Access to Finance for SMEs at a Regional Level - The Case for a Development Bank for Wales?

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ABSTRACT

Objectives
In 2013, the Welsh Government announced an independent review into access to finance in Wales. Its aim was to examine how effectively SMEs in Wales are served by existing sources of funding, identify areas of particular challenge and provide recommendations for action. This paper reports on the work undertaken during this review and on its conclusions regarding a potential solution to the funding issue facing SMEs in Wales through the creation of a Development Bank for Wales.

Prior Work
With a devolved system of government within the UK, there has been increasing interest in the role of SMEs as engines for developing prosperity and growth at a regional level. In Scotland and Northern Ireland, the devolved administrations have commissioned reports that have examined the financial environment within each nation although they specifically focused on the current support available rather than developing new solutions. Prior to this work, there has been no detailed review undertaken on access to finance for SMEs in Wales.

Approach
An extensive and detailed consultation was carried out through interviews with over 140 representatives of the banking sector, other financial institutions, the Welsh and UK Governments, intermediaries, academia and businesses. This has been supported by a substantial amount of data collated from various sources and discussions with a range of other publicly funded bodies in other countries, including Canada, Finland, Germany, Scotland, Sweden and the USA.

Results
Public sector financial support in Wales is fragmented and more relevantly, the organisation tasked with providing debt and equity finance to SMEs is not specifically focused on developing the Welsh economy. The Welsh Government needs to consider an approach where public funding for SMEs is affordable, focused on economic development, is supplemented by business support and is oriented towards the needs of the business customer. It is also critical that the public sector does not displace the private sector but works alongside the banks and other stakeholders to address a market failure in the provision of finance to SMEs.

Implications
The report recommends the establishment of a Development Bank for Wales that will be created by bringing together all the financial support schemes for SMEs within the Welsh Government, the funds managed by various agencies within Wales as well as UK Government schemes such as UK Export Finance and the Business Growth Fund.

Value
With increasing focus by politicians and policymakers on finance solutions for SMEs, a Development Bank for Wales could be a model for a new gateway for business and financial support to ensure access to the right type of support is provided to SMEs at a regional level.

1. INTRODUCTION

Within two months of taking office in 2010, the UK Coalition Government recognised that the lack of access to finance for small to medium-sized enterprises (SMEs) was a priority that needed to be addressed if the British economy was to recover from recession. One of the first reports produced by the UK Government demonstrated that one of the major issues for SMEs is that they "have generally experienced greater difficulties than their larger counterparts in accessing finance primarily due to the higher risk they represent, especially those firms without a significant credit history or track record. Around a third of SMEs do not use formal sources of external finance at all, relying instead on retained earnings or personal finance to fund investment and growth. Those SMEs that do seek external finance are almost entirely reliant on banks" (Department for Business, Innovation and Skills, 2010). The consequence of this is that much of the focus of the UK Government in supporting lending to smaller firms has been on developing and strengthening initiatives that would enable banks to lend money to businesses, including the Enterprise Finance Guarantee Scheme, Funding for Lending, and the announcement of a new Business Bank. In addition, it commissioned an industry-led taskforce that examined how businesses could gain access to non-bank lending channels (Independent Taskforce on Non-Bank Lending, 2012). Yet despite all of these efforts by government at a national level, the latest data on lending from the Bank of England indicates that there remain significant problems in getting capital from the high street banks to SMEs in the UK.

With a devolved system of government within the UK, there has been a growing appreciation of the role of SMEs as engines for developing prosperity and growth at a regional level. In Scotland and Northern Ireland, the devolved administrations have commissioned separate reports that have specifically examined the financial environment within each nation. In its study, the Scottish Government focused specifically on how to develop a strategy to set out the key principles of a "sustainable, responsible and healthy banking sector in Scotland, including providing access to finance for SMEs (The Scottish Government, 2013). In contrast, the Northern Ireland report focused on the availability of finance to Northern Ireland SMEs in order to establish the support currently available, the level of uptake and the potential reasons for any deficiencies in the market (EAG, 2013).

There had been no detailed examination of access to finance for SMEs in Wales and in 2013, the Welsh Government commissioned a detailed review to examine how effectively SMEs in Wales are served by existing sources of funding, identify areas of particular challenge and provide recommendations for action. This paper reports the main findings of this review which was conducted following an extensive and detailed consultation that included meetings with over 140 representatives of the banking sector, other financial institutions, the Welsh and UK Governments, intermediaries, academia and businesses. This was supported by a substantial amount of data collated from various sources and interviews undertaken with a range of other publicly funded bodies in other countries, including Canada, Finland, Germany, Scotland, Sweden and the USA.

2. TRENDS IN BANK LENDING IN WALES

2.1 British Bankers Association data

The main source of information on the supply of regional lending by banks to SMEs[1] can be obtained from the British Bankers Association (BBA) which publishes limited regional data on a quarterly basis, although this information only dates back to the third quarter of 2011 (BBA, 2014). However, these statistics do enable an examination to be made of the supply of debt funding from banks in Wales over this period. The latest data shows that the current value of loan balances in Wales in Q1 of 2014 was £4.216 billion, which is approximately the same as Q3 2011. However, the value of overdraft balances had fallen by 13 per cent over the same period from £672m to £581m (table 1). This currently represents 4.8 per cent of the total UK lending by banks (loans and overdrafts) to SMEs, with 87.9 per cent of all banking in lending in Wales being in the form of loans, slightly lower than the UK (89 per cent).

[1] SME customers are segmented by the BBA into 'small' and 'medium' sized businesses. The 'small' segment reflects SMEs that typically fall within banks' 'business-banking' operations, whilst the 'medium' segment reflects SMEs which typically fall within banks' 'commercial-banking' operations. A notional distinction between small and medium sized businesses is that small businesses have less than £1m or £2m annual debit turnover, medium businesses have greater annual debit turnover, but less than £25m.

During the 12 month period Q1 2013-Q1 2014, the banks approved 12,148 loan facilities for Welsh SMEs with a total value of £1.03 billion. The average loan was £84,780, the second lowest of any UK region, with an average loan of £58,433 for small firms and £300,185 for medium-sized firms. A total of 14,369 overdraft facilities were also approved for Welsh SMEs over the same period with a total value of £313 million. The average overdraft for SMEs was £21,798, the second lowest of any UK region with an average overdraft of £17,977 for small firms and £56,638 for medium-sized firms. Given this, what is the gap in funding for Wales? If we assume that the banks' approval rates for lending are an average of 70 per cent, as the BBA (2013) suggests, then we can estimate that around 5,000 firms are turned down for a loan every year with a total funding gap of £443 million (although a proportion of these may have applied more than once). Similarly, around 9,300 firms are refused an overdraft with a total funding gap of £203 million. Again, some may have applied for both an overdraft and a loan, and been rejected for one or the other but this data is not available.

