



**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



Strategic context

– *FI intervention logic*



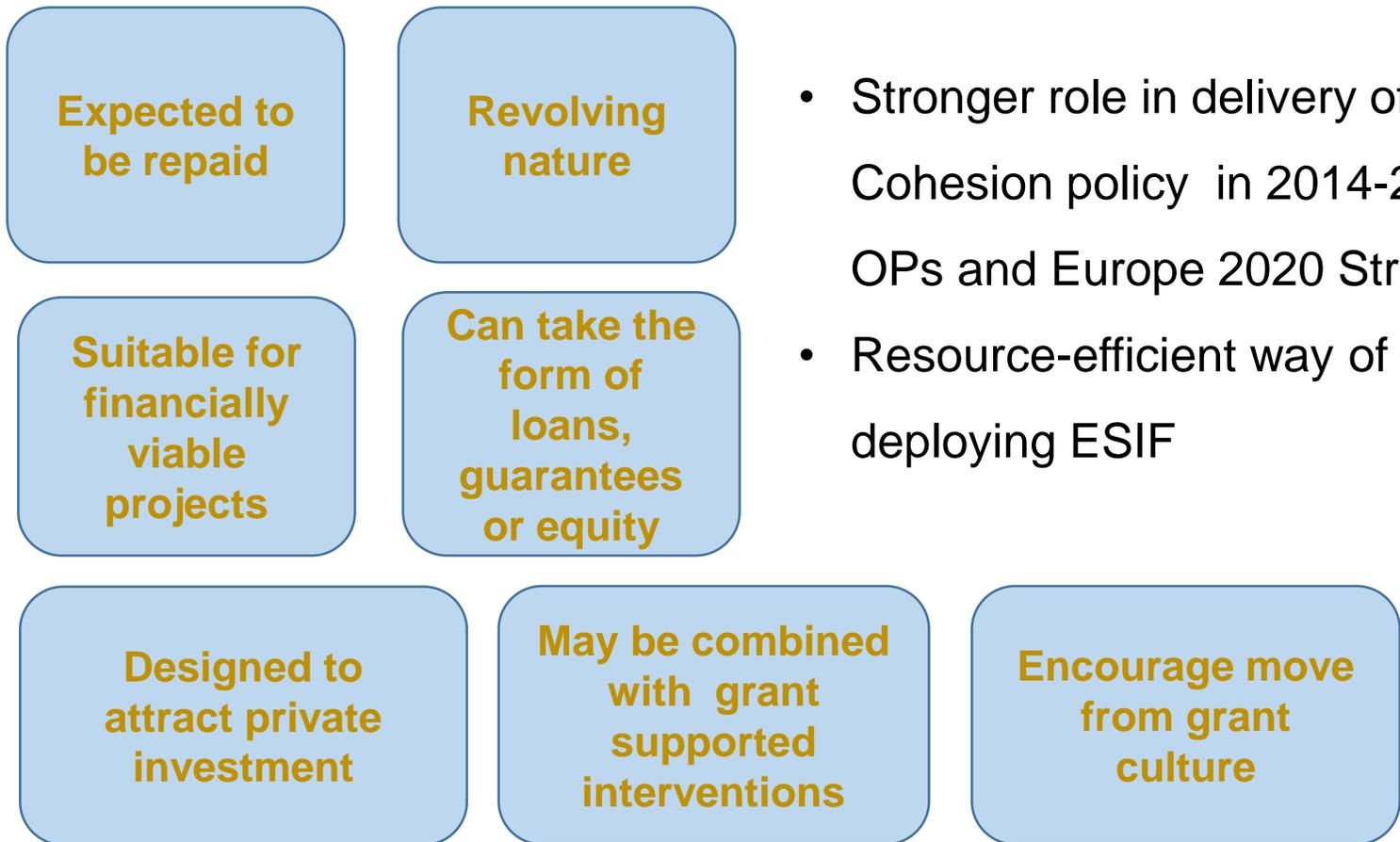
- Encourage business growth
- Increase number of high growth companies
- Compete in the global economy

