



Financial instruments for SME support in practice – Case study demonstrating the use of equity instruments

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Presentation Content

Section 1 - Strategic Context

Section 2 - Ex-Ante Assessment

Section 3 - Design and Set-up of Funds

Section 4 – Implementation & Performance



Section 1

Strategic Context





Key characteristics

- Northern Ireland
- ERDF Investment for Growth & Jobs Programme
- Thematic Objective (TO) 3 Enhancing the competitiveness of small and medium-sized enterprises (SMEs)
- Invest Northern Ireland – Intermediate Body of the Operational Programme (OP)
- Access to Finance Solutions – OP budget of €152M (ERDF and Match)
- 4 Equity Funds in place with 4 separate Financial Intermediaries involved

TO 3



Enhancing the
competitiveness of
SMEs

Strategic context



Introduction to the region

NI economy dominated by SMEs (98% of companies),
of which 89% are micro enterprises

- Access to finance is a major constraint to SME growth
- SMEs focused on short rather than long term strategies for growth
- Equity market is still very underdeveloped compared to other parts of UK and Ireland



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Strategic context

– *FI intervention logic*



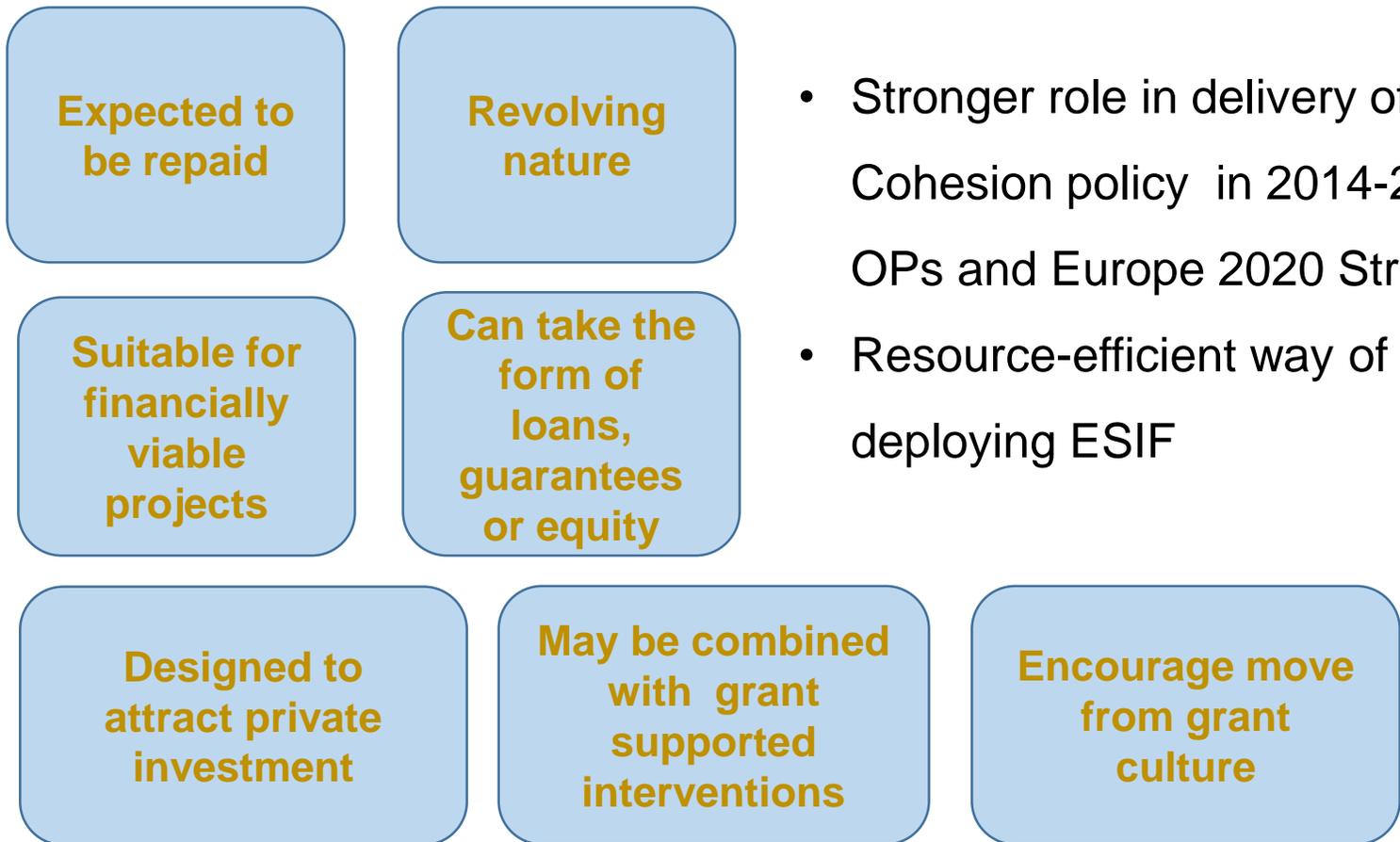
- Encourage business growth
- Increase number of high growth companies
- Compete in the global economy

In line with UK's Partnership agreement adopted by EC on 29 October 2014



Strategic context

– *Why Financial Instruments?*



- Stronger role in delivery of Cohesion policy in 2014-2020 OPs and Europe 2020 Strategy
- Resource-efficient way of deploying ESIF



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Strategic context

–Experience and lessons learned 2007-2013



- European Sustainable Competitiveness Programme for Northern Ireland 2007-2013 Operational Programme
- Focus on fewer more strategic interventions
- Focus on outputs/outcomes/results
- Establish robust management & control systems from outset
- Greater use of FIs to encourage SMEs away from grant support
- FIs provide recycled income which enhances sustainability
- Planning can never start too soon!



