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## Grants for SMEs in Wales

A Thinkpiece  
by Regeneris  
Consulting & Old Bell 3

# Grants for SMEs in Wales

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# 1. Introduction

- 1.1 Regeneris Consulting and Old Bell 3 were appointed by the Welsh European Funding Office (WEFO) to examine the case for the provision of grants to SMEs alongside repayable financial instruments. The purpose is to inform the development of the package of financial support for SMEs through the 2014-20 ERDF Programmes. This work builds on the analysis carried out through the ex-ante evaluation of Financial Instruments for the 2014-20 EU Structural Fund programmes.
- 1.2 In this context, the term *grant* primarily covers non-repayable finance but in practice the same principles apply to soft loans.
- 1.3 This thinkpiece sets out a review of the evidence on the case for the provision of grants in Wales. It is structured as follows:
- Section 2 reviews the theory on market failure in SME finance and the role of grants in addressing market failures
  - Section 3 reviews the current landscape of grant provision in Wales and evidence on demand
  - Section 4 provides evidence on the effectiveness and efficiency of business grant schemes in Wales and across the EU
  - Section 5 sets out our conclusions.

## 2. Market Failure in SME Finance and the role of Grants

### Key Points

- Market failure describes a general situation where the market mechanism cannot achieve economic efficiency: that is, net economic welfare for society could be enhanced. In the case of SME finance, market failure occurs where the market provides insufficient finance to SMEs, and as a result, business growth and wealth creation is constrained.
- In a perfectly-functioning market, investors would provide finance up to the point where their required expected net returns are equal to the net returns that are acceptable to the firm. Investors tend to deal with imperfect information by excluding marginal classes of investment, where average risks of failure are too high and returns too low to justify investment. This creates a finance gap.
- This is not a market failure *per se*. There is only market failure when net welfare could be increased by public intervention: the net societal benefits of intervening in the market need to exceed all net Exchequer costs.
- Alongside information failure the key rationale for public sector intervention in the finance gap is to achieve positive economic spillovers (technology and innovation, enterprise, employment and regeneration, regional development). Intervention through provision of finance can be justified as long as the combined value of these spillovers and net financial returns is sufficiently high as to offer value for money.
- In the case of grant funding there is no direct financial return to the public sector so the value of the net additional economic spillovers must be high enough to justify investment.
- For this to be the case any grant scheme must only support projects that have exhausted all other sources of finance; would not go ahead without the grant, or would go ahead on a significantly reduced scale or delayed timescale; that deliver significant additional economic spillovers of the kind outlined above; and that it would not be possible to deliver economically on a repayable basis.
- It is generally preferable to provide finance to SMEs in a repayable form because grants (if poorly targeted) crowd out existing sources of private investment and distort the market. The requirement of a return from investee firms also imposes a financial discipline that is absent in the case of a grant scheme. Grant schemes also do not build up any legacy fund that can be recycled into further investments. Nonetheless, there is a set of scenarios for which provision of a grant may be appropriate:

**1: Early stage R&D.** There is an established precedent for the provision of grants to new ventures to support proof of concept and provide seed funding. Grants may be particularly appropriate to young, small technology-based SMEs and often feature in the early rounds of funding, with later rounds including investment from sources such as business angels and publicly backed SME finance schemes.

**2: Encouraging behaviour change.** There is sometimes a case for the public sector to use a grant as a means of incentivising behaviour change in order to tackle an important market failure and to deliver public goods (e.g. providing grants to SMEs to invest in energy efficiency measures; stimulating risk-averse small businesses to invest).

**3: Social enterprises and charities.** Whilst some of these organisations engage in trading activities, certain activities which will never be able to be traded on markets and some social enterprises which will never be financially self-sustaining. These enterprises often need finance in the form of grants at key points in their development (it should be noted that ERDF cannot be used for activities that will never be self-sustaining).

**4: Addressing a viability gap.** There are instances of SME investment projects where there remains a funding gap even after their own contributions and those from commercial sources, where the expected financial return and gearing of the company mean it is not sensible to fund the project from these sources alone. In these circumstances there is a case for public sector grant to fill the viability gap and enable the project to go ahead, but only if the additionality and value for money tests we have outlined are met.

- 2.1 In order to understand the set of circumstances under which it may be appropriate for the public sector to provide finance to SMEs in the form of grants, it is necessary to review the theoretical market failure arguments in SME finance. This section therefore:
- Provides a summary discussion on market failure issues in SME finance and the rationale for public sector intervention
  - Discusses the implications of this theory for the provision of finance through grants and the circumstances in which grant provision may be justified.

## Market Failure in SME Finance

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- 2.2 Economic theory provides us with a clear framework for understanding the conditions and drivers for market failure, and hence the conditions for public sector intervention in SME finance.

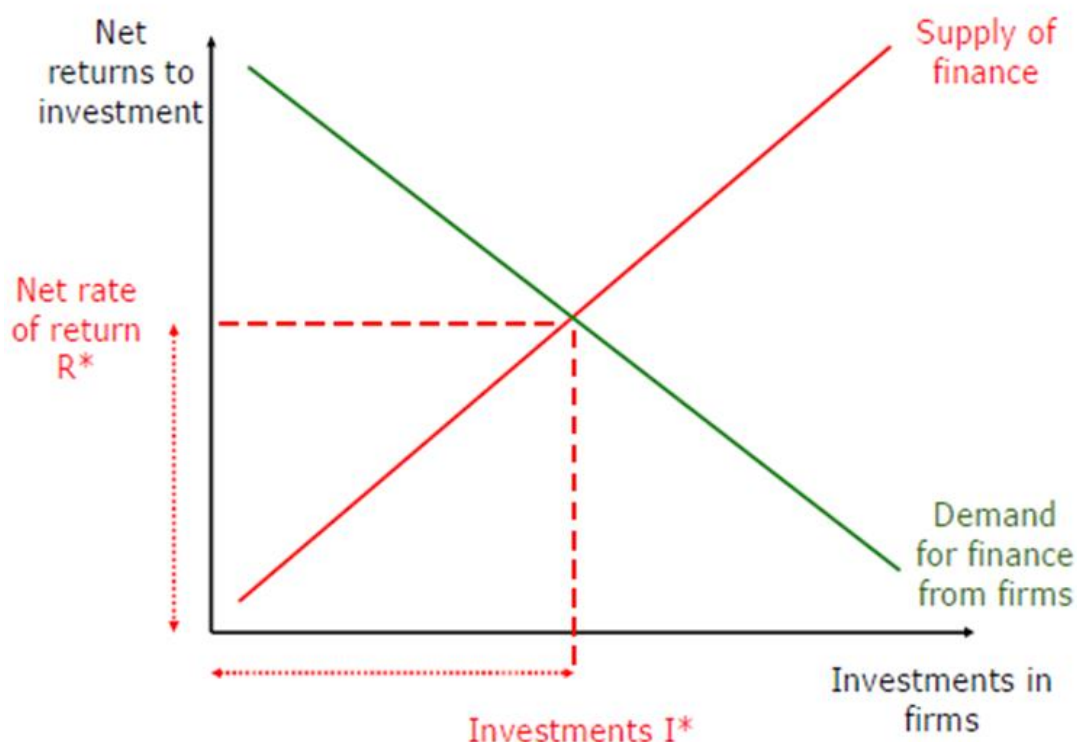
### Market Failure theory

- 2.3 Economic efficiency is achieved when nobody can be made better off without anybody else being made worse off. Well-functioning markets tend to achieve efficiency – which means that there are no unexploited gains from trade. Market failure describes the general situation where, for one reason or another, the market mechanism cannot achieve economic efficiency.
- 2.4 In the case of pollution, for example, the private costs of an economic activity do not reflect the costs incurred by society as a whole and ‘too much’ of that good is produced. In access to finance the question is whether the market, without public intervention, will provide ‘too little’ finance to SMEs and as a result, business growth and wealth creation is constrained. Market failure requires that there are unexploited gains from trade – in this case that there are deals which would be profitable both to firms and investors (and wider society) that for some reason are not made. Public intervention to raise supply may improve economic welfare, but only if the benefits outweigh the costs of the intervention.

### Market Failure in Access to Finance

- 2.5 The idea of market failure in access to finance can be illustrated by a simple analysis of supply and demand. The upward sloping supply curve in Figure 2.1 (in red) shows that the greater the expected net returns from an investment, the more firms investors are willing to invest in. Net returns include interest and capital paid to an investor, net of all costs such as due diligence, administration and costs of bad debt. The downward sloping demand curve (in green) shows that as the net return required by investors falls - for example through lower interest rates - more firms will demand finance. These relationships apply equally to markets for debt and equity finance.<sup>1</sup> Note that in the case of a grant, the rate of return is effectively zero or negative.

<sup>1</sup> For equity investments the return is determined by the equity stake and dividend arrangements.

**Figure 2.1 Supply and Demand for Finance in a well-functioning market**

Source: Regeneris Consulting

- 2.6 In a perfectly-functioning market, investors will provide finance up to the point where the expected net returns required by the investor are equal to the net returns that are acceptable to the firm. This is the point where the market 'clears': at any point to the right of this, the costs of extending finance would exceed the benefits to investors. At any point to the left, there would be profitable investments that would be unrealised by the market. Such a scenario implies that investors have perfect information on investees' future performance.