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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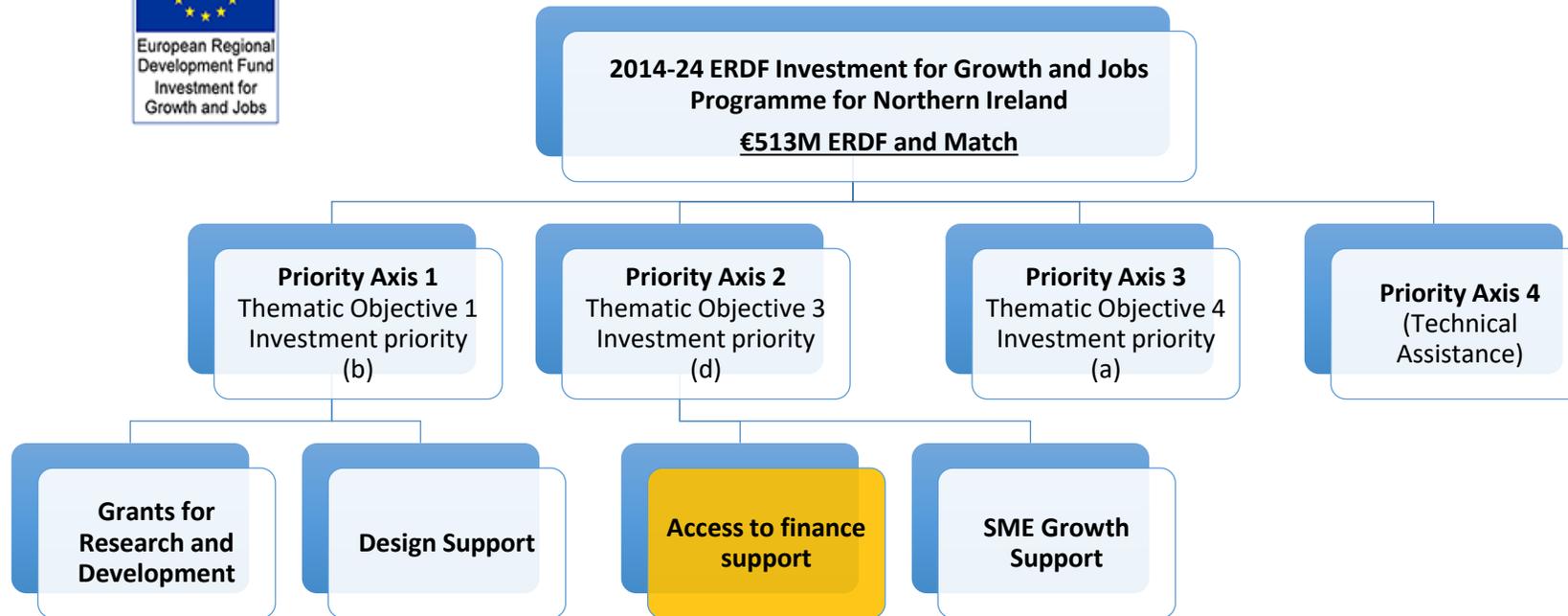


Strategic context

– Operational Programme



Investment for Growth and Jobs Programme 2014 - 2020



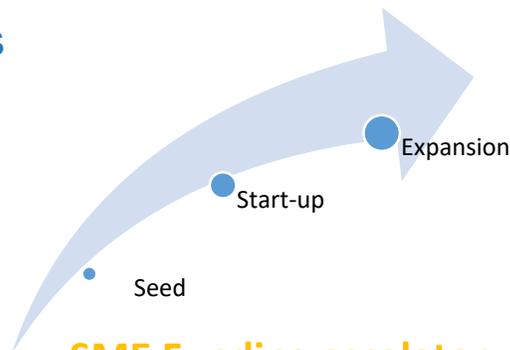
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Strategic context

– *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

Supported SMEs

464

New SMEs supported

102

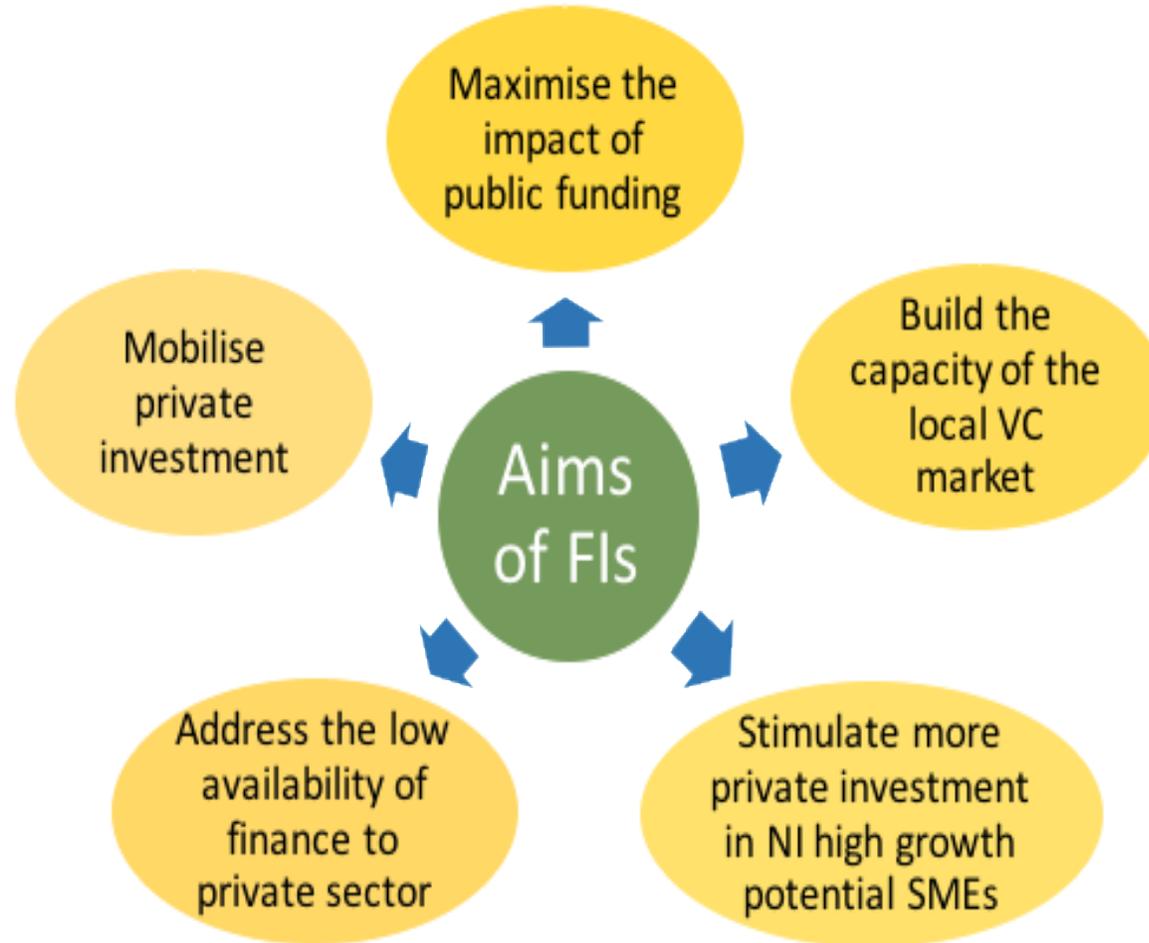
Private investment matching public support to SMEs

