

FIN(4)FW037  
Finance Wales Inquiry  
Response from  
CM International



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## Response to the Access to Finance Review

### Introduction

We welcome the opportunity to respond to the Access to Finance Review Stage 2 and are pleased to provide the following comments and observations.

CM International UK Limited, is a Cardiff based economic development consultancy with a track record of working across the EU on a range of subject areas including SME finance and venture capital.

CMI's UK director, Meirion Thomas, is a former employee of the Welsh Development Agency (1982-1994) where he worked as an investment manager and, later, Executive Director of the Business Services Division that incorporated responsibility for the Investment activities of the Agency. Meirion also acted as a Director of the Welsh Venture Capital Fund (alongside Lazard Bros.) and, along with the author of the Review, Professor Jones Evans, served on the Board of Finance Wales plc. in its formative period.

For the avoidance of doubt, CM International has been competitively commissioned by Finance Wales plc. on limited occasions in recent years mainly in the area of programme development, evaluation and some strategic review work. Our most recent commission was to conduct a strategic review of the xenos business angel network in 2010/11.

### Comments regarding the evidence and conclusions drawn

The evidence regarding SME financing whilst thorough has not, in our view, always been followed though effectively. As a result, we are concerned that the conclusions drawn from the evidence may not be as robust as it could have been and may leave the final conclusions and recommendations potentially open to criticism. Here, we offer a number of important examples:

Firstly, while the evidence regarding the cost of finance faced by SMEs is clear, the emphasis given to the later discussion regarding the cost of finance is rather contradictory to the evidence presented. For example, in Stage 1 of the Review, the report states that that "Security against the loan and affordability of repayment, *rather than the cost of borrowing*, have been cited in the interviews with banks, intermediaries and small businesses as being one of the main obstacles to accessing bank finance." (p 6) Again, in Stage 2, the Review states that "*this evidence suggests that the cost of borrowing to SMEs remains low*" (Stage 2 Report p 21).

If this is the evidence, and we do not dispute that this is the case, we are concerned that so much of the Stage 2 Report is concerned with a discussion of the Finance Wales interest rate policy. Notwithstanding that, following the Stage 1 Report Ministers, may have

requested consideration of this issue when one considers the assertion, in the Stage 1 Report that Finance Wales' lending activity represents less than 5% of the lending in Wales made by the High Street Banks (Stage 1 Report p 24), the effort and space devoted to this discussion seems out of proportion to its importance in the overall scheme of things.

As noted above, the interest rate policy adopted by Finance Wales is 'small beer' when compared to the issues of access to finance from the high street banks and the difficulties faced by almost all SMEs of meeting the onerous security requirements of the commercial lending institutions. As the Review makes clear on many occasions these are much more important issues for SME owners than the few percentage points either way that may eventually be charged.

In many respects, therefore, the focus on the Finance Wales interest rate policy is a serious distraction from the main issue of access to finance per se. This is a disappointment.

Secondly, we were surprised that, the evidence provided in Table 2<sup>1</sup> on page 10 of the Stage 1 Report, was not analysed or discussed in either report. Table 2 shows that between 64% and 87% of all businesses surveyed in Wales had managed to access all, or some, of the finance they require for their business. This evidence seemed to us, at the time of reading the Stage 1 Report, as being so fundamental to the overall Review that we assumed that it would be further examined in the Stage 2 review. However, this is not the case. Indeed, the Stage 2 Review continues to draw the conclusion that "*(Welsh) SMEs are still facing difficulties in accessing funding...*" (Stage 2 Report p 6) despite the Welsh Government's own evidence suggesting that this only applied to about 1/3 of all micro-businesses and 13% of large businesses.

We know from our work in Wales, and from our recent survey and interviews conducted with almost 200 businesses in South East Wales, that the availability of finance is seen as a potential barrier to growth in the period to 2020. Therefore, we are concerned that the Review has not analysed its own evidence to explain this seeming paradox. We are again concerned that this failure to fully review the evidence risks undermining the Review particularly amongst venture capitalists and high street banks.

Thirdly, the discussion of the performance and strategic aims and objectives of Finance Wales deal, in a rather partial manner, with the policy and implementation reality facing Finance Wales of which the report author will be fully aware.