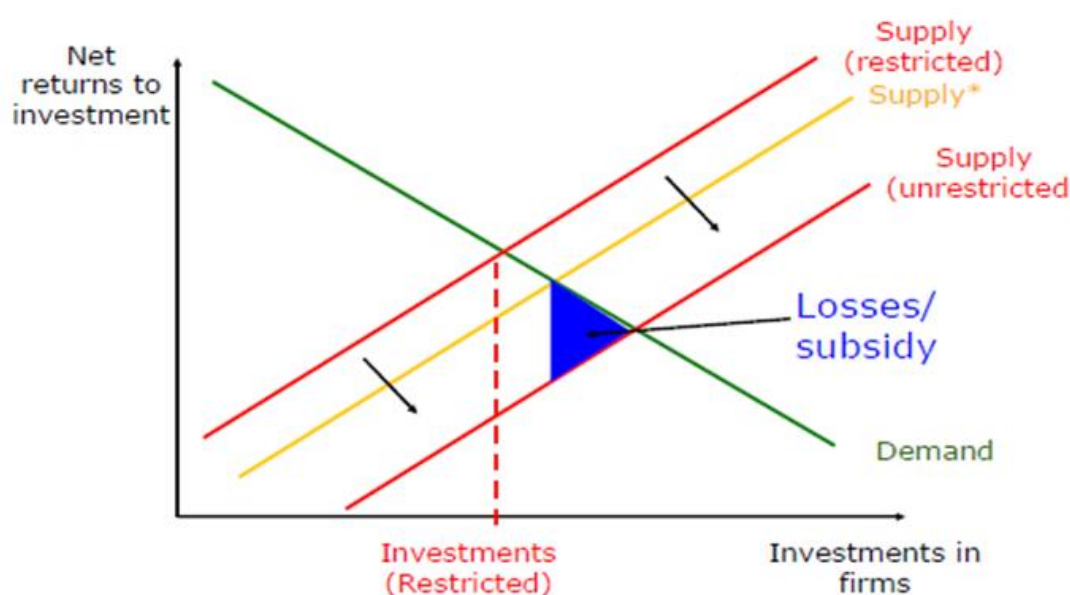
### Lack of Finance for Marginal Investments – the Finance Gap

- 2.7 Failure in the market for business finance is generally understood in terms of imperfect information: the risk of failure and write off is not known by the investor and there are costs associated with gaining the information to assess these risks. Information is not only imperfect but also asymmetric: firms seeking finance, in general, know more about the true risks of failure than investors and can undertake actions that affect the chances of repayment which the investor cannot monitor. Imperfect and asymmetric information gives rise to scenarios where the market does not provide adequate investment for firms, even when individually they might offer a good return on investment.
- 2.8 Where information on the risk of the investment is imperfect, this market clearing point may not be reached. The investor is likely to deal with imperfect information by dividing the market into classes of investment for which average failure rates are known. Marginal classes of investment, where *average* risks of failure are too high and returns too low to justify investment, will be excluded from the market.
- 2.9 There are likely to be many firms in this marginal class that are profitable investment prospects, but imperfect information means they cannot be distinguished from other riskier investments. This

situation is shown in figure 2.2 below where investors extend credit only up to *Supply (restricted)*. This is the supply curve under imperfect information, whilst *Supply \** is the supply curve under perfect information. In this space there is a *finance gap*: there are firms with viable business plans which cannot access the finance they need due to the above effects.

- 2.10 Restricting investments in this way is rational for investors, since if they relaxed their conditions and allowed credit for the risky group of firms - and increased the number of investments to *Supply (unrestricted)* - they would make losses equal to the area shaded blue.

**Figure 2.2 Supply and demand for finance for firms for a marginal class of investment**



Source: Regeneris Consulting

- 2.11 We do not regard restricted finance for marginal classes of investment (as described here) as constituting market failure *per se*. Likewise it can be said that information failures do not necessarily equate to market failure. Market failure requires that net welfare could be increased by public intervention. It is not possible to conclude that this condition is satisfied in debt and equity markets simply because information failure exists: it needs to be demonstrated that the net Exchequer costs of providing finance do not exceed the net societal benefits. For the public sector to operate in these areas some element of subsidy (returns below that acceptable by private sector investors) is required.
- 2.12 This type of scenario can be used to explain why banks tend not to make unsecured loans to small start-up firms with no collateral to secure a loan, as on average these firms represent too great a risk. It can also be used to explain why venture capital is not provided in smaller quantities, given that uncertainty over risks of investment and relatively high due diligence and management costs mean that investments below a certain level become prohibitively costly.

### Demonstrator Effects

- 2.13 There is a second type of information failure associated with market failure in credit markets. It may take some considerable time before the net returns that can be realised from any class of investment are established by the market. While net returns are underestimated, risk-averse

investors will fail to provide finance for profitable classes of investment. The public sector could in principle address this failure by working with the private sector in the short term to demonstrate that viable returns can be made from a certain class of investment.

- 2.14 This type of argument can be applied to small venture capital investments in particular. There is a high degree of uncertainty over the returns that can be expected from this market over time, in part because returns are realised over a number of years, are highly dependent on the skills of particular venture capitalists, the strength of local markets, and may themselves be highly variable by Fund. In our judgement there is probably a greater chance of the market reflecting the true situation than government. This would tend to be supported by an apparent lack of commercial rates of financial return generated by most public sector venture capital funds to date.

## Economic Development Impacts

- 2.15 There are also economic development and regeneration arguments for the public sector intervening to provide additional business finance for SMEs in the finance gap. **These arguments apply equally to repayable and grant finance.** There is a generally a recognised need for government support to raise levels of enterprise, research and innovation, employment and regeneration in the UK. It can be argued that investments which support these types of impacts will generate positive spillovers – benefits that accrue to the wider region, above and beyond that reaped by the fund. These are market failures as described in the HM Treasury Green Book. Market failures are as follows:

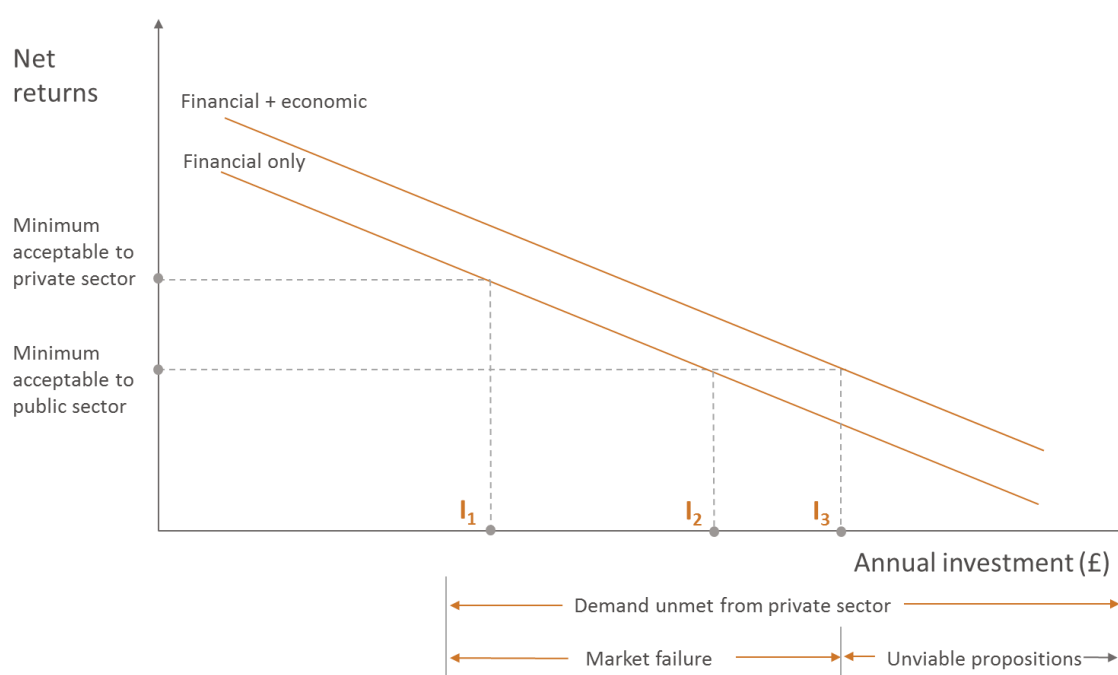
- Technology and Innovation Spillovers – firms which develop or commercialise new technology will tend to generate economic returns beyond the firm as the technology or innovation is imitated. There is a strong rationale for supporting new or existing firms to develop and commercialise new technology. In our experience most firms supported by equity funds are engaged in some form of innovation, and this is an important rationale for Venture Capital and Loan Funds (VCLFs) as a direct way to support innovation.
- Enterprise Spillovers – enterprise, through the creation of new and innovative firms, generates benefits for the regional economy beyond those reaped by the firm. This is through spurring greater productivity, innovation and creating employment.
- Employment and Regeneration Spillovers – in regions where there is a need to support employment, worklessness and deprivation creates negative spillovers on others in families and communities. There is a strong market failure as well as equity argument for supporting employment in relatively deprived areas. This type of argument is likely to be more important for Funds providing mezzanine or loan finance to established firms, or non-technology start-ups rather than equity funds. It is likely to be more important in a recessionary macroeconomic climate.
- Regional Development and Lock-In Arguments – firms and regional economies can become 'locked into' low or high growth trajectories. This is a form of market failure, since firms which contribute to a 'better' trajectory confer benefits on others in the future. Regional development policy is often predicated on the basis of developing knowledge or technology-based sectors in regions with relatively low productivity. Publicly backed funds tend to directly support the growth of these sectors and as such are potentially valuable tools of regional economic development policy.

- 2.16 This can be illustrated as in figure 2.3. In general the private sector will be providing finance up to the point where the overall net financial returns are acceptable. This target return will be set at a level determined by their cost of capital. In figure 2.3 this is up to around  $I_1$ . Due to the existence of the spillover effects cited above, there is a rationale for the public sector intervening to provide

finance to firms to the right of  $I_1$ , but only if the net economic and financial returns<sup>2</sup> are high enough to justify the investment. HM Treasury Greenbook uses a real discount rate of 3.5% - in effect this means that any project must achieve a net economic and financial return of at least 3.5% after inflation to be a value for money investment.

- 2.17 The same principle applies to publicly supported SME finance: any fund providing finance to SMEs achieving needs to achieve a 3.5% net rate of economic return to offer value for money for the public purse. In figure 2.3 this means that the public sector may invest up to the point  $I_3$ , but beyond this point the net returns fall below the required level and, in effect, the public sector would here be supporting a set of investment propositions that by this definition are unviable.

