Speeches by the Governor of the Bank of England

Given at the Lord Mayor's dinner to the bankers and merchants of the City of London on 20 October 1977.

In speaking for the fifth time at this annual dinner, I find myself, despite her fate, in the position of Lot's wife – unable to resist the temptation of a retrospective glance. For the period since October 1973 has seen us and much of the world at grips with a malignant and unparalleled combination of inflation, financial disequilibrium and recession. The consequences for the world economy are likely to be long-lasting, and may, I fear, prove inhospitable to the optimistic expectations of earlier years.

The nadir of our own fortunes came at around the time of this dinner last year. The early stages of the way back from that situation, the way back to health, have proved beyond expectation successful. After what has already been said, I need not elaborate on the turn-round in our financial condition.

Perhaps more interesting is why it has happened. The causes include such important factors as the strengthening current account position, due to reducing dependence on imported oil and lower commodity prices, and the outstanding success of stage two of incomes policy. But the essential catalyst was the credibility at last of the efforts made to put the national finances onto a more prudent and stable basis. Bankers are sometimes disbelieved when they speak of the effects of confidence. Let me simply record that our financial turn-round is a spectacular demonstration of what confidence can do. The December measures and the endorsement – not the cash – of the International Monetary Fund turned opinion, led to the agreement that I was able to reach in Basle with my fellow central bank Governors concerning the sterling balances, to the euro-dollar borrowing which the Bank arranged on behalf of the Government and thus by successive steps effected a cumulative reinforcement to confidence. The lesson should not be forgotten.

The real economy has not been transformed in the same way. Output has continued to stagnate, and unemployment to grow. Here too, however, though progress can only be gradual, we can begin to see better things. Having taken a cut in living standards, we can now expect the economy to show some growth over the next year and indeed, provided we manage things properly, we can look forward to a longer period in which growth is sustained at more normal levels.

None I am sure will dispute my proviso about good management. If a fiscal stimulus is needed to support the process it must clearly be modest – and, I would add, consistent with prudence in the monetary sphere. The need for such prudence is indeed the first theme I intend to develop tonight.

But I want to relate my remarks on this and other matters to a longer time scale. For the advent of North Sea oil is going to give us a special chance in the years to come. There is nothing, however, in history to suggest that chances are necessarily taken. They can just as easily, or perhaps even more easily, be muffed. I want us to take our chance. I propose therefore to indicate some guideposts which, from where I sit, seem relevant to the direction of policy.

Monetary restraint and the containment of inflation have been my constant preoccupation over these last years, and I see nothing to suggest that they will not continue to have a crucial importance in the period ahead. I want therefore to say something about our experience.

Financial stability requires monetary stability; and I regard the adoption of published monetary targets, first formally enunciated at this dinner last year, as an essential foundation. Allow me, my Lord Mayor, to indicate again the reasoning that leads me to this view.

Probably the most immediate benefit from publicly announced monetary targets derives from the assurance that money will not itself be a source of instability. Beyond this, monetary targets give a clear indication to those responsible for economic decisions – including those affecting the course of future costs and prices – of the limit to which the authorities are, in effect, prepared to see inflation financed in the months ahead: the implication being that inflation at a faster rate will inevitably put output and employment increasingly at risk. I would not myself look for any short-term relationship between changes in the money supply and changes in prices; but, over time and as they are persevered with, I would expect monetary targets to be an increasingly pervasive influence in moderating inflation.

Such perseverance with monetary targets in the longer run would require a changed perception of monetary policy. Monetary instruments have hitherto tended to be seen as providing essentially flexible support for other tools of economic management. But if monetary targets are to provide, as I believe they should, a continuing and long-term constraint on the inflationary bias which our economy, along with others, has been shown to possess, it would follow that the availability of monetary instruments for other purposes would, over time, be significantly reduced. This seems to me to be a logical and desirable extension of the course we are now on.

