it through government-backed loans such as the Coronavirus Business Interruption Loan Scheme (CBILS) or Bounce Back Loan Scheme (BBLS).

Unsustainable debt is set to reach up to £70bn in 2021 and small businesses are estimated to incur half of this debt. We are concerned that as many as 250,000 businesses are in danger of folding over the next year. One third of SMEs have increased their levels of debt and are carrying an average of £173,000 additional debt to service annually – of these businesses, four in ten owners say that this debt is unmanageable.

The need for debt relief:

We are most concerned about areas that are facing a 'perfect storm' of (i) poor or sluggish recovery in economic activity (ii) high proportion of staff on furlough and (iii) high levels of government-backed debt through CIBLS or BBLS. As the various business support schemes have tapered or closed at the end of the year and the scale of the business debt burden becomes clearer, these areas could see a marked increase in unemployment and business insolvency. This could create long-term scarring in the places and communities that were already struggling before the pandemic and present a serious challenge to plans for levelling up the country.

Our analysis of the data shows:

- **There are significant geographic disparities in the economic impact of Covid**: The constituencies that have experienced the greatest economic damage over 12 months are generally concentrated in London, the South East and East of England – although there are also deep recessions around other urban centres across the rest of the country.

- **Some sectors have been hit significantly harder than others:** Businesses that relied on visitors or in-person services – hospitality, leisure, arts, recreation and other service activities – have suffered a sustained hit to their turnover, sales and employment. These businesses will be entering the Covid-19 recovery period in a substantially more precarious financial situation compared to other sectors.

- **The concentration of debt is evenly spread across the country**: there is relative heterogeneity in the regional distribution of CBILS/BBLS loans. While the highest levels of debt are in London and the North West, and there are certain hotspots of high indebtedness around other urban areas, there is no clear regional distribution to the levels of government-backed debt.

- **However, the most at-risk constituencies are heavily concentrated in the North West, London and West Midlands:** when debt is combined with additional compounding economic pressures – including the local recession, cumulative furlough uptake and deprivation – it reveals a set of places that are at serious risk of long-term scarring. Constituencies in the North West, London and the West Midlands account for almost two thirds of the 20% most at-risk constituencies.

- **Urban areas – particularly those in core cities[1] – are at significantly higher risk than rural areas**: based on our analysis 9 in 10 of the 20% most at risk constituencies are in either a city or large town – with constituencies in the core cities and London alone accounting for 4 in 10 of the 20% most at-risk constituencies

The opportunity:

We are interested in interventions that can reduce the debt burden while also driving improvements in the economy and society. The scale of Government backed lending presents a rare opportunity to think about ways of providing debt relief, while also encouraging alternative ownership models like employee, worker or community ownership. This has the potential to ease pressure on SMEs, protect jobs and create a more inclusive and social economy. We also hope to build mainstream recognition that investment in alternative ownership models is an effective pathway for levelling up the country, and through that start to mobilise greater levels of capital to support the growth of these high impact businesses.

There have been calls for wholesale debt write off from various parts of the business community. Whilst this might be a preferable option for business owners, it would also see vast amounts of public money lost without any widespread improvements to business governance or employment terms and conditions. The real opportunity is to find a solution that can both provide urgent debt relief and simultaneously create a more democratic and social economic system, either through wholesale alternative ownership transition or through a partial conversion / hybrid model.

Why alternative ownership?

There are several alternative ownership options – each of which can be adapted to suit the most appropriate legal and governance structures for businesses, employees and their wider stakeholders

- **Direct, indirect or hybrid employee ownership** – through an Employee Ownership Trust model and/or hybrid employee shareholding schemes.
- **Worker cooperative** – workers own and control the business, participating in decision making and benefiting from its financial success.
- **Community business** – a locally rooted enterprise that is accountable to the community (via direct ownership or through its governance) and generates profits that deliver positive community impact.

[1] Core cities: London, Birmingham, Glasgow, Liverpool, Bristol, Manchester, Sheffield, Leeds, Edinburgh, Cardiff, Nottingham, and Newcastle-upon-Tyne – based on the House of Commons Library's City & Town classification of parliamentary constituencies.

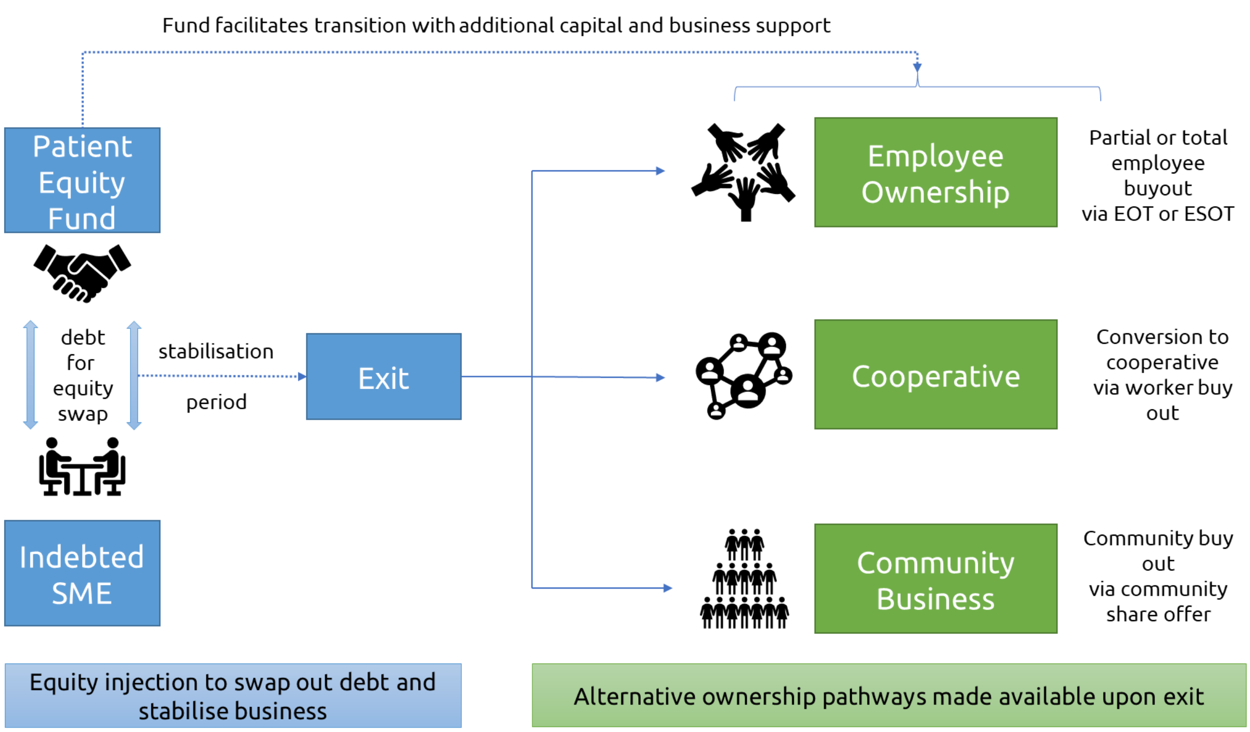
Expanding alternative ownership would have a demonstrably positive impact on businesses, employees and the wider economy. These models have been shown to improve firms' economic performance and resilience, enhance employee satisfaction and reduce inequalities, and strengthen communities in which they operate.[2]

Debt-for-Equity Mechanisms:

During the campaign, SIB hosted two roundtables to discuss the feasibility and design of this kind of debt-for-equity swap – these were (i) a 'patient equity' model bringing together a consortium of investors and (ii) establishing government-backed Employee Ownership Trusts as part of a comprehensive debt relief scheme.

Option 1: Patient Equity Model:

The Fund makes an equity injection into an ordinary company, followed by a transition period where alternative models can be explored. It provides flexibility and wide targeting remit for SMEs, without being too prescriptive on the transition pathways (e.g. employee ownership, worker cooperative, community business or other hybrid shared ownership model). A patient equity approach would allow for repayments to be made when possible, giving time to facilitate conversations with business owners on alternative models and their respective benefits. It could then provide different pathways for businesses that would like to convert straight away, and those that might come to appreciate the value of doing so over time.



[2] The Employee Ownership Association, Cooperatives UK and Power to Change have published substantial amounts of data and evidence on the economic and social benefits of employee, worker and community ownership models respectively.

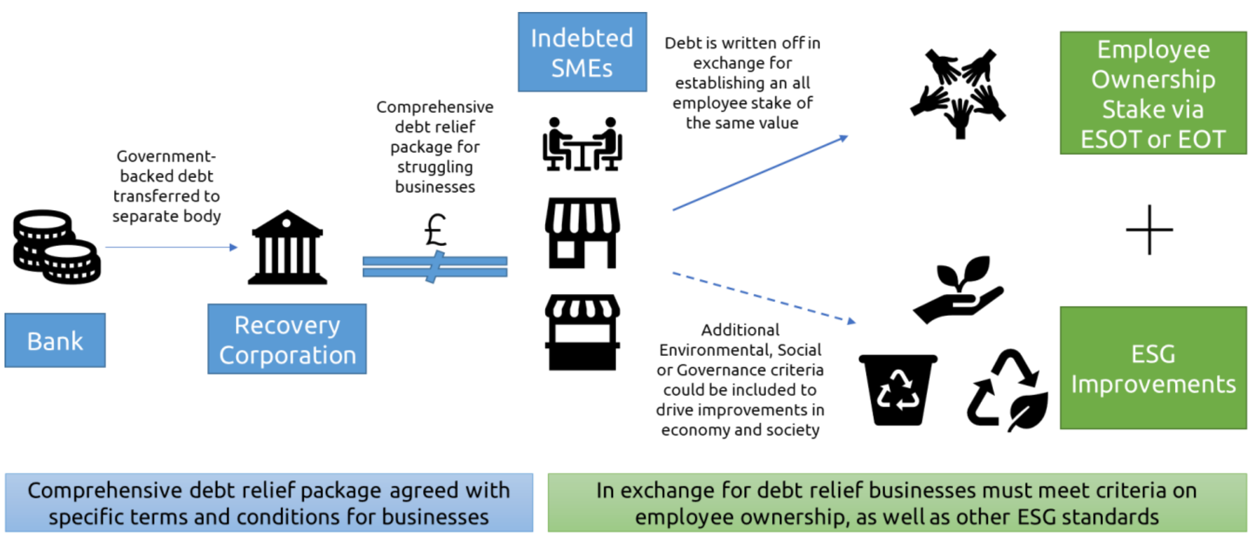
Option 2: Government-backed Employee Ownership Trust:

Employees take a stake that is equivalent to the value of the Government-backed debt. Through this mechanism, employee motivation is super-charged to ensure the business survives and succeeds. If that works, all stakeholders benefit:

- The business can repay the debt, taking it off Government's balance sheet
- The employees hold a stake in their business which enables them to benefit through sharing profits - ideally that stake is accompanied by the other benefits associated with employee ownership (sharing information and influence)
- The business owner has given up ownership of part of his business – but in return the business survives and grows (in part because of greater employee motivation) – and the new internal shareholder is patient (i.e. not driving an early exit)

On the other hand, if the business fails, government and business owners lose what they would have lost anyway, and employees are not out of pocket.