Table 1: Loans and overdrafts, Wales UK, Q3 2011 – Q1 2014

		Q3 2011		Q1 2014	
All firms		Wales	UK	Wales	UK
Value of overdrawn balances	£mn	672	13,658	581	11,001
No. of overdraft facilities approved		4,529	68,916	3,453	45,168
Value of overdraft facilities approved	£mn	87	1,582	84	1,266
Value of loan balances	£mn	4,227	92,443	4,216	88,939
No. of loan facilities approved		2,948	49,910	3,293	38,122
Value of loan facilities approved	£mn	323	7,330	239	5,530
New loans	£mn	260	5,920	310	5,179
Loan repayments	£mn	289	6,886	298	5,223
Small Firms					
Value of overdrawn balances	£mn	372	5,821	319	4,910
No. of overdraft facilities approved		4,036	58,718	3,140	37,813
Value of overdraft facilities approved	£mn	52	712	56	612
Value of loan balances	£mn	2,209	33,205	2,051	33,110
No. of loan facilities approved		2,326	35,037	2,869	26,839
Value of loan facilities approved	£mn	167	2,409	144	1,965
New loans	£mn	120	1,803	158	1,592
Loan repayments	£mn	167	2,095	158	1,870
Medium Sized firms					
Value of overdrawn balances	£mn	299	7,836	262	6,091
No. of overdraft facilities approved		493	10,198	313	7,355
Value of overdraft facilities approved	£mn	35	870	28	655
Value of loan balances	£mn	2,017	59,239	2,165	55,830
No. of loan facilities approved		623	14,873	424	11,283
Value of loan facilities approved	£mn	156	4,921	95	3,565
New loans	£mn	139	4,118	152	3,587
Loan repayments	£mn	123	4,792	140	3,352

Table 1 shows that the amount of loans and overdrafts available to SMEs in Wales has decreased by £101 million (or -2.1 per cent) between quarter 3 of 2011 and quarter 1 of 2014. In contrast, the amount of lending to SMEs at a UK level has decreased by £6.1 billion (-5.9 per cent). If we compare the lending profile of small firms and medium-sized firms in Wales, then there has been a decline of £158m in the value of loan balances for small Welsh firms, which is the largest overall decline of any UK region over this period. Whilst the number of new loans to smaller firms has increased, the average loan has decreased from £71,720 in Q3 2013 to £50,113 in Q1 of 2014. This supports comments from the interviews with stakeholders that smaller firms are struggling to get the finance they require from the banks. Whilst this could be due to poorer investment proposals relative to other UK regions, there was no evidence for this from interviews with stakeholders, including the banks. Whilst data on quality of finance applications is impossible to obtain, information from the latest review of the appeals process against rejected finance applications from the banks (Griggs, 2014) shows no difference with the other regions with 4.3 per cent of the appeals coming from Wales, the same as its share of the UK business population.

With the average loan for businesses with a turnover of less than £1million (i.e. small firms according to banking definitions) remaining relatively high as compared to what would be expected from most micro-businesses, such ventures may not be getting access to the smaller loans they require[2]. This may indicate that whilst bank funding is available to businesses in Wales, many newer and smaller businesses do not get the funding they require. This view is also evidenced by the findings from the latest Bank of England (2014) Agents' summary of business conditions that suggests that whilst credit availability has continued to improve gradually, conditions remained tight for the smallest businesses.

The actual number of loans for small firms did increase during this period by 23 per cent although there has been a decline of 22 per cent in the number of overdrafts, as well as a 14.2 per cent fall in overdraft balances for small firms (£52 million). To explain this trend, banks have indicated that the reason that small firms' overdrafts had been withdrawn or converted to loans and/or invoice discounting was because of a lack of utilisation. For example, data from the BBA (2014) regarding overdraft facilities shows that only around 55 per cent is currently utilised by SMEs. Whilst this leaves almost half the agreed borrowing commitments available as 'headroom funding' for businesses to draw on, it is reducing year on year.

With regard to medium-sized enterprises, there has again been a similar change in the balance between loan and overdraft balances. The value of overdraft balances has declined by 12.6 per cent but the value of loan balances has increased by 7.3 per cent (£180m), which is the reverse of the situation for smaller firms in Wales. However, the number and value of loan and overdraft facilities to medium-sized businesses has also declined over this period at a higher rate than for the UK which suggest that there has been a reluctance by the high street banks to fund all sizes of SMEs in Wales.

2.2. SME Finance Monitor

The other credible source of information on SME access to finance, this time from the demand side, is the SME Finance Monitor (BRDC International, 2014), which has been surveying some 5,000 SMEs on a quarterly basis since the summer of 2011. The second annual report, published in May 2014, provides regional data covering Scotland, Wales, Northern Ireland and the nine English regions and is based on a sample of over 20,000 businesses (with up to 249 employees).

The main findings for Wales estimate that 55 per cent of Welsh SMEs (100,000)[3] had not used external finance in the last five years (vs. 56 per cent for the UK). In this case, external finance includes bank overdrafts, credit cards, bank loans or commercial mortgages, leasing or hire purchase, loans/equity from directors, loans/equity from family and friends, invoice finance, grants, loans from other 3rd parties, and export/import finance. This suggests that the majority of Welsh businesses are self-funded from either the owner or from retained profits and have no external funding requirements. This finding is supported by the result that 37 per cent of Welsh SMEs (67,000) are permanent non-borrowers (vs. 40 per cent for the UK)[4], an increase of 30 per cent since 2011. It is also worth noting that only 9 per cent of Welsh SMEs perceive access to finance as a major obstacle in running the business over the next 12 months (vs. 8 per cent for the UK).

In terms of bank lending, 75 per cent of Welsh SMEs (136,000) are classed as "happy non-seekers" i.e. those SMEs that had not had a borrowing event[5] with a bank and also said that they had not wanted to apply for any (further) loan/overdraft funding in the previous twelve months. Therefore, only 25 per cent of SMEs in Wales (45,000) have had a borrowing event from the bank or would have liked to have a loan/overdraft during the previous 12 months. Of these, 18 per cent of SMEs (33,000) reported a borrowing event with a bank (same as the UK) whilst 7 per cent of Welsh SMEs (13,000) are "would-be seekers" i.e. those SMEs that had not had a borrowing event but said that they would have ideally

[2] Microcredit is defined by the EC, as a loan or lease under EUR 25,000 to support the development of self-employment and microenterprises (which are defined by the EC as less than 10 employees, and a turnover of less than € 2million)
[3] We extrapolate the number of Welsh firms from the population weighting used within the SME Monitor so as to give an estimation of the number of businesses facing such issues in Wales.
[4] These are SMEs who seem firmly disinclined to borrow because they meet all of the following conditions: they are not currently using external finance, have not used external finance in the past five years, have had no borrowing events in the past twelve months, have not applied for any other forms of finance in the last twelve months, said that they had had no desire to borrow in the past twelve months and reported no inclination to borrow in the next 3 months.
[5] A borrowing event happens when SMEs report any Type 1 (new application or renewal), Type 2 (bank sought cancelation/renegotiation) or Type 3 (SME sought cancelation/reduction) borrowing event in the 12 months prior to interview, or the automatic renewal of an overdraft

liked to apply for loan/overdraft funding in the previous twelve months (vs. 10 per cent for the UK). They were also more likely than others to cite the process of borrowing as the main barrier to future borrowing (16 per cent vs. 12 per cent for the UK).

Some 9,000 Welsh SMEs applied for a new or renewed loan and 49 only per cent of these loan applications reported in 2013 were successful (vs. 56 per cent for the UK). Alternative sources to bank funding were taken up by some Welsh applicants (12 per cent vs. 9 per cent for the UK) and so 38 per cent of Welsh loan applicants ended the process with no facility at all (vs. 35 per cent for the UK) the highest regional score. Whilst this is extremely worrying, it is important to place this in context as it only equates to around 3,500 businesses in Wales. There were 13,000 SMEs applying for a new/renewed overdraft and were less likely to be renewing a facility for the same amount (31 per cent Wales vs. 45 per cent for the UK), down from 2011 (45 per cent Wales vs. 49 per cent for the UK). 65 per cent of overdraft applications reported in 2013 were successful (vs. 73 per cent UK) which equates to around 6,750 Welsh SMEs receiving overdraft facilities. 2,900 of those applying in 2013 ended up with no facilities. It is also worth noting that overdraft applicants in Wales were less likely to have been offered the facility they wanted and taken it (53 per cent vs. 58 per cent for the UK). They also were less likely to be first time applicants (26 per cent Wales vs. 30 per cent for the UK) and more likely to be consolidating their existing borrowing (35 per cent vs. 16 per cent overall).

