

Evidence Paper in advance of the Public Accounts Committee Scrutiny Session – 24.06.2019

Auditor General for Wales Report on ‘The Welsh Government’s Financial Support for Business’

The purpose of this paper is to provide Written Evidence to the Public Accounts Committee on the Auditor General for Wales’s Report on ‘The Welsh Government’s Financial Support for Business’ published in November 2018.

Section 1: The administrative arrangements and systems that the Welsh Government has in place to manage and monitor its financial support to business.

Section 2: How the Welsh Government is putting arrangements in place to manage its financial support to business under its Economic Action Plan.

Section 3: The new Ministerial Advisory Board.

Section 4: The overall coherence of the different ways of providing financial support to business, including how transparent access to financial support is, as well as how and why the Welsh Government decides which mechanism it uses to provide that support.

Section 5: Update on recommendations from PAC reports – Kancoat, Circuit of Wales and Pinewood.

Our role in providing financial support for business is to assist Ministers in successfully delivering commitments outlined within key policy objectives set out in Prosperity for All, Economic Action Plan and the Wellbeing of Future Generations Act, aimed at improving the lives of people in Wales.

Against a background of reducing budgets, it is important that the objective of our funding is set against the framework principles that we operate within, which include:

- Funder of last resort, by supporting access to private and public debt based investment
- State Aid regulations
- Value for money assessment
- Treasury Green Book guidance.

Section 1: The administrative arrangements and systems that the Welsh Government has in place to manage and monitor its financial support to business

A key part of the administrative arrangement and systems that are used to manage the department’s financial support to business is to the appraisal and due diligence process, and the use of our Business Account system (BAS). Throughout the life of the

project, BAS will be updated to show the project progress and ensure that regular customer contact is maintained.

As a pre-qualification requirement for funding, business must demonstrate commitment to the four pillars of the Economic Contract. The associated documentation must be approved by Welsh Government officials.

Subject to budget availability, business will be invited to apply for the most appropriate scheme within the Economy Futures Fund, aligned to the EAP Calls to Action.

Upon receipt of the fully completed application form, the Relationship Manager within the Business and Regions Team of the Economy and Transport Department, will complete the appraisal of the project, including undertaking financial due diligence. Depending on the nature of the project financial due diligence will either be undertaken by the Relationship Manager or one of the Investigating Accounts Team, that supports the Business and Regions Team. In addition, the Investment Advisory Team will undertake quality assurance as the project is appraised.

The appraisal will include such considerations as fit with policy value for money, need for funding, State Aid and, risk assessment. Once the appraisal is completed the Relationship Manager will make a recommendation to support or reject the application, which must be supported by the Chief Regional Officer/Deputy Director within the department.

Due Diligence undertaken for projects, is in line with the level of investment being considered. We continue to learn from experience and develop our due diligence processes.

As part of the financial approval process, the case will be submitted for final recommendation to the Welsh Government Internal Investment Panel or the external Welsh Industrial Development Advisory Board (WIDAB)*, depending on the level of support being recommended. *see section 3.

Research & Development (R&D) grants paid under the EU Funded SMART Cymru project, under-go a separate internal project validation process following WEFO guidelines that recognise specific requirements of R&D projects.

The case will be submitted via Ministerial Advice to the Minister and will include an outline of the project, risks identified and the recommendation of the Investment Panel or WIDAB. The Minister makes the decision to support or reject the recommendation.

An award letter or letter of rejection is then issued. The award letter will include the Welsh Government's standard terms and conditions, and any project specific conditions that are relevant to the individual award. Any rejection letter will include reasons why the Welsh Government is unable to support.

Once the business has accepted the award letter, the case is assigned to a Monitoring Officer within the Business and Regions Monitoring Team who will assess and monitor the project in line with the accepted award letter. Following satisfactory assessment of

all evidence by the Monitoring Officer, the case will be passed to a senior official to make the final certification before passing to the Finance Team for payment.

Payment of instalments will be made upon receipt of a fully completed claim form, plus other supporting evidence required as detailed in the award letter. As appropriate, monitoring visits are undertaken during the life of the project.