This could be implemented as part of a wider government-backed debt-relief scheme – perhaps as one pathway for business to choose. The debt relief scheme could also include additional conditions to drive improvements in the business' environmental, social and governance standards.



The two options both have potential – albeit with different sets of stakeholders involved – and could even run in tandem. The patient equity fund would bring in capital from a variety of different sources and offer flexible pathways to suit SMEs that are open to a more substantive alternative ownership transition (although this may not be appropriate or desirable for all businesses). On the other hand, the EOT option would require more significant government involvement, and could be offered as part of a wider debt relief scheme that aims to drive improvements in the economy and society.

The debt-for-equity proposal outlined in this paper has the potential to not only support a swift recovery from the pandemic by providing much needed debt relief to businesses, but also to turbocharge the Government's levelling up agenda by empowering the workforce, democratising corporate governance and including more people in the wealth creation process.

Key Recommendations:

Banks, funders and social impact investors:

1. Build the impact case for investing in private businesses to protect jobs and provide good employment in areas of deprivation and/or sectors with endemic job insecurity.

2. Establish impact funds that focus on supporting alternative ownership models, bringing together private equity and institutional investors who are seeking both social and financial return and social and philanthropic funders, particularly as part of a place-based programme to level up deprived areas.

3. Pilot a patient equity fund with a consortium of investors across the spectrum of capital that will support at-risk, yet viable, enterprises transition to alternative ownership models.

Government:

4. Establish an arm's length body to hold and manage bad government-backed debt and provide a comprehensive and conditional debt relief package for struggling businesses with a dedicated employee ownership pathway.

5. Establish a new Alternative Ownership Unit across BEIS and DCMS to support the growth of alternative ownership models – including funding to support technical and legal costs associated with transition.

6. Recognise through both economic policy and industrial strategy the value of alternative ownership models as an effective vehicle for turbocharging the Covid-19 recovery and supporting levelling up agenda.

Introduction

Covid-19 has affected people, places and businesses in different ways. The economic collapse at the beginning of the pandemic has subsided but, as we've edged back toward normality, the shape and pace of recovery has been uneven. While some parts of the country have bounced back swiftly, others have experienced an economic version of long Covid, with a deep and protracted recession that continues even beyond the relaxing of restrictions.

As a result of the unprecedented economic shutdown, many businesses have taken on substantial levels of debt to stay afloat – in part through government guaranteed lending schemes, as well as rent holidays and other commercial loans. There is now a looming danger that high levels of corporate indebtedness will hinder the economic recovery and cripple the SME sector, endangering jobs and livelihoods.

The Government's business support schemes have now been tapered or closed following the easing of Covid-19 restrictions. This will have left businesses in some parts of the country facing a set of compounding economic pressures: high levels of debt, sluggish local economic recovery, and the removal of lifelines like the furlough scheme. It is these places that are most likely to see business closures and job losses – particularly if they were already economically vulnerable due to higher levels of deprivation.

The scale of Government-backed lending presents both a challenge and an opportunity: is it possible to provide debt relief to businesses, while also driving improvements in the economy and society? Debt-for-equity swaps are a mechanism for achieving just this; by writing off debt in exchange for establishing a stake of the business that is owned by employees, workers or the local community. This has the potential to ease the SME debt burden, protect jobs and create a more inclusive and social economy. Alternative ownership models have demonstrable benefits for business performance, employee satisfaction and the wider community: they can drive up wages, improve living standards and strengthen local economies. In short, they can be used as an effective tool for levelling up the country.

It is worth noting in passing that much of the existing social economy (charities and social enterprises) cannot do equity as they have no shareholders. For them, making debt instruments as flexible, patient, impact-led and only used in a viable way is critical to ensure they are not similarly burdened. This is Social Investment Business' approach with both our historical and more recent funds.

This paper is the culmination of SIB's debt-for-equity campaign which brought together communities, practitioners, investors and policymakers to look at this issue in greater depth and co-design ambitious solutions. Chapter 1 presents an overview of the 'Corona Shock' with a breakdown of the economic impact of the pandemic on different geographies and sectors. Chapter 2 presents a geographical analysis of the areas that are most at-risk due to high levels of indebtedness and other economic pressures. Chapter 3 sets out the debt-for-equity proposal, based on discussions during two roundtables exploring the feasibility and design of a fund that would swap out debt and then transition businesses to alternative ownership. The paper concludes with a set of recommendations for banks, funders, social impact investors and Government to implement these ideas, and in doing so create a more democratic economy anchored in alternative ownership models.

1. The Corona Shock:

Covid-19 Impact on Local Economies

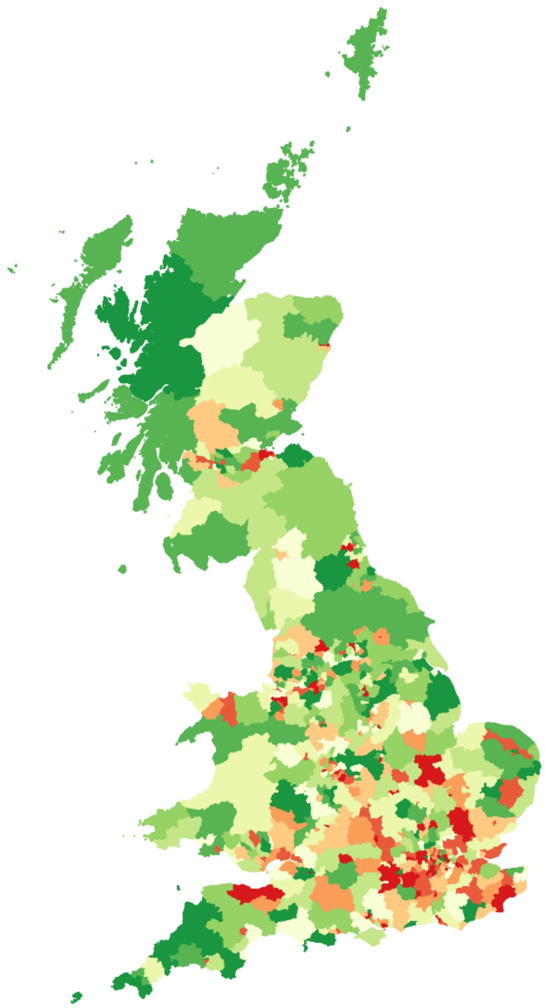
SIB has been tracking the economic impact of Covid-19 on local economies since March 2020 using transaction data on merchant sales at the MSOA level generated for us by the Impact Information Company (Imfoco). By analysing these flows, we have been able to compare economic activity in the latest week or month available with the equivalent period in 2019 to assess the scale and depth of the economic shock in close to real time. These trackers have given us an invaluable insight into how different localities have been able to weather the economic damage caused by the pandemic.

Following the first national lockdown, the overall economy contracted swiftly and immediately but not uniformly (down -33% in April 2020 compared with 2019), with certain parts of the country seeing a far greater impact through this first lock down period. Notably, there were differential impacts between cities and coastal areas, with the greatest health exposure in densely populated areas and the sharpest economic decline in seaside towns and resorts reliant on visitor spending.[3]

As the national restrictions eased during the summer of 2020 and again following the winter lockdown at the beginning of 2021, we saw spending levels in the more vulnerable areas return to 2019 levels generally faster than the least vulnerable. We found this same trend when splitting by IMD deciles and Cameo groups; the areas perceived as disadvantaged did not appear to suffer the same severity in drops of total sales, and they were recovering faster. However, this could have been largely due to a higher percentage of total sales being spent on necessity goods, whereas, less deprived areas will have a higher percentage of total sales on luxury goods (i.e. items that can be cut back without having a significant impact on the consumers' standard of living).[4] A major area of concern is now on those vulnerable and deprived areas that have not recovered in line with the rest of their group, as this points to lower total spend on necessity goods that have a significant impact on the consumer's well-being.

[3] SIB, Covid-19 & Coastal Communities: investing in the social economy to revive seaside resorts and coastal towns (July 2020)
[4] SEDL, Covid-19 & Communities: Sales Deep Dive (April 2020)

Figure 1 - Cumulative change in spending over 12 months at constituency level



Source: SIB's analysis of Imfoco transaction data.[5]

In the 12 months up to July 2021 (and the final easing of national restrictions), there were significant geographical disparities in the economic impact of Covid-19. As some places have seen a recovery or even surge in economic activity, others have faltered or entered into an economic form of 'long Covid' that will have a particularly damaging effect on local businesses. The 10 worst affected constituencies are set out in the table below – this shows the cumulative reduction in economic activity up to July 2021 compared with a pre-Covid 12-month baseline.

[5] This is a year-on-year comparison of 12 months of sales data up to July 2021 compared with a pre-Covid 12-month baseline. This map only shows data for England, Scotland and Wales as the quality of data is patchy in Northern Ireland due

Table 1 – Top 10 constituencies experiencing deepest recession[6]

Constituency	Region	Spending Change (12 months to July 2021)
Hayes and Harlington	London	-60.91%
Luton South	Eastern	-56.20%
Uxbridge and South Ruislip	London	-44.78%
Crawley	South East	-42.39%
Leeds North West	Yorkshire and The Humber	-40.12%
Harrow West	London	-39.81%
Newcastle upon Tyne Central	North East	-37.10%
Peterborough	Eastern	-37.05%
Gateshead	North East	-36.90%
North West Cambridgeshire	Eastern	-35.41%

The regional distribution of the top 20% of constituencies experiencing the deepest recession is also revealing – over half (56%) of these are located in London, the South East and Eastern regions:

Table 2 – Regional distribution of constituencies experiencing deepest recession (top 20%)

Region	Constituency Recession Count	Constituency Recession Percent
London	28	22%
South East	27	21%
Eastern	16	13%
West Midlands	10	8%
North West	9	7%
Scotland	9	7%
South West	8	6%
Wales	6	5%
North East	5	4%
Yorkshire & Humber	5	4%
East Midlands	4	3%

The most severe economic impact has generally been concentrated in London and the South East and East of England, although there are also deep recessions around some urban centres across the rest of the country. It is striking to see the depth of the recession in these constituencies, compared to the England, Scotland & Wales constituency average of 2.93% *growth* – it is also worth noting that over 100 constituencies have seen a substantial increase in spending levels (+10% or more) compared with 2019.