Having lived with published monetary targets for only a year, I am sure that we still have much to learn about them, but I think we can look on our experience in the first year with cautious satisfaction. If one goes back to July last year, we had a succession of months when the money supply grew unduly rapidly, so that for a time it seemed we were going to fail to live within the limit we had set for that financial year. Yet over the whole fifteen-month period since July last year M_3 has grown by $9\frac{1}{2}\%$ at an annual rate, comfortably within our target range. And so we have done what we said we would do, and I am greatly encouraged by the general recognition, by people of widely differing political views, that our monetary policy has been a key factor in turning the financial situation.

This achievement has not been without its problems. But we have, I think, shown some ingenuity in meeting

them. Our use of debt management techniques such as the partly-paid issue and the variable rate stock has helped us to match the Government's funding programme more closely to the needs of monetary control. I should, however, remind you how difficult it is to forecast month by month what these needs may be, for the behaviour of the money stock reflects a wide array of financial flows which may vary considerably in the short run. Not only do external capital flows defy prediction. The central government borrowing requirement itself fluctuates widely, as also does the scale of bank lending to the private sector. Fluctuations on the domestic side frequently tend to offset variations in external factors. Nonetheless, it is inescapable that there will be erratic variations in the figures, as the statistics for the latest two banking months illustrate.

The figures for September, published today, have shown a large rise in the money stock and bring the cumulative growth this financial year to 5.2%. Scaled up to an annual rate this comes to a figure at about the upper end of the 9%–13% range within which we are working. I need hardly say that this carries no implication of failure to meet our targets for the year. But equally the situation gives no ground for complacency; rather it emphasises the need for a sharp weather eye on present and possible future developments and the exercise of nice judgement.

The achievement of monetary stability during the last year has been accompanied by encouraging headway in checking the pace of inflation. But it is still far far too high both from the domestic standpoint and in comparison with our principal trading partners. There must be no wavering in our resolve to bring inflation down not just to single figures but well into single figures, and I am sure that this must require the continued assurance and discipline of living within appropriate monetary limits. I see it as one of my prime purposes and, indeed, as a duty for me and the Bank to ensure that we continue to do so.

I have so far been speaking principally of monetary conditions. I do not however for one minute overlook, and am indeed painfully conscious of, the waste of resources, both labour and capital, in our economy. Yet continuing monetary stability is a necessary condition if we are to overcome these fundamental problems: but it is only a necessary, not a sufficient, condition and it is to other conditions that I now turn.

Without doubt we are now faced with a world environment much less hospitable than a decade ago. Although inflation remains almost everywhere disturbingly high, the world economy is still in deep recession; recovery is at best uncertain; and the prospects for general recovery towards what we had come to regard as normal capacity utilisation seem, unfortunately, far from assured. This has given a severe jolt to confidence – confidence that the economies of the free world are capable of performing and being managed in a way that had come to be taken for granted.

Amidst all this, we in the United Kingdom have in North Sea oil an advantage not available to many other countries. But we must see straight just what North Sea oil can, and what it cannot, do for us. It can help us solve our problems, but it does not of itself do the job. For our problems stem basically from the patent inadequacy, when taken overall, of our economic performance. What we have to find is a way of converting the energy from the North Sea into a force that will give momentum to the rest of the economy; and we must use the time it buys us – for it is only a temporary endowment – to tackle in a fundamental way the constraints, largely self-imposed, which hold us back.

The benefits of North Sea oil will not all come at once. Perhaps fortunately therefore there will not be a single point in time when we have to take one decision on how best to use them. But we need to agree on the guideposts for policy.

Oil is a depleting asset. Responsible husbandry of our resources indicates that we need to convert it into a permanent gain – that is to create additional income-yielding assets and to reduce income-sapping liabilities. There are three ways in which we can do this: by repaying external debt, by investing at home and by investing overseas.

