

Council for Economic Renewal

Review of Welsh Business Access to Private Sector Finance

Introduction

1. Following the last meeting of the Council for Economic Renewal, it has been agreed that a paper on the independent review of the availability of funding for Small and Medium sized Enterprises (SMEs) in Wales would be presented for discussion at the next Council meeting.

Background Information

2. Edwina Hart MBE OStJ AM, Minister for Economy, Science and Transport, announced an independent review of the availability of funding for SMEs in Wales on 16th January 2013. The aim of the review is to examine how effectively SMEs in Wales are served by existing sources of funding, identify areas of particular challenge and provide recommendations for action. It will look specifically at whether the high street banks are meeting the funding needs of Welsh SMEs (first part of the review) and will consider the merits of alternative sources of funding for Welsh SMEs (second part of the review).

Timetable

3. An interim report which will examine the efficacy of the high street banks in providing the finance needed by Welsh SMEs will be delivered at the end of May 2013. At the time of writing, the analysis of the data gathered so far is ongoing and therefore this discussion paper reports the preliminary findings only. A final report covering alternative sources of finance in Wales is scheduled for delivery in the autumn of this year.

Progress to date

4. A voluntary advisory panel from academia and business has been established and undertaken three meetings.
5. One of the meetings was dedicated to taking evidence from the representatives of the high street banks. They have been asked to come up with specific recommendations on how Welsh Government and the Welsh banking community can work together on this issue to support access to finance to SMEs in Wales. This is expected at the end of May and their evidence is not included in this discussion paper.
6. A substantial amount of data has been collated from various sources including Welsh Government, Finance Wales, individual high street banks, the Bank of England, British Bankers' Association (BBA), Department for Business, Innovation and Skills (BIS), Federation of Small Businesses (FSB), Confederation of British Industry (CBI), HM Revenue and Customs (HMRC), the Office of National Statistics (ONS), NESTA, the British Private Equity and Venture Capital Association (BVCA) and various universities within the UK and abroad.

7. Data has been requested directly from the BBA and the big five high street banks in relation to bank lending in Wales. One bank has refused to provide the data and we are still waiting to hear from others. This is unfortunate as the information is available at a Welsh level, as evidenced by the BBA data produced at a quarterly level. However, it would seem that the banking sector itself might be unwilling to provide such detailed information to the review.

Consultation Engagement

8. An extensive consultation with over 90 representatives of the banking sector and other financial institutions, the Welsh and the U.K. Government, intermediaries, academia and businesses has been carried out. More detailed discussions have also been held with members of the Institute of Directors (IOD), Confederation of British Industry (CBI) and the Institute of Chartered Accountants for England and Wales (ICAEW). Further interviews will be carried out as part of the second part of the review and will include meetings with all nine Welsh Government sector panels.
9. Welsh Government also conducted an online consultation (which closed on 30 April) on its website. Over 30 responses have been received so far including a detailed response from the Federation of Small Businesses (FSB).
10. Individuals and bodies from the rural community have been included in the consultation: through meeting the Board Members of the Robert Owen Community Finance Bank (ROCFB) in Newport, F&PS Sector Panel members and ICAEW members in North Wales.

Preliminary recommendations

11. It is still too early to comment on the final list of findings and recommendations, as a full paper is to be presented to the Minister for Economy, Science and Transport at the end of May. However, the following preliminary recommendations have emerged from the detailed stakeholder interviews, formal responses to the consultation and secondary data analysis, on the role that Welsh Government could play in supporting access to finance not only within the banking sector but also in promoting other sources of funding for SMEs.

Banks

12. Welsh Government should raise the issue of the unfairness of Basel III rules directly with the UK Treasury and BIS. This will enable the UK Government to make representations directly to the Basel Committee on Banking Supervision to recommend that SME lending should be excluded from consideration in terms of determining suitable capital and liquidity within the banking system.
13. Welsh Government needs to ensure that Wales, and Welsh businesses, gets its fair share of funding from the new Business Bank given concerns that the funding will not be distributed regionally across the UK and may be concentrated in the more prosperous areas of the UK.

