

# STRATEGIC REPORT

## OUR OBJECTIVES

### INCREASE SUPPLY OF FINANCE

to smaller businesses where markets do not work effectively



### CREATE A MORE DIVERSE MARKET

for smaller businesses' finance with greater choice of options and providers



### PROVIDE BETTER INFORMATION

in the market connecting smaller businesses and finance providers



### MANAGE

taxpayers' resources efficiently



The directors, in preparing this Strategic Report, have complied with s414C of the Companies Act 2006 (as amended by the Strategic Report and Directors' Regulations 2013).

This Strategic Report has been prepared for the British Business Bank plc Group as a whole and therefore gives greater emphasis to those matters which are significant to the British Business Bank plc and its subsidiary undertakings when viewed as a whole.



# OUR OBJECTIVES

The British Business Bank aims to improve finance markets for smaller businesses – Small and Medium sized Enterprises (SMEs) – and small mid-cap businesses. We develop and manage finance programmes designed to enhance the working of finance markets in these areas. We currently support £2.3bn of finance to over 40,000 smaller businesses through our programmes and participate in a further £2.9bn of finance for small mid-cap businesses.

Through our programmes, we aim to achieve the following objectives:

1. Increase the supply of finance available in areas where markets do not work effectively
2. Help create a more diverse market for finance with greater choice of options and providers
3. Promote better information in the market, building confidence among smaller businesses in their understanding of the finance options available
4. Achieve this whilst managing taxpayer resources efficiently and within a robust risk management framework.

We have developed a series of key performance indicators (KPIs) to help measure and reflect performance against each of these key objectives. These are

outlined on page 24.

The British Business Bank has a dedicated market analysis team that monitors trends in small business finance markets so that we can better understand the types and severity of these market issues. We use this analysis to inform our business planning and product development processes. Since launching we have published a range of important research:

- In December 2014, we published a detailed Smaller Business Finance Markets report with insight on the latest market developments, the characteristics of different sub-markets, such as financial technologies and alternative forms of finance.
- In March 2015, we published an Equity Report and tracker. The report offers a wide-ranging view of the market, covering the reasons for seeking equity; recent trends; market failures and the role of Government institutions.
- In March 2015, we also published an analysis of the UK Smaller Business Growth Loans Market. This research paper examines the finance market for growth loans to UK smaller businesses, and was used as the basis for launching our Help to Grow pilot.

Surveys also provide a way of improving understanding of the use of finance by smaller businesses. The British Business Bank's SME Finance Survey completed in autumn 2014, and published alongside our Small Business Finance Markets Report, gives updated insight into the experience of smaller businesses when accessing finance.

We will also be conducting evaluations of our programmes on a regular basis in order to understand their economic impact, to improve the design of our products and to inform the resource allocation process. Evaluations are published on the British Business Bank website.

## Supply of finance

The British Business Bank has previously stated that it is supporting over £3bn of finance. We have now made some technical improvements to our calculation of this figure. The most significant change is that we have split the total into two components to better reflect our role with respect to small mid-cap businesses. Previously we applied a discount to the finance figures for small mid-cap business to attempt to reflect the level of private sector involvement at the time of our original commitment or investment. However, this methodology lacked consistency and didn't reflect the ongoing role played by the British Business Bank. It also created issues providing breakdowns of the figure by region or industry for interested stakeholders. As a result, we have updated our methodology to report the total amount of finance in which we are participating, without discounting adjustments. Consequently we have changed the description of our involvement to better reflect our role. For further details on our methodology refer to the British Business Bank website.

# OUR BUSINESS MODEL

The British Business Bank is a public limited Company wholly owned by Government with three principal subsidiaries. While products are delivered through different subsidiaries, the central functions are shared, in order to align the strategic direction and minimise costs. The British Business Bank is subject to European Commission State aid rules that ensure Member States do not distort competition in the Common Market. Our Group structure allows us to achieve our objectives in line with State aid and other legal considerations. This structure was agreed with the European Commission in October 2014, prior to the launch of the plc in November 2014. A diagrammatic version of our structure is set out on page 15.

British Business Bank plc is 100% owned and funded by the Secretary of State for Business, Innovation and Skills, with the shareholder relationship managed through the Government's Shareholder Executive. The shareholder sets the Bank's remit

Our objective of enabling finance markets to support smaller businesses is consistent with Government's wider objectives

and high level strategic objectives, but the British Business Bank is operationally independent in its delivery against this remit, and has its own board. We agree a medium-term plan with our shareholder, updated on an annual basis.

We have also agreed a Financial Framework with HM Treasury which outlines how we can allocate our resources in aggregate. This Framework provides flexibility for us to allocate our resources in areas where they will have the greatest effect, including by reallocating funding from programmes when we have assessed our support is no longer required. Key resource allocation decisions are made by the board through the annual planning cycle and are subject to shareholder approval. In-year, the Bank's senior team discusses any major potential reallocations between programmes and makes recommendations to the Board and shareholder as required. Over the medium term, British Business Bank programmes aim to make a return across the Group in line with Government's medium-term cost of capital.

As a public institution, we adhere to the highest standards of corporate governance from the public sector as well as private financial institutions and combine best practices for managing public money with a commercial outlook. Our objective to manage taxpayers' resources efficiently and the associated KPI illustrate our focus on creating value for our shareholder. In advance of new delivery partners coming on-stream we conduct rigorous due diligence on the organisations and key individuals.

We also conduct audits of all our delivery partners on a periodic basis.

We work with and through private sector delivery partners, allowing us to maximise our impact and utilise existing infrastructure to achieve our goals on a cost-efficient basis and enabling us to generate and preserve value.

This model allows us to leverage our own resources with private sector resources, either via guarantee structures or co-funding of debt or equity.

Our objective of enabling finance markets to support smaller businesses is consistent with Government's wider objectives. While we have our own brand and marketing activities, we are aligned with the GREAT Britain campaign - a nationwide Government-run campaign which provides support, advice and inspiration for businesses to grow.

We also co-ordinate closely with:

- the new Business Growth Service, which provides business support to businesses with high-growth potential
- UK Export Finance and UK Trade and Investment, which support exporting businesses
- Innovate UK, which provides seed finance and promoting collaboration with academia and industry for innovative businesses.

The British Business Bank's headquarters are in Sheffield with another office in London. We employ expertise from the private and public sector across our business in areas including investment, product management and development, finance, risk, policy and economic assessment.

# STATE OF THE MARKET

The UK economy is growing - according to the Office for National Statistics, quarterly GDP has increased for nine consecutive quarters, growing by 3% in total over 2014. And further growth in business investment in Q1 2015 means that the value of business investment in the year to Q1 2015 was 7.5% higher than the previous year.

These improvements are expected to continue: forecasters expect GDP to grow by 2.5% in 2015 and 2.3% in 2016, and the Office for Budget Responsibility is predicting that business investment will increase to form a larger component of our economy.

Smaller businesses form an important part of the UK's diverse business population, with SMEs accounting for 60% of private sector employment, and almost 50% of turnover. In addition, survey evidence shows that over time business conditions among SMEs have been improving: an increasing proportion of SMEs reported making profit in the previous 12 months - 79% in Q1 2015 compared to 69% two years earlier<sup>1</sup> - and in 2014, 40% of SME employers reported increases in annual turnover, up from 29% in 2012<sup>2</sup>.

Smaller businesses are optimistic about growth in 2015 - the 2014 BIS Small Business Survey showed that a third of SME employers expect to employ more people in the next 12 months, compared to 20% in the 2012 survey.

