Paul Davies MS
Chair, Economy, Trade and Rural Affairs Committee
National Assembly for Wales
Cardiff Bay
Cardiff
CF99 1NA

Via email to: SeneddEconomy@senedd.wales

17th May 2024

Dear Mr. Davies,

Please find attached with this letter the Development Bank's responses to the additional questions from the Economy, Trade and Rural Affairs Committee.

Please do not hesitate to get back to me if any further information is required.

Yours sincerely

Giles Thorley
Chief Executive

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Economy Trade and Rural Affairs Committee

Development Bank of Wales inquiry – supplementary questions
May 2024

What guidance is given to businesses in order for them to understand everything involved with an equity investment?

We recognise that our role as a development bank is to counteract the cyclical nature of the mainstream capital markets and to develop new or underserved markets. Our approach as a lender or investor is supportive while still being commercial.

Equity finance is the primary funding mechanism for innovative early-stage businesses and is a means to fuel growth in later stage businesses without the cashflow burden of debt repayments. The demand for equity in Wales has grown but is still relatively small, with UK research from the British Business Bank showing that Wales had 2.6% of the total UK transactions in 2022[1]. It is interesting to note however, that the value of equity investment into UK SMEs contracted in the year but that Wales was one of only three UK regions which had an increase in the number of transactions and that the Development Bank participated in over half of these.

There are some fundamental differences between an early-stage technology business and a later stage business in approaches to fundraising. With pre-revenue businesses, equity is typically the main if not only route to raising the capital necessary to bring a product to market. From a company point of view, founders have a strong belief in the commercial opportunity of their technology whereas from an investor point of view, an unproven business will always be perceived as higher risk. More mature business will have a broader range of funding options available to them and have other priorities when considering an investor such as such as goal alignment or route to exit. These differences shape the way we work with companies and as discussed in our previous paper, we have specialist teams with the appropriate skills and experience to work with each customer group.

When a business applies to the Development Bank for finance, a colleague from one of our five offices across Wales will work directly with them through the process to understand their funding needs. The aim is to tailor a package of funding for them from the full range of funds available and consider equity where appropriate.

The process from thereon when negotiating an equity investment includes considerations such as ensuring good alignment of growth goals and strategy, validating the commercial opportunity and valuation. We invest the time meeting and developing a relationship with management teams as we work through these during the diligence process.

When working with businesses, particularly those who may be raising funding for the first time, we recognise the importance of communicating transparently through the process. It is however, important to be aware that this process is a negotiation with commercial aims for both the company and for the Development Bank as an investor and this cannot be a replacement for a company taking its own independent advice. We encourage external advice on all transactions, and this is something we are considering formalising. We also actively encourage companies to do their due diligence on us through speaking to other equity backed companies.

There are a number of very good business support programmes in the ecosystem that offer guidance and support including Business Wales and the Accelerated Growth Programme, Alacrity Foundation and the Fintech Foundry. We regularly work in partnership with these other business support

[1] Small Business Equity Tracker 2023 (british-business-bank.co.uk)

organisations to support their programmes, participating in events and panel discussions and supporting accelerators with training.

We have taken other steps such as making our term sheet on equity deals clearer and easier to understand and ensure it highlights key terms early in the process. This is ongoing work for us and we reference our approach to that of the market including using BVCA documentation.

There is more to be done. For example a recent discussion with Fintech Wales members highlighted the need for us to better explain the Wales Angel Co-Investment Fund which is a passive investment fund whereby the Development Bank follows the terms agreed between the company and a lead Angel investor.

More broadly, we have and will continue to invest in assets and guides to support the wider market on the fundamentals of equity investment. We have run information campaigns on the topic, including digital content such as videos and blogs, and promotion through various media and speaking opportunities. This is a strategy that will continue this year as we publish our learning hub.

How wide is the pool of potential Investor Directors that the Development Bank appoints from? Do you ever appoint the same Investor Director to sit on the boards of multiple companies that the Development Bank has invested in?

We currently have a database of 165 potential non-executive directors or chairs, some of which could also be investor directors. We do appoint the same people multiple times if their experience and skillset is a good match for the company's needs, and they have the bandwidth to make a positive contribution. As explained in our previous evidence, appointments are always made with consideration and a genuine expectation that the investor director will help the company achieve its business aims and typically with agreement and consensus from the company and other shareholders and stakeholders.

What degree of control does the Development Bank have on the way an Investor Director operates and the decisions they take once appointed?

An equity investment from the Development Bank will typically contain the right to appoint either an investor director or a board observer. The role and way in which an investor director is appointed, when that right is exercised, was covered in our earlier paper.

The investor director is a director of the company and has the same legal duties as any other director as governed by the Company's Act and director's duties. They are required to act in the interest of the company and all shareholders. Through our monitoring role we consider the decisions and proposals made by the board which includes the investor director, but do not exert any degree of control on an investor director.

The investment agreement outlines the matters/decisions that require specific consent. These would be matters considered to be important and material to our investment such as major items of expenditure, taking on additional debt, the appointment of an employee at a salary above an agreed threshold or the appointment and removal of directors.

When an investor director is appointed, we maintain our relationship with the company through a monitoring role and can remove and replace an investor director, typically this might happen in a business on a growth trajectory and where there may be a need for different skills as a business evolves. Investor directors suited to an IP rich pre-revenue business can be very different to those required when the company is driving towards an exit event.

Investor Director remuneration

In cases where an investor director is appointed, remuneration is negotiated and agreed between the company and the individual.

How many complaints has the Development Bank received in each year over the last 5 years?

The Development Bank Group received 1,765 applications for business funding last year and more detail is provided below.

