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For:

Welsh Assembly Finance
Committee

FIN(4)FW073

Finance Wales Inquiry
Response from HWB Cymru



January 2014

Invitation to Provide Evidence

Finance Wales

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Invitation to Provide Evidence

Finance Wales

HWB Cymru very much welcomes the Finance Committee's call for evidence regarding Finance Wales. We feel that much has been said about Finance Wales, yet there's very little understanding what their role actually entails. We hope that the evidence submitted will support the Committee in forming an outcome which reflects the true picture of the role Finance Wales, and goes beyond negative headlines.

About HWB Cymru

1. HWB Cymru is a private business whose primary mission is to bring government and business closer to support the Welsh economy.
2. We work with private businesses, government and business organisations throughout Wales.
3. We conducted a Welsh SME Finance Survey, in August 2013. Some of our findings are relevant to this call for evidence and we have therefore provided them in this paper for the use of the Committee.

Background

4. As a business, we would rarely respond to consultations, preferring not to form personal opinions on matters. We pride ourselves on neutrality and objectivity.
5. We have decided to respond to this consultation as we have found that much of the negative headlines regarding Finance Wales have been unfair and damaging to business. We wanted to bring some balance into the debate.
6. We work with Finance Wales to support their efforts to increase targeted awareness among SMEs of the availability of finance, such as the Wales Micro-business Loan Fund.
7. Our directors, whilst working for the Federation of Small Businesses (FSB), worked with Finance Wales during the Welsh Government's Economic Summits, and were fully supportive of their hard work in bringing the JEREMIE fund to Wales. This was the first fund of its kind in Europe and was one of the highlights of the Economic Summits.

Our Directors

8. Nia Davies and Non Rhys of HWB Cymru were formally the policy team of the Federation of Small Businesses in Wales, up until 2012 and throughout the Economic Summits. Both were members of the Council for Economic Renewal and its predecessor, the Business Partnership Council, and Business Wales (now Commerce Cymru).
9. Non Rhys was Chair of Business Wales and was the main voice of the business community during the Economic Summits, the set-up of the Economic Renewal Programme, and formation of the Council for Economic Renewal.

The role and strategic purpose of Finance Wales

Should it be self-financing by operating on commercial investor principles, or should it primarily support the economic development priorities of the Welsh Government?

10. HWB Cymru doesn't believe that this is an either/or question or answer. The polarisation of this question is misleading as Finance Wales has helped Welsh businesses and the economy, at a time when their reliance on Welsh Government funding has diminished.
11. The Access to Finance Review also polarises the debate, asking if Finance Wales has moved away from economic development to a fund manager role. HWB Cymru believes that it is possible to become more commercially sustainable without sacrificing its role in developing the economy. This would ensure longevity of their funds and support Welsh business further.
12. Finance Wales has become less reliant on the Welsh Government for its funding. Welsh Government Support for Finance Wales has decreased from £4.2m in 2011-12 to £3.1m in 2012-13¹ yet they still boosted Welsh business by over £50million from 2012-13.

How do banks operate alongside public bodies such as Finance Wales, and how could this be improved?

13. Our understanding is that Finance Wales works well with banks, for example Barclays, in leveraging further support for their funding pots.
14. We aren't in a position to say how their working relationship with banks could be improved, but we do categorically believe that the working relationship would not be improved if Finance Wales were to be absorbed into the Welsh Government. We believe this would also apply to other potential private investors. An arms-length and commercially run body would be preferred by investors.
15. We would welcome the committee looking into this area as we are concerned that a Development Bank within the Welsh Government could deter investors.

Current performance – has Finance Wales achieved appropriate outcomes in areas such as jobs created/safeguarded, business support, return on investment, economic impact, associated private sector investment etc?

16. HWB Cymru isn't in a position to pass judgement on Finance Wales' economic impact etc. However, we are unaware of any report which raises major concerns about Finance Wales' performance. As far as we are aware, apart from the Access to Finance Report, there is no other report condemning Finance Wales and its performance. We are happy to review our position, if additional independent reports come to light, and raise concerns over Finance Wales.