The payment to the claimant is then organised via the Welsh Government's finance system 'SAP' (SAP Pay-grants process) by the Finance Team.

Once the payment phase of the project is completed, and if appropriate, the case is passed to the Post Completion Monitoring Team, within the Economy and Transport Department. In most cases, there is a requirement for the business to retain assets within the area for a defined period (3 or 5 years). At the expiration of this period, the monitoring team will request information from the business to ensure this requirement has been met.

Upon completion of the post completion period, the project is closed and the business released from the conditions of the award.

We have a continuous improvement approach to the way that we administer our financial support, which reflects our learning from a number of areas including Internal Audit and Wales Audit Office reports. These reviews have led to more detailed guidance being produced for case officers and managers, clearer advice on risk assessment and the introduction of the pause and reflect approach to the management of projects.

Management Monitoring of Financial Support

In addition to the project data held on BAS, the Welsh Government maintains financial and performance data for each project that is in receipt of funding within Management Accounts.

The financial data includes the details of the annual budget, total value of the project grant offer, actual 'in year' and previous years spend on the project, together with the forecast spend for the remainder of the project's grant offer commitment, broken down by year. The actual spend is reconciled to the ledgers in the Welsh Government finance system "SAP".

The spend forecast is reviewed monthly in conjunction with the budget holders, to ensure effective budget monitoring takes place.

These records in the Management Accounts are updated on a timely basis and provide the detailed information necessary to prepare monthly management accounts.

Section 2: How the Welsh Government is putting arrangements in place to manage its financial support to business under its Economic Action Plan

New Operating Model

In our Economic Action Plan, we set ourselves a clear policy objective – to raise levels of wealth and well-being across Wales, whilst reducing inequalities in both. The Welsh Government has a range of policy levers at its disposal to help achieve that objective. This is why the Plan is so broad in its scope.

However, we recognise that our ability to provide financial support to business is amongst our most critical and influential levers in driving change. Through managing our financial support judiciously, we are able to influence the behaviours of firms who receive it, recognising of course that our financial support to business will only directly touch a proportion of Wales's business base.

At the heart of our Economic Action Plan is a new policy approach to delivering and managing our direct financial, predominantly grant, support to business (see section 4 on Development Bank of Wales, DBW). This new approach is what we refer to as our new operating model, comprised of the Economic Contract, the Calls to Action and the Economy Futures Fund.

Each part of the model has a specific policy driver that collectively helps support our overarching wealth and well-being policy objective. For example, the Economic Contract is underpinned by the objective of inclusive growth, requiring businesses seeking our support to act responsibly.

We expect businesses to commit to growth, fair work, reducing carbon footprints, health, skills, and learning in the workplace. These are the behaviours already exhibited in successful and responsible businesses. The Economic Contract allows us to recognise where good practice exists and through engagement enables us to encourage others to take a similar path.

Where the Economic Contract focusses on the values and ethos of a business, the policy driver for the Calls to Action reflects the importance of business investment in activities that drive productivity and future proof the economy. The Calls to Action are clear in providing the lens through which we will support responsible businesses with their investment activity, focussing on some of the key strategic challenges business and the economy faces.

The policy driver for the Economy Futures Fund reflects the need for simplification of our financial support. There is no doubt that businesses value the financial support we provide and it plays a big role in helping some businesses to fulfil their aspirations to sustain and grow. However, we know that in the past the range of schemes, programmes and funds that we offer can be confusing and complex to businesses.

Without losing the need for funding to hit multiple objectives, we have responded to those concerns and as part of the model, we have taken the step of consolidate a number of current schemes within a new Economy Futures Fund so that the direct financial support we offer to business is clear, easily understood, and responsive.

Economic Contract

The Economic Contract is the framework for a new relationship with business. Through it we require businesses to demonstrate their commitment to growth, fair work, employee health (including mental health) and skills and reducing carbon footprint.

The Economic Contract is effectively a pre-qualification stage to funding and satisfying it does not automatically lead to a business accessing finance.

The Economic Contract operates through engagement, incentive and good practice rather than legal force. It is part of a reciprocal and “something for something” approach aimed at delivering public investment with a social purpose.

To date over 200 Economic Contracts have been discussed and agreed with business since launch in May 2018.