14. For both loans and overdrafts, smaller and younger SMEs remain less likely to have been successful with their application to their bank for lending. Whilst banks do provide funding facilities for micro-firms and start-ups, the impression is that many of the banks are looking for a smaller number of larger transactions at the bigger end of the SME market. Indeed, it was generally accepted that if you were a business of a certain size, then you would find little trouble in finding a loan from the bank although there may be concerns about the actual terms of that loan. As a result, it has been suggested by a number of stakeholders that banks will not be able to fulfil the lending role for this part of the business community in the future and that other forms of funding will need to be considered for smaller firms, especially micro-businesses. The second part of the review will therefore consider whether mechanisms such as microlending or community-based lending to smaller local businesses should be encouraged and supported by the Welsh Government.
15. Security against the loan and affordability of repayment, rather than the cost of borrowing, have been cited by banks, intermediaries and small businesses as being the main obstacles in accessing finance from banks. To date, the UK Government's various schemes, such as Funding for Lending Scheme (FLS) and the Enterprise Finance Guarantee Scheme (EFG), do little to address either issue. Therefore any intervention by the Welsh Government should focus on these two critical obstacles. For example, given that the actual government guarantee for the overall EFG programme is far less than what is promoted, Welsh Government could provide additional guarantees to cover the loans to Welsh firms and reduce the perceived risks for banks.
16. Local decision-making by banks is seen by many small businesses as critical in ensuring that their business case is considered fairly. Yet there is very little evidence of this happening with most credit decisions being made outside of Wales. Given this, Welsh Government is encouraged to open up discussions with the main banks to ensure that Welsh regional managers make final credit scoring decisions for Welsh businesses.
17. There needs to be greater transparency over the lending process. This is to ensure that SMEs, especially those without any formal financial support internally, know exactly what is required in terms of preparing an application to the bank (business plan, cash forecasts, support from an intermediary). In exchange for the provision of this information, banks would then agree to examine each potential funding request in more detail than simply through a credit-scoring device normally applied to the majority of applications. Such "a banking covenant" could ensure greater transparency and accountability within the lending process and Welsh Government could work with the BBA to pilot such a scheme in Wales.
18. Welsh Government should examine the disconnect between the business support programmes it offers and the funding supplied by the banking community in Wales. In particular, it needs to consider how it can work more closely with banks to:
 - Ensure the right support is given to Welsh firms and therefore improve the quality of business proposals and information supplied to the banking sector
 - Play a far greater role in supporting greater signposting to all sources of finance for Welsh SMEs, potentially through an interactive website
 - Encourage the development of specialist managers to support the nine key sectors being supported by the Welsh Government

Other forms of funding

19. There are currently low levels of informal investment in Wales that could be addressed by (a) raising awareness of equity investment as a viable form of funding amongst growing SMEs in Wales and (b) developing an equity guarantee scheme to attract further investment by private individuals into Welsh businesses. These potential interventions, and the role of Welsh Government in supporting them, will be explored in further detail during the second half of the review.
20. The lack of availability of trade credit, especially through late payment, is an issue that leads to many smaller businesses seeking short term funding for working capital from banks. Whilst it does not have the legislative powers to do so, Welsh Government could set an example by ensuring that all contractors operating within the public sector in Wales have to pay their suppliers within a maximum 30-day period. With over £4.3 billion being procured via the public sector, this could have a major effect on the cashflow of a significant number of smaller businesses. It could also build in such conditions into other programmes that it currently manages.
21. Given the indications that building societies have had their commercial lending severely restricted since 2008, the Welsh Government should discuss, with the UK Government, how to lift such restrictions that may be preventing hundreds of millions of pounds of funding for the property sector to be released into the economy.
22. Currently, the Welsh Government does not provide loans to start-ups that, according to recent research, create the vast majority of jobs in the economy. This needs to be addressed quickly and the most appropriate mechanism for this type of support will be examined in further detail with the appropriate department.
23. There is a major opportunity for Welsh Government to take the lead in supporting alternative sources of funding such as peer-to-peer lending and crowdfunding, either through partnership or direct funding.

Finance Wales

24. As the sole shareholder, Welsh Government needs to determine the future strategic direction of Finance Wales and, more importantly, the role it should play in the future financial landscape for Welsh business alongside other providers.

Data Collection

25. This review has shown that there is a lack of regional data, especially for Wales, as a devolved nation. If policymaking within the Welsh Government is to be based on evidence, then it is critical that UK organisations in both the public and private sector are made more fully aware of the implications of devolution and the need for accurate data being collected at a regional level.

Questions / Issues for Discussion

26. The Council is requested to note the content of this discussion paper and, in particular, to examine and comment upon the preliminary recommendations as to the potential future role of Welsh Government in supporting access to finance for Welsh SMEs.

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