Interim evaluation of Invest NI's Access to Finance model: Fund of Funds

Final Report to Invest NI

September 2019

SQW

Contents

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Executive Summary

1. In April 2019, **Invest Northern Ireland (Invest NI) appointed SQW to undertake the second interim evaluation of its Access to Finance, Fund of Funds (FoF) model, covering the period from January 2014 to June 2018**. The study involved a literature review of the strategic context and evidence relating to the Access to Finance model and the funds that operate within it, and consultations with key stakeholders including those involved in the delivery of the FoF and those operating in the wider access to finance landscape. The primary objective of the evaluation was to review the current effectiveness of the model, taking into account ten recommendations set out in the NIAO report, Access to Finance for small and medium sized enterprises (SMEs) in Northern Ireland, September 2017, and to recommend changes and improvements for the future.

2. **The FoF is a holding vehicle which delivers a continuum of risk capital funding, from start-up finance to development capital.** Currently, the model includes six live funds that offer a mix of debt, equity and mezzanine finance to SMEs, which are growing or exporting (or have the potential to) in Northern Ireland. The model was designed to deliver against the following strategic objectives:

   - Provision of a continuum of risk capital funds, including venture capital and debt finance
   - Provision of a deal flow chain ranging from seed / early stage funding to development funds
   - Retention and development of skills and capability of risk capital fund managers in Northern Ireland.

3. The total funding available under the FoF model, including private match funding is currently £252.2m (across six funds). The FoF model draws on four main funding streams: European funding (ERDF), Financial Transaction Capital (FTC) from UK Government, Invest NI baseline funding and private investment.

Strategic context and rationale

4. The access to finance landscape in Northern Ireland has evolved considerably since the FoF model was implemented in 2010. The consultations provide evidence of growth in volumes in the business finance market, and for increased activity and capacity across the access to finance eco-system. **The challenges which persist in the access to finance landscape in Northern Ireland include low levels of bank lending and a low number of equity deals, relative to other UK regions.**

5. **The demand for business finance among SMEs in Northern Ireland has shown recent positive signs of growth**. The full deployment of the funds provided evidence of this, and several Fund Managers stated that they had not experienced difficulties in finding companies in which to invest. The growth in demand was explained by consultees to be a result of SMEs' increased knowledge and understanding of the finance options available to them; the marketing activities of the funds and improved communication and referral routes between

finance operators; SMEs increasingly seeking alternative types of finance to traditional methods and willingness to use a 'cocktail' of funding; better understanding of the potential benefits of equity finance; increased SME investor readiness and improved quality of investments. While progress is evident in the increased demand for business finance, stakeholder consultees noted that **further intervention is required to develop the eco-system and achieve the level of demand experienced in other parts of the UK**, such as Scotland.

6. There has been a marked improvement in recent years in the supply of early stage and growth finance in NI. This is attributed mainly to the suite of public sector interventions provided under the FoF model, but there is also evidence of market widening, with more private sector involvement. The level of private sector risk investment in Northern Ireland businesses has increased since the FoF model was put in place, as shown by the activity of private investors, and their involvement at deal level. Bank lending on the other hand has decreased in Northern Ireland since 2014, both the number of applications and the number of applications approved fell by just over a third (34%) between 2014 and 2018, while the value approved fell by 2%. While, therefore, the volume of approved applications has decreased, the average value of approved loans is increasing.

Estimating the funding gap in Northern Ireland

7. The objectives for this study include an updated estimate for the SME funding gap in Northern Ireland, as well as a proposed methodology for calculating this going forward. The estimated gap was calculated using available secondary data, underpinned by a series of assumptions informed by wider finance evidence. The **principal steps in quantifying the approximate scale of the finance gap include**:

- developing an estimate for the number of companies that considered and/or sought external finance in the last year
- quantifying the amounts of equity/loan sought, and how much was obtained – calculate the difference between what was sought and what was obtained (viable demand for finance)
- in addition to (full and partial) unmet demand where equity/loan finance was sought, taking into account data on number of companies requiring but not applying for finance, and the amounts sought (unmet demand for equity/loan finance)
- drawing the evidence together, estimating the finance gap for finance based on the business survey data of unmet demand – using survey data to estimate effective/viable demand, including those discouraged from seeking finance.

8. Using this methodology, the current **annual funding gap was estimated as between £74.3m and £89.1m**. This includes:

- **£39.1m for equity** (£391k* 100 businesses)
- **£50m for debt** (£166k* 300 businesses)

9. Invest NI, through the access to finance funds, is enabling funding on a scale equivalent to around 50%-75% of the current equity gap, however, this is much less in terms of loans (approximately 25%-50%). We consider that this seems reasonable, as the latter are heterogenous (covering some types of funding which Invest NI will not seek to offer).

10. These estimates should be treated as indicative only, as they are based on multiple secondary data sources, and the detailed data available at a Northern Ireland level is limited in scope and potential use by small sample sizes. It is recommended that DfE work with BEIS to establish regional data from the UK Longitudinal Small Business Survey to provide a more robust and accurate estimate of the funding gap.

Design, operation and delivery

11. **The FoF model is delivering well against its three objectives**.

- Objective 1: Provision of a continuum of risk capital funds, including venture capital and debt finance.
  - Evident in the operation and structure of the model. The FoF mechanism has allowed Invest NI to establish a continuum of risk capital funds to address market failure, from seed/early stage funding to development funds. This includes a range of debt, equity and mezzanine finance.
- Objective 2: Provision of a deal flow chain ranging from seed / early stage funding to development funds.
  - Evidence gathered from the consultations and the literature review showed that a deal flow chain ranging from seed/early stage funding to development funds exists, but that progression is not a linear process. Businesses rarely go through all three funding stages; this was not considered to be a negative outcome, as the availability of choice of funding is of prime importance in meeting this objective.
- Objective 3: Retention and development of skills and capability of risk capital fund managers based in Northern Ireland.
  - The broad view from consultees was that risk capital fund managers with relevant skills and capability were now being developed and more relevantly retained in Northern Ireland, and that retention had increased as a result of the on-going development of the funding eco-system, and the FoF model. Some stakeholders perceived there to be limited progress, as they saw the same limited number of key actors, and the same funding partners. However, evidence from Invest NI showed that new individuals were entering the market and being trained, through the access to finance funds.

Performance and wider impact

12. Since the FoF model was established in 2011, a total of £251.5 million has been invested across 14 funds. Invest NI's investment totals £93.4 million, just over a third of the total investment (37%). The private sector investment leveraged at the fund level totals £39.2

million. The total amount of investment leveraged at deal level represents nearly half of the total funding invested (47%), and totals £118.9 million.

13. Data drawn from evaluations and economic appraisals of sub-funds indicate that, **since its implementation, the total impact generated by the fund include 1,101.5 net additional jobs created and £379.9 million generated in net additional sales. The net additional GVA achieved to date is £76.7 million.** When compared with expected outcomes, outcomes achieved to date for sales, jobs and GVA are significantly lower. However, the funds are still within the expected timeframe for delivery of outcomes, and the available figures come from an evaluation undertaken within the expected timeframe.

Overall assessment

14. **The FoF structure was found to provide a robust mechanism to deliver and manage a suite of access to finance funds in Northern Ireland, at a relatively low cost**. It has enabled Invest NI to maintain strategic oversight of the access to finance funds, to facilitate market growth, and to report systematically and coherently against a detailed set of measures. It provides a useful forum for the exchange of information on the activities across the suite of funds both for Invest NI and for the NI Department for Economy (DfE), the sponsor Government Department.

15. **The Invest NI FoF model has delivered outcomes for businesses in Northern Ireland and for the local access to finance eco-system**. However, it is difficult to quantify the extent to which outcomes have been realised as a result of the holding fund structure, and to determine the counterfactual, what might have been achieved through the delivery of individual funds with no formal coordination. Without the FoF model, the funds would have still produced notable economic outcomes, and Invest NI would have maintained an overview of the funds' role within a changing access to finance landscape.

16. However, the evidence from consultees is clear that the **FoF model and mechanism has helped to give confidence to both public and private investors**, and some believed that FoF had enabled more funding than would have been possible otherwise. In addition, the management and governance structures implemented as a result of the FoF model have meant that the implementation of new funds, and approval for funding extensions have been expedited. Thus, **while many of the benefits would have been realised without the FoF model, it has enabled processes to happen more smoothly, quicker, and probably on a slightly bigger scale**. Wider strategic outcomes, such as increased partnership working and increased awareness of the funds in the market could have been realised without the FoF structure, but this would have been delivered with more difficulty, and over a longer period (consultees suggested this would have taken 5-10 years longer).

17. **As the UK prepares for its departure from the EU, the political and economic conditions moving forward are uncertain, and European funding cannot be assumed after 2023**. To address this, Invest NI should continue to work towards co-investment arrangements and increase the proportion of private sector funding in the model. There is also potential for Invest NI to use a greater proportion of FTC funding in the model, however the availability of FTC funding beyond March 2021 is uncertain at this stage. **If European funding is withdrawn in the future, replacement funding will need to be sourced elsewhere for the model to continue to operate at the same scale** (for example, from DfE or the UK

government/BBB); alternatively, the scale of the access to finance provision delivered by Invest NI could be reduced significantly. While the proportion of legacy funds available for recycling is forecast to increase, this is not currently expected to be at a sufficient level to replace European funding.

Recommendations

18. **The findings highlight that the FoF model is operating effectively, and only relatively minor operational changes are recommended to improve join up and collaboration across the eco-system and to increase the profile of the model.** This will deliver improved strategic understanding among stakeholders, particularly as the use of the flexible features in the model are increased, such as the recycling of returned funds and the reallocation of funding between funds.

19. **The evaluation identifies thirteen recommendations for Invest NI and other stakeholders** which are set out below; nine directly relating to the FoF model, four to the wider growth business support and risk finance eco-system:

- While there are practical difficulties in implementing a reserve fund under the FoF's current operating conditions, it remains a valid consideration. **Invest NI should review the practicalities of implementing a reserve fund in the future, as the FoF model evolves/matures.**

- **Invest NI should develop a communication strategy for the Access to Finance funds to raise greater awareness of the continuum of funds** among SMEs, professional advisers, and, in some cases, other Fund Managers. This should include a two-staged approach: greater education regarding equity finance for SMEs, and promotion of the Access to Finance funds.

- Invest NI should implement a risk strategy for the FoF model, to be reviewed and updated on annual basis. The Access to Finance Working Group should have responsibility for managing this.

- **Invest NI should continue to explore co-investment** in the economic appraisal of the individual funds, **with a view to increasing private investment in the model** and attracting skills and expertise to NI.

- **Invest NI should identify opportunities to align the delivery timeframe for the debt and equity funds**, respectively; with a view to facilitating a robust economic assessment of the rationale and demand for the suite of Invest NI funds and assessing the performance of the FoF model. **Moving forward, consideration might be given to implementing a top-down approach at the end of the current funding period** (2023).

- **Invest NI should develop a long-term strategy for the FoF model** which includes the aims and objectives in line with the long-term vision for A2F. This should be developed with the Access to Finance Working Group, and **the strategy should then be owned and reviewed by the Working Group**.

- **Invest NI should agree and implement a performance framework for the FoF model, over a ten-year period**, based on the targets developed by SQW. This should be reviewed annually to assess the impact of the model at a strategic level.
- Following recommendation 7, Invest NI should look to develop targets that provide an indication of market conditions, and the overall quality of outputs, to better assess the overall contribution of the FoF model to the Northern Ireland economy. For example, the extent to which job or GVA outcomes are realised in the sectors key to the Draft Industrial Strategy; the extent to which knowledge and skills are being developed and retained in the access to finance landscape in Northern Ireland.
- **Invest NI should systematically record the number of firms that receive follow up investments from alterative access to finance funds, on an annual basis**.
- Building on existing initiatives, Invest NI should work with regional partners in Northern Ireland to develop educational activities, tailored to the local business population, to support SMEs to understand the range of access to finance options available.
- Invest NI should work with Fund Managers to increase the promotion of examples of successful SMEs that have utilised access to finance funds to achieve growth, particularly examples of small deal sizes.
- **DfE should seek to establish more robust, local data on SME demand for finance in Northern Ireland.** This includes working with BEIS, in the first instance, to explore the viability of regional data from the Longitudinal Small Business Survey, or commission a biennial survey of SMEs in Northern Ireland.
- In light of new Fund-of-Funds delivery arrangements in the UK (e.g. NPIF) and the anticipated changes to EIB funding, **Invest NI should review the FoF delivery model every three-to-four years**, in order to benchmark against best practice, and identify areas for further development.

1. Introduction

1.1 In April 2019, Invest Northern Ireland (Invest NI) commissioned SQW Ltd (SQW) to undertake the second interim evaluation[1] of its Access to Finance, Fund of Funds (FoF) model, covering the period from January 2014 to June 2018. Developed as part of its Access to Finance Strategy, the FoF offers a continuum of risk capital investment funds, encompassing a mix of debt, equity and mezzanine investment.

1.2 This report presents the findings from the evaluation, which was undertaken between May and July 2019.

Access to Finance in Northern Ireland

Background and context

1.3 The Fund of Funds model was designed against a particularly challenging market context for both bank lending and equity investment, caused by the global economic crisis in 2009, and the consequent shift in investor attitudes to risk. At this time, commercial lending to Small and Medium-sized Enterprises (SMEs) across the UK contracted considerably, including in Northern Ireland.

1.4 In response, and with the aim of addressing the historically weak venture capital market in Northern Ireland, Invest NI developed and obtained Ministerial approval for an Access to Finance Strategy (2010). The strategy was to ensure the delivery of a suite of business finance support, spanning debt and equity, on a sufficient scale to meet anticipated demand from start-ups and early stage SMEs with growth potential.

1.5 European Investment Fund (EIF)[2] research undertaken at that time identified significant market failure for SME business finance in Northern Ireland and estimated a total required intervention of £75m for equity, debt finance and loan guarantees, over three to five years. The report advocated the establishment of a JEREMIE[3] holding fund, underpinned by an EIB loan matched against ERDF and Invest NI funding. This would provide an overarching structure for the existing funds, delivered under the Access to Finance Strategy. The market gap to be addressed by the proposed JEREMIE holding fund was estimated to be in the region of £75m per annum.

1.6 The JEREMIE model was explored by Invest NI, but EIB investment was not pursued for a variety of reasons, including the limited scale of the finance on offer and concerns around set-up/management costs. However, building on the key features of the JEREMIE model, Invest NI developed an alternative Fund of Funds model, financed by Invest NI, ERDF, and private

[1] Invest NI intend to review the Fund of Funds model every three to four years. A final evaluation will only be possible on completion of the intervention.
[2] European Investment Fund, 2008, *JEREMIE - Interim Report for Northern Ireland - SME Financing Gap Assessment*
[3] Joint European Resources for Micro to Medium Enterprises (JEREMIE) is a joint initiative set up in 2007by the European Commission in co-operation with the European Investment Bank Group and other financial institutions to enhance cohesion across the EU. The JEREMIE instrument (model) was set up to deploy part of the EU Structural Funds allocated to the regional and national Managing Authorities through new risk finance initiatives for SMEs.

investment. Rather than commission an external fund manager, Invest NI decided to deliver this in-house, which was expected to provide a significant cost saving.