For my part, as I said at the beginning of this year, I am clear that the first claim on the use of North Sea oil should be a strengthening of our external balance sheet. The great increase since then in our official reserves does not cause me to change that view. More than $20 billion of foreign currency debt falls due for repayment between now and the end of 1984. Some refinancing can responsibly be envisaged to spread the burden from heavy repayment years. But the goal must surely be to run these external debts right down, well before the time when the oil – on the strength of which they were raised – begins to run out. This may strike some as an unimaginative use of part of the North Sea resources, but I see it differently. We only have to look back one year to be painfully reminded of the extent to which the extreme weakness of our external balance sheet compromised our independence. We must ensure that we never find ourselves in that position again. In short, we must strengthen our external balance sheet directly while we can – not only for economic ends but to ensure that our voice is fully effective in the counsels of Europe and the world.

I turn now to domestic investment. A natural priority here must surely be the development of new sources of energy, for it is not oil in the North Sea only which promises to be running out before the year 2000. Investment in the energy sector will make an important claim on our resources and responsibility for this will no doubt lie principally, though by no means wholly, in the public sector. I should also want to stress the importance of conservation and I should be happier if I saw greater determination in this respect in all industrial countries.

We all agree, I think, on the desirability of using the benefits of North Sea oil to assist in the re-equipment and revitalisation of British manufacturing industry. The question is: how? It is not going to be easy. After the long decline of profitability and the trauma of recent years, confidence in much of the private sector in this country, as elsewhere, has been seriously shaken.

As I said here in 1975, we shall not get the investment we want simply by a flood of finance. Such investment will stem from genuine opportunities affording the prospect of a good return. Moreover we can hardly expect industry generally to find more investment for expansion an attractive proposition until better use can be made of existing equipment. What we badly need is better productivity. Let me give you an illustration of what this could mean. A 1% increase in our annual rate of productivity growth would, if sustained, be worth more to us in output, even by the early 1980s, than the annual contribution to GDP of North Sea oil. You will not be surprised therefore that I stress productivity as a key aspect of the improved efficiency we need. There is no greater task before us than to raise our productivity to international levels. It requires a national focus calling for the combined energies of management and unions alike, in which Government can help by making approbation and reward a consequence of increased efficiency. It is also a key – through increased profitability – to increased investment. If we could begin to see a real transformation in our productivity performance, new investment would not be far behind, and finance would not be lacking to support it.

Besides domestic investment, there should, in the longer perspective I am describing, be scope later on for some relaxation in respect of direct investment overseas. Such investment is also a way, and a good way, of securing a future flow of overseas earnings. The importance of that will become all the clearer when North Sea oil has passed its peak. I see a policy of relaxation here as complementary to a policy of encouraging higher domestic investment; and I do not believe that the first must or would damage the second.

Quite aside from the need for physical investment at home and abroad, invisible trade also requires to be nurtured with new injections of capital resources. In this connexion I think we can appropriately on this occasion take justifiable pride in the City's continuing contribution to our overseas earnings. I want to record tonight my warmest congratulations on this achievement. I hope that our stronger external financial position will in due course enable us to reduce at least some of the obstacles to efficient further development of its already major contribution.

It is time for me to be done. But let me first recapture the themes I have been developing. There is in front of us a reasonable, indeed a good, prospect. If it is not, as we move forward, to fade forever with the horizon, we need a stable structure of policy. I have suggested three elements: to respect the restraints – sometimes seemingly severe – of a stable monetary environment; to husband prudently the temporary endowment of the North Sea; and above all to encourage by approbation and reward the skills and productivity of all who in their myriad different functions create the national wealth. It is on this basis that our prospects rest not only of a materially successful but also of a civilised and compassionate society.

Given at the ICFC Conference on the Future of the Private Company in Britain on 25 October 1977.

