National Audit Office

Report
by the Comptroller
and Auditor General

Department for Business, Energy & Industrial Strategy

British Business Bank

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National Audit Office

Department for Business, Energy & Industrial Strategy

British Business Bank

Report by the Comptroller and Auditor General

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National Audit Office

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This report examines whether the British Business Bank (the Bank) is improving access to finance for small and medium-sized enterprises (SMEs) and is well prepared to respond to future challenges.

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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.

Part One

Background

1.1 This part examines government's rationale for the British Business Bank (the Bank), the Bank's creation and its objectives.

Market failures in small business finance markets

1.2 Small and medium-sized enterprises (SMEs) are typically defined as businesses with fewer than 250 employees and an annual turnover of less than 50 million euros. SMEs are an important part of the UK economy. They represent 99% of all private sector businesses, 60% of private sector employment and 52% of private sector turnover (**Figure 1**). The Department for Business, Energy & Industrial Strategy (the Department) estimated in 2016 that 9% of UK SMEs export and a further 15% were part of the supply chain for other exporting businesses.

1.3 Many SMEs struggle to access the finance they need to grow. The Department identifies a number of factors that may affect the supply of, and demand for, finance for SMEs, including:

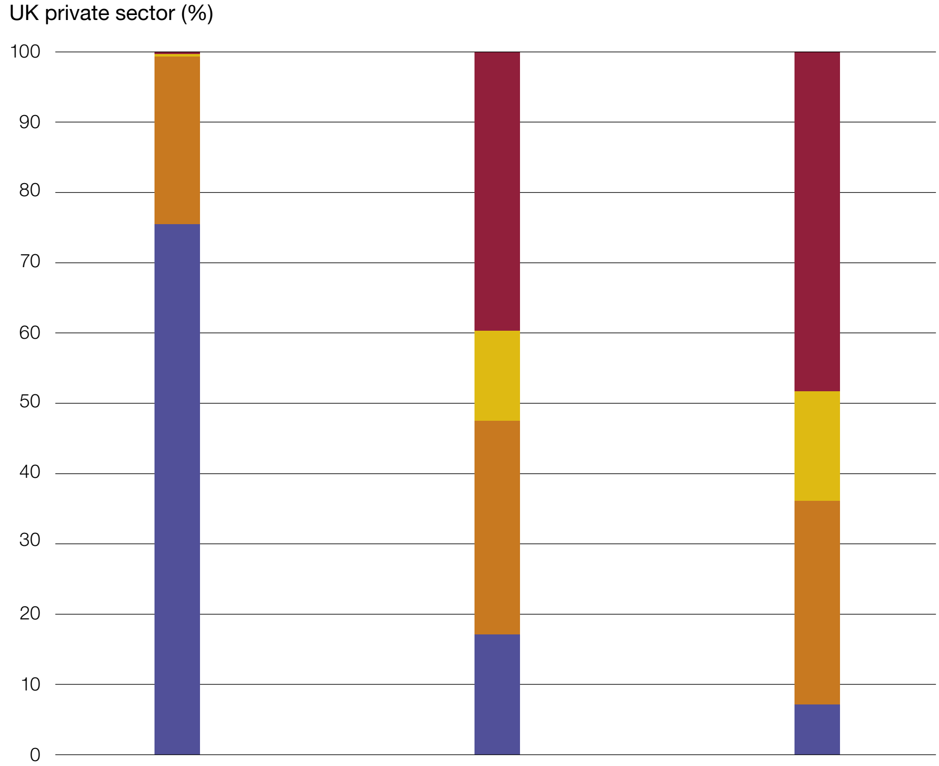
- **risk aversion among finance providers** – limiting the supply of finance, as lenders are less willing to take risks on SMEs who lack security or a track record;
- **lack of diversity in finance sources** – limiting the supply of finance, as SMEs are overly reliant on traditional high street lenders;
- **the behaviour of SMEs** – restricting demand for finance, as SMEs are often less aware of their financing options than larger businesses; and
- **demographic issues** – SMEs in some regions, and female, black, Asian and minority ethnic entrepreneurs face specific challenges that can affect both the supply of and demand for finance.

Many of these factors result from how markets function (structural factors). They can be exacerbated by uncertain economic conditions, when lenders become more risk averse and when there is greater uncertainty (cyclical factors). These factors can hinder the growth of SMEs and have a wider economic impact.

Figure 1

Proportion of UK private sector at the beginning of 2019, by size of business

Self-employed owners, small and medium-sized enterprises represent more than 99% of all UK businesses



	Businesses	Employment	Turnover
Large (250+) (%)	0.13	39.52	47.76
Medium (50–249) (%)	0.61	12.63	15.41
Small (1–49) (%)	23.29	30.26	29.50
Self-employed owner (%)	75.97	17.58	7.34

Note

1 Figures may not sum due to rounding.

Source: National Audit Office analysis of Department for Business, Energy & Industrial Strategy, *Business population estimates*, 2019

Setting up the British Business Bank

1.4 The Department established the Bank to provide more coherence and focus around the government's interventions to provide access to finance. In March 2011, the government noted worsening UK global competitiveness and identified access to finance as one of several priority areas to encourage growth. In September 2012, the government announced that it planned to establish a government-backed business bank to "address long-standing, structural gaps in the supply of finance". In October 2013, the Bank began operating in 'shadow form' within the Department, and in November 2014 the Bank formally launched.

1.5 The challenges faced by SMEs in obtaining finance are not new, and previous governments have intervened in markets to help SMEs access finance. Until 2008, most interventions were run by officials within central government departments. In 2008, the Department's predecessor established a new body – Capital for Enterprise Limited – to develop financial measures to support SMEs. However, both the National Audit Office and the Committee of Public Accounts reported on weaknesses in government's approaches to SMEs' access to finance.[3] Our 2013 report on improving access to finance for SMEs recommended that greater benefits and public value could be achieved through treating the interventions as a programme, with a clearer focus on assessing what results can realistically be delivered.[4]

1.6 The Department set out its rationale for creating the Bank clearly in a business case, based on the market failures it had identified in both the supply of and demand for finance for SMEs. The Department built on analysis commissioned from Deloitte and on the work of the Breedon Taskforce Review, a government-commissioned, industry-led independent taskforce on non-bank lending. This analysis informed the process of setting the Bank's objectives. The Department appointed an advisory group, comprised of a panel of experts, to guide the design, set-up and strategic direction of the Bank. The Major Projects Authority (now part of the Infrastructure & Projects Authority) reviewed the planning and set-up process before the launch.

The Bank's objectives

1.7 The Department launched the Bank with an overall mission "to make finance markets in the UK work more effectively for SMEs… allowing them to prosper, grow and build UK economic activity". The Department gave the Bank four objectives at launch:

- increase the supply of finance available in the UK to SMEs, in areas where the markets supplying such finance do not work effectively;
- help create a more diverse market for finance available in the UK to SMEs, with a greater choice of options and providers;

3 HC Committee of Public Accounts, *Improving access to finance for small and medium-sized enterprises*, Thirty-eighth Report of Session 2013-14, HC 775, January 2014.

4 Comptroller and Auditor General, Department for Business, Innovation & Skills, HM Treasury, *Improving access to finance for small and medium-sized enterprises*, Session 2013-14, HC 734, National Audit Office, November 2013.

- help promote better information in the market in the UK, building confidence among SMEs and in the finance options available; and
- achieve the Bank's other objectives while managing taxpayers' money efficiently within a robust risk management framework.

From 2018-19, the Department introduced two further objectives for the Bank to:

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

1.8 The Bank's operating principles require it to manage its programmes as a portfolio, balancing the different activities to achieve its objectives, which can involve trade-offs. For example, certain actions to address finance gaps left by market providers could adversely affect the Bank's financial returns target.

The Bank's activities

1.9 **Figure 2** summarises the range of activities the Bank undertakes to further its objectives. The Bank has 12 finance 'programmes' or 'products' aimed at increasing access to finance through support and indirect investment (**Figure 3** on pages 18 and 19). The Bank has a clear view of which of its products it considers are most likely to achieve its objectives in different circumstances.

Figure 2
British Business Bank's activities

The Bank undertakes a range of activities to further its objectives

Finance programmes

The Bank develops and implements a range of finance programmes aimed at increasing the amount and range of finance available to small and medium-sized enterprises (SMEs) through indirect investment (often investing alongside other market participants).

Information provision

The Bank undertakes a range of activities aimed at helping SMEs to understand the finance options available to them, and to find the finance best suited to their needs. For example, the Bank operates an online Finance Hub, runs campaigns and events, and engages with external stakeholders who provide advice to SMEs.

Regional networks

The Bank has finance programmes aimed at supporting investment in SMEs in the North, Midlands, Cornwall and Isles of Scilly. In addition, in 2018-19 the Bank established a regional network of staff who are physically located in each of the English regions and the three devolved nations. Originally announced in November 2017 as part of the government's Industrial Strategy, the regional network engages directly with stakeholders and businesses across the UK.

