



Economic Intelligence Wales

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Max Munday, Annette Roberts, Nikos Kapitsinis & Meng Song

Welsh Economy Research Unit,

Cardiff Business School

mundaymc@cf.ac.uk

For further information or to submit feedback and research proposals please email:

EconomicIntelligence@developmentbank.wales

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Economic Intelligence Wales Limited, Unit J Yale Business Village, Ellice Way, Wrexham, Wales, LL13 7YL, 11001584.

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Executive Summary

The background to QR2 is the expectation for **slowing UK growth** in the short to medium term. QR2 reveals continued uncertainty across the UK economy in the context of Brexit negotiations, and a tightening global trading environment. In August 2018, the Monetary Policy Committee voted to increase the bank rate to 0.75%. This is expected to impact on growth in the latter part of this year, with rate increases also influencing the costs of finance for Welsh SMEs.

SME indicators

Of the 252,000 SMEs in Wales in 2017, 95.5% were micro businesses contributing 56% of Welsh SME employment and 42% of turnover, while small companies (3.7% of all Welsh SMEs) supported one quarter of SME employment and 28% of turnover.

The *Small Business Survey 2017* revealed that the proportion of surveyed **Welsh SMEs exporting** had declined to 10%, and Wales had the **smallest proportion of SMEs making a profit** (73%), below Scotland (80%), England (83%) and Northern Ireland (86%).

The period 2012-17 saw **micro businesses in Wales experiencing the largest increases** in the number of companies (up 18.8%) and turnover (up 25.2%).

QR2 reveals a consistently **lower business birth rate** in Wales compared to other parts of the UK, with large differences in the density of the birth companies across different regions of Wales.

SME finance

The *SME Finance Monitor 2017* reported **41% of Welsh SMEs using external finance** (overdrafts, credit cards and loans), and revealed just **40% of Welsh SMEs had plans to grow** (up from 32% in 2016).

Beauhurst research on equity finance trends to 2018Q3 shows Wales featuring relatively low amounts invested, but recorded a higher number of deals in the first three quarters of 2018. ONS' *Longitudinal Small Business Survey 2017* finds just **6% of Welsh SME owners use alternative finance**.

The proportion of Welsh SMEs estimated to be at **high credit risk** increased from 3.9% to 4.1% in quarter ending September 2018. The share in the **caution** category increased from 70% to 73%.

Development Bank of Wales activity

Cumulative investment to 2018/19Q2 reached **£540m**.

Over **3,000 firms** have received loans to date, with these linked to activity estimated to have created over **30,000 new and safeguarded jobs**. There was a **strong increase in new loan investment in 2018/19Q2**. Trends are volatile and impacted by individual approvals and investments in any period.

The Development Bank's recent investment activity is highest in construction (£26 million), followed by professional services (£8.3 million) and manufacturing (£8.1 million). Investment in micro businesses predominates.

The value of investments during the first half of 2018/19 summed to over **£33m**, with these linked to almost **330 jobs created** and a further almost **930 jobs safeguarded**.

1. Introduction

This is the second Economic Intelligence Wales (EIW) quarterly report (QR) by Cardiff Business School examining key trends in the Welsh economy, with a focus on the demand and supply for SME finance.

The content of the QR series varies through time, in part reflecting the availability of small and medium sized enterprises (SME) data. QR2 aims to build on and expand the baseline picture of Welsh SME activity that was established in QR1. Sections 2 and 3 of this report provide data and commentary in respect of the UK and Welsh macroeconomic context within which Welsh SMEs operate, together with analysis of factors relating to the demand for SME finance, and the supply and cost of finance. These sections have the objectives of understanding:

- Macro-economic factors shaping the demand for SME finance in Wales.
- Trends in SME growth, start-ups, and business survival prospects in Wales.
- The supply of finance to SMEs in Wales.
- The amounts and types of lending/investment into SMEs in Wales.

Section 4 summarises the activities of the Development Bank of Wales in the context of factors affecting the demand for, and supply of, finance to SMEs in Wales. In summary, the QR will identify:

- The use of Development Bank funds in financing Welsh SMEs, and what type of enterprises and industries are being supported.
- The geographical distribution of SME investment around Wales.

The final section draws conclusions from the overall analysis.

This report is largely based on publically available data (generally reported in calendar years) together with a special analysis of data provided by the Development Bank of Wales (mostly reported in financial years). Due to differences in reporting periods there will be some slight temporal mismatch of data within this report.

2. The Welsh Economic Context

2.1 UK and regional economic prospects

Many complex and interlinked factors determine the demand for, and supply of, external finance to Welsh SMEs. Overall economic conditions in local, national and global markets affect economic and business growth, and hence the demand for, and supply of, different types of capital and external financial support.

There is continued uncertainty across the UK economy in the context of Brexit negotiations, and a tightening global trading environment following recent trade announcements from the US and China. For example, business investment in the UK has remained relatively weak, with a 0.7% fall during 2018Q2 and the annual three year downward trend of Growth Domestic Product (GDP) growth continued in 2017.

The UK's GDP increased by 0.7% in the three months to August compared with the previous three months. Second quarter output growth was driven by services, partly relating to a rise in retail sales

and by increased household consumption, which increased by 0.4% during the second quarter of the year.

The Federation of Small Businesses (FSB) have commented that general UK economic conditions are fuelling pessimism in the second half of 2018. The *Small Business Index*¹ of UK business confidence fell from +12.9 in 2018Q2 to -1.7 in 2018Q3, with confidence amongst the self-employed falling to a record low. Additionally, the FSB survey found that 27% of small exporting companies in the UK reported falling international sales in 2018Q3, increasing from 19% of small exporting companies in the same period in 2017.

Whilst the FSB have reported an overall fall in SME business confidence in the UK in the third quarter of 2018, business confidence in Wales was found to be the highest of the UK regions and nations. However, a higher proportion of surveyed companies recorded an increase in production costs in Wales (71%) than in the UK (65%). This is partly linked to rising labour costs, with over 70% of surveyed Welsh businesses expecting salaries to increase in the coming year.

In August 2018, the Bank of England's Monetary Policy Committee voted to increase the bank rate from 0.5% to 0.75%, and this is expected to impact on UK economic growth in the latter part of this year, with these rate increases also influencing the costs of finance for Welsh SMEs.

It is useful to review other macroeconomic indices in the UK that influence the banking and finance system, and affect the supply and cost of external finance in Wales. Important in this respect is public debt and deficit which affects the health of the banking and finance system, and thus the finance supply side in Wales. UK public debt declined slightly from 86.5% of GDP in 2017 to 84.3% of GDP (£1.8 trillion) at the end of August 2018, being around 24 percentage points above the EU reference value of public debt (i.e. below 60% of GDP). Longer term reductions of public debt could stimulate bank borrowing and lending, as well as the issuing of bonds.

UK labour markets have remained strong with this also reflected in Welsh labour market trends. Data for 2018Q3 reveals that the employment rate in Wales (for those aged 16–64) was 74.8% (UK 75.5%), up from 72.4% in the previous year. However, earnings growth remains subdued. The continued strength of the labour market in an environment of continued uncertainty among selected sections of the business community is an interesting phenomenon, and perhaps hints that firm behaviour is not currently being well picked up in self-report surveys to major business institutions.

In summary, the middle quarters of 2018 reveal some contrast in the evolution of different economic indices for Wales and the UK. However, current labour market strength might be serving to hide real uncertainty facing some goods and services sectors, and then short term prospects for Welsh economic growth. The uncertainties relating to global and local economic growth have been exacerbated during 2018 by a lack of any emerging conclusions from the Brexit negotiations, and this partly contributed to a downgrading of recent economic growth projections for the global economy,

¹ "The Small Business Index is a weighted index of the responses to the question: 'Considering your overall business performance, and ignoring any normal seasonal variations at this time of the year, how do you view business prospects over the next three months, compared with the previous three months?' The share of firms reporting 'much improved' are given the following weightings: +2, slightly improved +1, approximately the same 0, slightly worse -1 and much worse -2; the Small Business Index is derived from the sum of these factors" (FSB, 2018: 8).

and for Europe and the UK by the International Monetary Fund (IMF) in its October *World Economic Outlook*.

2.2 The SME picture in Wales: understanding factors shaping demand for finance

The first dashboard (Dashboard 1, D1-D10) provides summary information on the nature of the SME sector in Wales, and selected factors that drive demand for external finance.

D1 shows the distribution of SMEs in Wales by size band, and highlights the very large number of micro enterprises (i.e. employing 0-9 people) in the total population of SMEs in 2017. Of the 252,000 SMEs in Wales in 2017, 95.5% were micro, compared to 96.1% in the UK. However, micro businesses account for a slightly higher proportion of total SME employment and turnover in Wales than in the UK. This is significant with micro firms having different financial requirements compared to larger firms.

In the year ending 30 June 2018, the number of people in Wales who are self-employed fell slightly, compared to the year ending 31 March 2018, down from 208,400 to 204,200.

SMEs are characterised by high levels of 'owner-only employment', which accounted for 76.8% of these firms in Wales and 78.5% in the UK in 2017².

Micro enterprises contributed 56% of SME employment and 42% of turnover in Wales in 2017, while small companies (with 10-49 employees and accounting for 3.7% of all Welsh SMEs) supported one quarter of SME employment and 28% of turnover. At the other end of the spectrum, medium-sized enterprises (50-249 employees) accounted for less than 1% of the SME enterprise count in Wales in 2017, but supported nearly one fifth of SME employment (19.3%) and nearly 30% of turnover. By contrast, medium-sized businesses in the UK account for a lower proportion of the SME company count and turnover than those in Wales, but a slightly higher share of SME employment. Overall, in 2017, there were around 800 SMEs per 10,000 residents in Wales: 769 micro, 29 small and 6 medium-sized. This compares with more than 1,000 SMEs for every 10,000 people in the UK: 972 micro, 33 small and 5 medium-sized.

According to the *Small Business Survey* conducted by the Department for Business, Energy and Industrial Strategy in 2016, Wales recorded the smallest proportion of exporting SMEs (14%), compared to Scotland (16%), England (19%), and Northern Ireland (29%), while the UK average was 18%. In 2017, according to the same survey, the rate of exporting SMEs in Wales declined to 10%. The low relative proportion of exporting SMEs could be related to the different industrial structure of Wales, with more SMEs in industries that have a higher propensity to serve domestic demands. Finally, the *Small Business Survey* also showed Wales to have the smallest proportion of SMEs that made a profit (73%), below Scotland (80%), England (83%) and Northern Ireland (86%).

² The zero employee size band also includes companies with one employee. This is because people who work on their own and register as a company automatically become an employee of the company when it is set up. Without this adjustment, the numbers of businesses with zero employees will change purely because of changes in legal status (which can be driven by changes in tax / liability laws for example), rather than any real change in the economy. (StatsWales)

D2 summarises the changes in the Welsh SME count, and corresponding employment and turnover between 2012 (after the recovery of the British economy from the global financial crisis) and 2017. The micro SME group in Wales experienced the largest increase in the number of companies (18.8%) and turnover³ (25.2%), while it recorded the second largest rise in employment (14.6%). The greatest employment increase was by small businesses (19.2%), which also experienced a positive change in number of companies (17.7%) and turnover (23.9%). Medium-sized enterprises also saw an increase in their count (7.1%), employment (6.5%) and turnover (10%).

The business population of different sized Welsh SMEs and changes in the numbers in each size-band, are not evenly distributed across Wales. South East Wales, has the highest share of Welsh SMEs: micro (41%), small (44%), and medium-sized (58%), whilst North Wales has the smallest share of SMEs. However, a different perspective is provided when accounting for business density (firms per 10,000 residents). Mid and South West Wales had the highest number of micro companies in relation to its population, with 920 micro businesses per 10,000 residents, while North Wales recorded the highest density in small firms (34 per 10,000 residents). Finally, South East Wales had the highest density in medium-sized businesses, nearly 8 for every 10,000 residents, compared with 7 in both North Wales and Mid and South West Wales.

With regards to the change in the count by region and size band between 2012 and 2017 (see D3), the largest increase was in the number of micro companies in North Wales (22.8%), followed by small businesses in Mid and South West (19.2%), and medium-sized enterprises in South East Wales (9.5%). The smallest change was in the number of medium-sized firms in North Wales (around a 1% change between 2012 and 2017).

Welsh SMEs are also unevenly distributed across sectors of the economy. D4 shows the sectoral distribution of Welsh SMEs together with the change in count since 2012. Again, the sectoral mix of Welsh SMEs could influence the propensity of the SME sector to export. The wholesale/retail trade, hotels and catering, and communication services sector had the highest SME count with a little over 60,000 SMEs in Wales. These industries however experienced the smallest change in SME count in the period 2012 to 2017 (7.5%). Financial and business services (over 54,000 businesses) recorded the largest increase in SME count (almost 30% since 2012).