There are three particular reasons why I am delighted to be able to address this conference today. The Bank of England might reasonably be described as midwife to the birth of ICFC in 1945: first then, it is appropriate that I should try to make a contribution to its enterprising initiative in organising this conference. Second, ICFC was my first home when I exchanged the exposed rigours of the Bar for the competitive pressures of finance: it was as a sort of supernumerary adviser at ICFC from 1955–57 that my interest in the financing of industry was first allowed a practical expression. I have therefore a personal as well as an institutional interest in ICFCs activities. The third and most important reason is that I am wholly convinced of the importance of the subject to which your deliberations today are devoted: all who share my belief that the future prosperity and well-being of this country can only be based on a properly balanced mixed economy must be concerned with the health and prospects of the small business sector. And may I say in passing that I intend to treat 'private companies' as synonymous with small firms or businesses. I am of course well aware that it is neither legally nor semantically exact to do so, but it is, I believe, small firms – defined in the 1971 Bolton Report on small firms as those 'managed by the people who own them' – that we essentially have in mind.

That report must be the starting point for any analysis of the small business sector. It for the first time gathered statistics for, and analysed the problems of, a sector of the economy which at that time – using the definition of its term of reference – employed over seven million people (or nearly one third of the working population) and produced about one fifth of GNP.

I do not want to take up too much time explaining why I think the sector important. I should be preaching to the converted, and the essence of the case is admirably put in the Bolton Report. But there are some things which I should single out. I want to stress for example the adaptability and flexibility which small firms can give to our general industrial and commercial structure – a particular merit at a time of much necessary change. Then again I would single out as particularly significant, as did Bolton, the innovative function of some small firms, and their importance as a means of entry into business for new entrepreneurial talent and as a seed-bed from which new companies will grow to challenge and stimulate larger and more established companies.

We must also look to the small business sector for an important contribution to the lowering of unemployment. Not only is it relatively more labour-intensive than much established industry, but also it is in this sector that new industries to replace those that are declining must have their origin. Finally, I would attach considerable importance to the industrial relations aspect: small firms can more easily be manageable than large companies, not least because it is easier in a small firm for those who work there to identify themselves with the activity and fortunes of the enterprise. I need hardly say that in pointing to these characteristics I do not of course in

any way intend to underrate the crucial rôle of larger companies.

The final judgement of the Bolton Report – stated with some misgivings and reservations – was that the decline in the sector had not gone so far that there was a general case for statutory discrimination in favour of small firms. Nevertheless the report produced some sixty recommendations aimed basically at removing discrimination against small firms, and these have mostly been implemented.

The Bolton Committee based its cautious optimism about the future of the sector on the feeling that the 'vigour and adaptability of the small firm' would naturally combine with the increased demand and personal wealth accompanying any general improvement in the economic climate, provided 'market forces are allowed reasonably free play'.

But what they could not anticipate at that time was the economic trauma that would be experienced from 1973 onwards. This massively affected business profitability generally, but bore especially harshly on small firms. For in times of low demand and liquidity pressures, large firms are always in a better position to transmit the pressures they feel down the line, in terms of higher prices or tighter trade credit terms. Furthermore, the deteriorating economic climate has been accompanied by an increase in the amount of new legislation affecting business in general, with a corresponding increase in the administrative burden borne by small businessmen, which they already regarded as excessive.

Such considerations have led John Bolton to give his revised judgement that in retrospect the recommendations of the committee should have been stronger – leaning more towards positive discrimination in favour of small firms. With Sir Harold Wilson having indicated at his recent press conference that, in the first stage of his committee's inquiry, they would be looking at small firms very closely, and with Mr Lever also making a special study, it would clearly be foolish of me to attempt to pre-empt their findings. But examination of the evidence seems to point to three, by no means unfamiliar, areas where there may be remediable deficiencies. Perhaps I may categorise these as the perpetuation of the MacMillan equity gap, the lending gap and the information gap, and I wish to say something about each in turn.

The MacMillan gap – as now perceived – is twofold: a shortage of initial, venture or seed capital for start-up situations, and a shortage of equity capital to finance the expansion of a firm which has successfully got itself going. Bolton concluded in 1971 that the health of the sector required:

> . . . an economic and taxation system which will enable individuals to acquire or establish new businesses out of personal resources and to develop these on the base of retained profits. Without this no institutional financing arrangements can preserve the small firm sector.