Assistance to other government bodies

The Bank offers advice and support to other government departments and public bodies to help them design and implement their own access to finance interventions. For example, the Bank has worked with Homes England to develop access to finance interventions in the housebuilding sector.

Source: National Audit Office analysis of British Business Bank information

Figure 3

British Business Bank finance programmes, planned investment and gross amounts invested to 31 March 2019

The Bank has 12 finance 'programmes' or 'products' aimed at increasing access to finance through support and indirect investment

Programme	Description	Planned investment to 31 March 2019 (£m)[7]	Gross amounts invested to 31 March 2019 (£m)[8]
Debt programmes[1]			
Start-Up Loans	Loans and mentoring to help people start their own businesses or become self-employed.	389	410
ENABLE Funding	Access to funding through the capital markets for smaller lenders, meaning they can provide more finance to businesses.	407	246
Investment Programme	Support to increase the volume and diversity of finance for smaller businesses by enabling the growth of new and alternative lenders.	651	847
Regional debt funding	Micro and small business debt finance in the North, Midlands, Cornwall and Isles of Scilly.	3.2	2.7
Equity programmes[2]			
Angel CoFund	Investing alongside angel investors[3] to increase the volume of early stage finance available to smaller businesses.	35	41
Regional Angels Programme	Support to reduce regional imbalances in access to early stage equity finance.	2	0
Enterprise Capital Fund	Investing alongside private sector venture capital funds to address the 'equity gap' restricting access to finance for SMEs with high growth potential.[4]	291	282
British Patient Capital[5]	Investing in third-party funds aimed at long-term and growth investments.	133	187
Managed Funds	Investing in third-party pooled investment funds designed to increase institutional funding of long-term patient capital for high growth innovative businesses.	0	0
Regional equity funding	Equity finance in the North, Midlands, Cornwall and Isles of Scilly.	2.8	2.3
Financial guarantees[6]			
Enterprise Finance Guarantee	Government-backed debt finance for viable smaller businesses lacking security.	1,020	870
ENABLE Guarantees	Guarantees which reduce the amount of capital that lenders need to hold for their loans to small businesses, so that they can provide more lending.	1,532	934

Figure 3 *continued*
British Business Bank finance programmes, planned investments and gross amounts invested to 31 March 2019

Notes
1 'Debt' investment refers to lending money to a company. Debt investors expect to receive interest payments on the amounts lent, and the repayment of the principal either over time or at a set date.
2 'Equity' investment refers to the purchase of shares in a company. Investors receive a return either through dividend payments or by selling their shares for more than their initial investment. Equity investment is generally higher risk than debt investment, as returns are more uncertain.
3 'Angel investors' or 'business angels' are private investors, generally wealthy individuals, who provide finance and other support to start-up or early stage businesses.
4 'Venture capital' investment is financing that is provided to start-up or early stage businesses. As these investments are generally high risk, venture capital investors can expect a relatively higher return than other forms of investment.
5 British Patient Capital incorporates an earlier fund, VC Catalyst Fund. The cumulative figures cited here include the earlier VC Catalyst Fund.
6 A 'financial guarantee' is an arrangement where the guarantor agrees to take responsibility for a company's financial obligations if it is unable to meet them. This reduces the risk for the lender.
7 Planned investment is taken from the Bank's internal business plans.
8 Gross amounts invested reflects the total amount of cash resource placed into each programme by the Bank. For financial guarantees, a measure of the notional value of all loans supported through each scheme is used.
9 'Planned investment' and 'Gross amounts invested' relate to the time since the Bank launched in November 2014; the Figure excludes any investments which may have been made under these programmes before that date.

Source: National Audit Office analysis of British Business Bank information

1.10 The Bank does not provide finance directly to SMEs. Instead, it provides its support through more than 130 privately owned delivery partners. The delivery arrangements with these partners vary depending on the nature of the product. For example, some of the Bank's funding is through third-party fund managers who also invest on behalf of private investors. The Enterprise Finance Guarantee product is delivered to SMEs through a variety of lenders.

1.11 When designing the Bank, the Department decided against giving it the ability to lend directly to SMEs because of costs the Bank would need to incur in establishing its own delivery infrastructure. It also concluded that providing finance directly to SMEs would lead to less finance reaching SMEs and involved risks of displacing private sector activity, whereas operating through delivery partners allows the Bank to invest alongside private investors. This delivery partner model differs from the Department's approach to the UK Green Investment Bank, a company it created to address failures in the green infrastructure finance market by investing directly in projects alongside other investors.

1.12 As a company in receipt of public funds, the Bank must comply with European State Aid rules. In 2014, the European Commission granted approval for launching the Bank. The Bank has activities where it acts commercially as any other market participant and, in these instances, the Bank has greater flexibilities under the existing State Aid rules than where it is acting in a non-commercial manner.[5] In 2018-19 around 41% of the Bank's investments were commercial.[6] In 2019, the European Commission renewed its state aid approval for the Bank's activities for a further five years, to 2024.

Performance indicators and success criteria

1.13 The Department is the sole shareholder of the Bank and is ultimately responsible for overseeing the Bank's activities and its performance. The Department also holds overall policy responsibility within government for support to business. UK Government Investments (UKGI) manages the shareholding in the Bank on behalf of the Department. The Bank's governance arrangements are covered in Part Three.

1.14 The Bank has developed performance indicators to monitor performance against its objectives, which provide good coverage of the range of the Bank's activities, outputs and intended outcomes. **Figure 4** summarises how the indicators align with the Bank's objectives. The Bank's performance indicators are agreed with the Department, which works with the Bank to set targets for each indicator. For its four original objectives (see paragraph 1.7), performance targets are set at three levels: 'lower', 'stretch' and 'challenge'. The Bank's performance against these targets informs the bonus payments made to its senior management.

1.15 The Department has occasionally revised the metrics or success criteria of the Bank's original four objectives since launch, to ensure that the Bank focuses on the correct priorities and responds to market conditions. The Department introduced two new objectives in 2018-19; however, the Bank measures only activity against these objectives, with no targets and no link to impact or outcomes from this activity. The Bank told us that these objectives are complex to measure. In its business case the Department outlined other success criteria for the Bank, such as job creation, but it does not assess the Bank's performance against these criteria.

5 For example, investments at a lower rate of return or higher risk profile than would be acceptable to other market participants.

6 At the end of 2018-19 the Bank held commercial investments with a fair value of £1,349 million compared to total assets of £3,297 million.

Figure 4

British Business Bank's key performance indicators

The Bank has developed performance indicators to monitor performance against its objectives

Objective	Key performance indicator
1 To increase the supply of finance available to smaller businesses where markets do not work well.	Measured through the increase in the stock of finance made available to small and medium-sized enterprises (SMEs), both by the Bank and other lenders/investors, through the Bank's programmes.[1]
2 To help create a more diverse finance market for smaller businesses, with a greater choice of options and providers.	Measured through the percentage stock of finance made available to SMEs (both by the Bank and other lenders/investors) through providers other than the UK's five largest banks.[2]
3 To encourage and enable SMEs to seek the finance best suited to their needs.	Measured through a balanced scorecard of seven measures, covering website visits, social media engagement, media coverage and events. The scorecard is also informed by the Bank's customer surveys.
4 To achieve the Bank's other objectives while managing taxpayers' money efficiently within a robust risk management framework.	Measured through the Bank's rate of return on its investment, with an aim of achieving a return equal to the government's medium-term cost of capital.[3]
5 To be the centre of expertise on smaller business finance in the UK, providing advice and support to government.	No quantitative performance indicators yet developed.[4]
6 To identify and help to reduce regional imbalances in access to finance for SMEs.	No quantitative performance indicators yet developed.[4]

Notes

1 From 2018-19, the Department for Business, Energy & Industrial Strategy (the Department) revised the Bank's target to provide a greater focus on supporting smaller SMEs.

2 Prior to 2018-19, the measure applied to providers other than the UK's four largest banks.

3 The Bank's rate of return measure is an adjusted return on capital employed. This measure is defined in the *Shareholder Relationship Framework Document*. Prior to 2018-19, the Bank's objective was to achieve a return greater than the medium-term cost of capital.

4 The Department introduced two new objectives for the 2018-19 financial year, measuring performance using qualitative information.

Source: National Audit Office analysis of British Business Bank performance information

Part Two

Performance and impact

2.1 This part examines the British Business Bank's (the Bank's) performance against its objectives and how it monitors and evaluates its progress.

The Bank's performance against its objectives

2.2 **Figure 5** summarises the Bank's performance against each of its objectives. The following sections consider each objective in turn.

Increasing the supply of finance

2.3 Since the government announced in 2012 that it planned to establish a government-backed business bank, some of the constraints faced by small and medium-sized enterprises (SMEs) following the 2008 financial crisis have lessened. By the time the Bank launched in 2014, the situation in many areas of the market for SME financing had improved.