In selected services sectors the capital constraints for starting up a company are lower than they are in manufacturing. Indeed, production industries had the lowest SME count in Wales in 2017 (just over 17,000 companies), although this industry experienced the second largest increase in SME count between 2012 and 2017 (at 26%). With this sector more directly exposed to overseas export markets and Brexit-related risks, it will be particularly important to monitor SME survival and growth in these production industries over the next quarters.

D5 compares changes in the SME count in Wales and the UK. With the exception of agriculture in the UK, all sectors have increased their SME counts over the period 2012-2017. Whilst the growth in the agriculture, production and construction sectors has been higher in Wales than the UK, growth in other sectors has been stronger for the UK overall than for Wales. This is particularly evident for the wholesale and retail trade, hotels and catering, and communication services sector (23% growth in count in the UK compared to 9% in Wales) and health and education (29% in the UK and 19% in Wales).

³ Note that turnover is in nominal prices with no adjustment for inflation effects.

The trends in SME count, employment and turnover link through to wider changes in short term output indicators in the Welsh economy. D6 reveals the Welsh output indices of production, construction and market services, and shows the quarterly movement in each of the indices from 2012Q1 to 2018Q1.

The increase in the Welsh index of construction industry output is significant. During the period from 2012Q1 to 2016Q3 the construction index in Wales outperformed the UK construction index. The market services index is characterised by a steady increase in Wales over the period shown in D6, although declining slightly in the first quarter of 2018. Over the same period, the production index has also increased, but with more volatile quarterly changes compared with market services. While output in this sector in Wales is dominated by larger often internationally owned firms, this trend has significance for Welsh SMEs either directly, or through their supply linkages to larger production industry firms within or outside Wales.

Taken together, the indices show in the year to the first quarter 2018 private sector output (PSO) in Wales increased by 0.1% (compared to 2.4% in the UK). PSO makes up approximately 75% of total gross value added (GVA) in Wales.

D7 and D8 examine business birth and survival rates, and changes in the number of birth enterprises in Wales. Wales recorded the second lowest business birth rate in 2016 across the UK regions, at 12.3% of active businesses, while the birth rate in the UK was 14.6%. London had the highest business birth rate in UK at 17.5% in 2016. Moreover, Wales recorded a lower business death rate than the UK in 2016 (10.5% in Wales and 11.6% in the UK). Similarly, Wales also had the second smallest change in number of birth companies in the UK between 2012 and 2016 (46%), with Scotland considerably below this rate (at 28%), while the average UK change is 53%.

The South East Wales region recorded the highest business birth rate (14.3%). The other two regions had a birth rate lower than the all Wales average (North Wales 10.7% and Mid and South West Wales 9.7%). In South East Wales there was a 62% increase in the number of birth companies between 2012 and 2016. In Mid and South West Wales the corresponding increase in business births was 36%, with a 26% increase in North Wales.

The Welsh regions are also characterised by significant differences in the density of birth companies. South East Wales recorded 42 new companies per 10,000 residents in 2016, compared with 36 new firms in North Wales, and 34 in Mid and South West Wales. By comparison, there were 117 new companies per 10,000 residents in the London region in 2016. Across the UK, relative business birth rates have previously been found to be influenced by factors such as population, population skills levels, the size distribution of existing firms, the presence of large agglomerations, and importantly the differential availability of capital across regions.⁴

⁴ The classical reference study here was Keeble and Walker (1994) *New Firms, Small Firms and Dead Firms: Spatial Patterns and Determinants in the United Kingdom*. *Regional Studies*, 28, 411-427. There has been very limited research since this time focusing on the determinants of business birth rates across different parts of Wales.

Dynamism in terms of the birth and death rates of SMEs in Wales is illustrated in terms of three-year survival rates (D8). There is some variation in survival rates across different parts of the regional economy, but the figures reveal that 61% of the enterprises that started in Wales in 2013 were still active three years after birth. Three-year survival rates are lower in Northern Ireland (57%) and London (58%), but higher in Scotland (62%). The survival rates for UK enterprises are similar to overall rates in Wales. An analysis of enterprises born in 2011 demonstrates that the five-year survival rate falls to 43.2% in Wales, compared to 44.1% for the UK.

D9 provides information from the *SME Finance Monitor 2017* on the proportion of Welsh SMEs that use external finance (whether in the form of overdrafts, credit cards and loans). Based on annual survey data from interviews with SMEs in 2017, these results suggest that 41% of Welsh SMEs made use of such provisions (either now or in the past). This rate was similar in England, but slightly higher in Scotland (43%) and much higher in Northern Ireland (53%).

The *SME Finance Monitor 2017* also revealed that 40% of Welsh SMEs had a desire to grow. This compares with 32% in the previous *Survey* (undertaken in 2016), and was the lowest rate across the UK countries (D10). The *Survey* also showed that 53% of SMEs in Wales were content to maintain activity at current levels (compared to 54% in the previous survey), which was the highest in the UK. This data indicates the low growth ambitions of many Welsh SME owners, with this a factor influencing the number of small and micro enterprises that evolve into medium-sized firms, but also a factor directly influencing aggregate demands for funds to grow.

3. Provision of SME finance and cost of finance

This section (Dashboard 2, D11-D19) focuses on factors affecting the provision of finance to SMEs in Wales. Before commenting on Welsh level information, the first graphs in Dashboard 2 provide some important context on wider UK trends.

According to D11, total bank lending, the dominant mode of external finance to UK SMEs, plateaued at £59 billion in 2016, having grown by 55% since 2012. There was a slight fall in bank lending in 2017 to £57 billion. This fall is expected to continue in 2018, when considering the data in D12 which shows a declining trend in the 12-monthly growth rate of loans provided to UK SMEs. The trends in annual growth rates of loans to UK SMEs have been affected by the rise in the cost of bank loans, with the average interest rates to SMEs which are successful in gaining loans increasing from 2.91% in July 2017 to 3.15% in July 2018, although with some variation around these average figures. Indeed the recent FSB report *Going for Growth*⁵ suggests that over two-thirds of SMEs applying for external finance are being offered rates in excess of 4%.

The *Bank of England Credit Conditions Survey 2018Q2*⁶ revealed contrasting results about the supply of credit to UK SMEs, which increased in 2018Q2, after three consecutive quarters of stagnation during the period 2017Q3 to 2018Q1. In addition, the demand for credit by UK SMEs increased by almost 28% in 2018Q2 compared to the previous quarter, after a stagnation in 2018Q1, weak growth of 1.7% in 2017Q4, and a significant decline of -22% in 2017Q3.

⁵ FSB (2018). <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/going-for-growth-final.pdf?sfvrsn=0>

⁶ Data available from: <https://www.bankofengland.co.uk/-/media/boe/files/credit-conditions-survey/2018/2018-q2.pdf?la=en&hash=E471699A6946CB8E72B4D0782BCFC056154669AB>

Both asset finance and flows from private equity organisations have been steadily increasing in the period to 2017, with average growth rates of 8.8% and 33.9% respectively. Whilst private external equity investment and peer-to-peer lending flows make up a much smaller share of external finance to SMEs, this has increased significantly from £1.73 billion in 2013 to £6.25 billion in 2017. This trend will have some importance for Welsh SMEs seeking external finance.

The Welsh share⁷ of total national (here Great Britain) bank lending to SMEs has fluctuated between approximately 4.5% and 4.7% during the last five years (D13). Based on latest quarterly figures, the average Welsh share of total GB bank lending to SMEs was 4.6%. The share of lending to Welsh SMEs fell slightly in the period 2017Q3-Q4. Bank lending to British SMEs declined from £89.2 billion in 2017Q3 to £87.1 billion in 2017Q4, (-2.3%); bank lending to SMEs in Wales declined from £4.12 billion in 2017Q3 to £3.95 billion in the last quarter of 2017 (-4.1%). Overall, the amount of bank lending to SMEs in Wales declined between 2016Q2 and 2017Q4.

According to *Small Business Finance Markets 2017/18*⁸ (p23), the Welsh share of the value of British loan facilities approved in 2017 was 5%, the second lowest region in Britain, after the North East. Additionally, when examining the distribution of bank lending in the UK relative to the *business* population, Wales, alongside the South West, North East and Scotland, had a higher share of bank lending value and volume.

D14 shows the average share of bank lending to SMEs across Wales between 2017Q1 and 2017Q4. More than half of total loans were to the Cardiff and Swansea postcode areas, with just over 21% to the Llandudno postcode area. It should be noted that it is difficult to draw firm conclusions from this data because of problems matching economic activity to postcode areas, with some postcode areas crossing local authority boundaries. D14 includes an estimate of bank lending to SMEs with a Shrewsbury postcode, but located in Wales (for example including those in Newtown and Aberystwyth).

Overdraft facilities are a major source of SME finance. D15 shows that in Wales, the value of overdrawn balances was in general decline, falling from £660 million in 2012Q1 to £453 million in 2017Q4, but increased to £489 million in 2018Q1 and then to £535 million in 2018Q2. This recent increase is related to a growth in the value of overdraft facilities approved which has been steadily increasing since 2017Q2, from £46 million to £76 million in 2018 Q2.

External finance to SMEs in Wales also embraces venture capital finance and private equity sources. Recent research by Beauhurst on equity finance trends to 2018Q3 shows that Wales, together with the East Midlands and North East featured relatively low numbers of deals and amounts invested in deals in the first three quarters of 2018⁹ (in comparison to the size of their economies).

Alternative finance is that originating from any other sources apart from the banks, the state, and internal finance. Welsh SMEs have the lowest propensity to take up alternative finance in the UK. How far this reflects weakness of SME demand, or deficiencies in the local supply side for these finance sources will be a subject of future EIW research. According to the ONS *Longitudinal Small Business*

⁷ This data excludes SMEs in Wales with a Shrewsbury (SY) postcode.

⁸ Data available from: <https://www.british-business-bank.co.uk/wp-content/uploads/2018/02/Small-Business-Finance-Markets-2018-Report-web.pdf>

⁹ See Beauhurst 2018. <https://about.beauhurst.com/blog/equity-investment-update-q3-2018/>

Survey 2017, just 6% of Welsh SME owners used alternative finance, compared to 11% in Scotland, 10% in England, and 8% in Northern Ireland. The FSB have suggested that smaller businesses are becoming more confident in assessing different finance options, but that there is a lack of awareness, and suitable signposting to alternative financing options for SMEs¹⁰.

According to BVCA¹¹, 52 firms in Wales received equity investment in 2017, a small increase on 2016 (D16). In the UK a total of 817 firms received investment in 2017 compared with 728 firms in 2016. The investment amount in Wales increased from £49 million in 2016 to £57 million in 2017, with the Development Bank of Wales playing a significant role. The Development Bank directly invested £14 million in equity in the calendar year to December 2017, with associated private sector leverage of £27 million. The BVCA also reported that Welsh SMEs accounted for 1% of total UK venture capital investment in 2017, compared to a 61% share for the South East and London area. Much of the venture capital and private equity investment in Wales was related to companies in the ICT and biotechnology & healthcare sectors (D17), at around 82% of the total investment in 2017.

The level and structure of lending to SMEs is strongly related to their credit risk. D18 and D19 provide an overview of this risk. Detailed risk information is not available for all Welsh SMEs, reflecting data availability problems. However, the dashboard presents information from over 60,000 SMEs in Wales.¹² The risk classifications used range from High Risk to Secure, being derived from accounting and other information available to credit risk agencies. SMEs classified in the High-Risk category will likely become insolvent within one year and will be unable to continue trading without significant remedial action. The Caution category carries a significant risk of failure and with enterprises in this category typically four times more likely to fail than those in the Normal category.

D18 reveals the proportion of Welsh SMEs estimated to be at High Risk at the end of September 2018 was 4.1%, and the proportion of SMEs estimated to be in the Caution category was 73%. Interestingly both of these figures show an increase from those reported in QR1 for June 2018, which were 3.9% and 70% respectively.

D19 shows how the proportions of SMEs in the different risk categories vary by sector. In the quarter ending September 2018 the proportion of SMEs in the Caution category increased in every industry group. The sectors with the largest proportion of SMEs in the Normal, Stable or Secure categories include chemicals etc., and metal and metal products.

4. Development Bank of Wales activity

The final dashboard (Dashboard 3, D20-D31) summarises Development Bank of Wales' investments to date, with analysis of investments by type, sector, location, Fund and size of business. Together the information provides an overview of investment activity within the demand and supply context provided earlier.

The first five panels in Dashboard 3 indicate the scale and distribution of Development Bank of Wales investment to date, with cumulative figures covering the financial year periods from 2001/2 Q1 to

¹⁰ FSB (2018). *Going for Growth*. <https://www.fsb.org.uk/docs/default-source/fsb-org-uk/going-for-growth-final.pdf?sfvrsn=0>

¹¹ Data available from: <https://www.bvca.co.uk/Portals/0/Documents/Research/Industry%20Activity/BVCA-RIA-2017.pdf?ver=2018-07-05-190000-180×tamp=1530813602675>

¹² Data available from: <https://fame.bvdinfo.com/version-2018327/Home.serv?product=fameneo&setlanguage=en>

2018/19 Q2. Total investment to 2018/19 Q2 was almost £540m. D20 reveals that loans accounted for 52% of this total, with equity investments representing around 28%, and mezzanine investments the remaining 20%.¹³

D21 provides the same analysis by type of investment, but shows the total number of enterprises and jobs supported over the period to the second quarter of the 2018/19 financial year. There are more than 3,000 firms which have received loans to date, far outnumbering those receiving other types of investment, with these loans linked to activity that has created an estimated total of over 11,600 jobs, whilst safeguarding almost 19,000 jobs.

