



National Audit Office

Report

by the Comptroller
and Auditor General

Department for Business, Energy & Industrial Strategy

British Business Bank

Key facts

£13.9bn

increase in the stock of finance resulting from the Bank's programmes, including its own funds and private investment

92%

proportion of the finance made available through the Bank's programmes outside the UK's five largest banks

3.6%

the Bank's rate of return in 2018-19

134

number of third-party delivery partners through which the Bank indirectly invests in SMEs at December 2019

12

number of finance programmes the Bank currently operates to intervene in SME finance markets

89,900

number of businesses supported at March 2019

£5.60

amount of private investment the Bank has attracted for every £1 it has invested

3 times

amount by which the Bank's operating expenditure has grown from its first full year of operation (2015-16) to 2018-19

Summary

Introduction

1 Small and medium-sized enterprises (SMEs) are a major part of the UK economy, accounting for 60% of private sector employment and 52% of private sector turnover. Like any business, SMEs often need external finance and other support to launch and grow. However, SMEs can face challenges when trying to access finance, which can limit their ability to grow.

2 Previous government interventions aimed at addressing these issues have provided some benefit to SMEs. However, past National Audit Office and Committee of Public Accounts reports found these interventions lacked coherence, clear objectives and success criteria, and transparency. Our 2013 report on improving access to finance for SMEs recommended that greater benefits and public value could be achieved by treating the interventions as a programme, with a clearer focus on assessing what results can realistically be delivered.

3 In 2014, the government formally launched the British Business Bank (the Bank) to address signs of weakness in the UK SME finance market. The Bank is a company wholly owned by government. The Department for Business, Energy & Industrial Strategy (the Department) is the sole shareholder and has a wider policy responsibility for business and enterprise. UK Government Investments (UKGI) manages the shareholding in the Bank on behalf of the Department. The Bank's mission is "to help drive economic growth by making finance markets work better for smaller businesses – wherever they are in the UK and wherever they are on their business journey – enabling them to prosper and grow". It has six objectives:

- to **increase the supply of finance** available to smaller businesses where markets do not work well;
- to help **create a more diverse finance market** for smaller businesses, with a greater choice of options and providers;
- to encourage and **enable SMEs to seek the finance best suited** to their needs; and
- to achieve this while **managing taxpayer resources efficiently** and within a robust risk management framework.

Two objectives were added in 2018-19:

- to be the **centre of expertise** on smaller business finance in the UK, providing advice and support to government; and
- to identify and help to **reduce regional imbalances** in access to finance for smaller businesses **across the UK**.

4 The Bank provides funding for SMEs indirectly through its delivery partners and aims to stimulate demand for finance by raising awareness among SMEs of their finance options. The Bank's 12 current finance programmes support SMEs' access to a range of finance, including debt, equity investment and financial guarantees.¹ However, the Bank's delivery model limits its engagement with programme beneficiaries. The Bank has grown substantially since 2014, with its assets under management growing to £3.3 billion in 2018-19 and costs having trebled since its first full year of operation.

Study scope

5 This report examines whether the Bank is improving access to finance for SMEs and is well prepared to respond to future challenges. The report structure is as follows:

- Part One sets out the background and rationale for the creation of the Bank, and examines the Bank's objectives, performance monitoring and success criteria;
- Part Two considers the Bank's performance against its objectives, and the evaluation of its impact; and
- Part Three looks at the Bank's governance arrangements, considering its expansion over time, its costs and its preparedness for future challenges.

Our methods are set out in Appendix One. Alongside this report, our *Government support to business* report reviews the government's wider approach to business support; it looks at a sample of the Department's business support schemes and considers how it manages them and their performance.

Key findings

The Bank's objectives and performance to date

6 **The Department established the Bank as a more coherent response to access to finance compared with past government interventions.** The Department set out clearly why it was intervening to support finance for SMEs, with analysis of the problem it was trying to address. The Department sets clear objectives, targets and – in broad terms – outcomes for the Bank to achieve. The Bank has developed a range of activities and financial programmes to address issues in different areas of the market. The Bank also has a clear view of which of its products it considers are most likely to achieve its objectives in different circumstances (paragraphs 1.6, 1.7, 1.9 and 1.14).