The diagram below shows how we bring expertise and Government money to smaller business finance markets:

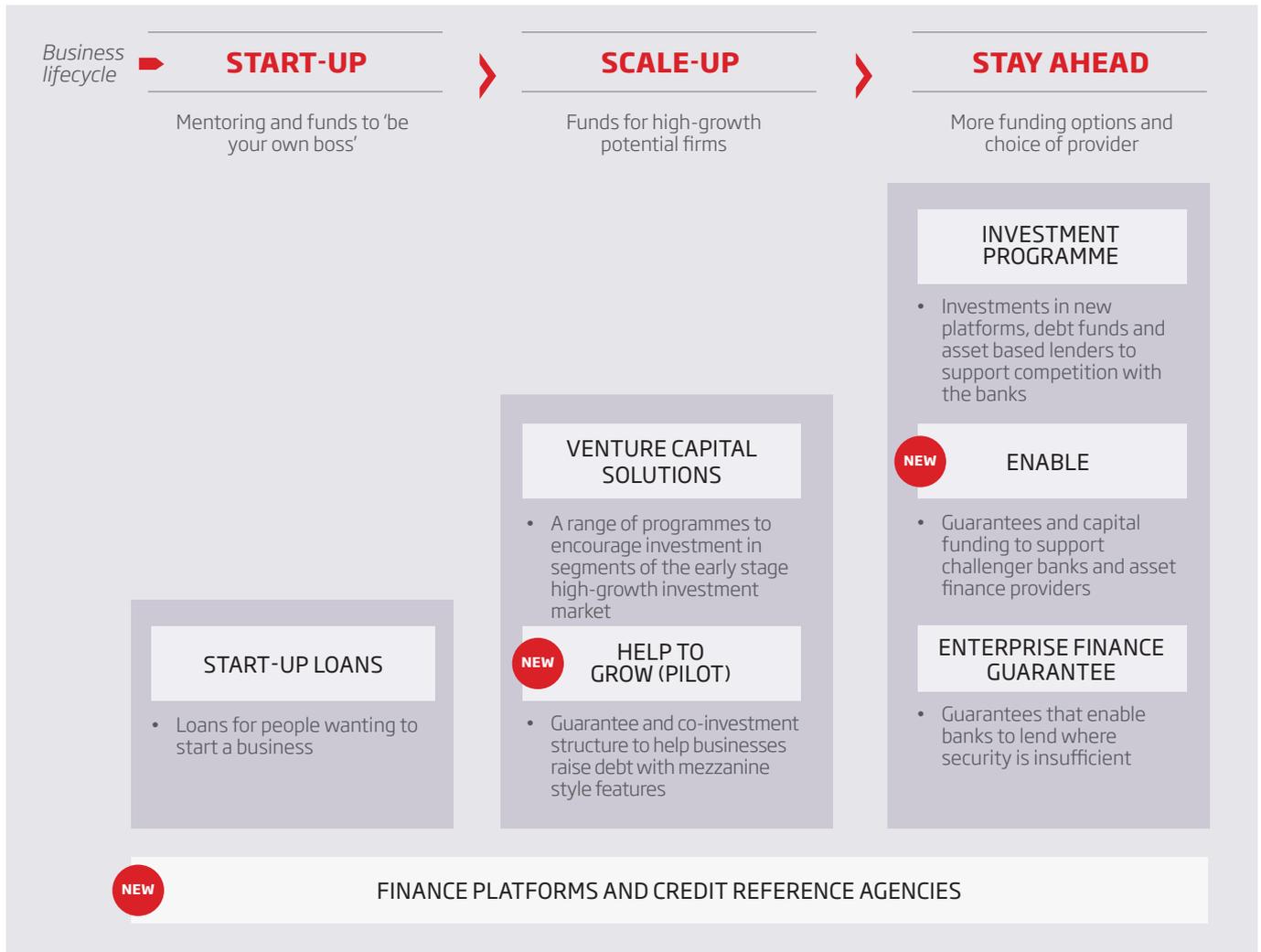


1. SME Finance Monitor, Q1 2015, BDRC Continental  
 2. Small Business Survey, Department for Business, Innovation and Skills

# MARKET SEGMENTATION

Our analysis has identified three groupings of smaller businesses - start-ups, businesses with high-growth potential that are looking to scale up,

and those looking to stay ahead in their market. The table below shows how our programmes are targeting these market segments.