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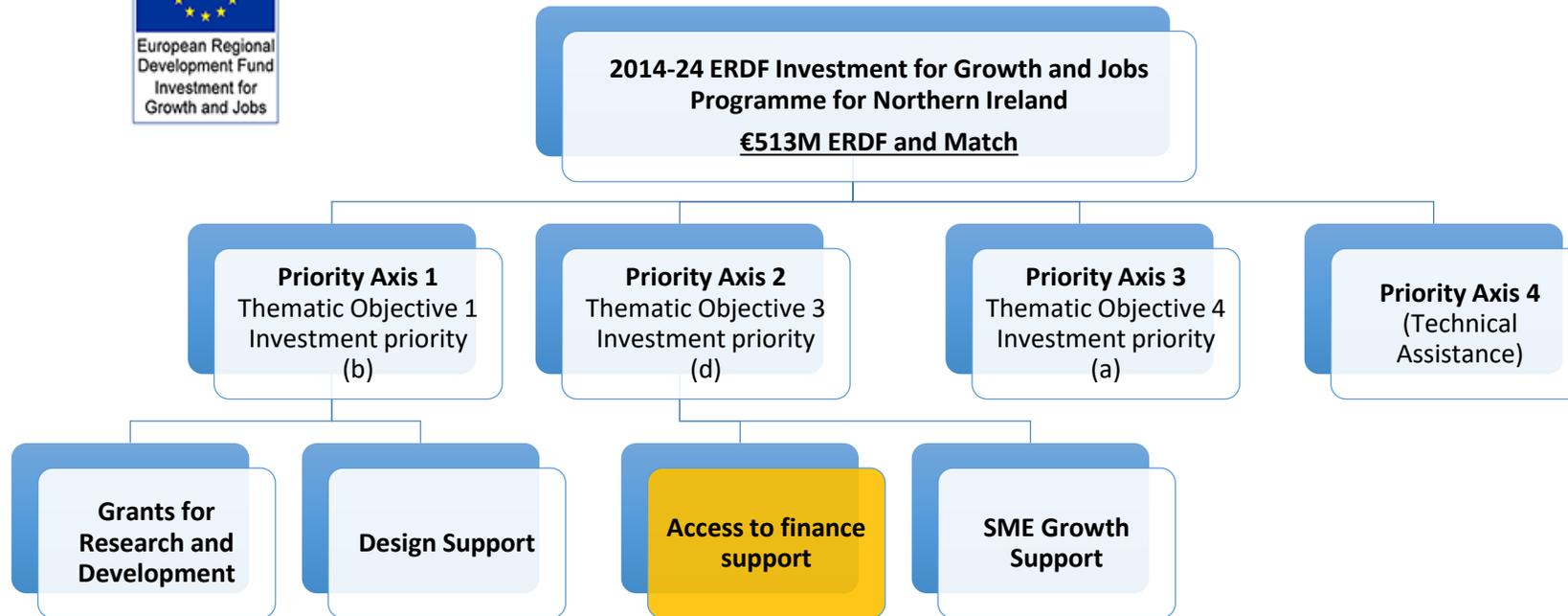


Strategic context

– *Operational Programme*



Investment for Growth and Jobs Programme 2014 - 2020



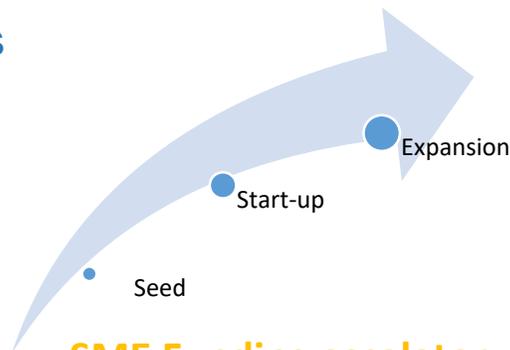
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Strategic context

– *FIs in 2014-2020*

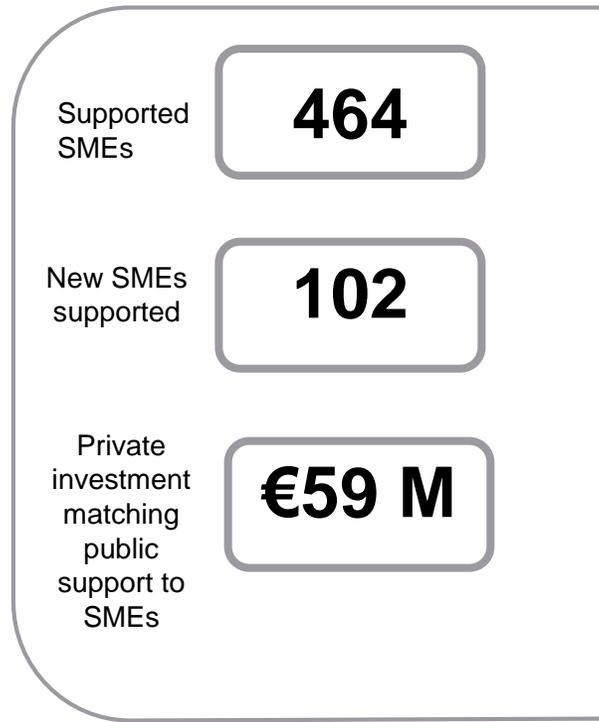
- Invest NI appointed as IB for PA1 and PA2
- Not a Fund of Funds (FoF) structure
- Fund interventions based on ex-ante assessment
- Suite of Funds addressing all stages of the development cycle of SMEs in NI:
 - Seed funds
 - University funds
 - SMEs Equity funds
 - Development funds
 - Loan fund



SME Funding escalator
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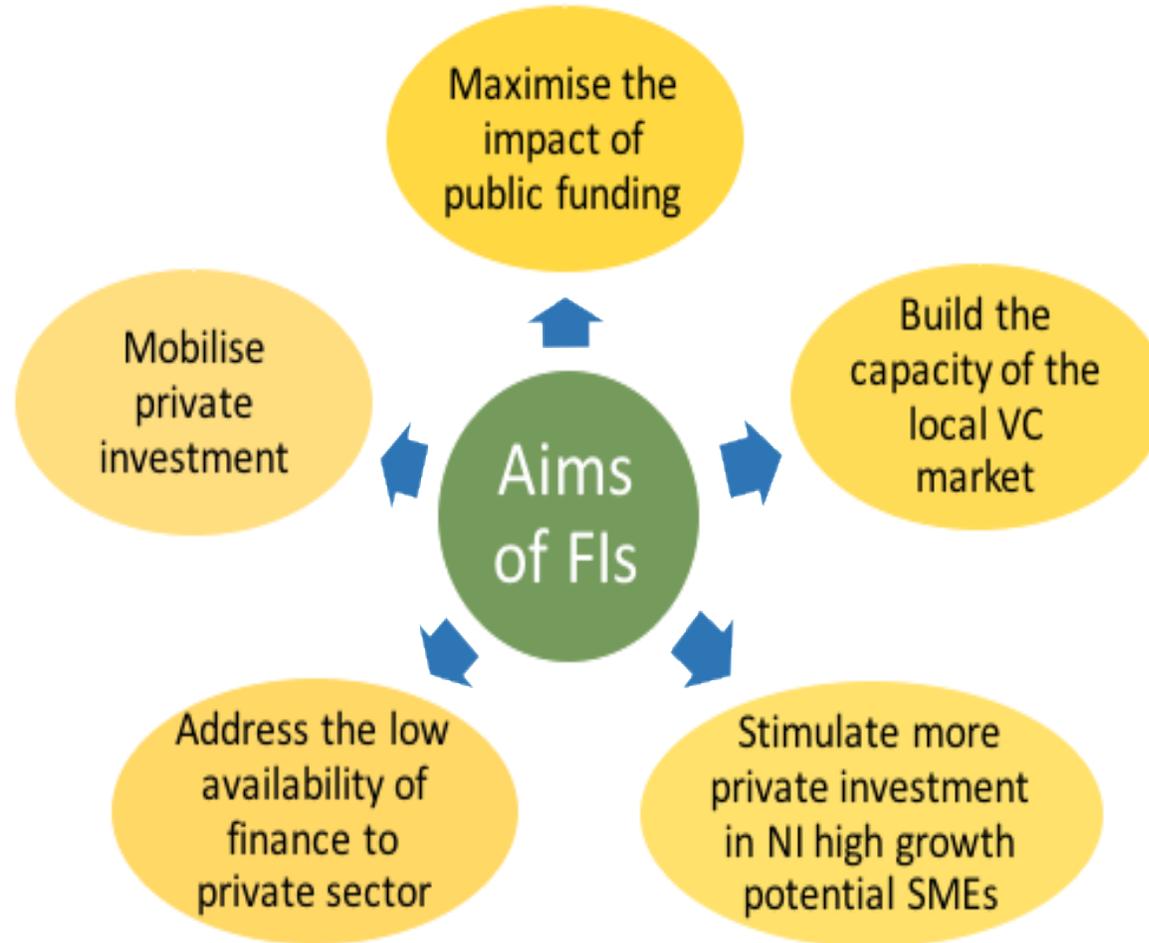


