



# Mid-Term Evaluation of the Wales Business Fund: Executive Summary

A Final Report by Hatch, Belmana  
and Beaufort Research  
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# Development Bank of Wales

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# Executive Summary

- i. The report sets out the findings of the mid-term evaluation of the Development Bank of Wales' Wales Business Fund (WBF), an investment fund managed and delivered by the Development Bank. The WBF was launched in 2016 and is due to continue investing until late 2023. The evaluation has been undertaken by Hatch, with support from Beaufort Research and Belmana.
- ii. The WBF continues a long-term commitment within Welsh Government, with the support of the European Union, to using repayable financial instruments to address market failures in the provision of external business finance to SMEs in Wales. It builds on the success of the Wales JEREMIE Fund, which invested over the period 2009-15, providing finance to early stage and growth-oriented businesses across Wales and securing substantial economic benefits.
- iii. The WBF is split into four operations which are defined by the geographies of the two 2014-20 ERDF programmes in Wales (the East Wales and the West Wales and the Valleys programmes) and the thematic investment focuses of these programmes, which are as follows:
  - finance for business start-up and business expansion (Specific Objective 2.1 of Priority Axis 2: SME Competitiveness)
  - finance for innovative and R&D orientated early stage and growth orientated SMEs (Specific Objective 2.5 of Priority Axis 2: SME Competitiveness).
- iv. The WBF has undergone a series of adjustments to its size, funding sources, profile of funding, structure, and output targets since it launched in 2016. This has predominantly been driven by the increased availability of ERDF funding within the programmes, in addition to more recent changes in response to the emerging impacts of Covid-19. The Development Bank have worked closely with WEFO to make changes to the WBF, whilst continuing to address market failures and business needs.
- v. The MTE report primarily focuses on the performance of the WBF to the end of March 2020 therefore looking at performance against the £180.9m Fund size. However, following an Ex-Ante Assessment carried out in Autumn 2020, the WBF size was revised further in December 2020 to £204m (consisting of £140.5m allocated to WWV and £63.5m allocated to EW, and a split of 65% debt and 35% equity). Therefore, the report also includes updated analysis using data provided more recently, which reviews headline performance against revised business plan targets to the end of December 2020. A summary of the headline findings of the evaluation is provided below.

## Relevance and Consistency

- vi. **The WBF has been well designed to address market failures:** there is an evidenced long term and structural equity gap in the Welsh SME Finance market<sup>1</sup> and a reduced supply of debt finance. The need for public sector intervention and the financial instruments provided are underpinned by clear market failure rationale.
- vii. **Whilst original targets were on the whole realistic pre-pandemic, the situation has changed:** the contractual output indicators were designed based on market assessments, practical experience in delivering previous funds, and adjusted to reflect current market

<sup>1</sup> Regeneris Consulting for Finance Wales, Venture Capital and Loans Market Assessments for SMEs in Wales, 2014.

conditions. Prior to the pandemic, the evaluators would judge the majority of output targets to be appropriate and realistic. However, performance against the original business plan job targets (jobs created and safeguarded) has been lagging. This may be due to a number of factors including the original assumptions underpinning the targets being based on experiences with a fund operating in a different environment, as well as the lags in job creation with early-stage investment. More recently the targets have been revised in line with performance to date and expected changes to future outputs as a result of the Covid-19 pandemic.

- viii. **The WBF remains relevant and consistent, despite changing context:** the DBW has worked closely with WEFO to make changes to the WBF to ensure that it continues to address market failures and meet business needs, which has been an iterative process. This has involved commissioning market assessments and Ex-Ante assessments to identify where the market gaps are and reassess the rationale for the WBF design in light of changes in the market and economic and policy context. This proactive approach has ensured that the WBF remains relevant, in light of these changes.