The SME Monitor data confirms that whilst the majority of businesses in Wales either do not access funding from banks or do get access, there is a sizeable minority that are still seeking the funding they require. These consist of the 12,700 firms that are "would-be seekers" as well as the 6,400 that have been turned down for an overdraft or a loan. We estimate that this accounts for approximately 10 per cent of the Welsh SME population or 19,000 businesses. This number could be further reduced if we assume that around two thirds of the "would be seekers" applying for overdrafts and half of those applying for a loan would receive funding from the banks and that none of those businesses refused funding would get a negative decision on loan or an overdraft overturned via appeal. From this data, we can estimate that the funding problem for SMEs in Wales approximates to around 15,000 firms (or 8 per cent of the SME population). As stated, given that this data is based on the survey of the SME Monitor, it is an estimate but it is the first time the Welsh Government has been given an idea of the number of SMEs in Wales that are struggling to get funding. Whilst this level of demand is not high relative to the business population, it does represent a third of all Welsh firms that are seeking finance from the banks and calls into question why there has been a reduction in the funding available to the SME sector, as evidenced in the previous section.

Whilst the Welsh data does not give us an accurate picture of what type of business is having difficulty in gaining access to funding, the latest data from the SME Monitor for quarter 3 of 2013 suggests that the majority of those looking for bank funding will be micro enterprises i.e. applicants with fewer than 10 employees for both loan and overdrafts were less likely to have been offered, and taken, the funding they wanted and so were less likely to have a borrowing facility in place. In fact, the bigger the SME, the more likely they were to have had an event and the less likely they were to be a 'would-be seeker' of external finance. This is supported by other studies such as the 2012 Small Business Survey for Wales (Welsh Government, 2013) which showed that bank finance, including loans, overdrafts and mortgages, was more likely to be sought by micro enterprises (58 per cent) than by small businesses (31 per cent). This would indicate that, extrapolating the data from the regional data discussed earlier in this section on bank lending to SMEs in Wales, that there are nearly 5,000 Welsh firms that have been turned down for loan funding during the last 12 months and a further 7,000 for overdrafts. The total is probably higher given that a number of businesses are actively discouraged from applying formally to the banks for support. In fact, as the review into Royal Bank of Scotland lending practices recently pointed out, the bank discouraged a disproportionate amount of businesses from making formal applications and that staff were risk averse (Large, 2013). This total of 12,000 compares with the estimate generated earlier in this paper using the BBA data that 14,300 firms had been rejected for loans or overdrafts.

Therefore, the report estimates, by utilising these two sources of data, that there are around 12,000-15,000 businesses in Wales with a funding requirement of between £440 and £650 million[6]. A similar estimate can be made from the recent NAO (2013) report on access to finance for SMEs, which

[6] This is calculated by examining the total amount loaned to SMEs in the last 12 months using BBA data and then extrapolating the gap by using the rejection rate of the BBA to work out how much could have been lent to those turned down

indicated that the ‘funding’ gap (the difference between the funding required by SMEs and the funding available) for the UK as a whole is £10 billion to £11 billion (which equates to approximately £450 million for Wales) Whilst it is likely that a significant proportion of those turned down may not be ready for funding, if SMEs that do not receive finance from the banks could be supported with their application or to get access to other sources of funding, then this would have a significant effect on supporting business within the Welsh economy. There are a number of implications from this finding including ensuring that more Welsh businesses are ‘investment ready’ and there is more effective signposting to alternative sources of funding.

3. ALTERNATIVE SOURCES OF FUNDING

With bank lending falling, it is critical to consider whether availability to other types of finance can help close the finance gap that currently exists for some businesses and whether there have been some developments in the field of alternative sources of lending, which is a significant factor given that banks continue to struggle to lend to SMEs in Wales and the rest of the UK (Federation of Small Businesses, 2012).

3.1. Invoice discounting and asset finance

Data from ABFA (the Asset Based Finance Association), which has 140 members across the UK, suggests that there has been a recent growth in asset-based finance (factoring and invoice discounting) during the last year. The latest industry figures (for April-June 2013) show that whilst the number of clients has only grown by 1 per cent, the total funding advanced by the ABFA’s members to firms has increased by 10 per cent year on year, the balance rising from £15.8 billion to £17.4 billion (June 2012-June 2013). Sales from firms using asset-based finance have also risen markedly, reaching £131.2 billion in June 2013. This represents a rise of some 12 per cent in the past year, with businesses utilising export factoring (29 per cent) and export invoice discounting (24 per cent) showing a considerable increase in their sales during the last quarter. By sector, service-based firms account for 29.5 per cent of all clients and manufacturing firms account for 29.3 per cent. By size, both small and large companies using asset based finance, with advances to small firms (£500K – £1 million turnover) recording 6.2 per cent growth in the last quarter alone, whilst larger companies (£50 million - £100 million turnover) have similarly seen growth in advances of some 14.3 per cent.

ABFA members only work with around 43,000 UK businesses, with an estimated 2,100 clients in Wales[7], which demonstrates that there is considerable scope for further development of this alternative source of finance although there continues to be misconceptions about the products in the current context of mistrust of the financial services industry and the fact that, like most forms of commercial finance, asset based finance products are not regulated products. To deal with the latter issue, ABFA launched their own Code, Professional Standards and Complaints framework in July 2013 overseen by a new Professional Standards Council for the industry. This may provide further confidence in the industry and encourage more SMEs to utilise asset-based finance in the future.

Asset finance, which comprises mainly of leasing and hire purchase products, is also an area that has seen growth in recent times. As the submission to the review from the Federation of Small Businesses (FSB) points out, the attractiveness of asset finance is that it is more predictable and agreements will not be cancelled by lenders (due to the structure and contractual nature of deal), which helps all businesses, especially those with limited capital. Usually the credit line is secured with the asset being leased rather than any other business or personal asset, which is also a key benefit. The Finance and Leasing Association (FLA) has worked with the UK Government to ensure that asset finance is included in various programmes aimed at improving the availability of credit for SMEs, such as Funding for Lending. This is estimated to have supported up to £300 million of asset finance for investment in new equipment in 2,000 businesses (Finance and Leasing Association, 2013). As of 2013, the UK’s leasing market to both consumers and businesses is one of the largest in Europe worth around £76 billion. The latest data from the FLA show this trend is continuing, with asset finance for business growing for the fifth consecutive month in August 2013 (by 3 per cent to £1.5 billion). Growth occurred in most asset sectors over the previous 12 months including plant and machinery finance (13 per cent), commercial vehicle finance (15 per cent), and IT equipment finance (6 per cent)

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[7] ABFA do not yet collect regional statistics so this an extrapolated estimate from data collected from a number of ABFA members

and business equipment finance (3 per cent). Unfortunately, there is no regional data available from the FLA.

3.2. Informal investment

There is very little detail available on informal investment (or business angels) on a regional level. The best proxy for this, at least in terms of investment by individuals into SMEs, is the Enterprise Investment Scheme (EIS) although because the region is based on the registered address of the company, which may be different from the region in which the business activity is carried on, caution must be exercised in interpreting the following data[8]. Table 2 shows that the latest data from HM Revenue and Customs (HMRC) show a concentration of investments in companies registered in London and the South East England (63 per cent) between 2009 and 2012

Table 2. Enterprise Investment Scheme - Number of companies and amount of funds raised, by region, from 2009-101 to 2011-12. (source: HMRC)

Government Office Region	2009-10		2010-11		2011-12	
	Number	Amount	Number	Amount	Number	Amount
England	1,781	579	1,792	499	2,346	961
- North East	41	9	40	14	55	13
- North West	128	25	127	22	150	39
- Yorkshire & the Humber	75	18	74	11	89	17
- East Midlands	78	13	65	13	77	18
- West Midlands	100	14	93	16	110	23
- South West	154	36	147	32	178	41
- East of England	141	40	143	39	201	56
- London	676	317	712	265	1,011	582
- South East England	388	108	391	86	475	172
Wales	50	6	51	11	65	14
Scotland	117	30	146	30	155	34
Northern Ireland	17	7	26	5	30	7
United Kingdom	1,965	622	2,015	545	2,596	1,017

Table 3: xénos investments, 2001-14 (Source: various xénos reports).

