

FIN(4)FW065
Finance Wales Inquiry
Response from the Federation
of Small Businesses



Federation of Small Businesses
Ffederasiwn y Busnesau Bach
The UK's Leading Business Organisation
Mudiad Busnes Arweiniol y DU

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9th January 2014

Jocelyn Davies AM
Chair, Finance Committee
National Assembly for Wales
Cardiff Bay
CF99 1NA

Dear Jocelyn

RE: Finance Wales

FSB Wales welcomes the opportunity to contribute to the Finance Committee's inquiry into the performance of Finance Wales. The Finance Committee will be aware that FSB Wales has been heavily engaged with Professor Dylan Jones-Evans in his work on access to finance by SMEs in Wales. FSB Wales submitted detailed evidence to both parts of the review that can be found on our website (www.fsb.org.uk/Wales/consultation-responses).

Furthermore, FSB Wales has responded to the Minister for Economy, Science and Transport's request for responses in light of the report in its entirety. This response is attached for the benefit of the Finance Committee's consideration. A significant portion of the response relates to the role, functions and performance of Finance Wales and FSB Wales agrees with Prof Jones-Evans' assessment that Finance Wales as presently constituted is not fit for purpose. By way of summary, the following key issues are considered in relation to Finance Wales:

- 1) It is clear that there is a lack of transparency and accountability leading to insufficient levels of scrutiny from all stakeholders into the performance of Finance Wales. As such, there is an urgent need to establish clear accountability mechanisms with both the Finance Committee and the Enterprise and Business Committee to properly scrutinise the work of Finance Wales as a wholly-owned Welsh Government subsidiary.
- 2) Despite being a publicly funded body, Finance Wales publishes no annual report for public consideration and scrutiny. This is in marked contrast to many other public organisations such as the Welsh Language Commissioner, ESTYN and the Climate Change Commission. It is also in contrast to many financial organisations that operate in similar sectors such as the Principality, or

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perhaps more importantly the Development Bank of Canada. Previous annual reports have been produced by Finance Wales but there has been a general reluctance by the organisation to share this information with stakeholders such as FSB Wales, further weakening transparency.

- 3) Finance Wales' mission statement has evolved away from "[to] assist Welsh businesses to realise their true potential for innovation, growth and economic impact in the region" to a situation where its prime objective is to "to become the UK's leading SME investment company". This has been rectified in part by the Minister for Economy, Science and Transport but should be significantly strengthened to ensure Finance Wales' primary focus is the promotion of growth of SMEs in Wales. This should be accompanied by clear guidance from the Minister on objectives for Finance Wales and a mechanism to regularly report performance.
- 4) FSB Wales believes further consideration is needed on the 'hidden costs' of finance from Finance Wales. This includes the use of guarantees, lending, monitoring and security fees that significantly increase the cost of finance. Furthermore, the practice of referring businesses to third party business support should be examined, particularly in cases where Business Wales or private provision (such as accountants) have already been used by the applicant business.
- 5) Prof Jones-Evans' report confirmed FSB Wales concerns that Finance Wales interest rate policies are punitive and excessive, leading to perceptions of Finance Wales as a 'lender of last resort' for many businesses. For instance, the review states that the average interest rate for the Micro-Business loan fund is currently 11.2 per cent. FSB Wales believes this policy undermines Welsh Government's economic development focus (to promote jobs and growth) and is placing undue risk on businesses in Wales. The Finance Committee should examine the process behind the setting of this policy, as well as the misinformation provided by the Welsh Government and Finance Wales around the inflexibility of Finance Wales' interest rate policies in respect of EU regulations. FSB Wales believes the Minister for Economy, Science and Transport should review this policy and calls on Finance Wales to charge more competitive rates.
- 6) Any reform of Finance Wales should be organic and not simply initiative churn. In moving towards a Development Bank of Wales, the Welsh Government should set out clear objectives and vision around the model that is to be used, drawing on experiences from other developed economies. Any reform must secure real change for businesses in Wales and there should be a focus on accountability and transparency throughout this process.

I hope you find the comments of FSB Wales of interest. FSB Wales would be happy to provide the Committee with any further information required in order to facilitate the inquiry.

Yours sincerely



Janet Jones
Wales Policy Chair
Federation of Small Businesses Wales

Access to
Finance Review

FSB Wales
Response

6th December 2013





Access to Finance Review The Federation of Small Businesses Wales

The Federation of Small Businesses Wales welcomes the opportunity to present its views to the Welsh Government on access to finance for SMEs in Wales. FSB Wales is the authoritative voice of small businesses in Wales. With 10,000 members, a Welsh Policy Unit, two regional committees and twelve branch committees; FSB Wales is in constant contact with small businesses at a grassroots level. It undertakes a monthly online survey of its members as well as an annual membership survey on a wide range of issues and concerns facing small business.