1 The Bank also operates nine 'legacy' programmes formerly run by the Department and by Capital for Enterprise Limited.

7 The Bank provides support and advice to government on SME access to finance, but it is not “the default” operator of government interventions.

The Committee of Public Accounts concluded in 2014 that the Department’s access to finance schemes were not a coherent programme. The government responded that “the default position will be that the British Business Bank will operate all national SME access to finance schemes”. Although the Bank does not operate all schemes, since 2018-19 it has an objective to act as a centre of expertise providing advice and support to public bodies; this can help make government’s interventions more coherent. For example, the Ministry of Housing, Communities & Local Government told us that the Bank’s skills were essential to the development and delivery of its ENABLE Build programme – a guarantee scheme for SME housebuilders. The Bank, the Department and HM Treasury plan to assess the Bank’s role, remit and governance (paragraphs 1.5, 2.14, 2.15 and 3.10).

8 The Bank has introduced some new products and scaled back others, in part based on its extensive analysis of small business finance markets.

The Bank has analysed and monitored small business finance markets extensively since launch. HM Treasury, the Department and UKGI told us that while the Bank has implemented new activities well, for the future they want it to go further in making use of the analysis and research to inform its activities and wider government policy decisions. There is some evidence of the Bank withdrawing or scaling back existing products based on analysis of market need or its evaluations, although it does not generally publicise this (paragraphs 2.22 and 2.24 to 2.26).

9 The Bank’s initiatives require a long-term assessment of impact and show some evidence of successes to date.

The Bank has undertaken good-quality evaluations to assess how products are working. The Bank estimates that its different products achieve benefit–cost ratios of between 2.8:1 and 11.3:1. This compares with an expectation at launch that overall the Bank would generate at least 5:1. The Bank has to date evaluated a relatively small part of its activities, as many are long-term interventions (such as its equity investments) which are not yet ready to be evaluated. The Bank’s activities aimed at promoting better information, addressing regional imbalances and creating a centre of expertise may also require a longer-term assessment. The Bank’s metrics for its newer objectives are activity-based and give a limited picture of the impact that the Bank achieves against them (Figure 4 and paragraphs 1.15 and 2.17 to 2.20).

10 The Bank has exceeded its targets set at launch, within the context of a generally benign economic environment. The Bank's ability to achieve its objectives is dependent on external factors, particularly the economic environment. Lending conditions for SMEs have improved since the Department set up the Bank following the financial crisis. The Bank has performed well against several objectives:

- The Bank has increased (through its own funds and capital attracted from private investors) the supply of finance for SMEs by around £13.9 billion, exceeding its £10 billion target for its first five years. Of this increase, £11.8 billion comes from the private sector – £5.60 for each £1 of the Bank's money, compared with an expectation of between £2 and £3 at launch. The Bank's annual survey does not separately identify how SMEs use this finance.
- The Bank has supported the diversity of SME finance, with 92% of finance made available through the Bank's programmes outside of the UK's largest banks, compared with 79% in 2014-15.
- The Bank has met or exceeded its financial return target in each of its five years of operation.

The Department has tightened some targets since launch, to reflect market conditions and provide more challenge for the Bank (Figure 5 and paragraphs 2.3 to 2.7, 2.11 and 2.22).

11 There is some evidence of improvement in awareness of SME finance options but less focus on other factors which can limit how SMEs access finance.

The Bank is clearly responsible within government for SME awareness of finance options. It is less clear who is responsible for actions on other factors that play an important role in the ability of SMEs to access finance, for example cultural attitudes to finance (particularly equity), trust in finance providers and SMEs' financial education. The Bank has made some progress against its objective to improve information for SMEs, increasing its measure of awareness of options among SMEs from 43% in 2015 to 50% in 2017-18. The Bank increased its focus on 'demand-side' activities from 2017, for example launching its Finance Hub website in 2018.² However, due to its delivery model, through partners, the Bank does not engage directly with SMEs benefiting from its programmes (paragraphs 2.8 to 2.10 and 2.23).

