



10 January 2014  
Our ref: ICAEW Rep 03/14

By email only: [FinanceCommittee@wales.gov.uk](mailto:FinanceCommittee@wales.gov.uk)

Dear Sir/Madam

## **Invitation to provide evidence – Finance Wales**

### **Introduction**

ICAEW welcomes the opportunity to provide evidence to the Committee's Inquiry on the current operation and future role of Finance Wales.

We have recently responded to the separate consultation undertaken by the Welsh Government on the recent report by Prof. Dylan Jones-Evans and we draw on the views of our members submitted in the context of that consultation in framing our response to your questions.

### **Background**

ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter, working in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 141,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.

ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.

ICAEW, an active member of Commerce Cymru (formerly Business Wales) and the Council for Economic Renewal, has 3,000 members in Wales. We work closely with the Welsh Government in a number of different ways.

ICAEW has more than 20,000 members working outside the UK. The ICAEW qualification is recognised around the world as a prestigious professional business qualification. Members are entitled to the description chartered accountant and to the designatory letters ACA or FCA. Examinations for the qualification can be taken in a wide range of countries across the globe including China, Russia, Malaysia and Pakistan: however, papers are always set and marked in the English language.

### **Response**

**The role and strategic purpose of Finance Wales:** We broadly believe that Finance Wales is fit for purpose.

*'Finance Wales as a source of funding to SME's remains a great success. It has done what it says on the tin and bridged the funding gap between the private and public sector. It has repositioned itself away from its initial offering of "funder of last resort" into a much more commercial organisation, which is self funding and without the stigma normally attached to the public sector.'*

While we believe that Finance Wales should and does promote investment and thus the creation of jobs and prosperity in Wales, it is essential that it operates on the basis of commercial investor principles.

In our view, the main market failure experienced by Welsh businesses in terms of access to finance is not with regard to the cost of borrowing, but to the *lack of availability* of finance: the role of Finance Wales is largely (quite correctly) to increase the volume of finance available for investment in Welsh businesses.

By acting in a commercial manner, Finance Wales is addressing market failure without perpetuating it. By demonstrating that investment in Welsh SMEs can both respond to a demand for finance and generate a commercial return, Finance Wales can potentially act as an exemplar to encourage competitors to enter the market. By contrast, were Finance Wales (or the Welsh Government) to offer investment on the basis of subsidised interest rates, it would effectively make it impossible for venture capitalists or commercial lenders to enter the market in competition with them because they could not 'match' the offer available from Finance Wales. A more commercial model also provides longer-term sustainability against the day when European funding (the mainstay of Finance Wales public funding) is no longer available.

*'It would be wrong for FW to be the equivalent of a grant provider. European funding will come to an end and, if there is nothing to show for it, then the ramifications for Wales could be catastrophic. FW must be commercial in its approach, even though it may be not as mercenary as other sources of finance. It needs to be viewed as another option.... Taking FW in-house would be disastrous. Financial operations should not be run by politicians'*

Moreover, by acting in a quasi-commercial manner, Finance Wales is able to lever in co-investment from other funders, to supplement public funding available from the Welsh Government or the European Regional Development Fund, notably Barclays Bank Plc in the case of the Wales SME Fund and the European Investment Bank in the case of JEREMIE. These partners need to believe that the Finance Wales investment approach is sound.

**Current performance:** we are not aware of any published recent evaluation of Finance Wales' activities, though we are aware one has been undertaken, and would welcome sight of such evidence.

However, from reports provided to the All Wales Programme Monitoring Committee for the Structural Funds, it would appear that the JEREMIE fund has supported the creation of 1,991 jobs and safeguarded a further 6,409<sup>1</sup>. At this stage it is impossible to be sure whether the fund overall will generate a surplus or will register a net cost to the exchequer, since for any venture capital operation, a significant profit on a small number of equity investments over the longer term tends to be critical. While the current valuation of the JEREMIE portfolio is below the overall level of funds invested<sup>2</sup>, the fund may return a surplus over its lifetime, in which case the net cost to the exchequer per job created will be zero. Even if the fund makes a loss, we would judge that with this level of job creation, the Fund is likely to show relatively good value for money compared to the grant schemes which have represented the usual Government intervention to support job-creating investment.

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<sup>1</sup> Report to the Programme Monitoring Committee, December 2013

<sup>2</sup> The current value is £61.88 million, with £33.18 million having been repaid and £115.34 million having been invested.