Interest rates charged – are these appropriate relative to those charged in the private sector or other sources, and given State Aid requirements? Should interest rates charged by Finance Wales be commensurate with risk?

¹ Finance Wales Group, Annual Review 2012-2013. P13.

17. It has become fashionable to criticise Finance Wales by saying that their interest rates are high. Most businesses would like lower interest rates, this is a given. But this rather simplistic criticism of Finance Wales does little to explain the complexities of setting interest rates.
18. We are concerned that there has been very little research into the interest rates of the high-street banks in the Access to Finance Report, stating instead that it was *“Impossible to know the cost of lending on the Welsh Highstreet”*². As a consequence, the report uses Bank of England figures as its methodology.
19. These figures indicate that mean interest rates from 2008-2013 were between 3.5%-5.5%. It is unfair to compare these interest rates with those of Finance Wales for two reasons. Firstly, The Bank of England statistics don’t give a clear picture of small and micro businesses in Wales, using the statistic of £1m turnover for ‘smaller SMEs’, when this would be a top end SME in Wales. FSB membership in Wales, for example, on average has a much lower turnover than £1m.
20. Secondly, even after a quick internet search of the high-street banks, the lowest interest rate of a small unsecured business loan is 7.9%. This is dependent on the credit worthiness of the business. Even if a business had an excellent credit rating, if they wanted a loan of say £1,000 over two years, the lowest rate you would pay would be 17.54%.

21.

The screenshot shows the Santander Business Loan Calculator interface. At the top, there is a red header with the Santander logo and a 'Close window' button. Below the header, the page title is 'Business Loan Calculator' with a sub-heading 'Calculate my monthly repayments'. A note states: 'Please note, the fields marked (*) are mandatory.' The input fields are:

- (*) Amount I would like to borrow: (£1000 - £10000 in increments of £50) with a value of £1000.
- (*) Length of loan: 24 months (2 years) with a dropdown arrow.

 A 'Recalculate' button is located below these fields. Under 'My arrangement fee', it shows 'Business Loan arrangement fee: £100.00'. Under 'My monthly repayments', it shows 'APR: 17.54 %', 'Monthly loan repayment: £ 49.09', and 'Total amount repayable: £ 1278.22 **'. A red-bordered box labeled 'Important' contains the text: 'The actual rate you will pay depends on a credit assessment of your personal circumstances. Please ensure you read all documentation carefully to ensure you fully understand the product before you apply. ** Total amount repayable includes the arrangement fee of £ 100.' An 'Apply here' button is at the bottom right of the form.

² Access to Finance Review, 2013, Stage 2, p.19

Current Interest Rates - Finance and Borrowing: Business: HSBC UK - Hotmail
 https://www.business.hsbc.co.uk/1/2/interest-rates/finance-borrowing HSBC Holdings plc [GB]

HSBC

Close window

Interest Rates

Business

- Current accounts
- Savings
- Finance & borrowing

Finance & borrowing

[Compare to previous interest rates](#)

Business Overdraft	Margin over Bank of England Base Rate %
With an overdraft facility ¹	From 3%

Standard Debit Rate	Effective Date	Monthly %	Annual %	EAR % ²
Quarterly interest	01.03.12	2.46	29.50	32.9
Monthly interest	01.03.12	2.46	29.50	33.8

Small Business Loan	From 7.9% ¹ AIR (Annual Interest Rate)
An arrangement fee, currently £100, is taken when the loan is drawn down. This is added to the AIR to give the APR.	
A quotation is always given before you take a loan from us.	
Once a loan is taken, the interest rate is fixed for the duration of the loan	

¹ Interest rates are set on the basis of our assessment of your financial status.