D22 shows that the manufacturing sector has been the main recipient of Development Bank of Wales' investment, followed by construction, information and communications sectors and then professional, scientific and technical activities. This pattern of investment does not match the general sectoral distribution of SMEs in Wales (see D4), where the production sectors featured the lowest number of SMEs, and relatively low associated jobs.¹⁴ However, these same production sectors often have relatively higher demands for capital to gain growth prospects.

The geographical distribution of investment to date is shown in D23. As noted earlier, loans make up the majority of investments in all locations, with the South East region accounting for the largest share of all types of investment. Similarly, the South East region had the highest investment per 10,000 residents (£2 million), followed by Mid and South West Wales (£1.44 million) and North Wales (£1.33 million). D24 provides more details of monies invested and available by Fund to the end of the 2017/18 financial year. The largest active fund is the EU co-financed Wales Business Fund which has invested £66m, while almost £350 million has been invested by 'Retired' Funds, which are no longer investing.

The next data sets (D25-D28) show more recent investment activity. There was a significant increase in new loan investment in 2018/19Q2 compared with the same quarter in the previous year (D25). This upward trend is further illustrated in D26. Equity investment growth was strong in the period 2017/18 Q3-Q4, but new investment fell in 2018/19 Q1. This is a typical investment pattern, with Q4 tending to be the busiest investment period, linked with companies seeking investment before the financial year end. This will generally be followed by less demand for investment in Q1. Both D25 and D26 show declining trends in mezzanine investment over the period shown, in contrast to a positive growth of these investments as reported in QR1¹⁵. As noted these short term trends in finance types are volatile, and heavily influenced by individual loan and investment approvals in any particular period.

South East Wales, with the highest share of the Welsh business population, continues to account for the largest share of new investment (D27), whilst investments to firms in Mid and South West Wales have exceeded those to firms in North Wales since the start of the current financial year (D27). Investment into each of the three regions is on an upward trajectory in line with DBW's commitment to increase its annual investment to £80 million per annum within 5 years from launch (October 2017).

¹³ Following a review of the performance to date for its largest investment Fund, the EU-backed Wales Business Fund, the Development Bank of Wales is in the process of moving away from the 'mezzanine' investment classification.

¹⁴ Investment data from the earliest funds did not have an integrated means of recording sectoral information due to sectoral reporting requirements. Consequently, approximately 13% of the Development Bank of Wales' dataset lacked sectoral information. The investment, jobs created and safeguarded jobs from these enterprises are not included in D22.

¹⁵ See footnote 13.

D28 shows recent investment by selected sector. This shows the amounts (£m) of overall investment during the four quarters to 2018/19Q2. Investment has been highest in the construction sector (obtaining £26 million of investment), followed by professional, scientific and technical activities (£8.3 million), manufacturing (£8.1 million) and then and wholesale and retail trade (£7.4 million).

Recent investment activity by the size of firm is shown in chart D29. In the four quarters to Q2 2018/19, investment in micro enterprises accounted for the largest share of funds at 43%, with small companies accounting for 36% of investment funds, and with 19% of investments to medium-sized enterprises. Around 1.5% of the value of investments was to large enterprises.

An historical perspective of investments, number of enterprises and jobs supported is shown in D30 and D31. D30 highlights the fluctuations of new investment and private sector leverage, which follow a similar pattern: declining after the 2007 financial crisis, and recovering after 2012. D31 shows the short-term impact of Funds in creating and safeguarding jobs. Similar to D30, the pattern of jobs created has been volatile over the period since 2001.

There is a lower rate of jobs created and safeguarded per firm supported in 2018, compared with those in the previous year, which may in part be a consequence of tight labour market conditions noted earlier. However, in the first two quarters of the financial year 2018/19 the number of firms receiving investment is high (188) at this half year point, suggesting that this will be the 5th consecutive year of growth in number of businesses receiving investment from the Development Bank. The value of new investments made by the Development Bank of Wales during the first half of the financial year 2018/19 summed to over £33 million, with these linked to almost 330 jobs created and a further almost 930 jobs safeguarded.

5. Conclusions

The heightened economic uncertainty and instability is expected to have some influence on business demands for finance. The widely forecast slowing of economic growth in the short to medium term implies that SMEs in Wales could expect more challenging economic conditions in the coming months, reflecting the pessimism that prevailed for UK small businesses in the third quarter of 2018, and the low growth ambitions amongst Welsh SMEs.

This second QR provides evidence of strong variations in SME density and significant growth in the number of Welsh SMEs in financial and business services and production between 2012 and 2017. Moreover, Wales recorded the second lowest birth rate in the UK in 2016, with South East Wales seeing the highest birth rate within Wales. Overall, the high numbers of Welsh (and UK) enterprises that fail within their first three years of existence are linked with the findings on credit risk ratings of Welsh SMEs, which show large and increasing numbers of enterprises categorised into High-Risk and Caution categories.

In this context, Welsh SMEs make relatively low use of external finance. There was a larger decline in bank lending to SMEs in Wales than in Britain, resulting in an overall decline in the Welsh share in GB bank lending in the most recent data. Whilst Welsh SMEs had the lowest propensity towards alternative finance in the UK, the numbers of firms receiving venture capital and equity finance, as well as the investment amount increased during 2017.

In the first half of 2018/19, 188 enterprises received Development Bank of Wales investments of over £33m, with this linked to £40m of private sector leverage, and almost 1,300 jobs created or safeguarded.

During the process of completing both QR1 and QR2 a number of new research questions have arisen and a number of these will be investigated as part of EIW's future research programme. These questions include factors affecting demand and supply for export finance in Wales, how structural change in Wales might affect the requirements for lending, and better understanding equity clusters in Wales.

6. Emerging data gaps

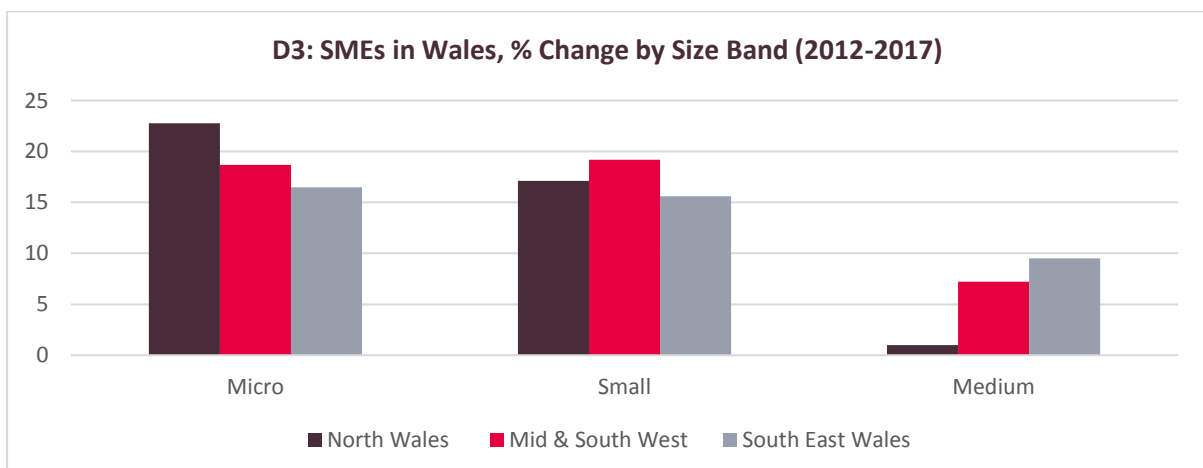
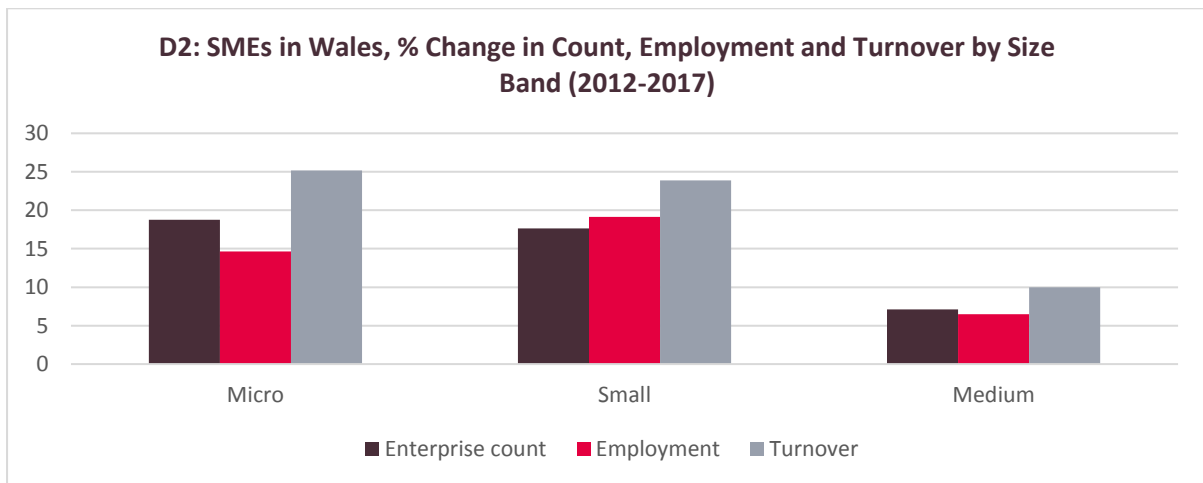
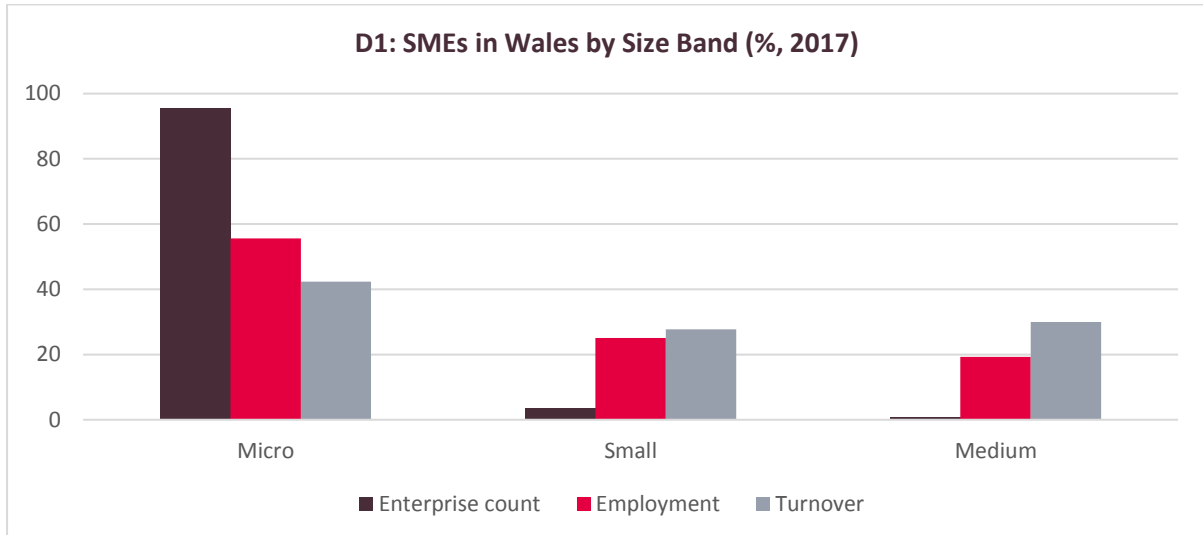
The analysis in both QR1 and QR2 has identified issues in terms of data availability, challenging researchers to use new and innovative sources, some of which are becoming available through partners at the ONS Data Science Campus.