1.7 The model, similar in scope to JEREMIE, was approved by the Invest NI Board in May 2010, and was subsequently given DETI/Ministerial approval in December 2010. At that time, two funds were operational, although two proposals for funds were at an advanced stage of development, and another was at an early stage.

The Fund of Funds model

1.8 Since its implementation in 2011, the breadth and complexity of the FoF model has evolved significantly as some funds have been fully allocated and closed (notably NISPO), the delivery of other funds has been extended, and new funds have been established and begun to operate. The full list of funds, including those currently live and those now closed, is in Table 1-1.

Table 1-1: List of the FoF live funds and completed funds (June 2019)

Completed funds (realisation phase)	Live funds
Small Business Loan Fund	Small Business Loan Fund II
Growth Loan Fund	Growth Loan Fund II
NISPO (x3)	techstart NI (x3)
Co-Fund	Co-Fund II
	Development Fund (x2)
	Growth Finance Fund

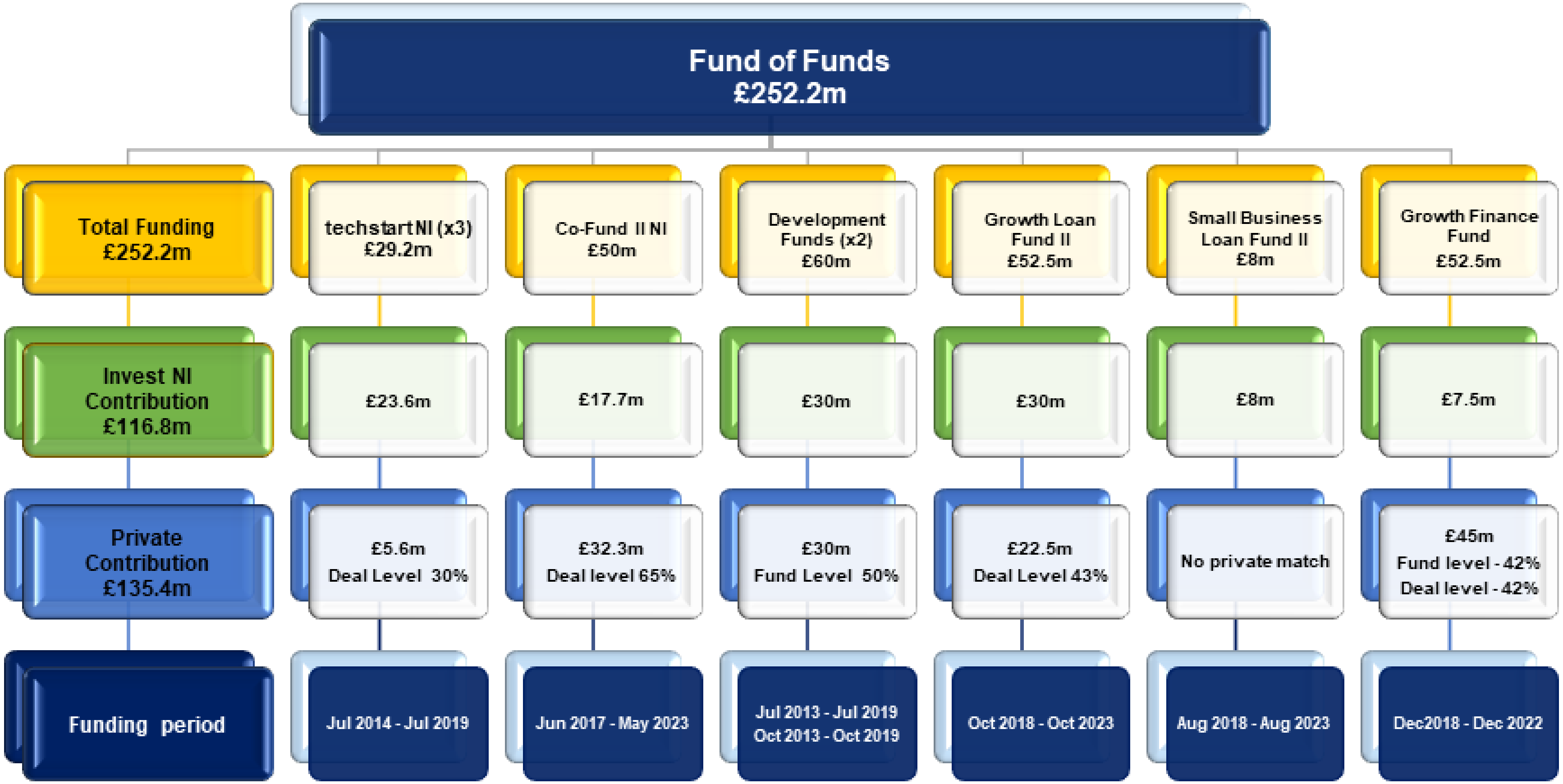
Source: Invest NI

1.9 The scale has also increased substantially since 2011; the overall amount of Invest NI funding in the FoF model has more than doubled, from a planned amount of £50.6 million in 2010 (as set out in the casework submission for the FoF model), to £116.8[4] million in 2019. The total funding available under the FoF model, including private match funding, is currently £252.2m across six funds, as set out in Figure 1-1 below.

1.10 The delivery periods for the funds differ, as set out in Figure 1-1 below. However, in general, equity funds tend to invest in new companies for five years and provide follow-on investment over the subsequent five years. The debt funds lend over five years and collect over the following five years.

[4] This figure only includes live and completed funds.

Figure 1-1: The current structure for Invest NI's Access to Finance model



Source: Invest NI

1.11 The FoF model draws on four main funding streams: European funding (ERDF), Financial Transaction Capital (FTC) from UK Government, Invest NI baseline funding and private investment.

1.12 Invest NI appointed fund managers to oversee each fund through a competitive tendering process. Fund Managers are responsible for the delivery of the funds, including leveraging private finance, approving investments, loans and grants, providing post-investment support, and deciding when to exit.

FoF Objectives

1.13 The FoF model aimed to address market failure in the provision of access to finance across the various stages of business development, providing a continuum of risk capital funding from start-up finance to development capital of up to £3 million in any one firm, over multiple investment rounds. In line with Invest NI's strategic objectives, funding is restricted to businesses which are growing or exporting, or which have this potential. The FoF was designed to deliver against the following strategic objectives:

- Provision of a continuum of risk capital funds, including venture capital and debt finance
- Provision of a deal flow chain ranging from seed / early stage funding to development funds
- Retention and development of skills and capability of risk capital fund managers in Northern Ireland.

Key features

1.14 A holding fund structure, such as the Invest NI FoF, has key features which distinguish it from a suite of individual funds with no shared oversight and exchange. The scale, flexibility and potential for recycling in the Invest NI FoF are broadly similar to the features which could have been offered under a JEREMIE model: the important differences are that the FoF does not utilise EIB finance, and that the holding fund mechanism is retained in-house.

- Scale of intervention
  - ➢ The scale of intervention is £252.2m, from 2013 to 2018, which includes the public-sector commitment and the anticipated private sector leverage. This is broadly comparable with the scale of the JEREMIE funds in the North East of England and in Wales.
- Structure
  - ➢ A Fund of Funds Working Group of the Invest NI Board was established in 2011. Invest NI is the Fund of Funds holding vehicle and the Working Group has responsibility for oversight and reporting to the main Invest NI Board. Fund Advisory Committees have been established for each individual fund.
- Recycling

  - Financial returns of up to £10m per annum can be recycled in the model. However, ERDF funding must all be recycled on condition it is applied to SMEs.

- Flexibility

  - In the event of a change in economic demand or poor fund management, monies can be transferred between funds (subject to need and approval).

1.15 Unlike other fund-of-funds models, such as the Northern Powerhouse Investment Fund (NPIF) in England, the Invest NI model is a bottom up approach, in which the individual funds are developed and delivered independently, based on their separate economic appraisals/business cases, and reviews. NPIF is a 'top-down' structure, in which, the total fund size was identified first, with funding distributed among sub-funds according to assessment of demand. One consequence for the FoF in Northern Ireland is that there is no end date to the model, as different timespans have been set for the delivery of the funds, and some of these may be refinanced for continued operation at the end of their initial delivery period. As new funds may also be added, the form and content of the model is continuously evolving.

Evaluation objectives, approach and method

Study objectives

1.16 The primary objective of this second interim evaluation is to review the current effectiveness of the FoF model in ensuring Access to Finance in Northern Ireland, taking into account the ten recommendations in the NIAO report (Access to Finance for small and medium sized enterprises (SMEs) in Northern Ireland, September 2017) and to recommend changes and improvements where appropriate. As no additional direct expenditure is incurred by Invest NI, a Green Book evaluation was deemed not to be required[5].

1.17 The 11 specific objectives for the evaluation, grouped under four headings, are reproduced in Annex A. In summary, they are:

- ***Strategic context and rationale***, including i) testing the on-going validity of the model, ii) assessing from the available evidence the scale of the current SME funding gap, and iii) recommending how a formal on-going means of assessing this could be put in place for the future

- ***The appropriateness and effectiveness of the design, operation and delivery of Fund of Funds against its objectives***, including governance and management, complementarity with other products, response to risks encountered to date, anticipated lifespan and potential to move towards a more holistic approach

- ***Performance and impact, including value for money*** – fit with NI Programme for Government objectives, impact on total equity and debt investment in SMEs, wider economic benefits associated with this approach, contribution to management of economy, efficiency and effectiveness within individual funds. Also,

[5] As per the Terms of Reference

recommendations on performance management and target setting, including private sector leverage and subordination and Invest NI role and aims for long term development of risk capital in Northern Ireland

- ***Overall assessment and lessons learned,*** with SMART recommendations and consideration as to how a robust model can be sustained and evolved, taking into account the future loss of EU funding.

Approach and method

1.18 The evaluation is both process and impact focused: we sought to identify i) the continued appropriateness of the model and how effectively it has been delivered, and ii) any emerging outcomes from the model, and to what extent the FoF has added value (over and above what would have been delivered by the funds individually).

1.19 The focus is on the FoF holding fund model, the performance of the individual funds that sit under the model was not assessed. However, where relevant, the appraisals and evaluations of these funds are drawn on to inform the evaluation.

1.20 A logic model for the FoF was developed early in the evaluation, based on the document review and initial discussions. This was then agreed with Invest NI, and is depicted below, as Figure 1-2. The logic model sets out the objectives and the rationale for the FoF overarching structure, and details how the inputs and activities are expected to lead to the anticipated outputs and outcomes. It articulates the form of the model that was tested during the evaluation.

1.21 The timeframe to impact is inevitably prolonged for interventions of this nature; the second intermediary evaluation sought to identify relevant enabling factors and barriers to achieving the anticipated outcomes and impact, which then informed the recommendations on future delivery.

Figure 1-2: Invest NI Fund of Funds logic model

Invest NI Access to Finance: Fund of Funds Logic Model

Strategic context and rationale

- Northern Ireland aims to be the best region to start and grow a business (Invest NI's Business Strategy, 2017-21); this will be achieved by encouraging and supporting new businesses with high growth potential to start up and accelerate their growth and by ensuring that businesses can access the finance required to support their growth ambitions. This is of strategic importance to Northern Ireland in supporting its economic growth and competitiveness.
- Due to the global economic crisis in 2008, commercial lending to SMEs in the UK contracted considerably. This led to market failure in both supply and demand (e.g. information failures, perceived high risk and uncertainty, and investment readiness).
- In Northern Ireland, a European Investment Fund report (2008) concluded that the overall scale of market failure for debt and equity at the time was £75 million. Since 2013, evaluations and economic appraisals of the individual funds suggest that while there are signs that market failure is reducing, due to increasing demand, there is continued market failure for both debt and equity funding at each stage of the business lifecycle in NI. This was mainly a result of both the prolonged economic recession which had changed the risk attitude of both investors and lenders, and a reduction in the level of grant funding available. To date, there has been no formal measurement or estimate of the current or potential future funding gaps in NI.
- The market failures (barriers and gaps) identified in NI mean that a continuum of risk capital funds does not exist without market intervention, and thus a deal flow chain from seed/early stage funding to development funds is not available to SMEs.
- Delivering a Fund of Funds model in-house and commissioning local fund managers means that the skills and capability of risk fund managers are developed and retained in Northern Ireland.

Intended impacts

Increased private sector provision: the funding requirements of SMEs are increasingly met by the market

Reduction in the funding gap for SMEs in Northern Ireland

Reduction in public funding in access to finance

To stimulate future growth and finance needs of potential growth companies and sectors

Access to Finance market in Northern Ireland matures, and is similar to that of comparator regions in the UK (e.g. Scotland)

Increased growth of SMEs in Northern Ireland

Increased economic growth in Northern Ireland

Programme objectives

The Fund of Funds (FOF) is anticipated to deliver against the following strategic objectives:

- Provision of a continuum of risk capital funds, including venture capital and debt finance;
- Provision of a deal flow chain ranging from seed / early stage funding to development funds; and
- Retention and development of skills and capability of risk capital fund managers based in Northern Ireland.

Inputs

- £252.2m funding to SMEs: private investment (£135.4m), ERDF, FTC, Invest NI (£116.8m) (2013 to 2023)
- Time and resources invested by INI
- Fund of Funds Committee (Working Group)
- Time and capital invested by Fund managers
- Time invested by private sector investors

Activities

- Design and development of the FOF model and structure
- Marketing and awareness raising of the FOF among SMEs, intermediaries and investors
- Procurement of fund managers
- Delivery of the FOF model (e.g. screening of investments and propositions by fund managers, engagement of investors, cross referrals between funds, recycling of returned funds)
- Management and governance of the FOF, including performance monitoring
- Strategic review/evaluation of the FOF model

Outputs

- A FOF holding vehicle structure established
- Sub-funds and fund managers commissioned
- Marketing and awareness raising material produced and disseminated through different channels (e.g. financial intermediaries, events, online)
- Private investment matching public support to enterprises (non-grants) (£)
- Number and value of loans/ equity investments (£)
- Number of enterprises that apply for support / number of enterprises that receive support
- Value of financial returns recycled in the model (£)
- Value of funding reallocated across the funds (£)
- Number of referrals between sub-funds
- Performance framework developed

Intended outcomes

Improved provision of risk capital finance for viable SMEs at every stage of the business lifecycle for growth

SMEs progress through finance stages, from seed/early stage funding to development funds

Increased networking and knowledge sharing between fund managers, leading to increased skills and capacity and greater retention of fund managers in Northern Ireland

Increased sustainability of the FOF models, through the recycling of financial returns

The access to finance model is better aligned with SME demand and economic conditions in Northern Ireland through the flexible reallocation of funds

Increased cost-effectiveness of the Fund of Funds model, in contrast to other models (e.g. JEREMIE)

Improved management and governance of access to finance in Northern Ireland, including improved performance monitoring and target setting

Source: SQW, based on documents provided by Invest NI

1.22 A mixed method research approach was employed with four key elements as outlined in Figure 1-3 below.

Figure 1-3: The research approach for the FoF interim evaluation

In-depth desk-review of documents (n=27)

- Strategic and contextual information (e.g. Invest NI/DfE strategic and corporate plans)
- Fund of Fund documents (e.g. NI Audit Office Report 2017, interim evaluation of Fund of Funds 2014)
- Evidence on Fund of Fund components (existing appraisals, evaluations of the funds)

Semi-structured interviews with those involved in the Fund of Funds (n=15)

- 1x Government departments (Department for Economy)
- 5x Invest NI ('oversight and management' side)
- 3x Access to Finance Working Group members
- 6x Fund managers (delivery side)

Semi-structured interviews with others in the access to finance landscape (n=10)

- 7x Representatives from UK and local finance agencies (British Business Bank, Catalyst Inc, UK Finance, Scottish Investment Bank, Development Bank of Wales)
- 3x Professional advisors in NI (accountancy firms, solicitors, banks)

Synthesis of evidence

- MaxQDA analysis – analytical framework and findings
- Internal workshop -discussion of headline findings
- Draft and final reports, with recommendations

Source: SQW evaluation approach

Report structure

1.23 The report is structured to follow the themes and objectives set for the study, presenting findings and conclusions under each heading.