€59 M



Strategic context

– *Past and envisaged future*

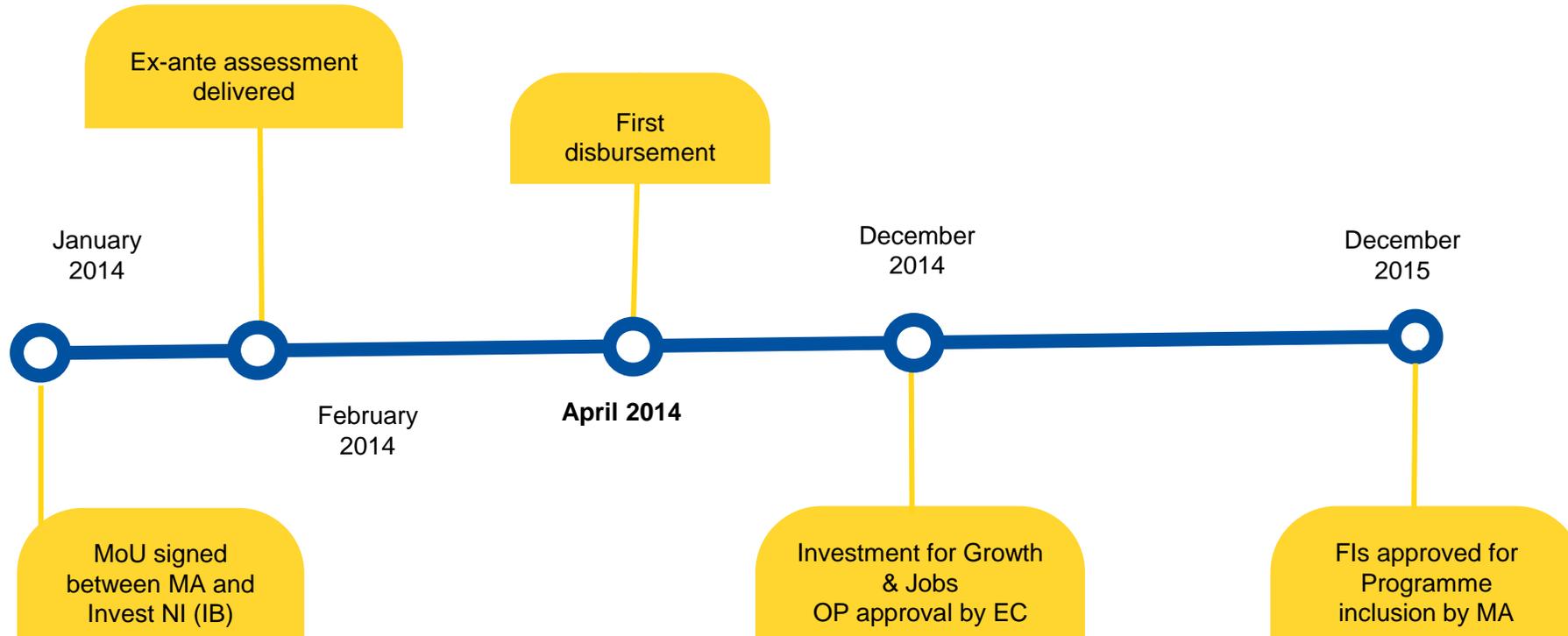


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Strategic context

– *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



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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