2.4 The Bank has performed well against its objective to increase the supply of finance available to SMEs. It has exceeded its target of facilitating more than £10 billion of finance to SMEs by 31 March 2019. In total, the Bank's programmes have helped to increase the supply of finance to SMEs by £13.9 billion. This includes both the funds the Bank has itself indirectly invested (cumulatively around £2.1 billion) and the funds invested by third-party investors alongside it (£11.8 billion). This means the Bank has attracted investment of £5.60 for every £1 of its own funds invested, compared with its expectations set out in its 2014 Strategic Plan of between £2 and £3 for every £1 invested. At 31 March 2019, the Bank's programmes supported 89,900 businesses.

2.5 From 2018-19 the Department for Business, Energy & Industrial Strategy (the Department) revised the Bank's target to provide a greater focus on supporting smaller SMEs, where it identified the need was greatest. In 2018-19, the Bank increased the supply of finance to smaller SMEs by £1.4 billion. Cumulatively this amounts to £6.6 billion over the period from 2014-15 to 2018-19, meaning the Bank has exceeded its revised target of £6.2 billion.

Figure 5

The British Business Bank's performance against its Key Performance Indicators

From 2015-16 onwards, the Bank has met or exceeded its targets, within the context of a generally benign economic environment

Objectives/performance indicators	2014-15	2015-16	2016-17	2017-18	2018-19
1 Increasing the supply of finance					
Cumulative stock of finance made available/supported					
Target[1]			£10 billion by 2018-19		
Outturn (£ billion)	5.1	7.5	9.2	12.3	13.9
Cumulative stock of finance for smaller businesses made available/supported[2]					
Target[1]	n/a	n/a	n/a	n/a	£10 billion by 2021-22
Outturn (£ billion)	2.3	3.0	4.3	5.2	6.6
2 Creating a more diverse finance market					
Finance made available through the Bank's programmes outside the UK's largest banks[3]					
Target (%)[1]	70–80	70–80	70–80	81–91	81–91
Outturn (%)	79	90	94	96	92
3 Promote better market information					
Balanced scorecard measuring small and medium-sized enterprises' (SMEs') awareness and engagement[4]					
Target (%)[1]	47–51	47–51	47–51	47–51	4 (Green)[5]
Outturn (%)	43	48	50	50	5 (Green)
4 Managing taxpayers' money efficiently					
Rate of return on investments[6]					
Target (%)[1]	1.2–1.8	1.2–1.8	1.2–1.8	1.6–2.2	2.3–3.2[7]
Outturn (%)	1.3	2.0	3.9	4.7	3.6

Since the Bank was created in November 2014, it has generated cumulative excess returns amounting to £195 million.

Notes

1. The bottom of the target ranges reflects the lower threshold target set by the Bank and agreed with the Department for Business, Energy & Industrial Strategy (the Department). The top of the range reflects the 'challenge' target, the Bank's most ambitious targets.
2. From 2018-19 the Department revised the Bank's target to provide a greater focus on supporting smaller SMEs.
3. For financial years 2014-15 to 2017-18, the Department defined this indicator using the UK's four largest banks (Barclays, HSBC, Lloyds and the Royal Bank of Scotland). From 2018-19 onwards, the Department extended this measure to the UK's five largest banks (adding Santander).
4. The balanced scorecard consists of a range of measures, covering website visits, social media engagement, media coverage and events. The scorecard is also informed by the Bank's customer surveys.
5. The target was refreshed for 2018-19 into a Red, Amber, Green (RAG) system to signify different scale ratings. This means that both target and outturn for 2018-19 are on a RAG basis.
6. The target and outturn numbers for rate of return on investments are those shown in the Bank's Annual Report and Accounts for each year. In its 2018-19 Annual Report and Accounts, the Bank restated the rate of return on investments retrospectively, in line with IFRS 9 requirements.
7. From 2018-19, the Department clarified that the Bank should aim to meet, rather than exceed, the KPI 4 target over the medium-term planning period. This states that the Bank should aim to fall within a 2% range of the target return annually, on a 'comply or explain' basis.

Source: National Audit Office analysis of British Business Bank annual reports and performance information

Creating a more diverse market for finance

2.6 In recent years, a number of ‘challenger banks’ have entered the UK SME finance market, adopting new technologies and business models while offering a range of traditional banking services. However, the UK SME finance market remains dominated by the UK’s largest banks. From the outset, the Department set an objective for the Bank to create a more diverse market for SME finance with greater choice of options and providers.

2.7 The Bank has been successful in increasing the diversity of SME finance providers. By March 2018, the Bank had increased the proportion of the finance its programmes supported through providers other than the UK’s four largest banks to 96%, compared with 79% at launch and against a target of 81%–91% in 2017-18. From the 2018-19 financial year onwards, the Department tightened the Bank’s target to include providers other than the UK’s five largest banks (now including Santander). The Bank’s programmes, such as ENABLE Guarantees, have also directly supported several challenger banks.

Promote better information in the market

2.8 Many SMEs are unaware of the financing options available to them. Where they decide to self-finance rather than seek external finance, this can limit their opportunities to grow. Even where they seek external finance, many SMEs rely on overdrafts or credit cards. The most commonly cited reason smaller businesses give for choosing a finance provider (41% in 2018) is a pre-existing relationship, which may not be the type of finance best suited to their needs. The Bank aims to influence the behaviour of SMEs by increasing awareness of their financing options.

2.9 The Bank’s surveys indicate that more SMEs are aware of financing options compared with when the Bank was launched. There was little improvement in awareness of financing options among surveyed SMEs between 2015-16 and 2017-18, with the Bank’s measure increasing from 48% to 50%.

2.10 In 2017 the Department and the Bank agreed that the Bank would increase its focus on ‘demand-side’ activities such as improving awareness of financing options among SMEs. The Bank has since introduced a strategy for providing better information to SMEs, and a Finance Hub, a website which provides information to businesses regarding the finance options available that could enable them to grow. The Finance Hub was visited more than 200,000 times in 2018-19, although this was below the Bank’s target of 300,000.

Managing taxpayers' money efficiently

2.11 The Bank met or exceeded its target for securing financial returns to the taxpayer in each of the four years to 2017-18.[7] It achieved returns of 3.9% in 2016-17 and 4.7% in 2017-18, well above its challenge targets for those years (1.8% and 2.2% respectively). In 2018-19, the return was lower, at 3.6%, but still exceeded the Bank's target (to exceed the government's medium-term cost of capital, approximately 2.5%).[8] From 2018-19 the Department clarified that the Bank should aim to meet, rather than exceed, the target over the medium-term planning period, with the expectation that returns could be higher or lower than the target in individual years.[9]

2.12 However, the Bank's returns target is lower than the returns government would usually expect when using public money to invest in projects. The investment appraisal guidance set out in HM Treasury's *Green Book* requires public bodies appraising investment decisions to use the Social Time Preference Rate. This rate is intended to reflect the value society attaches to present, as opposed to future, consumption and is set by HM Treasury at 3.5% (in real terms). As the Bank's target return is lower than the Social Time Preference Rate, this suggests the Department is willing to accept the opportunity cost of funding the Bank relative to other higher-return projects. We have previously commented on the use of this rate in government asset sale valuations.[10]

2.13 The Department has emphasised to the Bank that it should not prioritise exceeding its returns target over achieving its other objectives, as the Bank's investments are generally higher risk than would be acceptable to commercial lenders and investors. The Department recognises that the Bank should balance returns alongside its other objectives, and thus it has not set a more challenging returns target.

Additional objectives

2.14 From 2018-19 the Department introduced two further objectives for the Bank: to act as government's centre of expertise on smaller business finance and to help reduce regional imbalances in access to finance (see paragraph 1.7). Through its work with other government departments, the Bank had been informally acting in the capacity of government's centre of expertise for some time. By formalising this as an objective, the Department aimed to be able to encourage and hold the Bank to account for these activities.

7 The Bank's rate of return measure is an adjusted return on capital employed. This measure is defined in the *Shareholder Relationship Framework Document*.

8 The medium-term cost of capital, which represents the government's required return, is measured by the weighted average nominal yield of UK government gilt issuance reported by the Debt Management Office.

9 The Bank has retrospectively restated all of its historic return figures (and targets) to take into account the impact of IFRS 9 in its 2018-19 Annual Report and Accounts. The return numbers used in this report are the initial percentage returns published in each annual report.