- Section 2 outlines the strategic context in NI and presents an assessment of the continued rationale for the model.
- Section 3 outlines the design and delivery of the model and assesses the appropriateness and effectiveness.
- Section 4 sets out the performance of the model, and the strategic impact realised to date.
- Section 5 provides an overall assessment of the model and provides recommendations for the future.

1.24 Supporting information is included in the Annexes.

2. Strategic context and rationale

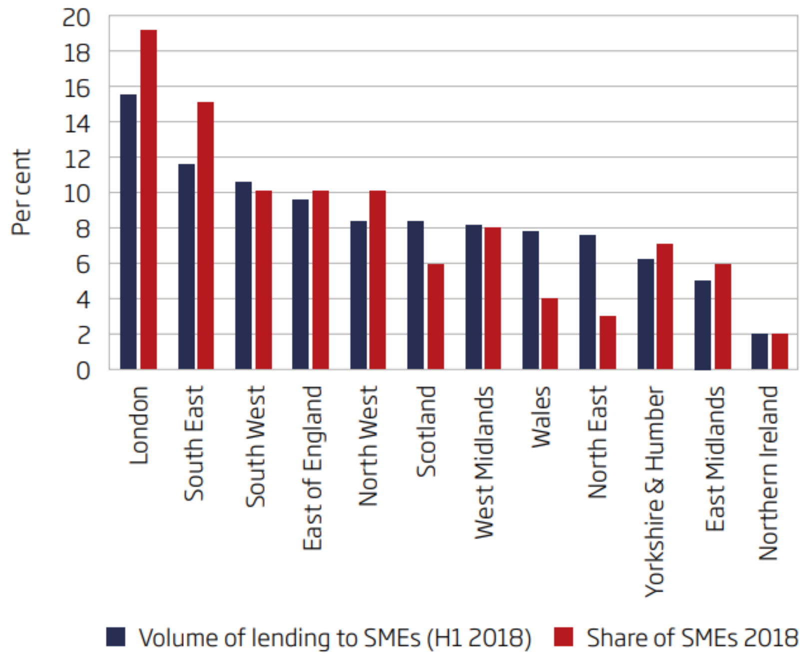
The access to finance landscape in Northern Ireland

2.1 The access to finance landscape in Northern Ireland has evolved considerably since the FoF model was implemented in 2010. The consultations provided evidence of growth in volumes in the business finance market, and for increased activity and capacity across the access to finance eco-system.

2.2 ONS Business Demography data[6] indicates that the birth rate of businesses in Northern Ireland increased from 6.7% in 2010 to 8.6% in 2016, and the business death rate decreased slightly, from 7.7% in 2010 to 7.6% in 2016 (the business death rate across the UK increased in this period)[7]. The latest British Business Bank (BBB) Small Business Finance Report (2019)[8] suggests that in 2017, Northern Ireland had the highest proportion of start-ups reaching scale[9], but had the lowest proportion of start-ups in the UK (2.7%).

2.3 The challenges which persist in the access to finance landscape in Northern Ireland include low levels of bank lending and a low number of equity deals, relative to other UK regions (see Figure 2-1 and Figure 2-2 below). The proportion of equity deals in Northern Ireland, have remained relatively flat since 2016, and lags behind the rest of the UK.

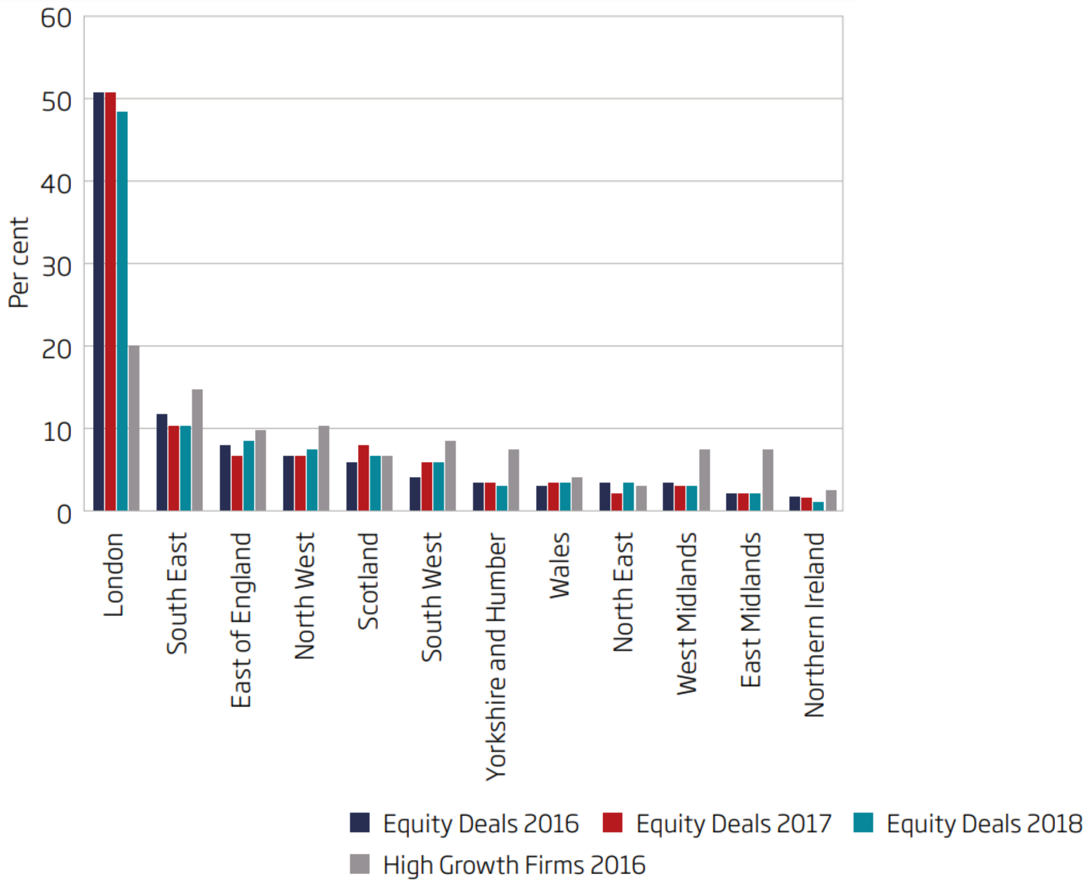
Figure 2-1: Volume of bank lending to SMEs and SME population, by region and devolved nation



Source: British Business Bank, 2019, Small Business Finance Markets 2018/19

[6] UK Business Counts, ONS, Accessed July 2019.
[7] The birth rate is calculated using the number of births as a proportion of the active businesses. Similarly, the death rate is calculated using the number of deaths as a proportion of the active businesses.
[8] British Business Bank, 2019, *Small Business Finance Markets 2018/19*
[9] 'Scale' is defined by the Enterprise Research Centre as start-ups (with revenue of below £0.5m) that have survived, and then grown to over £1 million in revenues after 3 years.

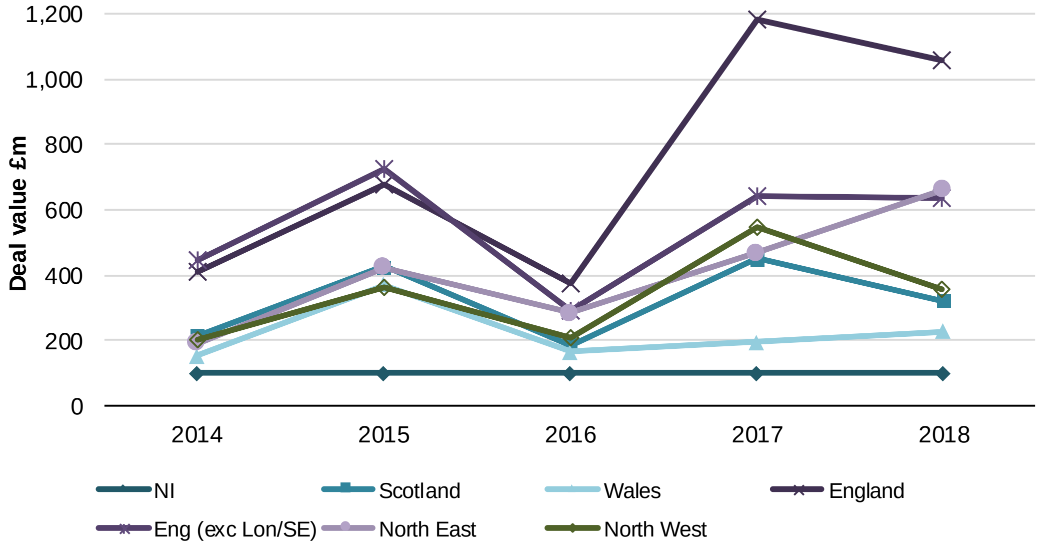
Figure 2-2: Share of equity deals and high growth firms, by region and devolved nation from 2016



Source: British Business Bank, 2019, Small Business Finance Markets 2018/19

2.4 The value of equity deals is also significantly lower than comparator regions, such as Scotland and England (excluding London/South East). Figure 2-3 shows that year on year, since 2014, the value of deals in Northern Ireland is lower than other UK regions. While demand side barriers to accessing finance, such as business reluctance to accept equity and business awareness of financing options, are common across the UK, Northern Ireland's economic geography has increased the difficulties in developing a mature venture capital market. The small population of businesses, relative isolation from larger venture capital markets, notably London, and the small domestic markets for all types of goods and services, are all seen as significant constraints, limiting the attractiveness of Northern Ireland.

Figure 2-3: Value of deals (relatively to Northern Ireland) in selected regions, 2014-2018



Source: Data provided by Invest NI

2.5 Against this backdrop of some potential growth in demand, and barriers to private sector supply, the funds delivered by Invest NI under the FoF model have significantly enhanced the scale of risk capital in Northern Ireland. Prior to 2010, there were three local equity funds with total funding of £39.5 million, there are now six live debt and equity funds in operation, with a combined scale of £252.2 million. While Invest NI's support is considered to have stimulated and strengthened the market, those consulted for this study believed that there was still a need for substantial public intervention. This view was also evident in recent appraisals and evaluations of the access to finance funds in Northern Ireland, all of which concluded that market failure in the local loan and venture capital market was expected to continue for some time.

Wider UK developments

2.6 Since the FoF mechanism began to operate in 2010, there have also been some important policy developments at UK level, and pointers to other changes in the near future.

- At a local and national level, there has been an increased emphasis on raising productivity and addressing sub-national output gaps. Improving SME access to finance is one of several policy interventions that aims to improve the competitiveness of SMEs in the UK, with an increasing focus on a greater use of financial instruments in place of grants.
- With the launch of the UK's Industrial Strategy,[10] announcements were made to improve access to finance for SMEs on both the supply and demand sides. Demand side stimulation included the roll out of a network of BBB representatives throughout the UK linked to comprehensive information sources for businesses to access finance.

[10] HM Government, 2017, Industrial Strategy; Building a Britain fit for the future

On the supply side, recent interventions include British Patient Capital, a wholly-owned commercial subsidiary of the BBB which has been given resources of £2.5bn over the next 10 years to support venture and growth capital funds.

- There has been a new focus on the devolution of responsibility and funding for local economic development, creating opportunities for local governments to have more influence over the distribution of public sector funding, investment strategies, and identifying economic development priorities.

Demand for finance in NI

2.7 The demand for business finance among SMEs in Northern Ireland has shown recent positive signs of growth. The full deployment of the funds was noted as evidence of this, and several Fund Managers stated that they had not experienced difficulties in finding companies to invest in.

2.8 Consultees explained the growth in demand as a result of SMEs' increased knowledge and understanding of the finance options available to them, and greater clarity on how to access finance. Others emphasised the marketing activities of the funds and improved communication and referral routes between finance operators.

2.9 With increased knowledge of business finance options, SMEs are increasingly seeking alternative types of finance to traditional methods. This includes a greater awareness of and willingness to use a 'cocktail' of funding, including the Invest NI funds, bank finance, and private sector investment, at multiple stages of the business lifecycle.

2.10 There is some recognition that attitudes among businesses for equity finance are changing, and while businesses are still reluctant to 'give equity away', there is a better understanding of the potential benefits. This is attributed to success stories - exemplar SMEs, notably tech start-ups, which have received equity investment and have achieved substantial growth. The characteristics of tech companies and the markets they operate in, mean that non-traditional forms of finance often need to be put in place quickly to meet the fast pace of developments.

2.11 SME investor readiness and the quality of investments has also increased to a degree, prompted by the fact that there are more transactions happening in the market and a better understanding of the type of finance available. In addition, other access to finance initiatives are providing support to SMEs to develop the pipeline of SMEs, for example, INI's Propel Pre-accelerator programme and the Ulster Bank Entrepreneur Accelerator.

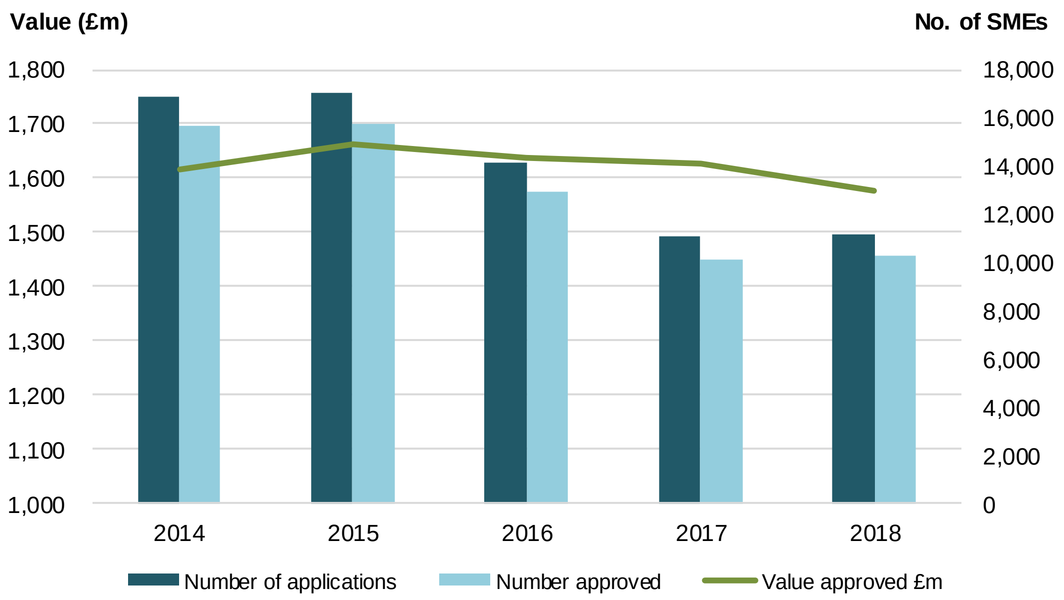
2.12 While progress has been shown in increased demand for business finance, stakeholder consultees noted that further intervention is required to develop the eco-system and achieve the level of demand being achieved in other UK regions, such as Scotland. The extension of the Development Funds, by one year, to achieve full deployment of the fund was highlighted as evidence of insufficient market demand. In addition, the large stock of family owned businesses in NI, hesitant to dilute ownership, was also cited by the majority of consultees as a substantial barrier.