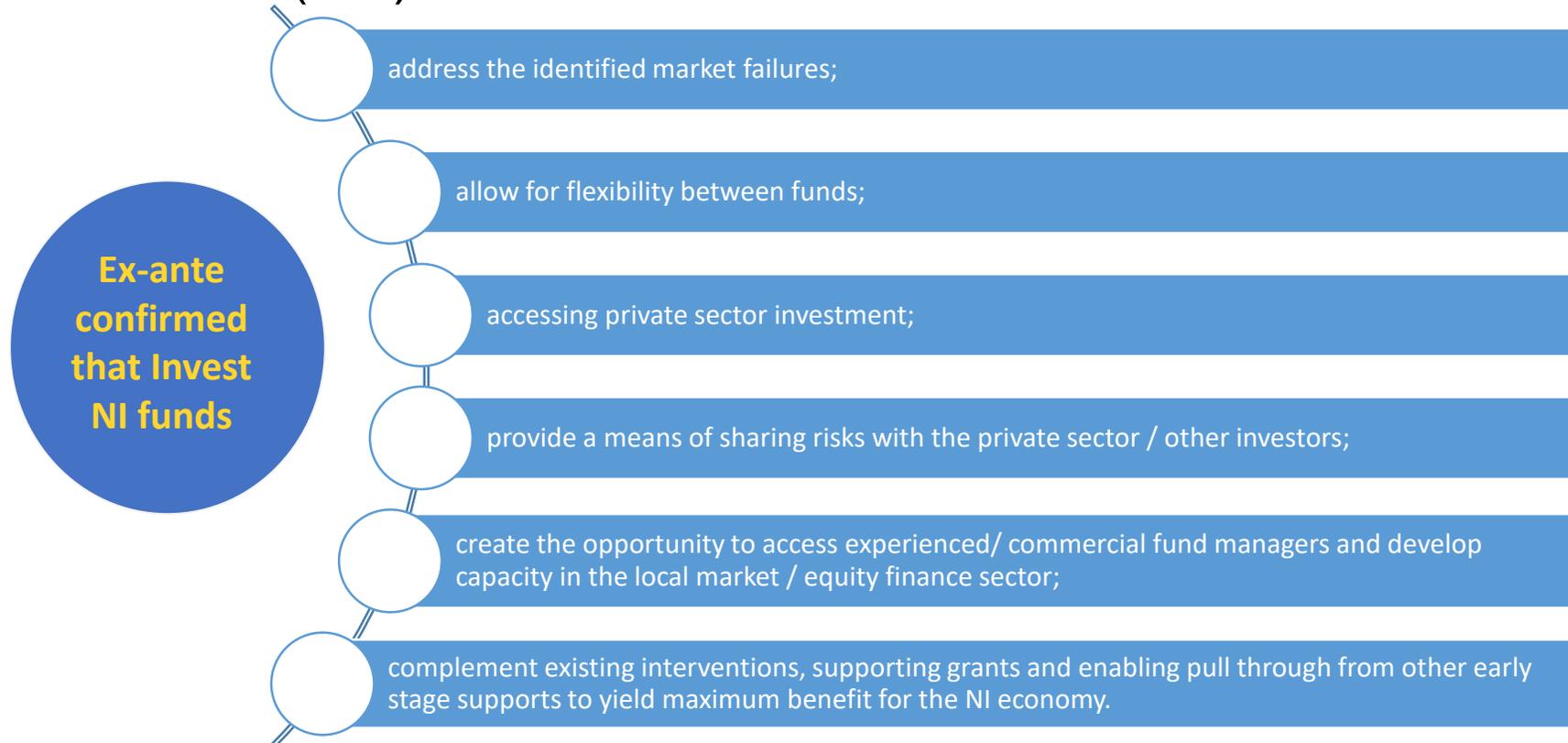


Ex-ante assessment

– *The study*



Market assessment (2/2) – Value added



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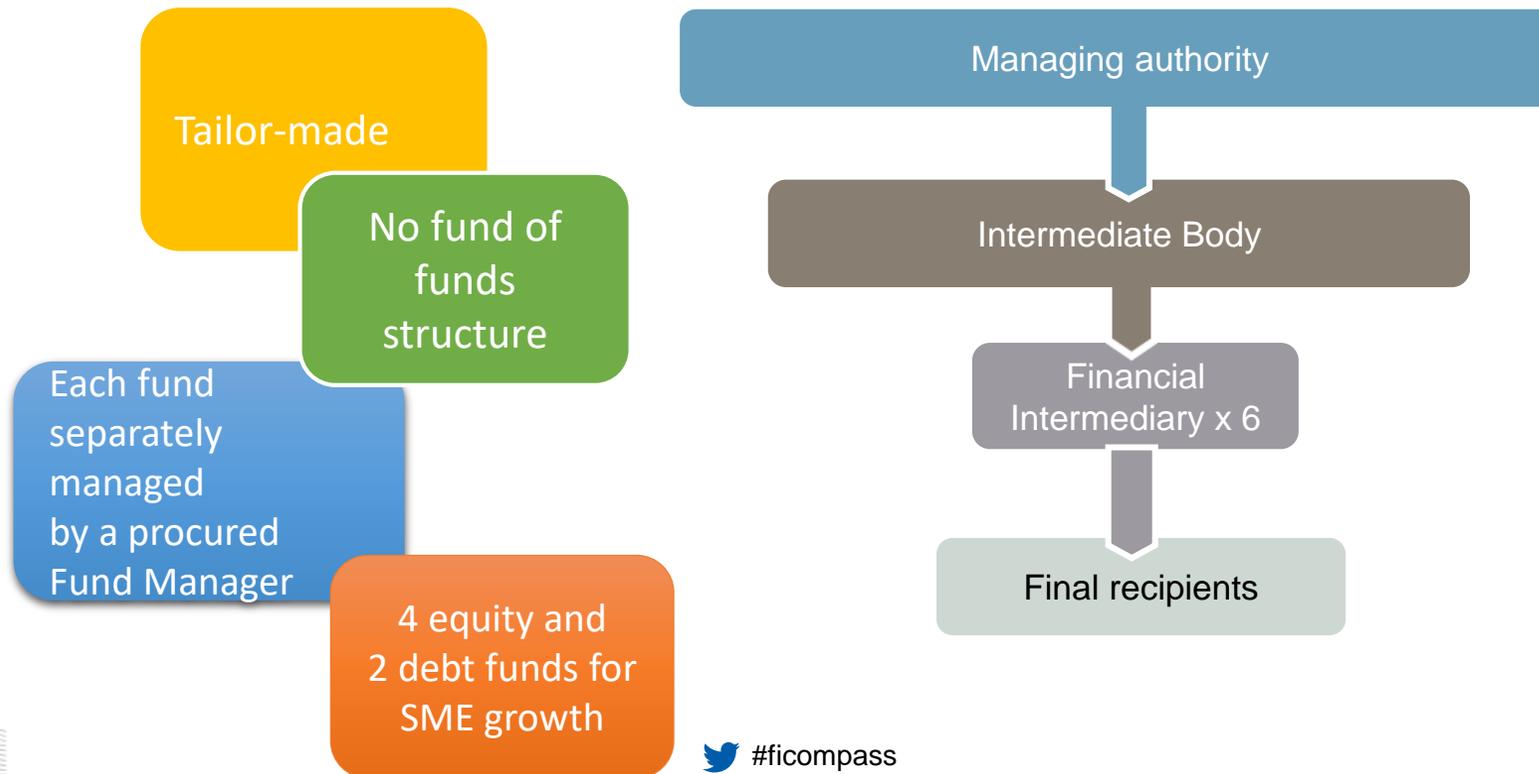


Ex-ante assessment