10 The National Audit Office's past work on asset sales and privatisations is available from our website: www.nao.org.uk/search/pi_area/asset-sales-and-privatisation/type/report

2.15 The Bank provides support and advice to government on access to finance, but it is not "the default" for government interventions. In 2014, the government said that "in order to preserve coherence, the default position will be that the British Business Bank will operate all national SME access to finance schemes across government", but the government has not done this. There can be good policy reasons for other public bodies to develop their own access to finance proposals, but this creates risks of piecemeal interventions – our January 2020 report on wider support to business found that the Department could still make business support interventions work better as a programme. In undertaking its centre of expertise role, the Bank can help make the government's access to finance interventions more coherent. For example, the Ministry of Housing, Communities & Local Government told us that the Bank's skills were essential to the development of its ENABLE Build programme, which the Bank delivers, with Homes England providing advice on the housing market. 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.

2.16 Since its launch the Bank has been sensitive to the differing experience of access to finance in the regions and put in place regional programmes to help address these imbalances (such as the Northern Powerhouse Investment Fund and Midlands Engine Investment Fund). Previously, in response to the Business, Energy & Industrial Strategy Select Committee inquiry into access to finance, the government noted that introducing a regional objective "could lead to a distortion of outcomes and complicate the Bank's governance". The Bank told us that it believes the policy environment has changed since then and that, given the increased prominence for regional issues in the context of the government's 2017 Industrial Strategy, the new objective helped to confirm and formalise government's commitment to the regional agenda. The Bank launched the Northern Powerhouse Investment Fund in February 2017. For the Midlands Engine Investment Fund, the Bank launched the debt funds element in August 2017. However, the equity funds element was delayed by six months due to problems with the process it ran for procuring delivery partners. The Bank told us that it cost an estimated £275,000 to re-run the process, allowing the equity funds to be launched in February 2018.[11]

2.17 The Bank and the Department have found it difficult to develop quantitative performance indicators to measure progress towards these new objectives. This is because the stated 'centre of expertise' objective is not easily measurable, and because regional imbalances and the Bank's effectiveness in addressing them may vary across the country. To date the Bank has adopted a qualitative approach in assessing the Bank's performance against these objectives. This shows the Bank has delivered a range of activities in line with its own and the Department's expectations for the year. The Bank engaged with a range of departments and agencies, helping support the government's wider access to finance priorities. The Bank also launched its Regional Angels Programme and set up its UK Network team to address the regional imbalances across the UK.

11 This estimate includes legal and consulting fees only, it excludes other costs such as Bank staff time.

Evaluating the Bank's impact

2.18 At launch the Department set out a framework for the Bank to evaluate the impact of its activities and to assess whether its activities are meeting its objectives. The Bank undertakes or commissions evaluations at key points in the lifecycle of each of its financial products. It undertakes 'early assessments' around two years after launching an activity; these are generally process evaluations which provide a baseline for future assessment. The Bank told us it then performs either interim or full evaluations around four to five years after launch, including impact evaluations and economic evaluations. Our review of the Bank's individual product evaluations indicated that they are of good quality and in line with HM Treasury's evaluation guidance, including the use of comparison groups of non-assisted SMEs to give a clearer picture of the impact of individual products.[12]

2.19 The Bank has to date undertaken full evaluations of a relatively small proportion of its activities, in part because some activities are relatively recent, for example regional funds and new activities around better information for SMEs. This is also because many of the Bank's activities – particularly those involving equity investments, but also around influencing behaviour – are interventions where benefits are more likely to be seen over the longer term. The Bank has set out a longer-term plan for evaluating these activities.

2.20 The Department expected at launch that overall the Bank's economic benefits would exceed the economic costs by a ratio of at least 5:1.[13] The Bank has estimated the additional economic impact of each of its products, taking into account their differing purposes and which of the Bank's objectives it aims to address. The Bank's estimated benefit–cost ratios from business cases for its products range from 2.8 to 7.1 (**Figure 6** overleaf). The full evaluations the Bank has performed to date estimate that its interventions have generated benefit–cost ratios in the range 5.8 to 11.3.

2.21 In setting up the Bank, the government aimed to avoid displacing private sector market activity, in part to ensure compliance with relevant State Aid conditions. To avoid crowding-out, the Department noted the Bank would need to work in close cooperation with the market and to keep its range of activities under regular review. The Bank's evaluations suggest that the 'finance additionality' of its programmes ranges from 32% to 65%, although some SMEs report that they would have been able to access finance without the Bank's support.[14] In some cases, the Bank's programmes have helped increase the size of the funding SMEs were able to access, and some SMEs were able to secure funding faster than they would have been able to without the Bank's support. The Bank's evaluations also indicate that its activities contribute to additional growth for individual SMEs.

12 HM Treasury, *Magenta Book: Guidance for evaluation*, April 2011.
13 Economic costs include the administrative cost of the Bank's activities, the opportunity cost of alternative uses of resources and, for loans and loan guarantees, the cost of defaults.
14 'Finance additionality' is an estimate of the proportion of the finance secured by SMEs that would not have been available without the Bank's programmes.

Figure 6

Estimated benefits of British Business Bank's current finance programmes

The Bank's estimated benefit–cost ratios[1] for its 12 current products range from 2.8:1 to 11.3:1 in benefits for every £1 spent

Programme	Assets under management as at 31 March 2019 (£m)	Estimated benefit–cost ratio from business cases	Benefit–cost ratios from the Bank's evaluations
Debt programmes			
Start-Up Loans	137		5.8 (7.4)[2]
ENABLE Funding	341	7.1	
Investment Programme	531	3.7	
Regional debt funding[3]	64	3.6 – NPIF	
		3.7 – MEIF	
		2.8 – CIOSIF	
Equity programmes			
Angel CoFund	61	6.0	
Regional Angels Programme	0	5.0	
Enterprise Capital Fund	227	6.2	
British Patient Capital	203	5.0	
Managed Funds	0	4.3	
Regional equity funding[3]	61	3.6 – NPIF	
		3.7 – MEIF	
		2.8 – CIOSIF	
Financial guarantees			
Enterprise Finance Guarantee	587		7.2–11.3[4]
ENABLE Guarantees	439	6.8	

Notes

1 A benefit–cost ratio (BCR) is an indicator used to show the relationship between the relative benefits and costs of a proposed project.

2 7.4 BCR includes the distributional weight, an option in the *Green Book* that gives recognition to benefits for those in lower income groups.

3 For each of Northern Powerhouse Investment Fund (NPIF), Midlands Engine Investment Fund (MEIF) and Cornwall and Isles of Scilly Investment Fund (CIOSIF), one overall BCR is generated, which is the weighted average of the different components, across debt and equity.

4 The Enterprise Finance Guarantee evaluation assesses three different loan cohorts (2010-11, 2011-12 and 2012-13) and therefore produces a range of BCRs depending on loan cohort.

Source: National Audit Office analysis of British Business Bank information

Monitoring market developments

2.22 The Bank regularly analyses the UK small business finance market. There is evidence that SMEs continue to use finance for short-term operational cash-flow reasons. The Bank's surveys of SMEs indicate that their main reasons for seeking external finance are working capital and cashflow (40%) and purchasing fixed assets (33%), rather than starting a business (4%) or expansion (9%).[15] These findings are broadly similar to survey results from 2013, suggesting that SMEs' motivations for seeking external finance have not changed since the Bank was launched. However, the Bank's annual survey does not separately identify how SMEs actually use the finance supplied or supported by the Bank's activities.

2.23 Some stakeholders told us that behavioural and cultural factors, trust in financial institutions and financial education can be as important (as awareness of options) in determining whether SMEs access the finance they need to grow their businesses. Some of the Bank's survey data provide information on how these factors are changing over time, although the Department and the Bank do not formally use these as part of their monitoring information.

2.24 The stakeholders we interviewed were positive about the way the Bank analyses the market. The Bank has worked with government to introduce new interventions based on the Bank's market analysis. For example, the Bank's analysis identified that only a small proportion of SMEs use equity finance. This finding, alongside the government's own review, led to the creation of British Patient Capital (Figure 3). HM Treasury, the Department and UK Government Investments (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 it does to inform its activities and wider government policy decisions.

2.25 The Bank told us it has previously decided not to proceed with a product based on evaluation of a pilot. This Trade Credit Enterprise Finance Guarantee pilot was closed, and the Bank decided not to create a direct successor scheme because of limited impact and cost-effectiveness. However, beyond this we found limited evidence of the Bank withdrawing a financial product or scaling back interventions in response to evaluations.

2.26 There is some evidence of the Bank withdrawing or scaling back existing products based on analysis of market need, although it does not generally publicise this. The Bank decided in 2015 that the availability of finance for 'mid-cap' businesses had improved since 2009, and therefore it could cease further investment beyond the existing commitments.[16] A further example is the Help to Grow loans programme, which aimed to address the financing needs of SMEs struggling to raise enough financing to fund their growth. The Bank launched the initial phase of Help to Grow in May 2016 with £30 million of lending made available, but to date only one loan of £600,000 has been issued. This low uptake led the Bank to close the programme to new proposals.

15 The capital of a business which is used in its day-to-day trading operations, calculated as the current assets minus the current liabilities.