Supply-side finance

2.13 There has been a marked improvement in recent years in the supply of early stage and growth finance in NI. This is attributed mainly to the suite of public sector interventions provided under the FoF model, but there is also evidence of market widening, with more private sector involvement.

2.14 Bank lending has decreased in Northern Ireland since 2014, both the number of applications and the number of applications approved fell by just over a third (34%) between 2014 and 2018, while the value approved fell by 2%. While, therefore, the volume of approved applications has decreased, the average value of approved loans is increasing.

Figure 2-4: SME bank funding applications



Source: SQW analysis of bank lending data provided by Invest NI

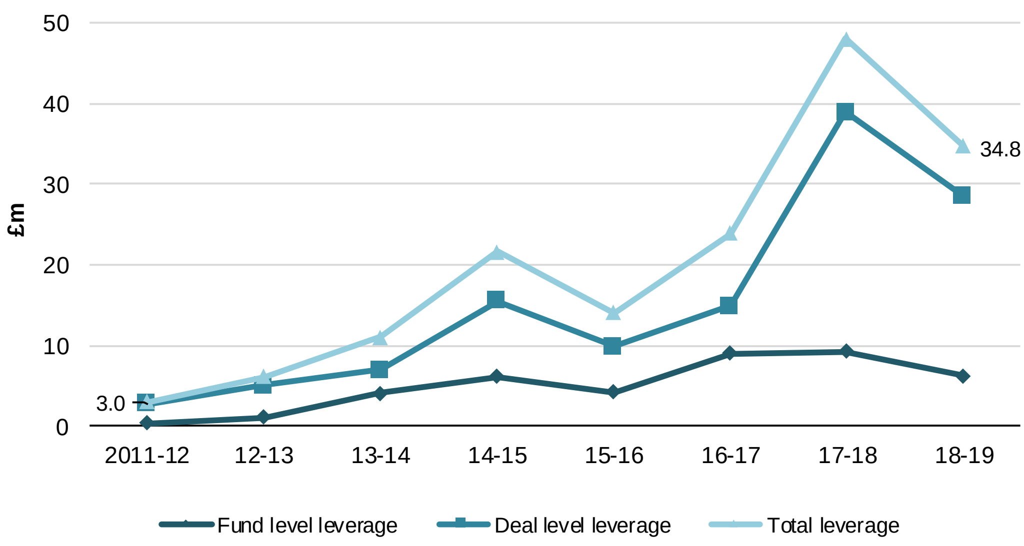
2.15 In contrast to the information presented in Figure 2-4, consultees perceived that bank lending in Northern Ireland has increased, with banks showing increased willingness to lend, particularly to more established SMEs. One of the other market operators noted that when tendering for a business, banks are now in competition with three or four other banks. This positive development was seen as indicative of a maturing eco-system for business finance in Northern Ireland.

2.16 However, banks continue to be selective in terms of the sectors they support and show limited appetite for risk. Bank finance criteria continue to focus on evidencing historical business performance, rather than looking forward at businesses' growth potential; this process favours more established SMEs. Bank lending at the lower end for start-up businesses appears to still be very limited.[11] The bank's propensity to lend to more established SMEs may provide some explanation of the increase in the value of approved loans.

2.17 Feedback from consultees suggests that banks have become more open to working with the access to finance funds, and the relationship between the banks and Fund Managers has improved. Fund Managers highlighted examples of banks entering co-investment funding arrangements with the funds, with the bank offering a limited amount of finance and the remainder secured or, topped-up through the Access to Finance funds. The banks are also increasingly referring SMEs to the Access to Finance funds where they are unable to provide finance. This creates greater awareness of the funding options available to businesses and enables their finance requirements to be met through a mix of different types of funding.

2.18 The level of private sector investment in Northern Ireland businesses has increased since the FoF model was put in place, as shown by the activity of private investors, and their involvement at deal level. Figure 2-5 illustrates private sector investment in the Fund of Funds over time, total private sector leverage in the Funds increased significantly, from £3 million in 2011/12 to just under £35 million in 2018/19. In recent years, the Co-Fund has had a central role in attracting significant private sector investment. In addition, the GLF has helped to leverage significant funding at deal level. There is also some evidence of linkages and networks being made between business angels, corporates and small businesses, but the engagement of business angels in the Northern Ireland eco-system has been limited to date. The findings from the Co-Fund evaluation suggest that there is still a limited number of skilled private investors in Northern Ireland, and the Lead Investor market has not yet developed sufficiently.

Figure 2-5: Private sector investment over time



Source: SQW analysis of Invest NI data

[11] ASM, 2017, *Economic and Financial Appraisal of Potential Successor Fund(s) to the Northern Ireland Small Business Loan Fund*

2.19 The increased prevalence of alternative finance options for SMEs across the UK and Europe, including crowd funding and peer-to-peer (P2P) business lending was also noted by our consultees in Northern Ireland. Crowdfunding has grown quickly in response to the emergence of online platforms, which connect investors with entrepreneurs. In 2016, crowdfunding backed more UK businesses at seed stage than any other source of finance.[12]

The funding gap in Northern Ireland

2.20 Regular and reliable information is required to understand the extent of market failure regarding business finance and to inform appropriate interventions. In recent years, while research has been conducted into SME demand in Northern Ireland[13], there is no formal and structured means of gathering data.

2.21 The objectives for this study included an updated estimate for the SME funding gap, as well as a proposed methodology for calculating this going forward, the need for which was highlighted in the NIAO report. It was agreed with the Steering Group at inception that SQW's updated estimate would draw on existing sources of information, including reviews of constituent funds, stakeholder consultations, and any wider information available from national sources or comparators. These sources would also be used in developing a methodology for regularly updating of the funding gap.

Estimate of the current SME funding gap in Northern Ireland

2.22 The current gap is challenging to calculate in any statistically robust sense, given the limitations of data specific to Northern Ireland. Our estimates are based on the available secondary data[14], underpinned by a series of assumptions which are informed by wider finance evidence, including on financial viability for all SMEs and previous/similar studies we have delivered.

2.23 The principal steps in quantifying the approximate scale of the finance gap are to:

- develop an estimate for the number of companies that considered and/or sought external finance in the last year
- quantify the amounts of equity/loan sought, and how much was obtained – calculate the difference between what was sought and what was obtained (*viable demand* for finance)

[12] British Business Bank, 2019, *Small Business Finance Markets 2018/19*

[13] An Access to Finance survey covering the period 2007 to 2010 was conducted for the Department and the DoF in 2011. InterTrade Ireland carried out several surveys of SME financing needs between 2010 and 2014 and the EAG published a report on access to finance for local businesses in March 2013. In 2014, Analytical Services Unit in the Department conducted a follow-up survey to assess changes since the EAG report was published. The EAG published a further update report in September 2015.

[14] Secondary datasets include: BEIS Small Business Survey 2018, ONS Business Demography Data (2017), and BDRC BVA SME Finance Monitor.

- in addition to (full and partial) unmet demand where equity/loan finance was sought, take into account data on number of companies requiring but not applying for finance[15], and the amounts sought (*unmet demand* for equity/loan finance)
- draw the evidence together, to estimate the finance gap for finance based on the business survey data of unmet demand – using survey data to estimate effective/viable demand, including those discouraged from seeking finance.

2.24 As noted above, the estimates should be treated as indicative only, as they are based on multiple secondary data sources, and the detailed data available at a Northern Ireland level is limited in scope and potential use by small sample sizes. Our approach is based on:

- weighted responses of 1,000 Northern Ireland businesses to the BDRC BVA survey
- UK average data from the BEIS Small Business Survey. The paper does include some Northern Ireland specific figures which are utilised in the calculation, however, this is based on a small, weighted sample
- the average amount of finance sought is based on an average of the deal values across the FoF model
- the equity to debt funding gap ratio is based on a financial assumption, rather than quantified business finance demand for either type of finance. This assumes that a higher proportion of the funding gap will be equity, due to the higher deal sizes.

2.25 The calculations are highly sensitive to changes in certain assumptions – e.g. the proportion of SMEs with a viable business plan. For this reason, sensitivity testing has been undertaken on the proportion of SMEs with a viable business plan, based on 25% and 30%[16] (particularly as the model assumes that the pool of SMEs includes those that are planning to grow and those that are seeking external finance). We believe, however, that the assessments which inform and underpin our assumptions are broadly conservative.

2.26 The estimates and key assumptions are set out in Table 2-1. In summary, the indicative annual funding gap calculated is between £74.3m and £89.1m.

Table 2-1: Indicative estimates for funding gap for debt and equity finance (based on 30% of businesses with viable business plans)

Steps in calculation and assumptions	Number/percentage/ amount (£)
Number of Northern Ireland SMEs	73,000
Unmet demand	
% of NI SMEs planning to grow[17]	57%

[15] Demand from discouraged SMEs is unlikely to present itself to a public lender by the very fact that they are 'discouraged'. However, it is important that the unmet demand from discouraged SMEs remains a consideration in the overall scale of public intervention in order to stimulate demand and address demand side market failure.
[16] This assumption is based on analysis of BEIS Small Business Survey Data which indicates that 61% of SMEs that successfully secure external finance have a viable business plan. (ERC, 2019, *An Investigation of UK SME Access to Finance, Growth and Productivity, 2015-17*)
[17] Data from BDRC SME Finance Monitor 2018 for Northern Ireland.

Steps in calculation and assumptions	Number/percentage/ amount (£)
No. of NI SMEs planning to grow	41,610
% of NI SMEs seeking external finance	12%[18]
No. of NI SMEs seeking external finance	4,993
% of NI SMEs that could not raise any finance	15%[19]
No. of NI SMEs that could not raise any finance	749
% of these SMEs with viable business plans	30%[20]
No. of these SMEs with viable business plans	225
Average amount sought	£213,437[21]
Unmet demand from those who could not raise finance	£47,958,013
Unmet partial demand	
% of NI SMEs that only received some of the finance	13%[22]
No. of NI SMEs that only received some of the finance	649
% that could not be sourced from elsewhere	70%[23]
No. that could not be sourced from elsewhere	454
% of these SMEs with viable business plans	30%[20]
No. of these SMEs with viable business plans	136
Average amount sought (assumption that they typically receive half)	£106,719[21]
Unmet demand from those who could not raise full amount of finance	£14,513,784
Discouraged SMEs	
% of NI SMEs discouraged to obtain finance	1%[19]
No. of NI SMEs discouraged to obtain finance	730
% of NI SMEs planning to grow	57%[24]
No. of NI SMEs planning to grow	416
% of these with viable business plans	30%[20]
No. of these with viable business plans	125
Average amount sought	£213,437[21]
Unmet demand from those discouraged from seeking finance	£26,643,341
Total finance gap	£89,148,618

[18] Data from the BEIS Small business survey, using a figure for Northern Ireland (includes seeking external finance for investment, working capital and cash flow).
[19] Data from BDRC SME Finance Monitor 2018 for Northern Ireland.
[20] Figure taken from SQW's previous methodology applied to calculating the finance gap in Europe and in London (note, in the European study this referred to businesses that are financially viable)
[21] The average deal value across the FoF model.
[22] Data from the BEIS Small Business Survey, UK average figure
[23] Figure from NIAO report which references research commissioned by BIS (2013) that found 70% of businesses who's finance applications were rejected could not source finance from elsewhere.
[24] Data from BDRC SME Finance Monitor 2018 for Northern Ireland.

2.27 The split of the debt and equity finance gap, based on the total finance gap (£89.1m), has been calculated based on:

- the methodology used above which indicates that there are approximately 400 'effective frustrated businesses' in one year
- historic performance/forecasted performance of the Invest NI access to finance funds which deliver approximately 100 deals per annum (both debt and loan). Approximately half of these deals are equity (mainly due to techstart working at the lower deal sizes in equity)
- SQW's analysis of the funding gap in other areas (for example, London) which suggests that the proportion of firms seeking equity for growth would be no more than 25% (100 firms out of the 400 businesses). Our previous work (for example, the Northern Powerhouse Investment Fund evaluation) also shows that equity deals are likely to be larger on average than loans, the average deals size used here is £391k for equity and £166k for loans.

2.28 Based on these assumptions, by multiplying the average deal size for debt and equity by the estimated number of firms seeking debt and equity finance respectively, it is estimated that the annual funding gap is comprised of:

- **£39.1m for equity** (£391k* 100 businesses)
- **£50m for debt** (£166k* 300 businesses)

2.29 Invest NI, through the access to finance funds, is enabling funding on a scale equivalent to around 50%-75% of the current equity gap, however, this is much less in terms of loans (approximately 25%-50%). We consider that this seems reasonable, as the latter are heterogenous (covering some types of funding which Invest NI will not seek to offer).

2.30 The methodology draws on a number of assumptions, most notably, the amount of funding sought by SMEs. The use of proxy measures and the limited data available at a regional level means that the figures presented here should be treated as an indicative calculation, which it is anticipated will be refined through the proposed methodology going forward. Our recommendation for how the data, and subsequently the model, could be strengthened is set out in the section below.

Proposed methodology for calculating the funding gap going forward

2.31 There are multiple approaches outlined in the literature to calculate an SME funding gap, depending on the data available and its quality. The aim is to quantify the viable demand for finance from SMEs, and contrast this with the supply of finance available locally. One approach to calculating this is based on existing statistical data available at a national level. For example, in its assessment of the SME financing gap in 2008, the European Investment Fund set out a three-stage methodology as follows.

- Demographic trends within the SME environment and in each market segment is used to estimate the future potential size of market space and potential demand.

- The range and scale of sources of supply are measured or estimated using the latest available statistical data from industry sources and national data sources as appropriate.
- The trends and shifts in these sources of supply are then reviewed together with the current levels of public (and private) support to identify evidence of market failures, gaps or absences.

2.32 The NIAO report also suggested utilising existing data that is available as a proxy measure of SME demand. In particular, the data from UK Finance (formerly the British Bankers Association) would provide details of the amount of bank funding which was sought but not obtained by SMEs, due to applications being rejected. When combined with other research[25] this information could be used to calculate the percentage of businesses which would not have subsequently obtained finance, as an indicator of unmet demand. This data and data from the BVCA on private equity and venture capital in the UK[26] provide quantified, monetary figures on the supply of finance to SMEs.

2.33 An arguably more precise approach to calculating the SME finance gap locally is to gather primary evidence from SMEs in the region in order to assess the quantity and nature of demand for business finance, the type and amount of finance required, and the extent to which these different demands are unmet. This approach is adopted in both the Republic of Ireland and Scotland; research is undertaken on the SME finance market on a regular basis to inform the rationale for and the delivery of market intervention.