	Value of deals completed (ex- leverage)	***Private sector leverage***	***Value of deals completed (including amount leveraged)***	***Ratio private sector deals***	***Average value per deal (excluding leverage)***	***Average value per deal (including amount leveraged)***	***Number of deals completed***	***Number of companies supported***
2001/02	£323,900	£155,000	£478,900	0.32	£32,390	£47,890	10	6
2002/03	£465,650	£574,500	£1,040,150	0.55	£46,565	£104,015	10	8
2003/04	£205,000	£74,326	£279,326	0.27	£29,286	£39,904	7	4
2004/05	£1,014,000	£78,472	£1,092,472	0.07	£112,667	£121,386	9	8
2005/06	£1,511,678	£109,220	£1,620,898	0.07	£125,973	£135,075	12	10
2006/07	£2,108,173	£924,636	£3,032,809	0.30	£140,545	£202,187	15	12
2007/08	£2,003,250	£830,000	£2,833,250	0.29	£154,096	£217,942	13	13
2008/09	£1,650,000	£1,038,500	£2,688,500	0.39	£82,500	£134,425	20	15
2009/10	£2,699,266	£1,305,165	£4,004,431	0.33	£117,359	£174,106	23	21
2010/11	£2,170,000	£763,000	£2,933,000	0.26	£108,500	£146,650	20	20
2011/12	£2,710,645	£1,281,000	£3,991,645	0.32	£117,854	£173,550	23	23
2012/13	£2,223,000	£1,746,000	£3,969,000	0.44	£111,150	£198,450	20	20
2013/14	£2,347,180	£954,000	£3,301,180	0.29	£138,069	£194,187	17	16
Total	£21,431,742	£9,833,819	£31,265,561	0.32	£107,697	£157,113	199	176

[8] There is no data yet available on the Seed Enterprise Investment Scheme (SEIS), which encourages investment into new seed stage companies by providing a higher rate of income tax relief

There have been 166 EIS investments in Wales during the period 2009-12, raising £31 million. This represents 2.5 per cent of the number of investments in the UK but only 1.4 per cent of the value of investment. Only Northern Ireland has a worse record than Wales in terms of regional involvement in the EIS. The average Welsh investment via EIS during this period is £186,240 as compared to £286,000 for the UK.

Business angel networks have also been shown to be effective as a conduit to financing early stage companies. Xénos - the Welsh Business Angel network – was established in 1997 to introduce business angels to companies seeking growth funding. It works closely with investors and businesses to find a suitable introduction, often using its successful investment forums as a way for companies to present their requirements to the angels where necessary and has been compared favourably to other business angel networks elsewhere (Christensen, 2011). In the period 2001-2014, xénos had completed 199 deals totalling £21.4 million in 176 companies during the period, at an average investment of £107,697. However, if we compare this to the latest data for investment by angel groups in Scotland (Mason et al., 2013), the total aggregated investment (i.e. including co-investors) has increased from £6.8 million in 2002-03 to £30.9 million in 2012 (peaking at £34.5 million in 2011). This may suggest that there is an increasing appetite for angel investments across both countries but it clearly demonstrates that the scale of investment is somewhat different, even though the business population of Scotland is only 1.6 times that of Wales.

3.3. Venture Capital

The latest data from the British Venture Capital Association (BVCA) shows a mixed picture for venture capital investment in Wales (table 4). A total of 37 Welsh companies received venture capital investment of £87 million in 2012, with an average investment per business into Wales of £2.3 million - the second lowest of all the UK regions (after Northern Ireland). Whilst it represents a decrease on the 50 companies that received funding in 2011, the amount invested had increased by 74 per cent. This represented 4.5 per cent of all venture capital backed companies in the UK but only 1.5 per cent of the total amount invested. Only ten per cent of this funding was for venture capital (seed, start-up and early stage) within Wales, with the largest amount of funding going into later stage deals (40 per cent). By industry, the two sectors receiving investment were healthcare and consumer services (£52 million) and oil and gas, basic materials and industrials (£30 million).

Table 4: Venture Capital investment by region (Source: BVCA, 2013)

Region	**No of companies**	**Amount invested £m**
London	191	2062
South East	115	1281
South West	49	172
East of England	39	424
West Midlands	77	332
East Midlands	32	163
Yorkshire and the Humber	39	131
North West	66	535
North East	82	410
Scotland	67	159
Wales	37	87
Northern Ireland	26	9
TOTAL	**820**	**5767**

Although there are venture firms such as Hafren Ventures and Westbridge Capital based in Wales, much of this growth in equity investments is a result of the role of the Welsh Government's fund manager, Finance Wales with a number of respondents noting that there is hardly anyone else investing equity into Welsh businesses. However, some respondents have suggested that there is a need to develop programmes that create demand for venture capital not only for new start-up businesses but also growth firms where equity investment is key for further development. In this respect, there has been a positive development during 2013 with Finance Wales recently appointing Arthurian Life

Sciences Ltd to manage a new £100m fund which will invest in life sciences and related medical, pharmaceutical and healthcare companies currently based in Wales (as well as those companies from across the UK, Europe and the rest of the world where such investment will bring meaningful developmental and economic benefit to Wales). The fund will make initial investments of between £500,000 and £5,000,000 and will preserve capital to provide follow-on investments. This is a welcome development and one that could result in funds being established for other key sectors such as ICT and the creative industries although, as with informal investment, there remains some disconnectivity between the development of such funds and other elements to support high growth firms in Wales. There also seem to be no links with the various UK Government programmes discussed earlier that provide equity for growth businesses. If Wales had received its fair share of this funding, an additional £12 million of potential funding could have been invested into Welsh businesses. It is also disappointing that the Business Growth Fund still only has one investment in Wales – SHS Integrated Services – despite research showing that the potential Welsh market for their funding is around 85 mid-sized growth firms.

3.4. Peer-to-peer lending and crowdfunding

There is increasing attention being placed by SMEs on peer-to-peer (P2P) and crowdfunding as new types of lending platforms to raise capital (Pierrakis and Collins, 2013). The largest P2P lender in the UK is Funding Circle and as of November 2013, it had lent over £166 million to over 3,000 businesses since it was started at an average lending rate of between 7 per cent and 9 per cent (which is lower than the average cost of funding from Finance Wales). In Wales, Funding Circle has lent £6.4 million to 108 businesses at an average of £59,000 per firm. This is a considerable acceleration on the funding situation back in June 2013, when £4 million had been raised for 72 Welsh businesses, and perhaps reflects the current stalemate in lending from the banks. Wales has also developed its first ever P2P platform last month. Funding Empire, based in Cardiff, has been set up by a number of professionals coming together to combat the problem of banks not lending to businesses. Unlike some other P2P lenders, Funding Empire accepts loan applications from start-ups and provides them with free mentoring and support to ensure they are ready to apply for funding through the platform.

The other important development in alternative funding is crowdfunding i.e. the collective effort of individuals who network and pool their money, usually via the Internet, to support efforts initiated by other people or organisation. The two main crowdfunding platforms currently in the UK at the moment are Crowdcube – which is meant for users to invest small amounts and acquire shares directly in start-up companies - and Seedrs - which, as a nominated agent, pools the funds to invest in new businesses. To date, there has been one investment by Crowdcube in Wales, namely Affresol in Swansea, which has developed a technology process that produces a "synthetic" concrete (called TPR) from waste diverted from landfill. Seedrs has twice raised money for Wales-based start-up Veeqo - the first round raised £30,000 from 66 investors and the second round £120,000 from 32 investors. A new Welsh crowdfunding platform has been developed but has yet to make any new investments.