Few would feel that the situation in this respect – not least through the effects of inflation – had improved since those words were written.

I shall come later to what I think Government and the City can do about this, but I have two immediate comments. First, not all small firms deserve to succeed. It is an essential strength of the market sector of the mixed economy that businessmen have to sell themselves and their ideas to others, and that their products have to meet the test of the market place. If no entrepreneurs complained of failure to get finance, I should be concerned lest this sifting process was not working. What is important is that there should be a variety of sources of finance, institutional or otherwise, for budding or expanding businesses to approach, so that survival is not put at risk by sheer absence of financial facilities.

My second comment is that if there is an equity gap, then it is unrealistic to expect it to be filled by a simple return to the past. The decline in the number of individuals with capital which they are prepared to invest in small businesses, and in the amount of the resources such individuals command, does not seem to me wholly reversible. Some shift in the pattern of personal savings towards the institutions must be accepted, along with its corollary that institutions must be looked to as a source of some part of the funds which earlier were mainly provided by individual investors directly. We should not, however, be blind to the consequences of the differences of approach to investment between individual and institutional investors. The individual takes risks with his own money because he has a tendency – not always justified by history – to trust his own judgement. If he is wrong, however, only he and his family suffer. But institutions are investing other people's money, which induces a caution of which few of those entrusting their money to them are likely to be critical. There are also administrative economies of scale which reinforce the natural tendency of institutional investors towards investment in large companies. If the small business sector is not to suffer from this trend towards the institutionalisation of personal savings, we must look to the institutions to devise new vehicles for making their due contribution to the financing of small business. This in turn implies some change of attitude by the proprietors of small businesses: they may have to be willing to share more of their equity than their instincts urge them to do.

What I have called the 'lending gap' also has two aspects: the availability of money from banks, and its cost. The availability of bank finance is, of course, closely related to the availability within a business of equity. If a business is short of equity, its owner may well soon be aware of a gap in the availability of bank finance. But the burden of small business complaint to the Wilson Committee on this score is not so much that banks are unwilling to lend, but rather that small businesses pay higher interest charges than larger ones and receive stiffer demands for security in respect of borrowing. Here I would simply like to say that new and small businesses generally, not only in the United Kingdom, have historically paid more for finance than established and large businesses. They have been able to pay the premium that lenders reasonably require for greater risk, either because they enjoy a kinder tax regime or because of the existence of a climate in which

takers of high risks can reasonably contemplate high rewards.

Both these gaps may be to some extent widened by the existence of the third gap – the information gap. Some of the Wilson evidence suggests, as did both Radcliffe in 1959 and Bolton in 1971, that small firms are often unaware of the variety of finance available to them or where to seek it. This is coupled with criticism that banks – and it is evidently clearing bank branches that are primarily intended – are unsympathetic to the needs of small business. One cannot of course controvert those who deny having access to information on sources of finance. But, in view of what is in fact available – from the Confederation of British Industry, from the Department of Industry's Small Firms' Information Service, and various other government agencies, and from the banks themselves – I am puzzled at the apparent lack of financial inquisitiveness of a number of would-be entrepreneurs. The information is there; the problem seems to be to get it disseminated.

I turn now to what Government can do. In one important sense they can do a very great deal – most importantly to get the business climate right. This is partly a question of macro-economic management. But there is also a major rôle for Government to play in determining the attitudes of people towards business and profitability. In our present situation, I believe that the creation of an environment more benign to business is likely to be far more efficacious for the small business sector than any specific acts of intervention or legislation.

Furthermore, taken as a whole, I do not read the Wilson Committee evidence as seeking substantial and particular government intervention to solve the problems of small businesses. Rather its main message is a desire for a more friendly environment, from which inflation and the uncertainties and damage it causes are eliminated, in which effort, enterprise and risk-taking have the prospect of reward and in which there is some sign that the web of legislation and administrative regulation is being loosened rather than tightened. A distinctive additional plea from small business – distinctive in that in many cases it lies at the core of the willingness and ability to carry on a business at all – is for an environment in which capital can be accumulated and passed on.