2.34 In the Republic of Ireland, the survey is delivered by Fitzpatrick Associates[27] (economic consultants), commissioned by the Department for Finance (Government of Ireland), and is undertaken twice yearly. The methodology comprises of a telephone survey undertaken with a random sample of approximately 1,500 SMEs. The business data is secured from a comprehensive database of SMEs. Sampling quotas are set, using the data extracted, to ensure the sample is representative of the SME population. The survey seeks to provide the Department for Finance with a clearer understanding of the SME lending environment and asks questions regarding business activities, business performance and current and future business finance activities and perceptions.

2.35 In contrast, in Scotland the Scottish Government utilises regional data from the UK Longitudinal Small Business Survey, delivered by BEIS[28], to undertake analysis of SME business finance[29]. In 2017, this included 739 SMEs. The survey data is stratified by business characteristics and weighted to ensure the results are representative of the wider SME population. The survey aims to collect a range of information on SMEs including business performance and expected performance, capabilities, experience of accessing finance, use of business support, major obstacles that prevent SMEs fulfilling their potential, and business characteristics.

[25] Research commissioned by BIS in 2013 found that 70 per cent of SMEs whose applications to banks are rejected obtain no alternative finance.
[26] BVCA, 2018, *BVCA Report in Investment Activity 2018*
[27] Fitzpatrick Associates, 2018, *SME Credit Demand Survey – April 2018 – September 2018*
[28] BEIS, 2019, *Longitudinal Small Business Survey: SME employers – UK, 2018*
[29] Scottish Government, 2017, *Small Business Survey Scotland 2017*

2.36 It is recommended that, in the first instance, DfE follow the approach used in Scotland. This method is more cost-effective as it builds on an existing survey undertaken by BEIS, thus, requiring less resource, and it is expected to achieve similar results. DfE should seek to access regional data for Northern Ireland from the existing BEIS Longitudinal Small Business Survey. This will provide detailed information annually on the SME lending environment in Northern Ireland and provide the regional data to improve the accuracy of the calculated funding gap in Northern Ireland (such as the amount and the range of funding sought by SMEs). Due to a low sample size, additional interviews were required in Northern Ireland in the 2018 survey, to allow for meaningful analysis on a nation basis[30]. With this in mind, and with consideration of the small number of SMEs in Northern Ireland (in contrast to other UK nations), it is suggested that DfE work with BEIS to develop a larger, more representative SME sample.

Consultees views on the funding gap in Northern Ireland

2.37 Those consulted for this study believed that business needs from seed and early stage venture funding up to £3 million can be, and for the most part are being, met through the initiatives put in place by Invest NI, under the Access to Finance strategy. However, four consultees identified a gap in funding for larger scale projects from £3 million and up to £5 million. There were different views on whether this gap was a supply or demand side issue, as currently very few deals are done at the £5 million level in Northern Ireland (in 2017, there were no deals of this size[31]). But a Working Group member noted that businesses typically apply for the funding that is available or what they consider can be obtained. Therefore, SME growth ambitions can be restricted by the level of funding perceived to be available.

2.38 Our observation is that in most cases the demand will be for up to £3 million, and that this is covered by the access to finance funds in NI. Some of these investments may subsequently seek additional funding, and, the question is then whether there is potential to assess and meet this demand in the current offer, and also for any 'one-off' enquiries for a larger first tranche of investment. In some cases, this demand may not be met, however, due to the large size of investment, we would expect that as and when these deals are delivered, these would take the form of customised deals, bringing private sector partners alongside, and might involve only a relatively small public investment (for example, 25%). On the evidence available to us, we have not found a clear case for market failure at this deal level which would require new public sector intervention.

2.39 Other consultees, such as Invest NI representatives, noted that this level of funding would need to be sought outside the Northern Ireland eco-system. This could benefit both the business, and the wider Northern Ireland eco-system, in terms of raising awareness of the Northern Ireland market to private investors. The new Development Fund, which will be launched imminently, was considered by Invest NI to address this gap, as this includes individual deals of up to £2.5 million and total investment in any one business of £5 million.

2.40 The majority of consultees did not recognise any specific sectoral gaps. Specific conditions in the construction sector were mentioned by a small number of consultees, however this is not a target sector across the FoF.

[30] BEIS, 2019, *Longitudinal Small Business Survey: SME employers – UK, 2018*
[31] Catalyst, Inc, 2018, *NI Deal Tracker Analysing Equity Investment in Northern Ireland 2018*

2.41 Stakeholder consultees agreed that sufficient provision was now in place for the supply of business finance to SMEs in Northern Ireland. The issue was seen more in terms of stimulating demand: moving forward, greater focus and resources should be put in place to educate businesses on the funding options available, and how these might be customised to best meet their needs.

Rationale for Fund of Funds model

Alignment with policy objectives

2.42 The consistent view from all consultees and the review of relevant documentation was that the rationale for the FoF model in Northern Ireland remains valid. The FoF model aligns closely with and delivers on Invest NI's Business Strategy (2017-2021)[32] to support SMEs to access finance and to achieve economic growth. The draft Programme for Government (2016-21)[33] sets out key aims to achieve a strong, competitive regionally balanced economy which include stimulating innovation, R&D and creativity; growing the size of the business base, making it easier to do business and promoting employment; attracting and embedding greater levels of higher quality inward investment and supporting the conditions where a greater number of businesses are competing successfully overseas. Access to finance for SMEs is essential to deliver on these aims: the market in Northern Ireland is not sufficiently mature to deliver the finance required and public sector intervention is therefore required. This is reiterated in the Department for Economy (DfE) Draft Business Plan 2019/20[34] which sets out the DfE aim, through Invest NI, to "*grow the local economy by helping new and existing businesses to compete internationally by attracting new investment to NI*".

Market failure

2.43 Consultees were in broad agreement that public sector intervention is still "*absolutely necessary*" to ensure there is sufficient access to finance provision in Northern Ireland, this view was held by both those involved in delivery and those operating in the wider market. Two consultees (a professional advisor and a market operator) stated that this is particularly the case for funding at the lower level, start-up/seed funding. Most consultees confirmed that market failure continued to be particularly evident at the early seed stage, owing to limited bank lending in this area, and a recognised trend for VC firms to focus on larger and later stage investments.

"There is a need for a continuum of funds, as there are challenges at the bottom end (where techstart and the Co-Fund are doing a great job in creating the high-growth businesses). There are so many investments that would not have happened without the funds".

[Professional advisor]

"There is no evidence that the private sector is yet willing to come forward to the extent necessary to fill funding gaps. The reasons are complex: the size of the private sector within NI remains small, and unsophisticated in its organisation; Halo acts as a network, but is still relatively young

[32] Invest NI, 2017, *Invest NI Business Strategy 2017-2021*
[33] Northern Ireland Executive, 2016, *Draft Programme for Government Framework 2016-21*
[34] DfE, 2019, *Draft Business Plan 2019/20*

and is still working to develop angel groups and syndicates that invest on a consistent basis; and there is a lack of examples of successful exits that might encourage private individuals to become investors within Northern Ireland".

[Access to Finance Working Group member]

2.44 The recent revival in bank lending, at least at a higher level, and a greater interest from private sector investors in later stage investments, led some external consultees to suggest that the rationale for public sector intervention at the Development Fund level (£450k to £3 million) was now less evident. Specifically, it was suggested that the model could have improved functionality with one larger private equity, rather than two disparate funds. This would replicate the structure of the JEREMIE model in Yorkshire and Humber, with one, larger equity sub-fund. Another suggestion included removing the Development Funds and investing the funding at the seed stage to create two competing funds with larger fund sizes "*which take companies up to where existing UK money can kick-in"*.

2.45 The external evaluation of the Development Funds found that, while there was growth in investments at this level, market failure remained. The banking sector has shown increased willingness to provide finance to more established SMEs but is often unable to provide the entire loan value requested by businesses to achieve their growth plans (for example, where the business/project is considered to be higher risk). The Development Funds (and other funds) are playing an important role in providing the 'risk-component' within syndicated lending packages, alongside other funders, including, but not only, venture capital. To date, the Development Funds have had some difficulty in attracting private sector investment without a high level of subordination, which is also attributed to the restricted local market in Northern Ireland and suggests that the private market is not sufficiently mature to deliver equity finance at this level without public intervention.

"There is no evidence that the private sector is willing to come forward to the extent necessary to fill funding gaps, therefore the model is still required. A whole range of support is quite necessary, given the dynamics of NI itself, it is very small which presents its own difficulties. There is a way to go yet before those supporting structures could be lived without".

[Access to Finance Working Group member]

2.46 The bottom-up structure of the model, and the varying timeframes to which the funds are delivering means that, while evidence across the current access to finance landscape exists, this does not aggregate to a completely coherent and up-to-date view of market failure in Northern Ireland. The economic appraisal and the evaluation of each fund is undertaken individually, at key milestones in delivery. Invest NI recognises the benefits of an overview assessment and is working towards a more structured and joined up approach to evaluations and appraisals, in which the equity and debt landscape will be re-assessed as a whole. This will feed directly into the FoF model, providing critical information for its role and operation, and testing the on-going relevance of the overarching structure.

Fund of Funds Structure

2.47 The FoF model is a well-tested and established model among public sector backed venture capital/loan funds in the UK and was seen by the stakeholders consulted for this study as an appropriate overarching structure for access to finance funds in Northern Ireland. The model is a useful vehicle in enabling Invest NI to have, and be seen to have, effective oversight of multiple funds, and a strategic overview across the access to finance landscape. While Invest NI might in any case undertake this overseeing role as part of its remit to monitor the take-up and performance of individual funds', the formal structure of FoF is valued internally, as focusing attention on the strategic role of risk funding for business, and as a mechanism for review and bringing forward actions in this space. It also provides a clear signal of engagement and intent to partners and to other external stakeholders.

2.48 The structure, and relation with component funds, varies across the different FoF models. For example, the Yorkshire and Humber JEREMIE model adopted a simple structure, with three funds: a loan fund, a seedcorn fund and an equity fund. The evaluation of that model[35] suggested that this structure worked well in the region and, for the most part, provided the right mix of finance required by SMEs.

2.49 The North East JEREMIE model was closer to the form adopted in Northern Ireland, with seven funds, reflecting the perceived market need, a desire to strengthen the SME finance market and specifically to encourage greater choice for SMEs and create competition between fund managers. This structure was judged to have proved effective in the North East but had higher operational costs with oversight of a larger number of funds.

2.50 The North West JEREMIE model structure included six funds, three of which were sector-specific, focused on biomedical, digital and creative, and energy and environment. This was primarily driven by the regional economic development strategy, and the priority growth sectors identified as strategically important to future growth. There were some challenges, relating to the mismatch between fund size and the effective demand for investment within each targeted sector. This raises the question of whether the overarching fund was, in practice, able to reallocate funds in response to effective economic demand.

2.51 The Invest NI FoF structure has evolved considerably since the implementation of the FoF model in 2011. Now consisting of seven funds which cover a range of debt, equity and mezzanine finance, the offer provides a choice of finance options for SMEs and a level of competition between fund managers. Consultees saw both as being broadly appropriate to the funding environment in Northern Ireland, and in addressing market failure and strengthening the SME finance market.

2.52 Alongside this broad approval, some questions were raised: first, the concept of a continuum of funding, with some competition on the supply side points to issues around cross-over and possible duplication. A government representative suggested that, it may be useful to assess which funds are most effective in delivering outcomes. However, the structure and multiplicity of funds in the model is generally accepted as a strength of the model, which is recognised as delivering greater choice of finance options for SMEs and strengthening the market.

2.53 One of the market operators noted that the amount of debt funding available to SMEs under the FoF model has recently been increased (up to £2 million); if SMEs show a preference for

[35] Hatch Regeneris, 2019, *Final evaluation of the Northern English JEREMIE Funds – Summary Report* (unpublished)

grants and loans before equity, this may have the unintended impact of "*squeezing out*" the equity funds. It is still too early to assess this possible effect.

3. Fund of Funds - design, operation, delivery

FoF positioning and objectives

3.1 There was unanimous agreement across all consultees that the three FoF objectives, detailed below, remain valid, both for the model and in the context of the access to finance landscape in Northern Ireland. Moreover, the model is delivering well against the objectives, with notable progress made in recent years as the model has evolved and momentum is building.

"The three FoF objectives are still valid and it is meeting objectives. NI has a much more active risk capital eco-system than it would without the Invest NI FoF interventions".

[Other market operator]

Objective 1: Provision of a continuum of risk capital funds, including venture capital and debt finance

3.2 The achievement of the first objective of the FoF model is evident in the operation and structure of the model. The FoF mechanism has allowed Invest NI to establish a continuum of risk capital funds to address market failure, from seed/early stage funding to development funds. This includes a range of debt, equity and mezzanine finance. This is outlined in Figure 3-1 below.

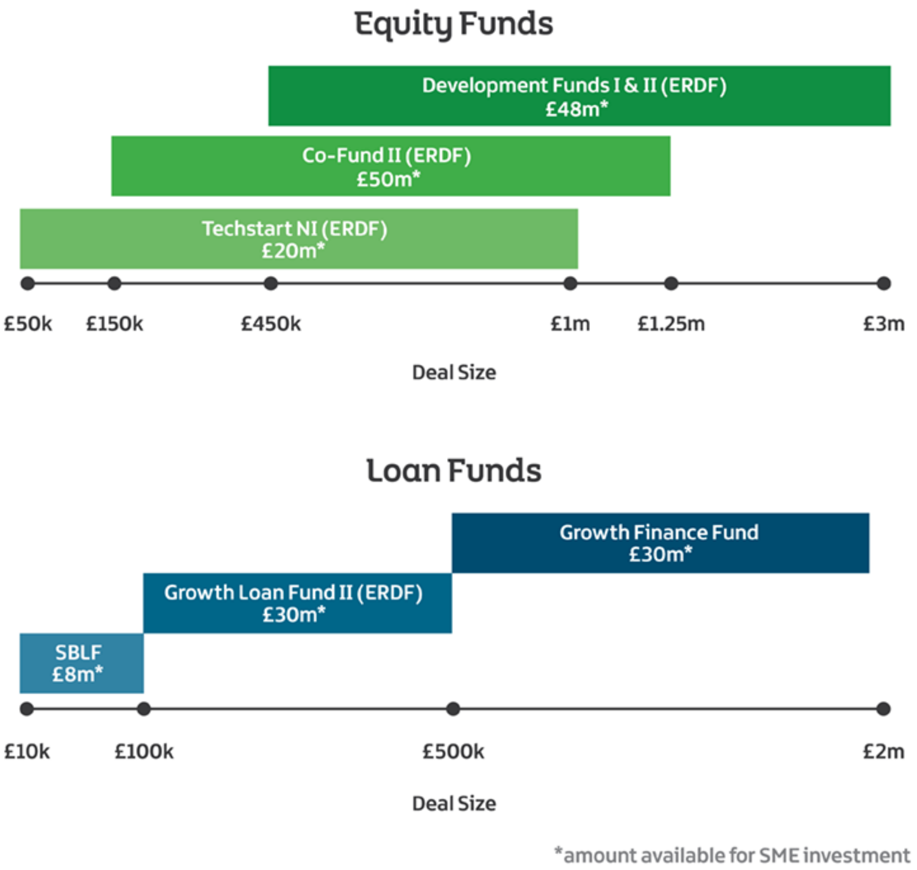
"It has got them covered pretty well, there is an escalator which comes in at one end of it and gets SMEs growing up to the next level and after that".