### WBF Performance

- ix. **Continued strong investment performance:** The WBF has continued to make strong progress against the original and revised Business Plan delivery profile, investing a total of £141.4m (101% of the revised profile for Q4 2020) in 317 companies to the end of December 2020 (only 5% behind the revised profile for Q4 2020). Comparing to the revised lifetime project targets, the WBF has invested 56% of the overall £204m fund value to Q4 2020 and supported 63% of the revised lifetime target for number of SMEs supported (505 SMEs).
- x. **Performing well against revised targets:** The target output indicators for the WBF were adjusted in December 2020 in line with performance to date and expected changes to future outputs as a result of the consequences for the WBF of the Covid-19 pandemic. This included reducing employment and private-sector leverage targets, and the adoption of the voluntary jobs safeguarded target as a core indicator. The WBF is performing well against the key economic development targets, having achieved, or exceeded all revised targets to date other than the jobs safeguarded target (where performance is still on track with 97% of the target to date achieved).
- xi. **Driving equity investment in Wales:** despite lower than anticipated equity investment in WWV, the DBW has been successful overall in driving equity investment in Wales: BVCA Private Equity and Venture Capital Reports on investment activity indicate the level of expansion equity and early-stage equity investment has increased in Wales, particularly over the last three years. Government backed funding, such as the WBF, is an important driver of this. According to the British Business Bank, 60% of all announced equity deals in Wales in 2019 involved a Government fund, and this is backed up by consultation evidence which suggests DBW, with its higher market profile and local approach, has had much more success in penetrating the market and investing in SMEs compared to other UK wide equity schemes. This suggests that DBW funds such as the WBF have been successful in funding a gap in the market where private sector provision has not historically met the demands of SMEs, whilst also encouraging much higher co-investment from the private sector.
- xii. **The average value of equity investment has been higher than anticipated:** while this may be beneficial in meeting the finance needs of these businesses and providing marginally lower investment costs for DBW (per deal), the investment is arguably not spread as far compared to

the original plans in terms of driving economic development benefits amongst Welsh businesses.

- xiii. **Significantly exceeded original private sector leverage targets:** this was exceeded by approximately £110m, achieving £250.7m as of March 2020, reflecting the DBW's growing reputation and increasing confidence in the market which have contributed to an increased awareness among intermediaries and other investors and an increased willingness to co-invest. Given the strong performance against private sector leverage targets, the lifetime target was revised in December 2020 from £178.3m to £370.3m. The latest quarterly Fund report indicates that the WBF is on track against the revised target, achieving £270.7m private sector leverage as of the end of December 2020 (99% of the revised cumulative quarterly target).
- xiv. **Defaults and write-offs consistently below business plan profile:** however, it should be noted that from Q4 2019 to Q1 2020, default levels increased by £3.4m. This is largely due to a sector wide review following the onset of the COVID-19 pandemic, through which portfolio companies considered to be highly vulnerable to a negative impact of COVID-19 were applied with a 50% blanket provision. Operating costs have been in-line with projections.
- xv. **Rate of job creation has slowed since the first Covid-19 lockdown:** While the WBF is now on track against the revised business plan jobs targets, having achieved 100% of the new Q4 2020 jobs created target and 97% of the new Q4 2020 jobs safeguarded target, it is worth noting that the rate of creating and safeguarding jobs amongst businesses receiving finance has slowed since the first Covid-19 lockdown. This could provide early evidence of a negative impact of Covid-19 on the achievement of jobs amongst supported businesses and could have an impact on the overall economic development benefits delivered by the WBF. This will need to be monitored closely in the coming 12-24 months.
- xvi. **The portfolio continues to demonstrate a reasonably healthy performance to date, despite the emerging impacts of COVID-19:** The health measure of the WBF (calculated as the capital repaid to date, plus investments graded A, B and C, divided by the gross book value) has decreased from 77% in Q4 2019 to 65% in Q4 2020. However, beyond the initial drop in the health measure following the provisions put in place in March 2020, there has not been any large increase in default rates or any drastic deterioration of the portfolio to date. DBW consultees indicated that this is largely due to the COVID-19 measures put in place by the UK government and Welsh Government. The DBW also offered a three-month capital repayment holiday (which a large proportion of the portfolio took up) and a further extension was offered to businesses that needed it. It is worth bearing in mind that this will delay the return of capital for some businesses and any subsequent increase in default rates could result in lower legacy and economic development returns.

#### **Contributions to the Cross Cutting Themes**

- xvii. **Genuine awareness and commitment to embedding the cross-cutting themes (CCTs):** the DBW have demonstrated a strong commitment to embedding the CCTs at the fore end of the project design. Discussions between DBW and WEFO around the CCTs have been positive and proactive and the DBW regularly reports on progress towards the eight case level indicators in quarterly monitoring reports and annual CCT reports.
- xviii. **The referral mechanism and relationship with Business Wales has supported delivery of the CCTs:** Between the September 2016 and the end of March 2019 (the latest Annual CCTs report

provided), the WBF referred 280 businesses to Business Wales, the majority of which were at the enquiry stage. Through referring businesses when they first enquired about the WBF, businesses are able to access support around sustainability and diversity practice from Business Wales at a stage when it is easier for the businesses to build this into their investment plans.