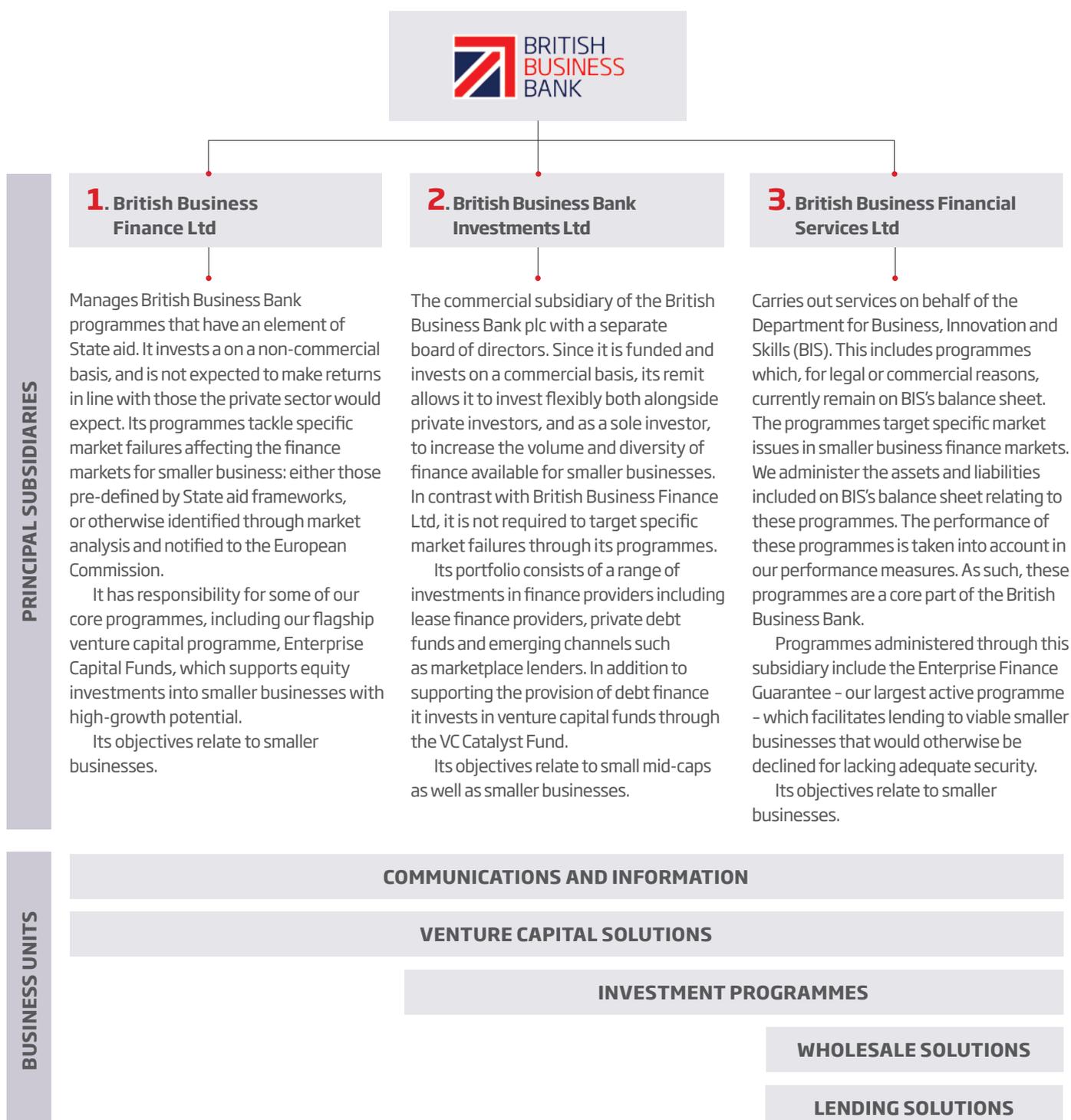


<b>START-UP</b>	<b>SCALE-UP</b>	<b>STAY AHEAD</b>
<p>Smaller businesses looking to start up are often deemed to be too risky for commercial lenders or investors, who find it difficult to judge the distinction between good and bad prospects, leaving this part of the market underserved. The Start-Up Loans programme, which we administer on behalf of BIS, seeks to address this problem by offering a repayable loan of up to £25,000 and access to a business mentor.</p>	<p>Our programmes in this market segment seek to help ambitious smaller businesses scale up their operations. We do this by promoting investments in the earlier stages of the Venture Capital market and also encouraging the provision of growth loans to more established smaller businesses with significant growth plans, helping to address long standing information asymmetries.</p>	<p>Our programmes in this market segment seek to address the high levels of concentration within finance markets in order to provide more funding options and choice of provider for businesses that are looking to stay ahead in their market; and also to allow good companies without sufficient security to access finance.</p>

# STRUCTURE OF THE ORGANISATION

The British Business Bank is a public limited company and operates a group structure with three principal subsidiaries, which allows us to achieve our objectives in line with State aid and other legal considerations. The British Business Bank is also organised into business units which operate across the subsidiaries to pool expertise. The diagram below outlines this structure.

## British Business Bank plc and principal subsidiaries



# PERFORMANCE REVIEW AND FUTURE DEVELOPMENTS

On 1 November 2014, the British Business Bank successfully transitioned from a ring-fenced team within the Department for Business, Innovation and Skills to an operationally independent, Government-owned economic development bank. This represented the culmination of two years of set-up work, including obtaining State aid approval from the European Commission on 15 October 2014 for the mandate and organisational structure of the organisation.

While we have made great progress over our first financial year of operation, we recognise there is still much more to do to ensure smaller businesses have access to the finance that enables them to fulfil their potential.

Our market impact has grown significantly over the last year - British Business programmes currently support over 40,000 smaller businesses with over £2.3bn of finance. In addition, we participate in £2.9bn of finance for small mid-caps. Our activity is forecast to increase significantly as we deliver our plan of supporting £10bn of finance over the next few years.

The section below gives a performance update of each of our business areas, and outlines future developments.

## LENDING SOLUTIONS - A RANGE OF DEBT SOLUTIONS TO HELP BUSINESSES START-UP, SCALE-UP AND STAY AHEAD

Programmes included within this business area are the Start-Up Loans Programme, our new Help to Grow programme - where we are currently requesting proposals from delivery partners - and the Enterprise Finance Guarantee (EFG).

**Our Lending Solutions are supporting £0.9bn of smaller businesses finance**



► Yvonne received a loan from the Start-Up Loans Company - supported by the British Business Bank - enabling her to start her business, Avalo Home

Recent highlights include the Start-Up Loans programme reaching the milestone of 25,000 new businesses supported in January 2015 and the announcement by the Prime Minister in February 2015 that the British Business Bank will pilot a new programme, under the banner Help to Grow, to support ambitious smaller businesses looking for Growth Finance.

In the Autumn Statement, December 2014, the Chancellor announced that EFG's lending capacity had been increased, enabling its partners to guarantee up to £500m of new lending to smaller businesses in 2015-16.

Over the coming year we will be increasing our support for growth finance through the Help to Grow pilot. We published a Request for Proposals in March 2015 seeking participants to generate at least £100m of lending to growing businesses. This followed market engagement and extensive market analysis that indicated more firms are likely to seek finance for growth going forward. The Help to Grow pilot is a flexible instrument, with the British Business Bank having the ability to provide guarantees or funding to facilitate growth loans.

## VENTURE CAPITAL SOLUTIONS - HELPING BUSINESSES SCALE-UP

Included within this business area are our interest and activities in the Business Angel Co-Fund, Venture Capital Catalyst Funds and the Enterprise Capital Funds (ECF) - all of which are focused on supporting a vibrant and diverse venture capital market to support early stage and high-growth firms in the UK.

**Our Venture Capital solutions are supporting £0.9bn of smaller business finance**

Investments have been made during the year through Venture Capital programmes, with a focus on early stage companies with high-growth potential in the technology and business to business sectors.

The Venture Capital Catalyst Fund has made four commitments totalling £30m from a total allocation of funding of up to £125m and will continue to support funds that are near to reaching a first close but which might not otherwise meet their target.

We were also awarded an additional £400m of funding in the Autumn Statement 2014 to extend the ECF programme following market analysis into the equity-gap in the provision of smaller amounts of equity finance to SMEs due to asymmetric information between the investor and the business on likely viability and profitability.

## WHOLESALE SOLUTIONS - HELPING BUSINESSES STAY AHEAD

Programmes included within this business area are ENABLE guarantees and ENABLE funding.

The ENABLE Guarantees programme aims to address capital constraints associated with SME lending by enabling participating banks to share a portion of the credit risk of a newly originated small business lending portfolio with HM Government in return for a fee. This will lead to a reduction in capital requirements connected to the guaranteed lending, allowing more lending to be generated from the same allocated capital base.

We have launched the first ENABLE Guarantee transaction, which will facilitate £125m of new lending through Clydesdale and Yorkshire Banks.

The ENABLE Funding programme is designed to improve the provision of asset and lease finance to smaller businesses, by 'warehousing' newly-originated asset finance receivables from different originators. Once this structure is big enough, we will seek to refinance a portion of our funding through securitisation in the capital markets, which will enable smaller finance providers to access institutional investors' funds. Over the coming year the Bank will bring the programme fully on-stream.



▶ Gousto received two rounds of investment from the Angel CoFund - supported by the British Business Bank - and other investors

## INVESTMENT PROGRAMMES - HELPING BUSINESSES STAY AHEAD

Programmes included within this business area are the Business Finance Partnership and the Investment Programme.

**Our Investment Programmes are supporting £0.5bn of smaller business finance and participate in £2.9bn of finance to small mid-caps**

Our investment programmes have made the following commitments:

- Business Finance Partnership Mid Cap - £863m total commitments
- Business Finance Partnership Small Cap - £87m total commitments
- Investment Programme - £400m of funding allocated, of which £228m has been committed to date.

The BFP was set up to improve credit access for SMEs and small mid-caps from sources other than established banks. It is delivered through two variants: BFP Mid Cap and BFP Small Cap.

The BFP Mid Cap was announced in November 2011 to ease the flow of credit to small mid-cap businesses in response to the lack of liquidity caused by the global economic downturn. It made investments alongside private sector matched-funding into debt funds targeting mid-market companies with turnover up to £500m.

The BFP Small Cap was launched in May 2012, with the aim of increasing the flow and diversity of finance available to smaller businesses with turnover up to £75m, by supporting the development of sustainable non-bank finance markets that are attractive to businesses and investors alike. It has supported a range of non-bank lenders, such as invoice finance platforms and asset-finance providers, making investments alongside private sector matched-funding.

Following the success of the BFP programmes, the Investment Programme was launched in April 2013, with a focus on making commercial investments, in a variety of forms, on terms and conditions that would be benchmarked to the private

sector. The main aim of the Investment Programme is to promote volume and diversity of supply of lending to smaller businesses by encouraging new entrants and supporting the growth of smaller lenders in the market. To date it has invested in a number of debt funds, asset finance firms, marketplace lenders and invoice finance.