[Access to Finance Working Group member]

3.3 The first interim evaluation (2014) found that the mechanism provided by the FoF model to manage and govern a suite of access to finance funds helped to build the confidence of DETI, DFP and Ministers. This had subsequently unlocked approval for a larger quantum of funding than is likely to have been the case had the funds been operated and managed in silos. The scale of funding approved in the model has enabled Invest NI to deliver multiple funds, under the FoF umbrella, to address SME funding gaps and provide choice to SMEs seeking finance.

3.4 The FoF continuum supports SME progression through the model and, in doing so, provides access to finance at every stage of the business lifecycle. However, the benefits for businesses and for the Northern Ireland market are not yet fully realised as there is not yet sufficient SME demand to widen supply and demonstrate progression through the model. It is anticipated that as the structure becomes more embedded and the finance market matures, SME awareness, and subsequent demand, will increase, and the benefits of the structure will be better realised. The model and structure are not expected to change significantly in the immediate future, as there is continued market failure in access to finance at all levels; evidenced by the limited number of private sector funds operating in Northern Ireland.

Figure 3-1: The continuum of risk capital funds under the Invest NI FoF model, by equity and loan funds



Source: Invest NI

Objective 2: Provision of a deal flow chain ranging from seed / early stage funding to development funds

3.5 Evidence gathered from the consultations and the literature review showed that a deal flow chain ranging from seed/early stage funding to development funds exists, but that progression is not a linear process. Businesses rarely go through all three funding stages; this was not considered to be a negative outcome, as the availability of choice of funding is of prime importance in meeting this objective.

3.6 However, Fund Managers and Working Group members provided multiple examples of SMEs that have moved between funds or have received co-investment from a number of funds, as evidence that deal flow, and some progression, is happening. For example, Small Business Loan Fund (SBLF) clients have graduated to the Growth Loan Fund (GLF), and GLF companies have gone on to receive investment from the Development Fund. The linkages between the SBLF and the GLF, and Co-Fund and techstart were seen as particularly strong.

"Clarendon have co-invested with all the other Invest NI Fund of Funds e.g. alongside techstart in early stage companies. Clarendon have also received referrals from Kernel and Crescent Fund Managers".

[Fund Manager]

"There are examples of businesses moving between different funds. One received three, a seed fund, Co-Fund and Development Fund".

[Invest NI representative]

3.7 Where SMEs move between the funds, this is, in part, a result of the good partnerships and referral routes in place between Fund Managers. An Invest NI representative suggested that while it has taken time for collaboration to develop, this is now starting to happen, and bring benefit. To date, specific investment partnering between Fund Managers has been opportunistic, drawing on pre-existing, informal networks between individuals, rather than a result of forward planning, or systematic facilitation from Invest NI.

"Crescent (Development Fund) have good relationships with Co-Fund (Clarendon) and techstart with referrals to and from them both. The FoF structure has helped in this".

[Fund Manager]

3.8 While there is evidence of some Fund Managers working well together, feedback indicated that this was not consistent across the FoF structure, and consultees suggested that referrals and deal flow between funds could be improved. For example, the GLF reported receiving 'only' 10% of business referrals through other Fund Managers. Two main challenges were identified:

- Each fund operates independently, and Fund Managers do not necessarily consider, and certainly are not incentivised by, other fund managers performance.
- Fund Managers have limited awareness of the wider, strategic aims of the FoF model, and are unlikely to take into account the wider benefits which referrals can bring.

3.9 While some competition to secure deals between the funds is intentional and seen as positive a small number of consultees identified what they saw as an 'unhealthy' level of competition between some funds. Where Fund Managers specifically avoid collaboration, the deal flow may be restricted.

3.10 Invest NI has not undertaken any detailed analysis of SME progression through the investment pipeline and has stated that this is not seen as a valid performance indicator.[36] However, if information were collected on SMEs taking up successive funding offers with different providers, this, alongside the existing monitoring of the Funds' performance against investment targets, could enhance Invest NI's understanding of the potential value of collaboration and referral, and point to areas where further effort might bring benefit. An Invest NI representative argued that for this to happen, further intervention would be needed.

3.11 SQW tested whether a roundtable event for Fund Managers might widen Fund Managers' understanding of the strategic aims of the Fund of Funds model and help increase deal flow. However, Invest NI advised that this approach had already been tried and did not prove to be effective. While we accept that Invest NI continuing to work with Fund Managers on an individual basis is the right approach, we suggest that the agenda is widened to systematically

[36] Northern Ireland Audit Office, 2017, *Access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland*

record, and present information back to Fund Managers, on the number of companies that receive follow up investments from all access to finance funds.

Objective 3: Retention and development of skills and capability of risk capital fund managers based in Northern Ireland

3.12 The value of commissioning local fund managers was reiterated as a key point of learning in the evaluation of the Northern England JEREMIE evaluations, "…t*he evaluation has demonstrated the delivery and supply side economic benefits of having independent fund managers located in the regions in which they are investing. Future programmes should ensure fund managers establish a permanent presence in the areas where they are investing in order to maximise the supply side benefits of the funds".*

3.13 Those consulted for this study strongly agreed with the value in having people with the necessary skills and expertise locally, particularly in developing the access to finance eco-system in Northern Ireland. They saw the Access to Finance Strategy as a 20- to 30-year infrastructure project, in which developing local skills and expertise would be a key element.

"It is definitely important, we need people here to make deals; good investments with good follow through to exits. It is better to have people on the ground looking for investments here, with confidence in coming into the market. People with experience help to raise future funding as they can show how you've brought the money back for investors".

[Invest NI representative]

3.14 The broad view from consultees was that the skills and capability of risk capital fund managers are currently being retained in Northern Ireland, and that this retention has increased as a result of the on-going development of the funding eco-system, and the FoF model. Many of the Fund Managers have significant financial experience from former banking roles and know the market very well. Moreover, as many of the funds, such as Crescent (Development Fund), have been operating in NI for a long time, they are well known, and well connected.

3.15 As new Fund Managers have started operating in the Northern Ireland market, there is evidence that knowledge is being developed through connecting with and learning from other Fund Managers elsewhere in the UK. For example, the Co-Fund connected with Yorkshire Fund Managers to develop their knowledge and experience. Techstart has taken and implemented learning from its experience in the Pentech delivery of funds in the Scottish market.

3.16 In regard to the development of skills and capability, there is some evidence of this happening internally within funds such as the GLF, and as a result of new funds setting up in Northern Ireland. However, this is a relatively slow process and feedback from two consultees suggested that employment in the access to finance market is fairly static; the evidence for a pipeline of talent coming through is, as yet, limited. The feedback suggests that stakeholders see the same limited number of key actors, as the funding partners are the same. However, evidence from Invest NI shows that new individuals are entering the market and being trained, as, through the access to finance funds, the overall volume of activity has increased. If market demand continues, then increasing local knowledge and expertise on the supply side should stimulate further increase in the scale and type of active funds. In turn, this will help to further widen the career choices in this sector within Northern Ireland.

"There are more funds setting up here and recruiting people locally- that's where you would like to see it going next… We should be doing that within our funds, recruiting locally and developing skills".

[Invest NI representative]

3.17 The FoF model adopted in Northern Ireland brings a further important advantage, and one which is not available through the JEREMIE structure. Implicit learning about the roles and performance of the various funds is captured in-house through direct responsibility for coordination and review: under JEREMIE, this would be through third-party management and reporting. Invest NI as host organisation for the FoF model is better positioned to ensure that operational and market understanding underpins strategic review and informs decision-taking.

Additional objectives

3.18 The FoF objectives are primarily focused on delivery, and as discussed above, these are for the most part being achieved. But while these objectives were appropriate when the model was first implemented in 2011, and perhaps at the initial interim evaluation in 2014, the context and eco-system in Northern Ireland has evolved, and they might now be expanded to incorporate long-term, more ambitious, strategic economic objectives. The objectives of the JEREMIE funds include, for example, 'to deliver a better functioning SME finance market' and 'to deliver local economic growth'.

3.19 Two Invest NI representatives suggested that the strategic objectives should also include a focus on increasing the sustainability of the model, with a view to the model operating more commercially. This would place greater focus on the recycling flexibility offered by the model and generating increased returns through strong exits and good returns. The reliance on external funding would also be reduced.

3.20 There is clearly a balance to be struck here, as addressing market failure is about increasing supply to meet potentially serviceable demand, and value-for-money solutions creating economic benefit that would not otherwise be gained. This could require taking on more risk than a purely private operator might be comfortable with (particularly scale of potential benefit relative to the costs of the transactions) – or better utilisation, more astute interpretation, of information. The balance between this and commercial performance, and any trade-off, should be continually reviewed for changes in conditions, including demonstration effects, and other changes in market conditions and confidence, taking into account the necessity for fund management structures to operate over lengthy timespans.

Contribution to higher level objectives

3.21 The evaluation considers the contribution of the FoF to the strategic objectives of Invest NI's Business Strategy 2017-21, the DETI Corporate Plan 2011-15 (and Invest NI's strategic targets within this), and, ultimately, to the Draft NI Programme for Government objectives.

3.22 Access to finance is a key enabler in the delivery of a number of the strategic objectives, particularly in relation to business growth, increased innovation, increased employment, and attracting investment.

3.23 The first interim evaluation (2014) of the FoF model found that the FoF structure has had a notable impact on the quantum of public sector funds that have been approved for access to finance in Northern Ireland. Arguably, without this structure, it is questionable whether Departmental/Ministerial approval would have been secured for the scale of the public sector risk capital funds that have been achieved. Consequently, the contribution made by the Access to Finance funds, or a smaller scale FoF model, towards the strategic objectives would then have been much diminished.

3.24 Table 3-1 details the specific objectives in the policy documentation that the FoF model has contributed to or is expected to contribute to, and the evidence for this.

Table 3-1: Progress against strategic objectives

Policy	Objectives	Evidence of the risk funds' aggregate economic outcomes and strategic contribution under Access to Finance with the FoF model in place
Invest NI Business Strategy 2017-21	Embed innovation and entrepreneurship to support more businesses with high growth potential to start-up and scale up	990 SMEs supported with high growth potential to start-up and scale up. NISPO and techstart have supported 515 technology-based business.
	Attracting more quality inward investors	Stakeholder consultations indicated that the number of inward investors has increased; this is particularly evident in the Co-Fund.
DETI Corporate Plan 2011-15 (under a high-level objective to 'achieve business growth')	Secure £400 million of investment commitments	£252.2 million of investment commitments in Northern Irish businesses[37]
	Promote 6,500 new jobs in new start-up businesses	1,101.5 new jobs created in SMEs (including start-up businesses)[37]
	Enable 300 SMEs to access the funding required to drive growth through the Access to Finance Strategy	As above, 990 SMEs supported to access the funding required to drive growth[37]
Draft NI Programme for Government	Increase the size of the economy	Evidence of economic outcomes from the funds shows that £76.6 million GVA has been delivered

Source: SQW assessment based on strategic documents

[37] The figures include the total aggregate economic outcomes achieved by the FoF model, across the full delivery period (2011 to 2018). This period is longer than the timeframe in which the DETI Corporate Plan objectives are expected to be achieved. However, it is not possible to disaggregate the data to provide outcomes for this period (2011-15) only.

Design and delivery

Scale of intervention

3.25 The FoF model encompasses £252.2 million of public and private risk capital funds. This has increased fourfold since 2010, when the FoF initiative was established, and is evidence of growing momentum in the market. For example, techstart and Co-Fund required additional funding to meet market demand.

3.26 The quantum of funding available through the Invest NI FoF model is comparable to other UK Fund of Funds models, despite the exclusion of the EIB funding. For example, the Finance Wales JEREMIE Fund oversees £150 million, and the North East Finance JEREMIE Fund £125 million. Two recently implemented Fund of Funds models, the Northern Powerhouse Investment Fund and the Midlands Engine Investment Fund, are at a significantly larger scale, £400 million and £250 million respectively (not including deal level leverage); however, both funds have leveraged significant EIB funding through the pooling of Local Enterprise Partnership (LEP), European and BBB funding and cover larger business population areas.

3.27 We found that the scale of the Invest NI FoF model is appropriate and necessary to meet the model's objectives, particularly in delivering a continuum of risk capital finance. To achieve the level of market growth outlined in the Access to Finance strategy, the model must operate at sufficient scale to address the gaps in the supply of finance, and to also generate increased demand from SMEs.

3.28 The level of public investment in the model must be sufficient to build confidence in the market, and to demonstrate that strong investment opportunities exist in Northern Ireland. This can then generate and attract further private sector interest in the access to finance market.

Recycling of returned funds

3.29 The ability to recycle returned funds is a key feature and potential benefit of the FoF model, as it is in most UK holding fund models, including those with a JEREMIE structure. From Invest NI's perspective, the ability to recycle funds supports strategic aims to increase the sustainability of the model. In doing so, it reduces the reliance on other funding streams, such as ERDF and Financial Transactions Capital (FTC)[38]; the future of both is uncertain beyond March 2021.

3.30 Since 2016, £1.9 million[39] has been recycled back into Fund of Funds. While this is low relative to the scale of intervention (£116.8 million), other market operators as well as Invest NI representatives saw this as inherent in the nature of equity investments, given the inevitable time lags before exit and potential re-use. For example, the BBB start-up loans programme achieved substantial recycling only after seven years.

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[38] Financial Transactions Capital is funding provided by HM Treasury, which is administered in Northern Ireland by the DoF. FTC can only be used as a loan to, or an equity investment in, a private entity. DoF allocates the funding to Northern Ireland departments which are delivering eligible initiatives. Departments are entitled to retain half of any net benefits realised.

[39] Sourced from financial spreadsheet provided by Invest NI.

3.31 The ratio of debt to equity funds was key to the amount of returned funds; while equity returns are typically higher, returns from debt funds are much more predictable. The JEREMIE model requires a 60:40 ratio of debt to equity finance to repay and service the EIB loan; the Invest NI model has the advantage of flexibility in determining the debt-to-equity ratio, based on market demand and the local economic context.

3.32 As the EIB loan is generally treated as senior debt within the JEREMIE model, other investor funds are subordinated, and EIB is repaid first, delaying the receipt of the returned funds and the opportunity for recycling. While the Invest NI model does not receive funding through an EIB loan, it does experience a similar delay in receiving returns from a number of the funds, due to the proportion of Invest NI's investment that is subordinated.

"The recycling element takes time: the small business loan fund, you can start to get money back straight after the investment period was up. It will be 15 years before Crescent II get the money back because of the subordination and the priority returns".

[Invest NI representative]

3.33 As part of the management of the model, Invest NI has a 10-year financial plan for the FoF model which sets out the forecast level of returns from each of the relevant funds. This is based on the existing investments and the information provided by Fund Managers. It is currently anticipated that by 2026/27, just over £10 million will be returned per annum, and will be available for recycling. This amount does not include FTC, as FTC is not available for recycling. The amount of returned funds is forecasted up to 2028/29, this totals £112 million, based on investment of £181 million[40].

