



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

10th June 2015

Dear Ms Davies,

**Re: National Assembly for Wales Finance Committee Meeting – 13th May 2015
Finance Wales - Follow Up Evidence Session**

Thank you for your letter of 4th June 2015 requesting that we review the transcript from the session detailed above and provide you with our comments.

We welcome the opportunity to provide clarification on statements made in respect of Finance Wales during the meeting. For ease of reading, I have used the paragraph reference and text from the draft transcript from that meeting and provided the relevant clarification where appropriate.

We have also appended Finance Wales' submission to the National Assembly for Wales Enterprise and Business Committee which was provided in advance of the meeting held on 13th May 2015. As you will see this explains how Finance Wales has continued to evolve since the Access to Finance Review and Finance Committee Inquiry. We believe it would be beneficial if this could be shared with members of the Finance Committee as an update to the written and oral evidence Finance Wales provided last year.

If you have any questions about anything in this letter or the attachments, please do not hesitate to contact me.

Yours sincerely

A handwritten signature in black ink, appearing to read "Kevin O'Leary", written over a horizontal line.

Kevin O'Leary
Interim Chief Executive

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Finance Wales Comments on the draft transcript of the National Assembly for Wales Finance Committee Meeting on 13th May 2015:

Para 147. Professor Jones-Evans "I was up at 5 a.m. this morning and I saw that Finance Wales had released their annual results last night. So, as far as I can see, they've invested £48m into 164 companies. But what's interesting about that is that, while the amount has actually increased, what we've seen is that the average investment is about £300,000 and, like we say, what we see is that it's not that size of investment where the problem is; the real issue is in new companies and, particularly, microbusinesses."

Microbusinesses are at the heart of FW's investment strategy, In 2014/15 Finance Wales (FW) invested £48m into 164 companies. Of the £48m total, some £22.5m (47%) was lent or invested into a total of 123 microbusinesses.

There is an assumption that microbusinesses (i.e. companies employing fewer than 10 staff) only require loans of up to £50k. However, FW's experience is that microbusinesses and, in particular high growth technology businesses, often require larger loans or equity investments to realise their plans for growth. Taking this into consideration, the average investment into microbusinesses by FW was actually £183,000 during 2014/15. Finance Wales currently approves around 7 in 10 applications for finance by microbusinesses. In addition, we have also established a dedicated Micro Loans team based across Wales focused on making micro loans of between £1,000 and £50,000 to ambitious small businesses with a range of investment needs, such as start-up costs, capital expenditure and stock purchases.

Para 149. Professor Jones-Evans "We did think initially, and we still feel the same, that there is a disconnection between the Welsh Government's policy in terms of sectors and where the funding is going through Finance Wales in particular. So, if you could align that far better, particularly in terms of the way that a lot of innovation support is going to these key sectors, then you'll have a bigger bang for your buck, as most people would say."

FW's view is that generalist funds can be used to support the vast number of companies in the Welsh Government key sectors. The main exception is around equity funding for very early stage technology businesses (such as life science) where specialist fund managers, who can be attracted by an appropriate fund, can add real value. FW operates generalist funds in Wales, as it was originally set up to deliver European Regional Development Funds who require this approach. FW also operates the Wales Life Sciences Investment Fund with funding provided by the Welsh Government. FW's generalist funds can provide funding to any viable SME (including those in all the key sectors) in Wales according to their stage of development and funding requirement. In order to ensure FW's funding is targeted at the key sectors in Wales, FW has assigned a member of its investment team to each sector panel team and regularly attend their team meetings. FW will be adopting a similar approach with the Enterprise Zones and the City Regions in the future to ensure continued alignment with Welsh Government policy.

Para 151: Alun Ffred Jones. "You referred to the small business and microbusiness sector, and Finance Wales has a microbusiness loan fund and also a small loan fund. Are you saying that those aren't effective? I don't know, but maybe the other witnesses might have comments on that."

FW currently operates the Micro Business Loan Fund for WG providing loans of up to £50k to SMEs in Wales. These SMEs may be microbusinesses or larger. FW also provides loans and equity investments into microbusinesses from other funds.

Para 169: Professor Jones-Evans. "The second one was performance measurement. The problem that you have is if you have to basically measure performance; if you're a venture capitalist, you live and die by what you invest in and the return that you get. The problem is that there was no measurement of real performance against that. So, if you look at what Finance Wales have done, they've invested £114 million in equity and the return on exit has been £42 million. So, if that was a venture capital organisation, that would never have attracted any further funding because they weren't performing. There's a different rule for this; it was public sector-funded. So, that's an issue."

To 30 April 2015, FW has made equity investments totalling £121m. To date, realisations arising from FW selling some of its equity stakes amount to £48m. The value currently ascribed to FW's remaining equity portfolio is £81m. Accordingly, returns on the £121m total equity investments are currently forecast to be £129m. With almost two thirds of the current value of FW's equity portfolio yet to be realised, it is too early to assess how the performance of FW's equity funds compares to other areas of the UK.

FW has carried out public procurements for fund managers for all its European backed funds. However, these funds have struggled to attract fund managers from other parts of the UK. As a result, FW has taken the proactive step of developing its own in-house investment teams specialising in both debt and equity investments.