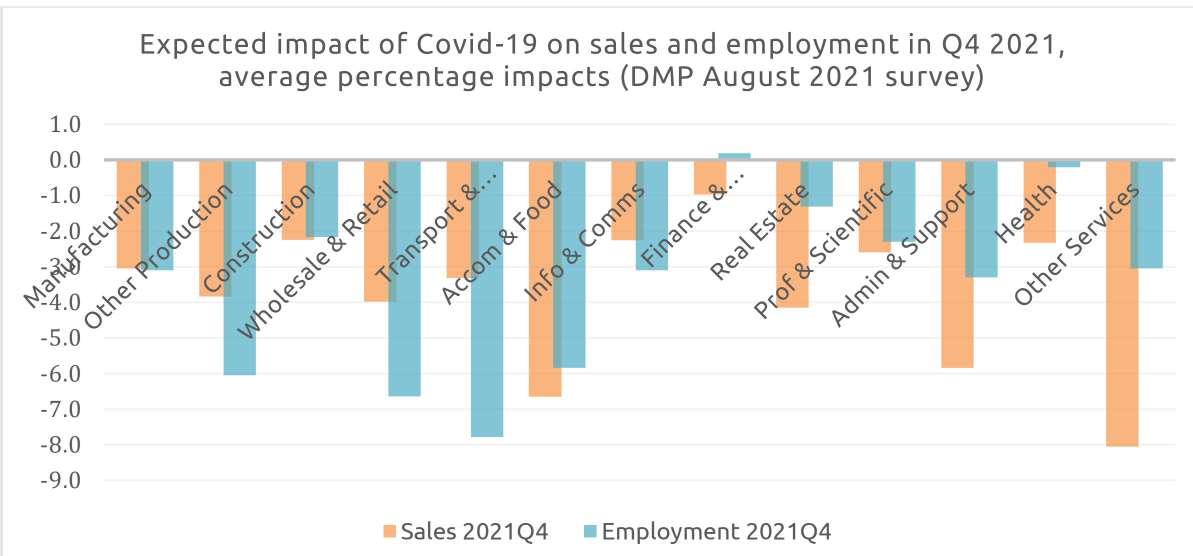
[6] See Table 8 in the Appendix for a list of the top 5% constituencies experiencing the deepest recession.

Covid-19 Impact on Sectors

There have also been significant disparities in the ways that sectors have been affected by the pandemic. Despite the fact that almost all businesses have been negatively impacted – firms reported that sales were 21% lower and investment was 26% lower than they would otherwise have been – there have been some industries that have been hit harder, including recreational services and accommodation and food services, which have seen sales slump lower than 50% than normal during the past year.[7]

The estimated impact on sales and employment by the end of this year shows this variation clearly, with the transport & storage, accommodation and food, and retail sectors seeing the largest comparative percentage point drops on both measures.

Figure 2 – Expected impact of Covid-19 on sales and employment in Q4 2021



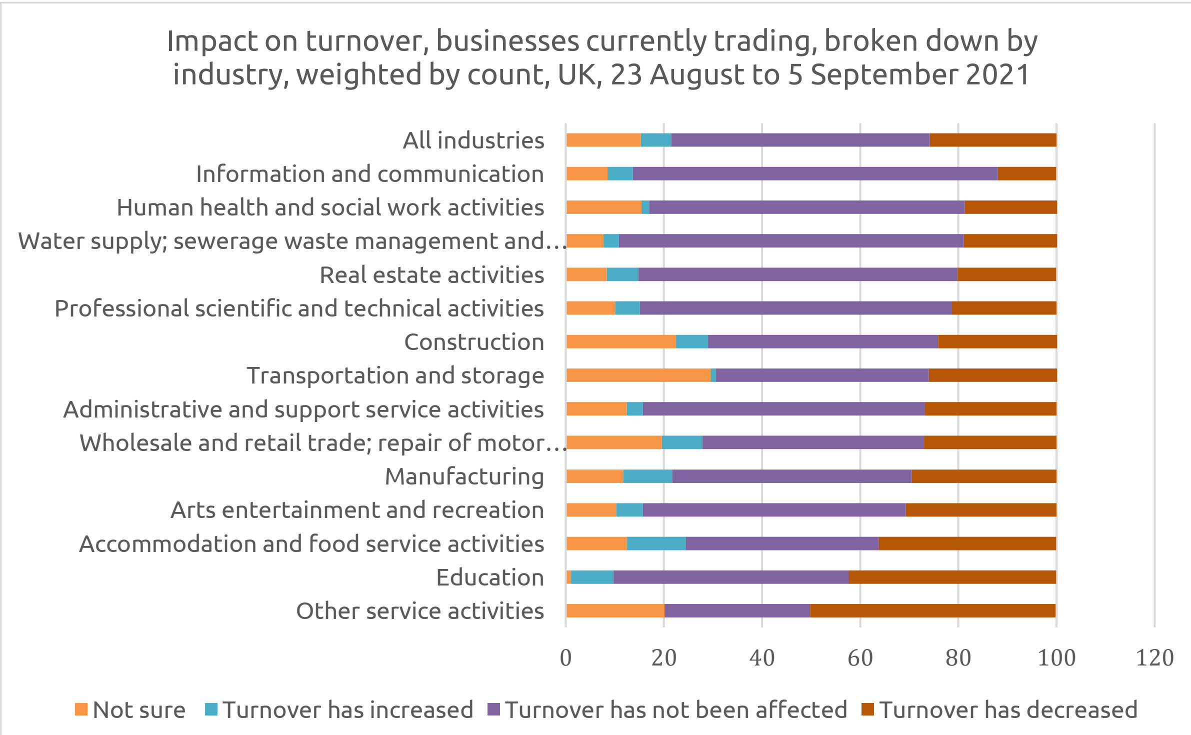
Source: Decision Maker Panel August 2021

A Bank of England staff working paper shows similar results. Their analysis focuses on the financial performance of 2 million SMEs using current account data provided by Experian. The average SME saw a 30% fall in turnover growth between April 2020 and December 2020, with turnover growth still well below the January 2020 level at the end of the year. This turnover shock was not evenly spread across all SMEs however, with younger SMEs and those that operate in Arts & Recreation and Accommodation and Food Services seeing larger turnover growth reductions than average.[8]

[7] Economics Observatory, Which firms and industries have been most affected by Covid-19? (May 2021)
[8] Bank of England Staff Working Paper No. 924, Impacts of the Covid-19 crisis: evidence from 2 million UK SMEs (June 2021)

This trend held even as the country reopened from the roadmap out of lockdown. For example, the ONS Business Insights and Conditions Survey (BICS) at the end of August (Wave 39) – including the summer bank holiday weekend – shows the sectors reporting the largest negative impact on financial performance were those in other service activities; education; accommodation and food services; and arts, entertainment and recreation.[9]

Figure 3 - Impact on turnover, businesses currently trading, broken down by industry



Source: [ONS BICS Wave 39]

Just as the economic impact of Covid has varied by geography, so too has it affected different sectors in different ways. Those that relied most on visitors or in-person services – hospitality, leisure, arts, recreation and other service activities – have suffered from a sustained hit to their turnover, sales and employment. These businesses will be entering the Covid-19 recovery period in a substantially more precarious financial situation compared to other sectors.

[9] Some parts of the accommodation and food services sector are, however, also seeing a slight boom with the easing of restrictions in July, with the largest share of businesses (22%) also seeing an increase in turnover compared with usual. This is something that has also been apparent in SIB's Coastal High Street Tracker, where the food and drink sector in some seaside towns is up as high as +70% compared with 2019.

Government Support Schemes

The Government has introduced various different support schemes and programmes to avoid business closures and job losses as a result of ongoing economic disruption caused by the pandemic. While the title, eligibility and structure of these schemes has changed to flex with the changing context, they can broadly be grouped into three categories:

Grants, Rates Relief and VAT Deferrals: a substantial amount of grant funding was provided by central government to be disbursed directly from local authorities to businesses under various different programmes – including the (now closed) small business / retail leisure and hospitality grant funds, and grants to support businesses whose trading activity was disrupted by restrictions. Business rates relief was also provided to high street businesses and nurseries; and VAT payments that were due in the second quarter of 2020 were deferred until the end of 2020/21 – a total of £33.5bn in VAT payments was deferred between 31 March and 30 June 2020.[10]

Employment Support: the Coronavirus Job Retention Scheme, was one of the most utilised forms of government support during the pandemic. Under this scheme, the Government paid a proportion of wages of people who couldn't work, or whose employers could no longer afford to pay them. The scheme was introduced in spring 2020 and ended on 30th September 2021. As of 14th September 2021, £69bn has been claimed under the Job Retention Scheme, with a cumulative total of 11.4m jobs put on furlough.[11] There was also support self-employed people, with grants given out under the Self-Employment Income Support Scheme (SEISS) – the total value of SEISS claims up to 6th June 2021 was £25bn.[12]

Guaranteed Loans: four different loans schemes were introduced by the Government: the Bounce Back Loan Scheme (BBLS), the Coronavirus Business Interruption Loan Scheme (CBILS), the Coronavirus Large Business Interruption Loan Scheme (CLIBLS), and the Future Fund. For the purposes of this paper focused on the SME debt burden, the two that are most relevant (and those with the largest uptake) are BBLS and CBILS: the former provided 80% guaranteed loans (up to £5m) for businesses with a turnover of less than £45m, whereas the latter focused on smaller and micro businesses with 100% guaranteed loans between £2,000 and £50,000.

The successor scheme to CBILS and BBLS is the Recovery Loan Scheme, which provides access to 80% guaranteed loans up to £10m – this was launched on 3rd March 2021 and was set to run until 31st December 2021. At the Autumn Budget, the Chancellor announced that the Recovery Loan scheme would be extended until 30th June 2022, albeit with a reduced guarantee coverage at 70% on loans up to £2m per business from January 1st 2022.[13]

[10] House of Commons Library, Coronavirus business support schemes: Statistics (September 2021)
[11] HMRC, Coronavirus Job Retention Scheme statistics: 7 October 2021 (October 2021)
[12] HMRC, Self-Employment Income Support Scheme statistics: July 2021 (September 2021)
[13] HM Treasury, Recovery Loan Scheme Guidance (October 2021)

Table 3 – Coronavirus Business Loan Schemes, 31 May 2021

Loan Scheme	Total Value (£bn)	Number Approved	Total Applications
BBLS	£47.36	1,560,309	2,094,858
CBILS	£26.39	109,877	251,342
CLBLS	£5.56	753	1,152
Future Fund	£1.12	1,140	2,206
Total	£80.43	1,672,079	2,349,558

Source: HM Treasury

2. The need for debt relief

A magnitude of debt has been taken on by SMEs since the onset of the pandemic, much of it via Government lending schemes. The BBLS accounted for 93% of loans approved and 59% of funds disbursed. In July 2020, the OBR estimated that 40% of BBLS borrowers might default – compared with 10% for CBILS.[14] In October 2020, NAO put the potential scale of BBLS losses at anywhere between 35-60% of borrowers.[15]

The Recapitalisation Group, convened by TheCityUK, estimated that the total unsustainable business debt by March 2021 would be £67-£70bn, with as much as £20-£23bn of that expected to stem from government-guaranteed lending schemes. Further analysis found:

- SMEs were estimated to incur around half of the total unsustainable debt.
- Over 70% of unsustainable debt is estimated to be held in UK regions outside of London. This is exacerbated by regional disparities in SME access to equity finance on favourable terms to meet demand for capital.
- While regions outside of London account for 72% of unsustainable debt, these regions account for 25% of SME equity finance – with equity finance heavily skewed to London.[16]

A confluence of factors are putting pressure on firms' balance sheets, including CBILS and BBLS repayments, the need to repay VAT and other deferred taxes, and other loan repayment holidays and interest-free periods winding up. Businesses now face further headwinds following the end of the furlough scheme, mounting supply chain issues and inflation. There is also a substantial amount of unsettled rent debt from Covid crisis period – especially for the hospitality sector, estimated at £1.6bn.[17]

The British Business Bank found that gross bank lending to small business hit record highs of over £100bn last year, up 82% compared with 2019.[18] A report from the Federation of Small Businesses found that two thirds of SMEs expect their performance to worsen in the near future; 34% of SMEs had increased their levels of debt, with 40% now saying that they are carrying 'unmanageable debt' (up from 13% pre-Covid).[19] A report by Sage found that small businesses would on average be carrying an additional £173,000 per year in debt due to loans taken out during the pandemic – and only 63% are confident in their ability to repay.[20] This picture has not changed over the course of this year, even as the country has reopened form lockdown restrictions: a recent survey by EY found that 35% of SMEs were concerned about

[14] Office for Budget Responsibility, Fiscal sustainability report (July 2020)
[15] National Audit Office, Investigation into the Bounce Back Loan Scheme (October 2020)
[16] The Recapitalisation Group, The demand for recapitalisation: updated estimates of UK unsustainable debt (September 2020)
[17] UK Hospitality, UKH warns sector is on countdown to rent judgement day unless moratoria are extended (December 2020)
[18] British Business Bank, Small Business Finance Markets 2020/21 (March 2021)
[19] Federation of Small Businesses, A Fighting Chance – avoiding a small business cashflow crunch and empowering a post-COVID recovery (December 2020)
[20] Sage, Impact of COVID set to burden the average SME with over £170K additional debt per year (February 2021)

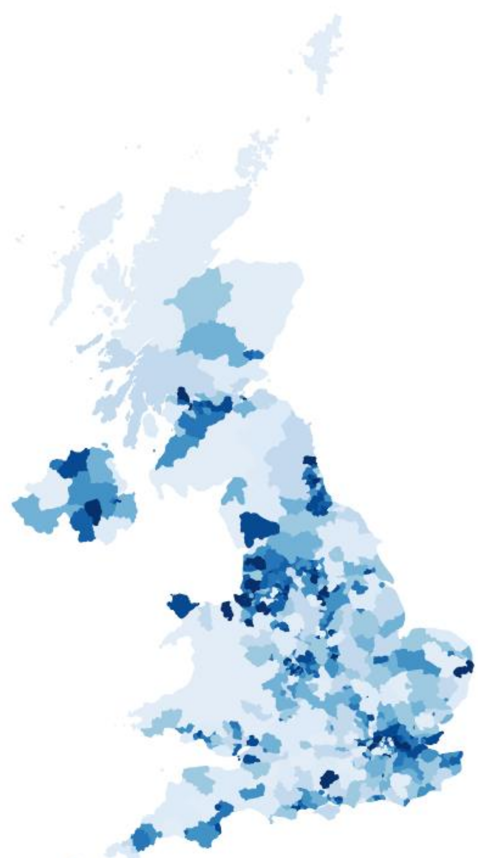
their ability to repay Covid-19 financial support[21], while a recent financial stability update from the Bank of England found a third of small business are highly in debt.[22]

Even for companies that do manage to stay afloat, there is a danger of creating a new generation of 'zombie companies' that are locked in a cycle of generating cash to service their debt load and are not able to make a material contribution to a growing economy.

Analysis of at-risk areas

Our analysis of the CBILS and BBLS data has found relative heterogeneity in the regional distribution of government-backed loans. The highest levels are in London, the South East and the North West, with the lowest levels in Wales and the North East. Broken down into constituencies we can see certain hotspots of high indebtedness, mainly (although not exclusively) clustered around cities and urban areas, however the spread is relatively even across different regions of the country.

Figure 4 – CBILS & BBLS loan density by constituency



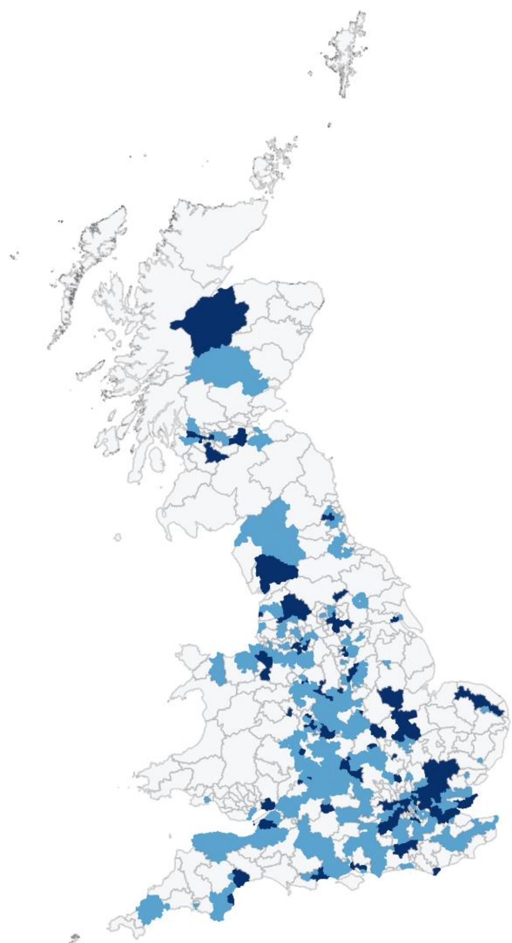
Source: British Business Bank

[21] EY, Over a third of UK SMEs concerned about ability to repay COVID-19 financial support (October 2021)
[22] Bank of England, Financial Policy Summary and Record (October 2021)

We are most concerned about the areas that are facing a 'perfect storm' of (i) poor or sluggish recovery in economic activity (ii) high proportion of staff on furlough and (iii) high levels of government-backed debt through CIBLS or BBLS. As the various business support schemes are tapered or closed at the end of the year and the scale of the business debt burden becomes clearer, these areas could see a marked increase in unemployment and business insolvency. This could create long-term scarring in places and communities that were already struggling before the pandemic and present a serious challenge for levelling up the country.

We have analysed data on furlough, CBILS/BBLS, and our MSOA-level spending data to identify at-risk constituencies across each dimension (i.e. high cumulative furlough take up, high levels of indebtedness, deep spending recession).

Figure 5 – Top 50% (light blue) and 20% (dark blue) at-risk areas based on CBILS & BBLS loan density, furlough uptake and local economic recession:



Source: SIB's analysis of furlough, CBILS/BBLS and Imfoco spending data. [23]

[23] **Furlough** = cumulative number furloughed as % of working population; **CBILS/BBLS** = value of loans as a % business population estimates; **Spending** = YoY % change in total spending for 12 months to May 2021 vs a pre-Covid 12-month baseline.

Table 4 - At-risk constituencies by region

Region	At Risk Count	At Risk Percent
London	30	24%
South East	16	13%
Eastern	15	12%
North West	14	11%
West Midlands	13	10%
South West	10	8%
East Midlands	9	7%
Yorkshire & The Humber	8	6%
Scotland	7	6%
North East	3	2%
Wales	2	2%

The regional distribution of these at-risk areas is concentrated in London and then spread throughout other English regions, with notably fewer in the North East, Wales and Scotland. Nevertheless, pre-existing socio-economic conditions in these areas will be a strong determinant for how easily a local economy can recover. Those areas that were more deprived will struggle to bounce back in line with areas that have stronger local purchasing power and greater economic capacity to return to normal as restrictions ease. For example, both Blackpool South (IMD rank of 3) and Beaconsfield (IMD rank of 514) are highlighted on the map above, but the former is at significantly greater risk of long-term economic scarring than the latter, and thus likely to need more targeted funding and support.

The map below shows the IMD weighted levels of risk for all English constituencies, where darker blue refers to a higher risk. The second, larger map shows the top 50% (light blue) and 20% (dark blue) at-risk constituencies.

Figure 6 – IMD-weighted risk by constituency

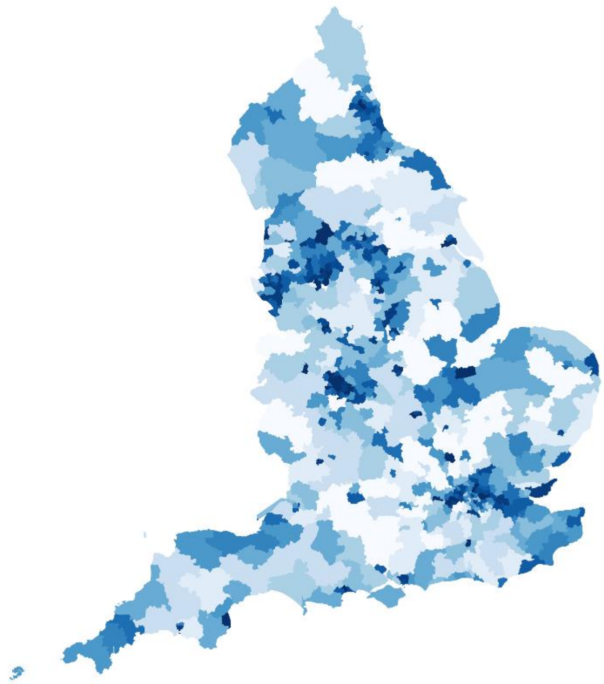
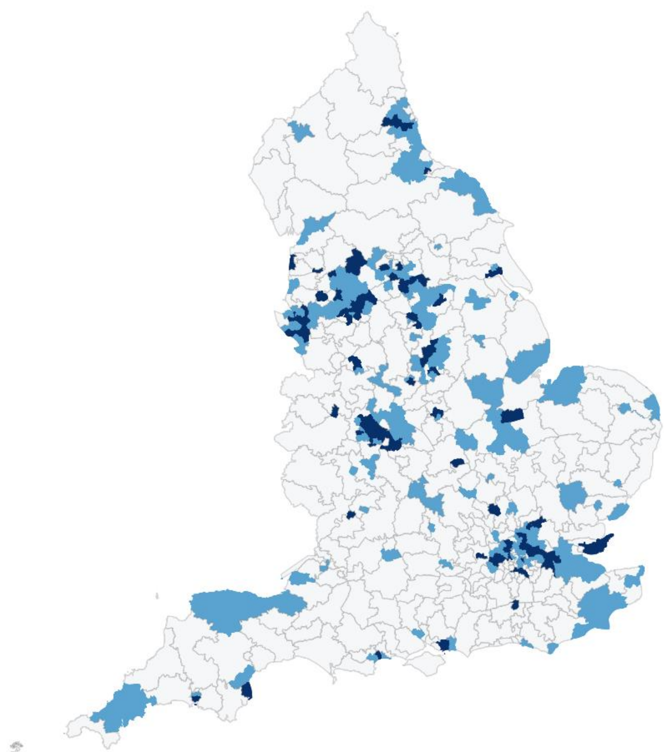


Figure 7 – Top 50% (light blue) and 20% (dark blue) IMD-weighted at-risk constituencies



Source: SIB's analysis of [furlough](), [CBILS/BBLS]() and [Imfoco spending data]() weighted by [IMD]()

Table 5 - Top 10 IMD-weighted at-risk English constituencies[24]

Constituency Name	Region	Risk Score (weighted by IMD)
Tottenham	London	**4.60**
West Ham	London	**4.54**
Birmingham, Yardley	West Midlands	**4.40**
Wythenshawe and Sale East	North West	**4.35**
Blackpool South	North West	**4.34**
Ealing, Southall	London	**4.31**
Hayes and Harlington	London	**4.31**
Pendle	North West	**4.30**
Luton South	East of England	**4.25**
West Bromwich West	West Midlands	**4.24**

When levels of deprivation are taken into account, the regional distribution shifts quite dramatically, with the North West, London and West Midlands accounting for almost two thirds of the 20% most at-risk constituencies.

