

Economy, Trade and Rural Affairs Committee: Development Bank of Wales inquiry

Summary

Since 2017 the Development Bank of Wales has matured and proven itself a stable and credible organisation which continues to show progress against strategic objectives within the policy and resource framework determined by Welsh Ministers.

By effectively deploying financial instruments the bank continues to demonstrate a clear contribution to economic development and wider Government priorities.

Over a period of unprecedented economic upheaval and uncertainty, examples such as the Covid-19 Wales Business Loan Scheme, the Green Business Loan Scheme and Help to Stay evidence the bank's capacity to effectively engage with complex policy challenges and deliver robust solutions into the market at pace.

Economic recovery and future growth

Government supported financial instruments, such as those deployed by the Development Bank of Wales and similar institutions in other nations, have an established role helping businesses access the finance they need to start up, develop and grow. Credibility and stability are keys to success in the marketplace, and since 2017 the Development Bank of Wales has embedded its position as a respected player within the finance ecosystem in Wales and beyond.

Engaging in the supply of business and property related finance, especially patient capital and equity investments, is a long-term commitment. Strategic investment decisions over recent years mean the bank is now capitalised and positioned to sustain core business lending and investment activities through to 2031, with options to continue recycling finance on an 'evergreen' basis thereafter.

The role of 'gap' finance is especially important during times of economic uncertainty and the Development Bank's level of investment has grown over the period. Indeed, with mainstream lenders taking a more risk-averse approach in the market¹, the bank is seeing an increase in new business enquiries from companies across a broader range of credit risk ratings and is playing a key role in sustaining the availability of finance to a number of essential sectors such as care in Wales.

Performance

In the view of the Welsh Government the bank has performed well against its key performance measures.

The Development Bank has worked closely with the Welsh Government to create a suite of products addressing market needs. The bank continues to identify opportunities for delivery where it can bring value and solutions to policy and delivery ambitions.

The bank is structured as a nationwide organisation, successfully supporting businesses across all parts of Wales. Across the four regions investment activity is

¹ [Small Business Finance Markets 2023/24 \(british-business-bank.co.uk\)](https://www.british-business-bank.co.uk) (Pg 16) *In 2023 Bank lending fell to £59.2bn, down 9% in nominal terms*

proportionate to the business population – with no evident bias toward any one region².

Between 2017 and March 2023, the Development Bank has had a total impact of £1.5bn on the Welsh economy. This includes £694m direct investment into over 3,600 Welsh businesses, supporting companies to create and safeguard 39,000 jobs.

An important aspect of the bank's approach involves working with co-investors to maximise the flow of private capital in Wales and minimise displacement. The bank secured £510m of direct private sector co-investment between 2017 and March 2023.

The bank's reach has also broadened to support policy priorities, such as residential and commercial property, investing £207m in property development projects, building over 1,600 new homes and developing 290,400 sq ft of commercial space.

The bank remains committed to the impact targets outlined in the Corporate Plan 2022-27³, these are to support over 2,200 businesses, support 20,000+ jobs, fund 1,900 new house builds and advance their decarbonisation offering.

Micro lending

Supporting the micro lending market continues to be a key objective of the Development Bank. The bank has directly supported micro lending since 2012 through two dedicated Micro Loan Funds. 2022-23 saw the bank investing £14.32m in start-ups and early stage companies, as well as supporting 320 different businesses with micro loans.

Patient capital

Patient capital is defined as lending over six or more years and provides a means through which businesses can reduce the monthly cost of servicing debts. Responding to the evolving needs of businesses, in 2021 the Welsh Government varied the terms of the Wales Flexible Investment Fund, enabling the bank to offer lending terms up to 15 years (up from 10 years). The market has responded positively to the availability of patient capital through the Development Bank. Since the start of this Senedd term the bank has extended the quantum of patient capital from £30m to over £46m per annum.

Private Sector Leverage (PSL)

We are aware that the bank's performance against PSL targets fluctuates. The Welsh Government does not consider this to be a reflection of any systemic under-performance on the part of the bank, but rather a reflection of market conditions. The Welsh Government has asked the bank to consider how it fully evaluates the impact of investment activity and the role of Economic Intelligence Wales in supporting this. We are mindful that driving the bank to increase PSL in the current market may work against broader economic development objectives.