16 The Bank defines a 'mid-cap' business as one with annual turnover of between £25 million and £500 million.

Part Three

Governance, costs and preparedness

3.1 This part examines the British Business Bank's (the Bank's) governance, the Bank's costs, the future challenges the Bank may face, and how it and government have planned to meet those challenges.

The Bank's governance arrangements

3.2 The Department for Business, Energy & Industrial Strategy (the Department) decided to set up the Bank as a company at arm's length, allowing the Bank to operate independently, and gave the Bank some flexibility from public sector controls, including pay controls. This has allowed the Bank to identify and recruit people with the skills it needs to fulfil its role. The Bank's operational independence also created a split between government policy and the Bank's investment decisions, further increasing its credibility with market participants. The Department has taken a similar approach in setting up other interventions, for example the UK Green Investment Bank.[17] We have previously reported on the wider increase in the number of companies in government, and how they are used.[18]

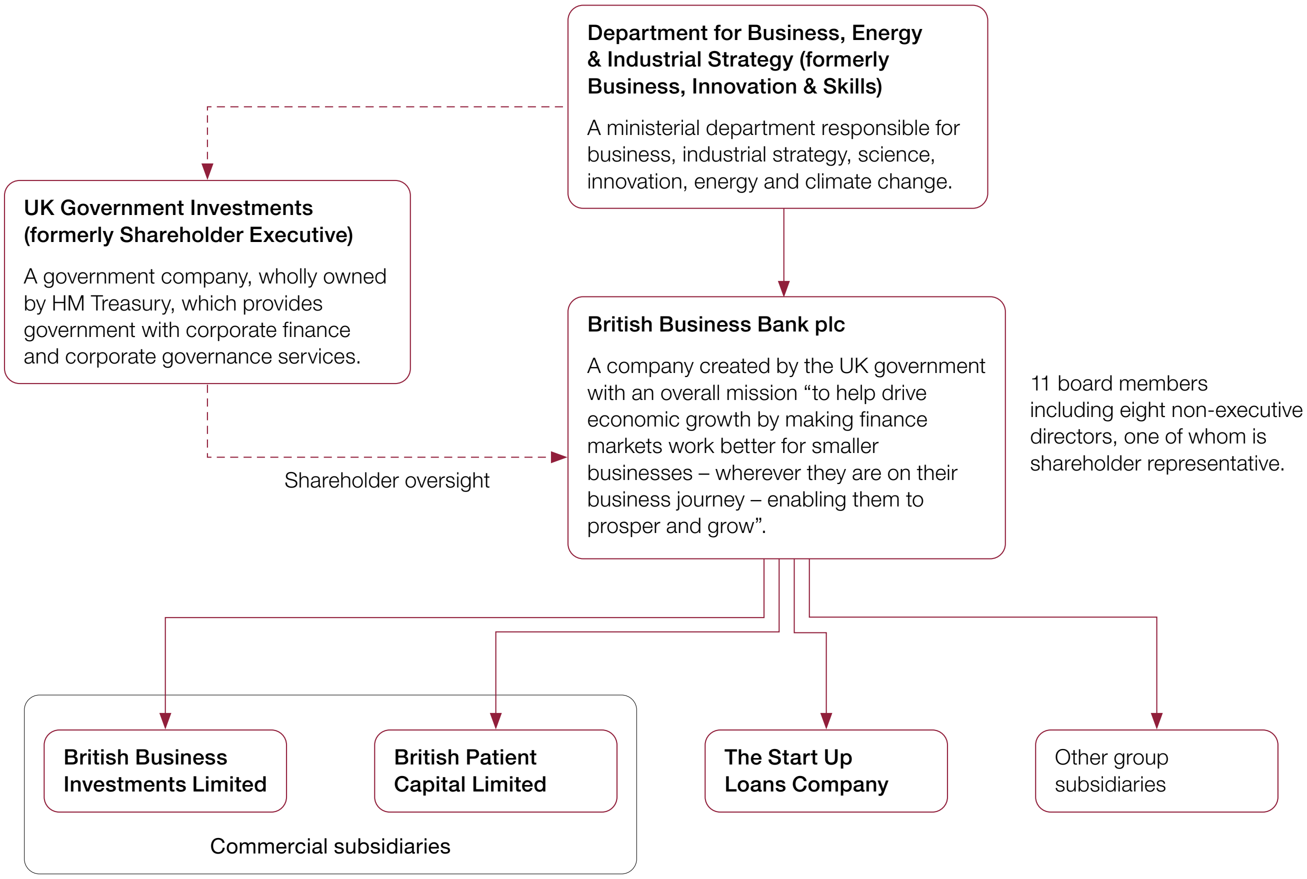
3.3 The Department has put in place a framework of governance and accountability, to ensure that the Bank considers how it manages public money. The Bank's Chief Executive is the designated accounting officer and is therefore directly accountable for the Bank's activities. The Bank must comply with a number of operating principles the Department specified at launch. These principles include minimising the Bank's impact on competition and trading conditions where markets function well and seeking to overcome market imperfections and improve market effectiveness where they are not functioning well. The Department sets out these principles in a *Shareholder Relationship Framework Document* that makes the Bank accountable to both the Department (as shareholder) and to Parliament. **Figure 7** shows the government bodies involved in overseeing the Bank's activities.

17 Comptroller and Auditor General, Department for Business, Energy & Industrial Strategy, UK Government Investments, *The Green Investment Bank*, Session 2017–2019, HC 619, National Audit Office, December 2017.
18 Comptroller and Auditor General, *Companies in government*, National Audit Office, December 2015.

Figure 7

Governance structure of the British Business Bank

The Department for Business, Energy & Industrial Strategy (the Department) wholly owns the Bank and UK Government Investments (UKGI) manages the shareholding on the Department's behalf



Note

1 Other group subsidiaries include: British Business Finance Limited, British Business Financial Services Limited, Capital for Enterprise Limited, Capital for Enterprise Fund Managers Limited, Capital for Enterprise (GP) Limited, British Business Aspire Holdco Limited, BBB Patient Capital Holdings Limited.

Source: National Audit Office analysis of British Business Bank information

3.4 The Bank receives an annual operations budget (£63.1 million in 2018-19) and a separate budget for its investment activities (£361 million in 2018-19) that it can allocate flexibly between its various activities. The Department allows the Bank flexibility to underspend or overspend on its budget if, for example, this arises due to a mismatch between the timing of a small and medium-sized enterprise's (an SME's) financing needs and the annual government budgeting cycle. The Bank is also able to arrange financial guarantees, subject to HM Treasury's specific approval, which applies to any public body wishing to take on contingent liabilities.[19]

3.5 The financial framework between the Bank and the Department is complex and requires close engagement between them and UK Government Investments (UKGI) to work effectively. The framework provides for an annual business planning process through which the Bank sets out the money it needs for the following year. In 2018 the Bank underestimated, by £9.5 million (almost 15% of operating expenditure), how much it needed in 2018-19, including failing to include fit-out costs of a planned property move. The Bank's Chief Executive outlined measures to reduce the funding gap, but these were unable to close it fully. This resulted in the Department making an additional £3.4 million (around 5% of operating expenditure) available should it be needed.

3.6 In June 2019 the Government Internal Audit Agency and the Bank's internal audit team identified the causes of the underestimate as weaknesses in:

- the clarity around process, responsibilities and accountability between the Bank and the Department;
- the quality of communication and engagement on finance, potentially coupled with concerns regarding the Bank's commercially sensitive information and operational independence;
- the Bank's financial management and planning controls, with some controls not working as intended, and a theme of known issues not being tracked through to resolution; and
- the Bank's capability in relation to government accounting rules and processes.

The report said that the Bank's management had not given sufficient priority to management, reporting and oversight in relation to government accounting requirements compared to the Bank's rate of return target. The report noted that the Bank and the Department had implemented some corrective actions, but also that finance-related recommendations from a 2017 Government Internal Audit Agency report on finance were still relevant.

3.7 The Department and the Bank are implementing actions aimed at minimising the risk of similar problems occurring in future. These actions include formalisation of responsibilities and reporting on progress to the Bank's Board Audit Committee. In addition, the Government Internal Audit Agency and the Bank's internal audit team are tracking their recommendations to completion.

19 Most of the financial guarantees arranged by the Bank are recorded on the Department's balance sheet.

3.8 The Bank considers that the financial framework is not optimal for the way it operates. The Bank's management told us that the budgeting and accounting framework reflects expectations of all public bodies, and is not well suited to planning and accounting for the specific nature and full range of the Bank's financial activities. There is a range of relationship models between government and arm's-length bodies, as we outlined in our reports on *Companies in government and the Financial institutions landscape*.[20,21] For example, CDC Group plc operates as a public financial corporation, while UK Export Finance is a ministerial department. The Bank's management considers that an alternative approach could address some of the problems while still allowing government to exercise appropriate scrutiny of the Bank.