² These are the actions focusing on the problems resulting in the reduced understanding and desire for external finance. For example, providing information to businesses regarding the finance options available that could enable them to grow.

The Bank's costs

12 While the Bank's costs have increased more than threefold since launch, they are broadly comparable with organisations undertaking similar activities.

The Bank has grown in scale and scope since launch, and its costs grew from £19.7 million in 2015-16 (its first full year of operation) to £64.0 million in 2018-19. It forecasts that costs will grow substantially further in future. The Bank has undertaken cost benchmarking work that indicates its costs are in the lower to middle range of similar organisations. Our own analysis suggests that the Bank's cost ratios are broadly comparable with organisations undertaking similar activities. The Bank has made some efforts to reduce costs, for example it estimates that it has reduced the fees payable to delivery partners for start-up loans by around 35% in the three years to 2019-20 (Figures 9 and 10 and paragraphs 3.11 to 3.13).

13 The Bank has information on cost-effectiveness of the organisation as a whole, but less information on cost-effectiveness of its individual activities.

The Bank's benchmarking work considers costs at an organisational level. It also benchmarks its staff costs to other organisations, but it does not benchmark costs of internal functions, for example IT, finance, human resource and estates costs. The Bank has limited information on the relative cost-effectiveness of its individual programmes and activities. It gathers benefit–cost ratio information for products at five-yearly evaluations but does not bring together more frequently information on costs, activity and outcomes from different programmes and products, to inform the Bank's decision-making. The Bank told us that it spends considerable time engaging with other organisations in its 'centre of expertise' role, although it does not collect information on how much resource it uses on this activity (paragraphs 2.15, 2.18, 3.14 and 3.15).

14 The Department and the Bank do not publish data on how much of the Bank's funding reaches SMEs and how much is paid to intermediaries. The Bank provides finance to SMEs through a range of delivery partners rather than directly. In 2014, the government accepted a Committee of Public Accounts recommendation to make clear how much finance is reaching SMEs, how much is paid to third parties and the direct costs, for each programme. However, to date neither the Bank nor government has published this information. The Bank considers that to publish such information would reveal sensitive information to delivery partners and weaken its commercial position (paragraphs 1.10 and 3.16).

Challenges and the Bank's preparedness

15 The Bank's governance framework gives it operational independence with safeguards around the use of public money, but there are challenges in some areas. The Department gave the Bank operational independence, within a framework of accountability and governance requirements reflecting the Bank's use of public money. The Bank has used its operational independence to identify and recruit people with the skills it needs to fulfil its role. The financial framework, which includes arrangements for the Bank to plan for the resources it needs from the Department, is complex and requires close engagement between the Department and the Bank to work effectively. In 2018 the Bank underestimated how much resource it needed in 2018-19, which resulted in the Department making an additional £3.4 million (around 5% of operating expenditure) available should it be needed. A June 2019 review by the Government Internal Audit Agency and the Bank's internal auditors identified unclear responsibilities between the Bank and the Department, lack of communication and engagement, and weaknesses in the Bank's controls and capability regarding government accounting. The review made recommendations which the Bank and the Department are in the process of implementing (paragraphs 3.2, 3.3 and 3.5 to 3.7).

16 The Bank has had to strengthen its governance and operational procedures in response to pressures from its rapid growth. The Bank grew rapidly after launch, particularly after the absorption of the Start-Up Loans Company in 2017, and after creating its British Patient Capital arm in 2018, which increased the Bank's total deployable capital from £3.7 billion to £6.2 billion. The Bank's management recognised that growth had placed pressures on its governance and operations. The Bank's management has developed a number of initiatives to strengthen governance, risk management and other procedures in response (paragraphs 3.9 and 3.10).