100%

22. The Bank of England figures are irrelevant if an average SME in Wales can't access this from their bank. Therefore, a comparison of the real cost to SME lending on the high-street is needed before Finance Wales can be truly criticised. Unfortunately this wasn't achieved in the Access to Finance Review. In addition, it is vital that all levels of business finance is compared, including the micro-finance level so we can get a true picture of Finance Wales' interest rates cost.
23. It must be noted that many high-street banks charge fees for arranging loans, as do Finance Wales.
24. Finance Wales' interest rates should not distort the market by competing with the high-street. Therefore, it should be expected to see Finance Wales' interest rates higher than that of the high-street banks.
25. Finance Wales' investments are fixed and their interest rates do and should reflect the added risk in comparison to a flexible loan.
26. The levels of investments that Finance Wales deals with are relatively small. One deal in London, for example, would easily swallow up Finance Wales' annual fund. Yet, because of the nature of the Welsh economy, Finance Wales deals with financial packages from £1,000 upwards. The result of this means that the running costs to Finance Wales is much higher, servicing hundreds of finance packages, rather than a handful of large ones. This obviously increases the pressure on Finance Wales to increase interest rates to cover this cost.
27. The Access to Finance Review states that Finance Wales shouldn't compete with the high-street banks with regard to interest rates. We would agree. We feel this is why research should've been completed into the interest levels in the high street, before the report could conclude that the interest rates charged by Finance Wales are too high.

28. There's a choice regarding interest rates which Finance Wales could make. They could charge very low interest rates if they only invested in larger businesses with excellent credit ratings and very low risk. Or, they could increase access to finance for smaller SMEs who aren't as credit-worthy (but still have a good business plans) but charge higher interest to cover the risk. We would argue that the latter is preferable for the majority of businesses in Wales. Access to finance is as great of a problem, if not greater than the cost of finance.

29. This is highlighted in our Welsh SME Finance Survey, August 2013.

Which of the following barriers or obstacles, if any, impact on the success of your business? ³

Answered: 366 Skipped: 22

Answer Choices	Responses	
Lack of financial understanding	7.10%	26
The economy	68.58%	251
Cash flow	40.16%	147
Barriers to exporting/importing	4.10%	15
Planning	8.74%	32
Availability/cost of suitable premises	11.20%	41
Shortage of skills/training generally	12.84%	47
Recruiting/retaining staff	11.48%	42
Lack of marketing skills	16.12%	59
Obtaining finance	22.13%	81
Cost of finance	20.77%	76
Competition in the market	34.97%	128
Increased cost in raw materials/fuel/energy	32.51%	119
Total Respondents: 366		

30. We have noted just a few examples of why interest rate setting isn't a clear-cut issue. There are commercial, legal and organisational considerations for Finance Wales. Much has been mooted regarding *de minimis*, but this is only a part of the jig-saw. Finance Wales' investment, for another example, is the 'last out' -meaning that if a business fails, Finance Wales is the last to see their investment returned, if at all. This wouldn't be the case for a high-street bank, thus adding pressure on Finance Wales' interest rates.

Value for money – does Finance Wales provide value for money to the Welsh Government, and how does it compare relative to other forms of public intervention and support? Arrangements for future sources of finance – what potential forms of finance should be considered by Welsh Government for Finance Wales (including sources such as European funds and the European Investment Bank)?

31. £3.1m support for over £50m worth of investment is good value for money for the Welsh Government, in our opinion. The extra finance that Finance Wales is able to support and/or lever over and above the financial support from the Welsh Government should be a testament to their success. £3.1m is a relatively small amount to fund an organisation the size of Finance Wales, especially considering this amount is a drop in the ocean compared with the rest of the financial sector.

32. We feel that bringing Finance Wales under an umbrella body within the Welsh

³ HWB Cymru, Welsh SME Finance Survey, August 2013

Government could risk this additional funding and decrease value for money for the government.