Rapid growth in the Bank's activities

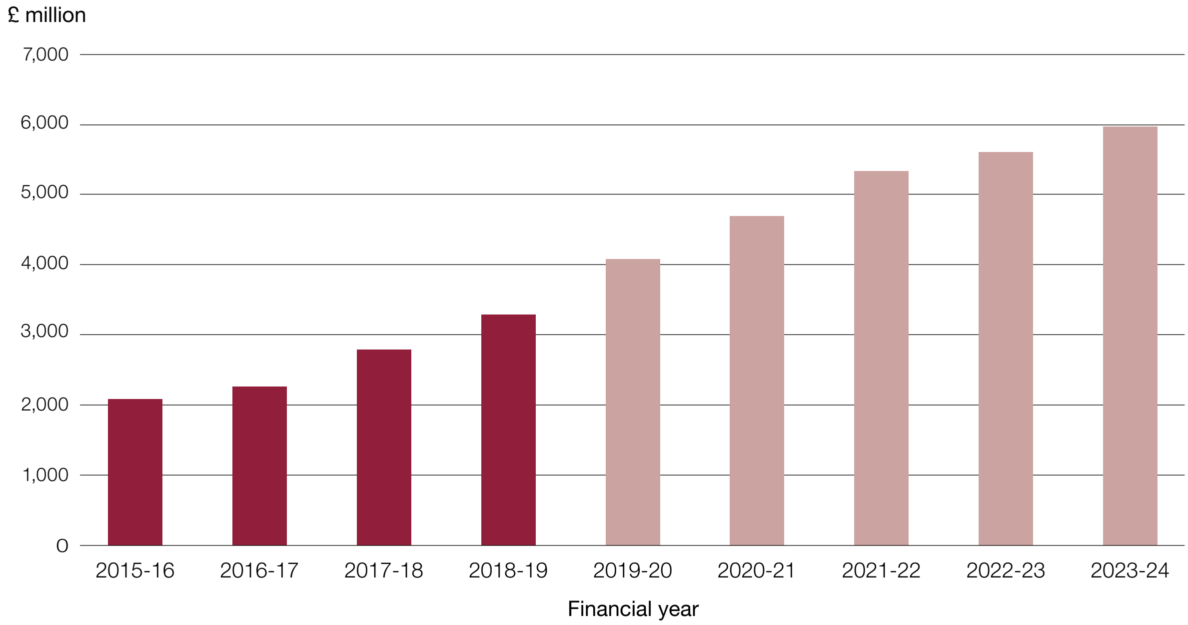
3.9 Since the Bank launched in 2014, its activities have grown in scope and scale. The Bank's assets under management have grown to £3.3 billion (**Figure 8** overleaf). In 2017 the Bank expanded through a merger with the Start-Up Loans Company, a government company established in 2012, which provides funding and support through a network of delivery partners. Between the Bank's launch and 2017, the Bank had overseen the work of the Start-Up Loans Company. In 2018, the Bank launched British Patient Capital Limited (BPC) as a new subsidiary intended to deploy up to £2.5 billion of finance to support SME growth. The Bank has also introduced several new financial programmes as part of government initiatives. For example, in 2017 the Bank launched the Northern Powerhouse Investment Fund to provide more than £400 million of investment to SMEs in the North of England. The Bank expects its assets under management to continue to grow to around £6 billion by 2023-24, based on its five-year business plan (Figure 8). This business plan assumes the Bank will receive almost £1.4 billion from government over the forecast period to help fund these investments.

3.10 The Bank told us that the rapid growth in its activities, with the addition of the Start-Up Loans Company, BPC and the regional funds in short succession, put pressure on its governance and operational arrangements. With the expectation of the Bank growing further, in 2018 the Bank's management chose to take on more risk than it was comfortable with for operational activity and adopted a number of initiatives to strengthen its processes and controls. By the end of 2018-19 the Bank concluded that it had returned to within its operational risk appetite, as a result of these actions. The Bank, the Department and HM Treasury plan to assess the Bank's role, remit and governance.

20 Comptroller and Auditor General, *Companies in government*, National Audit Office, December 2015.
21 Comptroller and Auditor General, *Financial institutions landscape*, Session 2015-16, HC 418, National Audit Office, September 2015.

Figure 8
The British Business Bank's assets under management, 2015 to 2024

The Bank's assets under management have grown to £3.3 billion and are expected to grow to around £6 billion by 2023-24



	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
Total	2,081	2,256	2,794	3,297					
Forecast					4,084	4,683	5,327	5,602	5,963

Note

1 Forecast figures reflect the numbers in the Bank's five-year business plan. This business plan assumes the Bank will receive more than £1.4 billion from government over the forecast period to fund these investments.

Source: National Audit Office analysis of British Business Bank information

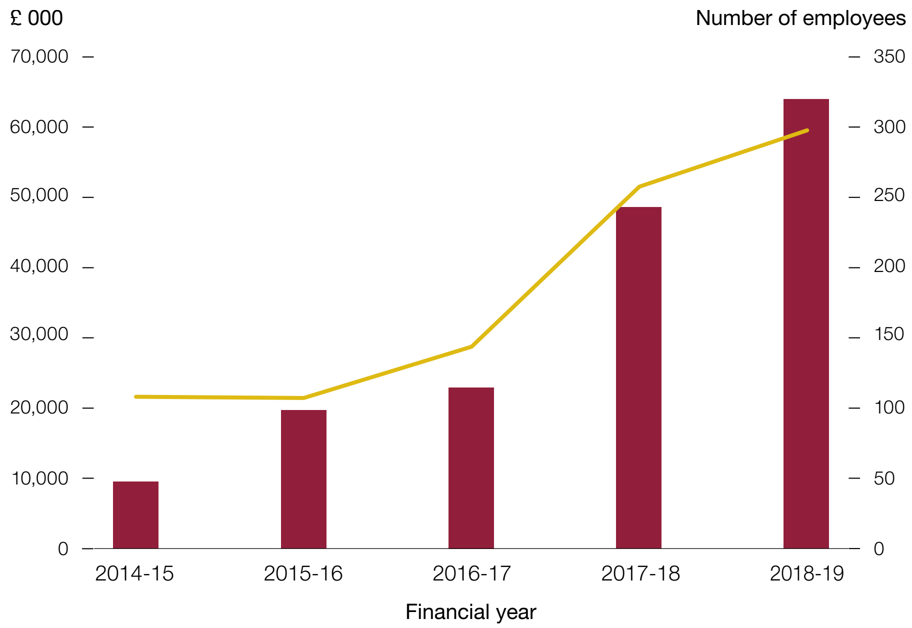
The Bank's costs and transparency

3.11 As the Bank's role has grown, its costs and headcount have also increased. **Figure 9** shows that since launch, the Bank's operating expenditure grew from £19.7 million in 2015-16 (its first full year of operation) to £64.0 million in 2018-19, and its headcount has almost trebled. Between 2015-16 and 2017-18, the Bank's headcount and operating expenditure more than doubled, largely due to the absorption of the Start-Up Loans Company. The Bank told us that, in part, this growth reflects that the Bank was initially under-resourced, and it took time to build its central support functions (such as human resources). 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 three years. The Bank's five-year business plan (2019-20 to 2023-24) forecasts that its costs will continue to grow alongside its activities.

Figure 9

The British Business Bank's operating expenditure and staff numbers, 2014 to 2019

The Bank's costs and staff numbers have increased substantially since launch



	2014-15	2015-16	2016-17	2017-18	2018-19
Operating expenditure (£000)	9,521[1]	19,739	23,004	48,622	63,983
Average number of employees	108	107	144	258	297

Note

1 The Bank was formally launched in November 2014. Therefore, the operating expenditure for the 2014-15 financial year does not reflect a full year of the Bank's operations as an independent body.