We will use the learning from the Economic Contract to implement the principles of the contract across our wider support arms such as Business Wales and DBW.

Calls to Action

Businesses seeking financial support from the Welsh Government via the Economy Futures Fund will be expected to contribute to at least one of the five Calls to Action which are designed to overcome the challenges of the future.

The five Calls to Action are

- Decarbonisation
- Innovation, Entrepreneurship and Headquarters
- Exports and Trade
- High quality employment , skills development and fair work
- R&D Automation and digitalisation

All new funding proposals that come forward for direct financial support will be subject to the new prism provided by the Calls to action.

The approach to each funding request will be proportionate to the size, location, type of business, the place it operates in and the prevailing macro and micro economic factors to ensure it is inclusive of the wide breadth of businesses operating in Wales.

Economy Futures Fund

The Economy Futures Fund is the simplification and rationalisation of a number of existing schemes, and has been achieved by linking the application, appraisal and monitoring process with the Calls to action criteria. The fund has been designed to be flexible enough to ensure future priority schemes can be delivered using this mechanism.

Currently the following schemes form part of the Economy Futures Fund

- Capital Investment and aid for job creation
- Research Development and Innovation

- Environmental Protection scheme
- Tourism Investment support scheme
- Creative Production Funding
- Repayable Fund for SMEs.

The consolidation of these schemes has enabled Welsh Government to create a single application form that captures the same business information across all of the schemes.

Each of the schemes that sit within the Economy Futures has its own guidance; this provides information on a number of key areas including eligibility criteria, State Aid legal routes, value for money assessment and assessment of risk. This will ensure we can recognise the different challenges of for example an R&D investment in an early stage business versus an expansion project in a mature business.

The appraisal of projects is undertaken using standardised templates to ensure consistency of approach.

To date, 96 projects have been approved under the Economy Futures Fund with a value of £44m. For each approval the Call to Action has been identified as part of the appraisal and monitoring process.

Section 3: The new Ministerial Advisory Board

The Ministerial Advisory Board (the Board) is an advisory body reporting to the Minister for Economy and Transport and has been established by the Welsh Government to deliver the Economic Action Plan commitment for an overarching Ministerial Advisory Board.

The main purpose of the Board is to provide good quality, timely and relevant external advice and challenge. This is used to inform the Welsh Government's policy-making, horizon-scanning and evaluation. In doing so, the Board will help improve the Welsh Government's understanding of the economic and business landscape, and the policy responses required to address current challenges and respond to future opportunities.

In offering an outlook and perspective based upon individual knowledge and expertise, the Board complements and adds value to existing sources of advice provided by the civil service, social partners and interest and representative bodies outside of the Welsh Government.

Sir Adrian Webb is Chair of the Ministerial Advisory Board. The Board was appointed by the Minister last summer on an interim basis, with a public appointments exercise to follow. A public appointments exercise was duly undertaken at the turn of the year but this was unsuccessful - an insufficient number of candidates were deemed appointable and, of those that were appointable, there was insufficient diversity and gender balance.

The public appointments exercise will be revisited. Whilst operating in such a volatile and uncertain environment due to Brexit and other matters, there are strong arguments for maintaining continuity in our current advisory arrangements. A hybrid process is likely to be followed, with an offer of re-appointment to current Board members who

wish to continue, and then run a public appointments exercise for the remaining places. This is likely to happen over the summer/early autumn.

The Ministerial Advisory Board is a separate function to the role of the Investment Panel and the Welsh Industrial Development Advisory Board (WIDAB) as outlined in Section 1 of this paper and plays no roles in the assessment of individual projects. The relevant Welsh Ministers legal powers for awarding funding are Section 7 of the Industrial Development Act 1982, Section 1 of the Welsh Development Agency Act 1975, Section 58a or Sections 70, 71(1) of the Government of Wales Act 2006.

