

WEFO response to Regeneris and Old Bell 3 Thinkpiece: “Grants for SMEs in Wales”

Purpose of Report

The Thinkpiece by Regeneris Consulting and Old Bell 3 complements, and should be read in conjunction with, the other detailed analyses informing the development of the 2014-2020 ERDF programmes in Wales. This includes the Socio-Economic Analysis, Ex-Ante Evaluations, and the Ex-Ante Assessment informing development of Financial Instruments (not yet complete).

The Thinkpiece relates to the principle of grants for SMEs in the round. It does not set out where grants should be used in the ERDF programmes; this is the purpose of the Operational Programme. It is also worth noting that the use of grants (or not) is not a means in itself; it represents a delivery choice, and that choice depends on the outcome being sought.

Before considering the best delivery method (e.g. advice, loans, grants) any proposal for ERDF funding must first demonstrate how it is directly delivering against the ERDF Operational Programme’s objectives. Once this can be demonstrated this Thinkpiece helps to clarify those areas in which grants *may* be an appropriate delivery response.

Should a proposal *first* meet the ERDF objectives, *then* be one of the areas in which grants might be appropriate, they would *then* need to be able to demonstrate how each of the four pre-conditions for grant funding are being met. Only if *all* these criteria are met would grant payments to businesses be used.

Summary

In the 2014-2020 ERDF Programmes, grants will only be used as a last resort. WEFO notes the different rationales for the use of grants set out in the report, some of which are applicable to the Welsh ERDF programmes and some which are not. The ERDF programme identifies in which areas investment will be targeted, taking into account the principles of prioritisation, concentration and simplification.

WEFO agrees with the set of four core preconditions identified by Regeneris and Old Bell 3 that must be met for any grant scheme to be considered, but emphasises that meeting these conditions does not mean the scheme will fit with the ERDF programmes. Before considering the use of grants any proposal must directly address one of the specific objectives set out in the ERDF Operational Programmes, and must also reflect the scenarios in which grant is an appropriate response.

Grants are already envisaged in the ERDF programmes and the following will be supported where an appropriate contribution to the relevant ERDF programme objectives and results can be evidenced, and all conditions for use of grants are met:

- Priority 1: To support research, development and innovation in enterprises, and attract more private and competitive research funding, where investments align with the smart specialisation approach

- Specific Objective 2.4: To support investments by SMEs in resource efficiency, given the lack of incentive to do so through other forms of finance
- Parts of Priority Axis 4: To stimulate private investment in infrastructure in carefully prioritised areas which directly deliver the relevant Specific Objective

Some of the conditions mentioned in the Thinkpiece are not applicable to the ERDF programmes as they were not identified as priorities as part of the process of concentrating on a limited number of very specific objectives in which the greatest impact can be delivered. These types of grant funding mentioned in the report will therefore not be supported:

- The ERDF programmes do not include any provision to support economically unsustainable Social Enterprises and Charities (they are able to access all of other support on the same terms as other SMEs)
- The ERDF programmes do not include provision to encourage risk-averse businesses to invest through grant support

Specific Objectives 2.1 and 2.5 both aim to address a market failure in the availability of finance to SMEs (principally through repayable finance). Evidence from JEREMIE indicates the ‘viability gap’ prevents a small number of viable investments in SMEs (who are already accessing repayable finance). The use of grants (or soft loans) to address this very specific ‘viability gap’ requires further investigation. This work will be done as part of the suite of assessments informing the design of Financial Instruments.

Background

WEFO welcomes this report, which generally mirrors the findings of the ERDF programmes. The Thinkpiece indicates repayable finance is the preferable form of finance for SMEs, noting its superiority over grants. The report also indicates that soft loans are an equally applicable response to grants. Given the presumption that grants should be a funding mechanism of last resort, WEFO will expect soft loans to be considered in those limited instances in which grants may be applicable.

WEFO notes that the Regeneris and Old Bell 3 report covers all possible forms of grant support, yet the ERDF programmes have had to identify a limited number of very specific areas in which to invest. The choices made in the ERDF programmes represent the areas of investment where the greatest need and opportunities are, validated through independent evaluation, extensive consultation, and negotiation with the European Commission. Therefore not all options included in the Regeneris and Old Bell 3 report are relevant, or eligible, for support under the ERDF programmes negotiated with the European Commission.