Professor Jones Evans is fully aware of the policy remit that Finance Wales was given by Ministers when it was instituted by the Welsh government. Crucially this remit was accompanied by **portfolio** performance targets endorsed by Ministers as well as by the main funding bodies including the European Commission and other lenders to the Finance Wales funds. At many Finance Wales Board meetings between 2001 and 2004/5, Professor Jones Evans was part of lengthy explanations, given by experienced bankers sitting on the board as Non-Executives, of the importance of regarding the Finance Wales performance in a portfolio context rather than on the basis of the micro-decisions applying to individual lending cases. This is the only way in which a publicly supported lending or investment institution, whatever the name or its location, makes sense either commercially or in policy terms.

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<sup>1</sup> Drawn from Welsh Government (2013) *2012 Small Business Survey*, BMG Research

It is therefore disappointing that this complexity is summarily dismissed in the Stage 2 Report and risks implying that new institutions can be immune from a clear economic logic.

### **Comments regarding the Recommendations made**

Given the importance of this topic and the potential influence of the Review, there are a number of points that we would make regarding the recommendations. These are based on our 20 years of experience working with many EU regional governments and the European Commission itself in this important area of policy.

Firstly, the Stage 2 Review and the recommendations are short on new analysis and fresh thinking to the crucial challenge, which is alluded to within the Report, of increasing the quality of the demand for SME finance. While there is mention of ‘investment readiness’ and bringing business support alongside financial provision, this was being done from 1975 to 2004 by the Welsh Development Agency and continues to be done by economic development agencies across the EU. However, the Review does not provide a basis for fresh action in this area.

Secondly, the focus on Finance Wales’ interest rate policy, allows the challenge of increasing lending activity by the high street banks to be somewhat glossed over. The recommendations in this area of the topic are rather dated and ‘soft’. Simply gathering the banks together with Ministers to talk about the issue will do no harm but neither will it make progress. In fact, it risks providing bankers, Ministers and civil servants with a ‘fig leaf’ of activity.

Thirdly, while it may appear that a development bank for Wales is a bold initiative, its aim is confused and contradictory. For example, at what point will the development bank be able to intervene if a business is having a difficult relationship with its bankers? If at all? Will a development bank be allowed to take over the bank’s lending and security in such cases?

The principles are particularly unhelpful in this respect.

Trying to manage on the basis of *“Every viable business in Wales should get access to funding at an affordable price”* while also adhering to *“It is not the role of the public sector to displace the private sector but to address a market failure in the provision of finance to SMEs”* leaves the development bank open to contradictions and confusion. In order to deliver anything useful in this respect, the Review could at least have indicated what level of provision and bad debts would be allowable for the development bank.

Similarly, the principle that *“The primary role of government-backed funding for SMEs is to drive forward economic development”* while appropriate and worthy pre-supposes that investment decisions are capable of being reduced to an economic development formula with no later consequences as to the result of the investment. The review ignores a clear principle installed in almost all state funded investment bodies across the EU since at least the late 1980’s that politicians should have nothing to do with investment (in decisions relating to lending or equity in SMEs). Ministers will need to be very cautious and judicious in this respect. Critics, commentators, political opponents and public auditors will look on the recommended principle with a mixture of horror and glee.

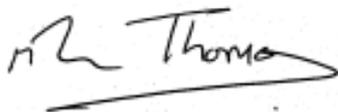
Finally, while the Report claims that *“It is not the intention of this report to consider in detail how this new organisation will be funded.”* (Stage 2 Report p 59), this is probably the fundamental issue for the establishment, governance and delivery of the proposed

development bank for Wales and failure to even address the funding significantly undermines the recommendation made by the Review to establish a development bank.

The funding of the development bank will, to a very large extent, determine, inter alia,

- to whom the bank will be accountable;
- who will monitor the financial management of the development bank;
- who will set the targets and which target (portfolio performance; lending figures; sectors supported, referrals made etc) will be most important;
- who will assess the performance of the bank and on what basis;
- who will take the blame when loans go bad, as they will from time to time, or apparently poor decisions have been made on the character, probity and trustworthiness of SME owners and managers;
- ...

These, and a range of other issues, are fundamental to the whole idea of a new institution. If the Review did not think it necessary to consider these types of questions, the whole basis for the recommendation regarding the development bank itself may be considered by some as of dubious value.

A handwritten signature in black ink, appearing to read 'Meirion Thomas', with a long horizontal flourish extending to the right.

**Meirion Thomas**

Director

On behalf of CM International UK Ltd