Indicators
Target value at 2023



Strategic context

– *Past and envisaged future*

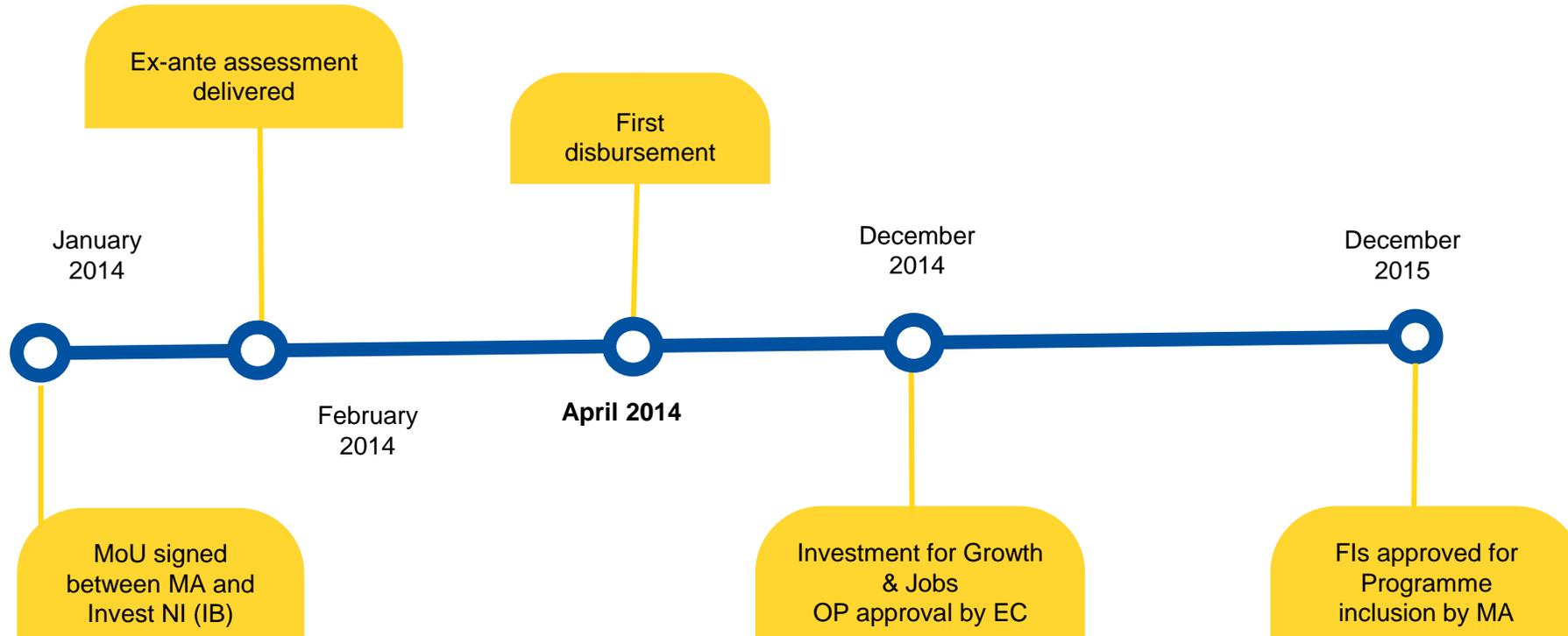


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Strategic context

– *Timeline*



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Section 2

Ex-Ante Assessment



Ex-ante assessment

– Approach



Overview

- EC requirement. No ex-ante = no FIs
- Completed by external consultant
- MA contracted RSM McClure Watters
- Timetable: 4 months
 - ❑ Assignment started in December 2013
 - ❑ Final report submitted in March 2014
- TA funded at cost of ≈ £30,000.
- Ex-ante assessment submitted to PMC 28 May 2015 (info only)
NOTE: This was first meeting of PMC after OP was approved by EC.



Ex-ante conclusion:

Invest NI's proposed FI provision and access to finance strategy in line with areas of market failure identified for NI SMEs with growth and export potential



Ex-ante assessment

– *The study*



Market assessment (1/2) – Market failure, suboptimal investment

- Methodology



- Market Failures identified for:
 - Equity (seed, private equity): with a demand of £ 83.2M
 - Debt (including mezzanine debt): with a demand of £ 50 M
- SME Proof of Concept (POC) grants to sit alongside the Seed Fund which is targeted at SMEs.
- Separate University POC grants sit outside Seed Fund but act as an incentive for Spin-out activity.