4. GOVERNMENT SUPPORT FOR SMES

4.1. UK Government

Governments of various political colours have introduced a number of schemes during the last thirty years that have attempted to ensure that they help small firms in the UK gain access to finance. The Funding for Lending Scheme (FLS) was launched in July 2012 by the Bank of England and HM Treasury to encourage lending to households and companies (Churm and Radai, 2012). This was quickly followed by the announcement that a Business Bank would be established in 2014 to increase the amount of lending to businesses and provide more diverse sources of finance by bringing together and building upon existing government schemes aimed at supporting access to finance for businesses under a single organisation (Department for Business and Innovation, 2013a). In addition to the Business Bank that is currently under development, there are a number of key SME finance initiatives that the UK Government is supporting:

- The Enterprise Finance Guarantee Scheme (EFG) is a loan guarantee scheme that enables banks and other lenders to lend to small businesses that lack security or a proven track record. EFG has not been set up to be a replacement for commercial products and is designed to account for 1-2 per cent of total lending to SMEs. It provides lenders with a 75 per cent guarantee on each individual loan issued under the scheme, subject to a 20 per cent limit on total claims arising from a lender's portfolio. Since January 2009, 981 loans with a value of £96.8M have been offered to Welsh SMEs

- The Business Finance Partnership (BFP) aims to increase the supply of capital through non-bank lending channels and, in the longer term, help diversify the sources of finance available to businesses. It will co-invest a total of £1.2 billion through these channels, matched by at least equal private sector capital, to help create and support new sources of lending for SMEs in the UK. No data was available for Wales.
- The Business Angel Co-investment Fund (or Angel CoFund) was launched in November 2011 with a £50m grant from the UK Government's Regional Growth Fund and invests alongside business angel syndicates from across England. This was extended to Wales in 2013 but no data is yet available.
- UK Innovation Investment Fund (UKIIF) was established in 2009 as a £150m venture capital fund of funds that aims to drive economic growth and create highly skilled jobs by investing in innovative businesses where there are significant growth opportunities. There have been no Welsh investments by this fund.
- Enterprise Capital Fund (ECF) Programme was launched in 2006 to address a long-term structural weakness in the provision of risk capital for SMEs in the UK. Currently this gap is considered to be most severe in investments of under £2 million. There is now a portfolio of twelve active funds with commitments totalling nearly £400 million, of which HM Government has committed £240 million. To date, £176.4 million has been invested through the funds in 149 fast-growing UK businesses with several strong exits and significant follow-on financings for portfolio companies already achieved. £5,1 million has been invested in three Welsh-based companies, which represents 2.5 per cent of investee firms and 1.8 per cent of investments.
- Start-Up Loans is a £112 million initiative that was launched in 2012 to provide 18-30 year-olds living in England who want to start a business with low cost loans and expert advice from mentors. The scheme offers unsecured loans of around £2,500, charged at a 6 per cent interest rate and repayable within five years. To date, it has provided around 3,000 young entrepreneurs with £13 million in start-up capital. It was introduced in Wales in 2013.
- The UK Government also provides financial guarantees to exporters via its export credit agency, UK Export Finance, which helps exporters and investors by providing credit insurance policies, political risk insurance on overseas investments and guarantees on bank loans. More specifically, it (a) insures UK exporters against non-payment by their overseas buyers (b) helps overseas buyers to purchase goods and services from UK exporters by guaranteeing bank loans to finance the purchases (c) shares credit risks with banks to help exporters raise tender and contract bonds, in accessing pre- and post-shipment working capital finance and in securing confirmations of letters of credit (d) insures UK investors in overseas markets against political risks. In 2012, it offered guarantees and insurance policies of £2.32 billion to UK exporters although no separate information on support for Welsh businesses was available.

One of the major concerns from respondents was that many Welsh businesses were either unaware of many of these UK programmes or weren't being encouraged to utilise them properly. This means that millions of pounds of potential funding has been lost to Welsh businesses every year. The Institute for Public Policy Research raised similar concerns in their recent examination of strategies for local authorities to promote investment in the North of England (Cox and Schmuecker, 2013) suggesting that any national business or investment bank must respond to the different regional economic contexts of parts of the UK. In addition, given that Welsh Government has its own funding programmes to support SMEs, it was considered that there should be better co-ordination between the two sources of support so that opportunities are maximised.

4.2. Welsh Government

Since devolution in 1999, the Welsh Government has had formal responsibility for most aspects of economic development including grant support for SMEs. This has been reorganised several times over the last fourteen years. For example, a Single Investment Fund was created in 2007 to replace the main capital schemes used at that time by the Welsh Government (including Regional Selective Assistance, Assembly Investment Grant, SMART Cymru, Property Development Grant, Business Property Improvement Grant, Tourism Grants and Environmental Goods and Services support). However, three years later, the Economic Renewal Programme (Welsh Government, 2010) removed direct grant aid to most firms only to have it partly restored in 2011 through the creation of the Economic Growth Fund.

Table 5. Welsh Government Funding Programmes, 2014.

Programme	Eligible Sectors	What it is	Maximum Funding	Minimum Funding	Maximum Intervention Rates
Repayable Business Finance (RBF)	9 priority sectors; strategic projects outside of priority sectors; and 'Anchor firms'	Major programme to fund projects delivering job creation.	£Ms+	£10,001	From 10% to 50%, subject to geography and business size
Processing and Marketing Grant Scheme	Food and Farming	Capital investment grant scheme to provides assistance for projects that add value to agricultural and forestry products	£1,000,000+	£500	From 20% to 50%, subject to geography and business size
Tourism Investment Support Scheme (TISS)	Tourism	Scheme for tourism businesses of all sizes (SMEs and large), undertaking capital investment	£500,000	£5,000	25% is guideline intervention. Will consider up to 50%, subject to geography and business size
SMARTCymru – Research, Development and Innovation	All*	Programme to support technologically innovative research and development of new products and processes with commercial potential	£200,000 - higher if world-leading R&D and huge market potential	£5,000	Variable
Enterprise Zone Business Rate Scheme	All*	Competitive grant available in all seven Welsh Enterprise Zones. It focuses support for SMEs (offset against business rates)	Up to £55,000 or actual business rate paid per annum	Not applicable (see max. funding definition)	Not applicable (see max. funding definition)
Advanced Materials and Manufacturing SME Growth Fund	Advanced Materials and Manufacturing	Fund to support revenue costs in business development activity	£50,000	£1,000	50%
Digital Development Fund	Creative Industries	Fund to develop digital opportunities	£50,000	£5,000	50%
Energy and Environment SME Growth Fund	Energy and Environment	Fund to support revenue costs in business development activity	£50,000	£1,000	50%
Innovation Vouchers	All*	Programme to support innovative research and development of products and processes	£25,000	£2,000	50%
Overseas Business Development Visit Support	All*	Aim is to provide support and assistance to develop new export business by visiting/ exhibiting in overseas markets	£10,000	£500	50%
SME Small Capital Investment Grant	All*	Introduced as a short term measure (Nov 13 - Jan14) to help fill gap left by reducing availability of LIF	£5000	£10,000	50%
Local Investment Fund (LIF)	All* (but subject to certain regional restrictions)	Only available in the Convergence Area of Wales. It can support a range of capital investment projects relating to business start-up, expansion and growth	£10,000	£1,000	40%

The Welsh Government has a number of business funding programmes which operate alongside private investment (table 5) and which have the potential to fill these 'funding gaps'. Within this £70 million annual grant programme for businesses, support is especially prioritised to eligible businesses within priority sectors, namely Advanced Materials and Manufacturing; Creative Industries; Construction; Energy and Environment; Financial and Professional Services; Food and Farming; ICT; Life Sciences and Tourism. Consideration is also given to strategically important projects outside of the priority sectors and to 'anchor businesses' i.e. those companies that are significant global or international players, have headquarters or a large corporate presence in Wales or provide significant employment within a particular region or sector. In addition, local authorities in Wales, and not the Welsh Government, manage the Local Investment Fund (LIF).