**Figure 2.3 Socio-economic returns and financial returns to investment in SMEs**

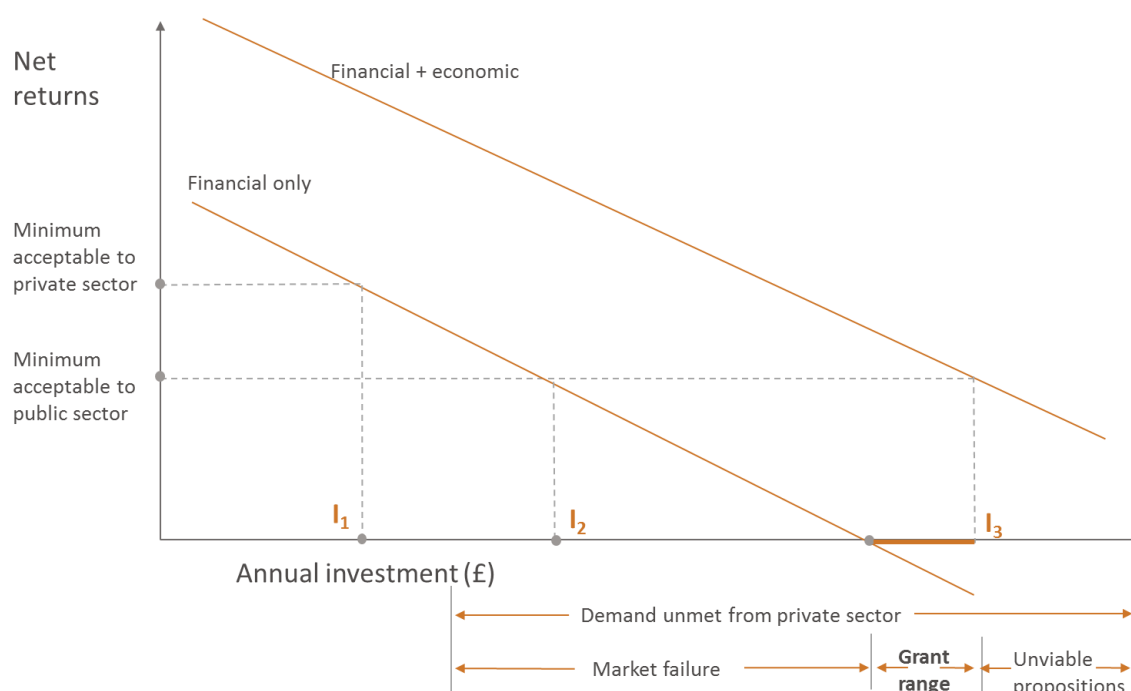


Source: Regeneris Consulting

- 2.18 Precisely the same principles apply when considering potential public sector provision of finance in the form of non-repayable grant. Such provision can be justified if the net economic returns can be shown to be at a sufficient level. Figure 2.4 sets out such a scenario: in this case there may be an argument for providing finance up to  $I_3$ , where the financial returns are zero or negative (i.e. finance is provided as a grant), if the net additional economic benefits can be shown to be sufficiently high to offer value for money. In practice this means that the project must:

- have exhausted all other sources of finance
- not be able to go ahead without the grant, or would go ahead on a significantly reduced scale or delayed timescale
- deliver significant economic spillovers of the kind outlined above.

<sup>2</sup> The economic returns can be valued as the net additional Gross Value Added generated for the economy after deadweight, displacement, substitution, leakage and multiplier effects. They can also include exchequer savings, for example, as a result of someone moving off unemployment benefit and into (self-) employment.

**Figure 2.4 Grant investment range**

Source: Regeneris Consulting

## Grants vs. Loans and Equity Finance

### Superiority of repayable finance

2.19 Providing grants as opposed to repayable finance introduces a set of particular considerations:

- 1) The financial model underpinning provision is very different. With a grant, there is no direct mechanism for the public sector to recoup any of its investments (although there may be wider exchequer benefits and savings associated with moving people from out of benefits or into more productive work). At the same time, however, the costs of administering grants are much lower than for repayable finance: costs of due diligence, contracting and monitoring are lower and there is less need for the financial expertise and skills associated with a publicly backed repayable financial instrument. Repayable funds also run for a much longer period, having both an investment and a realisation period, in which investments are fully paid back (e.g. JEREMIE Funds typically operate a five year investment period and a 5 year realisation period). This realisation period entails significant costs over and above a grant scheme.
- 2) Although a grant scheme has a reduced need for this corporate finance expertise, in practice this expertise can be invaluable to the process of making sound investment decisions, and thus in helping to secure economic returns.
- 3) The lack of any financial return places the onus entirely on the achievement of economic benefits. Effectively the value of these net additional benefits needs to be higher than for a (reasonably designed) repayable financial instrument in order for a grant scheme to provide value for money.

4) The provision of grants has particular effects on the SME finance market:

- Given the lack of interest rate or the need for repayment, there is a real danger that grants (if poorly targeted) crowd out existing sources of private investment, creating market distortions as firms gravitate towards finance offered under more favourable conditions. Demand for grants from businesses is theoretically limitless (although in practice the non-financial terms and conditions attached to the grant and the need for the business to match the grant funding with their own funds place a limit on take-up). The deadweight and crowding out elements of the additionality equation are therefore very different than for repayable finance; indeed a grant scheme may compete with a publicly backed repayable fund if poorly designed.
- For repayable finance, the requirement of a return from investee firms (albeit generally at a submarket level) imposes a financial discipline on firms and investors that is absent in the case of a grant scheme. There is a danger that grants can be seen as free money and can therefore be seen as risk-free by the investee.
- Related to this, excessive provision of grants can foster a “grant culture” where businesses become accustomed to, and dependent on, accessing free money, undermining demand for mainstream finance and imposing unnecessary costs on the taxpayer.

5) Finally, the lack of a financial return means that a grant scheme does not build up any legacy fund. A key advantage of repayable financial instruments is that any legacy fund they generate can be recycled into further investments and if sufficiently large the Fund can be operated on an evergreen basis.

2.20 Consequently, repayable finance is, in principle, superior to grants as a cost effective means of addressing market failure. This has been recognised in Welsh policy:

- The (then) Welsh Assembly Government’s economic development policy document, WAVE<sup>3</sup>, published in November 2005, argued for a shift towards repayable finance, with the introduction of repayable Regional Selective Assistance<sup>4</sup>.
- In April 2008, the Welsh coalition government announced a restructuring of the business support infrastructure with the creation of Flexible Support for Business, underpinned by a new Single Investment Fund (SIF) replacing both RSA and the Assembly Investment Grant, and offering grants and repayable grants above a minimum of £5,000 towards investment projects brought forward by Welsh businesses<sup>5</sup>.
- Economic Renewal: A New Direction (the ERP) was the first economic policy to be published by the then Welsh Assembly Government (coalition between Labour and Plaid Cymru) after the economy had gone into recession. The ERP flagged up a decision that the Welsh Government’s support in terms of finance to businesses should become investment based and re-payable:

*“We also need to move to an investment culture. Therefore all finance that DE&T provides directly will be repayable. The terms will vary depending on the purpose and size of the financial package.*

<sup>3</sup> Wales: A Vibrant Economy. The Welsh Assembly Government’s Strategic Framework for Economic Development. Consultation document. November 2005.

<sup>4</sup> Ibid. Page 55

<sup>5</sup> See Welsh Assembly Government press release of 17 April 2008  
<http://wales.gov.uk/newsroom/businessandconomy/2008/3986214/?lang=en>

*We have received strong feedback that the way we administer funding is slow and bureaucratic. We will ensure that for all direct financial support we provide in future, the service to businesses is swift and responsive.”*

- 2.21 There has been some softening of this approach in more recent policy, for instance with the introduction of the Wales Economic Growth Fund, which offers non-repayable grants on a competitive basis. However, there has generally been a recognition of the need to move away from “grant culture” in Wales.

### Findings on market for repayable finance

- 2.22 To put the subsequent discussion on the conditions for the provision of grants into context it is worth revisiting the findings of the ex-ante evaluation of Financial Instruments for the 2014-20 European Programmes. The key conclusions on market failure in debt and equity finance for SMEs are reproduced below.<sup>6</sup> The research – based on the performance of the existing JEREMIE Fund in Wales and consultations with financial advisors and intermediaries - indicated a persistence of market failure in the following areas:

- Microloans (up to £25k for businesses employing fewer than 10 people). Given the typical default rates, operating costs and the scale of funding in this area, the market is highly unlikely to operate in this area for the foreseeable future. However, the evidence on the volume of viable microloan propositions in Wales provides a case for continued public sector backed microfinance. The experience of the JEREMIE Microloan Fund in Wales and the Microbusiness Fund suggests that there is capacity for **of the order of £0.8-£1m per annum** if offered on similar terms to that provided by JEREMIE. This would equate to a total Fund of £4-£5 million over five years.
- Larger scale debt for established SMEs. The scale of the gap in the market is subject to uncertainty, given the challenges of predicting economic prospects and nature of demand and supply drivers. However, our analysis suggests a strong continuing need for publicly backed provision of debt finance in the period 2014-2020. Given the experience of JEREMIE, we would expect there to be capacity for at least the level of debt finance as that invested within the current JEREMIE Fund, if not more. This suggests of the order of at least **£10-12m per annum** of loans in Wales over a five year period, equating to a £50-£60m Fund, if offered on similar terms to those offered at present by JEREMIE.
- Risk capital for expansion. Given the continued persistence of the equity gap and the relative lack of provision in Wales, our analysis suggests a continuing need for publicly backed provision of risk capital in the next Programme period. Given the experience of JEREMIE, we would expect there to be capacity for **in the order of £9-11 million of risk capital investments in Wales per annum**, if offered on similar terms to those offered at present by JEREMIE.<sup>7</sup> This would equate to a total fund of £45-55 million over a five year period.

<sup>6</sup> Findings taken from Regeneris Consulting and Old Bell 3 (2013) *Wales Ex-ante Evaluation of European Programmes 2014-20 - Financial Instruments*.

<sup>7</sup> It should be noted that if any future JEREMIE Fund successor is to be part funded by the European Investment Bank (EIB) or other senior debt funder as match funding for EU Structural Funds, then a loan fund of sufficient scale will be needed in order to service the debt repayments to the EIB.