FY	Applications	Number of complaints	Feedback*
2019/20	1853	15	-
2020/21	2693	14	-
2021/22	1896	20	-
2022/23	1678	3	9
2023/24	1765	11	12

**N.B historically all forms of feedback and complaints were simply logged as a complaint, however in the last two financial years, we have separated feedback from complaints*

Has the Development Bank undertaken any benchmarking against other comparable institutions on a usual level of complaints they might expect to receive? If so, are the current complaints in line with the Bank's findings?

Complaints data is published by the FCA however it is difficult for us to benchmark ourselves directly as the FCA only requires regulated activity to be reported to them. Such activity is consumer credit, mortgages, banking, insurance and pensions, and therefore falls outside the scope of business lending. As an illustration, whilst the Development Bank received 11 complaints in the latest financial year, only 2 of these are reportable to the FCA as they relate to our regulated legal entity, DBW Investments 10 Ltd (DBW10). The primary mechanism for tracking satisfaction over time is through the common KPI Net Promoter Score which was detailed in our previous paper.

Whether the Bank has undertaken any work to understand how the Bank is viewed by businesses that have either been unsuccessful in securing funding from the Bank or have never applied to the Bank for support.

In addition to our existing customer satisfaction monitoring, we periodically undertake stakeholder perception research at least once during a corporate plan cycle, across all groups including customers, the wider SME population, business advisors and other business organisations, a summary of which was included in the 2022 annual report and accounts (excerpt below), and the next research is planned for this year at the mid-point of our current corporate plan.

"An independent study of almost 800 customers and key stakeholders including membership organisations was conducted in 2021. The objectives of the research were to understand the extent to which the Development Bank is perceived as:

- A trusted expert in business finance
- An authoritative voice in SME investment and economic development
- A commercial investor with a social remit
- A responsible/ethical investor

The study also considered the appetite and intent for external investment, in particular equity investment.

Key findings of the report show that the Development Bank scores well in terms of being a responsible investor*,* awareness of the Bank and likelihood of recommending it among Intermediaries interviewed as part of this research was strong. However, only one third (34%) of SMEs were aware of the Development Bank of Wales.

Among membership organisation participants in the qualitative research, the Bank was felt to have a number of roles including helping SMEs in Wales to access finance especially if they might have struggled to find financial support from more 'traditional' lenders; aligning with Welsh Government priorities; being an important tool for economic development in Wales; and developing as a strategic partner for businesses.

Some membership organisation participants deemed the Bank's priorities as supporting businesses that might find it difficult to access finance provided it made commercial sense. Prioritising growth and innovation were also noted.

Encouragingly, all groups were much more likely to spontaneously mention strengths rather than weaknesses of the Development Bank of Wales. For intermediaries, top of mind strengths related to market position factors such as its Welsh focus, our willingness to lend where others won't and our variety of funding. Our portfolio customers spontaneously mentioned strengths relating to customer service attributes such as good *communication, accessibility, listening to business and a personal, friendly service.*

Membership organisation participants in the qualitative research voiced similar, positive brand perceptions. They also associated the Bank with being 'professional', 'local' and 'proudly Welsh'. There was also reference to how our profile and reputation had reportedly improved in recent years."

Will the loss of over £62 million reported for the financial year 2022/23 have any impact on the Development Bank's ability to meet the aims and objectives set by the Welsh Government, and will said losses decrease the amount of money available for the Bank to loan out going forward?

In line with the Fifth Senedd's Economy, Infrastructure and Skills Committee's recommendation, I would encourage the Development Bank to publish information alongside its annual accounts – in

plain English and Welsh - that would allow any interested member of the public to see whether the organisation has covered its costs in the preceding year and to understand the practical effects of any losses or surpluses identified in the accounts.

The number quoted above appears to be the operating (loss)/profit line of the consolidated income statement on page 152 of the annual accounts. The correct figure for the year is the bottom line of the same table, reported as a £24 million loss for 2022/23. This does not impact the Development Bank's ability to meet the aims and objectives set by the Welsh Government. We remain on track to meet our investments targets and loan repayments to the Welsh Government as set out in the funding agreements.

We noted the request from the committee to include an explanation of the accounts and agreed that this was a positive development to improve transparency. As a result, we introduced the Chief Financial Officer (CFO) report from 2018 onwards.

The Economy, Infrastructure and Skills Committee commented on the change and its contribution to members understanding of the Development Bank's financial position.

> *"It was pleasing to hear a positive story about the Bank's progress against investment targets to date, and to see in the annual report a more transparent presentation of financial information that the Committee had recommended last year."*
>
> Russell George MS, Chair of the Economy, Infrastructure and Skills Committee
> Letter to Giles Thorley 7 February 2019 - ref EIS(5)-06-19(P1)

The CFO report provides a high-level review of our financial performance, describes the two parts to the business by separating the delivery from the funds themselves, and compares year on year performance.

The loss shown in the accounts is primarily a result of three non-cash items which are accounting exercises and meet the requirements of the International Financial Reporting Standards:

- Expected Credit Losses (£17 million)
- Changes in Fair Value (£30 million)
- Notional Interest on Welsh Government Loans (£9 million)

The CFO report shows that the Development Bank covers its operating costs (services business) annually and that surpluses or losses from the funds business should not be assessed annually because fund results include volatility caused by year-on-year movements in assets held at fair value, impacted by the prevailing economic conditions and which are estimates and unrealised.

A longer-term view on a fund-by-fund basis may be a more appropriate way to assess performance of the Development Bank's funds which are monitored through quarterly reports to the Welsh Government.