Section 4: The overall coherence of the different ways of providing financial support to business, including how transparent access to financial support is, as well as how and why the Welsh Government decides which mechanism it uses to provide that support

Introduction

The mechanisms developed by Welsh Government to help provide a holistic response to the funding requirements of businesses will consider in the first instance what the commercial offering is; this is the default position as it is not government's role to duplicate or compete with the private sector. Where market failure beyond the private sector offering is identified Welsh Government solutions will in the first instance look to develop repayable, commercial financial products as provided through the Development Bank of Wales and thirdly, as a final solution, grant based products.

At the macro level much has been done in recent years to allow challenger banks to develop. One of the consequences in the expansion of financial offering however is greater complexity and confusion for business owners in understanding and navigating the financial landscape. The problem has shifted in recent years from being a supply-side issue to one of demand-side; identifying good quality business propositions and matching them with the most appropriate financial support package.

Risk appetite impacts on Welsh Government investment decisions, and the starting premise for Welsh Government is that a grant is a funder of last resort. By exhausting repayable finance first and then grant, value for money is maximised.

Business Wales

Business Wales is the Welsh Government's bilingual business support service, launched in January 2013 and refreshed in January 2016, to make it easier for Welsh micro-businesses and SMEs including social enterprises, and aspiring entrepreneurs of all ages to access the information, advice and support they require to start and grow their businesses.

Many of these entrepreneurs and businesses seek impartial advice on access to finance to help them realise their plans. Business Wales also leads access to a number

of cross Government initiatives such as the Skills Gateway and direct links with Careers Wales and the food sector team.

Access to finance is one of the top tasks identified on the Business Wales website. It provides information on a wide range of finance options and how to apply for them including (commercial loans and debt products, equity finance, leasing, overdrafts, factoring, crowd-funding and grants etc.).

The website includes a finance locator tool which helps users to navigate and identify potential funding streams from commercial lenders, the Start-Up Loan Company (part of the British Business Bank), the Development Bank of Wales, (including Angels Invest Wales), and venture capitalists amongst others. Customers are also able to seek further advice and support via the Business Wales helpline (telephone, e-mail and live chat). Depending on the nature of their enquiry and their finance requirement, entrepreneurs and businesses may then be offered further face to face support in the form of a workshop or a one-to-one session with a Business Wales advisor or specialist advisor.

Business Wales' advisors typically work through a diagnostic process with customers to help clarify their objectives, develop their business plans and work out how much and what kind of finance they need. Advisors will then work with the customer to identify a range of potential finance products/solutions. This is done in a completely impartial way, wherever possible providing customers with a choice and enabling them to make informed decisions.

As well as being impartial, Business Wales advisors are also required to give responsible advice. This means that they will also advise the client on fundamental doubts as to the viability of a business or start-up idea to ensure that any finance applications are made with the benefit of third party advice.

Advisors will also help customers by introducing them to contacts (e.g. in commercial banks, the Development Bank of Wales and others) and will help guide them through the process of making an application.

For companies looking to grow rapidly and at scale, more intensive support can be offered through the Business Wales Accelerated Growth programme. This can include more in-depth, specialist investment readiness support to maximise chances of securing funding, sometimes from multiple investors or syndicates. Business Wales' advisors provide customers with impartial advice on repayable forms of finance as the default, reverting to grant options in cases where this may be needed as a measure of last resort or to complement/leverage other investment.

At each stage consideration is given to which scheme best fits, and if this is a grant it would include State Aid and the minimum necessary. The funding package is supported by a consistent enquiry management process through the website and helpline; and is further underpinned through alignment between Welsh Government departments and the digital information provision through Business Wales, such as the Finance Locator.

UK Government funded Start-Up Loans have been available in Wales since October 2013. The loans are available up to £25k, and are an integral part of Business Wales

and up to October 2018 over £22.9m has been invested in 2,609 start-ups in Wales, which equates to 1 business backed per day.

The Wales Micro-Business Loan Fund was launched in October 2012, and is now delivered by the Development Bank of Wales. It provides loans of between £1k and £50k. To the end of March 2019, the Fund has supported 711 businesses, investing £15.9m directly and attracting over £12.8m of further private sector funds. The Fund has created 1,679 jobs and safeguarded 1,560 jobs. The social enterprise element of the fund has supported 37 businesses, investing £900k directly and creating 74 jobs and safeguarding 134 jobs.