FW has performed strongly since its establishment in 2001 as compared to peers in other UK regions and has a record to be proud of. Since 2001, Welsh SMEs have benefitted from £337m of investment from Finance Wales. These investments have also leveraged further investment of £519m, taking our total impact on the Welsh economy to £856m and with our support, Welsh SMEs have created or safeguarded 38,454 jobs in Wales.

Para 170: Professor Jones-Evans. "The other one was this whole idea about financial incentives. There's a model called the 2 plus 20 model that all venture capital organisations follow. So, you get a 2 per cent management fee and 20 per cent of what's left over after you pay back the initial investment. Surprisingly, what we found in Finance Wales was that they were being paid on every investment. So, the minute they made an investment, they were paid a bonus—the managers—which, is again, as Roger said, 60 years of venture capital ethos. So, what needs to change there is not only the fact that you need to basically focus, as you've said, on key sectors, which is what we recommend within the report, and to get key funds—one ICT, which would be very different to life science, which would be different to environmental and to creative industries—but to change the particular ethos. What we question, or rather what Roger questioned, is whether that can be done within the public sector or whether you need to bring in specialist fund managers to do that externally. As you know, Mike, the Welsh Government has already subcontracted its life sciences fund to—I can't remember all these; it's Arthurian, isn't it, not Excalibur? It's Arthurian, because Excalibur was the previous one. So, it's already subcontracted that. I see no reason, going forward, why venture capital groups couldn't do the same."

FW does not pay bonuses on completion of individual investments. In accordance with market practice, FW's investment staff may receive a discretionary annual performance-based incentive. The quantum paid is determined by a range of qualitative and quantitative measures.

Regarding fund management activity, FW operates an arrangement similar to the 2 plus 20 model noted above which was a requirement of the European Investment Bank's participation for the Wales JEREMIE Fund and was the first long term incentive plan for FW. Rather than the 2% noted above FW charges 1.75% as a fund management fee in respect of the JEREMIE Fund but its long term incentive plan operates on the basis that once all funders have been repaid the fund manager retains 20% of any surplus generated by the fund.

FW acts as the holding fund for the Wales Life Science Investment Fund on behalf of the Welsh Government and procured Arthurian Life Sciences Limited as the fund manager.

Para 180: Christine Chapman. "what is wrong with evolving Finance Wales?"

Para 181: Professor Jones-Evans "If you look at what—. We're probably jumping ahead to the recommendations now, but when we looked carefully at this—. Like I say, this, unlike the previous report, was not my paper; this was basically all the panel producing different elements of the report because of their expertise in equity, angel, banking, et cetera. When we brought everything together, and we looked very carefully, what we had done is that we'd looked at, for example, what development banks do around the world, so we basically benchmarked Finance Wales against what we'd expect a development bank, on average, to do somewhere else. What we found, quite clearly, was that there were some key differences there. Most notably, and I know this is an issue that you've touched upon before, is the fact that I think that the first one was that Finance Wales didn't actually know what it was supposed to be doing. I think that's been appreciated by the Welsh Government, it's been appreciated by this committee and also, I think, by the enterprise committee that looked at this. So, having that mandate is absolutely clear.

The Finance Committee recommended, and the Minister for the Economy, Science and Transport accepted, that the remit for FW will be updated, as noted in the written submission to the Enterprise and Business Committee.

The market challenges facing SMEs in Wales have changed dramatically since 2001 and Finance Wales has evolved to address them. We would welcome the opportunity to evolve our remit further to ensure this is correctly focused on delivery of those priority areas raised in both the Review and the Study. As a result of the recommendation of the National Assembly Finance Committee, initial work on potential revision of the remit has begun.

FW sees its transition into a core constituent of a Development Bank for Wales as one of its next evolutionary steps.

FW is excited at this prospect and looks forward to working with the Minister and her team in developing a business plan and financial model for the Development Bank for Wales as part of this process.

Para 183: Professor Jones-Evans “The second one—I think this is a struggle—is that Finance Wales has been running at a deficit since it began. Most development banks actually run at a surplus. **In Canada, with the development bank for Canada, it’s actually enshrined** in Canadian law that it cannot make a loss. That may change the way it actually operates, but I think it is a key issue there in terms of, if you have a board that thinks it can make a loss every year, then it changes the way that board makes its investments going forward. **So, there are elements like that.”**

FW provides a versatile range of funding products for SMEs in Wales and has made significant progress on reducing its reliance on Grant In Aid (GIA) by generating income from its fund management activities in Wales and the North of England. In recent years the GIA has reduced from £5.6m in 2008/9 to £2.3m in 2013/14. FW is committed to removing the requirement for any GIA over the coming 3-5 years as its funds under management grow.