– *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.





Section 3

Design and Set-up of Funds

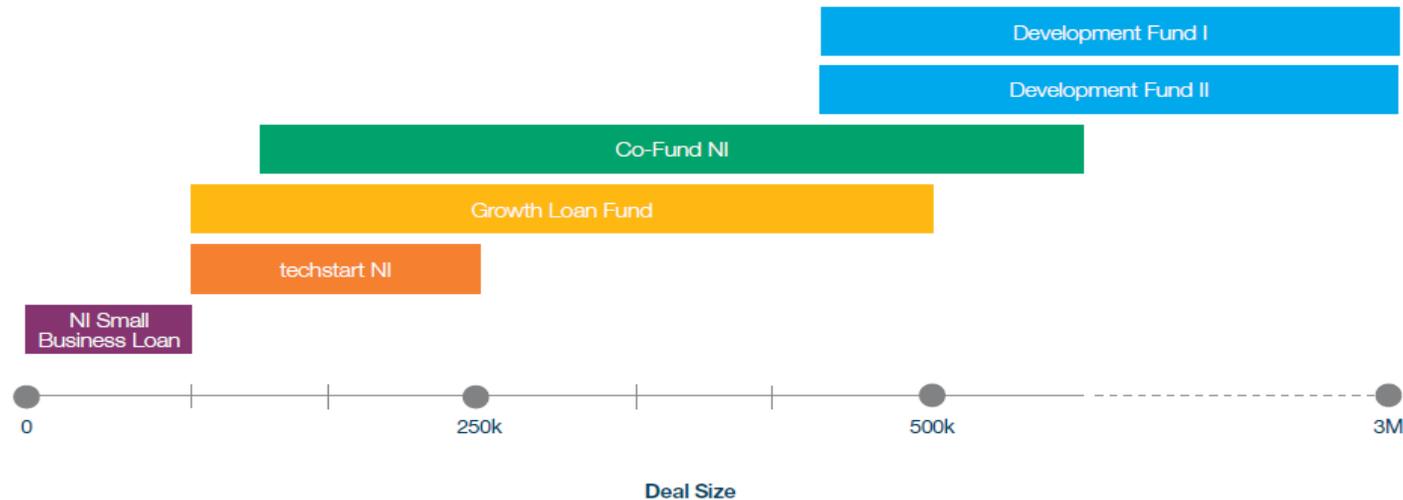


Design and set-up

– 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.