Gap size

Up to £154M
ERDF for the
period 2014-2023

Anticipated ERDF funding from
OP ≈ £ 70M

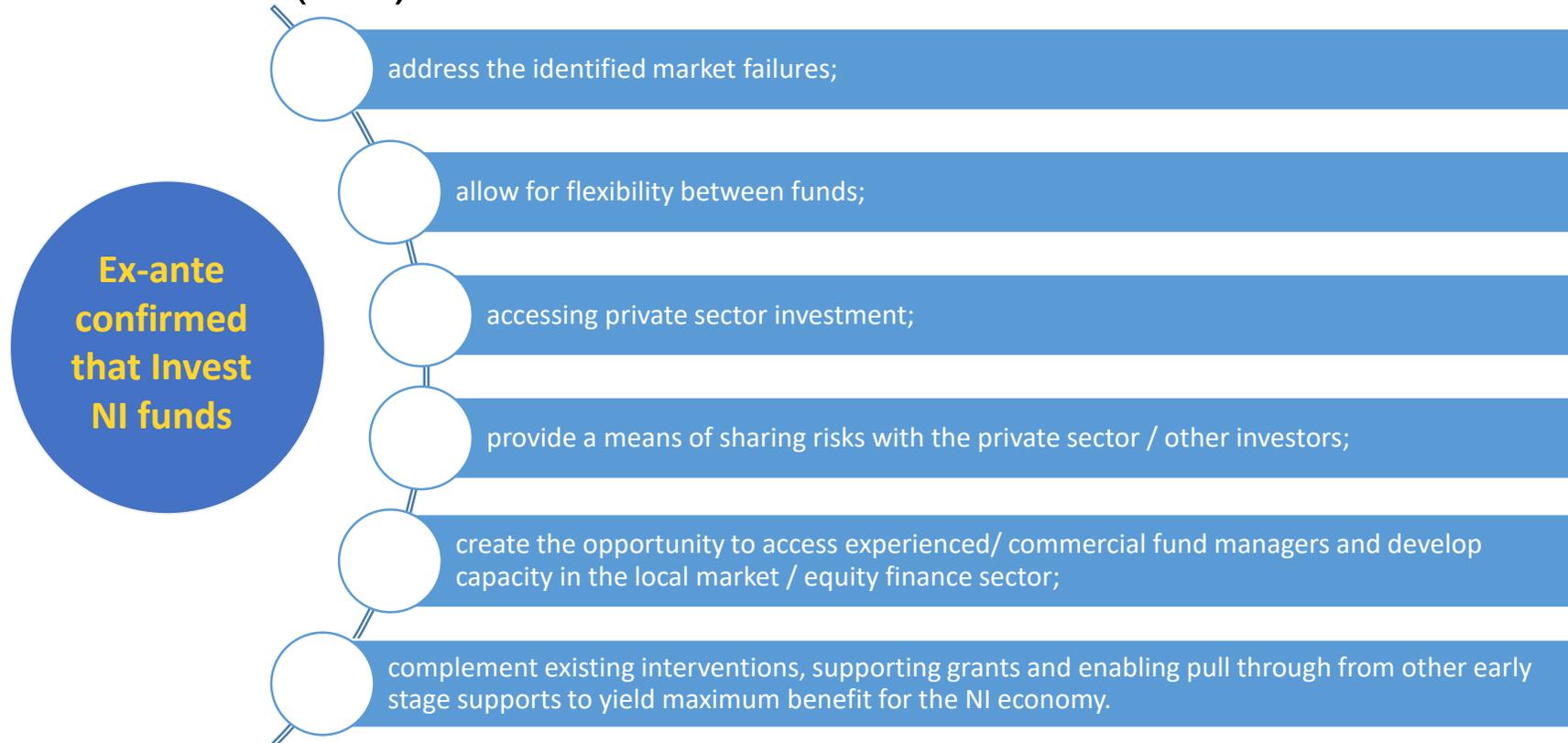


Ex-ante assessment

– *The study*



Market assessment (2/2) – Value added



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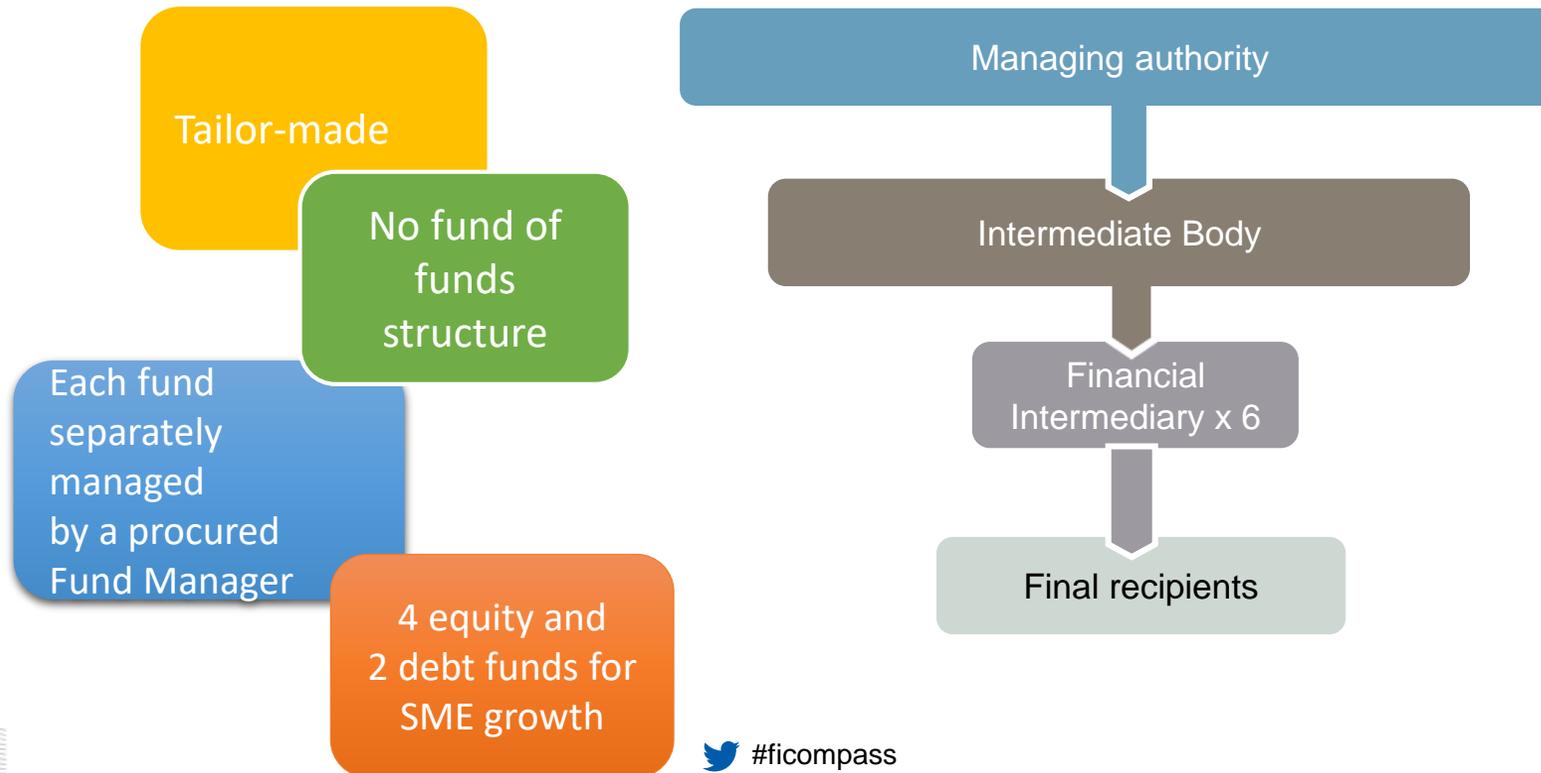


Ex-ante assessment

– *The study*



Delivery and management (1/3) – Proposed investment strategy



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Ex-ante assessment

– The study



Delivery and management (2/3) – Proposed investment strategy

- The ex-ante assessment recommended the following ERDF (Public) and Private sector match for the period 2014-2023 for the Equity Funds.