- xix. **Continued focus required on positive action measures to promote the WBF to disabled people:** Both Business Wales and the DBW agreed to donate £5,000 each to Disability Wales to look for opportunities to fund support for business owners with disabilities, and Disability Wales are looking for additional funding to develop a wider programme. In the latest CCT report provided, the DBW recognised that it must take more positive action measures to promote the WBF to disabled people as the numbers accessing the WBF are low (which suggests that there are some barriers for engagement with this protected characteristic).

### **Delivery and Management Performance**

- xx. **Positive feedback on management, governance and delivery of WBF:** Feedback across both internal and external consultees about the management, governance and delivery of the WBF was very positive. It was noted by external consultees that the DBW have attracted highly skilled staff, many of whom come from a banking and equity investment background or have prior experience in managing regional funds which has been helpful for delivery.
- xxi. **Effective portfolio management structures and risk pricing strategies:** there are clear structures in place to manage portfolios, identify and mitigate risks of underperformance early. The pricing strategy in place is cognisant of not displacing the private sector, therefore charges are higher than the private sector and the DBW regularly goes out to the market to get an understanding of the interest rates others are charging and reflects the level of risk associated with the investment propositions. The pricing strategy is therefore considered to be effective in avoiding the distortion of the market and appropriate given the level of risk, whilst securing a reasonable financial return for the purpose of the WBF and its class of investment.
- xxii. **Rigorous reporting and auditing requirements:** DBW consultees indicated that the increased level of regulation and audit required for the WBF relative to other DBW funds (due to EU funding requirements) has brought a level of rigour to the organisation which has been helpful, and the DBW has benefited from this across its other funds. However, it was also highlighted that this scrutiny can delay the release of cash, where the WBF is close to its available headroom, which can limit the availability of cash to continue to invest at times. Financial and KPI claims are completed on a quarterly basis, and a management verification team undertakes an audit of a sample, which can take some time ahead of releasing the next tranche of funding. It was noted by DBW consultees that it would be appropriate to reduce the sample taken for audit further over time if no issues are observed, as the audit can be quite demanding and time consuming. DBW consultees also cited challenges in collection of the 'impact of investment' data from businesses. The DBW has recently simplified this form, which it is hoped will help to improve return rates.
- xxiii. **Efforts to provide a service across all of Wales:** there have been significant efforts invested in providing a service across all of Wales, for example through opening a head office in Wrexham, opening regional offices and hiring regional Business Development staff. The launch of the WBF, as well as the DBW, marked an important step change in terms of going beyond previous funds in addressing SME gaps and market failures. The shift from Finance Wales to DBW is seen as being really positive among consultees. Marketing has focused on promoting SME access to

finance, rather than specific funds and this has helped to improve awareness than the DBW is there to provide finance at scale to meet the needs of businesses in Wales.

- xxiv. **Feedback on marketing and business development generally positive:** the launch of DBW was noted as being successful in building strong market awareness among financial intermediaries and business representative organisations which has facilitated deal flow. Consultees reported good visibility of DBW in the market. The most popular response for how businesses had heard of the WBF was directly via DBW. However, there are ongoing challenges faced with marketing around equity (particularly in WWV) and several SMEs that responded to the beneficiary telephone survey noted that the marketing of the available finance and local business development is an area that could be improved (the majority of those that commented on this were businesses located in WWV).
- xxv. **SMEs were generally satisfied with the quality of WBF service:** on the whole, SMEs surveyed as part of the evaluation reported being happy with the quality of WBF service. Aspects of the service which survey respondents thought could be improved were the speed and efficiency of administration and the cost of the finance and hence value for money. The relatively high cost of finance reflects the WBF pricing strategy focused on avoiding crowding out of the private sector and the higher risk involved. The DBW is undertaking a digital transformation project, which it is hoped will improve the speed and efficiency of administration for the WBF.