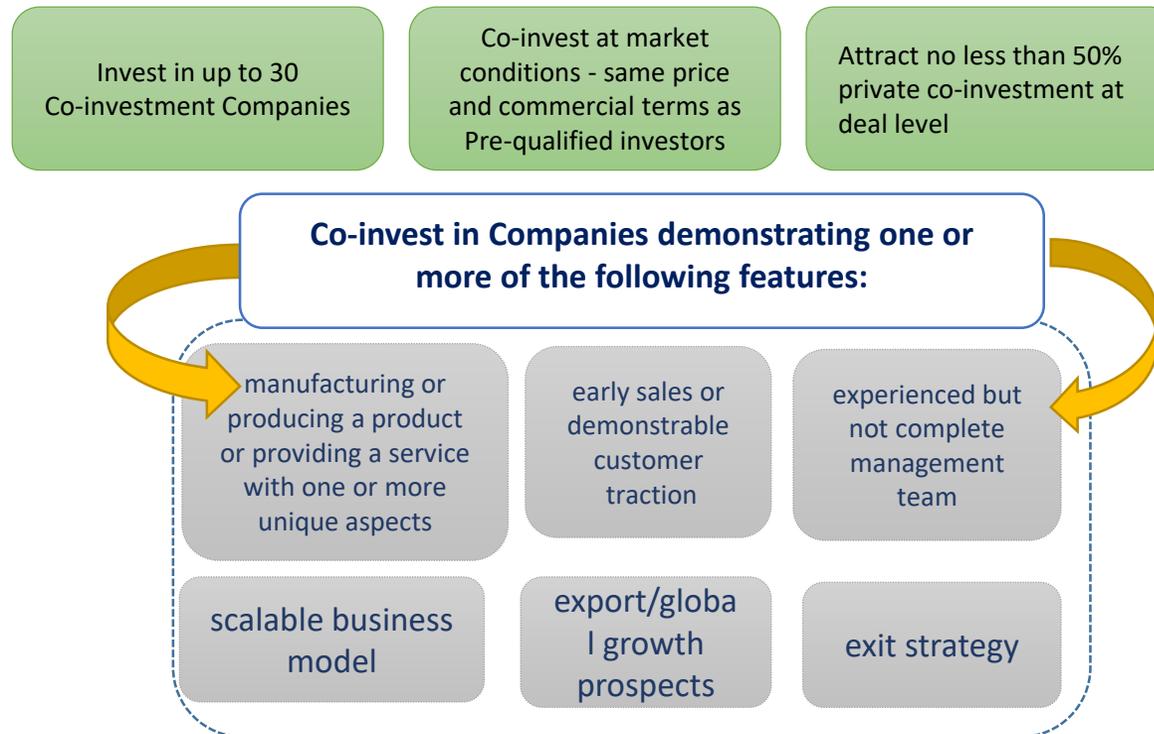


Design and set-up

- 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



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



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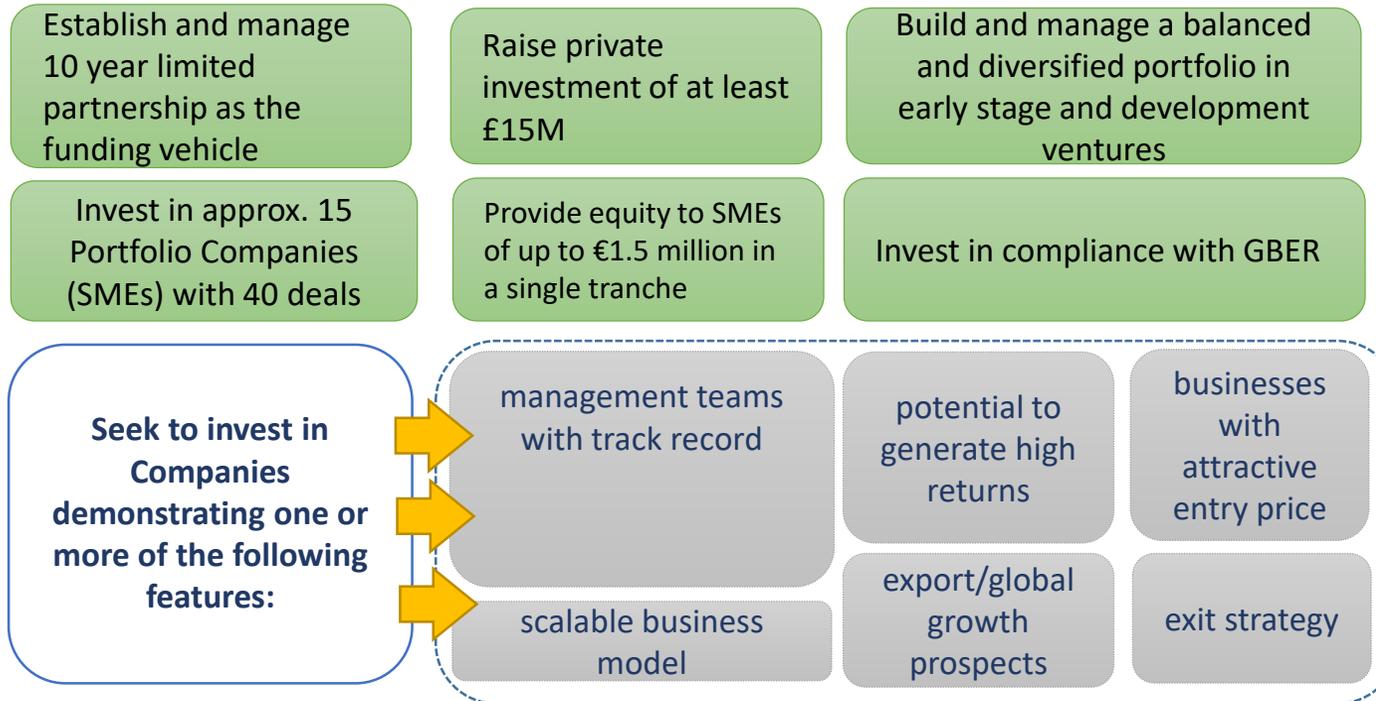