Source: National Audit Office analysis of British Business Bank annual reports

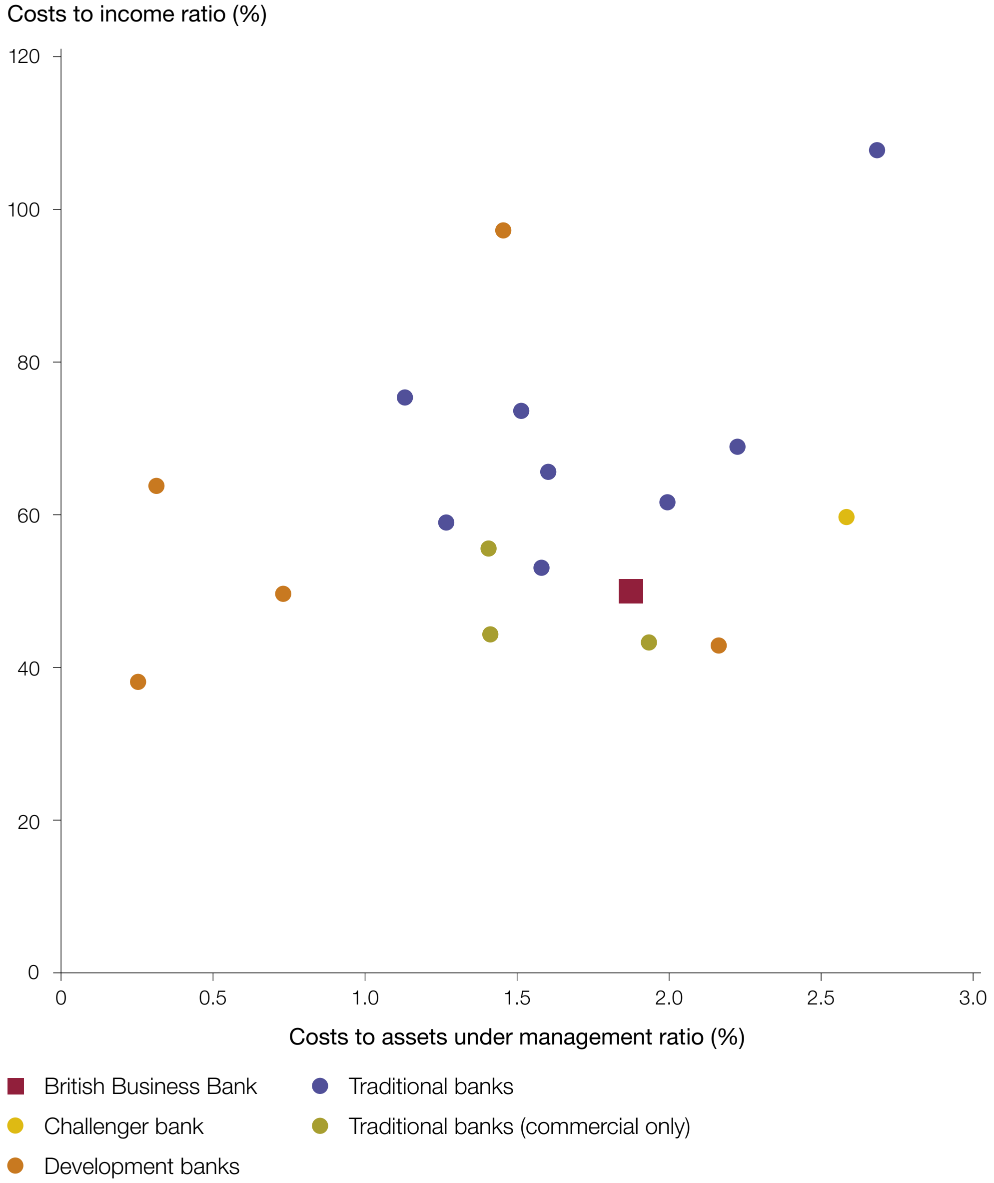
3.12 The Bank has undertaken its own cost benchmarking work, as a one-off exercise, that considers how its total costs compare with similar organisations (such as traditional lenders and development banks). It does this by using two common financial ratios used by lenders and asset managers: the 'cost to income' and the 'costs to assets under management'. The first ratio shows the scale of an organisation's cost base relative to the income it generates. The second ratio shows the scale of an organisation's cost base relative to the amount of assets it manages, a key driver of cost for asset managers. The Bank's benchmarking suggests that its costs are in lower-to-middle range of the costs of organisations undertaking similar activities.

3.13 We performed analysis comparing the Bank's cost ratios for the years 2015-16 to 2018-19 with ratios for organisations undertaking similar activities. Our analysis suggests that the Bank's cost ratios are broadly comparable with ratios for those other organisations. **Figure 10** overleaf provides the results of this analysis for one year, for simplicity. This shows that the Bank's cost ratios were in the middle of the range for 2018 (based on its 2017-18 data). Although it expects costs to rise, the Bank forecasts that its costs as a proportion of income and assets under management will decrease by 2023-24.

Figure 10

Benchmarking the British Business Bank's costs against similar organisations

British Business Bank's 2018 cost ratios are in the middle of the range compared with organisations undertaking similar activities



Notes

1 This benchmarking uses publicly available information for organisations using data from accounting years ending in 2018. Each marker relates to a single comparator organisation.

2 The further away from the origin (0,0), the less favourable the costs to assets under management and costs to income ratios become.

3 The 'cost to income' ratio is calculated using operating costs and operating income reported in financial statements.

4 The 'cost to assets under management' ratio is calculated using operating costs and total assets reported in financial statements. For the British Business Bank, the notional value of its financial guarantees has been included.

Source: National Audit Office analysis using British Business Bank financial information and other public information

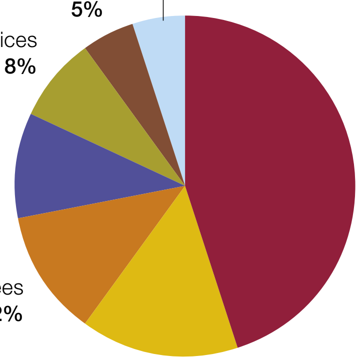
3.14 The Bank benchmarks its staff costs to other organisations, as part of an annual reporting requirement to government on remuneration. But the Bank does not benchmark non-staff costs to other organisations, although more than half of the Bank's operating expenditure in 2018-19 related to non-staff costs (**Figure 11**). It does not benchmark costs of internal functions, for example IT, finance, human resource and estates costs.

3.15 The Bank collects some information on the relative cost-effectiveness of its individual programmes and activities through its five-year product evaluations. However, it does not bring together information on costs, activity and outcomes from different programmes and products more often, to inform the Bank's decision-making about resource allocations. The Department and UKGI told us that they challenge the Bank's proposed costs each year at planning rounds, but they do not consider the cost of specific activities.

Figure 11

Composition of the British Business Bank's cost base in 2018-19

In 2018-19, more than half of the Bank's operating expenditure related to non-staff costs



Cost type	Value (£000)
Staff costs	27,765
Professional fees	9,444
Start-Up Loans Company delivery partner fees	7,677
Information technology	6,216
Accommodation and office services	4,971
Marketing	3,267
Other operating expenditure	3,200
Total	**62,540**

Note

1 Proportions have been rounded to the nearest 1%.

2 This figure excludes £1,443,000 of 'depreciation and amortisation', which would need to be added to make Figure 11 reconcile with Figure 9 on page 35.

Source: National Audit Office analysis of British Business Bank's 2018-19 annual report and accounts

3.16 Although the government accepted a Committee of Public Accounts (the Committee) recommendation regarding transparency around the relative amounts going to SMEs and intermediaries, neither the government nor the Bank publishes this information. In 2014 the Committee said the department must gather and publish data about how much financial support is reaching SMEs, and how much is diverted to other recipients or used to run the schemes. The government accepted this recommendation, saying the Bank would publish these data on a regular basis on its website. To date, neither the Bank or government has published this information. The Bank's management considers information on fees to be commercially sensitive and publication would compromise its ability to secure good terms from delivery partners.

Potential future challenges

3.17 As set out in the Bank's five-year business plan (2019-20 to 2023-24) the Bank's management intends to place a greater emphasis on providing equity finance to SMEs, through programmes such as BPC. In 2018-19, equity finance represented 25% of the total finance the Bank made available to SMEs. By continuing to roll out the BPC programme, the Bank forecasts that equity finance will increase to 65% of the total finance it supplies by 2023-24. Increasing the proportion of equity finance raises the expected financial return to the taxpayer, but also increases the risk to the taxpayer of losses if assisted SMEs perform less well than expected. The risk of losses may be increased by an economic downturn or uncertainty.

3.18 SMEs are likely to be affected in a downturn through worsening business prospects. As a result, SMEs could be more likely to seek finance for working capital to support their day-to-day operations, rather than to grow their businesses. However, the supply of finance available to SMEs may fall during a downturn. The Department and the Bank expect the latter could play an influential role in any government response to a future economic downturn.

3.19 The Bank also expects the Department to ask it to take a greater role in providing access to finance for SMEs following the UK's exit from the European Union (EU), including expanding into activities that EU institutions have previously undertaken. In many areas where the Bank operates to assist SMEs, the European Investment Fund (EIF) – an EU institution that helps SMEs access finance – has also provided finance through fund managers and other intermediaries. In his speech alongside the Autumn Budget 2018, the then Chancellor of the Exchequer announced he would "provide an additional £200 million of funding to the British Business Bank to replace access to the European Investment Fund if needed". Since then, the government has considered how the Bank might fill gaps left by the EIF after EU Exit.