Development Bank of Wales

The Development Bank of Wales (DBW) helps Welsh businesses get the finance they need to start up, strengthen and grow and provides loans from £1k right up to £5m, as well as mezzanine, and equity funding. It also helps businesses to find the right finance partner to leverage in private finance with its own gap finance when necessary.

In 2018/19 DBW invested £80m into the Welsh economy meeting its five year target in just its second year of operation. The bank is seen as a model of good practice and a lead initiative in the space. It is also being considered as a delivery model in other nations, for example Scotland.

The Bank now manages in excess of £1.1 billion of Welsh Government funds including over half a billion pounds across all business funds and the £454 million Help to Buy – Wales.

Since inception in 2001 through to 31 March 2019, Finance Wales/DBW has:

- Invested over £600m in Welsh businesses.
- Leveraged in an additional £800 million from the private sector.
- Had an impact of some £1.4 billion in to the Welsh Economy.
- Created or safeguarded over 52,000 jobs.

Funds	WG Department	Amount (£m)
Wales Micro Business Loan Fund	E&T	18*
Wales Micro Loan Fund	E&T	16.2
Wales Capital Growth Fund	E&T	25
Wales Technology Seed Fund	E&T	6
Life Sciences Investment Fund	E&T	50

Funds	WG Department	Amount (£m)
Technology Ventures Investment Fund	E&T	9.5
Wales Management Succession Fund	E&T	25
Wales Business Fund	E&T/WEFO	180.9
Wales Flexible Investment Fund	E&T	130
Wales Property Development Fund I	E&T	10
Wales Angel Co-Investment Fund	E&T	8
Wales Technology Seed Fund II	E&T	20
Wales Rescue & Restructuring Fund	E&T	11
Wales Tourism Investment Fund	E&T	50
Wales Commercial Property Fund	E&T	55
Total	E&T	614.64
Help to Buy Wales	Housing	454
Wales Property Development Fund II	Housing	30.5
Wales Stalled Sites Fund	Housing	40
Total	Housing	524.5
Local Energy Fund	Natural Resources	11.3
Total	Natural Resources	4.9

Funds	WG Department	Amount (£m)
DBW TOTAL- WALES		1,150.4

*£1m of the total fund is allocated for investment in social enterprises. That element is managed by the Wales Council for Voluntary Action (WCVA) in partnership with the Coalfields Regeneration Trust and Cardiff & Vale Credit Union.

Wider Welsh Government support for business

The mechanisms outlined above are only part of the way the Welsh Government can provide support and assistance to business across Wales. Further ways the Welsh Government can provide support to all sectors of the economy across Wales are as follows:

- Over £300million per year is provided under the Rural Development Plan for rural businesses across Wales.
- Over £100million per year for skills support which is match funded by the European Social Fund.
- Specific interventions such as the Food Development Grant to support particular sections within the economy.

This support also dovetails with other interventions available from elsewhere in the public sector from local authorities and the UK Government. Oversight of the support available is provided through Boards such as the Cross Welsh Government Delivery Board for delivery of the Economic Action Plan, and WEFO's Programme Monitoring Committee.

Section 5: Update on Recommendations

The Public Accounts Committee (PAC) asked for an update on WAO and PAC recommendations made in three areas:

- Circuit of Wales (CoW)
- Kancoat
- Pinewood

Circuit of Wales: There were 13 recommendations made in the Circuit of Wales report. 11 are considered closed and 2 are ongoing. The two ongoing recommendations relate to whether the Welsh Government has used any escrow accounts since the CoW intervention and what the status of the £7.3m debt is.

Officials are working to establish whether any more escrow accounts have been used in the Welsh Government. It is not common practise to use these accounts because of how we normally provide funding to organisations through grants so this work is taking longer to conclude than first anticipated. In respect of the debt owed, officials are working with

solicitors to understand the likelihood of recovering any of the outstanding debt. Final legal advice has yet to be received and is expected later this calendar year. Any decision with regard to the debt will be made then.

Kancoat: There were 11 recommendations relating to funding support for Kancoat. All these are considered to be closed.

Pinewood: 9 recommendations were made on the Pinewood report. All are ongoing due to the recent publication of the report.