Environmental changes do not take place at a stroke. Just as the decline in the morale of the sector has taken place over many years, confidence that the atmosphere has permanently changed for the better will not return quickly. Rather it can only evolve over a number of years against a background of stable and consistent policies.

Few of you here would disagree that it is in the field of taxation that there is greatest scope for benign government activity. A better tax climate would be a more potent token of a shift in sentiment in favour of small business than would specific measures taken to subsidise the cost of finance or to plug the information gap.

Now while my earlier legal experience gives me a great interest in fiscal matters, it is not my intention to trespass on the Chancellor of the Exchequer's territory. One cannot, however, do justice to the problems of small firms without pointing to certain areas where existing fiscal conditions clearly cause particular difficulties for them.

Let me begin by trying to put the emotive question of taxation into a more general context. A significant part of the intention of taxation is redistribution – of income and also of wealth. Many would, I think, argue that there can arise tension between the social purposes of redistribution and economic efficiency. But this either/or approach, posing the problem as a stark choice, may miss the point. It used to be the conventional wisdom to think that there was a choice between unemployment and inflation. It is now increasingly widely realised that they stand or fall together. Similarly, might not the achievement of our underlying social objectives be easier in the context of improving economic efficiency?

In applying this line of thought to the small business sector, I begin with capital taxation, since small businesses typically begin with an injection of capital, however small, from an individual and tend, if successful, to go on to involve members of that individual's family. The small business sector cannot thrive unless it is possible in the first instance to accumulate capital, and then to transmit it to one's family under conditions which do not compel either the wholesale withdrawal of funds from the business or its sale.

There are also a number of ways in which the taxation of income currently impairs the efficiency of small firms, particularly through the combined effect of company taxation and personal taxation. It might for instance matter less that taxation on the profits of small companies should inhibit the formation of capital from retained earnings and limit the willingness to take risks by limiting the rewards, were it not combined with the effect of personal taxation in inhibiting saving which could be channelled directly into small firms as outside equity. Government has recognised that the level of direct personal taxation adversely affects incentives and thus blunts initiative, entrepreneurial and otherwise. But welcome changes can take place here without necessarily enabling people to save a reasonable amount from their income.

It is therefore the aggregate of the tax burden on small businesses that needs to be looked at, as well as its complexity. It is to be hoped that the work being done by Professor Meade's Committee under the auspices of the Institute for Fiscal Studies may lead to some measure of simplification.

Another area that might be looked at is inhibitions to lending arising from uncertainty over the deferred taxation element in company balance sheets. There can be little doubt that the stock relief provisions of 1974 were designed to bring permanent relief to companies: yet banks and other providers of finance cannot prudently ignore the resultant and relatively very much larger deferred tax provisions in assessing the borrowing capacity of potential borrowers. Their particular concern, of course, is the possible preference of the Inland Revenue over other creditors in a liquidation. This is a technical area; and I believe that representatives

of the banks and the Inland Revenue might advantageously discuss the matter further, so that the nature of the problem may be further clarified and the best solution emerge.

Finally, value added tax. I have not studied this in detail since my committee reported on it in 1964. But here too there may be simplifications for small firms that would be worth exploring in order to contribute to relieving the administrative burden.

Compared with changes in the taxation field, the scope for useful government intervention of other kinds is, I think, likely to be more limited. What can Government do about the information gap? In response to the Bolton Report, the Department of Industry has established Small Firms' Information Centres in the main economic regions of England, Scotland and Wales, and similar services are provided through the Department of Commerce in Northern Ireland. Other government agencies, such as the Council for Small Industries in Rural Areas and the Welsh and Scottish Development Agencies, are also active in advising small firms. Nevertheless, the persistent claims of lack of knowledge suggest that a more positive approach may be required to the dissemination of information. We ourselves are looking into the idea of preparing, after wide consultations with other interested parties, a handbook on the availability of finance for industry, with the aim of having this available for circulation, directly or indirectly, to a large number of small firms.