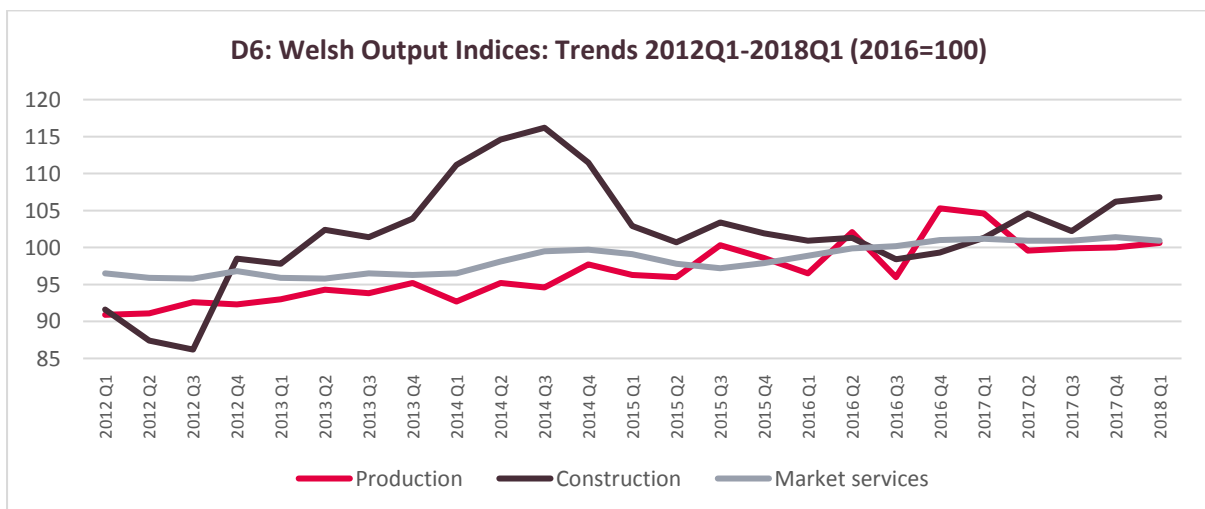
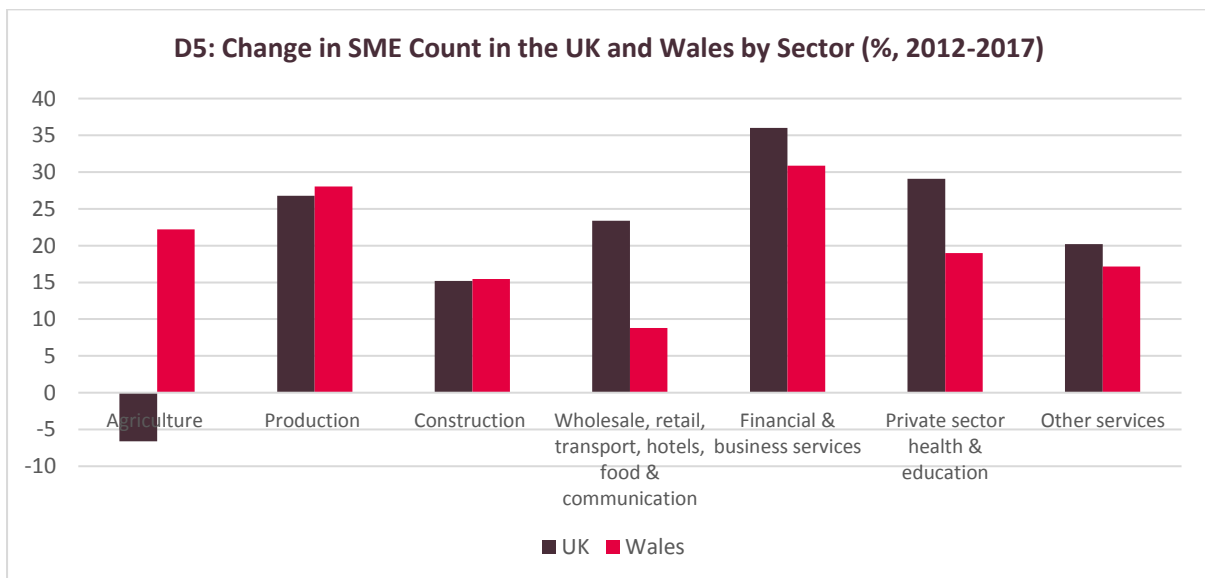
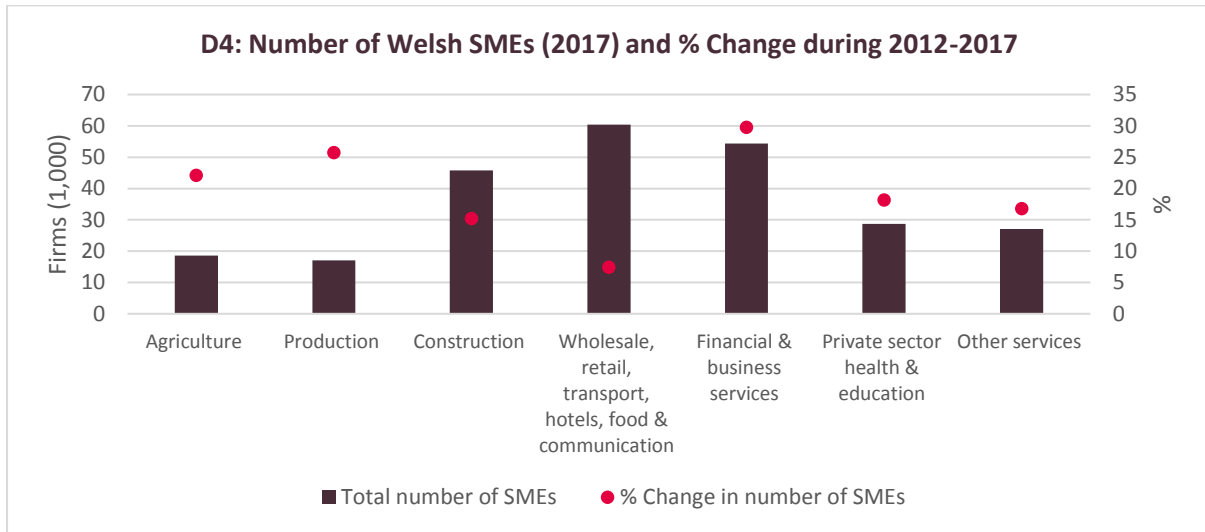
Given the very large number of firms with 0-1 employees, economic information in relation to the smallest firms in Wales still seems to be sparse, with these smallest firms often least likely to fill surveys, or network with organisations that collate industry statistics. The commonly used 'micro' SME category typically includes firms that employ between 0-9 people, although the average employment of firms in this category is between 1 and 2 Full Time Equivalent employees.

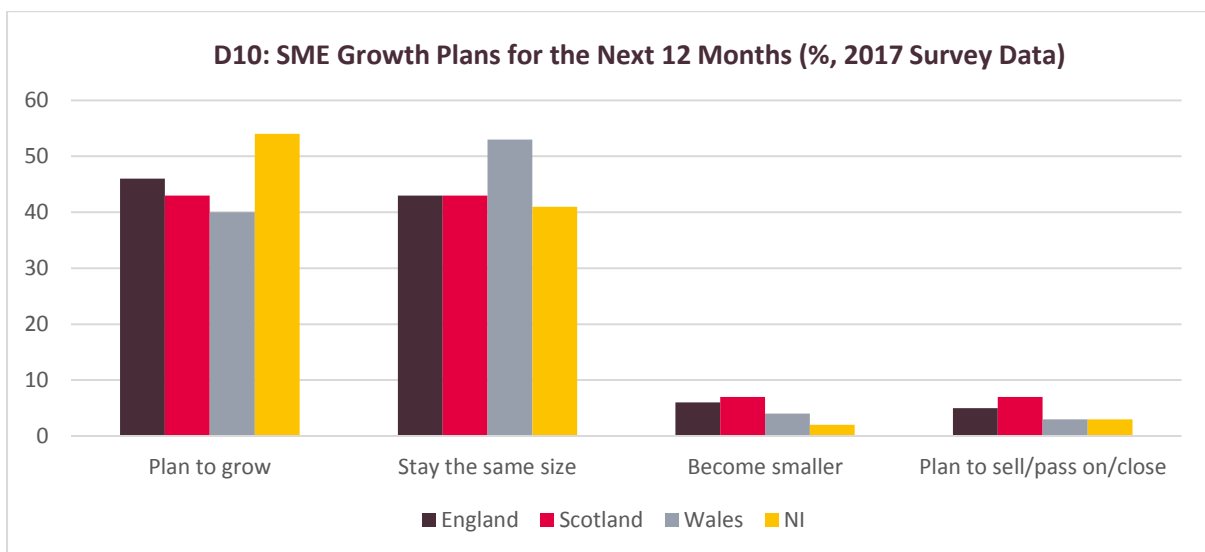
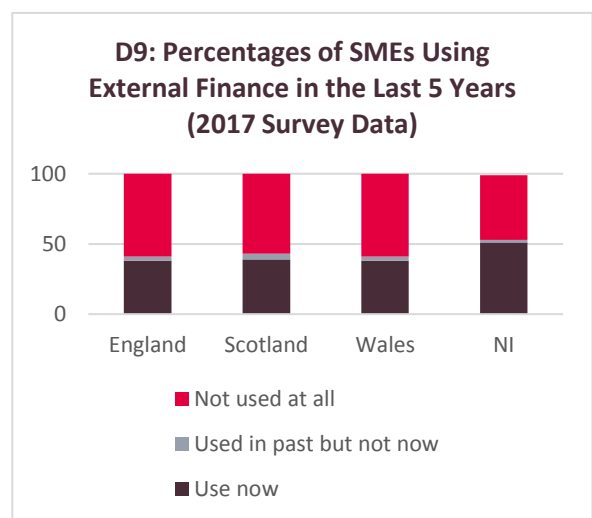
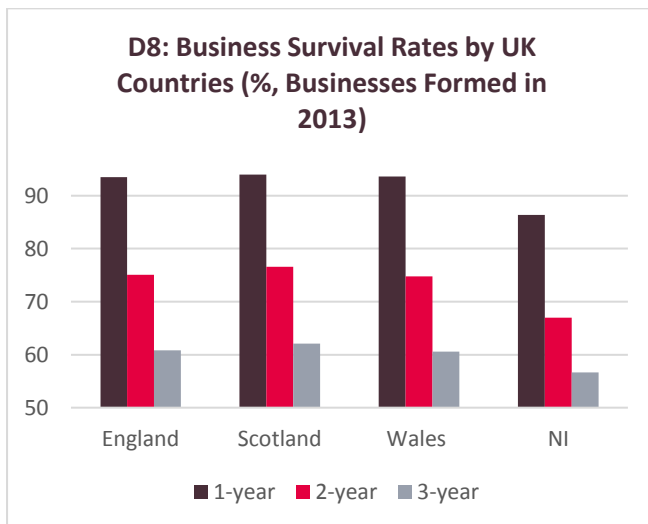
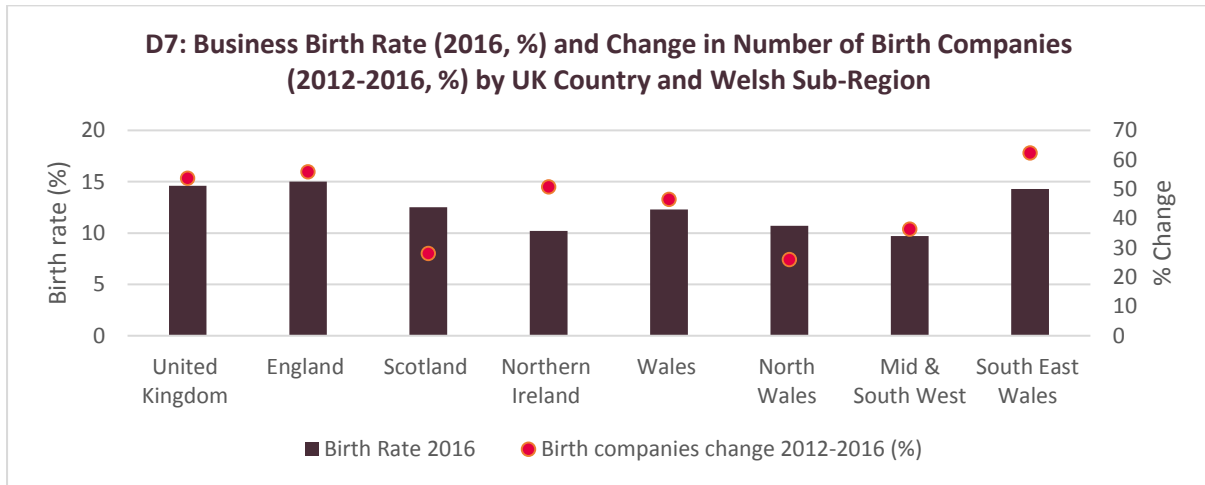
The current interest in Welsh trade reveals data gaps in terms of a paucity of knowledge on how many SMEs export overseas, the amounts involved and the destinations. There is a strong interest in patterns of Welsh trade overseas, and while this is dominated by large firms it would be useful to have more data on the overseas trade patterns of Wales' smaller firms. Linked to this there is also a general paucity of data on the trade of Welsh SMEs with rest of UK firms. This is important in terms of improving the general understanding of SME connections with other firms and sectors within the wider UK economy, and hence their future growth prospects, but also more specifically because selected SMEs may export to rest of UK firms which subsequently export overseas.

