



6 December 2013

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By email only: AccessToFinanceReview@Wales.GSI.Gov.UK

Dear Sir/Madam

Consultation on the Access to Finance Review Stage 2

Introduction

ICAEW welcomes the opportunity to comment on Stage 2 of the Access to Finance Review undertaken by Prof. Dylan Jones-Evans at the request of the Minister for Economy, Science and Transport.

We believe that, although unusual, it is appropriate to undertake such a consultation, given the radical nature of Prof. Jones-Evans' conclusions.

However, we regret the unusually short timescale provided for responses (only a little over three weeks). ICAEW members and other market participants have a keen interest in access to finance by SMEs and such a short timescale inevitably means that the Welsh Government will not benefit from many informed views. Notwithstanding this, we have contacted members with explicit knowledge and experience of advising businesses on accessing finance and quote from their written comments in the sections below.

Background

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

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

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

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

Response

While much of the analysis of the Review, particularly with regard to the difficulties experienced by businesses in access to bank finance, is of interest, ICAEW believes that there are two key areas of the Review's conclusions that should be challenged.

The first relates to the conclusion **that Finance Wales is 'not fit for purpose'** (p. 45). Almost without exception, members who have commented on the Review do not share this conclusion:

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

While lower interest rates would always be desirable from the point of view of the investee, in our view, Prof. Jones-Evans has failed to take fully into account a number of important considerations which have informed Finance Wales approach (and, indeed, the Welsh Government's support for that approach):

- The main market failure experienced by Welsh businesses in terms of access to finance is not with regard to the cost of borrowing, but to the *lack of availability* of finance (something which appears to be recognised in Chapter 3 of the Review): the role of Finance Wales is largely (quite correctly) to increase the volume of finance available for investment in Welsh businesses;

'In my experience availability of funding has been more important than its cost particularly in recent years. As mentioned above I do not believe the median interest rates mentioned on page 20 of the report accurately reflect market rates. Most banks operate a risk pricing model & I would be surprised if Finance Wales rates are out of line particularly considering much of their exposure will have been declined by banks'.

- A key element in increasing the volume of finance is to lever in co-investment from other funders, to supplement public funding available from the Welsh Government or the European Regional Development Fund, notably Barclays Bank Plc in the case of the Wales SME Fund and the European Investment Bank in the case of JEREMIE. These funders have first call on the repayment of their investment, and the approach to risk and interest rates adopted by Finance Wales must satisfy these funders that the investment approach is sound. Since Finance Wales provides a mix of loan and equity investment (with the latter having generally requiring a longer investment time horizon and having less certain returns), Finance Wales has to be confident that its loan investments will generate sufficient returns to repay the co-investors;

'My view is that Finance Wales has been a positive for the Welsh Economy and has made loans to companies where all other lending options had been exhausted. This has led to companies continuing to trade where they would otherwise have finished, and have kept and created jobs and economic growth.'

- Finance Wales lends at fixed rates of interest, whereas bank rates are normally variable, which at a time of low interest rates provides more significant risk for the investee;
- In increasing the volume of lending over and above what would be available from the banks, Finance Wales necessarily has to adopt a less risk averse approach, and interest rates charged reflect this. Where (as is often the case) Finance Wales invests alongside a commercial lender, the latter invariably has preferred security rights, with Finance Wales bridging the gap between what the commercial lender will loan and what the business needs:

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

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

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

- In this context, the fact that Finance Wales has successfully tendered to manage JEREMIE funds in the North-West and North-East of England should be regarded as a sign of success, helping to build Wales' reputation as a successful exporter of high value-added services.
- A critical gap in Access to Finance relates to equity, and here too Finance Wales provides a critical role. However, in terms of equity, there are 'market failures' not only on the supply side, but also on the demand side, with SMEs often reluctant to consider this route, even though it may offer the best prospects of large-scale investment. This points to the need to improve the quality of business advice to potential investees:

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

- While it would have been possible to rely on general State Aid exemptions (which would indeed have allowed Finance Wales, had it and the Welsh Government so chosen, to reduce interest rates), the decision to operate the JEREMIE Funds under a specific State Aid regime was entirely logical since it has allowed Finance Wales to make larger investments (GBER caps loans at £250,000) and to avoid a 'postcode lottery' where businesses on one side of a street are eligible for investment and ones on the other are not: this has been a significant problem with JEREMIE Funds in England, where the general exemptions have been relied on.

Overall, ICAEW believes that the criticisms of Finance Wales appear predicated on a model of Government intervention that we do not believe assists in achieving the long term goal of developing a vibrant private sector in Wales and that the sort of fundamental change recommended by the Review risks destabilising what has proved a broadly successful institution.

'I have no idea how he can say that Finance Wales is not fit for purpose. Up to early 2012 it saved many new projects from being unable to start because the clearers were improving their balance sheets. Since then it has worked alongside the clearers providing top-up finance where the banks could go no further on a secured basis... In short Finance Wales is fit for purpose, and is making a significant difference to our economy. If we change it now just at the point when we are experiencing an increased demand for finance as the economy recovers I am sure we would be faced with a disaster!'

The second area where we cannot endorse the Review's findings is in respect of **the recommendation to establish a Development Bank for Wales**, although here members' views are less unanimous.

In part, this is because it is not entirely clear how extensive the remit of the organisation might be and whether the term 'bank' is appropriate.

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

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

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

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

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

On balance, therefore, we doubt whether there is a strong case for the further structural change which Prof. Jones-Evans recommends. If the Minister is minded to move ahead with this, we would still recommend the retention of Finance Wales on much the same basis as at present, to continue to lever in additional resources to increase the supply of venture capital to Welsh businesses.

Yours sincerely

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