The Investment Programme has been further enhanced to include a new Expansion Capital initiative and a new Regional Finance initiative. The Expansion Capital initiative will enable investments either by way of long term equity or other forms of risk capital to support the growth of companies active in smaller business lending markets. We anticipate this will unlock further funding capacity for these types of finance providers. The Regional Finance initiative is designed to encourage the development of lending capacity outside South East England. Up to £50m is available through the Investment Programme to support regionally focused commercial business lenders. The scope of this initiative is designed to include both lenders operating in specific regions, and those who operate more widely but who operate one or more regional offices with a front office origination capability.



▶ Gin and fruit liqueur manufacturer Bramley and Gage raised £25k through Funding Circle - supported by the British Business Bank's BFP Small Cap - to purchase a new gin still to increase their production

# OUR IMPACT - SMALLER BUSINESSES

How our programmes deliver for smaller businesses.

## Equity finance unlocked by our Angel CoFund

e-Go Aeroplanes



Cambridgeshire-based e-Go Aeroplanes is the UK's first manufacturer of lightweight carbon-fibre aeroplanes, which cost significantly less to fly than traditional aircraft and are designed to be a product for discerning pilots who relish superior performance.

In May 2014 the Angel CoFund completed the first tranche of its £200k investment into e-Go Aeroplanes as part of the Company's £960k second funding round, investing alongside a new syndicate of 22 angel investors.

Adrian Hillcoat, e-Go CEO, said: "The Angel CoFund provided capital alongside our private investors to get us going - without it our little plane literally wouldn't have got off the ground. We're one of only a few companies still manufacturing complete aircraft in the UK, keeping British aeronautical skills and heritage alive."

## Equity finance unlocked, by our Enterprise Capital Funds programme

Solfex

Solfex is the UK's leading specialist integrator and distributor of renewable solar, heat pump and underfloor heating energy systems.

They wanted to grow their business' infrastructure, partnering with an investor bringing not only finance, but additional experience, strategic guidance and a network of contacts.

Panoramic Growth Equity, supported by our Enterprise Capital Funds programme, invested £1.25m, enabling rapid - and award-winning - growth. Solfex was subsequently sold to the Travis Perkins Group.

Stuart Cooper, Managing Director and Founder, commented: "Securing the funding through the British Business Bank's Enterprise Capital Funds programme proved to be an excellent result for us (and) enabled us to become part of one of the UK's



largest listed building companies."

## Debt finance unlocked by the Start-Up Loans programme backed by the British Business Bank

Fittamamma

Alexandra, a 29-year-old entrepreneur from West Sussex, has been given a £9,500 Start-Up Loan to help develop her clothing line and resource centre for active pregnant women. As well as funding, Alexandra has benefited hugely from the support provided to her through George Clayton, her mentor.

Alexandra said: "I have found the application process and the mentoring session incredibly helpful and believe this experience, along with the financial support will make a huge difference in taking FittaMamma to the next level."



## Debt finance unlocked by our Business Finance Partnership/Investment Programme

Predator

Predator Equipment is a manufacturer of large agricultural trailers and liquid tankers based in Dungannon, Northern Ireland.

MD Eamon McVeigh said: "In this climate, SMEs like ourselves need all the help we can get and it's great to see the Government making a real impact through the Business Finance Partnership and the work they're doing with the likes of MarketInvoice."



## Debt finance unlocked by our Enterprise Finance Guarantee

Team Sport

Team Sport Indoor Karting has nine indoor recreational racetracks across the south of the UK and opened a new go-karting centre in Brighton after securing financial help from a participating lender, Lloyds TSB.

Paul Wrightman, owner of Team Sport, said, "The support ... was essential in

securing the Brighton site when time was of the essence, and helped us to expand into a new geographic area that we had identified as being a good opportunity for future growth."



# OUR IMPACT - FINANCE MARKETS

How we work with our delivery partners.



**Martin Ling**  
*co-founder,  
BMS Finance*

"British Business Bank is enabling funders like us to tell businesses that there is capital out there and that deals can be done. That in turn allows us to meet the needs of a segment of businesses that are increasingly looking to move from subsistence into a growth phase, which can only benefit employment and the economy at large."



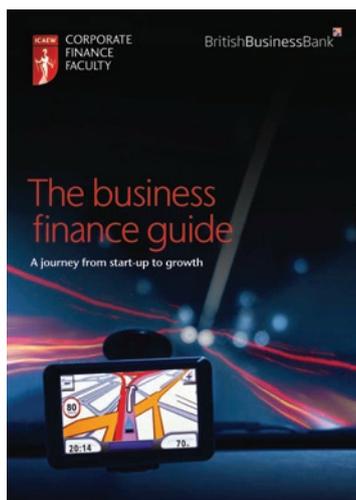
**Eileen Burbidge**  
*partner,  
Passion Capital*

"By supporting and incentivising private sector investors, the British Business Bank is making the best possible contribution to the UK's thriving growth culture."



**Rhydian Lewis**  
*co-founder, Ratesetter*

"Small businesses are the posterchild of economic recovery and growth and the British Business Bank has a crucial role to play in encouraging their growth."



British Business Bank and ICAEW's Corporate Finance Faculty jointly published a new Business Finance Guide in 2014

The guide was produced in partnership with a further 17 organisations



## COMMUNICATIONS AND INFORMATION: IMPROVING BUSINESSES UNDERSTANDING OF THE FINANCE OPTIONS AVAILABLE

As a newly established organisation, we need to raise awareness of both our institution and its offer to a wide range of audiences - smaller businesses, Government, the financial industry and potential partners. Achieving greater recognition of our brand and purpose enables us to attract more delivery partners and gives us greater access to channels to smaller businesses, helping us to achieve our objectives more effectively.

In our first year, we have concentrated much of our resources on building relationships with the major news outlets. Our work has been covered by television, radio as well as national, finance, business trade and local press, both online and in print. This has included high-profile interviews, placed opinion pieces and coverage of our programme launches and milestones.

As importantly, we have been establishing strategic relationships with those business intermediary bodies, delivery partners and other providers of support who have direct channels to smaller businesses. This has involved collaborating on events, providing speakers for conferences, distributing and signposting to each others' material and using joint messaging and branding wherever possible.

In addition, we have also held a series of our own successful events across the country - with more planned for this year - to help smaller businesses understand their finance options, and are building our presence and content on both LinkedIn and Twitter.

A key tool to help us achieve our objective of raising awareness of finance options amongst smaller businesses is the Business Finance Guide, which we published jointly with the ICAEW in June 2014. With endorsement from 17

other organisations representing the business and finance sectors, it sets out considerations when raising finance and what is available to businesses ranging from start-ups to growing mid-sized companies.

The Guide has been distributed in hard copy and electronic form to around 700,000 businesses and their advisers, has been featured on numerous websites and is used as a reference manual by Business Growth Service advisers and relationship managers in many banks. We will be issuing an updated edition later in the year.

Building on the success of the Business Finance Guide, the British Business Bank is taking forward two related Government programmes which will help to address information asymmetries in the smaller business finance markets and improve competition in banking.

Through the Small Business, Enterprise and Employment Act, the Government has legislated to create a system whereby small businesses rejected for bank finance are given the option of having their applications referred through a set of designated platforms to a range of alternative finance providers. A related process is also being put in place to create a set of designated credit reference agencies who will receive enhanced credit data (notably business account balance data) from banks.

The British Business Bank has a key role to play in the design and implementation of these policies, which will provide smaller businesses with access to a bigger market of potential lenders; and will be recommending to the Government which platforms and credit reference agencies will be designated to participate in the scheme.