Equity

² [Annual Report and Financial Statement 2022-23.pdf \(developmentbank.wales\)](#)

³ [Development Bank of Wales Corporate plan 2022/27](#)

The Development Bank has a central role to support the increased use of equity stakes in business support. Equity investment is inherently higher risk, with companies seeking such investment often being pre-revenue. Technology and medical related sectors represent key markets, with businesses often seeking several rounds of investment as products pass through market testing and regulatory approvals before the prospect of a return emerges. The development bank continues to be the biggest equity investor in Welsh businesses completing 350 deals across the high-growth ecosystem between 2013-2022⁴.

Since the start of this Senedd term in 2021, the bank has increased the use of equity stakes in business support from £14m (baseline FY 2021-22) to a rolling 3-year average of £15.5m. Reflecting market conditions, 2023-24 has seen deals taking longer to complete.

Even though equity deals are more high risk and complex in their nature there is evidence that this type of investment can yield strong economic development returns⁵.

Support for worker buyouts

The bank is also delivering in their supporting role on the Programme for Government commitment to provide greater support for worker buyouts and seek to double the number of employee-owned businesses. Between 2017-18 - 2022-23, the bank has funded 4 employee buyouts (EBO) and provided growth funding to 8 businesses after their EBO was completed. It should also be noted that since launch, in addition to funding these EBOs, the bank has also funded over 250 other succession investments worth c. £95m. These transactions demonstrate how effectively the bank contributes to the broad agenda of keeping businesses in Welsh ownership.

Increasing the flow of funds into Wales

The Development Bank has been successful in increasing the flow of funds into Wales.

The bank's delivery of EU Structural Funding via the Wales Business Fund helped maximise Wales' overall drawdown of this funding. Originally scaled at £136m, the fund ultimately delivered £216m of investment, creating a lasting legacy in Wales by the time the fund ceased investing in December 2023. 474 businesses were supported and over 8,800 jobs created and safeguarded. The finance deployed through the Wales Business Fund leveraged an additional £332m of private investment – multiplying the impact of funding and driving the value proposition. Evaluation⁶ has shown turnover growth 60% higher in companies that received Development Bank finance compared to those who had not.

⁴ [Beauhurst-Equity-Investment-in-Wales-2023.pdf](#) (pg 14)

⁵ [Beauhurst-Equity-Investment-in-Wales-2023.pdf](#) (pg 7)

⁶ Final Evaluation of the Wales Business Fund – Executive Summary [Regeneris Report \(developmentbank.wales\)](#)

In 2023 the British Business Bank launched the £130m Investment Fund for Wales. FW Capital, the FCA regulated subsidiary of the Development Bank, won the larger £30m debt contract, one of three fund management contracts in Wales.

British Business Bank and Development Bank of Wales funds have been operating alongside each other for some time and we do not expect these additional funds to displace Development Bank funding already in place in Wales.

Net Zero

The remit letter makes clear the expectation that the bank will be an active partner in developing the low carbon economy in Wales, directing the bank to not only stimulate and respond to market demands. We also wish to see the bank working with portfolio businesses to support their environmental actions.

The Development Bank has been active in its response to the decarbonisation challenge. The Green Homes Incentive, which launched in 2022, is supporting low carbon property developments. The Green Business Loan Scheme, launched in 2023, is financing business energy efficiency projects. The Green Business Loan Scheme has supported Welsh businesses to secure £4.5m for dedicated decarbonisation projects. A pilot in the initial phase, the scheme has helped establish the nature of demand in this new and evolving market segment. Consideration is now being given to how the scheme is mainstreamed.

The Development Bank is extending its role through active engagement with Welsh Government and other stakeholders to identify further opportunities and plans that will build the resource, capacity and impact of the bank's finance and service delivery on decarbonisation.

Commerciality and Risk

The Development Bank is required to operate on a commercial basis with the Board of the bank being accountable for the management of risk within the Group. The bank lends or invests where mainstream lenders are unwilling to offer terms, in full or in part. The finance available through the bank is therefore normally more expensive than might otherwise be secured from the mainstream market – reflecting that higher risk⁷. When making decisions the bank undertakes an assessment relative to the funding proposal to reach a view on the underlying strength, health and value of a businesses.