3.20 Future policy decisions may also directly affect the Bank's balance sheet and cost base. When setting up BPC in 2018, the government made clear that it could be sold to the private sector in the future. The business case for BPC indicated that it could eventually become listed on a stock exchange or sold to a private investor once it had established an investment track record, and the business case was approved in part on this basis. The privatisation of BPC would itself require a great deal of management time and cost to prepare for the sale and would likely have an operational impact on the Bank. In December 2017, we reported that the sale of the UK Green Investment Bank had taken longer than expected and had an operational impact.[22]

Preparations for the future

3.21 The Bank has worked with government to analyse how SMEs and its own balance sheet might be affected by an economic downturn. The Bank has performed stress tests of its current and future portfolio (based on its existing strategy) using a range of economic scenarios (**Figure 12** overleaf). The results of these tests show that the portfolio could experience significant losses in a downturn scenario ranging from £71 million to £1.2 billion. Each of the stress scenarios considered would prevent the Bank from achieving its objective of achieving a financial return equal to the government's cost of capital.

3.22 The Bank has considered how it might respond to various downturn scenarios, and the resources it would need to do so. This includes considering the actions it could take to adjust its existing programmes to address developments in the market and the likely impact of these actions. The Bank expects to be able to use some of its products in a downturn, and in certain circumstances the Bank can act quickly, although this is dependent on government making funding available unless the Bank can use existing resources. In early 2018, when Carillion collapsed, the Bank moved quickly to make an Enterprise Finance Guarantee facility of £100 million from existing resources available to SMEs, although take-up was ultimately very limited. The Bank has identified barriers that could limit its ability to respond quickly, including:

- the need for the Department to gain approvals from HM Treasury for additional funding and to take on contingent liabilities, such as ENABLE Guarantees;
- 'navigation' of the State Aid requirements for its existing programmes, or the need for State Aid approval for new programmes; and
- the capacity of the organisation to deliver current workload and take on further responsibilities.

22 Comptroller and Auditor General, Department for Business, Energy & Industrial Strategy, UK Government Investments, *The Green Investment Bank*, Session 2017–2019, HC 619, National Audit Office, December 2017, paragraph 13.

Figure 12

British Business Bank stress test results

The Bank has performed stress tests of its portfolio using a range of economic scenarios

Scenario	Cumulative net returns/losses over period 2019 to 2024 (£m)	Projected return on capital employed over period 2019 to 2024 (%)
1 Business plan central case, no stress scenario.	+£242	+8.0
2 Bank of England stress test, macroeconomic downside.	-£71	-2.5
3 One in 20-year downturn scenario[1], beginning in 2019-20, affecting all investments.	-£772	-25
4 One in 20-year downturn scenario[1], beginning in 2021-22, affecting all investments.	-£1,173	-39

Notes

1 The One in 20-year downturn scenarios reflect the Bank's projection of the impact of an economic downturn scenario, the scale of which is consistent with what it might expect to occur once in every 20 years.

2 Projections assume capital is deployed in line with the British Business Bank 2019-20 to 2023-24 business plan. This assumes average capital deployed reaches £3.6 billion in 2023-24.

Source: British Business Bank, *Business Plan 2019-20* (May 2019) and stress testing analysis

3.23 To help overcome some of these obstacles, the Bank has a high-level framework setting out the principles of how the Department, HM Treasury and UKGI will coordinate a response in the event of a downturn scenario. The Bank also notes that, if called upon to respond in a downturn, it would likely be unable to achieve its current performance targets. In particular, losses as outlined in Figure 12 would adversely affect the Bank's ability to meet its returns target. The Bank may also be required to quickly increase the stock of finance by routing its products through the larger banks, which would impact its diversity target. The agreed high-level framework allows the Bank to request temporary changes to its performance measures, business plans or the design of its programmes (such as broadening eligibility criteria for some programmes).

3.24 In October 2019, the Bank estimated that, if needed, it could make additional funding available within two to six weeks in a downturn through the Enterprise Finance Guarantee. For other products the Bank's analysis indicated that it could take anywhere between three and eight months to arrange these responses with delivery partners. It could take a further six months for delivery partners to make Bank-supported funding available to SMEs. While the delivery partner model has advantages around lower cost and attracting private investment in a 'business as usual' environment, it means Bank-supported funding could take longer to be made available to SMEs compared, for example, to a direct lending approach. The Department may be able to act more directly. The Department told us that the Bank's contribution would be a part of the overall government response to a downturn, but it is unclear how this fits within the Department's wider response.

Appendix One

Our audit approach

1 This study examined whether the Department for Business, Energy & Industrial Strategy (the Department) set up the British Business Bank (the Bank) effectively to meet its objectives, and its performance to date. The study considered whether the Department and the Bank have addressed weaknesses that we, and the Committee of Public Accounts, identified in past reports on this type of business support. The report examines whether:

- the Department and the Bank have developed a clear view of what they want the Bank to achieve, and how to measure it;
- the Bank is making optimal use of public funds to make markets work more effectively for small and medium-sized enterprises (SMEs); and
- the Bank is well prepared to deliver its current mission and to meet potential future challenges.

2 **Figure 13** overleaf outlines our evaluative criteria. Our evidence base is described in Appendix Two.

Figure 13
Our audit approach

The objective of government

In 2014, the government formally launched the British Business Bank (the Bank) to address signs of weakness in the UK small and medium-sized enterprise (SME) finance market.

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 finance programmes support SMEs access to a range of finance, including debt, equity investment and financial guarantees.

How this will be achieved

The Department for Business, Energy & Industrial Strategy (the Department) gave the Bank a mission 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".

Our study

The study examines whether the Bank is improving access to finance for SMEs and is well prepared to respond to future challenges.

Our evaluative criteria

Do the Department and the Bank have a clear view of why they are intervening, the change they want to see, and how to achieve and measure it?

Is the Bank addressing the problem it was set up for, and is it doing so cost-effectively?

Is the Bank well prepared to deliver its current mission and to meet potential future challenges?

Our evidence
(see Appendix Two for details)

We interviewed officials at HM Treasury, the Bank and the Department and reviewed their advice to ministers.

We reviewed the business cases and analysis performed prior to the creation of the Bank.

We interviewed officials in the Bank and the Department. We also engaged with business groups to understand their views.

We reviewed performance documentation, annual reports, and evaluation work. We also recreated benchmarking analysis.

We interviewed officials at UK Government Investments, the Bank and the Department. We also engaged with business groups to understand their views.

We reviewed the analysis provided by the Bank.

Our conclusion

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.

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.

Appendix Two

Our evidence base

1 Our conclusion was reached following an analysis of evidence collected between May 2019 and October 2019. Our main methods are outlined below:

Document review

2 We reviewed key documents including:

- publicly available information relating to the creation, operation and performance of the British Business Bank (the Bank), for example annual reports and accounts;
- formal public and internal documents underpinning the Bank's governance arrangements and its relationship with the shareholder and with other parts of government, including Board papers;
- the Department for Business, Energy & Industrial Strategy's (the Department's) original business case and other documents relating to launching the Bank;
- the Bank's management information and Board papers, to understand how the Bank has evolved since launch;
- the Bank's internal documents relating to its policies, operational processes and risk management, and its planning documents, including its forecasts of future activity and costs;
- the Bank's business cases for, and evaluations of products, together with its research and market analysis reports on the small business finance market; and
- third party documents on access to finance, including indications of how the small and medium-sized enterprise (SME) finance market has changed over time.

Interviews

3 We held interviews with a range of government bodies, including:

- officials at various levels across the Bank, including members of the Board and senior management, with responsibilities covering the full range of the Bank's activities – financial products; SME awareness activities; strategy, policy, research and analytical activities, and operational functions;

- officials at the Department, UK Government Investments and HM Treasury;
- other public bodies to understand how the Bank undertakes its centre of expertise role, including officials at the Ministry of Housing, Communities & Local Government, and officials at a regional Growth Hub and Local Enterprise Partnership, to understand regional perspectives on access to finance for SMEs; and
- the Government Internal Audit Agency, to understand the control totals issue (paragraphs 15 and 3.5 to 3.7).

We interviewed other stakeholders, including:

- individuals at six of the Bank's delivery partners, chosen to provide coverage of the full range of the Bank's product areas, differing sizes of operations and different perspectives on national and regional reach;
- individuals at three trade organisations representing banks and other finance providers; and
- individuals at three organisations representing small businesses, and to owners of a small business that the Bank's funding has helped to support.

Quantitative analysis

4 We performed analysis of data, including:

- analysis of the Bank's financial and operational information since its launch in 2014, to understand how the Bank has grown and to assess its performance over time;
- analysis of data that the Bank collected in surveys of SMEs since launch, and data, to understand the factors affecting SMEs' ability to access finance; and
- review of the Bank's comparative analysis of its costs relative to its income and assets, which we supplemented with our own analysis drawing in other comparators for the Bank.

5 In our report there are some limitations in the supporting evidence provided during our work. While we audit the Bank's financial statements, for example its operating expenditure in each year, we do not audit performance and other operational information that falls outside the scope of the financial statements. In these cases we have drawn data from the Bank's management information and other sources that the Bank provided to us, where possible confirming this against any available corroborating evidence.

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