1. Introduction

Access to finance is a perennial issue for FSB Wales members. Indeed, the debate about the role of the public sector in ameliorating access to finance has been present in political dialogue since the advent of devolution in 1999. In 2000, FSB Wales posited the idea of a Development Bank for Wales that would supply ‘money with management’, financial and business support.

The creation of Finance Wales was a reaction to this debate. Despite the good intentions behind the creation of Finance Wales, FSB Wales has long argued that it has not fulfilled its intended role. The review commissioned by the Minister for Economy, Science and Transport is therefore welcome and FSB Wales has actively engaged with Professor Dylan Jones-Evans and his team throughout the review process.

To this effect, the examination in both parts of the review has provided a welcome insight into access to finance for small firms in Wales in both the commercial and public sectors. We now know that there is a finance gap in Wales of around £500m¹. The review has made solid recommendations in terms of the high street banks in Wales, public providers such as Finance Wales and the, as yet, untapped role of novel, alternative forms of finance.

FSB Wales believes the Welsh Government should give detailed consideration to implementation of the recommendations. The status quo around finance Wales is untenable and FSB Wales agrees that it is “*not fit for purpose*”².

Our response to the second part of the review firstly discusses the scrutiny arrangements of Finance Wales before considering the implementation of the review on Finance Wales’ interest rate policy. We then address the proposals for a Development Bank of Wales, and what this could mean in practice. Finally, this response will consider the recommendations relating to alternative forms of finance.

2. Scrutinising Finance Wales

FSB Wales has long held concerns about the objectives of Finance Wales and how they accord with Welsh Government policy, and representations to this effect were made to the review. It is clear

¹ Professor Dylan Jones-Evans. 2013. *Access to Finance Review: Stage 2 review* [Online]. Available at: <http://wales.gov.uk/topics/businessandconomy/publications/accesstofinance/?lang=en> (accessed 26th November 2013). P 4

² *Ibid.* P. 50



that there is a lack of transparency and accountability leading to insufficient levels of scrutiny from all stakeholders into the performance of Finance Wales. There are numerous symptoms of this accountability deficit.

Firstly, there is no clear reporting mechanism between Finance Wales and the National Assembly for Wales. FSB Wales believes the scrutinising function of the National Assembly for Wales, and in particular the Finance and Enterprise and Business Committees that oversee both the spending of public bodies in Wales and economic development policy respectively, has a beneficial impact on service delivery. Regular scrutiny by stakeholders and Assembly Members allows for the early identification of issues and for their rectification in the policy process. Professor Jones-Evans' review illustrates this lack of transparency by highlighting the reluctance of Finance Wales to publish its fifteen reference rates used to assess the cost of loans³.

As such, a reporting mechanism to the National Assembly for Wales should be established urgently, alongside an inquiry into Finance Wales' performance by the Finance Committee at the earliest opportunity.

Secondly, despite being a publicly funded body, Finance Wales publishes no annual report for public consideration and scrutiny. This is in marked contrast to many other public organisations such as the Welsh Language Commissioner, ESTYN and the Climate Change Commission⁴. It is also in contrast to many financial organisations that operate in similar sectors such as the Principality, or perhaps more importantly the Development Bank of Canada⁵. Previous annual reports have been produced by Finance Wales but there has been a general reluctance by the organisation to share this information with stakeholders such as FSB Wales, further weakening transparency. The Minister for Economy, Science and Transport should call on Finance Wales to publish a detailed annual report explaining how they have supported the economic development of Wales in line with the Welsh Government priorities.

Finally, Finance Wales' mission statement has been correctly identified by Prof Jones-Evans as contrary to the Welsh Government economic development policies. The review highlights how Finance Wales' mission has evolved over the last decade from; "[to] assist Welsh businesses to

³ *Ibid.* P.37

⁴ Climate Change Commission for Wales. 2013. *Second Annual Report* [Online]. Available at: <http://www.cynnalcyrmru.com/library/climate-change-commission-wales-2nd-annual-report> (accessed 26th November 2013).

Welsh Language Commissioner. 2013. *First Annual Report* [Online]. Available at: <http://www.comisiynyddygyraeg.org/english/news/Pages/One-year-in-action---launch-of-the-Welsh-Language-Commissioner%E2%80%99s-first-Annual-Report.aspx> (accessed 26th November 2013).

Estyn. 2013. *Annual Report of Her Majesty's Chief Inspector of Education and Training in Wales 2011-2012* [Online]. Available at: <http://www.estyn.gov.uk/english/annual-report/annual-report-2011-2012/> (accessed 26th November 2013).