Design and set-up

- 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



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

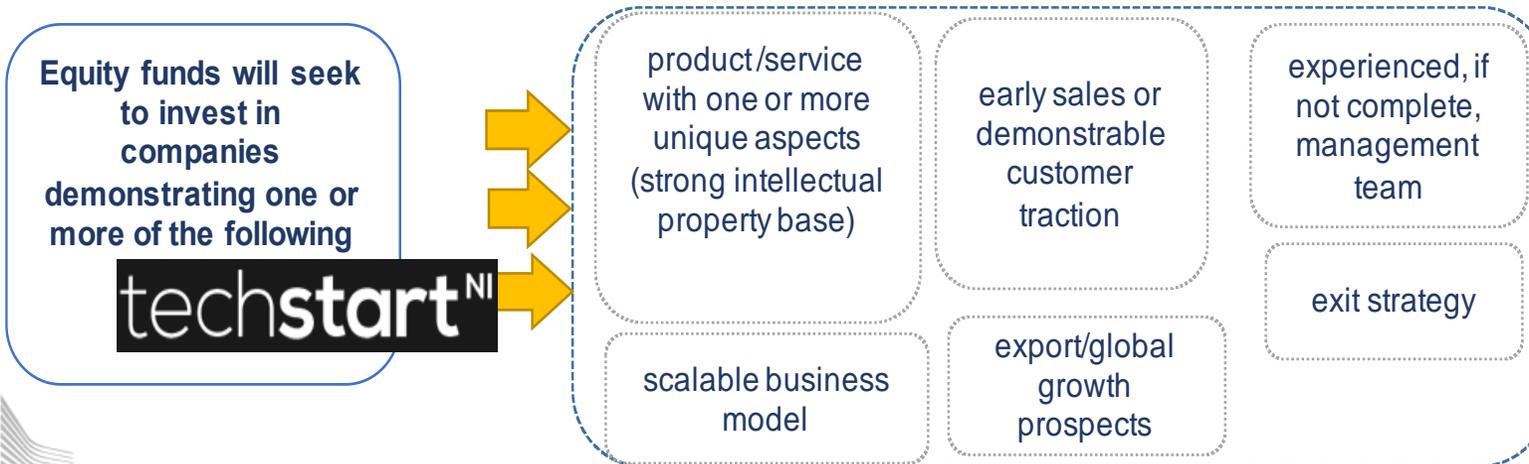
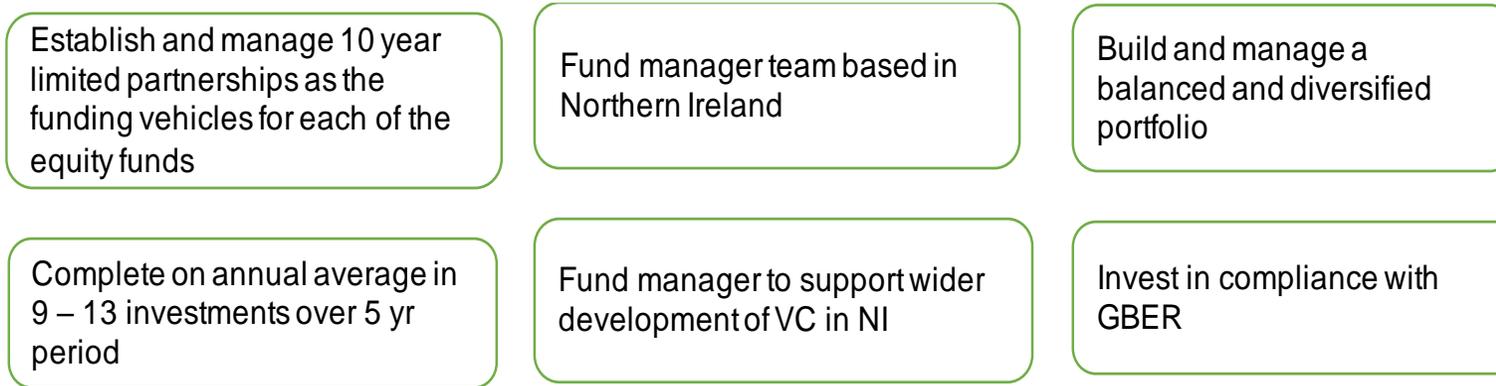