Para 185: Professor Jones-Evans “So, what we’re proposing is looking at what skills you need within that, which are already within Finance Wales, but build around them. **The reason we’re saying that is because we believe that a lot of this can be outsourced. We** believe that with a lot of the loans, we can work with the banks to actually fill the gap. Microloans can be done through business support, to a large extent, and a lot of the equity **stuff can be done through specific funds. So, you’re going to be left with, essentially, an** organisation that will not only be giving out funding, which I know the Welsh Government wants to do, but more importantly, will be an advocate for small business. It will be a real pro-business organisation within Wales that will be there, going out and trying to identify where the gaps are and encouraging the rest of the community to fill those gaps. The problem is, at the moment, that isn’t there. **You could argue that you believe that Finance Wales could evolve. We’re not talking about evolving; we’re talking about building on what they’ve got now, but you can’t just do that from Finance Wales itself.”**

FW’s experience is that these services are difficult to outsource and that the in-house team delivers both a high quality and value for money service. FW is proactive in identifying gaps in the market and has worked with the Welsh Government to address them. This is evidenced by the 5 new funds FW has set up since the JEREMIE fund.

A comparison with the other UK JEREMIE Funds, would provide greater clarity on Finance Wales’ relative performance against similar organisations in the UK.

Para 199: Professor Jones-Evans “On to Nick’s point about threat, that’s the last thing that any public development bank should be. It should be complementary to the private sector and not in competition. At the same time as we were doing our review, Sir Andrew Large was doing a detailed review of NatWest, and what he found, which we found as well, **was that, basically, a lot of deals weren’t going ahead because, say a business was applying** for £0.5 million, the bank would look at its collateral affordability and offer it £300,000, and they would turn it down. As a result, because of that £200,000, what would happen is that **deal wouldn’t go ahead, jobs weren’t created, technology wouldn’t be developed, et cetera. So, the way we looked at it is that we said, ‘Can we close that gap?’ So, rather than what would happen—they would go to Finance Wales and Finance Wales had given the £0.5 million when the bank had already given £300,000 just because they can’t get the £200,000—why not have the bank come in and close that gap? We’ve consulted with a**

number of banks about this and they're saying that that is where the gap is in terms of funding low-to-medium-risk businesses. So, if we can actually work alongside the banks to actually supply that, that means the Government's funding will go further because, basically, rather than having to give the whole £0.5 million, they're only giving a proportion of it. So, that means it'll go further and, certainly, the way that there'll be restrictions on public expenditure going forward, that's the sort of approach that's needed."

FW works with the banks to meet the needs of SMEs in Wales. This is evidenced by the private sector leverage FW achieves alongside its own investment (see appended submission). In the above example, FW would fund the gap of £200,000 alongside the bank. Enabling deals to happen in this manner is the reason that banks view FW as an enabler; bridging the gap between what they can provide and what the SME needs. A recent example of this is FW's funding of £500,000 towards the redevelopment of Barry Island fun fair alongside £1m from a high street bank and £500,000 from the management team, filling the gap that the bank was unwilling to fund.

Para 222: Professor Jones-Evans "Absolutely. I think the Welsh Government, obviously, has previous experience of merging organisations and looking at the costs of those. So, we can build on that experience, but also, I would say, looking at the British Business Bank and the experiences they've had in merging—I wouldn't say 'merging'; it's basically looking at what you have and building on it—. What's notable, of course, is that, like I said to you before, Finance Wales are running at a £2 million or £3 million deficit every year. It's been higher, but it's been brought down in recent years. But 75 per cent of the costs of Finance Wales— administrative costs — is staff and professional fees. Last year, Finance Wales spent well over £1 million on professional fees, for example.

Para 223: So, it's not a matter of—. Will there be a question on how it's going to be funded, because we were asked that, or do I bring it in now?"

Para 224: Jocelyn Davies: If you want to. We've completely lost our agenda on this session, so if you want to bring it in now and Members can—

Para 225: Professor Jones-Evans: That's fine. Like anything else, it's not about how much money you bring in; it's also about expenditure and how you set that.

FW's net expenditure on professional fees during 2014/15 was £694,000, including £277,000 of one off costs relating to IT consultancy and FW's new office move. We expect these costs to return to circa £350,000 in 2015/16 in line with the 2013/14 cost of £370,000.

It is FW's view that financial self-sufficiency must be considered from both revenue and capital perspectives. FW's commitment to reducing GIA dependence is clear and we are making good progress towards delivering on that goal. The successful delivery of legacy funds and a track record of successful realisations will attract private sector funders and deliver capital self-sufficiency thereby reducing/removing reliance on public sector funding. FW believes it is well on track in developing this track record, but will have to wait until the end of the realisation period on the JEREMIE Fund to fully assess if this has been achieved.

Para 232: Alun Ffred Jones “.....and it’s difficult to see exactly whether this is one body, or whether it’s two bodies, or whether they can do both things, but there is an element, which is to do with my questions, that is relevant, I think. You believe that the development bank could make efficiency savings if the fund or funds, or some of them, were managed externally. Could you explain how you’ve come to that conclusion, that you’d make efficiency savings through doing that?”

Para 233: Professor Jones-Evans: “Well, it’s being done already, of course, with the life sciences fund—the £100 million one that the Government is managing at the moment, so the system is in place already. ”

FW does not accept that awarding fund management contracts externally will deliver the efficiency savings as noted above. Using the example quoted above. The average fund management fee paid to FW for the funds it manages is equal to the industry standard fund management fee of 2%.