Across the portfolio of funds under management, different funds carry different risk thresholds – reflected in the finance award letters (contracts) in place between Welsh Government and the bank. Some funds require the bank to target repayment of 100% of the capital provided to it by Welsh Government. Other funds, which are inherently higher risk, reflect this by targeting returns significantly below 100%. Historically, much of the capital deployed by the bank has been Financial Transactions Capital (FT capital). This type of capital is allocated to the Welsh Government by HMT with certain conditions – including that it is deployed into the private sector on repayable terms through financial instruments. The bank has

⁷ Interest rates are benchmarked by an independent third party.

provided a successful vehicle through which FT capital can be utilised at scale in Wales.

HMT ultimately requires the Welsh Government to repay 80% of this capital. Therefore, this FT capital creates opportunities for the bank to accommodate risk in support of economic development objectives. Mainstream banks may tolerate loss rates of 1-1.5% on their lending portfolios. Development Bank loss rates carry up to and beyond 20% in some cases – reflecting the level of risk which the Welsh Government agrees with the bank on specific funds. Across the entire portfolio of funds under management, after operating fees are deducted, the bank is on track to return just over 90% of the FT capital provided to it by Welsh Government. The repayment figure, after fees, for those funds targeting business lending and investment (as opposed to property or housing related funds and services) is 80%.

The Welsh Government is therefore satisfied that the bank is deploying FT capital in a way which supports higher risk investments, doing so in a manner which prudently manages risk in the broader financial context in which it operates. The bank has used the opportunity presented by FT capital to operate financial instruments targeting the gap in the market where, without this support, quality deals and projects may go unsupported for lack of risk appetite in the wider lending and investment market.

Since the bank does not receive ‘grant in aid’ it utilises returns from the interest charged on loans (or returns from equity exits) to cover fund management fees and thereby meet organisational costs. In this way, when the Welsh Government provides capital to support a fund operated by the bank, 100% of that funding is deployed into businesses.

Value, efficiency, and customer service

As an organisation, the bank has grown since 2017, increasing the team to 269.67 FTE’s⁸. This growth is supported by advances in productivity, for example, through the bank’s programme of digital transformation designed to modernise customer interface to deliver efficiency and effectiveness gains.

It is now the case that algorithm based decision-making excludes many businesses from being able to talk to their bank about their finance needs. The bank is a regional impact investor with customer focus at its core. This point of differentiation has earned the bank a reputation among customers and wider network of business support partners as a credible, trusted and valued source of business funding support. The bank remains committed to a relational delivery model where customers can engage directly with individuals on a face-to-face basis as required.

The relational model is therefore an increasingly unique feature of the bank. The bank’s internal tracking measure on customer service is their Net Promoter Score, which allows the bank to benchmark against the industry. It is pleasing to note the current Net Promoter Score rates the bank as “excellent”.

The Development Bank has a role in business support more widely and there are clear benefits to effective working between Business Wales and the Development Bank. The Green Business Loan Scheme is an example of where an integrated approach has allowed businesses to access advice and support through Business

⁸ This figure includes FW Capital staffing delivering outside of Wales

Wales and where necessary grant funding for additional bespoke advice via innovation programmes as part of an integrated package designed around identified customer journeys.

Business Wales is there to provide impartial advice to SMEs. Development Bank of Wales services and funds are clearly signposted, as is information on opportunities from the wider market.

Concluding remarks

The actions and performance of the Development Bank of Wales demonstrate that repayable finance can successfully play a key role in supporting economic development and wider government priorities. Financial instruments are also offering a strong value proposition to Government, with private sector leverage amplifying the impact and returns available for reinvestment or redeployment.

The Welsh Government is confident in the Board of the Bank as it guides and challenges the organisation to deliver for Wales across an increasingly broad portfolio of business, property, housing and infrastructure projects and programmes.

All organisations develop and learn as they grow, and the Development Bank of Wales has matured and evolved its practices over time. In a fast changing world, the bank must continue to show agility and flexibility as it works with Government to deliver for Wales.