Flexibility to reallocate funds within the model

3.34 To date, the flexibility to reallocate funds within the model has not been utilised. From a holding fund management perspective, Invest NI noted that each of the funds has performed (more or less) as anticipated and the funding has either been fully committed at the end of the investment period or required follow-on investment during the realisation phase. Therefore, it has not been necessary to reallocate funds.

3.35 In addition, as the funds have varying delivery timescales, it is not possible to contrast performance of the funds at a similar point in delivery with a view to reallocating funds. The funds are appraised and evaluated at different times, and it is at this point the rationale for the funds are assessed against the economic conditions.

3.36 While it is considered to be positive to have the option of reallocation, Invest NI consultees noted the challenges inherent in utilising this feature, in particular, deviating from the contractual terms and conditions with each of the Fund Managers. The fund size and the funding stream is set out and agreed as part of each contract, which means Invest NI is unable to amend this without reasonable justification. Also, a number of the funds has private Limited Partners (LPs) which have provided investment under an agreement, and amendments to those terms would need separate negotiation and agreement.

[40] This amount includes Invest NI baseline funding, FTC and ERDF.

3.37 Evidence from the evaluation of other UK Fund of Funds models suggests, however, that this feature has been utilised, and it is seen as a key benefit of the holding fund model. This is due to the structure of other models, which are described as 'true' FoF models. *"All of the [JEREMIE] funds have benefited significantly from being able to use the flexibility of their sub-fund structures to reallocate resources to respond to market conditions and performance issues. This was particularly the case after a challenging start to the investment period and allowed the funds to respond to poor performance in specific sub-funds".*

3.38 What is seen as a 'true' FoF model has a top-down structure, whereby a holding fund is created, with investment from LPs, and those funds are distributed among the sub-funds. The Invest NI model is a bottom-up structure which has pooled existing individual funds under a holding fund structure. As a result of this, the funds are fixed, and this restricts transfers between funds.

3.39 Some other UK Fund of Funds models exercise this flexibility by holding a reserve fund. For example, the Scottish Investment Bank holds a proportion of capital (approximately 10 per cent of the total fund) in reserve, to allocate in response to market demand/sub-fund performance.[41] This is also the case in the North East. The implementation of a reserve fund was considered by Invest NI, following the initial interim evaluation of the Fund of Funds in 2014. However, it was agreed that a reserve fund would add limited value, over and above the existing structures and processes in place, and it would be difficult to gain Department approval for this. Invest NI are clear that this is still the case.

3.40 There remains a question as to whether Invest NI considers that 'flexibility' should continue to be a key feature, or aim, of the FoF model. This feature was considered to be relevant when the model was initially designed in 2010, based on the JEREMIE structure. However, the evidence from this review suggests that this feature has not been utilised to date, and that there is limited demand for this feature moving forward.

Management structure

3.41 Effective oversight of Fund Manager performance is essential to ensure that Fund Managers are delivering the required standard of performance and appropriately managing investments and risks. Feedback from the consultations and the documents provided by Invest NI indicates that the funds are managed well and effectively, with strong management processes in place.

3.42 The Corporate Finance Team at Invest NI is responsible for close and regular management of the funds, with a corporate lead for each fund. This includes gathering regular updates on the financial performance of investments and loans, updates on investee company performance, and identifying any issues in fund performance. The Team has significant private sector experience, predominantly in the financial sector.

"[Fund] has a very strong relationship with the Corporate Finance team at Invest NI, we have monthly engagements talking about enquiries, drawdowns and performance, we also have a quarterly advisory board meeting. We get the opportunity to meet with the FoF committee and

[41] Urbis Regeneration, 2014, *Interim evaluation of Invest NI Fund of Funds*

we've done that twice over the last few years which is useful for them to get an update directly from [us] on what is going on".

[Fund Manager]

3.43 Fund Advisory Committees have been established for each fund and they meet on a quarterly basis. The Advisory Committees comprise of observers from Invest NI and members from the Access to Finance Working Group, and, where appropriate, private investors and independent non-executive Board Members. The role of each Advisory Committee is to monitor fund performance against stated objectives, review investment performance, and ensure funds are complying with the requirements of the Limited Partnership Agreement, including the investment policy. The input from the Working Group members on the committees was described as particularly beneficial due to the working knowledge, insight and experience they bring to the discussions.

"The… processes around the management of funds, bringing information to the centre and ensuring Key Performance Indicators are met, is very strong, stronger than you would normally see in a private equity company or even a bank".

[Access to Finance Working Group member]

Performance monitoring

3.44 Each of the funds deliver against a set of Key Performance Indicators (KPIs) under their contract, which are agreed at the outset. The KPIs are monitored by the Corporate Finance Executive Team; the list of KPIs can be found in Annex B. If KPIs are not met (predominantly activity-based investment KPIs), Fund Managers may be liable to incur sanctions[42] and to attend the Access to Finance Working Group meeting to provide further information regarding fund performance. Clauses covering the provision of monitoring information, performance against plans, management of conflicts of interest and key executive departures are included in the legal documents for all funds. Remedies including the reduction and withholding of fees and contract termination clauses are also included in the legal documents.[42]

"We have monitoring of everything, we all have to monitor our own KPIs, this includes economic benefits, jobs, returns, exits, monies coming back in; as an indication of the standard of the investment".

[Fund Manager]

3.45 For the most part, the KPIs are output and delivery focused, with limited focus on the quality of investments, rather than the quantity. The Northern Ireland Audit Office (NIAO) suggested that this could result in "*Fund Managers focusing primarily on achieving investment KPIs which creates the risk that poor investments could be made*". Similar concerns have been raised in the NPIF model,[43] as focus on the output targets may promote short-sighted decision making based on short time horizons, rather than encouraging investments in opportunities that

[42] Northern Ireland Audit Office, 2017, *Access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland*
[43] SQW, 2019, *Northern Powerhouse Investment Fund – Early Assessment Report* (unpublished)

would potentially offer longer term commercial return. This view was reiterated by a consultee:

"The question in my mind when I looked at this is have we got the right KPIs for the fund… Our KPIs are quite process orientated: [for example], on year 1 we expect you to make this amount of investment, it is less oriented towards the attractiveness of the business and potential than it is to do with the number and size of investments that are made. So, investment in a profitable sector is treated no differently to other businesses that are not in the same league."

[Access to Finance Working Group member]

3.46 However, to address this, Invest NI informed that broad KPI ranges are now included on an annual basis for the funds to help give leeway to Fund Managers to manage the ebb and flow of quality investment opportunities.

3.47 In regard to the overall fund performance, there is ambiguity around what the model is expected to deliver, as a performance framework does not currently exist. This creates difficulties in any attempt to assess the level of performance of the FoF model. A range of KPIs have been established for individual funds, however, to date, no aggregated KPIs have been set for the FoF holding model. This was a recommendation of the previous interim FoF evaluation (2014), but we were not made aware of any progress on this.

3.48 The JEREMIE models, such as North East Finance, set up KPIs at both a FoF and fund level, with cumulative targets at a holding fund level,[44] including:

- The number of companies supported
- The amount invested from the funds (£)
- The amount of private sector funding secured, at both a deal level and fund level (£)
- The number of new jobs created
- The number of jobs safeguarded.

3.49 It is recommended that Invest NI consider these measures for FoF aggregate and cumulative targets. Based on the objectives of the Invest NI FoF model and the feedback from consultees, measures should also be included for: the number of referrals between sub-funds, the amount of returned funds recycled in the model (£), the percentage of public sector investment that is subordinated in the model, and the total GVA generated (£). The KPIs for and across the FoF model could be aligned with the objectives of the Invest NI Business Strategy and the DfE Business Plan, to streamline assessment of progress. The KPIs/targets recommended for implementation by Invest NI are set out in Table 4-3 in the section below.

Risk management

3.50 The main risks that have emerged during the operation of the FoF model are in relation to fund manager performance. In 2014, Invest NI had significant concerns about NISPO fund manager performance and was unable to address this appropriately because of lack of clarity

[44] Hatch Regeneris, 2019, *Final Evaluation of the Northern English JEREMIE Funds* (unpublished)

in the contract. During the delivery of the FoF model, Invest NI has sought professional legal advice and tightened contractual clauses.

3.51 In 2014, concerns were also raised regarding the limited investment activity the Development Fund had made against contracted targets. This was handled by the Working Group and the fund investment period was subsequently extended in 2018.

3.52 We found that the overall approach to risk management is robust and proportionate at a fund level; performance is closely monitored by the Corporate Finance Executive Team and issues are identified and addressed promptly through the Working Group. However, at a strategic level, while there is evidence of risks being discussed at the Working Group meeting, no clear risk strategy is in place for the performance and financial sustainability of the FoF model.

Fund management costs

3.53 Following an appraisal process in 2010, Invest NI agreed to implement and deliver the FoF model in-house, rather than through the JEREMIE structure in which an external fund manager is commissioned to manage the fund. In doing so, Invest NI concluded that the benefits of the JEREMIE model could be achieved, with significantly lower management costs.

3.54 Invest NI estimates that the FoF model lifetime costs will be approximately £5 million (including Invest NI Corporate Finance staff costs) in contrast to the anticipated costs in the Northern England JEREMIE models of over £14 million, as set out in Table 3-2. The lower costs are primarily because the FoF model is overseen by an in-house Access to Finance Working Group, rather than an external holding fund manager. These costs are subsumed by Invest NI.

Table 3-2: Estimate total management costs for the UK JEREMIE funds and Invest NI FoF

Costs	North East Finance JEREMIE (£ million)	North West Fund JEREMIE (£ million)	Finance Yorkshire JEREMIE (£ million)	Invest NI Fund of Funds[45] (£ million)
Set up	N/A	1.8	0.5	0.0
Holding Fund Costs	14.5	14.7	14.2	5.0
Fund Management Fees	32.1	27.7	14.0	29.2
Total	**46.6**	**44.2**	**28.7**	**34.2**
Funds under management	124.9	155.2	90.2	142.6
Total costs as % of funds under management	**37.3%**	**28.5%**	**31.8%**	**24.0%**

Source: NIAO, 2017, Access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland

[45] Excludes NISPO funds which were operating before the Fund of Funds was established and the techstart NI Proof of Concept grant fund as the JEREMIE funds do not include this type of grant scheme.

3.55 Building on the findings of the interim evaluation in 2014, this review found that the features of the JEREMIE approach are available in the Invest NI FoF model, and many of the benefits of these features have been realised in Northern Ireland, at a significantly lower cost.

"We deliver in house and the costs are maintained in-house. This is useful to Invest NI, as we have good knowledge of the market. The theory is if you do it the other way, devolving responsibility, to be more mindful of other support – we want to keep it as complementary as possible".

[Invest NI representative]

3.56 Although Invest NI does not allocate a specific budget heading to the FoF model, it is estimated that the overall staffing costs associated with the Fund of Funds, including Board member input, is approximately £500,000 per annum or 3.33 per cent per annum of the public-sector capital invested through the FoF model.[46] In contrast, North East Finance has incurred whole life time holding fund management costs of £14.5 million or some 11.6 per cent of the capital invested in the holding fund. This is equivalent to around £2.9 million per annum. Although the level of resource devoted to holding fund management is substantially larger in the JEREMIE funds, there do not appear to be significant differences in the general approach to holding fund management.

3.57 In contrasting the Invest NI FoF model with the JEREMIE approach, one Invest NI representative noted that *"it works as long as we have the right people. We probably aren't as hands on as JEREMIE funds, but it doesn't cost the same amount of money"*. However, as described above, both Fund Managers and Invest NI consultees described the fund management process at Invest NI as both comprehensive and constructive.

3.58 Fund managers will receive £33.9 million in fees for overseeing the six funds, over the lifetime of the funds. Invest NI will pay approximately £24.7 million of these fees. Overall, Invest NI's fees will equate to 23.7 per cent of its £104 million investment funding. Fees for individual funds are, on average, 13.4 per cent. This is based on the total funding, including private sector leverage raised at a deal level.

3.59 The Fund Manager fees broadly align with the general industry standard[46]; Invest NI's overall fee levels are 1.88 per cent which are below the 2 per cent industry standard. However, the benchmark applies to venture capital and equity funds and Invest NI's total fees for these types of funds are 2.16 per cent per year. One Fund Manager suggested that the small size of some of the funds has created economy of scale issues, as the smaller funds require the same level of effort and management as the larger funds, which means the percentage of fees in comparison to the total fund size is greater. The same concern is observed in similar holding fund structures, such as the North West JEREMIE model, and is largely unavoidable if the aim is to operate multiple funds in a relatively small economy where there is evidence of market failure.

3.60 Consultees noted that all the funds within Invest NI's Access to Finance programme are publicly procured, and the fees are a key part of the selection criteria. This ensures that potential fund managers consider the services they are bidding to provide, and they are costed on a commercial basis, reflecting market conditions at that time. In addition, fee

[46] Northern Ireland Audit Office, 2017, *Access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland*

benchmarking is undertaken as part of any economic appraisal process, and part of this process involves liaising with BBB to check and confirm current industry standards.

3.61 Feedback from the consultations suggests that the fee structure is proportionate, equitable and transparent. Moreover, there is recognition that the fees need to be at a level that is commercially attractive to fund managers and ensures that the right calibre of staff are attracted and retained.

Other costs

3.62 A financial concern raised in the consultations included the continued high level of subordination of Invest NI's investment. While this increases the attractiveness of investment opportunities to private investors, it reduces the likelihood of Invest NI receiving substantial financial returns and thus impacts on the sustainability of the model. For example, in 2017, the forecasts for the Development Funds suggested that Invest NI could receive £7.2 million for its £30 million investment while private investors might receive £52.8 million for their £30 million investment. Private investors would therefore receive 88 per cent of the total returns generated.[47]

3.63 Invest NI suggested that progress was being made towards reducing the level of subordination in the public sector investment; as the market in Northern Ireland remained immature, this was not seen as a major concern at this stage. The level of subordination reflected Invest NI's rationale for intervention; to support the growth of the access to finance market and to generate wider economic benefits.

"On the equity side, with subordination, we are making steps towards a normal market. To have normalised investment opportunities and attracting investment…. Some funds have reduced to 25% subordination".

[Invest NI representative]

3.64 The market context in Wales is similar to that in Northern Ireland, in that it is relatively immature in comparison to English city regions. In contrast to the Invest NI FoF model, the Wales Business Fund does not have any private funders at the holding fund level, but each investment at a sub-fund level must have a co-investment partner to match the Finance Wales contribution.[47] This approach has delivered positive outcomes in increasing the number of private sector investors at the deal level. Similar outcomes are observed in the Invest NI model; the private sector investment leveraged at a deal level represents nearly half of the total funding in the model (48%).

Co-investment

3.65 Co-investment arrangements offer several financial advantages which address some of the challenges regarding the proportion of private sector investment leveraged in the FoF model and the level of subordination of Invest NI funding in individual funds.

"Co-investment allows the market itself to be more aware of equity and loan investment; just by having it creates awareness of it, it is difficult to achieve a mature market any other way. When

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[47] Northern Ireland Audit Office, 2017, *Access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland*

you invest in a company that isn't in your locality it is difficult to track and support it, but by having government money available locally, and encouraging others locally to invest, it creates small virtuous circles"

[Access to Finance Working Group member]

3.66 The main advantage of a co-investment fund is in developing and signalling growth in maturity of the access to finance market. The matched investment by the public sector makes the fund more attractive to investors by significantly de-risking the investment. In addition to increased investment in the local market, this also brings business and finance experts into the local eco-system.