One of the key questions for Welsh Government is whether it should continue to provide direct grants to businesses at a time of reducing public sector budgets and priorities in key areas such as health and education. Certainly, there is a precedent in that in 2010, its Economic Renewal Programme (Welsh Government, 2010) removed direct grant aid to most firms only to have it partly restored again in 2011 through the creation of an Economic Growth Fund.

4.3. Finance Wales

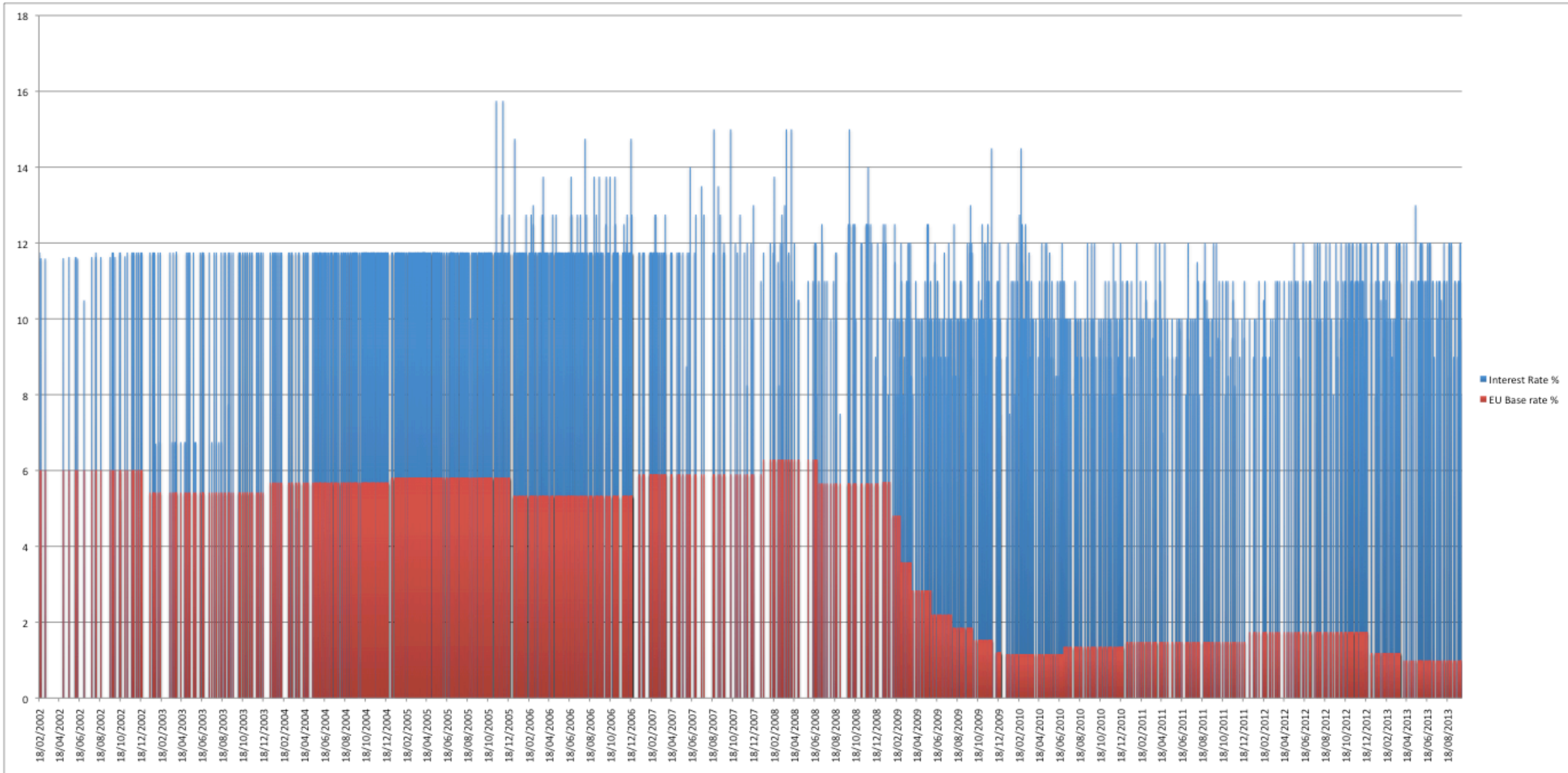
In additional to traditional grant support, the Welsh Government established Finance Wales in 2001 as a separate loan and equity fund manager to assist Welsh businesses to realise their true potential for innovation, growth and economic impact in the region. This follows calls in the 1990s for an enterprise development fund for SMEs in Wales (Snee, 1999). The main objective of Finance Wales was to improve access to capital and commercial expertise through the provision of funds and services that would be sustainable and would meet identified gaps in entrepreneurial activity as well as funding for businesses. It currently manage over £200m worth of investments in Wales over four main live funds namely:

- The £150 million Wales JEREMIE Fund that aims to encourage effective investment in small and medium-sized businesses. The Fund is backed by the European Regional Development Fund, the Welsh Government and the European Investment Bank;
- The £40 million Wales SME Investment Fund which is backed by the Welsh Government and Barclays and invests in micro, small and medium-sized firms;
- The £6 million Welsh Government-backed Wales Micro-business Loan Fund;
- The £10 million Wales Property Development Fund, which makes loans to small and medium-sized Welsh construction companies developing small-scale, non-speculative commercial and residential property.

Finance Wales also acts as the Holding Fund for the Wales Life Sciences Investment Fund on behalf of the Welsh Government although the fund itself managed by Arthurian Life Sciences Limited. It is also manages three funds in England namely the North East Growth Plus Fund (£20 million), the North West Funds for Loans Plus (£45 million) and the Tees Valley Catalyst Fund (£10 million). The latter was launched in June 2013.

As discussed earlier, in terms of equity investments into SMEs, it is generally accepted that Finance Wales is the 'only game in town' in Wales given the general reluctance of venture capitalists based in London and the South East of England to come to Wales to seek out new deals. In fact, a review of the Finance Wales' various funds show that a quarter per cent of the money distributed to date, equivalent to over £60 million, is in the form of equity investments. Whilst the default rate has been predictably much higher across these funds than those for loans, Wales now has the makings of a government backed venture capital house investing specifically in Welsh businesses that it has previously lacked. However, the majority of the provision of funding to SMEs by Finance Wales is in the form of debt finance and one of the key themes that emerged from interviews was that of the cost of debt lending, which a number of respondents had suggested was often higher than the rate offered by the banking sector in Wales. For example, a number of the Welsh Government's sector panels had concerns about the effectiveness of Finance Wales, stating that interest rates on offer are too high for the market and the security required against loans can be too onerous for small businesses.

Figure 1: Cost of borrowing on Finance Wales loans, EU base rates, 2002-



Since it was established, Finance Wales has operated a number of funds, all of which have charged different costs of borrowing to Welsh SMEs. Data from their detailed accounts shows that the difference between the average cost of borrowing across all funds and the average EU base rate has actually increased from 0.43 per cent in 2001 to 9.69 per cent in 2013. In addition, it is worth noting that the current Bank of England estimated median-lending rates for SMEs was 3.55 per cent in August 2013. If the difference between the cost of borrowing on each loan since 2001 and the EU base rate at the time is tracked, the difference between the two begins to increase considerably in 2008 (Figure 5)

Since October 2007, there have been 743 loan investments made by Finance Wales across its four main funds with 73 per cent of these loans have attracted a cost of borrowing of 10 per cent or higher and there have been only thirteen investments at a rate lower than 8 per cent. Yet, whilst there is evidence that that 'state-owned banks' tend to charge lower interest rates than privately owned banks (Sapienza, 2004) and other state backed funds in Europe have kept their interest rates relatively low (e.g. in Finland, Finnvera's normal cost of borrowing to Finnish SMEs is in the range of 1.5 per cent to 4 per cent), there have been no substantial reductions in the cost of borrowing from Finance Wales even though the EC base rates have fallen since 2008 (table 6).