**Interest rates charged:** while lower interest rates would always be desirable from the point of view of the investee, in our view criticism of the rates charged by Finance Wales is misplaced for a number of reasons:

- As noted above, the critical market failure is in volume not cost of finance available to business in Wales.
- The co-financing of public money by third-party investors is based on the latter having first call on the repayment of their investment, and the approach to risk and interest rates adopted by Finance Wales must satisfy these funders that the investment approach is sound. Since Finance Wales provides a mix of loan and equity investment (with the latter having generally requiring a longer investment time horizon and having less certain returns), Finance Wales has to be confident that its loan investments will generate sufficient returns to repay the co-investors.
- Finance Wales lends at fixed rates of interest, whereas bank rates are normally variable, which at a time of low interest rates provides more significant risk for the investee.
- In increasing the volume of lending over and above what would be available from the banks, Finance Wales necessarily has to adopt a less risk averse approach, and interest rates charged reflect this. Where (as is often the case) Finance Wales invests alongside a commercial lender, the latter invariably has preferred security rights, with Finance Wales bridging the gap between what the commercial lender will loan and what the business needs:

*'I do not agree with the verdict on Finance Wales. Interest rates can be high, but this is a reflection of the risk profile on what is very often effectively unsecured lending. Without them over the last few years and now, there are very few deals requiring funding that we would have been successful with due to the banking issues discussed above.'*

- While it would have been possible to rely on general State Aid exemptions (which would indeed have allowed Finance Wales, had it and the Welsh Government so chosen, to reduce interest rates), the decision to operate the JEREMIE Funds under a specific State Aid regime was entirely logical since it has allowed Finance Wales to make larger investments (GBER caps loans at £250,000) and to avoid a 'postcode lottery' where businesses on one side of a street are eligible for investment and ones on the other are not: this has been a significant problem with JEREMIE Funds in England, where the general exemptions have been relied on.
- A critical gap in Access to Finance relates to equity, and here too Finance Wales provides a critical role. However, in terms of equity, there are 'market failures' not only on the supply side, but also on the demand side, with SMEs often reluctant to consider this route, even though it may offer the best prospects of large-scale investment. This points to the need to improve the quality of business advice to potential investees:

*'More resources need to be put in place to ensure that the SME's have the management and/or professional advisers to be able to assess the amount and source of the required finance and to put winnable cases to the various institutions, whether it be in the form of equity/ loan finance or training schemes.'*

**Value for money:** Please see response on current performance above. While it is too early to make a definitive judgement on this, we believe that Finance Wales is likely to provide good value for money compared to other (predominantly grant-based) forms of public intervention and support. In this context, we are somewhat sceptical of the drift by the Welsh Government back towards deploying grants (for example, through the Welsh Economic Growth Fund) which represents a U-turn compared to the expressed intent in the Economic Renewal Programme to focus on repayable forms of finance for business.

**Arrangements for future sources of finance:** While your question asks specifically about sources of finance, it should be noted that the proposals from Prof. Jones-Evans suggest an integration of all forms of finance *and advice* to business under an umbrella body, the Development Bank for Wales.

In general terms, we agree with the analysis that suggests there needs to be more integration between the provision of finance and the provision of advice and guidance, and it is possible that Finance Wales should have been more pro-active in ensuring clients are accessing appropriate advice.

At the same time, we have always believed that the private sector (including our members), are capable of playing a larger role in providing qualified business advice to SMEs at crucial points in their development and that the proliferation of 'free' public sector business advice simply perpetuates rather than corrects any market failure.

We are also conscious that business support in Wales has been bedevilled by frequent structural change and 're-branding' resulting in confusion on the part of the business community. We strongly supported the recommendation of the Micro-Business Task and Finish Group in early 2012 to '*create a single well recognised brand for access to business support (public/private)*' and believe it would be unhelpful to embark on another re-branding just as 'Business Wales' is beginning to establish itself.

We are thus unsure if major structural change is needed now, and would in any case be opposed to dismantling Finance Wales to achieve it, although we would support better co-ordination between Finance Wales and Business Wales, and, potentially, better integration of all Welsh Government support for business (including any grants which are available) under the Business Wales brand.

Our members also believe that Finance Wales and the Welsh Government or any new organisation it might set up to co-ordinate support for business must work very closely with the new British Business Bank. Our members would not endorse duplicating the costs associated with the British Business Bank by establishing a separate Development Bank for Wales and believe that it is essential to ensure an integrated approach which encourages sharing of knowledge and lessons across government initiatives.

On balance, therefore, we doubt whether there is a strong case for the further structural change.

**Corporate structure of Finance Wales:** we do not feel well placed to comment on this. In the longer term, we believe it would be advantageous if Finance Wales could become free-standing from Government, as we believe this would provide an even stronger demonstration that it is possible to operate a Venture Capital business in Wales on a commercial basis, thus incentivising new entrants to the market.

**Activities of the Finance Wales Group in the north of England:** in our view, the fact that Finance Wales has successfully tendered to manage JEREMIE funds in the North-West and North-East of England should be regarded as a sign of success, helping to build Wales' reputation as a successful exporter of high value-added services.

We hope these views are of use to the members of the Committee and wish them well with their Inquiry.

Yours sincerely

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