# FINANCIAL PERFORMANCE & POSITION

## Overall results:

These financial results cover the first period of operations for the British Business Bank plc Group. In 2014-15:

- The Bank's operating income was £17.7m, compared to investment costs and operating expenditure of £9.9m. Operating income comprised largely of interest income (£12.0m) and management fees charged to the Department for Business, Innovation and Skills and others on a cost recovery basis (£5.3m).
- Although the Bank generated net operating income of £7.8m, it made an overall loss before tax for the period of £14m. This is as a result of the required accounting treatment for Enterprise Capital Funds, explained below.
- The Bank's operations were financed through the issue of shares totalling £664.3m to our shareholder.



## £17.7m

The Bank's operating income for the period

## FINANCIAL PERFORMANCE

For the period ended 31 March 2015

	British Business Bank Plc	Programmes managed on behalf of BIS (Unaudited)	Total
	£m	£m	£m
<b>Investment income</b>			
Investment Programmes	8.8	3.2	12.0
Lending Solutions	-	18.3	18.3
Venture Capital Solutions	3.2	0.1	3.3
Wholesale Solutions	-	-	-
	12.0	21.6	33.6
<b>Management fee and other income</b>	5.7	-	5.7
<b>Total operating income</b>	17.7	21.6	39.3
<b>Net investment costs</b>			
Investment Programmes	(1.6)		(1.6)
Lending Solutions	-	(16.4)	(16.4)
Venture Capital Solutions	1.3	(2.1)	(0.8)
Wholesale Solutions	-		-
	(0.3)	(18.5)	(18.8)
<b>Other operational costs</b>			
Staff costs	(6.0)	-	(6.0)
Professional services	(2.0)	(5.0)	(7.0)
General operations	(1.6)	-	(1.6)
	(9.6)	(5.0)	(14.6)
<b>Total operating expenditure</b>	(9.9)	(23.5)	(33.4)
<b>Net operating income</b>	<b>7.8</b>	<b>(1.9)</b>	<b>5.9</b>
Less: unrealised element of derivative gains	(2.4)	-	(2.4)
Adjusted return	5.4	(1.9)	3.5
Average capital employed			658.9
<b>Adjusted return on average capital employed</b>			1.3%

Reconciliation of operating income to loss before tax	
	<b>British Business Bank plc</b>
<b>Adjusted return</b>	<b>5.4</b>
<hr/>	
<i>Less:</i>	
ECF fair value provision expense	(26.1)
<hr/>	
<i>Plus:</i>	
Unwind of ECF fair value impairment	4.3
Unrealised ECF derivative fair value gains	2.4
<hr/>	
<b>Loss before tax per financial statements</b>	<b>(14.0)</b>

## KEY DRIVERS OF FINANCIAL PERFORMANCE

As an investment business focusing on generating appropriate risk-adjusted returns on our capital investment, our financial performance is dependent on a number of significant items, including:

- the amount of capital we have committed and the time period over which that funding is deployed
- the underlying performance of our investments and their ability to make interest and debt repayments
- over time the ability to exit investments successfully and make a capital profit.

Our financial performance is also sensitive to payouts under guarantee schemes. As agreed with our shareholder and HM Treasury, the British Business Bank includes programmes where it manages assets or liabilities on behalf of BIS when calculating its notional return on capital for the programmes as a whole. The financial performance for the period ended 31 March 2015 for the programmes managed on behalf of BIS included £17.5m

of investment income relating to the Enterprise Finance Guarantee, reported under Lending Solutions. In addition the £16.4m of Lending Solutions investment costs related to the Enterprise Finance Guarantee. During 2014-15 we have benefited from lower than expected defaults on debts covered by the Enterprise Finance Guarantee and this has contributed to the British Business Bank programmes achieving an adjusted notional return on equity of 1.3%. The level of defaults is dependent on market conditions and may increase again in future years.

Staff and other operational costs totalled £14.6m for the period and reflect the full costs associated with running British Business Bank programmes.

The British Business Bank accepts a lower return from Enterprise Capital Funds in order to encourage private sector investors to invest. Although the Bank expects to make a positive return from these investments, this return is less than that required by the private sector. As a result, accounting standards require the Bank to recognise a liability when it makes

a commitment to a fund and to impair the resulting investment when a fund manager draws down against a commitment. This results in a significant upfront expense which gradually reverses over the lifetime of the investment. The Bank has therefore recognised a provision totalling £26.1m in the year ended 31 March 2015. This expense doesn't relate to an underlying loss on our investments and is therefore excluded from the calculation of adjusted notional return on equity.

## FUNDING OUR INVESTMENTS

We require funding to make investments and run our operations. Depending on our requirements these can be met from two sources: our investment earnings and our shareholder.

To fund our capital investments we issue shares to our shareholder and utilise available cash from our operations, including asset repayments. At 31 March 2015, UK Government held shares totalling £664.3m in British Business Bank plc, comprising the entire share capital of the Company. Of this Shareholder investment, £477.4m was used to purchase assets from the Department for Business, Innovation and Skills on 1 November 2014, £172.9m was used for new capital investments and £14.0m retained for working capital.

Before 1 November 2014, the shareholder also provided funding for Board costs. Since 1 November 2014 all of the Bank's operational costs have been met from its investment income.

At 31 March 2015, British Business Bank plc held £71.0m in cash, generated partly through its own operations and partly through shareholder funding. The Bank maintains a cash balance of at least £50m to fund investments and can increase this balance in line with investment demands. The majority of these funds (£68.1m) are held within the Government Banking Service to ensure that there is minimal cost to the Exchequer.

**FINANCIAL POSITION**

As at 31 March 2015

	British Business Bank plc	Programmes managed on behalf of BIS (Unaudited)	Total
	£m	£m	£m
<b>Investment assets</b>			
Investment Programme	493.1	33.7	526.8
Lending Solutions	-	42.1	42.1
Venture Capital Solutions	165.9	140.8	306.7
	659.0	216.6	875.6
<b>Investment liabilities</b>			
Lending Solutions	-	(83.3)	(83.3)
Venture Capital Solutions	(71.6)	-	(71.6)
	(71.6)	(83.3)	(154.9)
<b>Net investment assets</b>	587.4	133.3	720.7
<b>Other Assets/(Liabilities)</b>			
Cash	71.0		
Tangible and intangible assets	0.8		
Net other payables	(11.1)		
<b>Total Net Assets</b>	<b>648.1</b>		



During the period to 31 March 2015 we invested £172.9m in assets included on our balance sheet

**OUR ASSETS**

Our programmes invest in a wide range of products through private sector partners, to enable us to achieve our objective of providing greater volume and choice of finance to smaller businesses and small Mid Caps.

This is reflected in the split of these investments:

- loans and receivables £18.5m
- available-for-sale assets £622.9m
- assets designated at fair value through the profit and loss £5.3m
- derivative financial instruments £12.3m.

For many investments, we make commitments to a fund and the fund draws down cash as it is needed. This means there is, at times, a delay between our investment commitment and capital being drawn. During the period to 31 March 2015 we invested £172.9m in assets included on our balance sheet. As at 31 March 2015, British Business Bank plc had further undrawn commitments of £849.3m to be invested across its portfolio.

# KEY PERFORMANCE INDICATORS

## OUR FIVE YEAR KEY PERFORMANCE INDICATORS

The British Business Bank’s overarching objective is to change the structure of the business finance markets for smaller businesses, so these markets work more effectively and dynamically. This will help businesses prosper and build economic activity in the UK.

This overarching goal has been broken down into a set of four key performance indicators (KPIs) that enable us to track our progress. Our KPIs clearly align with each particular objective and are set through our

annual business planning process. They are crucial in developing our understanding of the performance and position of the Company’s business and progress is monitored on an annual basis and reported in our annual report and accounts.

Progress against delivering our KPIs is embedded in all areas of the business, but is ultimately monitored by the Board of Directors. The table below outlines our strategic objectives, our KPIs and how we are performing.