⁵ http://www.principality.co.uk/~/_media/Files/PDF/Financial%20Reports/2012/PRINCIPALITY%20ANNUAL%20REPORT%202012%20ENGLISH.ashx
http://www.bdc.ca/en/about/publications/annual_report/Pages/annual_report.aspx



*realise their true potential for innovation, growth and economic impact in the region*⁶ to a situation where its prime objective is to *“to become the UK’s leading SME investment company”*⁷.

The report recognises recent interventions by the Minister for Economy, Science and Transport in rewording the mission statement for Finance Wales to closer align it with Welsh Government economic development priorities. This is a welcome step, however, in light of the evidence received in the review, the Minister should re-examine this issue and consider strengthening the mission statement further to align more closely with Finance Wales’ original aims from 2001. The Minister should also set out her expectations for how this should change delivery in practice and allow public scrutiny of progress via the methods explained above.

Taking the steps highlighted above will, in the short term, allow for greater public scrutiny and more closely align Finance Wales with wider economic development policies. These are short term steps that the Minister for Economy, Science and Transport could implement to begin the process of reform.

Should Finance Wales continue in its current role or indeed be transformed into a true development bank, it is also important that the processes and procedures it utilises in offering support to SMEs are monitored. FSB Wales’ concerns in this respect are twofold.

Firstly, the use of guarantees, the levying of charges and other costs should be monitored effectively as part of an annual review. A key feature of the review process should be to examine the costs faced by businesses for the administration of their loans.

Secondly, we are concerned about the use of external advisors and the transparency of the referral processes. Through queries raised by members, FSB Wales has become aware of the practice of referring applicant businesses to third party advisors. Whilst this maybe appropriate we are aware that in some instances businesses have already received advice and assistance from Business Wales and their own professional advisors but have been further referred to a third party by Finance Wales. The costs of any required advice prior to application should be fully disclosed and included when Finance Wales or any future body advertises its interest rates and charges.

3. Finance Wales interest rates

To many FSB Wales members, Finance Wales has been seen as a lender of last resort, somewhere to turn when the high street banks had refused finance. While this assumption is to be expected given Finance Wales’ role as a public sector finance body, the perception extends to the cost of the products available. Finance from Finance Wales is often perceived as expensive and this has largely been supported by the review’s findings.

Professor Jones-Evans’s review has provided the hard evidence that Finance Wales’ interest rates policy is excessive, confirming the concerns of FSB Wales members. The review has identified the

⁶ Professor Dylan Jones-Evans. 2013. *Access to Finance Review: Stage 2 review* [Online]. Available at: <http://wales.gov.uk/topics/businessandconomy/publications/accesstofinance/?lang=en> (accessed 26th November 2013). P. 39

⁷ *ibid.* P. 40



average cost of loans from Finance Wales at 10.41 per cent with loans reaching up to around 9.69 per cent above the EU base rate. Coupled with the hidden cost of loans including lending, monitoring and security fees, the true cost of borrowing will undoubtedly impact on the viability of the businesses in receipt of finance. The lack of flexibility in Finance Wales' interest rates, particularly following the dive in interest rates that following the 2008 economic crisis, is concerning.

This practice is clearly at odds with economic development policy and falls short of the support small businesses in Wales need. As the review correctly identifies, *“a dime in every dollar’ going back to the state when it could be used within the business to create jobs”* undermines the Welsh Government's aims of fostering jobs and growth.

Therefore, the Minister for Economy, Science and Transport should mandate Finance Wales to adopt interest rates closer to the EU reference rates in loan funds such as the micro-business loan fund in order to provide a more attractive offer to SMEs in Wales. Furthermore, Professor Jones-Evans has suggested that using levers such as the General Block Exemption Regulation and De Minimis, interest rates for Finance Wales loans could be reduced, particularly in West Wales and the Valleys.

For instance, the review states that the average interest rate for the Micro-Business loan fund is currently 11.2 per cent. By comparison, the report details Department for Business, Innovation and Skills backed loans that have a nominal fixed rate of 6.2 per cent and examples in Ireland and Germany both below the 9 per cent rate⁸. There is no reason why SMEs in Wales should not be given the same opportunities, particularly given the relative weakness in the Welsh economy. This should be rectified in the short term.

4. Development Bank of Wales

FSB Wales welcomes the solutions proposed by Professor Dylan Jones-Evans and believes they merit further consideration. While FSB Wales agrees with the review's conclusion that *“Finance Wales is no longer fit for purpose in supporting Welsh SMEs and helping to deliver growth to the Welsh economy”*⁹; it is vitally important that a long-term solution can be found and that the Welsh Government does not embark on a period of 'initiative churn' in reforming Finance Wales. As such, any reform should be organic and progressive, seeking to focus on outcomes rather than on simply designing a new organisation.