7. November 2018 Dashboards

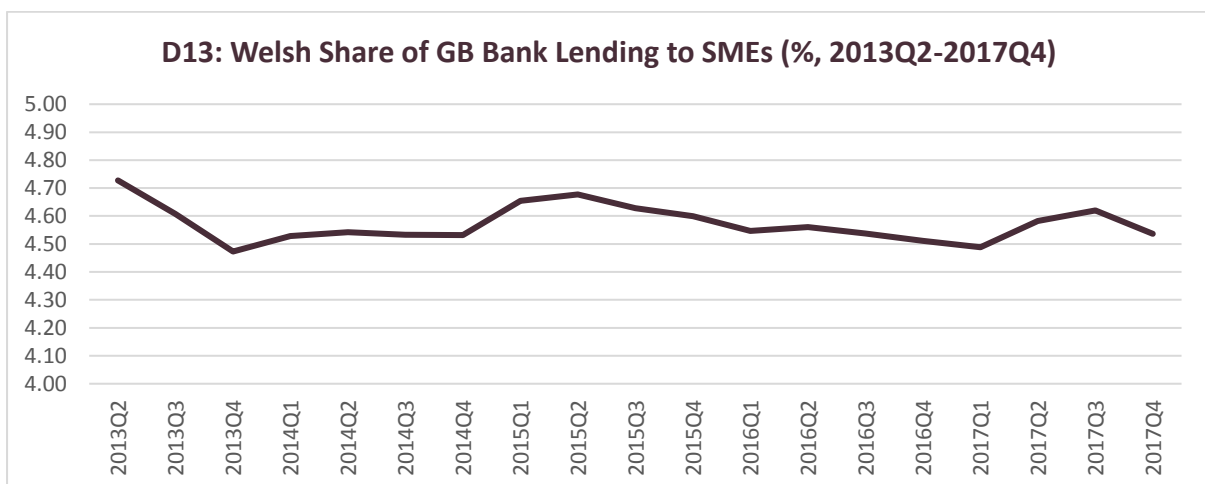
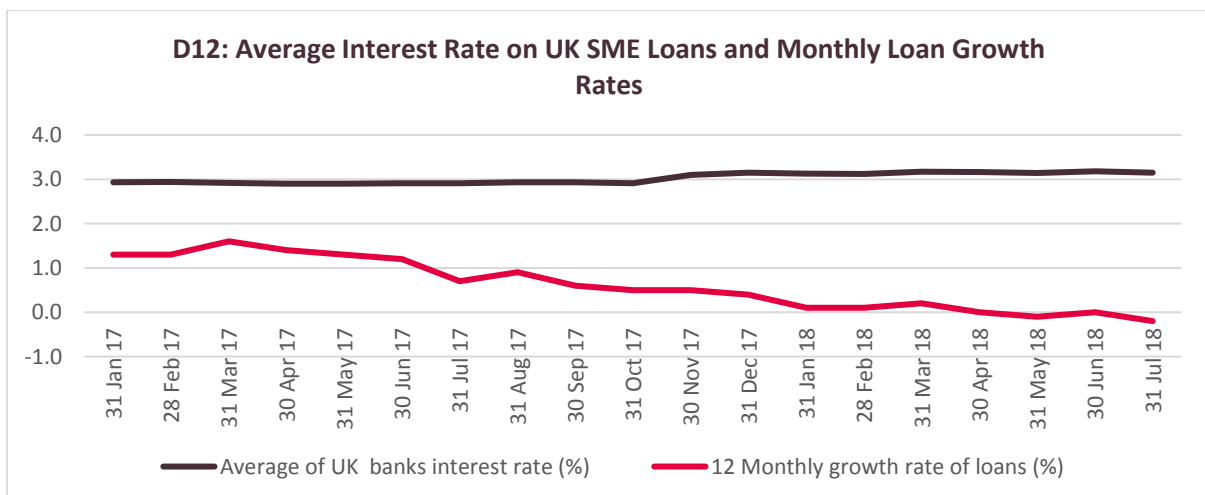
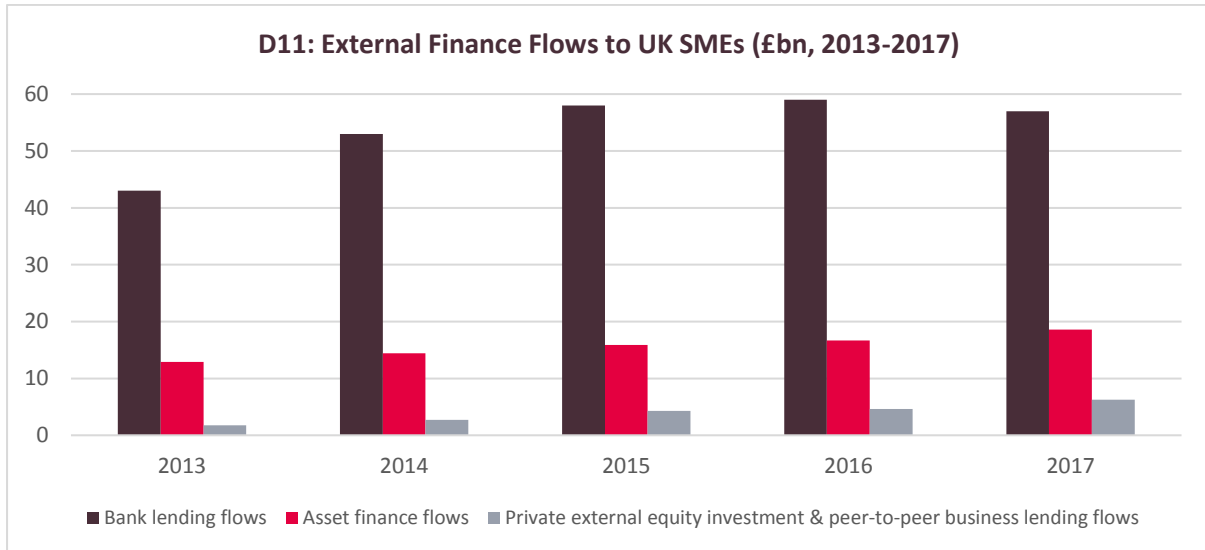
7.1 Dashboard 1: The SME picture in Wales

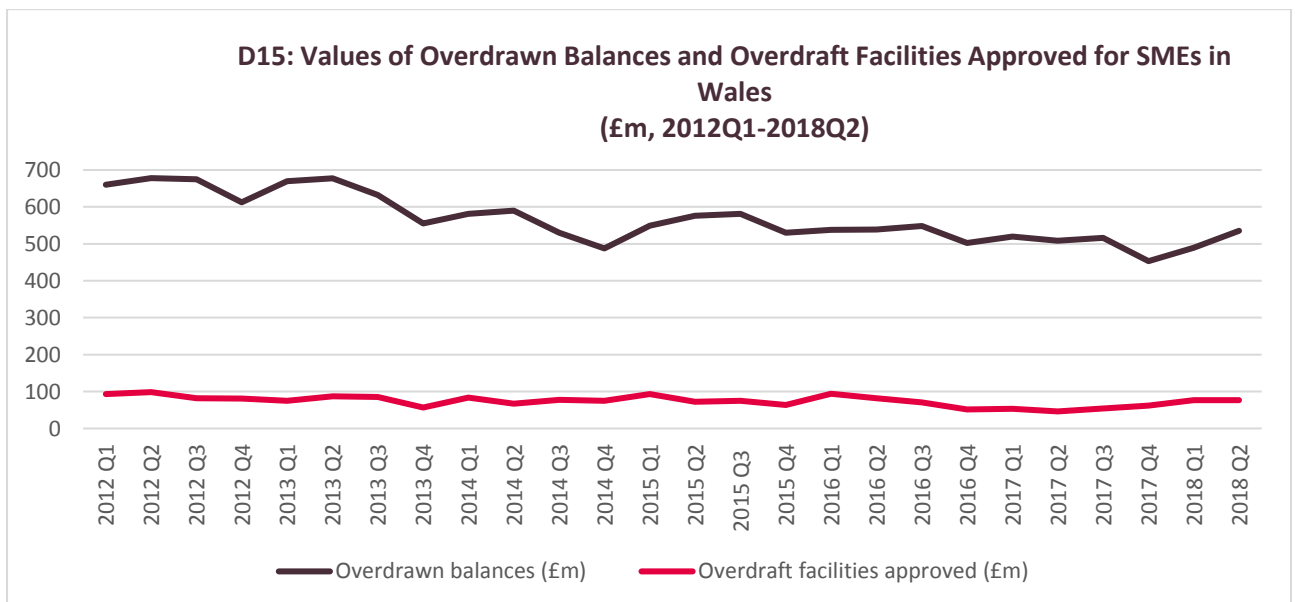
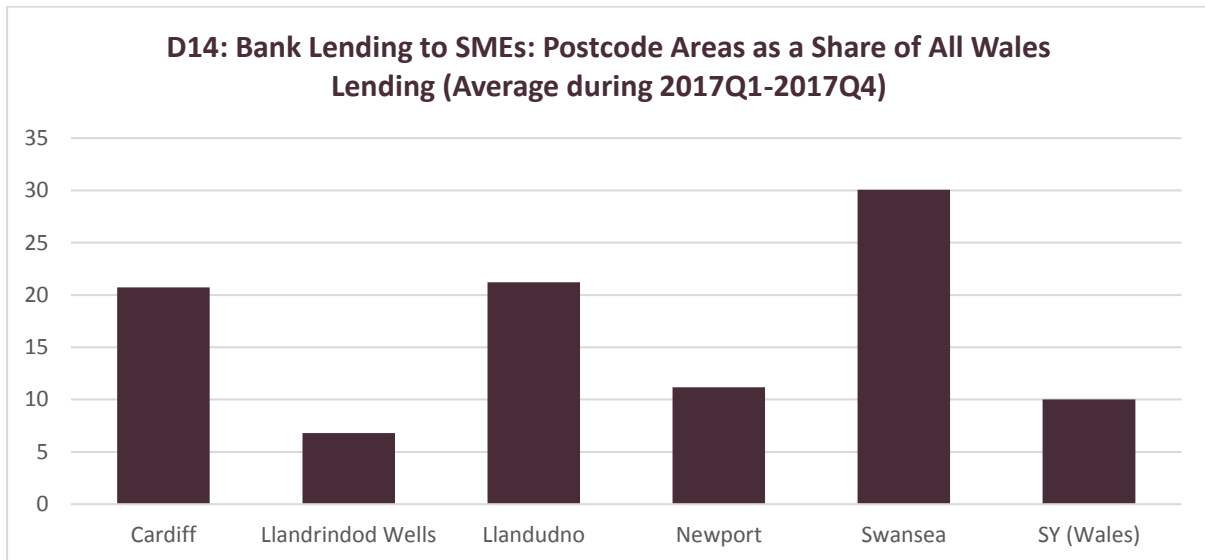