Objective	Key performance indicators	Current position
To increase the supply of finance available to SMEs in areas where markets do not work effectively	£10bn stock of finance facilitated through our programmes by the end of March 2019	Programmes currently support £2.3bn of finance to over 40,000 smaller businesses, and participate in a further £2.9bn of finance to small mid-cap businesses
To help create a more diverse market for SME finance with greater choice of options and providers	At least 50% of our finance facilitated through providers other than the four largest banks over five years	Over 75% of finance currently being delivered via non-major ('big-4') banks
To promote better information in the market, building confidence among SMEs in their understanding of the finance options available	Clear survey evidence from smaller businesses and finance providers that smaller businesses’ awareness of finance options has improved	Survey results show 43% average smaller business awareness of six alternative finance options. We are working to increase awareness, for example through the joint publication of the Business Finance Guide
To manage taxpayer resources efficiently and within a robust risk management framework	To earn greater than the Government’s medium term cost of capital at the end of March 2019	The return across the British Business Bank programmes for the period from 1 November 2014 to 31 March 2015 is 1.3%

There is some intended tension between our four strategic objectives and related KPIs, so that we are incentivised to aim for a balanced outcome that takes into account longer term structural market issues (through the diversity objective),

overall supply gaps (through the increase supply of finance objective) and demand gaps (through the awareness objective).

The return target ensures that the British Business Bank aims for a balance

between targeting very specific acute market failures and more commercial programmes which can have a positive impact on the market in the longer term by encouraging more diversity at provider and product level.

# RISK MANAGEMENT AND INTERNAL CONTROL

The British Business Bank is committed to ensuring the best standards of Corporate Governance and is supported in this by the Board of Directors and Board Committees. The Board of Directors of the plc has been set up along with Board-level committees, notably Risk, Audit, Remuneration and Nomination. To ensure robust and effective decision-making within the Group structure the British Business Bank Board has approved Terms of Reference for executive level Investment Committees for each subsidiary which makes investment decisions.

## OVERVIEW OF THE BRITISH BUSINESS BANK'S RISK MANAGEMENT FRAMEWORK

The establishment of a new entity with a mandate to support businesses underserved by sections of the financial services industry brings with it inherent risk.

Our Risk Management Framework is a collection of tools, processes and methodologies that support the British Business Bank in identifying, assessing, monitoring and controlling the risks it faces. The Board has overall accountability and responsibility for the management of risk within the British Business Bank.

Our Risk Management Framework has been designed to align to the size, scale and complexity of the British Business Bank and has been benchmarked against other financial services institutions. The British Business Bank is not a FCA/PRA regulated entity, though a subsidiary representing approximately 1% of the portfolio, Capital for Enterprise Fund Management, is regulated by the FCA for holding and not controlling client money. The British Business Bank does not hold regulatory capital and is not subject to FCA/PRA regulatory supervision. We

have policies and procedures in place to ensure compliance with applicable laws and regulations, including Anti Money Laundering, Data Protection, Freedom of Information and State aid regulations, and aspire to follow best practice where appropriate and applicable.

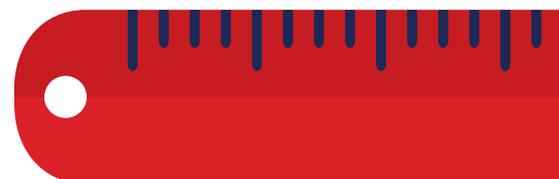
Our Risk Management Framework is the articulation of the overall strategy towards the acceptance, avoidance, management and control of risks, as well as the development of risk capabilities aligned to the business goals and objectives.

The Framework:

- demonstrates a clear link to the overall strategy and business plan of the British Business Bank
- is owned by the Chief Risk Officer (CRO) and approved by the British Business Bank Board. Any changes to the Risk Management Framework are recommended by the Board Risk Committee to the Board for approval
- outlines the risk management vision and objectives, and the approach for evolving the risk management capability of the British Business Bank
- is reviewed on an annual basis and, if required, more frequently to reflect any significant material changes to the business, economic or regulatory outlook.

The yearly review of the Risk Management Framework is a means to review the effectiveness of risk management within the British Business Bank. This review, carried out by third party advisers, began in February 2015 and is due to be completed in July 2015. The review benchmarks the target operating model of the risk function and outlines the key development priorities for the function in 2015-16.

Key elements of our Risk Management Framework include Risk Appetite and Risk Governance.



Our Risk Management Framework has been designed to align to the size, scale and complexity of the British Business Bank and has been benchmarked against other financial services institutions

**RISK APPETITE**

The British Business Bank’s Risk Appetite Policy acts as the link between overall business strategy, the risk strategy and the Risk Management Framework by bringing strategic context to identified risks, adopting clear escalation criteria, and informing the processes for the identification, assessment, control and monitoring of risk exposures.

The Risk Appetite Policy allows the Board to articulate the appetite for risks that are specific to their concerns for the business, such as risks to the reputation of the British Business Bank. The Financial Stability Board defines risk appetite as the aggregate level and types of risk a financial institution is willing to assume within its risk capacity to achieve its strategic objectives and business plan.

The Risk Appetite Policy of the British Business Bank is based on these high-level design principles:

- Risk appetite is the level of risk the

Board of the British Business Bank is willing to accept in order to deliver its public policy objectives

- Risk capacity is the maximum level of risk that the British Business Bank can assume given its current level of resources before breaching stakeholder constraints.

**RISK GOVERNANCE**

The British Business Bank Risk and Compliance function is based upon a ‘three lines of defence’ model, where the:

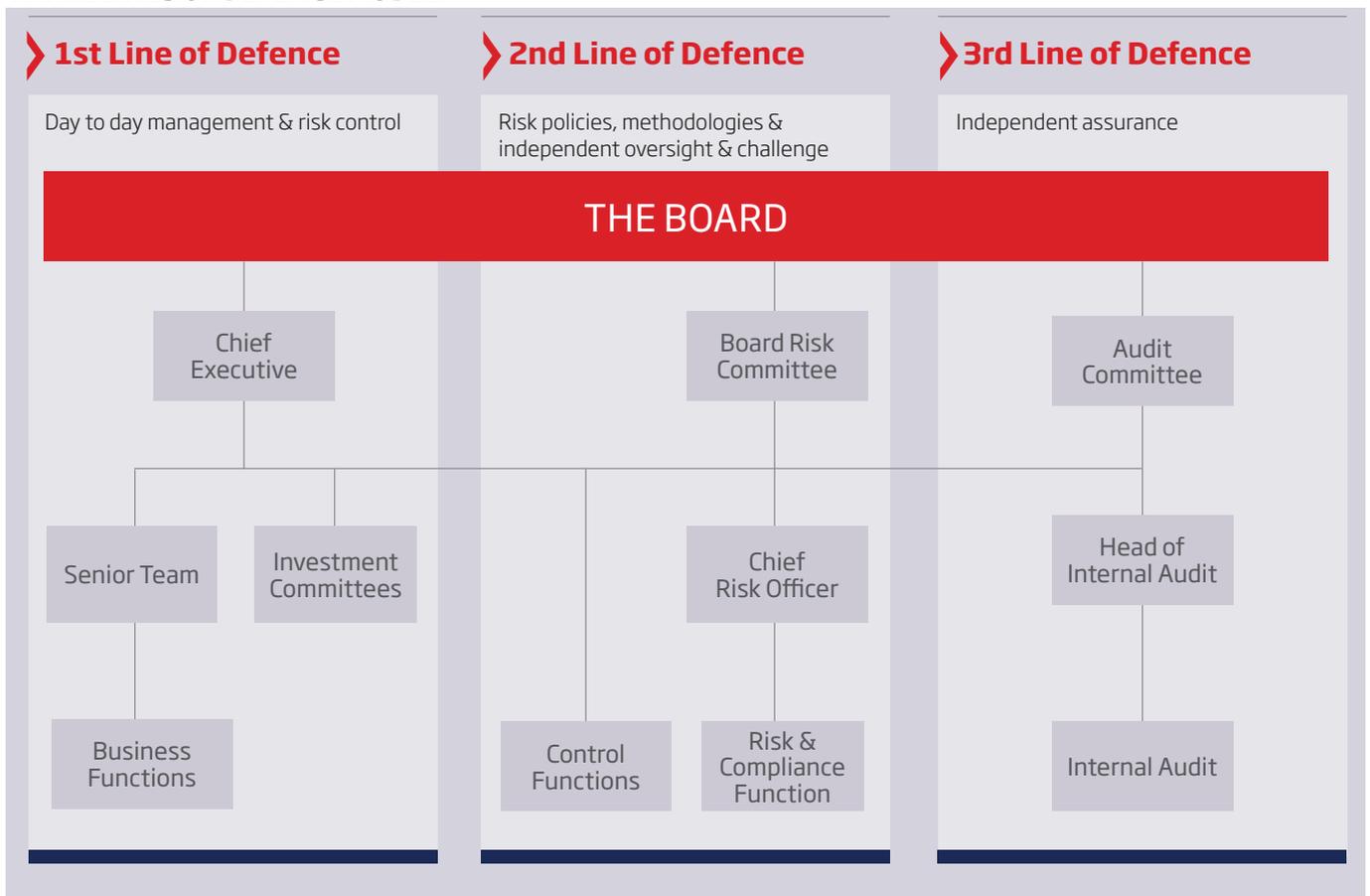
- first line of defence is responsible for the day to day management and risk control
- second line of defence is responsible for designing risk policies and methodologies, monitoring performance and compliance, identifying and reporting risks and providing independent and objective challenge to the first line of defence