33. Regarding future funds, we have faith in Finance Wales to be able to find sources of finance as they have successfully done on numerous occasions.
34. The main point we would like to make regarding value for money of Finance Wales is addressing the criticism of Finance Wales in the Access to Finance Review. Which accuses Finance Wales of neglected its economic development duty, because it's becoming more commercially sustainable. We wouldn't see it this way. As demonstrated above, Finance Wales receives a relatively small amount of Welsh Government support - considering the amount it invests and levers into the Welsh economy. There is not an endless pot of money available to Finance Wales and therefore the funds they do have, quite rightly, should be run more commercially.
35. Running funds on a more commercial level will ensure more of the funds are recycled and ensures a continued pot of money. If Finance Wales was, for example, to finance businesses with a lower interest rate this simply diminishes the pot available to businesses in the future. Finance Wales already runs at an annual loss. If this were to increase further, through lowering interest rates, it would harm Welsh business in the future.
36. In conclusion, Finance Wales is providing better value as it currently operates, rather than if it offered lower interest rates etc. Welsh Government support is therefore longer lasting and has a greater impact on the economy. As mentioned, £3.1m isn't a large investment considering how much Finance Wales levers into the Welsh economy as a result.⁴

The stage 2 report proposes that it would be less confusing for Welsh SMEs if all sources of finance, including UK programmes, were combined.

37. HWB Cymru doesn't agree with this conclusion of the Stage 2 report. Since Finance Wales has been established, the business support structure of the Welsh Government has changed several times, including the abolition of the WDA, Business Eye, GSB, FS4B, ERP and is currently in the guise of Business Wales. It has long been a criticism of the Welsh Government by the business community that there have been so many structural changes to the business service. Throughout this period Finance Wales has been a stable and consistent organisation supporting Welsh business.
38. We would agree that a 'One Stop Shop' for business is a great concept, but in reality this has not worked in practice. The Flexible Support for Business (FS4B) was supposed to provide this service, but this 'One Stop Shop' service was proven inefficient by the Economic Renewal Programme. We would feel uneasy at the prospect of Finance Wales being absorbed into another business support service.
39. To lose this established organisation and name into yet another business support re-structure, under the guise of the Welsh Development Bank would leave businesses struggling to navigate yet another business support structure - having been already three structures in the last four years.
40. We disagree with the Report and the FSB in Wales' conclusions regarding the

⁴ Finance Wales Annual Report, 2012-2013.

visibility of Finance Wales. In our Welsh SME Finance Survey, August 2013, even though Finance Wales only dealt with Business to Business finance until recently (and hasn't been in the micro business market) awareness of Finance Wales is high.

41. Almost 50% of businesses surveyed were aware of Finance Wales, which is a high penetration level into the sector. Other business services have a much lower awareness level.

42. Our research into the awareness of Finance Wales among SMEs in Wales was answered by four times as many respondents than the FSB's own research asking the same question, which was quoted in the Access to Finance Review. We are happy that our methodology provides a true picture of the visibility of Finance Wales among SMEs in Wales.

43. Are you aware of investments available through Finance Wales?⁵

Answered: 376

Skipped: 12

Answer Choices	Responses	
Yes, and am currently or have used them previously	8.24%	31
Yes, I have heard of Finance Wales but not been in contact with them	40.96%	154
I am not aware of Finance Wales	50.80%	191
Total		376

Would it be beneficial to devolve a proportion of UK public support programmes to be administered in Wales?

44. HWB Cymru is, on the whole, supportive of the devolution of UK support programmes to be administered in Wales. Wales has done relatively poorly in ensuring its fair share of business support programmes on a UK-wide level, consistently ensuring less than her 'Barnettised' share. Devolution of these programs should ensure Wales does get her fair share. However this would need to show benefit for Welsh business, and that further devolution of funds must mean that Welsh business benefits and the additional fund isn't lost into other budgets of the Welsh Government.

Corporate structure of Finance Wales - is the current structure fit for purpose and what potential alternative models could be considered?

45. We aren't in a position to make recommendations as to the corporate structure of Finance Wales. However, we are unaware of any evidence showing that the current corporate structure is failing, and unless proven otherwise, we support the current structure.

46. HWB Cymru believes that the current arms length from government approach is imperative to the success of Finance Wales. We believe that the funds will have a longer term impact on the Welsh economy if Finance Wales is less reliant on the Welsh

⁵ HWB Cymru, Welsh SME Finance Survey, August 2013

Government for funding and increasingly self-sustaining.