	ERDF		Other Public		Private		Total
techstart University Fund I	£2.2m	60%	£1.4m	40%	£0.0m	-	£3.6m
techstart University Fund II	£1.4m	60%	£1.0m	40%	£0.0m	-	£2.4m
techstart Equity Fund I	£13.8m	60%	£2.3m	10%	£6.9m	30%	£23.1m
techstart Equity Fund II	£9.2m	60%	£1.5m	10%	£4.6m	30%	£15.3m
Co-Fund I	£8.0m	47%	£0.0m	-	£9.0m	53%	£17.0m
Co-Fund II	£15.9m	46%	£0.0m	-	£18.3m	54%	£34.2m
Development Funds I	£26.0m	50%	£0.0m	-	£26.0m	50%	£52.0m
Development Funds II	£20.0m	50%	£0.0m	-	£20.0m	50%	£40.0m
	£96.5m	51%	£6.2m	3%	£84.8m	45%	£187.6m

- Any shortfall in funding requirement for Equity Funds to come from recycled ERDF, other public contribution or enhanced private contribution

Ex-ante assessment

– *The study*



Delivery and management (3/3) – Recommendations

- ✓ Update of the ex-ante assessment if the market changes and/or the output and result targets are not being delivered (to be considered 2018/19)
- ✓ Subordination of VC funds for SMEs is essential
- ✓ Providing funds based on specific stages of company development is effective, rather than taking a sector based approach
- ✓ Locally based fund managers who have links to wider VCs in order to help access further funding down the line
- ✓ Appropriate incentives (State aid compliant) for Fund Managers – enhances quality and quantity outputs, important for long term success
- ✓ On-going assessment of Funds' performance and results, as well as independent interim evaluation



Post ex-ante assessment



Overview – Designation of Invest NI

- Invest NI designated as Intermediate Body (IB) by the MA for P2 interventions (FIs, repayable assistance and grant support).
 - ✓ MoU signed on 1st of January 2014 between DfE and Invest NI setting the framework for cooperation under the OP (IB for P1 and P2)
 - ✓ 14 December 2014 - EC formal approval of OP

- Budget of the scheme €150M

ERDF allocation €91.2M + Match €59.6M (Public €5.8M & Private €53.8M)

- Eligibility period of the expenditures

1st Jan. 2014 - 31st Dec. 2023



- Non-Departmental Public Body of the DfE
- Established in April 2002
- Headquarters in Belfast with offices in Ireland, North America, Asia Pacific and mainland Europe
- Staff of over 600 ppl.
- Role: to grow the local economy.



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Section 3

Design and Set-up of Funds

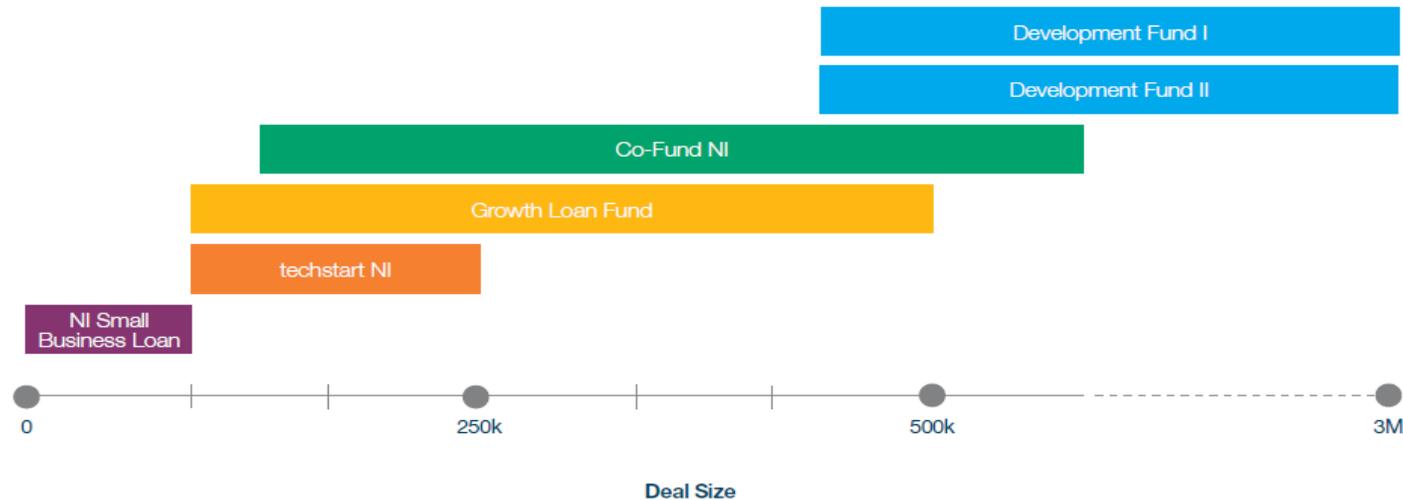


Design and set-up

– Implementation structure



Access to Finance Strategy - Provides a Risk Capital funding continuum from start-up to development capital of up to £3m



- NI Small Business Loan Fund (£5m) (Debt)
- techstart NI (£29m) (Equity & Grant)
- Growth Loan Fund (£50m) (Debt)
- Co-Fund NI (£28m) (Equity)
- Development Funds (£60m) (Equity)



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Design and set-up

– *Implementation structure*



Objectives

- Invest NI Access to Finance addresses market failures identified in ex-ante assessment
- Provides funding for SME's across seed, early stage and development funds
- ERDF used to support Equity Funds only
- Other Public Resources used to support Loan Funds
- No new Guarantee Funds established – already adequately covered UK wide



Design and set-up

– Implementation structure



Governance

- Strategic oversight and direction for all Invest NI activity - Invest NI Board
- Strategic oversight for Access to Finance Strategy – Access to Finance Working Group – Invest NI Board members and external experts, established in 2011

Strong governance structure is critical to ensure the professional credibility of the Access to Finance funding continuum

- Operational responsibility - Invest NI Corporate Finance Division
- Fund oversight and delivery monitoring – Individual Invest NI manager per fund.



Investment decisions are the sole responsibility of the appointed Fund Managers

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Design and set-up

– State aid considerations overview



Invest NI FIs (Equity funds) are State Aid covered

General Block Exemption Regulation (EU) 651/2014 (GBER)

Article 21 (Risk finance aid)

Article 22 (Aid for start-ups)

Commission Regulation (EU) No 1407/2013 (De Minimis Aid)

Community guidelines on state aid to promote risk capital investments in SMEs

Aid schemes registered in EC State aid Notification Interactive system (SANI2)

- ✓ Techstart NI (SA.39644)
- ✓ Development Fund (SA.34142)

Co-Investment pari passu so no aid



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Design and set-up

- *Selection of bodies implementing the FI*



Invest NI fund manager selection approach

- Each Fund Manager procured through NI's Central Procurement Directorate (CPD) processes to ensure compliance with procurement regulations (OJEU tender)
- Each Fund is separately managed by an appointed Fund Manager that is Financial Conduct Authority (FCA) regulated
- Invest NI has a Limited Partnership Agreement/ Management Service Agreement (MSA) with each Fund Manager



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Design and set-up

- Co-Investment Fund



Purpose: *Provide co-investment funding alongside private investors and/or business angels in order to meet an identified funding gap in a proposed investment*

- In line with TO3 and the OP, as well as confirmed in the ex-ante assessment
- Targeting co-investment in SMEs incorporated under the laws of NI with operations substantially based in NI
- Operating in accordance with best VC industry practice and Financial Services and Markets Act



KPIs

- 8 Investments per annum in 6 years
- Deal size range of £250,000 - £450,000 and average Investment of £150,000 per deal p.a.
- Invest pari-passu with pre-qualified investors
- Average private to public funding in the portfolio of 55:45
- Invest £7.2m over the term and no less than £1m p.a. by way of 1st investment and follow on as required
- Pre-qualify \geq 6 private investors and/or business angels as Pre-qualified Investors over the Term
- At least 3 are to be pre-qualified in the first 2 years of the Term.