- third line of defence provides independent assurance of the overall system of internal control including assessment of the risk governance framework.

The key principles of this model, as demonstrated by the diagram below, are:

- The Board has overall accountability and responsibility for the management of risk within the British Business Bank
- The Board delegates specific risk management roles and responsibilities to the Board Risk Committee, the Audit Committee and Chief Executive Officer (CEO) and the CRO
- The CEO is supported in delivery of these responsibilities through direct reports from the senior team
- The CRO is a member of the senior team and is also supported by the Risk and Compliance function in the delivery of their responsibilities.

**THREE LINES OF DEFENCE MODEL:**



The British Business Bank also operates an extensive Risk and Control Assessment process to identify and register key and emerging risks within each functional area and across the organisation at a more strategic level. The overall Risk Register, is reviewed in detail by the senior team and the Board.

This enables them to carry out a robust assessment of the principal risks facing the Company, including those that would threaten its business model, future performance, solvency or liquidity.

In 2014-15, the Board managed and monitored governance and risk and internal control matters through:

- the Board Risk Committee
- the Board Audit Committee
- the Risk & Compliance, Finance, HR, IT and Legal functions
- policies for risk management
- the independent review of proposed investments by the Investment Committee.

## PRINCIPAL RISKS AND UNCERTAINTIES

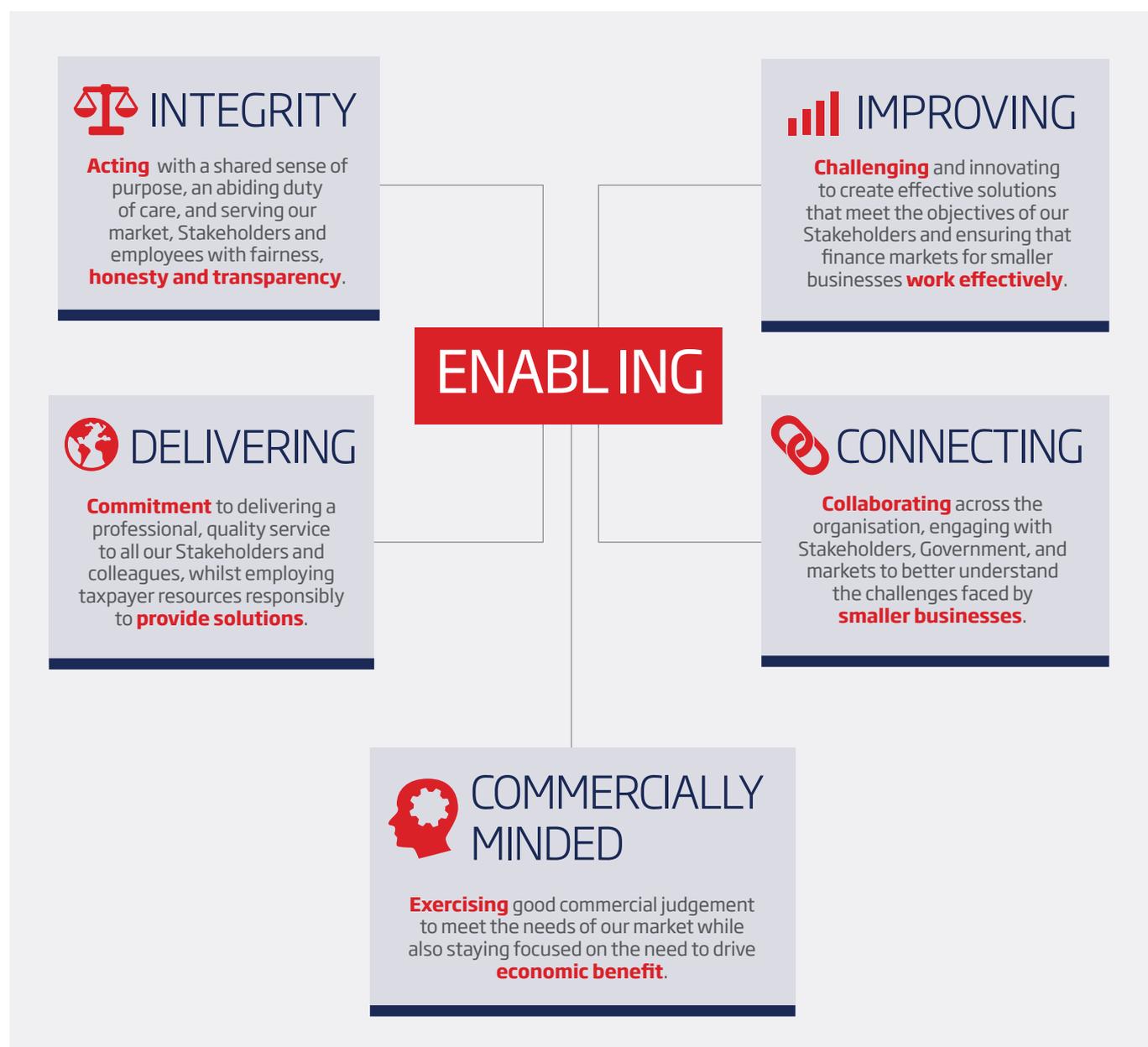
Risk	Definition	Risk Categories	Example Mitigants
Compliance & Conduct Risk	Risk of breaching UK or EU regulations, internal policies or conduct standards, which exposes the British Business Bank to regulatory fines and penalties, financial losses and reputational risk	<ul style="list-style-type: none"> <li>• Risk that British Business Bank's regulated entity breaches regulatory requirements</li> <li>• Breach of applicable laws relating to financial crime, money laundering and conflicts of interest</li> <li>• Risk that British Business Bank enters into regulated activities within its programmes, without being regulated</li> <li>• British Business Bank employees breach compliance standards</li> </ul>	<ul style="list-style-type: none"> <li>• The British Business Bank is not regulated except for its subsidiary Capital four Enterprises Fund Managers, which constitutes approximately 1% of the Group's net assets</li> <li>• New products and programmes are rigorously assessed against the UK and EU regulatory environments</li> <li>• All new investments are subject to a robust due diligence process incorporating 'Know Your Customer'</li> <li>• British Business Bank has a Compliance Risk Management Framework and a comprehensive suite of Compliance related policies in place</li> <li>• British Business Bank employees are subject to a Code of Conduct policy and annual Compliance Declaration</li> </ul>
Credit and Investment Risk	The risk of direct or indirect losses in on- and off-balance sheet positions as a result of the failure of an investee, end borrower or counterparty to meet its obligations in accordance with agreed terms	<ul style="list-style-type: none"> <li>• Risk of end borrower default, for example as a result of poor trading, or defects in the delivery process</li> <li>• Whilst the majority of individual exposures to end borrowers are small, exposures to mid-cap companies are typically larger</li> <li>• Delivery partner default or closure</li> <li>• Venture Capital is subject to vintage risk, with the year the investment was made the largest single risk driver</li> <li>• Concentration within one industry or location creates a portfolio that is subject to greater risk than a more evenly balanced one</li> </ul>	<ul style="list-style-type: none"> <li>• Delivery partner selection process includes assessment of underwriting and sanctioning processes, and thereafter is subject to portfolio monitoring and regular review, and rigid due diligence process in selecting delivery partners, including assessment of track record and financial strength</li> <li>• The credit quality of mid cap exposures is monitored closely</li> <li>• The British Business Bank aims to continue to invest throughout the economic cycle, therefore minimising the vintage risk</li> <li>• The portfolio is monitored closely for concentration risk</li> </ul>
Information Risk	The risk of loss of information or its hosting IT systems which may be difficult to recover, resulting in regulatory fines or reputational risk with business partners	<ul style="list-style-type: none"> <li>• Breach of legal requirements relating to safe-keeping and disclosure of information</li> <li>• Risk of business sensitive information being leaked or accidentally made available in public domain</li> <li>• Threats of cyber-attacks that steal sensitive data relating to the British Business Bank or its delivery partners as well as disrupt the British Business Bank's functionality</li> </ul>	<ul style="list-style-type: none"> <li>• Information Security and Information Assurance policies in place to manage information risk. The accreditation process assesses information risks and accredits new and existing information systems</li> <li>• The Data Protection Policy ensures that the British Business Bank fully complies with the requirements of Data Protection Act</li> <li>• The British Business Bank realises the threats of cyber-attacks and is developing a robust incident response plan</li> </ul>