**Written Submission made by
Finance Wales to the
National Assembly for Wales
Enterprise and Business Committee
Inquiry into the
Development Bank for Wales**

8th May 2015



EXECUTIVE SUMMARY

Finance Wales welcomes the opportunity to provide oral evidence to the Enterprise and Business Committee on 13 May 2015 in respect of the inquiry into the proposed Development Bank for Wales (DBW). In advance of the oral evidence session, this written submission summarises the position of Finance Wales in respect of the important issues being scrutinised by the Committee.

Finance Wales is excited by the potential of the DBW and note the clear and unequivocal commitment provided by the Minister for Economy, Science and Transport that the DBW will be established, and cross-party backing in the National Assembly to support the Minister in this task.

Finance Wales further notes the recognition of the talent, expertise and experience in its organisation acknowledged by the Minister during the oral evidence session held on 23 April 2015 and similar recognition noted by the Finance Committee in their May 2014 report on Finance Wales. As an organisation we look forward to playing a central role in ensuring the future success of the DBW and await further clarity on the roadmap to establishing the DBW, as indicated by the Minister.

Until the DBW is established, Finance Wales will continue to serve the Welsh SME community by providing comprehensive and innovative financing to help fill the funding gap that clearly currently exists. In fulfilling this role, Finance Wales continues to perform strongly and our latest annual results show that financial year 2014-15 has been the best ever year for Finance Wales Group, with a £104m impact on the Welsh SME funding gap, helping to create or safeguard 2,897 jobs.

Finance Wales continues to evolve in response to the demands of the SME community in Wales. The £6 million Wales Micro-business Loan Fund, the £7.5m Wales Technology Seed Fund, the £10m Wales Capital Growth Fund and the £10 million Wales Property Development Fund, all backed by the Welsh Government, have expanded the financing options we are able to provide. As a result of the wider range of funds invested by Finance Wales, our impact on the economy of Wales since our establishment in 2001 has grown to £856m, creating or safeguarding over 38,000 jobs.

Finance Wales shares the desire of the Minister to enhance scrutiny of our performance. We welcome the opportunity to provide evidence to the Enterprise and Business Committee, and stands ready to be scrutinised by other relevant committees of the National Assembly when invited.

EVOLUTION OF FINANCE WALES

In 2001 the Welsh Development Agency (WDA) established a wholly owned subsidiary, Finance Wales plc, with the primary objective of assisting SME firms obtain finance appropriate to their needs. At that time public intervention was required to address

market failure in the area of access to finance for SMEs. As a 'gap funder' Finance Wales was subject to specific criteria, which meant that it could not compete with the banks or other private sector funders and charged market interest rates which reflected the risks. On formation, Finance Wales inherited from the WDA a suite of equity and loan funds and a set of support services designed to enhance the ability of its SME clients to source funding.

These funds enabled Finance Wales to offer equity investments up to £250,000, small business loans of up to £50,000 and interest free loans for university spin-out businesses of up to £25,000. Other products afforded Finance Wales the means to assist businesses seeking investment finance, including access to informal investment via Business Angels and support for businesses starting up in the university sector.

The WDA was abolished in April 2006 and shares in Finance Wales plc subsequently transferred to the Welsh Ministers, with responsibility for its activities as a Welsh Government Sponsored Body passing to the Minister for Economy, Science and Transport. Around that time, Finance Wales' business support programmes were absorbed into the Welsh Government to become part of its overall business support offering.

Finance Wales plc has a number of subsidiaries which make up the Finance Wales Group and encompass both Fund Holding and Fund Management activities. In order to satisfy EU State Aid requirements, as a public financial intermediary the funding we provide to SMEs must be managed commercially, with our managers taking investment decisions at arm's length from the Welsh Government.

Finance Wales has grown into a key Welsh financial institution supporting the provision of risk finance to SMEs through a range of funds, some of which leverage private capital from banking institutions such as Barclays and the European Investment Bank (EIB) matched with public funds from either the European Regional Development Fund (ERDF) or more recently the Welsh Government.

The initial fund raising strategy was for Finance Wales to bid for ERDF backed investment funds for Wales. These funds included the Objective 1 and Objective 2 Funds and more recently the Wales JEREMIE Fund. These funds are financial instruments providing loans, equity and mezzanine funding and were developed to address the identified market failure to support SMEs in Wales.

In the last few years financial instruments have been gaining prominence in public policy mainly for two reasons:

1. They leverage limited public support by incentivising the involvement of the private sector so that every £1 provided by the public sector is matched by £1 from private sources and the total amount that benefits SMEs is doubled. In times of budgetary austerity this leveraging effect is very important to public

bodies with competing claims on finite resources.

2. Unlike grants, which are used in one-off interventions to support single companies, financial instruments can be re-used and can increase the total amount of available funding so many more companies can be assisted.

Finance Wales also identified market gaps in Wales where the Wales JEREMIE Fund could not invest, and developed additional funds financed by the Welsh Government.