## Conditions for the provision of grants

- 2.23 There is surprising little in the literature on the conditions for providing grants as opposed to repayable finance. Although there is some discussion in the context of developing economies,<sup>8</sup> the context and market failures are very different from those in a mature developed country so the analysis is not transferrable. Some discussion is provided in Arvantis (2013),<sup>9</sup> again in the context of developing economies, but this offers some useful pointers. We have drawn on this literature as well as our own experience and the preceding analysis to arrive at a set of conditions under which it may be appropriate to tackle an identified SME finance market failure through a grant mechanism rather than repayable finance.
- 2.24 The implication of the above analysis is that publicly backed finance for SMEs should be provided on a repayable basis by default, unless there is a clear and strong rationale for providing finance on a grant basis or as a soft loan. As set out earlier, for an SME to be supported by a grant it needs to be shown that a proposed grant scheme passes the following tests:<sup>10</sup>
- 1) It delivers significant economic spillovers (technology and innovation, enterprise, employment and regeneration, social or environmental), such that these spillovers justify the costs of the grant.
  - 2) Businesses to be supported have exhausted all other sources of finance, including commercial sources, alternative sources and publicly backed repayable sources (so the scheme does not crowd out the market or other public sector schemes).
  - 3) Investment projects supported would not go ahead without the grant, or would go ahead on a significantly reduced scale or delayed timescale. This is related to point 2, although there are some instances where other, repayable sources of finance may be available to businesses but their repayable nature disincentivises investments with significant spillovers (see the *encouraging behaviour change* scenario below).
  - 4) The programme would not be able to be delivered economically on a repayable basis due to the operating costs associated with administering loans. SME finance funding is subject to significant economies of scale consideration. As discussed above there is an additional cost associated with administering and monitoring loans or equity finance compared with grants. For a small scale scheme that offers small amounts of finance it can be uneconomic to do so on a repayable basis since the expected returns from the investments do not justify the additional transaction and operating costs to the public sector, even if default rates are relatively low. There is no general rule for the threshold (in terms of amount of funding provided) at which it becomes uneconomic to administer funding through loans or equity, as this is a function of the overall size of the fund, the interest rate and default rate<sup>11</sup>, and the wider economics of the delivery organisation.<sup>12</sup> However, for illustration it would

<sup>8</sup> e.g. Bulow and Rogoff (2005) *Grants versus Loans for Development Banks*

<sup>9</sup> Arvantis (2013) *Blending grants and loans for private sector development: The use of grant elements and the AfDB's experience*

<sup>10</sup> In practice these conditions would need to hold at the overall level of the fund and 1) -3) would need to hold for each project supported by the Fund.

<sup>11</sup> The latter two, in turn, depend on the nature of the target market and are interrelated.

<sup>12</sup> The delivery context is relevant here. For example, it may be economically viable to run a small loan scheme as part a wider Fund, if it is possible to use existing staff and overhead resource to deliver this element. Effectively this would mean that the wider Fund is cross-subsidising the small loan element, which, considered in isolation, is not economic to run. Indeed, Finance Wales offers some loans from £1,000 upwards through its JEREMIE Microloan Fund (operating up to £25k).

normally be the case that for a fund offering finance of up to a maximum of £10k per project it would be difficult to justify the administration costs associated with repayable finance.<sup>13</sup> It would not be possible (or desirable) to charge an interest rate high enough to cover these costs. This does not in itself provide a justification for providing grants of this size; the first three tests need to be met to ensure additionality.

- 2.25 We outline below a set of scenarios for which these conditions may be met.

### 1: Early stage R&D

- 2.26 There is an established precedent for the provision of grants to new ventures to support proof of concept and provide seed funding. The rationale for this centres around information failure (due diligence costs are prohibitively high relative to the amount of finance sought) and the positive spillovers from the R&D. In this respect the rationale is the same as for a publicly backed equity scheme. Grants may be particularly appropriate to young, small technology-based SMEs and often feature in early rounds of funding, with later rounds including investment from sources such as business angels and publicly backed VCLFs.

### 2: Encouraging behaviour change

- 2.27 There is sometimes a case for the public sector to use a grant as a means of incentivising behaviour change in order to tackle an important market failure and to deliver public goods. An example could be providing grants to SMEs to invest in energy efficiency measures. These measures have significant environmental benefits and are an important element in meeting statutory climate change targets, but the investments may not stack up on a purely financial basis or repayable finance may deter investment by SMEs, for which such measures are low priority. Such grant schemes are often introduced on a time-limited basis to pump prime a market.
- 2.28 This argument could also be used in the case of the desire to incentivise risk-averse small businesses with healthy cash balances to spend some of their cash on expansion. There is some evidence from the Local Investment Funds (see sections 3 and 4) that such an approach has delivered net additional economic benefits: there are SMEs which would not undertake project without grant, even if it might be possible for them to obtain repayable finance. However, in order to maximise additionality such a scheme would need to have clear operating parameters, with businesses only allowed to access a grant once and those that had previously accessed such a grant from another scheme being ineligible.

### 3: Social enterprises and charities

- 2.29 These types of organisation have socio-economic and/or environmental objectives at their heart. Whilst some of these organisations engage in trading activities, there are certain activities which will never be able to be sold on markets and some social enterprises which will never be financially self-sustaining. Such activities and organisations can therefore only be funded by grants and donations since they cannot generate a suitable income stream to repay finance.
- 2.30 It should be noted that ERDF funds cannot be used for activities that will never be self-sustaining, but even if the organisation is aiming to be a sustainable trading enterprise, grants can still play a role at key stages. A recent report by the Big Lottery Fund sets out some of the circumstances in which grants for trading social enterprises may be appropriate, including product testing, market

<sup>13</sup> There is some evidence from the CDFI sector, which found that only 30% of CDFA members were able to cover the costs of delivering finance via income earned from loan products.

testing, and funding activities that generate considerable social value but do not bring in enough income (see scenarios 1 and 2 above).<sup>14</sup>

#### 4: Addressing a viability gap

- 2.31 In practice, many investments supported by publicly backed Funds involve a package of different funding sources, comprising a mix of mainstream commercial and publicly backed finance, where the public sector operates as a gap funder. In some of these cases grant plays a legitimate role in making the project happen.
- 2.32 An example would be an established SME with a capital investment project where a bank is able to offer some debt finance but only up to a certain level given its risk-return policies and security requirements. A publicly supported Fund (e.g. Finance Wales) may be able to offer some of the remaining finance needed, but the SME's gearing position may make a 100% debt funded project excessively risky, and the return on an equity investment would not be attractive. In this case there would remain a residual funding gap for the project.
- 2.33 In these circumstances there can be a case for public sector grant (or soft loan) funding to fill the viability gap and enable the project to go ahead, but only if the additionality and value for money tests set out earlier are met. That is, it is dependent on the level of economic benefits such as job creation and the project not being able to go ahead at all, or even on a reduced scale without the grant (this could be the case where the capital investment required is fixed).
- 2.34 Finance Wales has provided a number of examples of such projects where public sector grant has played a role in filling such a viability gap. Such grants have been of a variety of sizes. In these cases the grant has generally come from local authorities.

<sup>14</sup> Big Lottery Fund (2014) *Social Investment Explained*.

### 3. Review of Grant Provision in Wales

#### Key Points

- The provision of general SME grants at a national level in Wales has been dominated by the LIF (up to £10,000) and the Economic Growth Fund (over £50,000). However, there is no significant provision of this type provided at between £10,000 and £50,000.
- Provision of R&D focussed grants is patchy outside of the Innovation Vouchers scheme.
- There is a relatively strong source of sector specific grant finance between £5,000 and £50,000 for investment in the priority sectors, such as tourism, digital, construction, manufacturing and advanced materials.
- A small number of local authorities provide general business grant support (e.g. Bridgend, Caerphilly, Conwy, Rhondda Cynon Taf), typically providing no more than £3,000 apart from a small number of schemes which provide up to £5,000.
- Applications for grants account for 10% of all SME applications for finance. However, assessing the demand for grant finance is problematic as demand for grants is intrinsically linked to supply; there is little cost to the business outside of those incurred in applying for the grant (and the associated risk of being unsuccessful in that application). Consequently there is no effective limit to demand for grant finance.

- 3.1 In this section we provide an overview of the current landscape of SME grant provision in Wales and the evidence on demand.

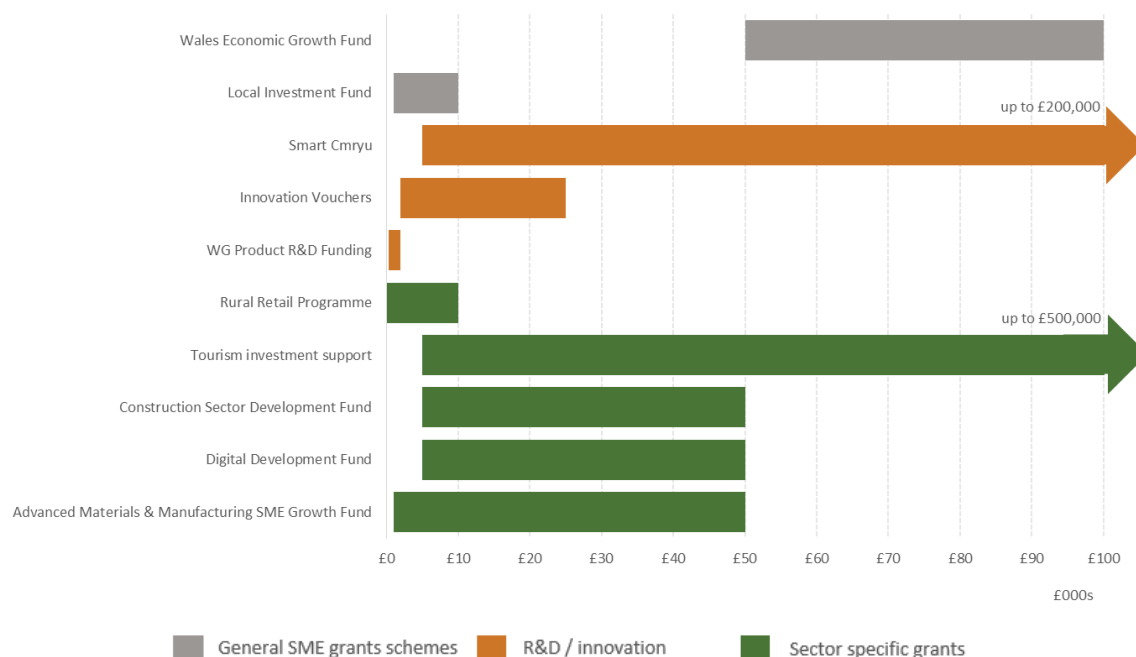
#### Current Supply of SME Grants

##### Grants delivered on a pan Wales basis

- 3.2 A significant number of grant schemes exist in Wales – many of these are targeted towards start-ups whilst others are restricted to specific geographical areas (typically local authority areas or rural wards) or specific groups (e.g. graduates, young people, the unemployed).
- 3.3 Figure 3.1 shows the scales of grant finance available through a number of key schemes operating in Wales at the time of writing.
- 3.4 The two key schemes that operate across various parts of Wales (the Wales Economic Growth Fund and the Local Investment Funds) have a different focus in terms of the scale of finance offered. The EGF offers relatively large grants (between £50-£100k), whilst the LIFs offer small grants (up to £10k)
- **LIF:** The three LIF projects have been operating in the North West, South West and South East Wales Convergence areas and are funded by ERDF and private match funding. They have a combined lifetime total of £42.6 million in SME grants available. The three schemes have recently been extended, with additional funds in some cases to Summer 2015. The schemes were designed to:
    - fill the gap at the ‘lowest levels of support for investment’
    - provide flexibility to respond to business need and without being targeted on any particular sector
    - stimulate private sector investment.
  - **Wales EGF:** which has a broad remit to support and bring forward business and social enterprise projects that stimulate economic growth and job creation.

