

Clerk of the Finance Committee
National Assembly for Wales
Cardiff Bay
Cardiff
CF99 1NA

10 January 2014

Dear Sir

Finance Wales – Invitation to provide evidence.

I refer to the Chair's letter of November 2013 and I am writing to provide evidence to the Finance Committee in relation to its enquiry into the current operation and future role of Finance Wales.

Credentials

I am head of Corporate Finance Advisory Services for Mazars LLP ("Mazars") in Wales and the South West. Mazars is an international accountancy and business services firm with offices throughout the UK and across 70 countries around the world. We are the 10th largest accountancy and business services firm in the UK.

I and my team in Mazars specialise in providing corporate finance advice to SMEs and mid market corporates. This includes advising on finance raising (equity and debt) and M&A transactions.

I am a chartered accountant and have 15 years experience of providing corporate finance advice to companies in the previously noted sectors. Prior to joining Mazars I was senior partner of Haines Watts Corporate Finance and before that an assistant director in Price Waterhouse Corporate Finance. I believe that I am recognised as a leading corporate finance advisor in the Welsh business community.

During the last 10 years I have dealt with Finance Wales on many occasions. This has included seeking finance from them for clients, negotiating investments from them, undertaking financial due diligence for them and managing the sale of some of their portfolio companies. However, my relationship has not been one of significant dependency, during the same period I have worked with numerous private equity funds and banks throughout the UK.

I should note that my firm provide internal audit services to Finance Wales, although I am not involved in that work. Therefore the views expressed herein are entirely my own rather than the corporate view of Mazars.

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Response to enquiry questions

The role and strategic purpose of Finance Wales

I strongly believe that Finance Wales should operate on commercial investor principles rather than operating as a state subsidised development bank providing subsidised or discounted financial support to companies in Wales. However, that position is not inconsistent, in my mind, with Finance Wales being owned by the Welsh Government, deriving some of its funding from Welsh Government and having an economic development purpose.

My rational for this is that Finance Wales can achieve a significant economic development purpose by bridging an equity funding gap (and in more recent years a debt funding gap) that exists in Wales, but doing so on commercial terms that will be affordable by good quality businesses able to pay a market rate for their funding. I see no merit in supporting businesses that will not meet reasonable commercial investment criteria or require a subsidised financing cost to survive. This is likely to benefit only weak companies and I cannot see that this serves economic development objectives in the longer term. Such an approach also appears to be regressive and contrary to Government business support policy in the last 5 years which has focused on key strategic sectors and anchor companies rather than trying to support any and every business.

Essentially, the question is whether Finance Wales should be a direct agency of economic development (“a development agency”) or one instrument serving a particular objective in a range of economic development initiatives. My view is that the latter would be most beneficial for Wales and that Finance Wales’ primary remit should be to provide equity and loan capital at commercial rates where there are evident gaps in private sector market provision. This should be at or near commercial rates to avoid displacement and to promote strong businesses which are capable of servicing funding costs at normal rates.

To the extent that there is a perceived need to provide early stage or micro business funding at below commercial rates for the purposes of economic development then it would be entirely possible for specific funds to be created (to be administered either by Finance Wales or by the Welsh Government directly) with this remit. The alternative approach of changing the whole remit of all Finance Wales activity to emphasise the primacy of economic development over commercial return puts in jeopardy the very considerable benefits that Finance Wales has provided in supporting good quality, profitable businesses in Wales.

Current performance

I have not seen the data to asses the economic development outcomes achieved by Finance Wales therefore I am unable to comment on this. However, I would say that in my view Finance Wales has achieved a considerable economic impact in supporting (through equity and debt investments) SMEs in Wales when other funding sources were not available. I contrast this with my experience in the South West of England, where the absence of a funding body of the size and scale of Finance Wales makes it more difficult to source investment funding in the range £2 - £5 million. In comparison, Wales is a more benign and supportive location to raise development capital for businesses.

Interest rates charged

It is evident that Finance Wales has charged interest rates that are higher than either European State Aid specified minimums and bank lending rates applied to SMEs where they have willing to lend to them. However I believe that the rates offered by Finance Wales are generally commensurate with the risk levels they are being asked to bear and a commercial appraisal. It should be recognised that Finance Wales has lent at these rates where the banks would not lend at all and that this generally reflects either a higher risk of default or a lack of collateral. Given the accepted differential across the UK between secured lending



rates at c 4% and equity investment rates at 25% + it is not unreasonable for forms of hybrid funding to command rates of 10-15%.

I would qualify the above comment to a degree. I do sense some element of opportunism on the part of Finance Wales in significantly increasing its loan activity at a time of weak bank competition and then seeking to maximise the returns it is able to generate from this. This would be entirely acceptable for a purely commercial orientated fund but perhaps should be tempered somewhat given Finance Wales' role as an instrument of economic development. In my view this could be achieved by setting aside specific funds and applying to them a greater economic development remit with some constraints on the interest rates to be charged and other terms of lending.

Value for money

I do not have data on this and am therefore unable to comment.

Arrangements for future sources of finance

As noted previously, it may be beneficial in the future for there to be a clearer separation of funds between those with a pure economic development objective and those that are an instrument of economic development but can and should be operated on commercial terms.

I am sceptical about the devolution of all UK public support programmes to a Welsh body. The range of support programmes is diverse and it would be administratively and managerially hugely difficult to combine these within one delivery organisation as well as incurring the risk of loss of focus and sectoral expertise for the specific funds. I also believe that it is healthy for SMEs in Wales to be looking both within Wales and beyond Wales for funding lines. We are part of an international economy and we should be encouraging Welsh SMEs to look globally not just locally.

In terms of a specific question around integrating the Business Growth Fund into a Welsh agency I can see no good reason for doing that. In my view the current BGF works perfectly well from its current base and there is evidence in the form of recent investment that companies and advisors in Wales are able to take advantage of the funding available from that source.

Corporate structure of Finance Wales

I believe that the present corporate structure of Finance Wales is fit for purpose and can see no advantage in any significant change. It is clearly open to the Welsh government to change or re-emphasise the remit of Finance Wales and if it is desired to strengthen the economic development remit then this can be done. However, as noted previously I would caution against this in that it risks jeopardising current benefits for questionable gains.

Activities of Finance Wales Group in the North of England

I believe we should applaud the success of Finance Wales in exporting its expertise to generate business elsewhere in the UK. We are looking to stimulate good financial services' businesses in Wales and I would argue that Finance Wales is an example of this. In my view, this activity is of benefit to the economy of Wales both in terms of creating jobs based in Wales and also through absorption of the existing cost base over a wider revenues which should ultimately drive down the cost of funding to SMEs in Wales.



I trust that these views are of assistance.

Yours sincerely

A handwritten signature in black ink, appearing to read "Adrian Godfrey".

Adrian Godfrey
Corporate Finance Partner