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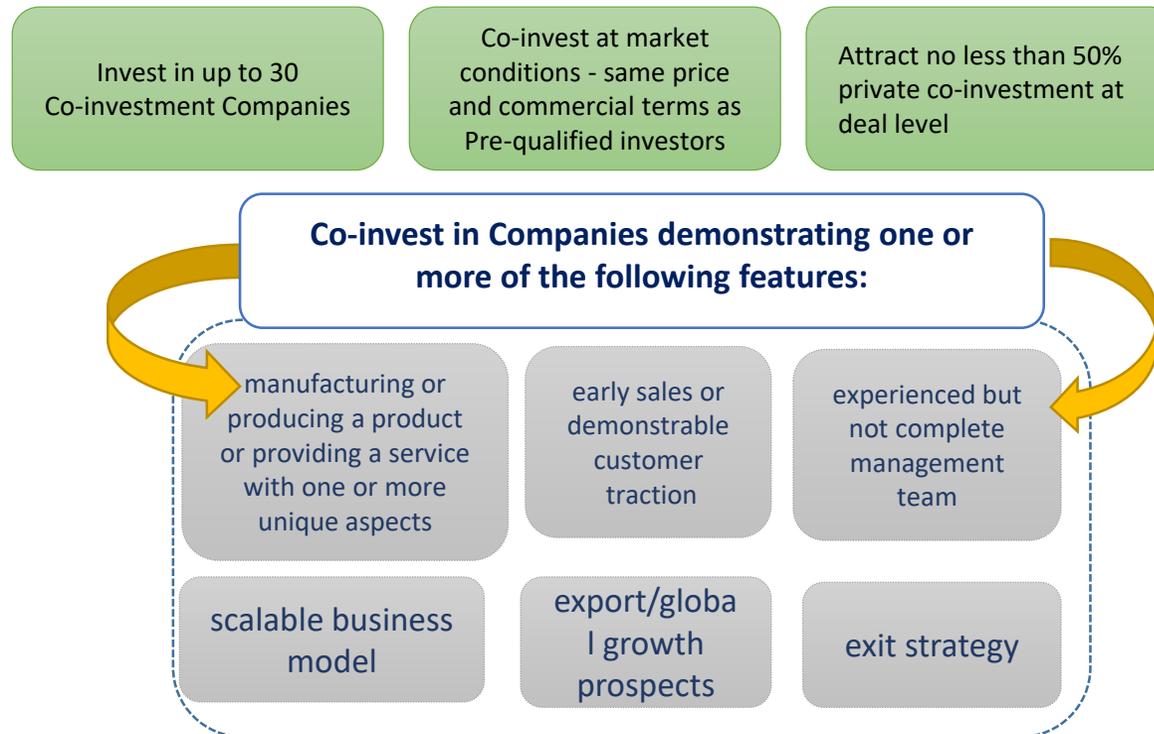


Design and set-up

- Co-Investment Fund



Investment strategy and business plan



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Design and set-up

- Co-Investment Fund



Implementation timeline



Co-Fund (I) from June 2011 to May 2017

Co-Fund (II) from June 2017 to May 2023



Co-
Investment
Fund
support
started in
the EUSCP

ACTIONS:

- ✓ Co-Fund (I) has been succeeded by Co-Fund (II), a further co-investment fund.
- ✓ Tender process was early 2017 with an award date in June 2017



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Design and set-up

- Development Funds



Purpose: *Provide development stage Investments by way of expansionary capital, anticipating at least early revenue generation, scaling up and/or technology commercialisation*

- In line with TO3 and the OP, as well as confirmed in the ex-ante assessment
- Targeting investment in innovative businesses (SMEs) incorporated under the laws of NI with operations substantially based in NI
- Operating in accordance with best VC industry practice and Financial Services and Markets Act



Invest in approx. 15
Portfolio Companies with
40 deals

Deal size range of £450,000
- £1.2M

Raise private investment at
fund level of at least £15M:
- £7.5M at first close
- £15M at final close