Table 6 – IMD-weighted at-risk constituencies by region

Region	IMD weighted At Risk Percent
North West	23%
London	21%
West Midlands	19%
Yorkshire & The Humber	9%
East Midlands	8%
Eastern	6%
North East	5%
South East	5%
South West	4%

One striking pattern is the concentration of risk in urban constituencies – based on the map above 89% of the 20% most at risk constituencies are in either a city or large town – with constituencies in the core cities and London alone accounting for 42% of the most at-risk constituencies.

[24] See Table 9 in Appendix for a list of the 5% most IMD weighted at-risk constituencies

Table 7 – IMD-weighted at-risk constituencies by rural/urban classification

Category	Most At-Risk Percent
Village or smaller	0%
Small Town	2%
Medium Town	9%
Large Town	26%
Other City	21%
Core City	42%

It is clear from our analysis that there are significant geographical disparities in the shape and pace of the recovery – which is compounded by other factors including corporate indebtedness, historic reliance on the furlough scheme and pre-existing levels of deprivation. The data shows that risk is most concentrated in urban areas in the North West, London and West Midlands.

Consideration of *place* must therefore be at the heart of an equitable economic response. In particular, those places that were most economically vulnerable – due to levels of deprivation, job insecurity, or low wages – will struggle to bounce back without additional support to ensure that local businesses don't collapse and people's livelihoods are protected.

3. The Opportunity

The scale of government-backed lending presents a rare opportunity to utilise debt-for-equity swaps that could have a transformative impact on society, by transitioning at-risk, yet viable, private enterprises to employee, worker or community ownership at scale. This has the potential to ease the SME debt burden, protect jobs and create a more inclusive and social economy.

We also hope to build mainstream recognition of businesses with alternative ownership models as an increasingly legitimate social/ESG investment category – and through that start to mobilise greater levels of capital to support the growth of these high impact businesses.

There have been calls for wholesale debt write off from various parts of the business community – although this might be a preferable option for owners, it would also see vast amounts of public money lost without any widespread improvements to business governance or employment terms and conditions. The real opportunity is to find a solution that can both provide urgent debt relief and create a more social and inclusive economic system, either through wholesale alternative ownership transition or through a partial conversion / hybrid model.

Alternative ownership models

Strengthening and expanding employee and worker ownership through debt-for-equity swaps can help bolster the Covid-19 recovery by stabilising the SME sector and ensuring that more people have access to good, secure jobs with decent pay and working conditions. There are several different alternative ownership options – which can be adapted to suit the most appropriate context for a business and its wider stakeholders.

- **Direct, indirect or hybrid employee ownership** – through an Employee Ownership Trust model and/or hybrid employee shareholding schemes.
- **Worker cooperative model** – workers own and control the businesses, participating in decision making and benefiting its financial success.
- **Community or customer coop** – existing to serve their members or the local community by locking in community / user benefit; this also has community investment potential.
- **Community-worker hybrid (multi-stakeholder)** – a combination of members own and control the co-operative business; this model retains the worker control benefit alongside the community benefit / community investment potential of the community business model.
- **Co-op holding entity** – adapting long-established coop models (worker, community and multi-stakeholder) to create ‘cooperative ownership entities’
- **Community business** – a locally rooted enterprise that is accountable to the community (via direct ownership or through its governance) and generates profits that deliver positive community impact.

Alternative ownership benefits

Employee Ownership (see more at the Employee Ownership Association)	• **Economic performance:** employee ownership has a positive influence on the economic performance of firms and there is also evidence that it improves productivity. For example, the Ownership Effect Inquiry found that, in 2017, EO businesses achieved year-on-year sales growth 3% higher than that of non-EO businesses.[25] • **Business resilience:** employee ownership increases the ability of firms to deal with economic and business crises by encouraging long-term thinking and investment in human and social capital. This has borne out during the Covid-19 pandemic, where the EO sector saw record growth in 2020, with a 30% increase in new EO businesses.[26] • **Employee benefits:** EO businesses invest in more human capital than non-EO businesses. Employee ownership is positive for employee engagement, reward sharing, employee satisfaction, organisational commitment, identification with the organisation, job attitudes and motivation.[27]
Worker Cooperative (see more at Cooperatives UK)	• **Efficiency in meeting people's needs** – the mutual purpose and democratic structure of co-ops drives inclusion and fairness and makes co-ops effective at meeting common needs – 92% of cooperatives saw their design as a major factor in responding to the pandemic, with 44% citing the support of committed members and 35% identified being able to respond to the needs of customers, members and the community.[28] • **Enhancing the resilience** of businesses, as well as communities, through commitment to the local economy and local supply chains. Co-ops across the UK grew by 1.2% between 2020 – 2021, with almost twice as many co-ops created as dissolved (in contrast to a net reduction in UK business numbers).[29] • **Building community capacity** by mobilising social capital and strengthening local ownership. There are 1,585 community-owned co-ops in the UK, an increase of 2.7% from 2020. Over £111.4m has been raised through community shares; this is money that is retained within communities and helps to generate additional wealth.[30]
Community Business (see more at Power to Change)	• **Bringing communities together:** 82% of community businesses target improving community cohesion as a primary focus – they socialise people from different backgrounds; creating, building and strengthening relationships.[31] • **Strengthening local economies:** 56p of every £1 spent in a community business stays in the local economy, compared with just 40p for large private sector firms.[32] • **Building and maintaining social infrastructure**: community businesses provide crucial, accessible services in response to community needs and wants. A key outcome area is tackling social isolation, cited by 85% of community businesses as a primary focus activity.[33]

[25] The Ownership Effect Inquiry, The Ownership Dividend (June 2018)
[26] The White Rose Centre, Employee Ownership Survey Snapshot (June 2021)
[27] BIS, The Employee Ownership Advantage (July 2012)
[28] Cooperatives UK, The Co-op Economy 2021, (June 2021)
[29] Ibid
[30] Ibid
[31] Power to Change, Community business: The power on your doorstep (2021)
[32] Ibid
[33] Ibid

Alternative ownership models are particularly aligned with the Government's levelling up agenda. They are generally more resilient and productive, they improve corporate governance and include more people in the wealth creation process, and they strengthen local economies and the communities where they are based. Alternative ownership has a substantial and significant role to play in supporting a strong post-Covid recovery and building a more democratic and fair economic system.

4. Debt-for-Equity Proposal

During May and June 2021, SIB ran a series of roundtables to test the feasibility of this proposal and explore different options for fund design. These were technical sessions bringing together expertise on alternative ownership structures, governance and finance to consider potential mechanisms for transitioning businesses to employee ownership, cooperative or community ownership by swapping out unsustainable debt.

The first session focused on the *feasibility* of using debt-for-equity swaps to facilitate this kind of ownership transition; and the second roundtable looked at how to *design* a fund that was practicable, scalable and able to meet this urgent challenge. This chapter presents an overview of the findings from these two events.

Feasibility

Target businesses:

There is 'continuum' of target businesses. At one end there may be 'failing' businesses (from a shareholder perspective) which have significant social value – in terms of, say, employment in a deprived area – and which, with an alternative capital and legal structure, might be viable. At the other end there could be businesses owners who've never considered alternative business models that simply see this as a route out of their unsustainable debt. In the middle there are businesses that might see the value of alternative ownership and would consider a transition – but it is important not to use a financial 'cattle prod' to force this decision; rather to provide an attractive mechanism, alongside capital, that facilitates this decision.

It is also important to ensure that SMEs are entering this fund for the right reasons – for example, there is a danger of 'adverse selection' – i.e. working with business owners that had never genuinely considered alternative models and were only doing so as it was the only/cheapest option available to write off debt, without honouring the other commitments.

Sector or employment type:

Some sectors have been hit harder than others and face a more acute debt burden – particularly accommodation, food and other service activities. Recently, there have been significant shifts toward community ownership in the arts and culture space, with patient equity products being developed for sector specific options. For example, the Music Venues Trust has made investments into grassroots music venues, where certain locally valued businesses have attracted interest from a mix of private investors, community shares investors and donations to sub out their debt.[34] The role of local places or local investors shouldn't be rejected. People who have a particular tie or connection with a business are more likely to be encouraged into different forms of ownership (the community pub movement is a good example of this). Local people could also act as better stewards of the Government stake in a business.

[34] Music Venues Trust, #SaveOurVenues (accessed 19th August 2021)

Another focus could look at specific employment types – for example, there is a real opportunity to drive improvements in employment conditions in businesses with dominant low pay workforces like social care, retail and hospitality. If a solution like this is also to be place-based, it should be up to the locality to decide its priority sectors/employment types and should also tap into national insights about which sectors are ideally suited to employee or worker ownership, as well as targeting those sectors most at risk.

There could also be an option for specific sectors to consider whether they might create a national version of this mechanism. Again, the social care sector could potentially fit: there are a large number of privately or family-owned SME organisations, with significant workforce recruitment / retention / engagement challenges, and an overriding requirement for Government not to let the sector fail.[35]

Technical support:

A significant amount of time and resourcing is needed to shift a business to alternative ownership – including technical support to enable the transition. Additional Government funding for ongoing technical and legal resourcing, beyond any initial equity investment, would be needed in order for a fund to be successful. This is something that is currently available in Wales and Scotland, where there has traditionally been more support made available to promote cooperative and employee ownership. In the US, where they have set up Local Economy Preservation Funds with a similar remit, they have also created a technical assistance fund to meet the ongoing technical support costs.[36]

The Ownership Hub

The Employee Ownership Association and Cooperatives UK have developed the first regional Ownership Hub with Sheffield City Region to grow resilient and inclusive businesses through employee and worker ownership. The Ownership Hub will support economic regions by offering expertise and resources to grow these alternative ownership models as part of their economic strategy.