Finance Wales also acts as Holding Fund manager in respect of the £50m Wales Life Sciences Investment and the £0.8m Social Enterprise Micro Loan Funds and procured specialist fund managers for these Funds.

In total, Finance Wales has raised and managed funds for SME investment in Wales of approximately £390m. Finance Wales continues to fulfil the central role of not competing with banks and private sector finance providers, but working to fill the funding gap arising from market failure.

xénos, the Wales Business Angel Network, is a member of the Finance Wales Group. xénos introduces private investors to companies seeking growth funding and sourced c.£2m of funding from angels for investment in Welsh SMEs in 2014/15.

In 2009, it was understood that Wales would not qualify for further European Structural Funds and as a consequence Finance Wales, with Welsh Government approval, bid for fund management contracts in England to both reduce its Grant in Aid (GIA) requirements and develop its investment and return track record in order to attract future private sector funders. This strategy also gave Finance Wales excellent regional market intelligence into the dynamics of the SME funding market in other UK regions, which is used by Finance Wales to improve the products available to SME firms in Wales.

In the UK, Fund Managers managing client money must be authorised by the Financial Conduct Authority (FCA). FW Capital Ltd is the FCA authorised subsidiary of Finance Wales, acting as Fund Manager for contracts totalling £75m with English Holding Funds. FW Capital contributes c.£0.5m pa towards the overhead costs of Finance Wales.

Finance Wales has demonstrated that it has the expertise to set up and manage commercial funds for the Welsh Government. For example, within four months of an initial approach by the Welsh Government, Finance Wales set up the £170m Help to Buy Wales Fund. Feedback received from builders active across the UK is that Help to Buy Wales is the best run scheme in the UK. This fund also contributes £0.5m pa towards the overhead costs of Finance Wales and links seamlessly with the Wales Property Development Fund providing a complete funding solution to property developers and house purchasers in the new build market.

The following table summarises the growth in Funds managed by Finance Wales since its formation, together with the sources of funds raised.

FW - Funds Under Management						
	Start	Source of Funding				Total Funds
Wales SME Funds - Managed by FW:	Date	WG (£'m)	ERDF (£'m)	EIB (£'m)	Barclays (£'m)	(£'m)
SLF	2001	17.7	0.0	0.0	0.0	17.7
Spin Out Fund	2001	2.6	0.0	0.0	0.0	2.6
Objective 1 Funds	2001	0.0	20.4	0.0	24.9	45.2
Objective 2 & Transitional Funds	2003	3.6	12.6	0.0	19.7	35.9
Creative Fund	2005	12.0	0.0	0.0	0.0	12.0
Rescue & Restructure Fund	2005	6.2	0.0	0.0	0.0	6.2
Interim Fund	2007	15.0	0.0	0.0	15.0	30.0
Jeremie Fund	2009	15.3	67.2	75.0	0.0	157.5
Wales SME Fund	2012	20.0	0.0	0.0	20.0	40.0
Micro Loans Fund	2013	5.2	0.0	0.0	0.0	5.2
Wales Property Fund	2013	10.0	0.0	0.0	0.0	10.0
Help To Buy Wales	2014	170.0	0.0	0.0	0.0	170.0
Working Capital Fund	2014	20.0	0.0	0.0	0.0	20.0
Technology Seed Fund	2014	7.5	0.0	0.0	0.0	7.5
Total		305.1	100.1	75.0	79.6	559.8
Wales SME Funds - FW Holding Fund Only:						
Micro Loans	2013	0.8	0.0	0.0	0.0	0.8
Life Sciences	2013	50.0	0.0	0.0	0.0	50.0
Total		50.8	0.0	0.0	0.0	50.8
External Fund Management Contracts:						
North East Growth Fund	2010	Funds are not held by FW - these are Fund Management Contracts				20.5
North West Loans Fund	2011					35.0
North West Mezz (Dev Cap)	2013					10.0
Tees Valley Catalyst Fund	2014					10.0
Total						75.5

PERFORMANCE OF FINANCE WALES

Finance Wales has performed strongly since establishment in 2001 as compared to its peers in other UK regions. The most recent (Q2 2013) comparison of the UK JEREMIE Funds' performance by region (Wales, North East, North West and Yorkshire) showed that the Wales JEREMIE Fund had the biggest impact on economic development with over 8,300 jobs created and safeguarded and a £248m impact on the funding gap as well as having the lowest lifetime operating costs as a percentage of funds under management.

Welsh SMEs have benefitted since 2001 from £337 million of investment from Finance Wales. These investments have also leveraged further investment of £519 million, taking our total impact on the Welsh economy to £856 million. With our backing, Welsh SMEs have since 2001 created or safeguarded 38,454 jobs in Wales.

The performance of Finance Wales continues to improve. The financial year 2014-15 has been the best ever year for Finance Wales Group, with a milestone £104m impact on the funding gap in Wales. Loans and other investments by Finance Wales helped SME firms in Wales create or safeguard 2,897 jobs in the last financial year. Investment levels

in Wales rose by £15.1m to £48.2m as all funds managed by Finance Wales achieved or exceeded their investment target. The annual jobs target for Finance Wales was also exceeded by 39%.