47. We believe that Finance Wales' remit could potentially be widened. Much of the criticism laid at the door of Finance Wales is often based on finance, which may well be needed, but they haven't traditionally had the remit to provide. For example, until very recently, Finance Wales was unable to help with loans in the Business to Consumer market, yet they came under fire for something they could not achieve. Much of the Access to Finance report and criticisms from others could be viewed as a reason to expand the role of Finance Wales, rather than alter the structure.
48. We are concerned that the Access to Finance Review is seen as an audit of Finance Wales, rather than a Task and Finish Group generally looking into access to finance. The recommendation to merge Finance Wales into the Welsh Government is the kind of recommendation you would expect to see following a condemning external audit.

Activities of the Finance Wales Group in the north of England – is this of benefit to the economy and SME businesses of Wales?

49. We see no conflict of interest in Finance Wales expanding their remit into the north of England. From an organisational and economic point of view, Finance Wales expanding their remit into the north of England brings benefits such as economies of scale into their operation. This can support their operations in Wales and benefit Welsh business. It also makes Finance Wales more economically sustainable and able to support business in the longer term.
50. We are unaware of any report which has questioned Finance Wales' commitment to Wales because of their operations outside of Wales, other than the Access to Finance Review. We take rather a different view to this report, and believe we should celebrate that we have a Welsh body which is good enough to expand their remit. There is no evidence to the contrary as far as we are aware.
51. We view their activities in the north of England as proof that the European Investment Bank has faith in Finance Wales to deliver the JEREMIE fund well, and is in fact an endorsement of their work in Wales.

Conclusions

52. We do not agree with the Access to Finance Review that Finance Wales is "no longer fit for purpose"⁶ and have found many of the recent headlines regarding Finance Wales to be unfair and damaging, not only to Finance Wales, but to business confidence generally.
53. We believe that any interest rates charged by Finance Wales are a complicated issue, and would need specialised expert analysis before concluding that any changes are justified. The longevity and sustainability of Finance Wales' funds and future investments must be considered if interest rates were lowered.
54. Finance Wales being run partly commercially does not mean that they have moved away from economic development. The two aren't mutually exclusive and we would argue that being more sustainable commercially ensures a greater economic impact in the long term. In addition, the commercial activity of Finance Wales should be kept at arms-length from government (of any colour).

⁶ Access to Finance Review, 2013, Stage 2, p.50

55. Throughout the Access to Finance Review, many statements were made as to what Finance Wales could do in addition, or that they should charge less interest, or give more business advice. It was also criticised for becoming too commercial, yet it was not explained in the report how Finance Wales would finance this extra support whilst lowering interest rates, as the report wanted. Instead the report concluded that “it’s not the intention of this report to consider in detail how this organisation [Welsh Development Bank] will be funded”⁷, and has produced an un-costed wish-list which has been used to undermine Finance Wales.
56. Finance Wales is focussed on the SME sector in Wales, and is held as an exemplar in other areas of the UK and beyond. Very rarely do you see any financial organisation which is solely servicing this section of the market. This approach should be supported.
57. We must highlight, as does our Welsh SME Finance Survey, that the supply of finance (although an issue for those who are looking for it now) isn’t as big an issue as is the demand for credit by Welsh business. This is a vital point to make, and we have found hardly any demand for finance amongst SMEs who we have worked with. Only 15% wanted finance now (and many looking for help with cash flow within this figure) whilst almost 50% don’t want finance now or in the future. We don’t feel that the demand side issue has been really addressed.

Are you currently searching or considering searching for finance in order to support future projects?⁸

Answered: 381 Skipped: 7

Answer Choices	Responses	
Yes, now	15.75%	60
Yes, in next 12 months	9.45%	36
Possibly in the future	25.20%	96
No	49.61%	189
Total		381

We would like to thank the Finance Committee and Clerks for their work on this enquiry, and hope you find this evidence of use. We are happy to provide oral evidence to back up our written evidence.

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⁷ Access to Finance Review, 2013, Stage 2, p.51

⁸ HWB Cymru, Welsh SME Finance Survey, August 2013