Table 6: Finance Wales guidelines on interest rates relative to EU guidelines

	High collaterisation & satisfactory rating		***Normal collaterisation & weak rating***		***Low collaterisation & bad rating***	
	Effective interest rates based on EC regulations	**FW pricing guidelines**	**Effective interest rates based on EC regulations**	**FW pricing guidelines**	**Effective interest rates based on EC regulations**	**FW pricing guidelines**
01/07/2008	6.66	7.5	9.66	10	15.66	16
01/01/2009	6.7	7	9.7	9	15.7	12.5
01/02/2009	5.81	7	8.81	9	14.81	12.5
01/03/2009	4.58	7	7.58	9	13.58	12.5
01/04/2009	3.84	7	6.84	9	12.84	12.5
01/06/2009	3.2	7	6.2	9	12.2	12.5
01/08/2009	2.85	7	5.85	9	11.85	12.5
01/10/2009	2.53	7	5.53	9	11.53	12.5
01/12/2009	2.2	7	5.2	9	11.2	12.5
01/01/2010	2.16	7	5.16	9	11.16	12.5
01/07/2010	2.35	7	5.35	9	11.35	12.5
01/01/2011	2.48	7	5.48	9	11.48	12.5
01/01/2012	2.74	7	5.74	9	11.74	12.5
01/01/2013	2.19	8	5.19	10	11.19	12
01/04/2013	1.99	8	4.99	10	10.99	12

Therefore, the evidence seems to suggest that Finance Wales' loans are more expensive than the median for UK banking sector with the rationale given that the risk profile of the companies justifies this approach. This is despite the fact that Finance Wales is an organisation that is wholly owned by the Welsh Government and, given this, there is expectation that its primary aim must be to support the Welsh economy, particularly the SME sector. Clearly, there remain questions as to why Finance Wales has been charging such high interest rates when it technically did not need to do so as a publicly owned body. If its main role is an economic development arm of the Welsh Government, then it could and should have supported businesses during the last five years through lower interest rates, especially as a time when banks were not lending for other reasons such as collateral, affordability and overexposure in some sectors (Department of Business, Skills and Innovation, 2012).

5. DISCUSSION – THE WAY FORWARD

5.1. Affordable funding

The access to finance review was established not only to examine whether there was an issue related to access to finance for SMEs but, more relevantly, what the Welsh Government could or should do to intervene if there was a perceived market gap in provision from private sector providers. As the research into lending patterns by the banks has shown, lending to SMEs in Wales remains fragile despite statements from the banking community that it has 'millions of pounds to lend', is 'open for business' and has one of the lowest rates of lending to businesses has seen in a generation. A number of reasons are given as to why small firms in particular are not meeting the criteria set by the banks for affordable lending, including under-collateralisation, shorter credit history, lack of an agency credit rating and paucity of verifiable financial information which banks can use to make credit allocation decisions (ACCA, 2008; Fraser, 2012; Bell and Young, 2010; Davis, 2011; Department of Business Skills and Innovation, 2013b). Given this, it can be argued that the state could, if it so wished, provide specific interventions to alleviate these different types of market failure and provide a greater flow of credit to businesses. This is the approach currently being undertaken by the UK Government with the creation of the Business Bank and the Funding for Lending scheme. In the context of Wales, the fiscal levers that are at the disposal of the Welsh Government are limited, although the recent announcement regarding borrowing powers from the UK Government suggests that there may be an opportunity to acquire funds from the capital market to support SMEs. There is also the opportunity to use its own economic development function, as well as the highest level of European Structural Funding, to provide solutions to address the lack of funding available to businesses.

Currently, Finance Wales is the main alternative supplier to the banks of debt and equity funding for SMEs in Wales but the cost of borrowing to Welsh businesses is above the EU reference rate for its loans despite being owned by the Welsh Government. This is different to other countries, with evidence from the European Union showing that there are numerous financial instruments that offer a lower cost of borrowing to SMEs than Finance Wales (CSES/EIM, 2013; European Commission, 2013). An interview with the Bank of North Dakota (BND) showed that it did not charge high interest rates because that would be tantamount to setting up the business to fail and there was no rationale in borrowing costs that amounted to "a dime in every dollar" going back to the state when it could be used within the business to create jobs. Discussions with Finnvera, the state owned Finnish Bank, showed that a public fund could offer lower rates of interest and, at the same time, generate a healthy surplus through its operations. Currently, and whilst operating under the EU reference rate regulations, Finnish SMEs can gain access to borrowing at a cost of between 1.5 per cent and 6 per cent. Unlike Finance Wales, Finnvera has also made a decision not to support businesses that it considers to be a bad risk.

5.2. Economic development

The primary role of government-backed funding for SMEs is to drive forward economic development and during the recession, publicly-owned financial institutions played a vital role in supporting SMEs and their financial requirements. For example, the Small Business Administration (SBA) in the USA worked closely with local financial institutions to distribute loans to small businesses whilst in Germany, the Sparkassen (savings banks) have played a vital role in ensuring that funding reaches businesses operating within the local area that each bank serves. Indeed, the dual focus of German regional banks on both their financial position and their wider social role has meant lower rates of return on capital but delivered greater stability and long-term support for small firms (Federation of Small Businesses, 2012). As a recent review of the German banking system noted, "*There has to be part of the financial system in Britain that operates not as an end in itself but to serve society and the real economy. Without this there is little prospect of rebuilding the economy on the basis of real products and real services that produce real wealth for the benefit of the nation*" (Simpson, 2013).

In Wales, various funding initiatives promoted directly by the Welsh Government are related to economic development priorities, including job creation. In contrast, the mission of Finance Wales had, until recently, been focused on establishing itself as the leading fund manager in the UK. It has been argued that both can complement each other but during a time of economic hardships experienced during the last five years when access to finance was difficult for SMEs in Wales, the primary and overriding focus should have been on supporting businesses to create jobs and yet Finance Wales's main funds

Contrast this with the situation in Finland where the state owned bank not only saw the number of businesses applying for public financing increase by 12 per cent, but focused its efforts on introducing counter-cyclical loans and guarantees to finance working capital for enterprises whose profitability or liquidity had declined because of the economic crisis. It was estimated that without this funding, the number of job losses in the Finnish economy would have been twice as high as actual job losses (23,700) in 2009 and 2010. Therefore, the role of any publicly funded programme to support access to finance for SMEs has to focus on economic policy goals as its first priority but can also support the individual goals of SMEs at the same time.

5.3. Addressing a market failure.

At a recent event to discuss access to finance for SMEs, there was consensus that it was not the role of the Government to make direct investments in SME financing, but rather to encourage an atmosphere in which SME lending could occur, as well as to increase the effectiveness of schemes to encourage funding (Barty and Miscambell, 2013). Others have noted the need to identify well specified market failures to avoid competition with the private finance sector and, where possible, to work with the private sector to the benefit of both the funding scheme and the wider development of the financial community. Whilst some have argued for the Welsh government to create a publicly owned institution that then competes directly with the banks for SME customers, one could argue that Finance Wales has already evolved into such an entity and is in the Welsh market looking for deals against the high street banks and other providers. As one respondent noted *"Offers of funding to clients from our investment fund have been displaced on more than one occasion by competing offers from Finance Wales….we do not feel Finance Wales should be competing with private sector funds – or indeed any other sources of funding. Surely it is not its role to displace other sources of finance. By competing with others it also discourages entrants to these segments of the business finance market*". Interviews undertaken during the review suggest that one of the strengths of publicly owned institutions such as BND and Finnvera is that neither organisation sees itself as competing with the banking system and is instead a complementary partner in supporting SMEs. This would avoid any "crowding out" by any public body and would ensure that the public sector would be working alongside private sector providers of finance. For example, the BND was created to partner with other financial institutions and assist them in meeting the needs of the citizens of North Dakota.