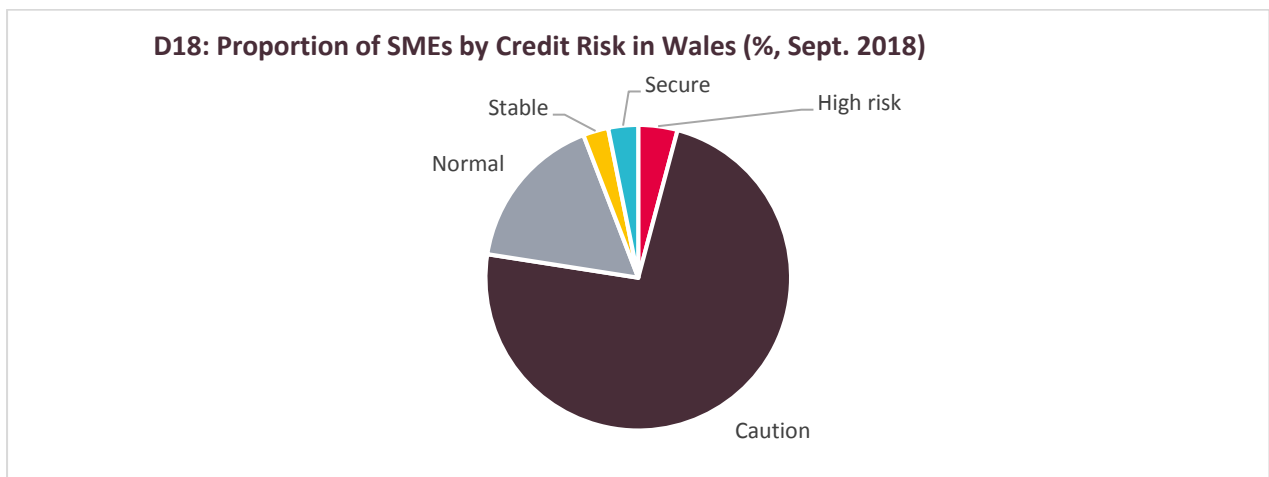
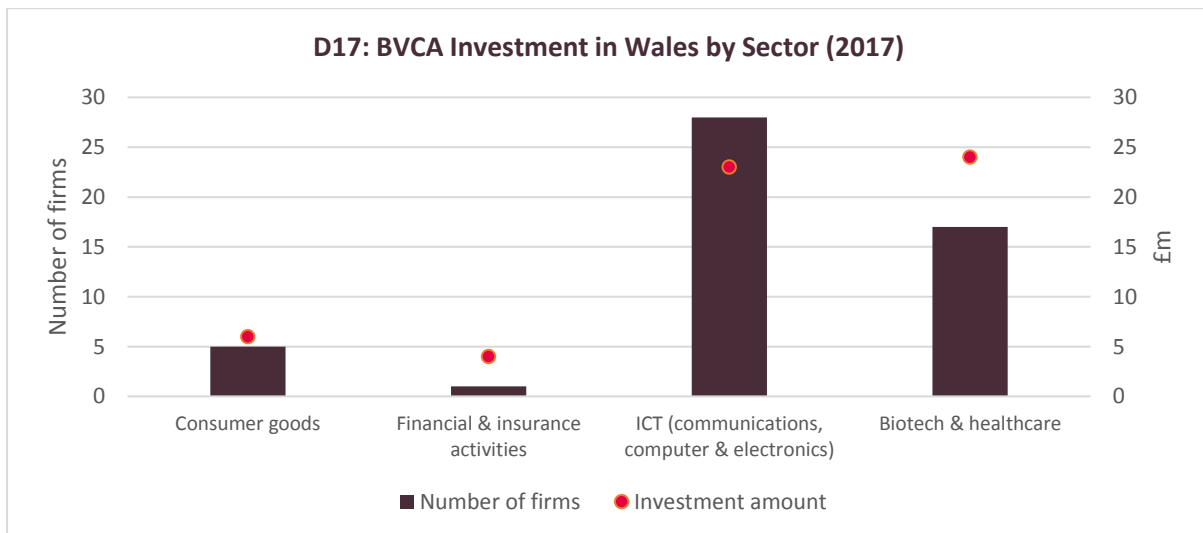
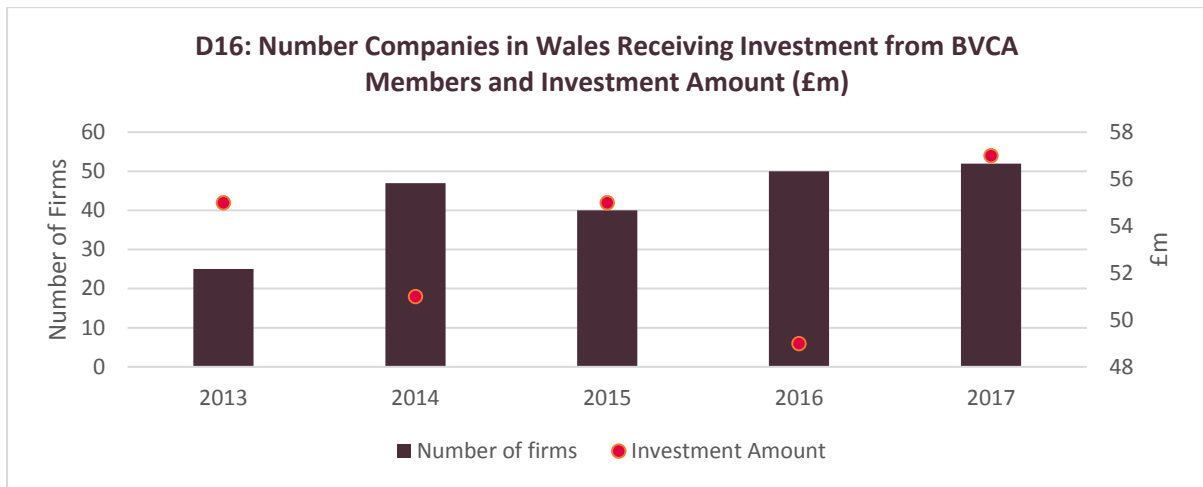




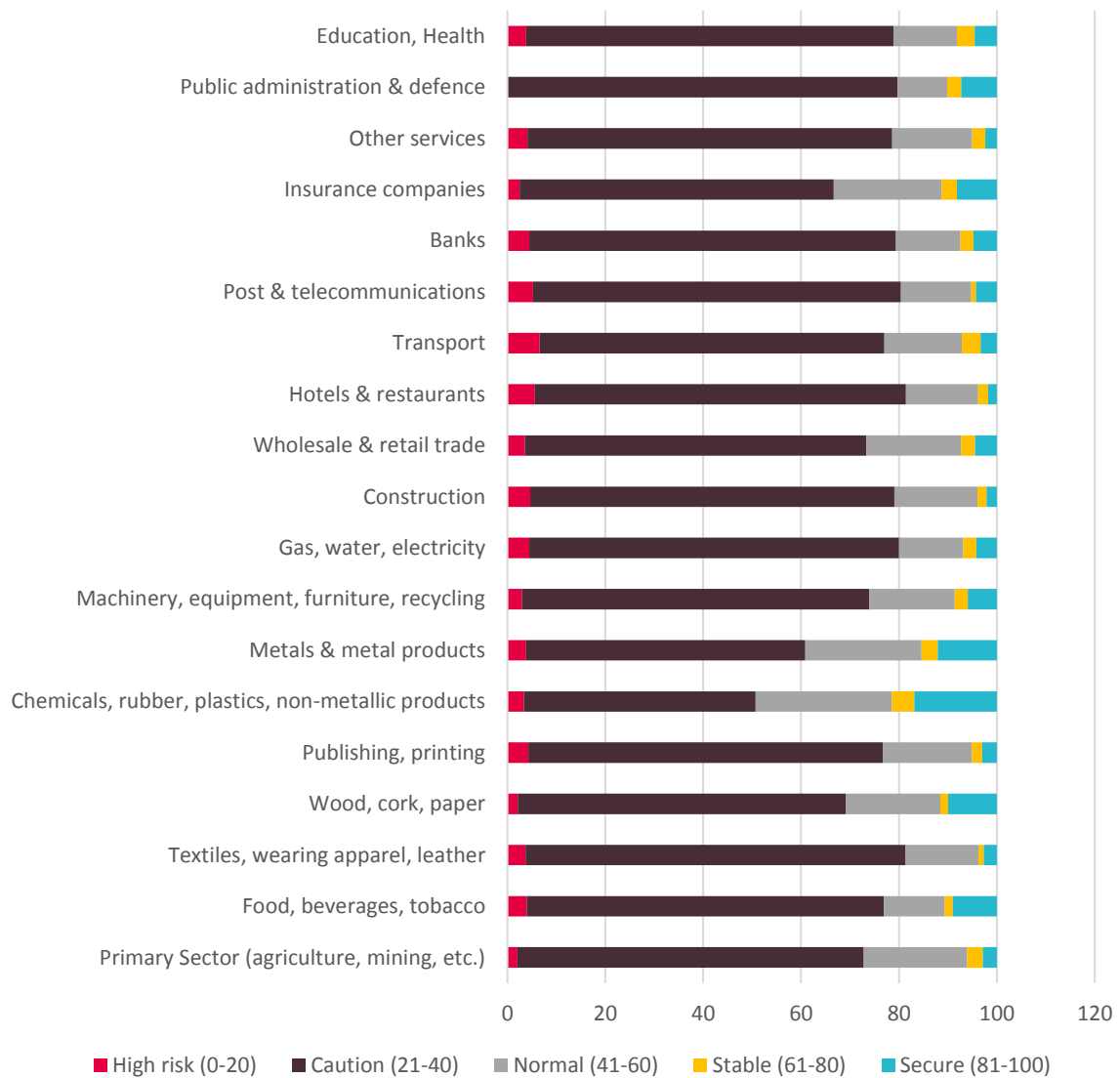
7.2 Dashboard 2: Provision of SME finance and cost of finance



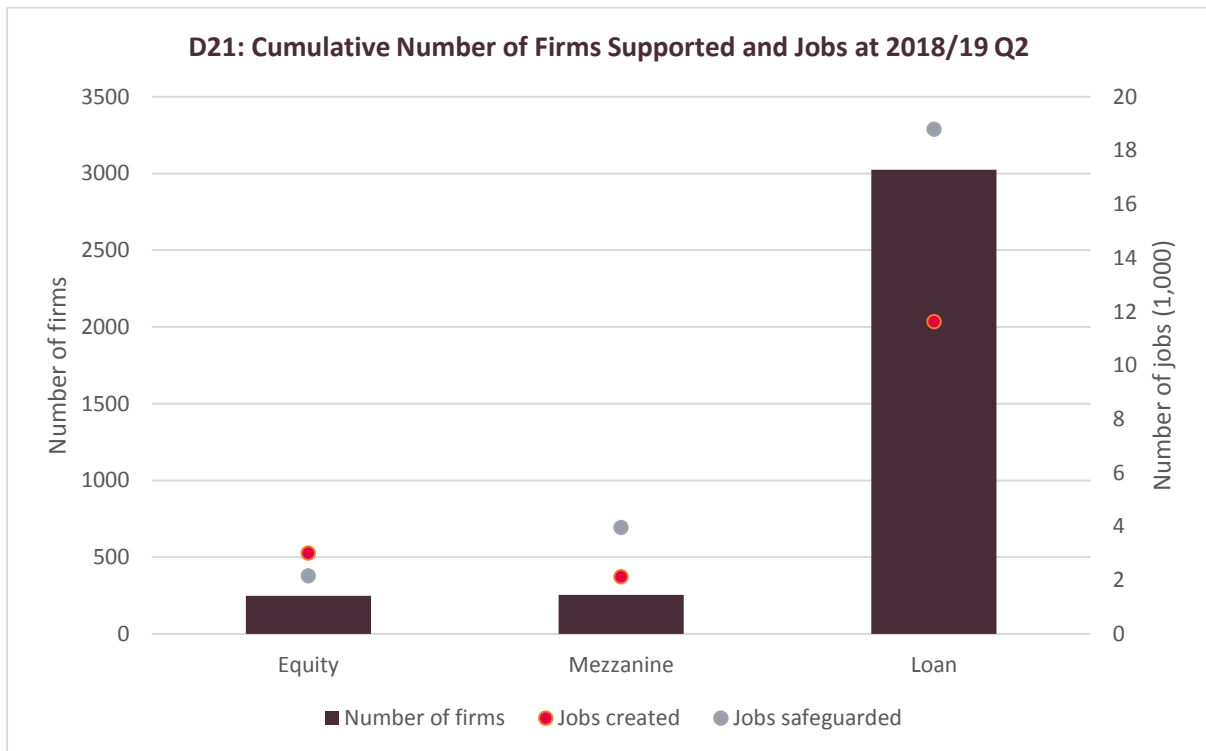
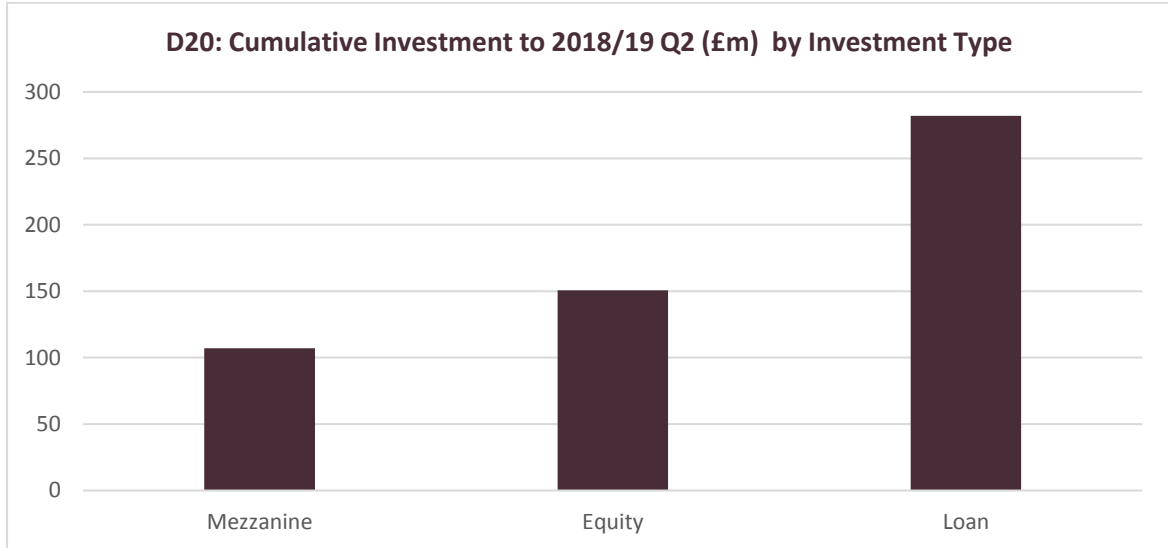