The five principles outlined by Prof Jones-Evans are a sound basis for moving forward with this reform. There are numerous models that could be considered to satisfy these principles including the Small Business Administration in the USA, the Development Bank of Canada, the German Sparkassen model as well as a raft of public banking organisations in Europe.

FSB Wales believes the Welsh Government should have a firm idea about the desired outcomes and the preferred organisational framework that can deliver change. This should include a clear timescale for short-term reforms, such as to Finance Wales' existing remit, while looking towards the longer term reforms needed for the creation of a development bank.

⁸ *Ibid.* P. 42

⁹ *Ibid.* P.50



Of prime importance in this should be to enable the new organisation to foster alternative and mainstream forms of finance. There should also be a strong focus on financial inclusion, recognising that many firms are marginalised from formal routes to finance and could benefit from active support. This should be a cornerstone of the development bank's objectives.

Finally, any proposed reform must include the accountability mechanisms that Finance Wales currently lacks to ensure that any future organisation does not become equally disjointed from Welsh Government's economic development policies.

5. Alternative sources of finance

Professor Dylan Jones-Evans' review provides a comprehensive examination of alternative forms of finance. This is an issue FSB Wales has highlighted in the past with the publication of the Alt+ Finance paper and in conferences in conjunction with the Institute of Welsh Affairs. FSB Wales therefore welcomes the recommendations relating to alternative forms of finance and calls on the Minister to act swiftly to give SMEs in Wales access to these novel forms of financial support.

Their implementation would serve to strengthen much needed competition in the financial sector. Alternative forms of finance should be a key consideration in any future proposals for a development bank.

Despite the comprehensive work carried out by the review, FSB Wales believes there is also further potential in the credit union movement in Wales. Changes to regulation set out in our submission to Part 2 of the review highlighted the possibilities for credit unions to take a role in lending small amounts (below £15,000) to SMEs¹⁰. Anecdotal evidence suggests credit unions already lend to sole-traders for business purposes and further support should be considered on how to maximise this potential.

6. Conclusion

Professor Dylan Jones-Evans' review has set out clear recommendations for reform in access to finance for SMEs in Wales that merit detailed consideration. The Welsh Government should respond positively to the recommendations and set out a clear timescale for reform.

In the short term, this should include providing far greater accountability from Finance Wales to the public and the National Assembly for Wales. The Minister for Economy, Science and Transport should set out clear objectives and performance measures, a new mission statement for Finance Wales and ensure interest rates are more reflective of EU guidelines.

In the medium term, consideration should be given to Professor Jones-Evans' Development Bank of Wales proposals. This should be an organic process bringing together already existing support such as Finance Wales and Business Wales. This should also include the facilitation of alternative forms of

¹⁰FSB Wales. 2013. *Part 2 Access to Finance Review – FSB Wales Submission* [Online]. Available at: <http://www.fsb.org.uk/policy/rpu/wales/images/final%20non-bank%20finance.pdf> (accessed 26th November 2013).



finance as set out in the recommendations as well as further analysis of the potential role for credit unions.

Finally, over the longer term, the Welsh Government should design a solution drawing on best practice from elsewhere, such as the USA's Small Business Administration, the Development Bank of Canada and the German Sparkassen model. There should also be consideration of how a long-term solution can address financial exclusion for businesses, focusing on models of community banking.

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The Federation of Small Businesses

The FSB is non-profit making and non-party political. The Federation of Small Businesses is the UK's **largest campaigning pressure group** promoting and protecting the interests of the self-employed and owners of small firms. Formed in 1974, it now has **200,000 members across 33 regions and 194 branches**.

Lobbying

Our lobbying arm - led by the Westminster Press and Parliamentary office - applies pressure on MPs, Government and Whitehall and puts the FSB viewpoint over to the media. The FSB also has Press and Parliamentary Offices in Glasgow, Cardiff and Belfast to lobby the devolved assemblies. Development Managers work alongside members in our regions to further FSB influence at a regional level.

Member Benefits

In addition, Member Services is committed to delivering a wide range of high quality, good value business services to members of the FSB. These services will be subject to continuing review and will represent a positive enhancement to the benefit of membership of the Leading Business Organisation in the UK.

Vision

A community that recognises, values and adequately rewards the endeavours of those who are self employed and small business owners within the UK

The Federation of Small Businesses is the trading name of the National Federation of Self Employed and Small Businesses Limited. Our registered office is Sir Frank Whittle Way, Blackpool Business Park, Blackpool, Lancashire, FY4 2FE. Our company number is 1263540 and our Data Protection Act registration number is Z7356876. We are a non-profit making organisation and we have registered with the Information Commissioner on a voluntary basis.

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