

COUNCIL FOR ECONOMIC RENEWAL

ACCESS TO FINANCE

1. Purpose

- 1.1 Ensuring that businesses have sufficient access to start up and growth investment, not only to meet current demands but to finance the ambitious expansion we want to see from the private sector, is critical for our economic renewal.
- 1.2 *Economic Renewal: a new direction* announced the intention to seek expert advice to identify where gaps in the provision of commercial finance currently exist and how the Government can best leverage private sector investment. It also recognised the importance of businesses being 'proposition ready' (i.e. able to identify and access the finance that is available) within the context of new levels of scrutiny and pricing.
- 1.3 The emerging findings from this work are set out in this paper. In line with our commitment to early and ongoing engagement in policy development we are now seeking views on the challenges identified to date and potential action which could be taken to address them.
- 1.4 The Council for Economic Renewal is asked to:
 - a) Reflect on the challenges identified;
 - b) Consider potential action; and
 - c) Discuss how action could be taken forward.

2. Background

- 2.1 Work has been undertaken to establish the nature of current provision (attached at Annex A) and get a better understanding of the issues businesses experience in accessing finance. This included stakeholder engagement; high level mapping of current provision; a review of relevant literature; and a roundtable event with representative bodies and financial organisations. Assembly Government economists have also provided some underpinning analytical work.
- 2.2 This work has been undertaken with the recognition that the UK Government and Business Finance Taskforce have also recently proposed a series of measures to help businesses access finance. We will need to ensure that Welsh businesses are able to take full advantage; and any potential action will need to take account of these to avoid duplication.

3 Challenges identified

3.1 Businesses can face two types of challenges in accessing finance – gaps in the *supply* of commercial finance and obstacles to *accessing* the finance that is available.

Ensuring sufficient supply of commercial finance

3.2 The Rowlands Review¹ identified a specific gap at the UK level in the provision of growth capital between £2m and £10m, and it is generally recognised that SMEs find it harder to access finance due to information asymmetries, transaction costs and lack of collateral. Though evidence suggests that majority of businesses with a good proposition seeking external finance (including SMEs) currently obtain some mainstream finance² there is consistent feedback that businesses in growth mode are unable to achieve the optimal level of finance in putting together financial packages and increased problems with ‘gap financing’, particularly given increased bank caution.

3.3 In response to the Rowlands’ Review the Business Finance Taskforce has announced a £1.5bn Business Growth Fund targeting the needs of growing businesses³. It is yet unclear the extent to which Welsh firms can take advantage of it and it may well be that we will need ourselves to address the equity gap in Wales. We are discussing this directly with BIS and the British Banking Association and will be able to give further information in the New Year.

Possible action: Seeking advice from Chris Rowlands on the need for securing gap funding for Welsh businesses. This could be done by the Assembly Government leveraging additional private sector investment through facilitating the establishment of a new, complementary, financial product aimed specifically at Welsh businesses.

3.4 Concern continues to be expressed about the nature as well as supply of bank lending, including the timeliness of decisions, move to more transactional approach, handling of overdrafts, and general perception of excessive due diligence.

Helping businesses access finance

3.5 Work to date suggests more also needs to be done to raise awareness amongst businesses of what is available and increase their understanding of what is required.

3.6 Businesses face obstacles in accessing the finance that is available, both in terms the ‘proposition readiness’ of businesses seeking equity finance and ‘bank readiness’ for traditional debt finance in the new climate of increased

¹The Provision of Growth Capital to UK Small and Medium Sized Enterprises, BIS, Nov 2009

²Results from the 2009 finance survey of SMEs, IFF Research (published by BIS), Feb 2010

³Supporting UK Business, The report of the Business Finance Taskforce, Oct 2010

scrutiny and more cautious approach to risk. A number of reviews⁴, including Rowlands, have pointed to management weakness and lack of business planning as reasons for failure of businesses to obtain investment.

- 3.7 Barriers also include awareness of and appetite for alternative forms of finance both in terms of less well-known financing options offered by banks, such as invoice finance, asset finance, trade finance and supply chain finance⁵, and non-debt products such as mezzanine or equity funding.
- 3.8 Separate work underway (currently referred to as the *Citizens' Bank*) to provide support to individuals and social enterprises/businesses in relation to accessing finance and financial advice and support has identified a similar set of obstacles, compounded by lack of familiarity of providers with some distinctive features of a social enterprise (management structures, social purpose etc.)
- 3.9 A range of information is already freely available for businesses to draw on – most banks provide online advice and guidance for businesses covering a range of topics including managing cash flow, business planning and raising finance. The Business Finance Taskforce has proposed the establishment of a dedicated website drawing together and linking useful sources of information. The Assembly Government also provides information online, and has committed in *Economic Renewal: a new direction* to providing more and better quality information to businesses.