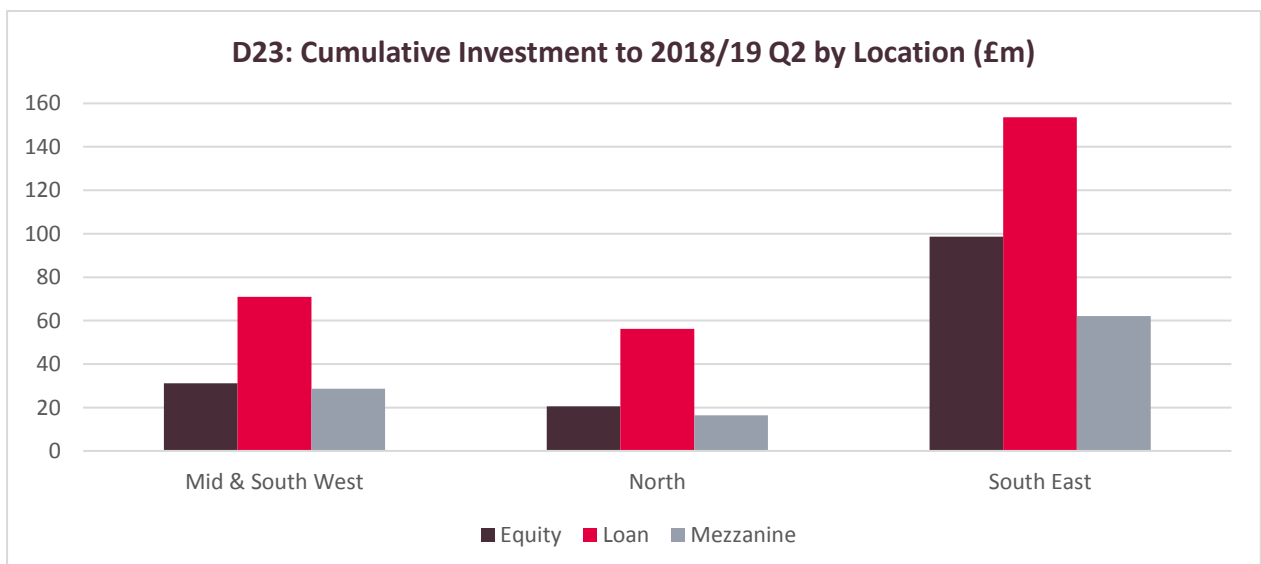
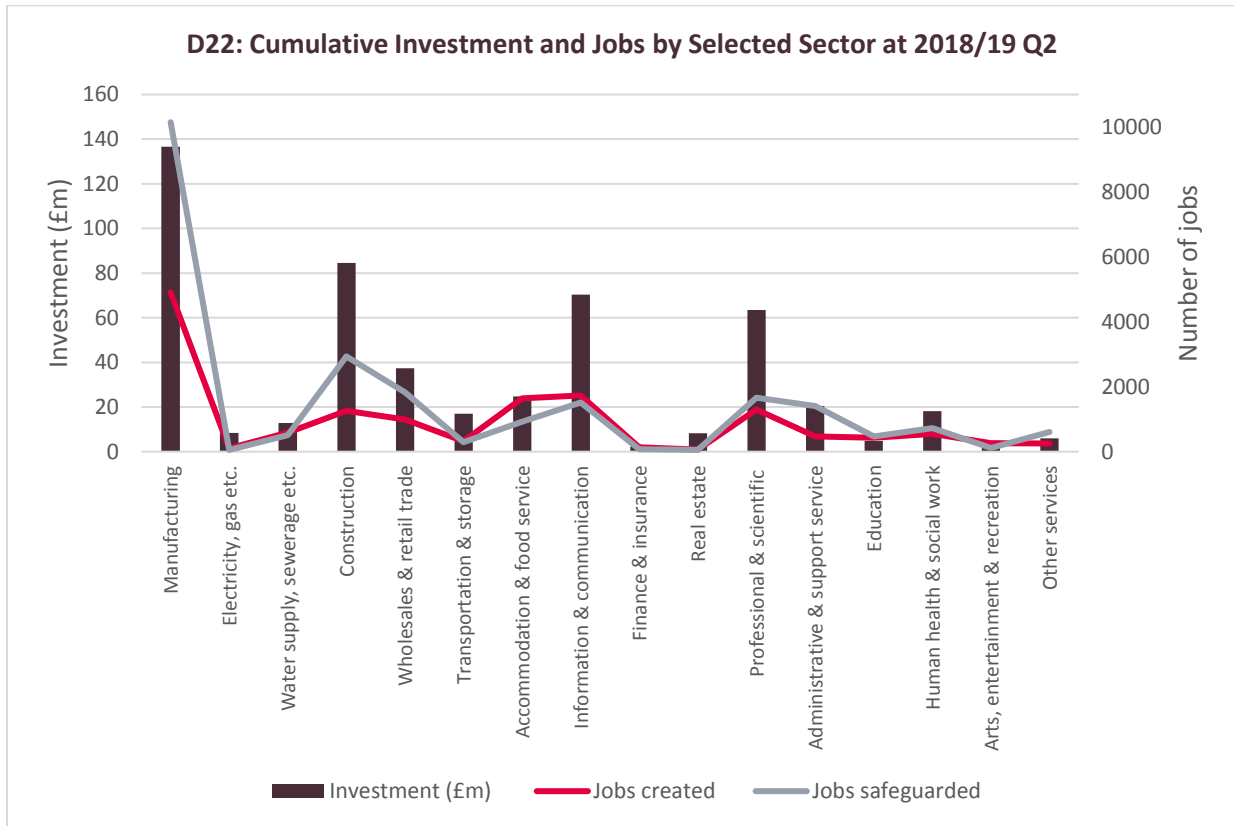


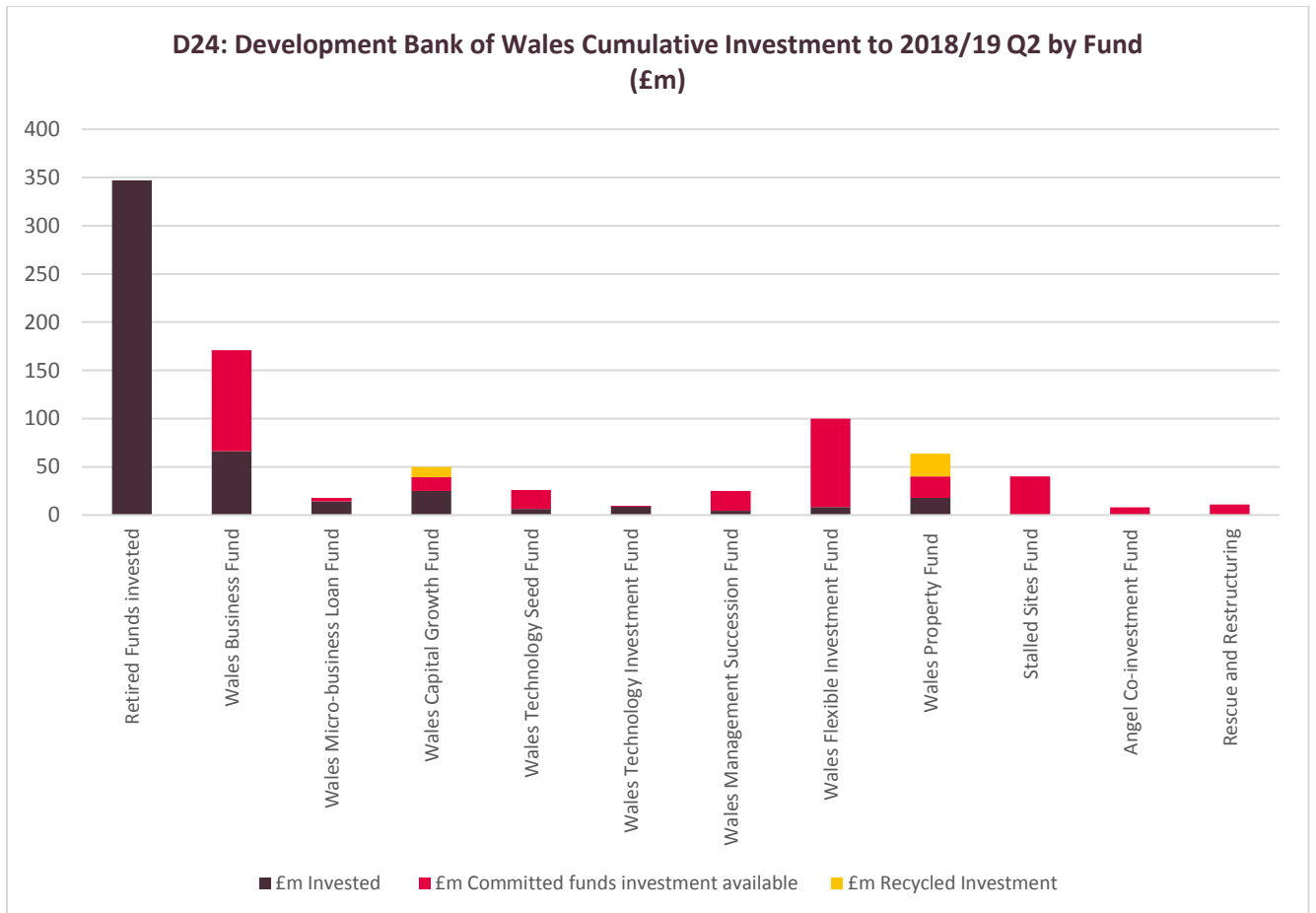
D19: Welsh SMEs Credit Risk by Sector (% in Each Risk Category, Sept. 2018)

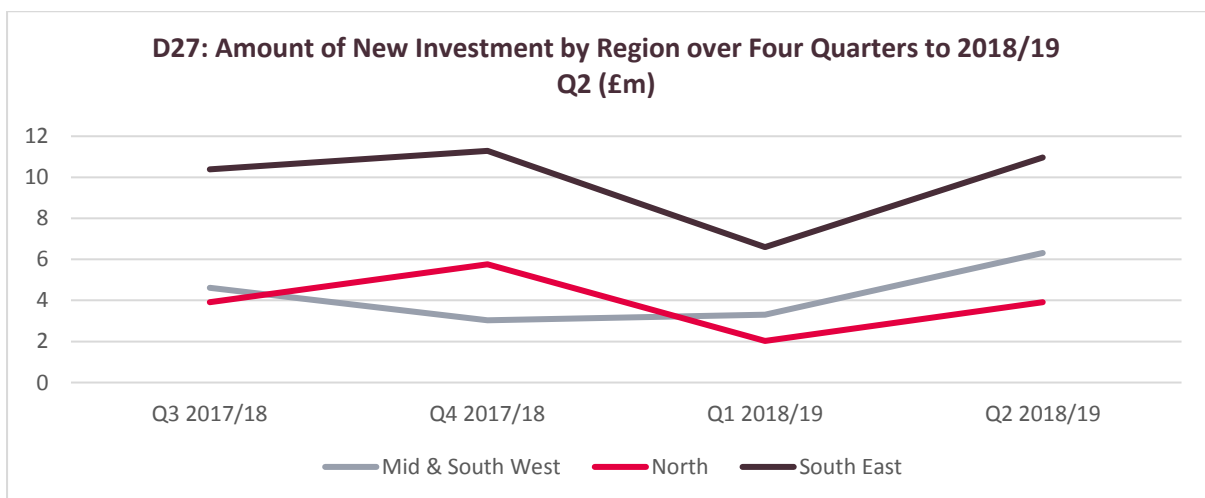
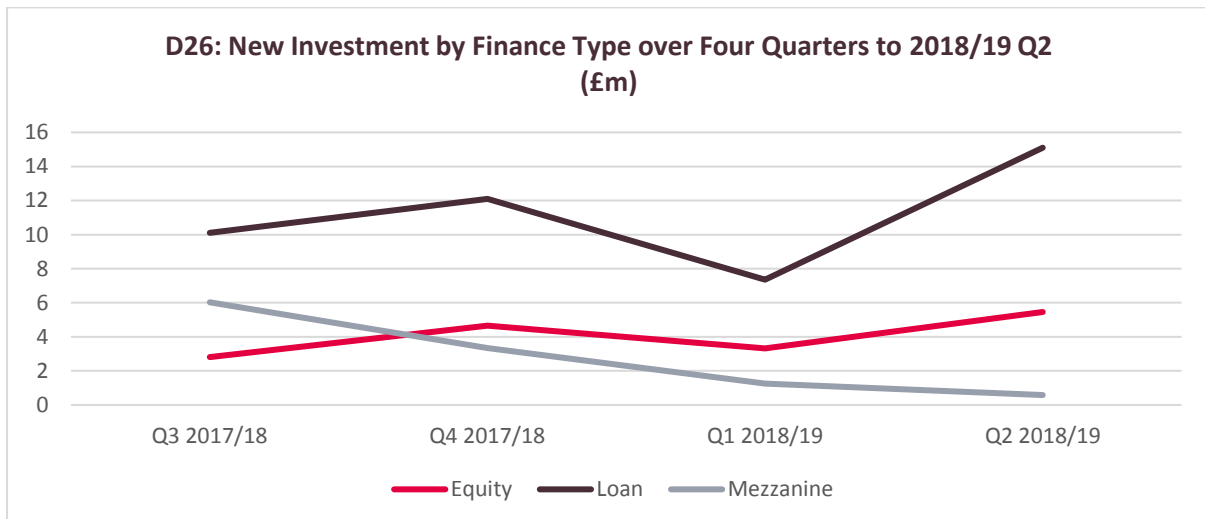
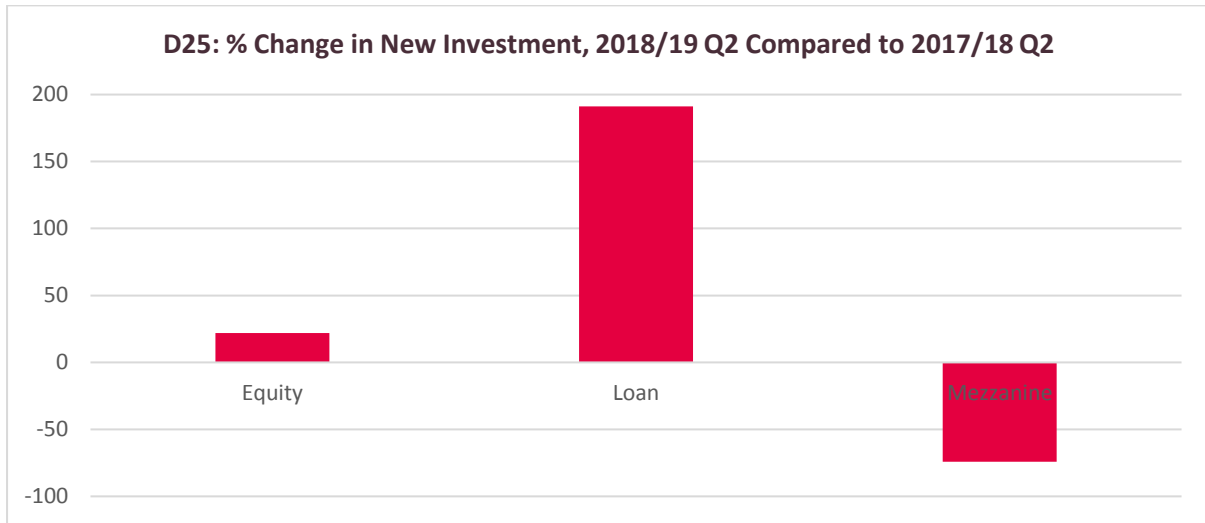