Design and set-up

- Techstart NI



Investment strategy and business plan



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Design and set-up

- Techstart NI



Implementation timeline:

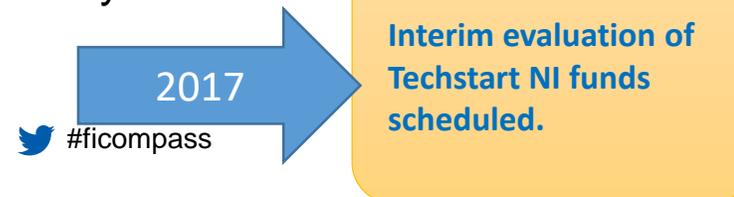


- SME Equity Fund - July 2014 - July 2024
- QUB Equity Fund - July 2014 - July 2024
- UU Equity Fund - July 2014 - July 2024



All techstart equity funds:

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





Section 4

Implementation & Performance



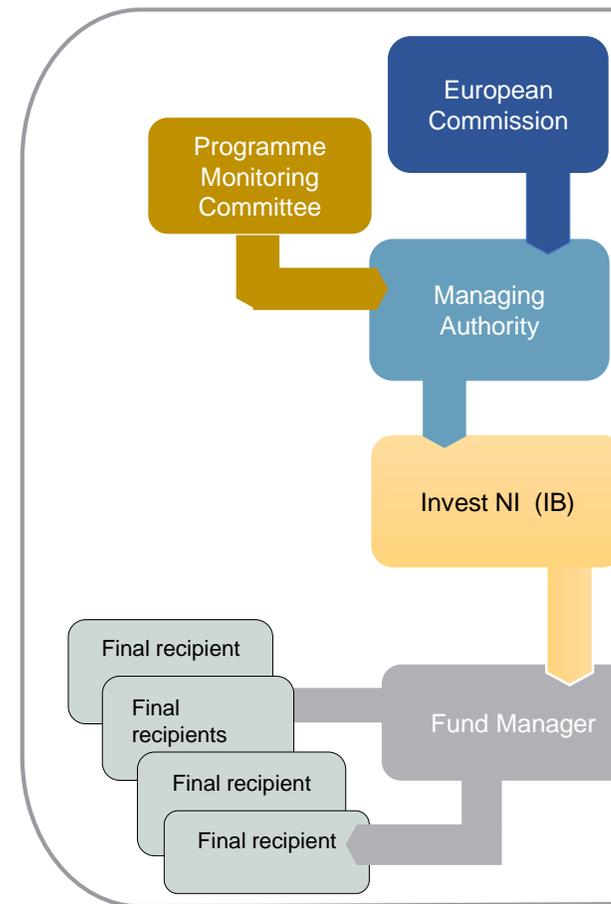
Implementation



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



Implementation



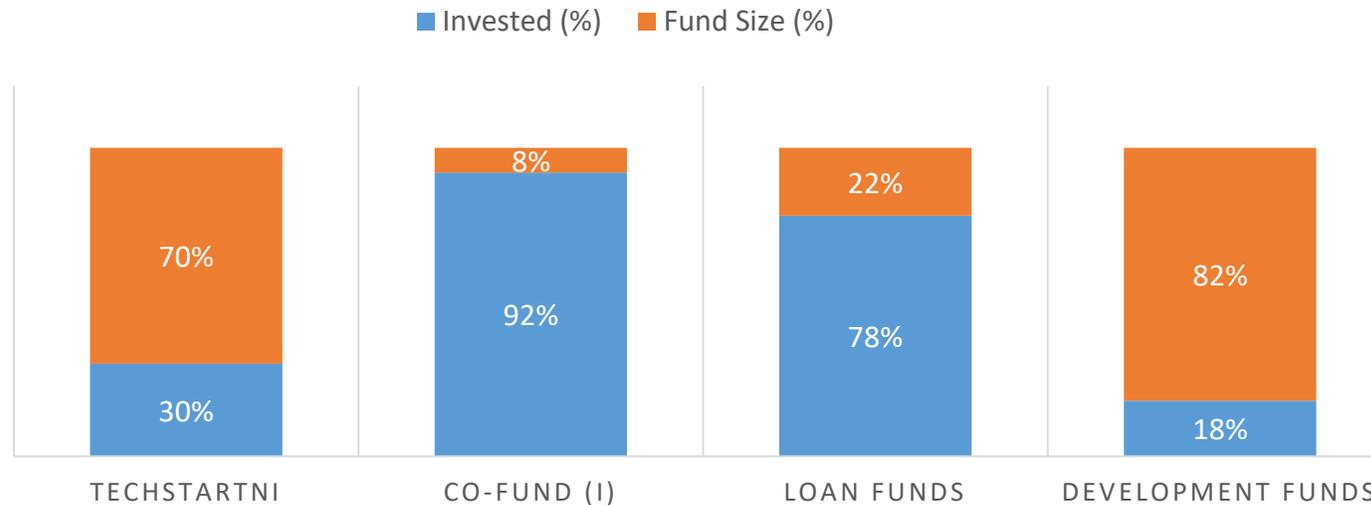
Returns and Exits

- 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