Possible action: Better communication of existing sources of information and advice

- 3.10 The Assembly Government is currently running a programme of workshops across Wales on accessing business finance and raising venture capital in response to issues raised during the Economic Summits. Other organisations such as business representative organisations, chambers and banks are also providers of information, workshops and seminars which could be used to enhance understanding and awareness.

Possible action: Awareness raising and capability building through workshops and seminars

- 3.11 There seems to be value in offering greater clarity and consistency to businesses on what will be required to secure finance. The Business Finance Taskforce has gone some way toward this with the proposed comprehensive checklist of information which will be needed from businesses for the application to be considered properly. This could be built on, and publicised, as a single set of criteria which businesses need to meet.

Possible action: Establish common understanding/definition of 'bank ready' and 'proposition ready'

⁴ For example, *The Supply of Equity Finance to SMEs: Revisiting the "Equity Gap"*, SQW, 2008

⁵ Ibid

4 Taking this forward

- 4.1 A key principle of *Economic Renewal: a new direction* is a redefined role for government in which Government moves from a direct deliverer in some areas toward a more strategic and enabling approach; only intervening where there is a clear and strong rationale to do so.
- 4.2 In the case of access to finance we believe that a role does exist for government in creating the right conditions in which businesses can thrive, including:
- Acting to stimulate the provision of commercial finance in Wales by leveraging private sector investment
 - Providing impartial information to businesses and raising awareness amongst businesses of what is available and what is required.
- 4.3 However the primary role/responsibility for providing and securing finance lies within the private sector – with the businesses themselves, their representative organisations and the financial and professional services. None of the actions set out above presume exclusive Government involvement and any action would need to be taken forward with, or by, the private sector for it to be successful.
- 4.4 The respective roles of businesses, the financial and professional services sector, and government in taking action, individually or together will need to be worked through.

5 Next steps

- 5.1 The Assembly Government will reflect on the views expressed at this meeting, and follow up any additional evidence before drawing conclusions and setting out its intentions.

Questions to consider:

- **What are the views of the Council on the potential actions set out in the paper?**
- **How can these actions best be taken forward and respective roles agreed?**

Annex A - Overview of Current Provision

Businesses and social enterprises access finance from a variety of sources, ranging from informal lending (“family and friends”) to equity funding and bond markets.

The primary source of finance is the commercial banking sector. There are no official figures of direct bank lending to firms operating in Wales, but a very broad estimate, drawing on an assumption about the likely Welsh share of UK lending, and informal advice from the sector, suggests an annual total of the order of £4billion, with perhaps 25% of that going to SMEs. This is likely to be supplemented by additional debt finance secured outside Wales (via headquarters or group) going to firms operating in Wales.

Finance Wales provides a variety of funds (loans, mezzanine and equity) for Welsh SMEs ranging from micro-loans at £5,000 to equity investments of up to £2m. In total £37m new investments were made in 2009-10. The JEREMIE fund administered by Finance Wales will invest £150m over next five years providing capital to SMEs in the form of loans, mezzanine finance and equity investments.

Finance Wales also runs xénos, the business angels network which introduces investors to small and medium sized businesses seeking growth funding. xénos facilitated £2.8 million private investment in 24 businesses in 2009/10. Angels typically invest below £100k and tend to focus on niche markets.

There is some venture capital and private equity activity in Wales but only for the most promising high-flyer start-ups (28 VC investments totalling £5m in Wales 2009⁶) and high-growth prospects with realistic 3-5 year exit potential for investors (16 investments totalling £9m in Wales 2009⁷). Of the £14m combined investments in this area in 2009, Finance Wales provided some £11m of the total investment. This £14m was spread across 44 companies and of these Finance Wales invested in 34 of them. This means that Finance Wales backed over three-quarters of all companies reported to have received venture and expansion capital investment in Wales in this period. Other organisations active in this area include Westbridge Capital (formerly Wales Fund Managers Ltd) which is currently raising an SME Fund, with a final close of £35m-£50m being expected within the next year.

Activity is limited at the larger investment end of the scale – only 23 Welsh based companies⁸ listed or quoted on the London markets (mostly AIM). There are few examples of Welsh companies able to raise finance through issuing bonds, largely because Welsh companies are financially not large enough to access these markets.

⁶ BCVA data for Wales 2009

⁷ BCVA data for Wales, 2009

⁸ *Huggins Report*, quoted in Business Insider, March 2009

At the other end of the scale there is existing provision of finance for small-scale start ups through the Local Investment Fund and Local Authority loan schemes, both of which offer up to £10k. Work is underway to explore the potential for additional support for micro-finance through European funding.

The Welsh Assembly Government offers some business finance as part of the new targeted approach to business support. For 2011/12, over £75m will be disbursed for investment to provide growth capital; to secure mobile projects and to support research and development. Other parts of the Assembly Government also provide direct financial support (e.g. food and tourism grants).

Welsh businesses also receive support from the UK Government, using non-devolved powers such as fiscal and tax incentives, but also in the form of initiatives such as the Enterprise Finance Guarantee Scheme which addresses the lack of collateral.