Another area where government intervention has been advocated is through various schemes either for subsidising the cost of finance to small businesses or for increasing its availability. These boil down basically either to some form of subsidised interest rates, or to some form of credit guarantee scheme.

It is very much to be hoped that Sir Harold Wilson's Committee – and Mr Lever – may throw some light on whether there is a significant number of small, viable companies which are unable to find – or cannot afford – loan finance on normal commercial terms from the private sector. If it were true that small firms were disadvantaged in this respect, then the arguments in favour of, say, an interest rate subsidy or a subsidised credit guarantee scheme might become more persuasive. In one sense, of course, all business would like cheaper loans – cheaper even than they are at today's rates. But the question of deciding which firms should qualify for such subsidies is difficult. So is the question of who should make the decision and in accordance with what criteria. By how much would the overall volume of bank lending to small business be increased, as opposed to bankers simply being put in a position to substitute a state guarantee for less good existing security? Who would decide what criterion of national interest should override bankers' own prudential judgement of how much to lend to which borrower? How does one, in fact, determine how close to the margin of prudence clearing banks' current lending to small business is? Those of us concerned with the health of the financial system would, I think, want to look very carefully at the answers to these questions.

A contribution by Government to the provision of equity to small business has recently been made by the National Enterprise Board. It is noteworthy that in its first annual report published in May 1977 it was able to report investing nearly £9 million in equity, quite apart from £5$\frac{3}{4}$ million in debt, to some fifteen small and medium-sized companies. A large number of these were companies which had failed to raise equity finance in the private sector. Under the Industry Act and the guidelines which set the framework for its work, the National Enterprise Board is required to look for an adequate return on the funds it employs, and must therefore base its investment policy on sound commercial criteria. It is, however, envisaged that these may be extended to embrace national interest considerations such as the creation or maintenance of employment or increasing exports or import substitutes.

I come now to consideration of what the City can do for small business. By and large I read the Wilson Committee evidence as refuting the charge against the financial system that it has withheld funds from industry or misdirected them. On the other hand, there are a number of areas where the performance of the City – or of the institutions which it comprises – might be improved. Perhaps I may touch on a few of them.

First there is the provision of information. Here, the branch banking network is ideally suited for the purpose. I am aware, of course, that competitive pressures will prevent the dissemination of information from being wholly disinterested, but his bank manager is the one person with a claim to financial knowledge and expertise with whom a small businessman has to talk. Branch bank managers, and, to a lesser extent, accountants are indeed the prime source of information on the availability of finance to small businessmen, and as such should recognise that they have special responsibilities. I believe the banks do a good job in this matter, but out of some 14,000 branch bank managers dealing with small businesses up and down the country there are bound to be some who may seem less good than others in helping those running small businesses. I know that the clearing banks are working to improve the training and knowledge of branch managers, and I am certain also that they are giving thought to ways in which the organisation and techniques of decision-making in the field of lending can be better adapted to the changing needs of industry and commerce. A balance must be struck here between, on the one hand, encouraging bank managers to be eager to react to opportunities and not to be lethargic or overcautious, and, on the other, ensuring that they exercise the necessary prudence and commercial judgement to ensure that resources are not wasted.

Another area where I am sure change and innovation must continue is in the mobilisation of institutional funds. I say continue, because there are in existence a number of channels for directing institutional funds into small business. Of these the longest established, best known and most successful is ICFC itself, owned by the London and Scottish clearing banks and the Bank of England, but drawing funds from a wide variety of sources, institutional and private, and of course

particularly concerned with the provision of finance for small businesses.