### Outcomes and Impacts

- xxvi. **The WBF has helped to address market failures:** that is, through filling a gap in the market where the risk of failure is perceived to be too high and returns too low for private sector investment. Consultations with DBW and financial intermediaries suggest that high street banks are using the WBF more intelligently, co-investing alongside the WBF in order to fill a gap where full commercial lending is not viable (due to the costs or risks involved).
- xxvii. **Beneficiary survey evidence suggests that the WBF has improved access to finance for SMEs in Wales:** before securing WBF investment most businesses surveyed had been actively seeking finance for at least 4 months (53%). The most common range of time to have been seeking finance was 6 to 12 months. Consultations with DBW suggest strong processes are in place to avoid displacing or crowding out high street banks, other lenders and venture capitalists.
- xxviii. **Significant growth achieved:** Analysis of the beneficiary survey, scaled up to full population of businesses in receipt of WBF investment up to March 2020, suggests the WBF has achieved a gross uplift in GVA of £382m and 3,200 jobs to date (not including any estimates of future economic benefit this investment will provide i.e. the persistence effects). Accounting for survey-based estimates of deadweight and displacement, the adjusted GVA impact is currently £187m per annum and 900 jobs.
- xxix. The counterfactual impact analysis also indicated that WBF investees experienced strong employment growth post-investment. Employment in the 204 supported businesses that could be matched to comparable non-supported businesses through the analysis summed to a **gross impact of 1,700 jobs**. Businesses that received investment from the WBF also experienced **stronger turnover growth than their comparators**.
- xxx. The CIE analysis indicated that **82% of this employment growth was additional**, in that it was not experienced in the comparable businesses over the period. This equates to a total of **1,400 additional jobs, an average of approximately 7 additional jobs per enterprise**.



- xxxi. The counterfactual impact analysis points to less employment creation than was identified in the survey, which suggests that there may be some optimism bias amongst the businesses that were surveyed regarding job creation experienced as a result of the investment received from the WBF, or that there may exist some sample bias whereby the survey sample is not entirely representative of the full population of supported SMEs. It is also worth noting that the CIE has not been grossed up in the same way as the survey analysis, covers a slightly different sample of beneficiaries and analyses over a slightly different period therefore the findings are not entirely comparable.
- xxxii. As the CIE gets revisited as part of the final evaluation, it will be possible to capture a larger proportion of the true impacts for beneficiaries supported through capturing a further cohort of businesses, and additional years of post-support data for businesses that have received WBF investment in earlier years. Therefore, it is likely that this position will improve as further GVA impact is realised and captured in the CIE analysis for the final evaluation.

### **Cost Effectiveness and Value for Money**

- xxxiii. **The WBF is delivering good value for money on the basis of net public sector costs:** accounting for predicted future return on investment to the WBF (that is, allowing for the anticipated legacy and repayment of the Financial Transaction Reserve), the survey evidence indicates that the net public sector cost per gross job created is £11,300 at this point in the life of the WBF. Accounting for deadweight and displacement, this increases to £40,700.
- xxxiv. If the counterfactual impact estimates of job creation are used rather than the survey, the net public sector cost per gross job created is £21,700. Adjusting the CIE estimates to account for the same displacement and deadweight adjustments as reported by businesses that responded to the survey, indicates that the net public sector cost per net additional job created at this point in the life of the WBF is £78,000.
- xxxv. It is clear that the both the estimated returns on investment of **£5.22 (based on the survey evidence) and £2.72 (based on the CIE evidence) of net additional GVA for every £1 of net public sector investment can be judged as good value for money.**
- xxxvi. In considering this analysis it should be borne in mind that the survey and CIE approaches do not capture exactly the same economic impacts and hence provide different measures of impact and VFM. In particular, the CIE estimates cover a shorter post-support time period to the survey estimates and hence is a lagging measure of impact. It also excludes early-stage businesses whose business performance will not yet be picked up in the ONS's business datasets. Over time, the CIE analysis will capture a higher proportion of the business impacts of the WBF, and this will be analysed in the final evaluation.
- xxxvii. Also, it should be noted that the estimates do not include any allowance for the future economic benefits which these businesses may generate if they continue to grow, nor does it yet account for the potential impacts of the pandemic on the performance of these businesses.
- xxxviii. The VFM estimates also include an allowance for the expected legacy return to the fund (which in effect reduces the costs of the delivering the fund to the public sector), which is subject to significant uncertainty at this stage.



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