17 The Bank faces a period of further change and potential challenges to how it achieves its objectives. The Bank is continuing a planned shift towards providing greater equity funding for SMEs, which is likely to affect both the potential returns and increase the risk profile of the Bank's investments. In the event of any economic downturn, SMEs would be likely to face additional pressures and the Bank could play a role in a government response. Currently, several European Union (EU) institutions also provide access to finance for SMEs in the UK, and the Bank may be best placed to take on some of these roles following EU Exit. Separately, the government has indicated that British Patient Capital could be sold in due course, and any potential sale would likely affect the Bank operationally, for example through management time. In December 2017 we reported that the sale of the Green Investment Bank had taken longer than expected and had an impact on its operations (paragraphs 3.17 to 3.20).

18 The Bank has worked with government to consider how it may support SMEs in future economic downturns. In a downturn the Bank would be able to increase availability of some of its products as part of a government response aimed at supporting SMEs. The Bank has analysed a range of scenarios and considered the potential impact on its activities, and the Bank and government have together developed a high-level framework that provides the Bank with greater flexibility to respond to a downturn. However, there are barriers that limit its ability to respond quickly in some areas. In October 2019, the Bank estimated that if needed it could make additional Enterprise Finance Guarantee support available between two and six weeks, but it could take anywhere between three and 14 months for other products to be made available to SMEs through delivery partners. The Department may be able to act more directly, but it is unclear how the Bank's contribution would fit within the Department's wider response to a downturn (paragraphs 3.21 to 3.24).

Conclusion on value for money

19 The Department set up the Bank as a more coherent approach than past government access to finance interventions. There are positive signs to date, in terms of performance against its metrics and from the Bank's evaluations showing SMEs are growing as a result. Many of its activities are longer-term interventions – in particular, promoting information to SMEs and greater regional activity – and the benefits of these will require ongoing analysis over time. The Bank's costs have risen significantly as it has grown; while there is evidence that they are comparable with other organisations overall, there is limited information on the cost-effectiveness of its activities. The Bank will need to develop further its evidence on both performance and costs, and make sure its financial management and governance arrangements are robust, to ensure it demonstrates value for money over time.

20 Additionally, the environment in which the Bank operates is changing rapidly. The Bank has analysed how it would respond to a downturn, but this could take time and it would only represent part of any government response to help SMEs. The Department and HM Treasury need to ensure that the Bank is able to fulfil its role, and that its activities better align with other government support to business.

Recommendations

- 21** For the Department, as shareholder, and HM Treasury, we recommend:
- a** In reviewing the Bank's role and governance, the Department and HM Treasury should more clearly set out an agreed view on their priorities for the Bank, including clarity on its remit:
 - The review should consider whether the government's view in 2014 that the Bank would operate all national SME access to finance schemes across government still holds.
 - Following the Bank's period of rapid growth, and making use of UKGI's insight as the government's centre of expertise for corporate governance, the review should cover the governance arrangements, skills, and budgeting and accounting framework of the Bank, considering lessons learned to date and outlining options for change.
 - b** The Department and HM Treasury should more clearly set out what they want the Bank to achieve in the context of government's wider support to business. For example, in setting out:
 - how the Bank's activities form part of a government-wide 'portfolio' response in the event of an economic downturn; and
 - who is responsible for other factors relevant to SMEs' access to external finance where they do not currently fall within the Bank's remit, particularly around financial education and trust among SMEs, and how government will act on and measure those elements.
 - c** The Department and HM Treasury should set out more clearly the success criteria for the Bank's British Patient Capital arm, so that any decision to sell can be informed by robust evidence that its mission has been accomplished.
- 22** For the Bank, we recommend:
- d** The Bank must develop impact metrics for its regional imbalance and 'centre of expertise' objectives.
 - e** The Bank cost analysis should be extended to demonstrate the cost-effectiveness of individual activities and programmes, and allow more granular comparisons of operating expenditure with those of other organisations.

- f** The Bank should publish information allowing Parliament and others to see in aggregate the relative amounts of money going to SMEs, to third parties and on the Bank's own activities, including its policy work and general administration.
- g** Drawing on its analysis of markets and evaluations, the Bank should report more clearly where it has withdrawn from activities because the market failure is addressed, or the intervention is not delivering the outcomes expected.