Principles for investment

WEFO agrees with the pre-conditions set out in the Thinkpiece and these reflect the approach in the Operational Programme. Any use of grants through the ERDF will

first need to demonstrate a proportional contribution to the objectives and results identified in the Operational Programme. Where that is the case, and it falls under one of the suitable types of investment (see report and below), it will also need to ensure it fully meets all of these requirements:

- Only projects that have exhausted all other forms of finance will be considered for support
- Only projects that would not go ahead without the grant, or would go ahead on a significantly reduced scale or delayed timescale will be supported
- Overall, the scheme will deliver significant economic spill-overs
- It is not impossible to deliver the desired outcomes economically on a repayable basis

WEFO will require beneficiaries to provide ongoing evidence that these requirements are being met, which will be checked through inspection and audit.

Types of investment suitable for grant support

WEFO notes the different rationales for the use of grants set out in the report, some of which are explicitly mentioned in the ERDF programmes as expected types of investment. Other areas identified in the report are not identified as priority areas for ERDF investment and will not therefore be supported. There is also one area in which further consideration will be needed to be given. The availability of ERDF in Wales to address each of these types of investment is outlined below:

Early Stage R&D: Priority Axis 1

WEFO has recognised this particular issue under Priority Axis 1 (Research and Innovation). Significant investments in businesses are expected, including through the use of grants, through this priority axis. Investments will be targeted in line with the smart specialisation approach.

Encouraging Behaviour Change: Specific Objective 2.4 and parts of Priority Axis 4

WEFO has recognised, under Specific Objective 2.4, that there is a particular issue with SMEs unwilling to invest in resource efficiency measures. Specific provision has therefore been included to allow for investment through the use of grants to support appropriate behaviour change. This links directly with wider ambitions for energy efficiency and previous investments in the supply chain.

Under Priority Axis 4, there may be exceptional cases in which grants are needed to persuade the private sector to make investments in priority areas where they currently see little benefit. This might include installation and take up of ultrafast broadband or infrastructure investments in prioritised sites.

No other areas of behaviour change have been identified as specific priorities for the use of ERDF funding given the need to carefully target resources. While WEFO recognises there may be some evidence grants can stimulate risk-averse businesses to invest, this is not a particular issue the ERDF is aiming to address and such grant activity will not therefore be supported.

Social Enterprises and Charities: Not supported where not self-sustaining

WEFO recognises the importance of grants to social enterprises and charities that cannot be financially self-sustaining, but the ERDF programmes are not aiming to address this issue so this support will not be made by available through the ERDF. Social Enterprises and Charities will be eligible for support, including grant support, on the same terms as all other SMEs (e.g. innovation, resource efficiency).

Addressing a Viability Gap: Further work required (potentially Specific Objectives 2.1 and 2.5)

WEFO notes evidence from JEREMIE that this issue has affected investments during 2007-2013 and notes ERDF may be a suitable funding source where the principles for investment set out above are fully met. In order to demonstrate there is a genuine gap and all other sources of funding have been exhausted any recipient will have been expected to apply for funding from any successor to JEREMIE. This implies any funding to address this gap should be managed alongside, or as part of, any financial instrument. Any development work should fully consider the use as soft loans as an alternative to grant, particular if there are economies of scale.

Further work will be undertaken as part of the ongoing ex-ante assessment informing the development of Financial Instruments to address market failures in the provision of access to finance under Specific Objectives 2.1 (loan, equity) and 2.5 (risk capital). This assessment already includes an assessment of the market failure for micro-loans and is recommending how ERDF might help address that gap.

Delivery mechanisms

Under EU rules any direct payment of grant to an SME represents a “project”. Schemes providing grants to SMEs, therefore, either need to be managed directly by WEFO or be managed by an ‘Intermediary Body’. WEFO has already indicated the use of such bodies will be very limited, given the risks associated with them. Grants will need to be managed entirely separately to other investment types. For these reasons WEFO only intends to allow a very small number of ERDF aid schemes to be run by the Welsh Government (allowing for full integration with business support).

WEFO, October 2014