## PRINCIPAL RISKS AND UNCERTAINTIES (CONT.)

Risk	Definition	Risk Categories	Example Mitigants
Market Risk	The risk of direct or indirect losses that arise from fluctuations in valuations, or interest income as a result of movements in interest or exchange rates	<ul style="list-style-type: none"> <li>• The British Business Bank makes material losses due to foreign exchange movements through its investments</li> <li>• The British Business Bank investments are subject to interest rate fluctuations</li> </ul>	<ul style="list-style-type: none"> <li>• The British Business Bank has minor foreign exchange exposure, less than 4% of its portfolio, and does not hedge these exposures. This is in line with government policy</li> <li>• British Business Bank conducts scenario testing of exposures sensitive to Interest Rate market valuation movements</li> </ul>
Operational Risk	The risk of losses resulting from inadequate or failed internal processes, people and systems or external events	<ul style="list-style-type: none"> <li>• Errors in execution, delivery, and processing</li> <li>• Failure of internal controls</li> <li>• External or internal frauds</li> <li>• Damage to physical assets, utilities disruption or systems failure</li> </ul>	<ul style="list-style-type: none"> <li>• Risk and Control Assessments with functional teams are held throughout the year to assess risks and associated internal controls</li> <li>• Operational Incidents management process in place</li> <li>• Close liaison with BIS counter fraud network and regular interaction with key business partners</li> <li>• Business continuity and disaster recovery plans in place</li> </ul>
Reputational Risk	The risk that the firm will act in a way which falls short of stakeholder expectations	<ul style="list-style-type: none"> <li>• The British Business Bank operates an outsourcing model which is subject to Delivery Partner conduct and performance</li> </ul>	<ul style="list-style-type: none"> <li>• A Reputational Risk Policy is in place</li> <li>• The British Business Bank undertakes extensive due diligence on new delivery partners and monitors existing delivery partners</li> <li>• Service Level Agreements are in place with Delivery Partners</li> <li>• The British Business Bank has a robust Complaints Policy in place</li> </ul>
Strategic and Business Risk	The risks arising from a suboptimal business strategy or business model that may lead to financial loss, reputational damage or failure to meet internal and/or public policy objectives	<ul style="list-style-type: none"> <li>• Risk that the British Business Bank's current and planned products may not be fit for purpose</li> <li>• Risk that the British Business Bank does not meet its deployment or commitment targets</li> <li>• The British Business Bank is not effective in meeting its objectives</li> </ul>	<ul style="list-style-type: none"> <li>• A clearly defined set of objectives and a robust governance model are in place</li> <li>• New products are subject to market assessment and New Product Approval process</li> <li>• Regular review of the Strategic Risk Register by the senior team and Board members</li> </ul>

# OUR VALUES

British Business Bank has five shared values, which stem from our core essence of Enabling. The values were developed from the views and input of colleagues across the organisation, based on a bottom up approach. They are a foundation for what we stand for as a business and will continue to positively shape our corporate culture as we grow. Our Values Forum meets monthly, with colleagues from Sheffield and London representing teams across the business.



## CORPORATE AND SOCIAL RESPONSIBILITY

Our governance arrangements mirror those of a quoted Company, while integrating best practice from the public sector as a Government owned economic development bank.

Since the establishment of the organisation we have developed a Values Forum that champions the key principles within the culture of the organisation. This forum will be instrumental in

developing a Corporate and Social Responsibility policy for the British Business Bank, which will use the values as a starting point. This is an area that will be of increasing focus over coming months.

# ENVIRONMENTAL MATTERS

The British Business Bank employs 106 people and leases office space in Sheffield and London to accommodate them. As a relatively small organisation the Bank has a limited direct impact on the environment. We have a greater

impact through our investments. In many cases our agreements with fund managers specifically prohibit investments in coal and we support green investments through our Venture Capital funds.



# COLLEAGUES

The British Business Bank has now built a strong team, with relevant expertise from both the private and public sectors. The recruitment process is continuing and we aim to stabilise in size at around

120 individuals within the next 6 months. Selection of staff is based purely on talent and suitability for the role, through a fair and open process. The Bank is currently developing the full range of

employee policies and further developing a detailed training programme to ensure that colleagues thrive, contribute to and develop in the British Business Bank environment.

	<b>Executive Directors and Managing Directors</b>	<b>Senior Managers</b>	<b>Other employees</b>	<b>TOTAL<sup>1</sup></b>
	Total	Total	Total	
<b>Female</b>	3	7	32	42
<b>Male</b>	8	20	36	64
<b>Total</b>	<b>11</b>	<b>27</b>	<b>68</b>	<b>106</b>

In addition, the Non-executive Directors comprised four males and four females as at 31 March 2015.

1. Staff numbers provided here are as at 31 March 2015 and not the average since the commencement of operations on 1 November 2014. Therefore they are calculated on a different basis to those included in note 5 to the accounts.

## APPROVAL OF THE STRATEGIC REPORT

This Strategic Report was approved by the Board and signed on its behalf by:

Keith Morgan  
Chief Executive Officer