- 3.5 The supply of R&D and innovation grants is patchy outside of the Innovation Voucher scheme and R&D support for product development (i.e. for grant values in excess of £25,000). While SMART Cymru grants span a wide range in terms of value, the majority of grants are towards the higher end of this value and are targeted through competition towards quite specific areas of research.
- 3.6 Sector specific grants or grants to finance specific investments (e.g. in business premises, ICT) are delivered Wales wide as opposed to at district level and tend to be available for up to £50,000 (though rural retail and tourism investment grants are an exception).
- 3.7 Two grant schemes supporting social enterprises have also been available. The South East Valleys Community Economic Development Programme (which has now closed), offered between £25,000 and £100,000 for investment in business support, IT, employment costs and buildings to South East Convergence areas. Meanwhile, the £4 million Cyfenter project provides grants of up to £75,000 to support sustainability and viability of services that meet unmet community needs. This has included community shops, tourism initiatives and elderly care services.
- 3.8 Further details on each of the schemes considered as part of this study are provided in Appendix A. The schemes listed are by no means exhaustive of all such support available across Wales and is only intended to illustrate the breadth of grant finance available currently.

**Figure 3.1 Key Grant Schemes Available in Wales**



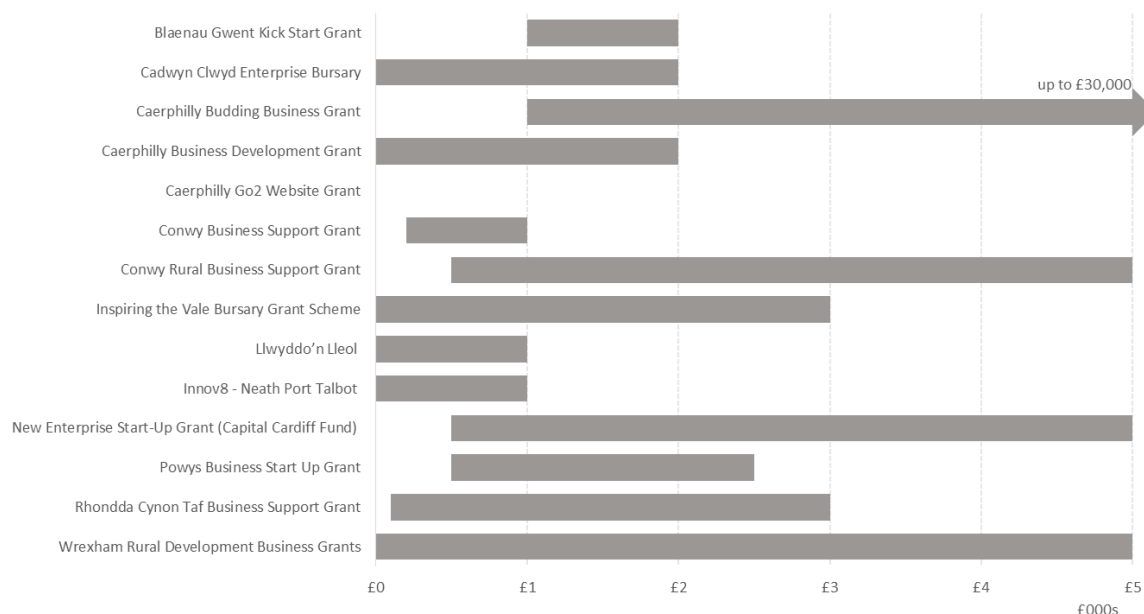
Source: Regeneris Consulting

### Locally Delivered Grants

- 3.9 A small number of local authorities provide general business grant support (e.g. Bridgend, Caerphilly, Conwy, Rhondda Cynon Taf) all of which offer relatively small amounts (typically no more than £3,000 apart from a handful of schemes, which go up to £5,000).
- 3.10 The table below excludes grants focused on regeneration activity, which tend to be for large amounts to fund the improvement of commercial buildings and townscapes. These are the North East Wales Town Centre Regeneration Scheme offering up to £80,000, the Aberdare Townscape Heritage Initiative (up to £100,000), the Bridgend Commercial Property Grant scheme (£15,000

grants) and the Pembroke Commercial Property Grants scheme (offering discretionary grants). In addition, several financial grant support schemes are currently available via the RDP to existing and new businesses in rural areas only.

**Figure 3.2 Local Grant Schemes Available in Wales**



Source: Regeneris Consulting

## Demand for SME Grants

- 3.11 Assessing the demand for grant finance is problematic. As we saw in section 2, demand for grants is intrinsically linked to supply given the lack of a price mechanism to ration demand. As a result take up rates can be high. Data on the performance of the existing grant schemes in Wales is hard to come by, so it has not been possible to look at take-up across these schemes. However, findings from the evaluation of the LIF support the notion that the low cost nature of grants was indeed a strong draw. The majority of businesses applying for a grant did not do so because they had had difficulty accessing finance elsewhere and would be far less inclined to have applied if the finance was repayable or incurred even low level interest payment<sup>16</sup>. Indeed the feedback from this evaluation - which showed that in around three-quarters of cases (72% of supported businesses surveyed) the LIF funded project would not have gone ahead without grant support - suggests that grant funding can act as an important stimulus for growth and development within businesses which would otherwise simply not have happened.
- 3.12 Results from the 2012 BIS Small Business Survey show that of the 24% of Welsh SMEs seeking finance, 10% applied for grants. Applying this across the total SME business base in Wales, this equates to around 2,700 SMEs<sup>17</sup>. Small business were more likely to seek grant finance – 19% of all those seeking finance having applied for at least one grant. For comparison, 53% of Welsh SMEs

<sup>16</sup> Oldbell3 and Regeneris Consulting (2013). Final Evaluation of the Local Investment Fund (LIF).

seeking finance applied for a bank loan, 28% overdrafts, 6% for leasing or hire purchase arrangements and 6% for factoring arrangements or asset-based finance.

- 3.13 The proportion of SMEs seeking grants across the UK as a whole is lower at 7% than in Wales. While data is not available for Wales over time Table 3.1 shows how demand for grants compare to a broader range of finance types and over time in the UK. After accounting for a 6% to 9% rise in the share of demand for finance between 2006/7 and 2010, the proportion of SME seeking finance who applied for a grant fell back in 2012.

<b>Table 3.1 Type of Finance Sought by SMEs across the UK (%)</b>				
	2012	2010	2007/8	2006/7
Bank loan	48	40	44	46
Bank Overdraft	35	35	26	22
Leasing or hire purchase	8	9	10	11
<b>Grant</b>	<b>7</b>	<b>9</b>	<b>7</b>	<b>6</b>
Factoring / invoice discounting	6	3	1	2
Mortgage	3	6	7	8
Loan from family or business	3	3	*	1
Credit card	3	1	n/a	n/a
Equity	2	2	2	2
Peer-to-peer or crowd funding	1	n/a	n/a	2
Loan from a CDFI	*	1	n/a	n/a

BIS (2012). Small Business Survey. \*less than 0.5% but greater than zero.

- 3.14 Local authorities consulted as part of the Final Evaluation of the LIF also highlighted the strong demand among small businesses for former Objective 1 grants, especially at a local level where smaller businesses are typically less inclined to apply for funding from larger schemes provided by central government or Finance Wales. Demand was especially high among leisure and tourism, accommodation and food, manufacturing and construction businesses.
- 3.15 In contrast, survey evidence from a review of grant support for the tourist sector shows that 80% of firms felt they would not have been able to undertake their project if it were not for the support received, grants were much larger on average, averaging £96,000<sup>18</sup>.

<sup>18</sup> Accounts for the removal of a single £1 million grant as an outlier. Jones, C., Munday, M., Bryer, N. (2012). 'Economic Impact Review of Investment within the Welsh Tourism Sector'. Welsh Economy Research Unit, Cardiff University and Old Bell 3; support comprised that from the Single Investment Fund (SIF) and Tourism Investment Support Scheme (TISS).

## 4. Evidence on Performance of Grants

### Key Points

- Assessing the effectiveness of grant support is difficult as grants often form one part of a wider package of support; evaluation evidence can be hard to come by and where it does exist an accurate assessment of the additionality of grants is often lacking.
- Grants are often less effective in generating increases in employment and turnover when compared with repayable grant, soft loans (sub-commercial interest rates) and interest rate subsidies on commercial rates. They should therefore only generally be offered where there is a clear case that other finance is not available or is inappropriate.
- The additionality of impacts appears to be greatest for smaller firms and smaller amounts of grant, as other finance (most notably debt finance) is often not available for these types of investment.
- The evidence suggests that grants are typically most effective where combined with a wider package of business support.

- 4.1 Here we review the benefits to have emerged from grant schemes elsewhere in order to draw lessons for how grants can be best designed and delivered in the future. The analysis draws on the research undertaken by Regeneris and Old Bell 3 for the 2013 Final Evaluation of the LIF funds.

### Problems Assessing Effectiveness

- 4.2 Drawing conclusions on the effectiveness of grant finance from current and existing schemes can be problematic for a number of reasons:
- Grants are often offered as part of a package of wider support measures. Where this is the case it is generally difficult to isolate the impact attributable to a specific grant, unless the evaluation specifically seeks to do this.
  - Availability of evaluation evidence can be limited, especially amongst schemes delivered locally and across other European states. This might be because the requirements in terms of monitoring and evaluation are less stringent or where grants are delivered directly from a local authority budget as opposed to drawing on European or central government funding pots that require a level of evaluation.
  - Evidence on deadweight and displacement is difficult to gather and is often omitted from the evaluation of grant schemes (a significant shortcoming in the evidence).
  - Impacts typically emerge over a number of years and so the timing of the assessment is important. In addition, it is not always clear whether additional costs such as a project management and administration are factored in, making it hard to compare findings on a like-for-like basis.