Since the Access to Finance Review process commenced in January 2013 the improvement in the performance of Finance Wales has continued, with key indicators reflecting our focus on listening, learning and responding to the Review:

- We have achieved overall record year on year improvements in performance:

	2014/15	2013/14	2012/13
Wales Investment	£48m (137% of target)	£33m	£31m
Jobs created/safeguarded	2,897 (139% of target)	3,435	1,915
Private Sector Leverage	£56m (121% target)	£26m	£22m
FW Capital Investment	£16m	£15m	£12m

- Proactively identified market funding gaps in Wales and worked to address them as follows:
 - Wales Property Development Fund £10m (bridging loans)
 - Wales Capital Growth Fund £20m (working capital loans/guarantees)
 - Wales Technology Seed Fund £7.5m (seed equity investments)
 - Wales Micro-Business Loan Fund £6m (funding for up to £50k for SMEs)
 - Wales Succession Fund £10m (to be launched in 2015, providing funding to support management succession deals in Wales)
 - Reduced the Grant in Aid (GIA) requirement of Finance Wales from £3.2m in 2012/13 to £2.3m in 2013/14 as a result of additional income from running more funds in Wales and England and from running the HTBW fund. By comparison, the GIA in 2008/9 was £5.6m.
- Deepened cooperation with Business Wales. Finance Wales provides, at minimal cost annual training for Business Wales advisers, which serves to strengthen relationships and understanding between the two organisations. In Oct 2014, Finance Wales delivered six training events across Wales to 62 Business Wales advisors covering areas such as financial products, investment readiness and financial analysis. In Q1 2015, Finance Wales also commenced roll out of general financial products training to Welsh Government business development managers.
- Maintained its reputation for investing ahead of target, exceeded economic development targets and maintained a stable portfolio default record well within bank covenant requirements. The loan and mezzanine default rates on

the Wales JEREMIE and Wales SME funds are running comfortably within their covenant review and default limits.

- Repaid EIB borrowings of £9.4m interest and £48.6m capital (since 2010). The current balance outstanding with the EIB from the original £75m loan is £26.4m.
- Continued to develop strong and trusted relationships with banking partners, with banks now acting as the leading introducer of clients to Finance Wales and they are a co-funder on most of our non-start up deals.
- Number of equity realisations in 2014/15: 8 comprising 6 sales generating £16.6m (c. 2x return) and 2 stock market flotations (current value 1.7X cash invested). In 2013/14 3 exits were achieved.
- Worked closely with the banks to develop a new £60m mid-market mezzanine fund model for which Finance Wales received three credit backed offers for bank debt funding of £20m from three high street banks to provide £40m of debt. Welsh Government balance sheet borrowing restrictions prevented this fund from proceeding further and an off balance sheet structure will need to be agreed for Finance Wales to tap into debt funds as part of a future fund structure.
- Procured fund managers for the Wales Life Sciences Investment Fund. Finance Wales now manage the relationship with the winning fund manager, Arthurian, on behalf of the Welsh Government.

These data points only tell one part of the story though. Our core constituency of SME firms operating in Wales or seeking to establish in Wales clearly value the role played by Finance Wales in addressing the funding gap and providing access to finance that is not being delivered by the market.

There has been credible, independent recognition of our performance and value. The Finance Committee of the National Assembly found in their May 2014 report “Finance Wales” that:

“Through this inquiry, the Committee was reassured to find that Finance Wales was well regarded across much of the business sector, as well as across the UK and further afield. We found that Finance Wales, on the whole, was making a positive contribution to the Welsh economy, and that what was needed was a clarification of their role and remit rather than a full scale overhaul” [page 5]

It is particularly notable that the Finance Committee when consulting directly with our core SME constituency at a stakeholder event found broad endorsement of the role played by Finance Wales:

“There was a lot of support for Finance Wales at the session, and many commented that they disagreed with the findings in the Access to Finance review. SMEs told the Members that they value the approach taken by Finance Wales, such as being flexible in funding arrangements and the stability it offers in comparison to high street banks” [page 53]

Finance Wales is an organisation that has had a demonstrably positive impact on the Welsh economy, is well respected, appreciated and valued by the SME community in Wales, and has continued to improve performance during the Review process.

ACCESS TO FINANCE REVIEW

Finance Wales has cooperated fully with the Access to Finance Review process. Our position on key areas raised during this process has been presented previously to the National Assembly for Wales Finance Committee, but is summarised below for ease of reference:

1. *Bank Funding.* Finance Wales agrees that there is a gap in the supply of finance to SMEs in Wales and notes that while there continues to be debate over the exact size of the gap, Professor Dylan Jones-Evans estimated the gap to be in the region of £500m in 2015.
2. *Alternative sources of funding.* Finance Wales endorsed the comments made on the strong availability of invoice discounting and other asset based lending. Finance Wales is looking at how to improve the impact of the xénos business angel network. Finance Wales also agree that peer-to-peer lending and crowdfunding are exciting growth areas in SME finance and is actively exploring these opportunities.
3. *Interest rates.* The main issue here centred on the interest rates charged by Finance Wales. In this regard Finance Wales lends at market rates which reflect the risk. This market approach was verified by an independent expert review commissioned by the Welsh Government and undertaken by Mr. Paul Goodman who is Vice Chairman of the National Association of Commercial Finance Brokers. The review questioned whether better use could have been made of de minimis provisions in accordance with EU State Aid regulations to provide lower interest rates. This is an area that Finance Wales agreed to review and has subsequently launched the Technology Seed Fund which operates in accordance with the de minimis provisions or where there are co-investors, the Market Economy Operator Principle.
4. *Development Bank for Wales.* See Development Bank for Wales section below.