The Ownership Hub project could be an important partner in this debt-for-equity proposal, providing valuable evidence and insight for how this a fund could be delivered at a regional level, as well as ensuring that there is local capacity building within the area rather than needing to parachute in support from elsewhere.

[35] Ownership at Work are considering how to take forward research specifically on opportunities for EO in the Care sector in the next few months – and this could be something to be considered for a pilot if there was sufficient interest.
[36] Democracy Collaborative, Local Economy Preservation Funds Concept Note (November 2020)

Social value / social business:

The target audience for this fund (privately owned SME's) would not traditionally recognise themselves as 'social businesses', although many are increasingly becoming aware of the need to manage their risks around ESG and some may be aware of the increasing interest of social value metrics for public sector procurement. However, it would be helpful if the social impact of privately-owned SMEs and mid-sized businesses were easier to measure – from the jobs they create and retain, to the value they add in local supply chains.

We need to recognise the positive social impact that many traditional or mainstream SMEs can have – in employment, through ownership and investment, and through their contribution to local communities – and move beyond the idea that these are simply profit-obsessed entities. The UK economy needs a plurality of different ownership models. More work is needed to articulate and evidence the social value and beneficial role that small businesses play within communities, as well as how these could better interconnect and support the local social economy.

Place-based approach:

A fund could be most effective at a place-based/regional-based level – and designed in a way that targets the areas that are most at risk based on their levels of debt weighted by deprivation. This seems especially relevant and appropriate, should the proposal include central Government public finances, as it could be a way to speak directly to the Levelling Up and devolution agendas. This model could offer places that are already innovating in the space of community-based wealth building and/or inclusive business models an attractive opportunity.

If Government provided a level of core funding to each regional fund, places could then be expected to match/contribute to the fund – either through public sector or private/charitable sector contributions. This could then allow a tailored approach to their place's specific needs and unique traits, whilst tapping into a central Government supported strategy. This approach to match-funding could also overcome the challenge around scale, with funds being attracted from the region/place – hopefully with supply matching demand.

Design

The design roundtable focused on two possible mechanisms for a debt-for-equity swap to assess which is most likely to succeed – (i) a 'patient equity' model and (ii) establishing government-backed Employee Ownership Trusts. The core aim was to arrive at a proposition that is practicable, scalable and able to meet the following criteria:

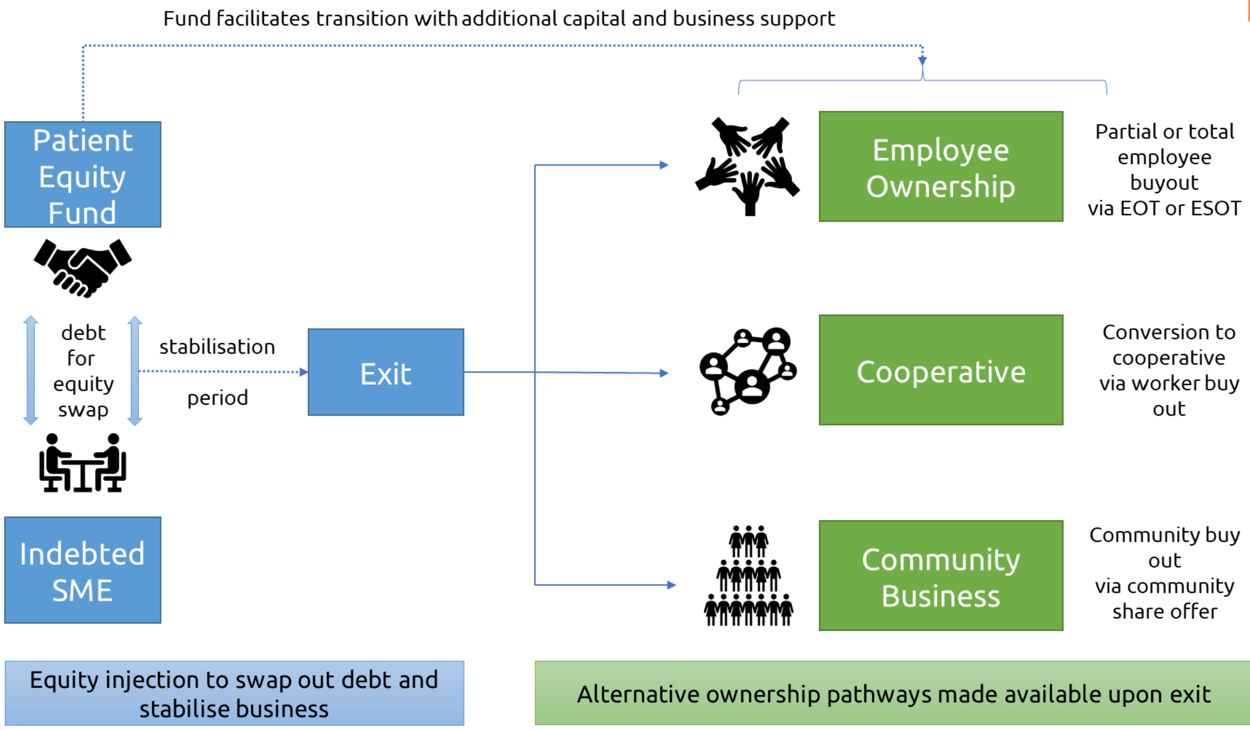
Urgency	• *Can this move quickly to ease the SME debt burden, protect jobs and create a more inclusive and social economy?*
Appetite	• *Is it likely to be an attractive proposition for both capital providers and fund managers?*
Demand	• *Will SME owners and employees be open to this option? Will there be a sufficient pipeline of investible organisations?*
Impact	• *Will this option satisfy the different investor and stakeholder expectations for social impact?*

Option 1: Patient equity model

Shifting ownership models takes time and this option has the benefit of being able to act swiftly – by making an equity injection into an ordinary company, followed by a transition period where alternative models can be explored. It also provides flexibility and wider targeting remit for SMEs, without being too prescriptive on the transition pathways (e.g. employee ownership, worker cooperative, community business or other hybrid shared ownership model). A patient equity approach would allow for repayments to be made when possible, giving time to facilitate conversations with business owners on alternative models and their respective benefits. It could then provide different pathways for businesses that would like to convert straight away, and those that might come to appreciate the value of doing so over time.

The Patient Equity model may need two institutions working hand in hand: one to purchase debt from banks and hold and manage these; and then the other as a social investment institution raising capital to provide patient investment to transition these businesses. There are examples of patient lending on an equity basis in the employee ownership space: Capital for Colleagues and Valloop.[37] A key consideration for a patient equity model would be to understand what the exit looks like.

[37] Capital for Colleagues specialises in advising, investing in and supporting businesses to grow that are, or want to become employee owned. Valloop is a platform that connects investors to a community of mature, profitable SMEs that are looking to exit via an employee co-ownership route.



Urgency:

The patient equity model, once established, would be able to quickly swap out debt for an equity stake in the business and, following a stabilisation period, be able to offer a range of different pathways (employee ownership, cooperative, community business etc) to be made available to owners upon exit. In this respect, it should be able to meet the urgent challenge of providing debt relief to businesses facing insolvency without intervention. The key challenges for this option are sourcing the appropriate capital and ensuring there are exit routes that meet different investors' expectations on financial return vs social impact.

Appetite:

Government may be satisfied with a proposition that retains jobs and keeps businesses afloat. However, the initial focus is likely to be on reclaiming capital, avoiding defaults and addressing the challenge of zombie firms – before thinking about a specific 'social economy' proposal that has a remit to transition businesses to alternative ownership models.

If this fund were to purchase debt from banks, it would need permission from the British Business Bank to novate the guarantee. There would be complexities in doing this, and it could put the fund managers in potential debt collection scenarios with those SMEs that do not want to release equity. The fund manager would need to have a specialised skill set and experience of managing debt – CDFIs would be well positioned here as a regionally distributed set of organisations that have this experience of working with small, fragile borrowers.

Social investors are also well positioned to manage this patient fund, as they have a track record of working flexibly with investees and generally *not* (aggressively) collecting debt from organisations that are struggling. Foreclosure rates are traditionally low in the social investment world – this is one of the significant contrasts that can be drawn with the corporate restructuring world, where SMEs are often squeezed in order to shore up a lender's balance sheets. Social investment sits at the opposite end with flexible relationships and an explicit commitment to seeing the organisations survive and thrive. This is how Social Investment Business approaches its work.

Private markets and financial institutions could be interested in providing liquidity to pay for the debt cash, provided there is another event occurring, for example (i) a sale and purchase via retirement, (ii) the owner has already committed to a co-ownership transition, (iii) or the owner is looking for growth capital to expand the business.

Demand:

The flexibility of pathways offered through a patient equity fund might be attractive to SME owners. There are certain sectors – for example hospitality and leisure – that will be particularly indebted as a result of Covid-19 and may be more open to this kind of fund. However, there are important considerations around targeting – and whether the focus should be on a relatively niche set of SME owners who are looking for a long-term solution to their debt and aligned to values of alternative ownership, or a more open fund that targets all indebted SMEs. One challenge is that there are significantly more 'non-social' SMEs than 'social' SMEs. If a patient equity fund were looking to scale and attract different sources of capital, it would need to be open to a wider set of businesses.

Impact:

There will be different impact expectations depending on the capital providers. For social investors, this proposition (investing in SMEs) is different from standard practice but there is appeal in the transition to alternative ownership models (e.g. employee, worker or community ownership). Additional criteria on environmental, social and/or governance standards could be included to take a more intentional approach to impact. This proposition could be made more attractive to social investors where there could be influence over particular SME working practices – e.g. living wage, employee terms and conditions, approach to low carbon etc. However, consideration would need to be given to the fact that the majority of SMEs would not necessarily see themselves as 'social' businesses, and so there may be resistance to the imposition of impact requirements.

Trusts and foundations would also be key stakeholders that could provide the patient, philanthropic capital needed for this fund. There was an interest in alternative ownership from an innovation potential, particularly around new business models that bring strength to worker voice in governance and improve conditions for lower paid workers. However, it was noted that the impact proposition would need to be more compelling to satisfy their expectations. Retained employment alone is unlikely to be attractive to foundations, especially when many have doubled down on more specific impact areas as a result of Covid-19.