### Findings from the LIF Evaluation

- 4.3 Despite this the 2013 Final Evaluation of the Local Investment Fund provides a recent source of information on the impact of SME grant finance given that more than £30 million has been invested in over 1,500 SMEs. The following findings and conclusions are of particular relevance:
- A review of the literature around grant support suggested that the return on public investment is especially strong where business formation and survival rates are low, where grants are directed towards smaller businesses and where they are integrated with local advice services.

- LIF Supported businesses had grown more rapidly in employment terms compared to a sample of businesses who had applied for funding but either had their applications rejected or had not gone ahead with the project: supported firms had increased employment by an average of 2.4 FTEs per firm compared to 1.4 among non-supported businesses.
- A total of 1,929 gross FTE jobs were created amongst supported businesses according to monitoring data up to March 2013. This equates to an average gross cost per job of £6,519. However, survey research suggested 4,240 gross jobs had been created with 2,080 assessed as net additional. This equates to a central estimate cost per gross job of £2,970 and a cost per net job of £6,060 (the worst case scenario cost per net job was £7,240).
- £12.58 million in grants had helped to secure £19.08 in additional private sector investment – a rate of £1.52 per £1 of public money invested. However, the majority of businesses applying for a grant did not do so because they had tried and failed to access finance elsewhere, suggesting that LIF was not a scheme of last resort.
- Similarly, only a minority would have applied for finance if the finance had been repayable<sup>19</sup>. This is an important point that links back to the additionality of grant finance in securing economic benefits in this arena. In around three-quarters of cases the LIF funded project would not have gone ahead without grant support, indicating a role for grant as a stimulus for business growth and attitudinal change towards investment (linking to the behaviour change role of grants discussed in section 2). Any future scheme operating on this basis would need to ensure that businesses could only use grant once, in order to maximise additionality.
- Finally, the original grant funding intervention rate was set at 40%, but the survey showed that the grant accounted for 25% of the investment made across the projects. This suggests that there could scope to reduce grant intervention rates in future European programmes.

### Grants versus other Finance

- 4.4 Perhaps the most fundamental question to be addressed by looking elsewhere is that of the benefit of grant finance over debt or equity finance. While evidence is hard to come by – due in part to the reasons cited above - Bondonio and Martini (2012)<sup>20</sup> looking at two publicly subsidised business finance schemes operating across Italy using control group businesses to isolate the additional effect of various interventions over the counterfactual. They find that grant support was less effective when compared with a soft loan or interest rate subsidy (although it should be noted that the cost per job observed here is vastly higher than observed in other studies, so caution is needed in interpreting these figures – see below). Soft loans and subsidies led to job creation at an average of €29,600 and €21,200 respectively compared to €64,000 where grant finance is provided. Similarly, soft loans were leading to increased sales at a rate of €8.33 for every €1 invested through interest rate subsidies, €2 for soft loan investment but just €0.87 under grant finance. This adds weight to the argument that where businesses are in a position to repay on a loan or grant and public money can be recouped and re-invested, grant finance should be restricted.

### Scale of support

- 4.5 Bondonio and Martini (2012) also find that across all firm sizes, smaller grant values prove better value for money, with the largest grants generating cost per job figures more than five times higher

<sup>19</sup> Old Bell3 and Regeneris Consulting (2013). Final Evaluation of the Local Investment Fund (LIF).

<sup>20</sup> Bondonio., Martini (2012). 'Counterfactual Impact of Cohesion Policy: Impact and Cost-Effectiveness of Investment Subsidies in Italy'.

than for the smallest. It is suggested that this is because smaller and micro businesses applying for generally smaller grants typically have less in collateral to offer in accessing credit. As a result the additional benefit brought is greater versus the counterfactual case, than for larger, more established firms.

- 4.6 Czamitzki et al. (2011)<sup>21</sup> find that follow-on grant support (two years after an initial grant) generates improved returns in terms of firm innovation and productivity. This suggests that grant finance (or follow-on finance of some type) at a new stage of firm development of some type may be beneficial over higher levels of one-off support or extended or on-going finance.

### Firm Size and Stage of Development

- 4.7 The LSE (2012) analysis of Regional Selective Assistance show that grant funding has an especially important role to play in the earlier stages of business formation and expansion; e.g. by removing the barriers to finance faced by smaller firms as a result of constrained access to finance and associated barriers to investment. Furthermore, grants to smaller firms have been shown to deliver stronger indirect impacts across local supply-chains, where employment and firm numbers have been seen to grow.

### The Benefit of Wider Accompanying Business Support

- 4.8 The Rotger and Gørtz (2009)<sup>22</sup> evaluation of a business support project in Denmark finds that a relatively modest investment of between 4 and 12 hours of accompanying support to businesses also in receipt of a grant can raise survival rates considerably. They also find a significantly higher job creation rate of 0.5 per business under extended support versus 0.27 and a moderate increase in long-term growth patterns under basic financial support (incorporating grants and soft loans).

### Job Creation

- 4.9 While there is significant variation in the scale of economic impacts generated by grant schemes depending upon the type of scheme, overall the evidence suggests that a strong return on investment can be generated in gross terms. Evidence on the impact of grant schemes delivered at local authority level across Wales is shown below and highlights strong value for money in terms of gross job creation. **Given the lack of evidence on deadweight factors this evidence on cost per gross job should be treated with considerable caution as the cost per net job could be considerably higher than these values.**

<sup>21</sup> Cited in Trzcinski, R. (2011) 'Towards Innovative Economy: Effects of Grants to Enterprises in Poland'. Polish Ministry of Regional Development. Polish Agency for Enterprise Development.

<sup>22</sup> Rotger, G, P., Gørtz, M. (2009). 'Evaluating the Effect of Soft Business Support to Entrepreneurs in North Jutland [Denmark]'.

Table 4.1 Local Grant Schemes in Wales: Employment Impacts

	SMEs Supported	Total Value of Grant Funding	Gross Jobs Created	Average Grant Value.	Cost per Gross Job
Pembrokeshire Business Grant Scheme <sup>23</sup>	164	£1 million	500	£6,000	c. £2,000
Anglesey Business Development Grants <sup>24</sup>	230 (114 new, 116 existing)	£442,000	172	Just under £2,000	£2,570
Bridgend Business Support Flexible Grant Scheme <sup>25</sup>	213 (63 new, 150 existing)	£320,000	284	£1,500	£1,120
Torfaen Business Development Grants	-	£1.86	1,976	-	£940
Blaenau Gwent Economic Development & Nurturing Grant Schemes		£355,000	52		£6,500 - £7,000
Rhondda Cynon Taf SME Grants		£380,000	133		£2,860

- 4.10 However, no evidence is available for these schemes on the additionality of these benefits and evidence on gross job creation is of limited value. A scheme with low costs per gross job may represent poorer value for money than one with high costs per gross job, if the first has significantly higher levels of deadweight (i.e. businesses receiving grants who would have made the investment even without the grant) and/or displacement (i.e. supporting businesses who go on to win market share by taking it from other, non-supported businesses in the same geographical area).
- 4.11 Findings from an assessment of **Regional Selective Assistance** across England and Wales show that there is a strong positive effect on employment where support is targeted towards smaller businesses (employing fewer than 150 employees)<sup>26</sup>. Specifically, a 10% grant subsidy leads to a 7% increase in employment, at a cost of less than £5,000 per net job. Half of this (3.6%) is attributed to growth in existing businesses and half to new business start-ups. The effect on local unemployment rates is also positive suggesting that employment growth has not necessarily come at the expense of other existing employment in the area.
- 4.12 The **Irish County and City Enterprise Boards** (CEB) have led to the creation of 33,500 gross FTE jobs at a cost of €4,300 per job (c. £3,425). However, while the grant component comprises the core element of the scheme overall, it is impossible to disentangle the effects of grant support from the other advice and support made available in creating these jobs. Caution must therefore be taken in interpreting the results<sup>27</sup>.

<sup>23</sup> WEFO (2007). 'Europe and Wales: Investing in Your Future'.

<sup>24</sup> Old Bell 3 (2007). 'Evaluation of Business Development Grants'. Isle of Anglesey County Council.

<sup>25</sup> Brooksbank, D., Arrowsmith, R. (2008). 'Evaluation of Bridgend Business Support Framework Flexible Grant Scheme' Cardiff Metropolitan University.

<sup>26</sup> Hart, M., Driffield, N., Roper, Stephen and Mole, Kevin (2008) *Evaluation of regional selective assistance (RSA) and its successor, selective finance for investment in England (SFIE)*. United Kingdom: BERR (Department for Business Enterprise & Regulatory reform). (BERR Occasional Paper).

<sup>27</sup> Department for Enterprise, Trade and Employment (2004). 'Local Enterprise – A Decade of Support: A Review of the City and County Enterprises Boards 1993-2003'.

- 4.13 However, elsewhere the cost per job is higher. Of perhaps greatest relevance, the Wales Economic Growth Fund returned a cost per gross job of £21,200<sup>28</sup>. Findings from Mouqué (2012)<sup>29</sup> - which looks at major grant schemes in Poland, Italy and Germany - also display a much greater average cost per job – between £12,600 and £54,100. However this was for much higher value employment<sup>30</sup>. Mouqué (2012) also finds that grant schemes typically lead to increased output but negligible productivity enhancement.
- 4.14 The lesson overall is that job creation is highly dependent upon the design of the scheme and the context in which it operates and the evidence suggests there can be a case for generating employment growth through grant investment at small scale aimed at smaller and new businesses and start-ups in particular.