In response to the Access to Finance Review process and the related inquiry conducted by the Finance Committee of the National Assembly, Finance Wales has implemented a number of changes:

- *Funding referral system.* Finance Wales and Nat West Bank are the first two members of the pilot Wales Bank Referral Scheme.
- *Scrutiny.* Finance Wales has published its annual accounts and interim reviews on a new performance section of its website. Finance Wales will be adopting a new “plc style” reporting standard in our Financial Accounts which gives more transparency on our performance. We have reaffirmed our long-standing willingness to accept invitations to appear before relevant committees of the National Assembly.
- *Transparency.* Finance Wales has published the interest rates it offered during 2013/14 by risk category in its ‘Frequently Asked Questions’ page of its website.
- *Stakeholder engagement.* Improved communications with our key stakeholders through specific measures including:
 - Strengthened relationships with Business Wales. As previously detailed, Finance Wales provides and funds annual training for Business Wales advisers, which serves to strengthen relationships and understanding between the two organisations. In addition Finance Wales has commenced general financial products training to Welsh Government Business Development Managers.
 - Finance Wales has appointed liaison staff for each Welsh Government key sector, significantly improving cross team communication and enabling a more ‘Team Wales’ approach to each sector’s target companies in terms of business support and funding.
 - Set up a 2% interest rate discount scheme for SMEs based in Welsh Enterprise Zones applying for loan funding from Finance Wales.
 - Greater stakeholder engagement via social media including LinkedIn, Twitter and Google+.
 - Welsh Government Snapshot launched at the end of Q1 2014/15 and issued quarterly since. We will be expanding circulation beyond the Welsh Government to a wider audience from Q4 2014/15.
 - Sponsored prominent annual awards including Business in the Community, Wales Insider, Daily Post and Powys Business Awards.
 - Ran a succession management campaign to stimulate succession deal flow alongside PwC and Morgan Blake to banks and other introducers, and ran campaigns to stimulate deal flow in the convergence area of

Wales in order to complete the investment of the JEREMIE fund in this area.

- Initiated a quarterly regional dinner programme with key opinion leaders in each region to discuss the local business market, understand key challenges and take feedback on the local performance of Finance Wales. The Mid and West Wales have generated very positive feedback on our approach and performance. The North Wales dinner is scheduled to take place in May 2015.
- *EU State Aid exemptions.* Finance Wales is in discussions with the Welsh Government regarding the best use of exemptions in considering new fund design.

Such improvements implemented by Finance Wales were recognised by the Minister for Economy, Science and Transport in her recent appearance before the Enterprise and Business Committee.

DEVELOPMENT BANK FOR WALES

Finance Wales has now also had the opportunity to review in detail the Feasibility Study into the creation of a Development Bank for Wales (“the Study”). Finance Wales is excited by the potential of the DBW and notes the clear and unequivocal commitment provided by the Minister for Economy, Science and Transport that the DBW will be established, and there is cross-party backing in the National Assembly to support the Minister in this task.

Finance Wales further notes the recognition of the talent, expertise and experience in its organisation acknowledged by the Minister during the oral evidence session with the Enterprise and Business Committee held on 23 April 2015 and similar recognition noted by the Finance Committee in their May 2014 report on Finance Wales. As an organisation we look forward to playing a central role in ensuring the future success of the DBW and await further clarity on the roadmap to establishing the DBW, as indicated by the Minister.

In particular, Finance Wales welcomes the opportunity to provide assistance in helping meet the challenges that need to be addressed prior to the establishment of the DBW. We believe these will include a comparison of the economic development outputs the DBW would look to achieve compared to the existing provision from Welsh Government Grants, Finance Wales and Business Wales. We also believe they will include the generation of a business plan and model showing whether the aims (economic development outputs, increased investment levels, lower interest rates and lower defaults than those achieved by Finance Wales and break even within five years) of the DBW could be achieved and how much it would cost the Welsh Government to fund.

Until the DBW is established however, Finance Wales will continue to serve the Welsh SME community by providing comprehensive and innovative financing to help fill the funding gap that clearly currently exists.

Finance Wales believes that the talent, expertise and experience within our organisation can play a role in the future success of the DBW. Key areas of capability and priority assigned by the Study for execution by the DBW could be delivered by ensuring the existing infrastructure of Finance Wales (including staff and financial products) are part of the solution. Crucially, this will also ensure the new organisation would have FCA fund management authorization, removing the time delays associated with a new application for authorisation for this activity. In the context of microfinance Finance Wales currently holds interim permission from the FCA for regulated consumer credit activities and will apply for full authorisation once the application period set by the FCA opens. We believe this would be a much stronger starting point, as compared to a new entity, for gaining any additional regulatory approvals that may be required once the structure of the DBW has been agreed.