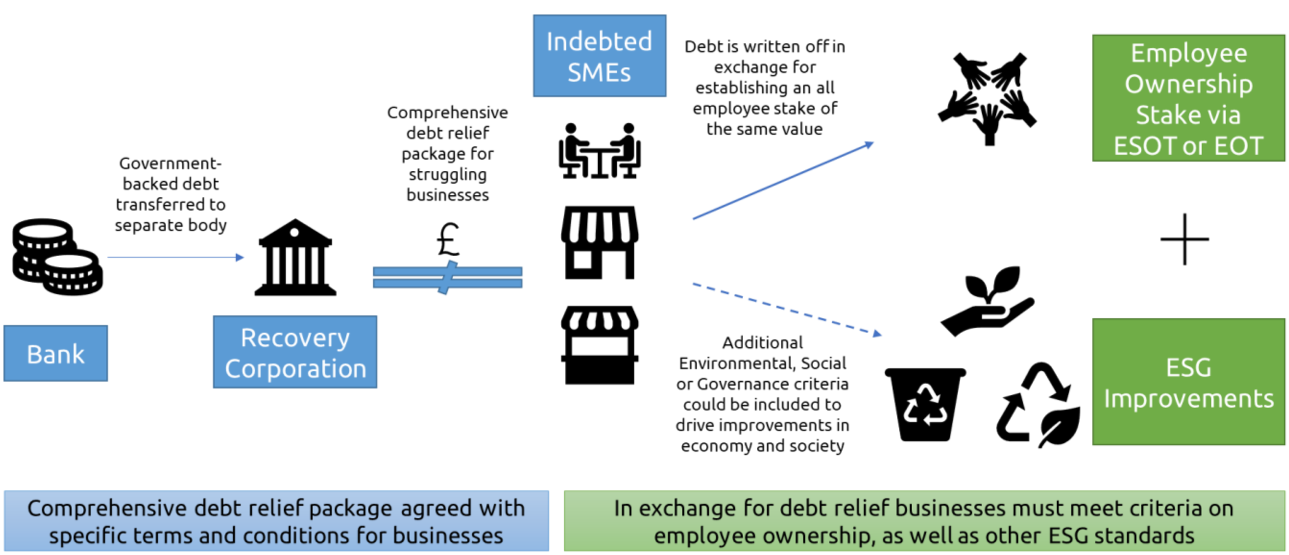
More needs to be done to build the impact case for supporting businesses based on their employment power, rather than a predominant focus on direct service delivery or certain legal forms. Protecting jobs and businesses, particularly in deprived areas, is a powerful lever for 'levelling up' and strengthening the social fabric of communities. There is an opportunity to develop a broader impact model that uses data to identify areas where the frontline social benefit to communities is through sustaining economic activity and creating good jobs.

Option 2: Government-backed Employee Ownership Trust

This option avoids the establishment of umbrella structures that hold a series of small stakes in firms, and instead focuses on ownership transfer only taking place at the level of each individual company. The core elements of this approach are:

1. Employees take a stake that is equivalent to the value of the Government-backed debt.
2. Through this mechanism, employee motivation is super-charged to ensure the business survives and succeeds. If that works, all stakeholders benefit:
    - The business can repay the debt, taking it off Government's balance sheet
    - The employees hold a stake in their business which enables them to benefit through sharing profits - ideally that stake is accompanied by the other benefits associated with employee ownership (sharing information and influence)
    - The business owner has given up ownership of part of his business – but in return the business survives and grows (in part because of greater employee motivation) – and the new internal shareholder is patient (i.e. not driving an early exit)
3. If the business fails, government and business owners lose what they would have lost anyway, and employees are not out of pocket.

The big challenge with this approach is finding a mechanism to do it which: (1) satisfies all the stakeholders (government, business owners, employees, banks), and (2) can be rolled out easily at scale with minimal set up cost in each instance. This EOT option was seen to be achievable as a part of a wider government-backed debt-relief scheme – perhaps as one pathway for business to choose.[38] This debt relief scheme could also include additional conditions to drive improvements in business environmental, social and governance standards.



[38] Ownership at Work, Federation of Small Businesses and RM2 recently released a report outlining a proposal to convert Bounce Back loans into employee equity – this can be viewed here.

Urgency:

The challenge with majority long-term EOT ownership (51% or above) is that it would likely need to be done on a case by case basis; this kind of transition takes time and would require a substantial number of owners to relinquish control of their business – it could therefore be difficult to scale. There are two potentially more scalable propositions which do not require full ownership transition:

(1) Establish minority share EOTs (holding between 25-50%) – this keeps original owners with their controlling stake in the business but adds a long-term employee ownership boost because the employees have a say/share in the success via the trust.

(2) Establish Employee Share Ownership Trusts (ESOT) (holding 25% or less) – this is more 'business as usual' but with some employee share ownership boost because of the ESOT shareholding. The expectations here would be less than with an EOT and may only involve a share in a company's financial success (rather than promoting employee voice etc.).

Appetite:

There appears to be a lack of appetite on the part of Government to establish an umbrella organisation that aggregates small stakes in organisations.[39] In contrast, an EOT is a well-established vehicle with cross party support which the Government understands and backs – potentially making it a more appealing starting point. However, there are challenges around how to arrive at a proposal that satisfies all stakeholders – i.e. government, banks, SME owners.

Nevertheless, the current levels of CBILS/BBLS debt provide a rare opportunity to try something that wouldn't have been possible before: the Government would never have set out to create a vehicle which establishes a set of EOTs but, in reality, a substantial amount of the work has been done already via the government-backed loan schemes.

There are significant transitional set up costs which would need to be covered by an external stakeholder – either the fund manager or the government – as the majority of SME owners are unlikely to want (or be able to) pay for these themselves.

Demand:

An EOT has tax incentives attached to it, although there are many other substantive reasons that SME owners choose employee ownership, including sustainability, legacy and values. However, an EOT structure will not work for all businesses, it will only be suitable for those SMEs where there are enough stakeholders with an active interest in being involved in the trust.

The cost and complexity of employee ownership transition is likely to be a barrier. However, this could be made a more attractive pathway for overindebted SME owners – for example, a fund which could refinance debt, while also facilitating the transition costs and training for

[39] Treasury Committee, Economic Impact of Coronavirus: the challenges of recovery (September 2020)

staff, would be much more desirable. Many businesses may be prepared to change the way they operate if presented with a straightforward and appealing proposition.

There is also a question over the extent to which employees value the idea of alternative ownership in abstract, without also seeing some level of financial benefit. A mechanism which blended a trust model with direct share ownership was suggested as a route to incentivising employees, and more generally involving more people in wealth creation.

Impact:

Arguably, the structural and cultural changes facing a business undergoing an employee ownership buy out are similar to shifting to governance arrangements more closely associated with the social economy. However, this would be dependent upon the size of the employee owned stake and the levels of employee representation and participation in wider decision making. A smaller stake held by an ESOT would see the main benefit through greater profit sharing and wealth generation, rather than workforce empowerment.

Additional conditions could be attached to the EOT pathway – i.e. in return for covering the costs of employee ownership transition the business would have to meet certain criteria on social and/or environmental impact.

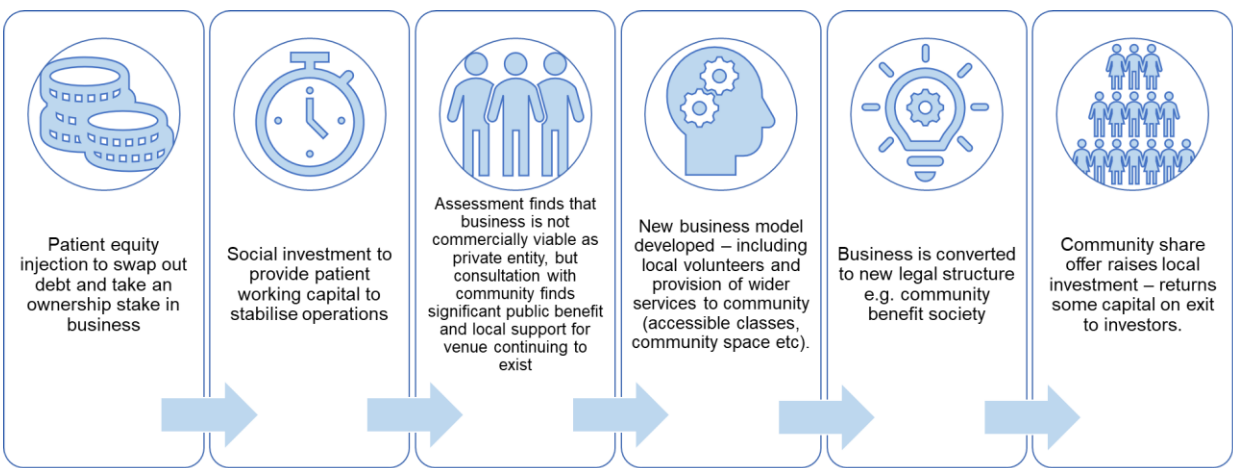
6. Pathways

The two options both have potential – albeit with different sets of stakeholders involved – and could run in tandem. The patient equity fund could bring in capital from a variety of different sources and offer more flexible pathways to suit SMEs that are open to a more substantive alternative ownership transition – although this will not be appropriate for all businesses. On the other hand, the EOT option would require more significant government involvement, as part of a wider debt relief scheme that aims to drive improvements in the economy and society – but may be more palatable to a wider set of businesses, particularly where the owners want to retain a more significant share in the business.

Two examples are set out below to illustrate the different pathways that could be taken with a debt-for-equity swap.

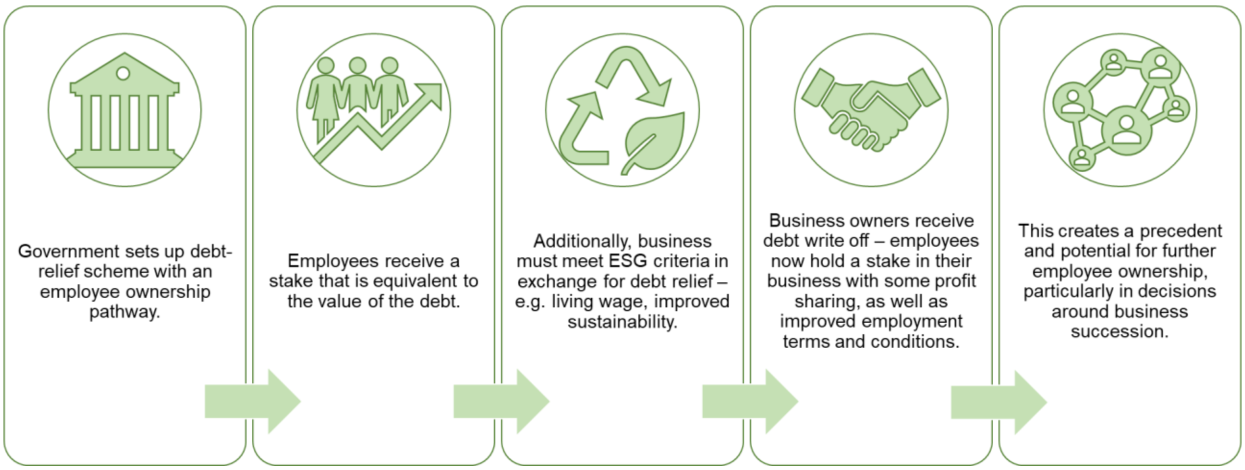
Pathway 1 – Patient Equity:

A local arts and culture venue in Blackpool – important part of local community but at risk of closure. Has received Government grants due to forced closure but facing mounting backlog from pre-existing debts.