### Levering Private Investment

- 4.15 While findings vary significantly, research generally shows that grant schemes have been effective in leveraging large sums of private sector investment.
- 4.16 Findings from the Final Evaluation of the LIF show that only a small proportion of businesses surveyed as part of the final LIF evaluation suggested that the requirement to provide 60% match funding had acted as a deterrent on demand and that more than 90% of businesses had been able to match the grant using their own funds (although it was suggested this might be difficult for start-up businesses to meet).
- 4.17 On average the grant schemes assessed by Mouqué (2012) lever an additional £0.30 for every £1 of grant. However, results from six studies across Germany, Italy and Poland vary; using control groups to estimate the scale of *net* finance leveraged, half of the schemes delivered a strong return (in excess of 130% of the grant) while two schemes delivered less investment than the value of the grant received. Here grants appear to be displacing some of the investment which would have been made by the business regardless i.e. there is a net reduction in the scale of overall investment.

<sup>28</sup> Old Bell3 and Regeneris Consulting (2013). 'Final Evaluation of the Local Investment Fund.'

<sup>29</sup> Mouque, D. (2012). 'What are Counterfactual Impacts Evaluations Teaching us about Enterprise and Innovation Support'. DG for Regional and Urban Policy. European Commission.

<sup>30</sup> Applies an exchange rate of €1 =£0.85

## 5. Conclusions

5.1 For the reasons discussed in Section 2, notably the value for money for the public purse and the risk of crowding out private sector alternatives, publicly backed finance to support SMEs should generally be done on a repayable basis by default, unless there is a clear and strong rationale for offering grant finance. Any grant scheme needs to demonstrate that:

- 1) It delivers significant economic spillovers (technology and innovation, enterprise, employment and regeneration, social or environmental), such that these spillovers justify the public sector costs of the grant.
- 2) Businesses to be supported have exhausted all other sources of finance, including commercial sources, alternative sources and publicly backed repayable sources (so the scheme does not crowd out the market or other public sector schemes).
- 3) Investment projects supported would not go ahead without the grant, or would go ahead on a significantly reduced scale or delayed timescale. This is related to point 2, although there are some instances where other, repayable sources of finance may be available to businesses but their repayable nature disincentivises investments with significant spillovers.
- 4) The programme would not be able to be delivered economically on a repayable basis due to the additional operating costs associated with administering loans (assuming that conditions 1) -3) are met).

5.2 The available evidence is very mixed on the strength of the rationale for existing grant schemes, their co-ordination with other, repayable sources of publicly backed finance, and the additionality of outputs. Our review of the market failure theory and available evidence on existing schemes suggests that there is an in-principle case for providing grant in the following circumstances:

- 1: Early stage R&D. Grant finance can be suitable for very early stage ventures to support specific activities including proof of concept and provide seed funding.
- 2: Encouraging behaviour change. There is sometimes a case for the public sector to use a grant as a means of incentivising behaviour change in order to tackle an important market failure and to deliver public goods (e.g. incentivising risk-averse small businesses to invest in expansion; providing grants to SMEs to invest in energy efficiency measures). Evidence from the recent evaluation of the LIFs indicates a reasonable case for supporting risk-averse SMEs to expand through the provision of small grants, provided that clear operating parameters are put in place to maximise additionality. In particular, we suggest that businesses can only receive one grant and those which have previously been in receipt of grant should be ineligible.
- 3: Social enterprises and charities. There is a case for supporting social enterprises via grant due to the significant social/economic/environmental spillovers from their activities. Such enterprises often need finance in the form of grants at key points in their development, although it should be noted that ERDF cannot fund activities that will never be financially self-sustaining.
- 4: Addressing a viability gap. There are instances of SME investment projects where there remains a funding gap even after their own contributions and those from commercial sources, where the expected financial return and gearing of the company means it is not sensible to fund the project from these sources alone.

- 5.3 Our review of the evidence also suggests the importance of ensuring that any grant scheme is well-integrated with accompanying business advice.
- 5.4 Any proposed grant scheme would also need to:
- ensure that any SME aid is State Aid compliant.
  - be clear on the position on match funding. For example, issues were encountered with the current JEREMIE Fund in Wales when it was determined that grants from the Local Investment Funds could not be used as match funding for the JEREMIE microloan since both are EU funded. This point needs to be clarified if any proposed EU-funded grant scheme is potentially to be investing directly alongside EU-funded products offered by Finance Wales.
- 5.5 Any proposed grant intervention would need to be subject to an appraisal as part of the project development process to ensure that these conditions would be applied and that demand on the basis of these conditions would be sufficient to make a scheme worthwhile.

## Appendix A - Grant Schemes in Wales

- A.1 Here we provide a list of SME grant schemes operating in Wales at present, distinguishing between those that operate throughout Wales, UK and EU schemes operating in Wales and local schemes and sector-specific schemes. The list is intended to be indicative rather than a comprehensive mapping.

## Grants for SMEs in Wales

**Table 5.1 Wales wide**

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
Wales Economic Growth Fund	Between £50,000 and £100,000  Fund value: £30million	For investments linked to creation and retention of jobs. Targeted at private sector, including social enterprises and inward investment companies including manufacturing and service sector serving more than just local markets.  Eligible expenditure can include new investment in capital assets such as plant and machinery, IT equipment, fixtures and fittings, buildings, capitalised lease costs over a minimum of 8 years for new leases. Intellectual property purchased from a third party and one off professional fees associated with the project can also be eligible. Fund operates across the economy except for those restricted by EC	More than £9 million was allocated to 135 projects in the first phase of the fund in early 2013 – creating 980 potential jobs across Wales and safeguarding the future of almost 800 more.	Wales wide	Welsh Government 2013 2014
Smart Cymru	Between £5,000 and £200,000	Assists businesses to undertake R&D projects leading to innovative products or processes. Grants are available at four different phases of the R&D process: Technical & Commercial Feasibility: investigation of the commercial and technological viability of innovative product concepts to develop a feasibility report. (£5,000 to £15,000 available for up to 75% costs Industrial Research: structured research to develop a basic working model (£30,000, to £100,000 to cover up to 70% of costs Experimental Development: application of research to prove new products, including conceptual formulation and designs and the creation and testing of a pre-production prototype (£60,000 to £200,000 to fund up to 45% of costs) Exploitation: including marketing, publicity, product certification (£5,000 to £20,000 to cover up to 50% of costs) Support could be higher if the project demonstrates ‘world-leading R&D and huge market potential, over a 2 year period’.		Wales Wide	Welsh Government Research and Development and Innovation Department. Future funding dependent on the 2014-20 ERDF Programme

## Grants for SMEs in Wales

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
Product Research and Development Funding	Between £300 and up to £2,000 for up to 50% of project costs	Grant support for salary and employment related costs. Available to established SMEs		Wales wide	Welsh Government (Business Wales)
Prince's Trust	Between £500 and £3,000 grant assistance	Financial assistance for 14-30 year olds with a particular focus on long-term unemployed, are in or are leaving care, who are struggling at school or have been in trouble with the law.		Wales wide	Prince's Trust
Graduate Start-Up Bursary	Discretionary bursary for £6,000	Eligible for clients with a turnover in excess of £80,000 per annum and projected growth of 20% year on year for first three years of trading. Minimum one full time position created. <a href="http://business.wales.gov.uk/bigideas/are-you-eligible-bursary-0">http://business.wales.gov.uk/bigideas/are-you-eligible-bursary-0</a>		Wales wide	Welsh Government – Big Ideas Wales/ Graduate Start Up Support
Young Entrepreneurs Bursary	Discretionary bursary for £6,000	Financial support for those not in education, employment or training aged between 16 and 24 who are due to start their business within two months of award being approved.			Welsh Government – Big Ideas Wales

## Grants for SMEs in Wales

Table 5.2 UK and European Schemes Available in Wales

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
Innovation Vouchers	Between £2,000 and £25,000 to fund up to 50% of costs	<p>To provide financial support for:</p> <ul style="list-style-type: none"> <li>• work commissioned with appropriate third party expertise delivering advancements in new products and processes</li> <li>• capital investment in transformational technology, where the investment results in a step change in the technology base of the company.</li> </ul> <p>The impact of each project should include improvements in efficiency, operating capability or capacity for business growth. The primary aim of the support is to assist the implementation of new processes via specialised equipment. Each project should represent a significant technology step and demonstrate commercial potential for the business in its industry or amongst its competitors. Businesses that have been trading and generating revenue for under two years are not usually eligible for the support of capital investment projects.</p>			2015 end
Manufacturing Advisory Service (MAS) Grants	£300-£3,000	.			
Collaborative R&D Grants		<p>Co-funds projects to encourage knowledge exchange, supply chain development and parallel working on complex challenges.</p> <p>Competitions are held periodically for grants to fund specific research areas. For example, at the time of writing competitions are open for grants for mechanical conversion manufacturing processes, energy harvesting for autonomous electronics and advancing regenerative medicines and cell therapies</p>		England & Wales	The Technology Strategy Board (TSB)

## Grants for SMEs in Wales

**Table 5.3 Local Schemes**

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
Local Investment Fund	Between £1,000 and £10,000 grant funding at up to 40% of project costs.	Provision of capital grant funding and some revenue expenditure (typically one-off non-recurring marketing costs and website development).		Convergence Authorities	Three lead authorities: Anglesey for the NW (03/09 to 08/14) Carmarthen for the SW (09/08 to 03/15) Rhondda Cynon Taf for the SE (11/08 to 12/13)
Connection Vouchers Scheme	£3,000  UK Fund of £150m. £10.2million for Cardiff. Newport has also been awarded funds	Assistance to businesses for capital costs relating to high speed broadband connections  To be eligible for funding under the Cardiff Connection Voucher Scheme you must be based within a business or residential premise in Cardiff's Local Authority boundary and be one of the following: <ul style="list-style-type: none"> <li>•Small or Medium Enterprise (SME), typically employing less than 250 people</li> <li>•Social Enterprise / Community Interest Company</li> <li>•Charity / Third Sector</li> <li>•Sole Trader / Small Office Home Office (SOHO)</li> </ul>		Cardiff and Newport	UK Government (administered via Newport and Cardiff Councils)  2014-present
North East Wales Town Centre Regeneration Scheme	Between £1,000 and up to £80,000 for up to 80% of external project costs and 60% for internal works.  £4m	Refurbishment of buildings and frontage in town centres. Funding available via ERDF, Welsh Government and local authorities.		Flint and Wrexham	Flintshire County Council