Areas where the expertise of Finance Wales could be harnessed to help ensure the future success of the DBW include:

- *Microfinance:* After listening to feedback from customers and advisers on making our micro loans more affordable, Finance Wales propose that the current Micro Fund is increased by a further £12 million and the maximum repayment term is increased from 5 years to 10 years. If demand outstrips supply, Finance Wales will keep the Welsh Government informed of the position and apply for top up funding as required.
- *Low to average risk SMEs:* Finance Wales' existing funds already cover this area. Finance Wales recommends that a review of the demand for funding from the Wales Capital Growth Fund is undertaken over the next year to assess further funding requirements. It is our view that getting banks to share their due diligence is likely to be challenging.
- *Proposed equity strategy for High Growth companies:* Finance Wales has always procured fund managers for its ERDF backed funds. In the experience of Finance Wales, these funds are too small to attract a specialist investor as fund management fees are unattractive. Finance Wales own fund management team has established an excellent reputation in the market place. We will continue to assess the market need for specialist funds. To date the development and launch of the Technology Seed Fund and the Wales Property Development Fund has demonstrated the capability of Finance Wales for identifying and responding to the market in a cost effective manner.

Finance Wales believes it is building a centre of excellence for generalist investment skilled jobs in Wales. If the DBW pursues a strategy of outsourcing to

specialist fund managers, Finance Wales believes that Wales risks losing this skilled workforce. These skills should be retained and grown in Wales forming a key part of the financial and professional services sector in Wales.

- *Social enterprise sector:* Finance Wales proposes to continue to provide funding into the social enterprise sector through its sub-contracted fund manager WCVA rather than taking a step backwards and only providing guidance and sign posting on how to become investment ready, as proposed in the Study.

Taken together, Finance Wales believes that there is a compelling case for retaining the expertise and experience of Finance Wales in order to reduce as far as possible the execution risk from establishing the DBW, while ensuring at all times continuity of financing to the SME community.

FUTURE PLANS FOR FINANCE WALES

Finance Wales is keen to ensure that as an organisation we are absolutely focused on serving the SME community in Wales in the most efficient, transparent and cost-effective manner possible. To this end, we have identified the following steps as being necessary to ensure that Finance Wales is fit for the future:

1. *Remit:* Finance Wales would welcome the opportunity to evolve our remit further to ensure this is correctly focused on delivery of those priority areas raised in both the Review and Study. As a result of the recommendation of the National Assembly Finance Committee, initial work on potential revision of the remit has begun.
2. *Transparency:* Finance Wales has already implemented significant improvements in this area, including making our Accounts and Annual Review available on our website, and re-affirm our long-standing willingness to accept invitations to appear before relevant committees of the National Assembly to scrutinise our performance. We hope also to regularise Ministerial contact and briefing by the Senior Management of Finance Wales.
3. *Sustainability:* Finance Wales has improved efficiency in its operations in order to reduce the dependence on the GIA from the Welsh Government. As a result our GIA requirement has more than halved in recent years, from £5.6 million in 2008/9 to £2.3 million in 2013/14. We aspire to removing by a fixed date the need for any GIA from the Welsh Government to Finance Wales. To this end, we propose continuing FW Capital's strategy of winning profitable fund management contracts in other parts of the UK and continuing to operate the Help to Buy Wales Fund and any other Welsh Government funds we are asked to manage.

4. *Co-operation:* Whilst Finance Wales is well regarded by the SME community, we believe that there is more that could be done to bring us closer to our core constituency. We would like to investigate further the establishment of a formal consultative committee, consisting of senior representatives of the SME community in Wales, to align Finance Wales more closely with this constituency. This committee might be chaired by the Chief Executive of Finance Wales and include senior CBI, IoD, BCC and FSB representatives, meeting on perhaps a quarterly basis. We are also seeking to develop closer working relationships with the Welsh Government grant and sector teams, the Enterprise Zones, UK Export Finance and Business Wales, with the purpose of developing a 'one stop shop' for SMEs in Wales.

5. *New funds:* Finance Wales will continue to work with Welsh Government and Welsh European Funding Office colleagues to design the JEREMIE Successor fund and other Welsh Government and/or private backed funds to ensure that Welsh SMEs have access to a complete range of funds.

We feel that taken together, this package of substantial but highly practical measures could ensure that Finance Wales is even more closely aligned with the interests of the SME community in Wales and provide comfort to the Welsh Government and other stakeholders that as an organisation; Finance Wales is absolutely focused on delivering meaningful economic development outputs for the benefit of all its stakeholders in Wales.

CONCLUSION

Finance Wales is excited by the potential of the DBW and firmly believes that the acknowledged talent, expertise and experience of its staff can play a key part in ensuring the future success of the DBW. We look forward to working closely with the Minister, National Assembly and all stakeholders in ensuring that the SME community in Wales continues to be provided with comprehensive and innovative financing to help fill the funding gap that clearly currently exists