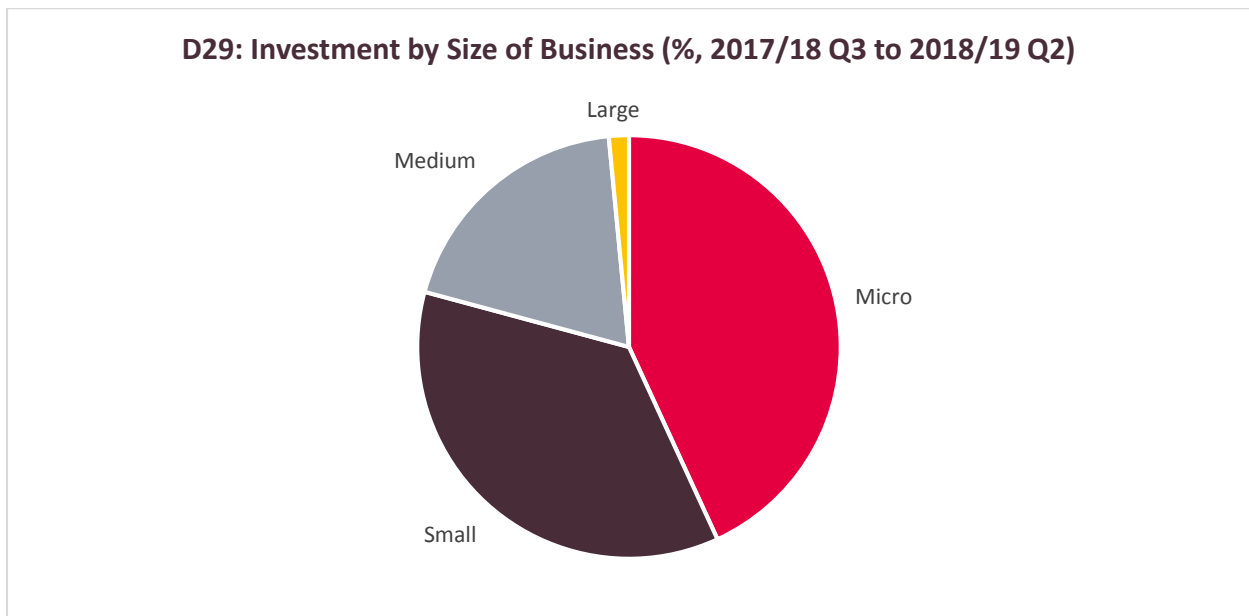
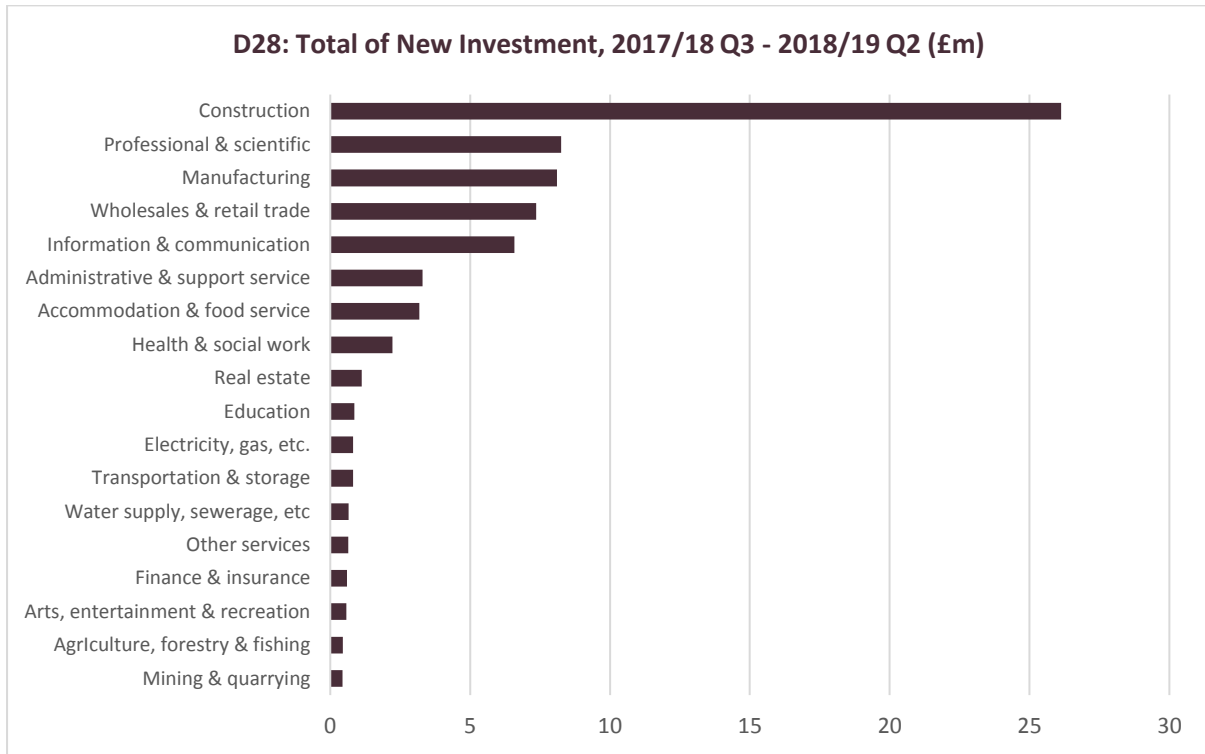
7.3 Dashboard 3: Development Bank of Wales

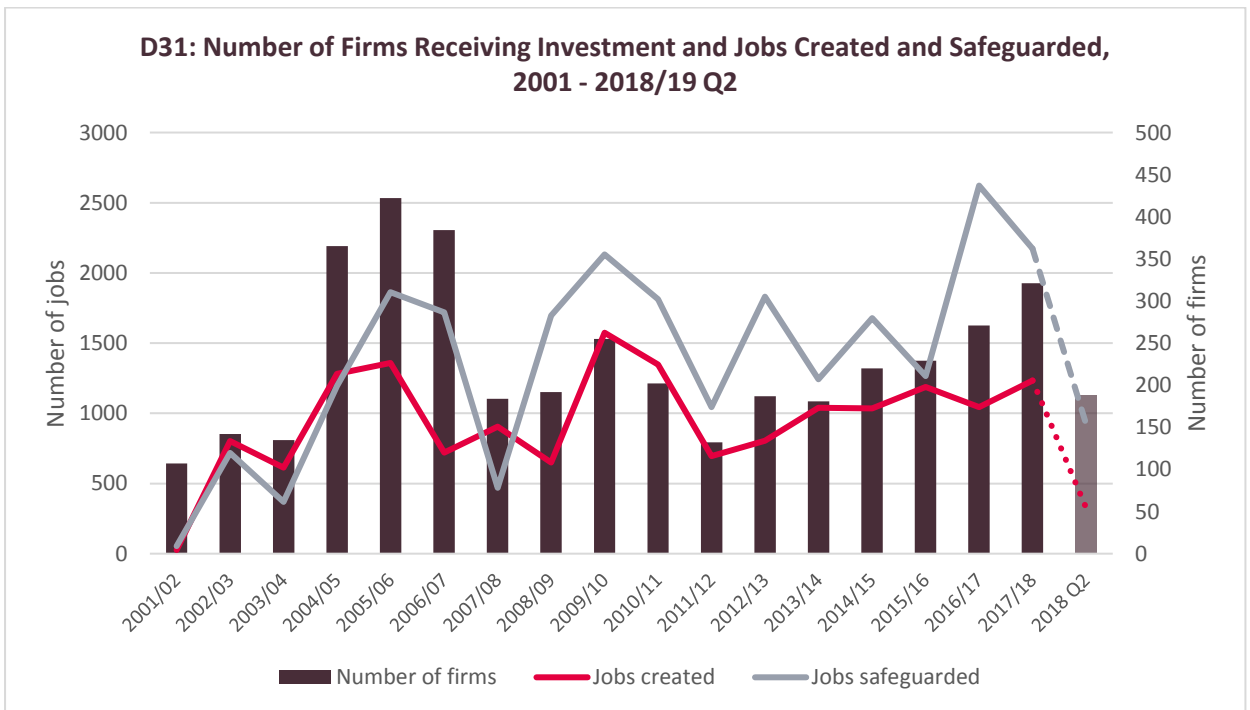
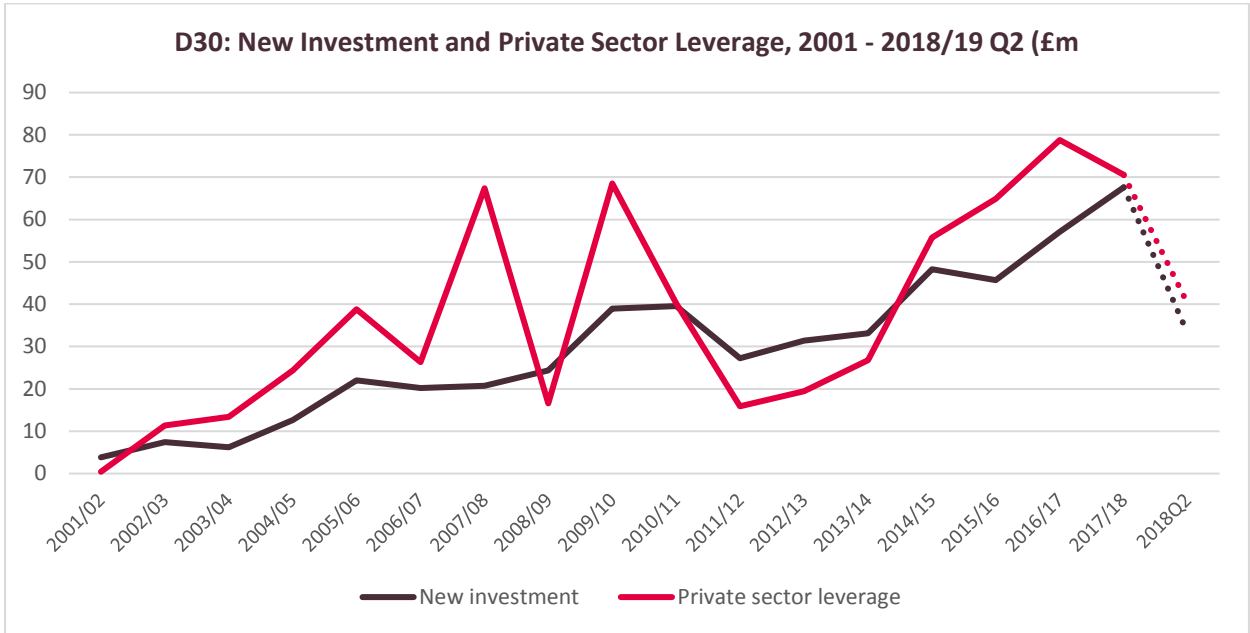














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