Pathway 2 – Government-backed Employee Ownership Trust:

A small logistics firm in Hayes & Harlington – previously profitable and viable business, but operations significantly disrupted by pandemic. Had part-furloughed employees and taken on a £50k BBLS loan.



Conclusion and Recommendations

Covid-19 has profoundly disrupted our economy and society. Many businesses are now under significant financial pressure as a result of the levels of debt they have taken on during the past year and a half, which is only likely to be further exacerbated by the long-term economic fallout from the pandemic, as well as ongoing uncertainty around Brexit and other supply chain concerns. Whilst this poses a serious challenge, it also presents an opportunity to design and test ambitious solutions that could have a profound effect on business governance and employment terms and conditions.

Our analysis of the data has shown that there are areas and sectors that have been disproportionately impacted by the pandemic. In addition, there are some parts of the country – particularly concentrated around urban centres in the North West, London and the West Midlands – that are at heightened risk of business insolvency or job losses due to the greater levels of CBILS and BBLS debt; higher reliance on Government support like the furlough scheme; and a more severe pandemic-induced recession. As a priority, we therefore should be focusing efforts on supporting businesses in these at-risk areas in order to avoid any long-term economic scarring – particularly in those areas that were already more exposed due to levels of deprivation.

The debt-for-equity proposal outlined in this paper has the potential to not only support a swift recovery from the pandemic by providing much needed debt relief to businesses, but also to turbocharge the Government's levelling up agenda by empowering the workforce, democratising corporate governance and including more people in the wealth creation process.

Our campaign has evaluated two viable options for using debt-for-equity swaps to promote alternative ownership models. Funders, banks and social impact investors should come together to explore options for a patient equity fund that can support at-risk, yet viable businesses and facilitate their transition to alternative ownership models. At the same time, the Government should urgently introduce a debt-relief package with the dual objectives of easing the SME debt burden and promoting employee ownership alongside the inclusion of certain ESG criteria.

The slogan 'build back better' has been taken up by the Government during this pandemic, and this rightly should be our overarching aim as we begin the post-Covid recovery. The proposals outlined in this paper are an attempt to make this slogan a reality: to create a more democratic, redistributive and inclusive economy at scale by promoting alternative ownership models that empower people and enhance business productivity. It is a unique opportunity to genuinely level up the country by doing things differently – we shouldn't let this moment pass us by.

Recommendations

Banks, funders and social impact investors

1. **Build the impact case for investing in private businesses to protect jobs and provide good employment in areas of deprivation and/or sectors with endemic job insecurity.** As social investors, the focus should be on 'good jobs' – with decent pay and working conditions – but this requires shifting the scope of what is deemed an impactful business to the level of employment, rather than focusing exclusively on the delivery of particular services. The benefit of this approach is that it significantly expands the potential of social investment by increasing the scope of investible organisations. It also opens space for innovative collaboration between social investors, enterprise lending CDFI's, trusts and foundations and mainstream impact investors.

2. **Establish impact funds that focus on supporting alternative ownership models, bringing together private equity and institutional investors who are seeking both social and financial return and social and philanthropic funders, particularly as part of a place-based programme to level up deprived areas.** There is the opportunity to design a fund that can satisfy investors differing expectations of financial return and/or social impact through a patient equity fund that is able to spread risk across its portfolio. If this fund were to be given a place-based dimension, there is further potential to draw in local anchor institutions to support investees through local supply chain development and preferential access to procurement contracts, which could help to grow a strong social economy anchored in alternative ownership.

3. **Pilot a patient equity fund with a consortium of investors across the spectrum of capital that will support at-risk, yet viable, enterprises transition to alternative ownership models**. There are several options that a patient equity fund could take to support the growth of alternative ownership models, including:
   - **Equity and transition:** an equity injection into a business followed by a transition to alternative ownership upon exit – be that some form of employee ownership, cooperative or community business – as described in Chapter 5.
   - **Asset acquisition and incubation:** where the fund purchases local assets to provide affordable working and trading spaces for local social enterprises, or indebted SMEs that are willing to incorporate some elements of alternative ownership. A grant pot is made available to support enterprise development (for social businesses) or facilitate transitional costs (for private SMEs). There would be potential for a full asset transfer over time when this is affordable to the organisations, either through growth in profitability and/or a community share offer to divest assets to the local community.
   - **Social merger fund:** an established local social enterprise would be selected to receive investment funding in order to grow their business and asset base – with part of the funding designated for onward investment to buy out struggling or at-risk local businesses or services that are of significant community value. Investors are paid back their original investment over time by the social enterprise as it grows in profitability. This model also has the positive benefit of building a stronger 'connective tissue' in the local social economy.

Government

4. **Establish an arm's length body to hold and manage bad government-backed debt and provide a comprehensive and conditional debt relief package for struggling businesses with a dedicated employee ownership pathway**. Businesses that are struggling with loan repayments and at risk of default would apply to have their debt transferred from their bank to this new body which would hold and manage the debt while the owners are presented with a debt relief package. This allows banks to recoup their capital without pursuing aggressive debt collection which puts businesses at risk of foreclosure. Debt relief would be offered to businesses on the proviso that certain conditions are met to drive improvements in the economy and society – including the establishment of an employee owned stake alongside other ESG conditions. This body would also act as a neutral arbitrator to determine a fair valuation of the business as it enters into the debt relief agreement. Additional weighting or special dispensations could be given to those businesses that are providing employment in areas of high deprivation to ensure alignment with the levelling up agenda.

5. **Establish a new Alternative Ownership Unit across BEIS and DCMS to support the growth of democratic ownership models such as employee, worker or community ownership – including funding to support technical and legal costs associated with transition.** Given the levels of resourcing needed to facilitate a transition to alternative ownership models, this unit should provide funding and expertise to facilitate and strengthen the presence of these models, working closely with the Employee Ownership Association and Cooperatives UK. There is still relatively low awareness of employee, worker or community ownership as viable succession routes for business owners. The Alternative Ownership Unit could work with regional and local government, membership bodies and funders to increase awareness, facilitate transition costs and provide expert advice on business governance and alternative ownership structures.

6. **Recognise in both economic policy and industrial strategy the value of alternative ownership models as an effective vehicle for turbocharging the Covid-19 recovery and supporting levelling up agenda.** There are demonstrable positive benefits of shifting business governance toward more democratic and inclusive models. The Government should recognise that these high impact businesses can actively support key policy priorities, including the levelling up agenda, and harness their potential to boost productivity, redistribute wealth and drive improvements in the workforce and corporate governance.

Next steps

We will continue to focus on this work, given the both the urgency of the challenge and scale of the opportunity presented by the levels of government-backed SME debt. Below we set out practical next steps that SIB will focus on, alongside a call to action for partners and stakeholders who are interested in taking forward this debt-for-equity proposal.

What SIB will do:

- Develop the impact case for protecting businesses and jobs in deprived areas, particularly in the areas that are most at risk of business closures and job losses due to levels of unmanageable debt.
- Draw up worked examples of how the fund would invest in a business and the different pathways it could offer.
- Test investor appetite from capital providers – public, private, philanthropic, institutional – to understand different expectations for impact / financial return.
- Test demand and pipeline from indebted business owners who may be willing to work with a patient equity fund to transition their business to alternative ownership.

What we are calling on partners to do:

- Engage with Government and British Business Bank to test appetite / feasibility for a mechanism that swaps out debt for an all employee equity stake.
- Build coalition of support within Government and across business infrastructure bodies for an EOT pathway as part of a wider debt relief package.

Appendix

Table 8 – Top 5% constituencies with deepest recession

Constituency	Region	Spending Change
Hayes and Harlington	London	-60.91%
Luton South	Eastern	-56.20%
Uxbridge and South Ruislip	London	-44.78%
Crawley	South East	-42.39%
Leeds North West	Yorkshire and The Humber	-40.12%
Harrow West	London	-39.81%
Newcastle upon Tyne Central	North East	-37.10%
Peterborough	Eastern	-37.05%
Gateshead	North East	-36.90%
North West Cambridgeshire	Eastern	-35.41%
Kingston and Surbiton	London	-33.68%
Kensington	London	-33.46%
Southampton, Itchen	South East	-33.21%
Ealing, Southall	London	-33.14%
Dartford	South East	-32.35%
West Ham	London	-31.10%
Hammersmith	London	-31.02%
Aberdeen North	Scotland	-30.01%
Brentford and Isleworth	London	-29.11%
Glasgow Central	Scotland	-28.62%
Islington South and Finsbury	London	-26.71%
North East Hampshire	South East	-26.43%
Pendle	North West	-26.42%
Reading East	South East	-26.30%
Nottingham East	East Midlands	-25.94%
Sheffield South East	Yorkshire and The Humber	-24.54%
Solihull	West Midlands	-24.29%
Cambridge	Eastern	-24.16%
Bridgwater and West Somerset	South West	-24.07%
Leicester South	East Midlands	-24.03%
Saffron Walden	Eastern	-23.64%
Edinburgh North and Leith	Scotland	-22.82%

Table 9 - Top 5% most at-risk English constituencies (IMD weighted)

Constituency Name	Region	Risk Score (IMD-weighted)
Tottenham	London	**4.60**
West Ham	London	**4.54**
Birmingham, Yardley	West Midlands	**4.40**
Wythenshawe and Sale East	North West	**4.35**
Blackpool South	North West	**4.34**
Ealing, Southall	London	**4.31**
Hayes and Harlington	London	**4.31**
Pendle	North West	**4.30**
Luton South	East of England	**4.25**
West Bromwich West	West Midlands	**4.24**
Burnley	North West	**4.22**
Blackley and Broughton	North West	**4.14**
Barking	London	**4.13**
Birmingham, Erdington	West Midlands	**4.12**
Edmonton	London	**4.05**
East Ham	London	**3.97**
West Bromwich East	Sandwell	**3.96**
Birmingham, Hodge Hill	West Midlands	**3.96**
Sheffield South East	Yorkshire & The Humber	**3.95**
Slough	South East	**3.95**
Leicester East	East Midlands	**3.95**
Leeds West	Yorkshire & The Humber	**3.94**
Kingston upon Hull West	Yorkshire & The Humber	**3.93**
Denton and Reddish	North West	**3.92**
Wolverhampton North East	West Midlands	**3.91**
Gateshead	North East	**3.91**
Northampton South	East Midlands	**3.86**

Methodology

In order to determine levels of risk, each constituency was ranked according to compounding economic pressures below. This score was then weighted by the constituencies' IMD ranking.

- **Levels of debt**: [value of CBILS & BBLS debt] / [constituency-level business population estimates]
- **Furlough uptake**: [cumulative number of people on furlough] / [working population]
- **Spending recession:** year-on-year percentage change in spending in the 12 months to July 2021 compared with a pre-Covid 12-month baseline.

Risk Score = [Levels of Debt] + [Furlough Uptake] + [Spending Recession] + ([IMD Rank] x 2)

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