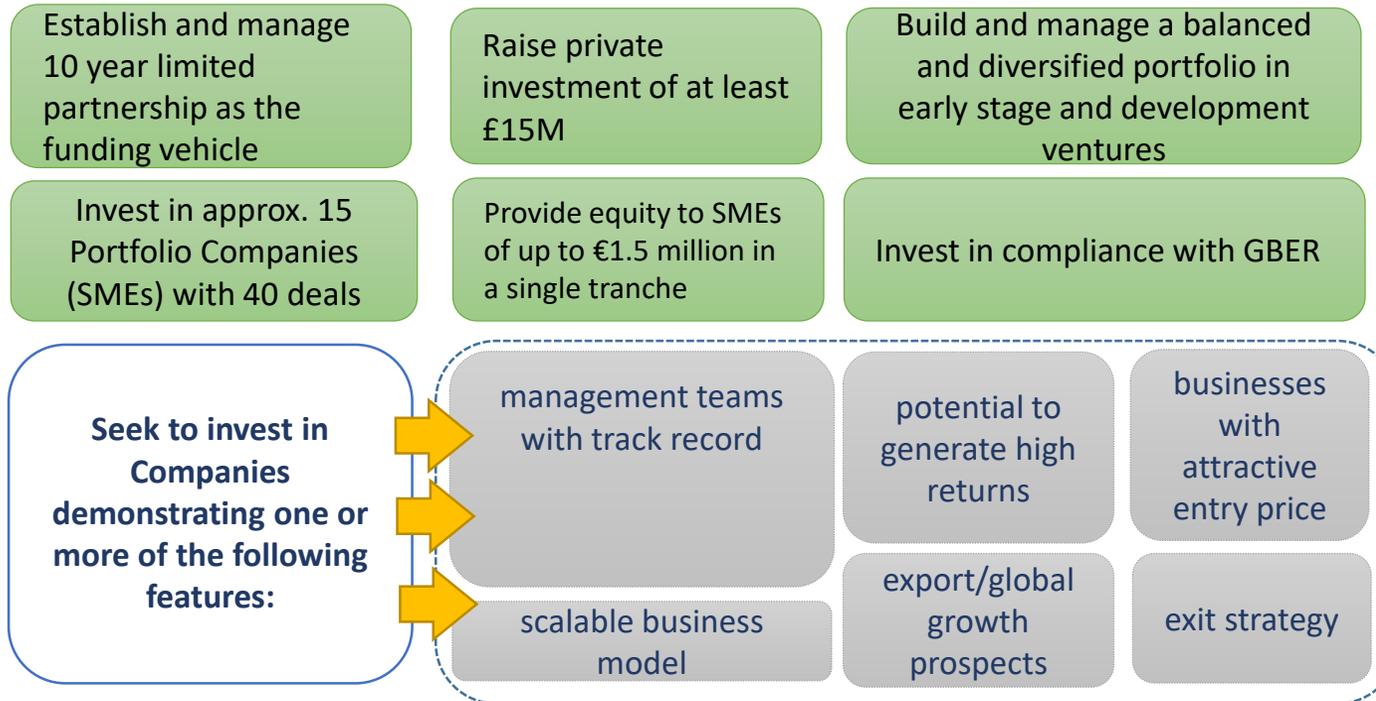


Design and set-up

- Development Funds



Investment strategy and business plan



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Design and set-up

- Development Funds



Implementation timeline



ERDF budget of up to £30M

Open procedure with stage selection process

- **Crescent Capital** - from July 2013 to July 2023
 - ✓ 5 year investment period July 2013 – July 2018
 - ✓ Further 5 year managing out period to July 2023



- **Kernel Capital** - from Oct. 2013 to Sep. 2023
 - ✓ 5 year investment period Oct. 13 – Sep18
 - ✓ Further 5 year managing out period to Sep. 2023



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Design and set-up

- Techstart NI

techstart^{NI}

Purpose: Provide seed and early stage investments with special focus on technology based and innovative services with high growth potential.

- In line with TO3, the OP and ex-ante assessment
- Implement Techstart NI, an integrated suite of equity and grant funds and a capability programme for Investment Awareness
- Targeting investment in innovative NI based SMEs
- Operating in accordance with best VC industry practice and Financial Services and Markets Act
- Fund Manager has absolute discretion on Investment decisions and management of Portfolio Companies



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KPIs

54 – 64 Investments over the first 5 years of the Term

Ensure private investment at deal level in compliance with State aid rules

Invest in approx. 9 – 13 companies (not in the Portfolio) p. a. in the first 5 years

Deal size range of a minimum of £50,000 and a maximum of £250,000

Drawdown at least 70% of the Loan Commitment over the first 5 years of the Term and the remaining 30 % between the 6 and 8 year

Ensure dedicated team for management and control of the Partnership

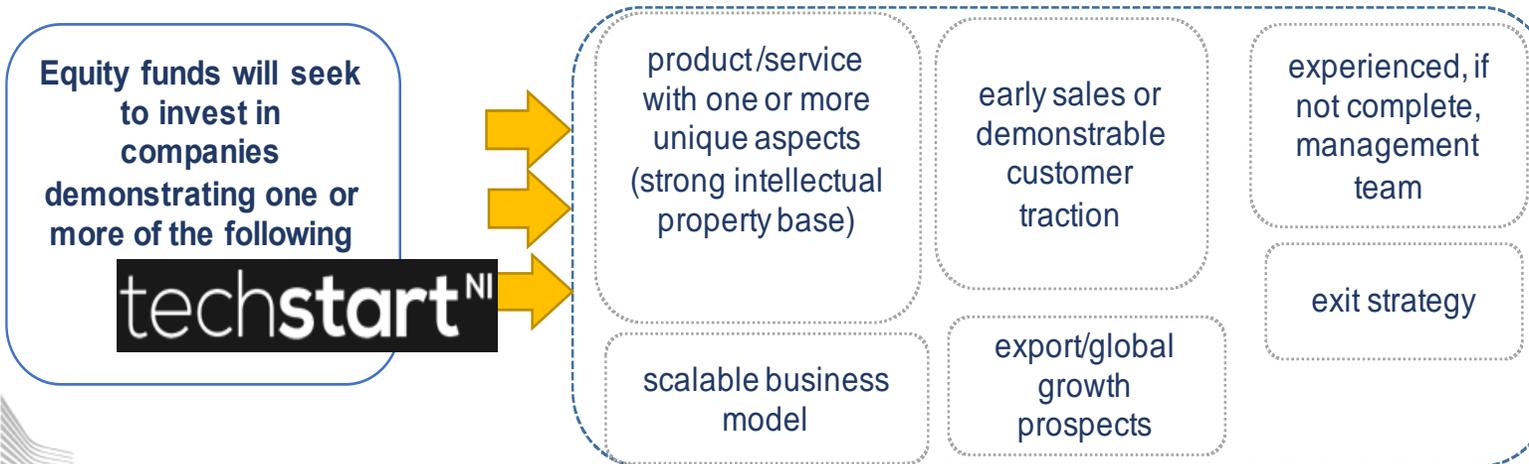
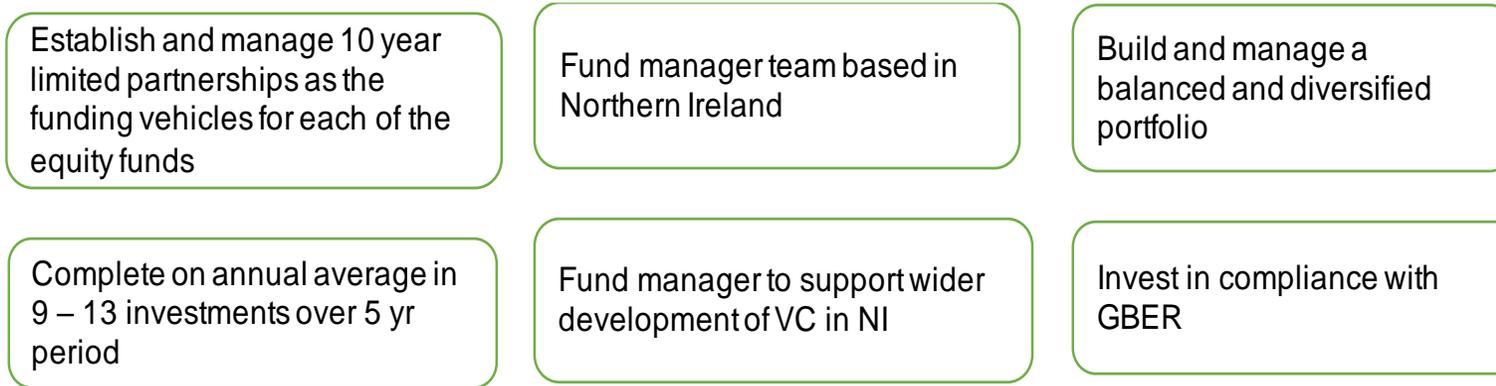


Design and set-up

- Techstart NI



Investment strategy and business plan



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Design and set-up

- Techstart NI



Implementation timeline:

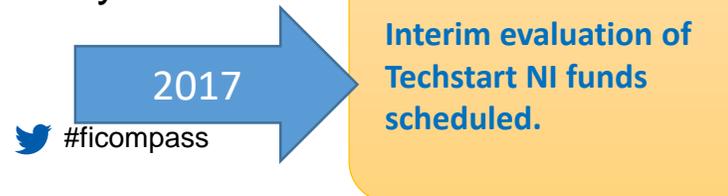


- SME Equity Fund - July 2014 - July 2024
- QUB Equity Fund - July 2014 - July 2024
- UU Equity Fund - July 2014 - July 2024



All techstart equity funds:

- ✓ 5 year investment period 09 July 2014 – 08 July 2019
- ✓ Further 5 year managing out period to 08 July 2024



SME Fund
£17M

2x University Funds
2x £1.5M

SME Proof of Concept
Grant fund
£3.6M

Investment Awareness
Programme





Section 4

Implementation & Performance



Implementation

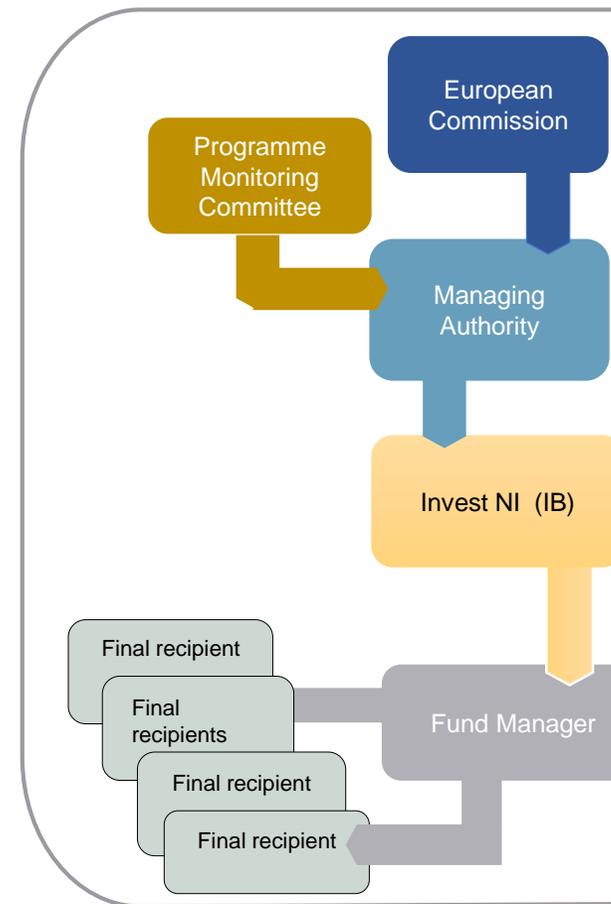


Monitoring FI implementation

Monitoring and Audit

- Invest NI is responsible for verification activity (administrative and on-the-spot)
- MA supplements checks already conducted by the IB to meet the regulatory requirement to oversee the process (via Service provider)
- Invest NI closely monitors Fund manager performance
- Funding agreements with Fund managers include rights of access of respective audit and controlling organisations

Tools: - seats in each Fund's Advisory Board
- regular roundtables
- monthly updates
- quarterly monitoring meetings



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Implementation



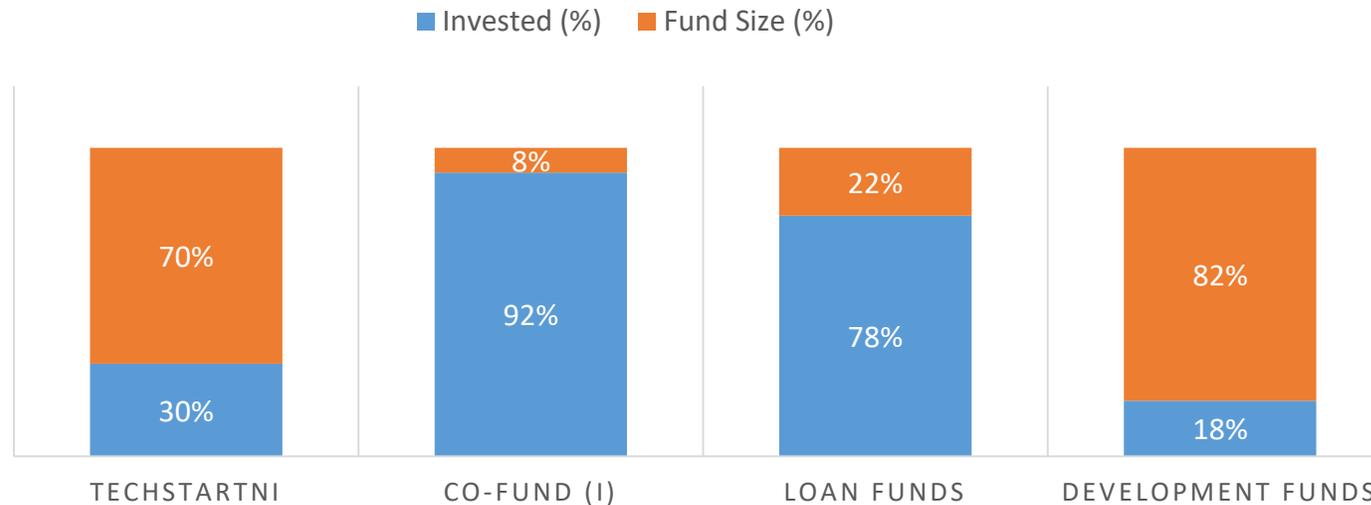
Returns and Exits

- Investment exit decisions made by each Fund Manager
- Returns to investors in line with investment agreements
- ERDF recycled through appropriate mechanisms for SME support
- Wind-up of a Fund is based on evaluation/market-need or in line with original agreement timeframes



Equity Funds Performance

Percentage of approved funding invested at 31st March 2017



Equity Funds Performance

April 2014 to March 2017

Fund	Total Invested	No of investments	No of investee SMEs
Co Fund	£29.7	92	35
Crescent Development	£ 9.2	10	7
Kernel Development	£ 8.6	11	5
Techstart SMEs	£ 7.8	29	22
Techstart University (QUB)	£ 0.6	4	4
Techstart University (UU)	£ 0.3	2	2
TOTALS	£56.2m	148	75

Invest NI's Access to Finance Strategy

6 year Performance from April 2011 to March 2017
(including Loan Funds that are not ERDF supported)

- **572 Deals**
- **Total Investment £106.4 million**
- **420 Businesses Supported**



financial instruments
 revolving capacity building
 added value **ERDF** funding agreement
 governance **ESF** EU guidance
 technical support seminars leverage financial intermediaries microfinance
 co-financing **ESIF** case studies
 investments **fi-compass** final recipients
 business plan **Thank you** thematic objectives
 advisory services guarantees banks loans **EaSI** equity
 private investors life cycle combination of support
EAFRD conferences factsheets
 fund of funds **EMFF** investment strategy **CF**
 managing authorities manuals