One way of doing this would be through providing government guarantees alongside bank finance to close the gap between what is being offered (because of issues of collateral and affordability) and what is required by the business. In fact, well-structured credit guarantee schemes can, if developed in partnership with the Welsh Government, spread some of the risk and thereby enable banks to extend loans to firms that would find it difficult to access credit otherwise (Bain and Co, 2013). As discussed in the first stage of this review, the UK Government operates the Enterprise Finance Guarantee scheme although there have been no recent regional loan guarantee systems developed in the UK, which is very different to what is found in other parts of the World. For example, of the 3.9 billion euros disbursed to enterprises by EU financial instruments, 32 per cent were in the form of loan guarantees with 134 funds offering guarantees as a financial product (European Commission, 2013). The Welsh Government has already been in discussions with three of the high street banks about the potential of this development which could, if implemented, give Welsh businesses access to funding across Wales. More relevantly, no new expensive branch network would be needed as this could be managed via the current structure of banking participants. In addition to working closely with the banks, it is clear that more can be done by the Welsh Government to attract and encourage greater levels of private sector investment into Wales, especially for high growth businesses, through encouraging informal investment and developing greater links with venture capital organisations.

5.4. Offering business and financial support together

Research has shown that various public organisations that are involved in supplying financial support to businesses also provide various types of business support to their clients. A recent evaluation of European financial instruments suggested that the provision of business advice is a key element of some financial intervention tools although this can depend on the development stage of business (CEIS/EIM, 2012). For example, the provision of advice and support for entrepreneurs who may have little business expertise is important although as the business grows, the founders and their managers may already have significant experience although they may also wish to buy in specialist support services. There are advantages in having a joined up approach to business and financial support so that a company can evolve as it grows towards different services being provided by such an organisation. There could also be benefits in terms of reduction in costs but also a stronger relationship with the beneficiary, which leads to better access to information (which is a problem for many banks) and a reduction in risk when lending. More importantly, financial and business support needs to be available at different stages of the life cycle of the business.

In the USA, the Small Business Administration provides grants and loans alongside its counselling and training programmes for small business. The Swedish funding agency Almi provides advisory services to customers at all stages of development from ideas to successful companies through both its own internal advisers and external sub-consultants. Another example of how finance and business support can lead to benefits for business can be found in Canada. The BDC is Canada's business development bank and promotes entrepreneurship by providing highly tailored financing, venture capital and consulting services to entrepreneurs. A recent review of its services (BDC, 2013) showed that whilst sales growth among BDC financing clients was up to 14 per cent higher than that of non-clients, those firms that used both the financing and consulting services performed better with sales growth of up to 25 per cent greater than that of non-clients.

5.5. Customer-oriented financial support and developing demand

There is a plethora of different public funding schemes available to businesses in Wales. These range from the ten grant programmes operated by the Welsh Government, the five different funds currently being managed by Finance Wales, UK Government schemes such as export guarantees and the Business Growth Fund, and various European funded initiatives to support innovative firms and high potential start-ups. Add to this the different types of funding that is available from the private sector such as bank loans, overdrafts, asset finance, and invoice discounting, as well as new types of alternative funding (P2P lending, crowdfunding) and the landscape therefore remains confusing to the average SME. According to a member of one the Welsh Government's sector panels, many SMEs including large successful companies, are either unaware of or confused by the variety of schemes available, deterring some from seeking finance. In its paper on establishing a new business bank, the British Chambers of Commerce emphasised the need for a single 'brand' for Government finance support and the consolidation, at a UK level, of various funding schemes into one organisation (BCC, 2012). This principle should be adopted for Wales and the Welsh Government should consider whether all funding schemes, including grant support currently operated within the Department for Economy Science and Transport, should be located within one single organisation. Not only would this have considerable efficiency costs and marketing synergies, but would enable the focus to be on the SMEs specific needs.

In addition, this confusion over the differences sources of finance could be stifling demand from the SME sector, which has very little awareness, beyond their normal banks, as to the type of appropriate funding that is available to help businesses to grow. There also seems to be little market intelligence by the public and private suppliers of finance on the actual needs of the SME sector in Wales, which in contrast to the situation for other parts of Europe e.g. the Sparkassen in their local area in Germany. By understanding the dynamics of the Welsh economy in more detail, especially if it worked alongside other financial institutions to generate the necessary data, the Welsh Government could then respond appropriately through its services and add value to other financial providers.

6. CONCLUSION

This paper has examined the current position with regard to access to finance for SMEs in Wales by drawing on a range of primary interviews and secondary data on funding for SMEs. It has shown that whilst the lending from the banks to Welsh SMEs has fallen, alternative sources of finance have yet to fill this funding gap. In addition, it has demonstrated that public sector financial support in Wales seems to be fragmented and more relevantly, the organisation tasked with providing debt and equity finance to SMEs is not specifically focused on developing the Welsh economy. Given this, the Welsh Government needs to develop an approach where public funding for SMEs is affordable, is focused on economic development, is supplemented by business support and is oriented towards the needs of the business customer. It is also critical that the public sector does not displace the private sector but works alongside the banks and other stakeholders to address a market failure in the provision of finance to SMEs and stimulate demand in the marketplace.

One of the options for the Welsh Government is to establish a new publicly owned bank and both Plaid Cymru (2013) and the Welsh Conservatives (2013) have put forward considered options for this development. Another review was commissioned by the Welsh Government examined the option for the establishment of a new Community Bank for Wales as a potential way forward. However, there needs to be a more pragmatic and immediate response to get funding flowing into Welsh businesses again especially, given the experience of the Business Bank, it is likely that that there would be numerous delays through state aid and procurement issues if a wholly new financial organisation were to be established, leaving Welsh business in limbo.

Given that many of the building blocks necessary for a new body to support the SME sector in Wales are already in place, there is now an opportunity to develop a new approach that can bring together all the different sources of Welsh Government funding for SMEs, works with other institutions in the public and private sector to add real value, and puts the Welsh SME at the core of what it does as an organisation. This would be achieved not by creating a wholly new entity but by bringing together, under the auspices of one organisation, all the financial support schemes for SMEs within the Welsh Government (which are estimated to be around £70 million per annum), the funds managed by Finance Wales (£30 million) and elements of the Welsh Government's Business Wales support programme. It is also proposed that, by agreement with the UK Government, this new organisation takes regional responsibility for the export functions of the UK Export Finance within Wales so as drive forward internationalisation in the economy. Discussions could take place with the High Street Banks over whether the Business Growth Fund should also be located here for its Welsh operations. This would then create a financial institution that would not only have funding of over £100 million per annum at its disposal immediately but could, working with banks and other organisations, leverage in larger amounts of further funding for Welsh SMEs. This would then go some to addressing the perceived funding gap of £440m-£660m identified earlier in this paper.

Therefore, the evidence gathered suggests that the most appropriate way in achieving this is through the creation of a single organisation – a Development Bank for Wales - that will draw together the various sources of public sector funding in Wales and utilise these efficiently alongside private sector finance solutions. Given this, the Welsh Government should examine the feasibility of this approach to ensure that a viable and coherent solution that supports SMEs in Wales is put into place as quickly as possible and enable the SME sector to gain access to the funding it needs to grow and support jobs and prosperity in the Welsh economy.

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