## Grants for SMEs in Wales

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
Aberdare Townscape Heritage initiative	Up to £100,000 Fund worth £7.7m	Grants for commercial property improvements in Aberdare town centre		Rhondda Cynon Taf	Rhondda Cynon Taf County Borough Council  Funding secured 2010
Pembroke Commercial Property Grant Scheme	Discretionary £1.47m fund	Grants for improving townscapes in Pembroke and Pembroke Dock	Suspended amidst allegations of Fraud	Pembrokeshire	Pembrokeshire County Council 2013-14
Bridgend Commercial Improvement Area Schemes	£15,000 for up to 30% of project costs.	Financial assistance for premises related improvements		Bridgend	Bridgend County Council
Bridgend Industrial Improvement Area Scheme	Up to £25,000 for up to 30% of project costs.	Financial assistance for premises related improvements available to new or established SMEs		Bridgend	Bridgend County Council
Blaenau Gwent Kick Start Grant	£1-2,000	Financial support for starting a business in Blaenau Gwent  The enterprise must be based in Blaenau Gwent and must not directly compete with an existing business in the same local area.		Blaenau Gwent	UK Steel Enterprise Ltd
Cadwyn Clwyd Enterprise Bursary	Maximum value £2,000 for up to 80% of project costs.	Bursary primarily for young people in rural areas to start up in business. Funded via RDP and Welsh Government		Rural wards of Denbighshire and Flintshire	Cadwyn Clwyd
Caerphilly Budding Business Grant	£1,000 to £30,000	Capital funding for micro-enterprises covering food, timber, craft, creative industries, marketing and promotion. Funded via RDP and Welsh Government		Rural wards of Caerphilly	Caerphilly County Council  Runs to Sep 2014

## Grants for SMEs in Wales

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
Caerphilly Business Development Grant	Up to £2,000 for up to 50% of eligible costs.	Grant for existing or new businesses to develop and grow to cover capital equipment, e-commerce and ICT, marketing, feasibility studies and business planning. Consideration given to potential job creation, other investment from private sector, value for money, cross cutting themes and need for grant support.		Caerphilly	Caerphilly County Council
Caerphilly Go2 Website Grant	Discretionary for up to 50% of costs	Grant for developing online presence or trading online open to businesses from all sectors, including retail		Caerphilly	Caerphilly County Council
Conwy Business Support Grant	Between £200 and £1,000 for up to 50% of project costs	Discretionary grant to support sustainability and growth of businesses with priority given to those demonstrating increase in profitability, turnover and employing additional staff. Open to new businesses (at least three months old) established businesses, social enterprises or farm diversification projects		Conwy	Conwy County Council
Conwy Rural Business Support Grant	Between £500 and £5,000 for up to 50% of eligible project costs	Financial assistance funded via the RDP to support business expansion for micro businesses (less than 10 employees), sole traders, limited companies, social enterprises and community groups		Rural Conwy	Conwy County Council
Inspiring the Vale Bursary Grant Scheme	Bursaries up to £3,000 for 80% of project costs  Over £60,000 is available during the coming year	Financial assistance to young people aged under 30 to start up new business or community enterprise. Two types of bursaries are available – taster bursaries for up to £1,000 or full time bursaries up to £3,000.	Between 2008 and 2011, supported 23 new businesses	Value of Glamorgan Council	Creative Rural communities  Ran 2008-11. Relaunched 2014
Llwyddo'n Lleol	Up to £1,000  £3.8m fund	Financial assistance for young people to create a culture of enterprise.  Available to individuals or groups of young people who are between 11 to 19 years old, and live in either Gwynedd, Anglesey, Conwy or Denbighshire who would like to trial a business idea.	16 successful applicants in June 2014	Anglesey and Gwynedd	Menter a Busnes  2011-present

## Grants for SMEs in Wales

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
Neath Port Talbot Innov8 Scheme	Up to £1,000 for up to 50% of start-up costs	Grant for those out of work aged 31 or over to start up a business		Neath Port Talbot	Neath Port Talbot County Council
New Enterprise Start-Up Grant (Capital Cardiff Fund)	Between £500 and up to £5,000	Available to new businesses for capital expenditure projects that are likely to create jobs. Not available to retail or local service industries.  Eligibility is dependent on the following criteria: Companies trading for no more than 2 years; No retail or purely local services; Business plan with 3 year financial projections; Business address (not working from home or any residential premises); Fixed asset capital expenditure (machinery/equipment/refurbishment/fit out); Creation of Jobs; applicants registered with an appropriate business advisor.	June 2010 article - 32 companies have been assisted with a total of £655,143 through grants, loans and, in the case of MedaPhor and Q Chip, direct investment through buying an equity stake. It is anticipated that the cash will create 405 jobs.	Cardiff	Cardiff County Council
Powys Business Start Up Grant	Between £500 and £2,500 for up to 50% of project costs	Grant funding for start-up businesses to help with capital expenditure. Restricted to particular sectors and particular expenditures (notably marketing, IT, office equipment, specialist equipment and retail fittings)  Who can apply: Consumer facing businesses which are based within Powys. Applicants will need to demonstrate that they have an ability to 'add value' or offer net benefits to the local economy (through job creation, evidence of job creation will be required within 3 months of grant payment).		Powys	Powys County Council
Rhondda Cynon Taf Business Support Grant	Between £1,00 and up to £3,000 for 50% of eligible project costs	Grant funding to develop growth of SMEs for expenditure such as capital and ICT equipment, website development, one off marketing materials and commercial property building works.		Rhondda Cynon Taf	Rhondda Cynon Taf Council

## Grants for SMEs in Wales

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
Wrexham Rural Development Business Grants	Up to £5,000 for up to 50% of project costs £960,979	Grants for SMEs employing less than 20 people and micro businesses employed fewer than five people. Funds for marketing, IT and environmental projects made available via the RDP programme.		Rural Wrexham wards	Wrexham County Council 2007-11

## Grants for SMEs in Wales

**Table 5.4 Social Enterprises**

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
South East Valleys Community Economic Development Programme (SEWCED)	Four options available including up to £25,000 revenue funding at up to 100% intervention rate and up to £50,000 at up to 100% capital funding.  EU Funds Awarded: £9,096,192  National Funds: £4,379,664	Provision of financial support – capital and revenue to third sector organisations. The project has come to an end.  Funding is available to community organisations that generate income through trading, with a legal structure and clear social objectives. Eligible projects could include purchase of equipment, land and buildings; building refurbishment; business planning, feasibility studies and marketing strategies; staff costs; project running costs		South East Convergence Authorities	Merthyr Tydfil County Council  2010-2015
Cyfenter	Up to £75,000  Project value £4 million  Has attracted more than £40m of funding since it was established	Provision of capital and revenue investment in new and developing social enterprises. <a href="http://www.cyfenter.com/index.php/en/">http://www.cyfenter.com/index.php/en/</a>  Ineligible for support – direct expenditure on building/renovation of housing, services that are statutory responsibility of central or local government or their agencies; generalised statutory education; activities in support of production/primary processing of agricultural, fisheries or forestry products; direct support for health services and local social welfare facilities; activities which demonstrably displace existing activities; activities covered by EC sectoral restrictions	Since its launch, the Cyfenter Fund has assisted almost 50 Social Enterprises in delivering new services across North West Wales	North West Convergence Authorities	Menter Mon  Established 20 years ago. Current fund launched 2012 and ends 2015
Collaborative Communities		Support for voluntary and community organisations (Third Sector) to become financially sustainable and to promote Social Enterprises. Runs until December 2013.		The County Councils and County Voluntary	Operating until June 2014

## Grants for SMEs in Wales

Name	Grant Value, Total Value	Remit, Eligibility	Performance	Geography	Provider, Time Period
				Councils in Carmarthenshire, Neath Port Talbot, Pembrokeshire and Swansea	
Ceredigion Social Enterprise Growth Fund	£30-125k	A grant scheme operating in Ceredigion designed to enable social enterprises to expand their trading activity, create permanent jobs and help ensure the sustainability of their organisation in the long term.		Ceredigion	Operating until April 2014

Table 5.5 Sector-specific

Name	Grant Value, Total Value	Remit, Eligibility	Geography	Provider, Time Period
Tourism investment support scheme	£5,000 to £500,000 for up to 25% of project costs.	For tourism businesses to update facilities/increase capacity. All tourism businesses irrespective of size are eligible for consideration if they meet the criteria.	Wales wide	Welsh Government
Digital Tourism Business Framework Programme	Up to £100,000	Funds innovative pilot projects in growing and established businesses.		Welsh Government, End 2014
Construction Sector Development Fund	Between £5,000 and up to £50,000 for up to 50% of project costs  Total Fund value £250,000	Support for construction SMEs to grow in domestic and international markets  Companies applying should ensure the proposed project shall benefit the Welsh construction sector economy and that the project delivers new or improved services or markets. Projects will involve the development or exploitation of a project, product or service for the use within the construction sector both home and abroad	Wales wide	Welsh Government  End 2014

## Grants for SMEs in Wales

Name	Grant Value, Total Value	Remit, Eligibility	Geography	Provider, Time Period
Digital Development Fund	Between £5,000 and up to £50,000 for up to 50% of project costs	Grants for creative industries to develop new creative products and services  Companies applying should ensure the proposed project will use the digital economy to access new markets	Wales wide	Welsh Government  2011-present
Fund Value: £2m				
Advanced Materials and Manufacturing SME Growth Fund	Between £1,000 and £50,000 for up to 50% of eligible project costs	Revenue grant for business development activity  External, invoiced, revenue costs only, which could include (not an exhaustive list): bringing in industry specific expertise; market research or studies; costs of UK trade events; costs associated with putting together a bid for larger funds (excluding Welsh Government funded grants); legal advice on formation of a consortium or other Special Purpose Vehicle (SPV); and production of a marketing strategy.	Wales wide	Welsh Government  End date March 2014
Processing and Marketing Grant Scheme (PMG)	Up to £1.2million with contribution dependent on type of business and whether they are based in Convergence or Non-Convergence areas – ranging from at least 50% up to 80% of project costs.	Grant for farm and forestry businesses, food and drink producers and processors in Wales  For agricultural products micro, small, medium and intermediate size businesses. For forestry products only micro enterprises can apply.	Wales wide	Welsh Government

The background is a collage of various images. It includes a large section of a modern building with a glass facade reflecting greenery and a blue sky. There are also smaller, semi-transparent images of trees and architectural details. The collage is composed of several overlapping rectangular and irregular shapes in shades of blue, green, and white.

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