Another example is Equity Capital for Industry, set up last year with a capital of just over £40 million, subscribed mainly by the insurance companies, the investment and unit trusts and the pension funds. It is designed to provide equity-type capital for established medium-sized companies, but that is not to say that any of the larger companies in the small firm category should feel inhibited from approaching it. It has an important rôle to play in that area.

A number of 'development capital' companies, which are either subsidiaries of, or consortia formed by, existing financial institutions have been in existence for some time. Institutional interest in the field of small business finance has been further demonstrated in the recent setting up of a venture such as Moracrest, which combines the Midland Bank, the Prudential Assurance Company and the British Gas central pension funds. I would hope that others might follow this path, seeing advantage in using their financial skills and judgement in the cause of small business in a direct way; and I am sure they will be aware that it is a question of making available those skills to those in whom they invest, as well as using them in the exercise of their own initial judgement.

There is a further general point. If investors, both individual and institutional, are to be further encouraged to invest in smaller enterprises, it would be useful if such investments became more marketable. It is therefore often suggested that an over-the-counter market should be developed, the qualifications for listing on which would be less stringent than those for listing on the stock exchange itself. This is not an easy area. Anyone concerned with the financial health of British business cannot lightly contemplate a lowering of standards. Proponents of an over-the-counter market point readily to the flourishing of such an institution in, for instance, the United States; but they are less ready to stress the control exercised over that market by the Securities and Exchange Commission. The exigencies of the stock exchange's requirements for listing are sometimes cited as a reason why small businesses no longer regard the obtaining of a stock exchange listing as their corporate coming of age. I doubt whether, except in respect of the size criteria, a well-regulated over-the-counter market's requirements could, or should, be much less exigent. It is encouraging that the stock exchange are well aware of the problem, have already taken some action to ameliorate it and continue to give it close study. It and other bodies involved should continue the search for solutions which combine flexibility without loss of control or lowering of standards.

I come finally to the field of venture capital – particularly relevant to the innovative rôle of small business. The experience of the venture capital industry in this country has been disappointing to some of those involved in it. In this connexion, the evidence of ICFC, the largest and most experienced of those in the field, to the Wilson Committee, relating to start-up situations struck me as being both pertinent and telling. Over the past ten years, ICFC – or its subsidiary TDC – invested £16.5 million in 277 ventures. Of these 57% are still trading and 44% – 123 companies – are regarded as well established. 33% failed and in only ten cases out of the whole 277 has ICFCs investment been realised at a profit, although there remain successful unrealised investments. This is some measure of the risk involved in such investment.

Venture capital is, par excellence, a field in which passive investment is not enough. It may be that some of the lack of success of UK venture capital concerns has been because the stakes taken in new ventures have been too small for the exercise of any helpful degree of management control – either because of a reluctance of the original entrepreneurs to cede more, or because of a desire to minimise risk on the part of the venture capital institution. Investments which turn sour – for what with the wisdom of hindsight may prove to be very understandable and avoidable reasons – then tend to cause a further caution, rather than a reconsideration of whether the way in which the investment was managed and monitored might not have been improved. I also sometimes wonder whether the experience of those who have entered the venture capital field in this country might not have been happier had they developed a greater capacity to monitor and judge markets and products, rather than just balance sheets and cash flows; for it is ultimately the markets and products which will determine the financial results which the balance sheets and cash flows simply measure.

I have now covered a considerable amount of what is, by now, familiar ground. But the fact that the ground is familiar is not an adequate reason for not traversing it again, particularly when the paths across it are still undecided and unconstructed.

My message simply is this: a healthy mixed economy requires as one ingredient a healthy small business sector. This sector is most likely to thrive if the general environment, cultural and economic, is benign towards business and enterprise. Such an environment is likely to be more powerful in producing results than a reliance solely on specific pieces of economic engineering. I recall to mind the words of Professor Arthur Lewis – 'the greatest growth occurs in societies where men have an eye to the economic chance, and are willing to stir themselves to seize it.' Should I be wrong in taking this conference as one of a number of encouraging pieces of evidence that this truth is increasingly recognised?