"There is the obvious and immediate impact of having experts more broadly involved, all of these companies are specialists in their own area and if you can get co-investors who know the area and understand the risk, the concepts, you get their expertise involved. It is a sensible approach to it".

[Access to Finance Working Group member]

3.67 The structure of the fund means that investments are led by the private sector, and thus the market has greater control over the deals and investments. As a result, less public sector intervention is required, and the fund operates at a lower cost due to reduced fund manager fees. In addition, as the investments are made on a '*pari passu*' basis, the financial returns are shared by the public and the private investor, based on the level of funding invested.

3.68 Many of the benefits outlined have been observed in the delivery of the Invest NI co-investment fund, Co-Fund. An Invest NI representative noted that this fund was introduced building on the success of this approach in other areas, such as Scotland. The model has attracted significant investment from international investors and is seeing an increased number of local investors in Northern Ireland.

3.69 The benefits of co-investment funds were recognised and highlighted by Invest NI consultees. This structure is actively explored for the delivery of other Invest NI equity funds and was explicitly appraised for the Development Funds. However, co-investment was not progressed as the economic appraisal identified notable risks with raising private funding for investments, and forecasted lower economic benefits on those terms. There was also limited interest from fund managers to bid for such a fund. The increased implementation and usage of co-investment funds in Northern Ireland will require greater market maturity, similar to that of Scotland, given the relatively small number of private investors.

Governance structure

3.70 A Working Group of the Invest NI Board was set up in 2011 to provide a governing function for the FoF model. The 'Access to Finance Working Group', has responsibility for decision making on the reinvestment of legacy returns (up to £10 million), within pre-defined parameters, and to consider/approve recommendations from the Invest NI executives on reallocating resources between funds. Each new fund requires Board casework approval, which may or may not include Invest NI Working Group members.

3.71 The group meets three times a year to discuss the performance of the Access to Finance funds, updates on other relevant access to finance activity in Northern Ireland, and any wider access to finance information and/or activity at a UK level. The Board receives an information pack on each of the funds, which outlines fund performance, including a trajectory of the fund. A separate advisory panel was created for each of the funds which has representation from the Working Group; the advisory panel has direct engagement with the Fund Managers. Consultees suggested that by having oversight across the FoF model, the Working Group have a greater level of scrutiny than would be possible if the performance of the funds were only reviewed individually.

3.72 Feedback from consultees suggests that the FoF governance is "*very strong*", and that the right people are in place to provide an effective challenge role. There is a wealth of experience on the Working Group, including those who have worked in the industry, those who have been involved in asset finance and people who have invested in businesses. Invest NI have also recently co-opted two Working Group members with a background in access to finance. The evaluation of the North East JEREMIE fund found that recruitment of expert advisors to the Board and Investment Advisory Board was essential in creating strong and appropriate governance structures.

3.73 Similar governance structures exist across other FoF models. For example, the NPIF has a Strategic Oversight Board (SOB) which has a clear oversight role (equivalent to the Working Group), and two Regional Advisory Boards (RABs) (equivalent to the advisory panels) that support the SOB in managing operational delivery and have regular engagement with the Fund Managers.

3.74 In practice, the focus of the Invest NI Working Group has been on performance management and reporting, as the model has established itself in the market. While the Working Group has decision-making powers, there has been limited requirement for these to be used, as there has been no potential need to reallocate resources between funds and limited funds available for recycling.

3.75 Thus, while the Working Group has strong oversight of the performance of the FoF model, the extent to which the group is influencing strategic direction is unclear. A long-term strategy for the Invest NI FoF model is not currently in place; this would set out the short and long-term goals of the model moving forward and outline a plan for how this will be achieved. Feedback from consultees suggested, however, that there is evidence of this focus changing recently, with greater emphasis on forward thinking and the future of the model.

Funding approval process

3.76 Invest NI's current approach for funding approval from DfE operates at the level of individual funds, rather than the umbrella fund (as observed in other Fund-of-Funds models, such as NPIF). A clear rationale and an economic case is required for each individual fund. This has notable advantages in targeting and engaging appropriate partners for each separate fund. But it also means that Invest NI has much less flexibility to re-allocate funding across the model in response to changing needs and performance; funds are approved individually, and further approval is required for any significant funding alterations (above 10%). Invest NI described that this process has not constrained activities previously and, while alternative arrangements to streamline the approval process have been explored, such as a reserve fund, it was agreed that this would add limited value to the existing process, and there would be difficulties in gaining Department approval for this.

Marketing and positioning

3.77 Feedback from professional advisors suggests that the individual funds are marketed and positioned well in the market and, as a result, they have good awareness of the finance options available to SMEs. The professional advisors and the Fund Managers have a central role in promoting the funds to businesses and, to this end, some of the funds have comprehensive marketing arrangements. For example, the GLF has hired a PR company.

3.78 Consultees stated that signposting to individual funds has improved, as there is now a stronger network across those involved in the market. In addition, as the market for higher risk business finance has become more active, there are positive examples of SMEs which have accessed the funds (particularly larger deals) and have achieved significant growth outcomes; this provides confidence, encouraging other SMEs to seek different forms of finance.

3.79 The marketing and positioning of each of the funds differs; some are more known than others. This is, in part, a consequence of the age profile of the funds. Greater market awareness would be expected for funds that are more established in the market and have been operating for a long time. Newer funds, such as techstart, appear to have a lower profile with professional advisors, but these are likely to have better knowledge of funds that focus on larger deal sizes.

3.80 As part of the Access to Finance Strategy, Invest NI delivers a wide range of marketing and communication activities with a view to promoting the suite of funds. This includes launch events, marketing materials and digital promotions. To increase SME demand, Invest NI is working collaboratively with BBB and InterTrade to deliver a number of regional events which will showcase local success stories of SMEs that have utilised finance to grow their business. A larger scale event took place in Belfast in June 2019, with a view to delivering this as an annual conference on access to finance in Northern Ireland.

3.81 While there is good knowledge of the individual funds, the FoF structure, or the collective name, 'Fund of Funds', is less well known in the market; both among professional advisors and Fund Managers. To date, Invest NI has not actively promoted the FoF as part of its marketing. This contrasts with the FoF models in Scotland and Wales, where, in effect, the Scottish Investment Bank and Finance Wales are used as the gateway or point of entry for businesses seeking finance. While Invest NI is well known in the market and recognised for its role in the access to finance landscape, businesses typically approach the individual funds directly or through an intermediary.

3.82 Queries were raised by consultees as to whether it is important or necessary for external stakeholders and SMEs to have knowledge of the FoF holding fund structure, particularly if they have knowledge of and/or relationships with the individual funds. While this does not appear important if SMEs are aware of and are able to access finance, some benefits regarding the objectives and wider strategic aims of the model could potentially be realised through greater brand awareness of Access to Finance.

3.83 The evaluation of the Northern England JEREMIE funds and previous SME finance initiatives showed the benefits of developing a strong brand identity and awareness for public sector backed finance advice and provision. Promoting the FoF structure more widely as a brand could communicate a clearer message to SMEs, intermediaries and private sector investors of the range of access to finance options available in Northern Ireland, with a view to increasing demand among SMEs and building increased confidence in the market.

3.84 From a Fund Manager perspective, a greater awareness of the FoF holding fund model would provide a greater understanding of the strategic aims and objectives of the model, highlighting their role within this and their contribution to the wider economy in Northern Ireland. This may lead to more opportunities for increased collaboration and referrals between Fund Managers, addressing some of the barriers to increasing deal flow in the model. Consultees noted that marketing the FoF model as a collective could be a useful complement to facilitating Fund Manager events/opportunities for networking.

4. Performance and wider impact

Quantitative overview of performance

4.1 Since the FoF model was established in 2011, a total of £251.5 million has been invested across 14 funds, as outlined in Table 4-1. The funds highlighted in grey indicate those that are in the realisation phase. Invest NI's investment totals £93.4 million, just over a third of the total investment (37%). The private sector investment leveraged at the fund level totals £39.2 million. The total amount of investment leveraged at a deal level represents nearly half of the total funding invested (47%), and totals £118.9 million. Over one thousand (1,400) draws have been made across the 14 funds.

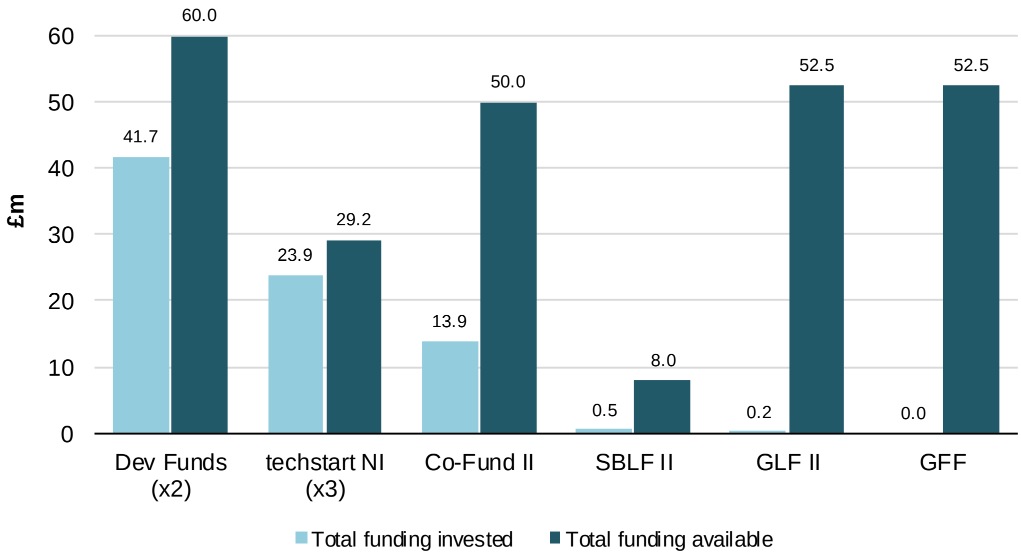
Table 4-1: Financial performance summary of the FoF model (to December 2018)

Fund	Delivery period	No. of deals	No. of companies	INI investment £m	Fund level leverage £m	Deal level leverage £m	Total funding invested £m
Small Business Loan Fund	Feb 13 - Jun 18	378	378	8.3	0.0	0.6	8.9
Small Business Loan Fund II	Jul 18 - Jun 23	24	24	0.5	0.0	0.0	0.5
Growth Loan Fund	Jun 12 - Sep 18	180	N/A	27.1	27.1	42.2	96.4
Growth Loan Fund II	Oct 18 - Sep 23	1	N/A	0.2	0.0	0.0	0.2
NISPO (x3)	Mar 09 – Jan 17	304	271	14.0	0.0	5.9	19.9
techstart NI (x3)	Jul 14 - Jul 24	309	244	15.3	0.0	8.6	23.9
Co-Fund	Jun 11 - May 17	111	37	13.0	0.0	33.1	46.1
Co-Fund II	Jun 17 - May 23	44	15	2.9	0.0	11.0	13.9
Development Funds (x2)	Jul 13 - Oct 19	49	21	12.1	12.1	17.5	41.7
Totals		**1,400**	**990**	**93.4**	**39.2**	**118.9**	**251.5**

Source: Invest NI Access to Finance Working Group Paper, March 2019, provided to SQW by Invest NI

4.2 Figure 4-1 compares the total funding available at the outset of each fund and the total amount invested by each of the funds (as at December 2018). This is for those funds that are currently live.

Figure 4-1: Total funding invested by live funds, December 2018



Source: SQW analysis of Invest NI Access to Finance Working Group Paper, March 2019. Note: Total funding available includes Invest NI and private contribution. There were no funds invested by the Growth Finance Fund (GFF) as it was launched in December 2018.

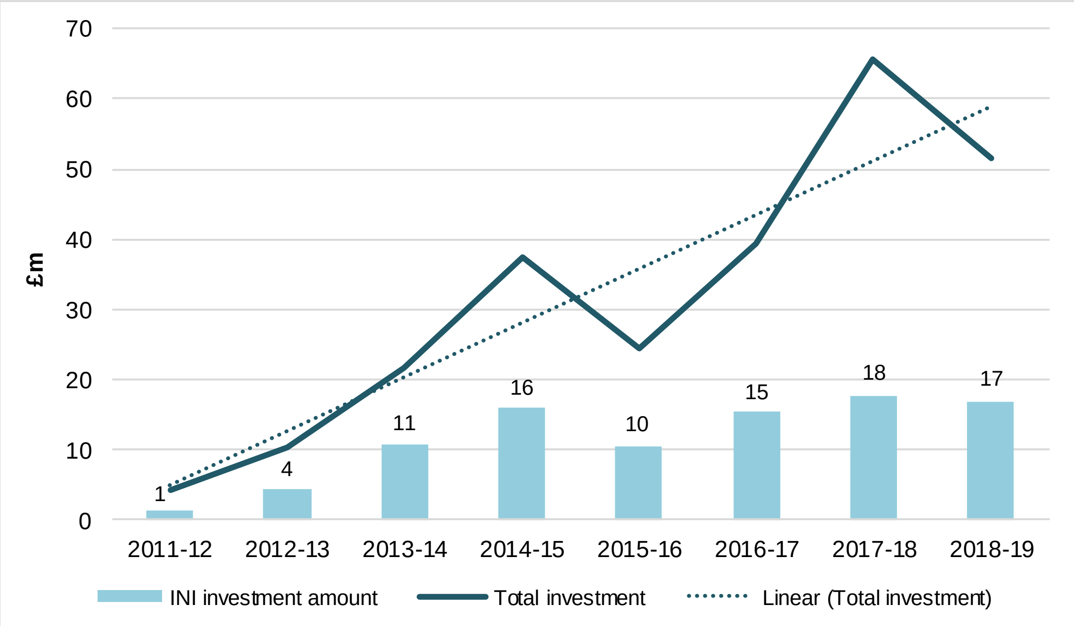
4.3 The funds are presented in chronological order from left to right, based on their start date. Therefore, while the GFF, GLF II and the SBLF II appear to have low levels of investment, this is due to the limited delivery period at the time of the strategic review.

4.4 The techstart funds and the Co-Fund are delivering well against the financial KPI targets, but the Development Fund continues to lag behind the targeted KPI performance in relation to monies invested; the investment period is set to close in July 2019, with the remaining follow-on funding expected to be allocated during the realisation phase.

4.5 With different delivery periods for each fund, it is not useful to provide an overall figure for the total amount of funding invested against the total funding available at a holding fund level. No targets are currently set for the total funding invested at interim timepoints; we understand this is because each fund needs to build momentum through a combination of market presence and understanding, and this will vary across types of fund and different Fund Managers.

4.6 Figure 4-2 shows the FoF funding trend since the model was established in 2011. Total investment in the funds has increased steadily since inception, starting at £4 million in 2011-12 and reaching £52 million in 2018-19. Invest NI's investment in the model has followed a similar trend; it started at £1 million in 2011-12 and reached £17 million in 2018-19. The proportion of Invest NI investment in the total investment has steadily increased, from 25 per cent in 2011-12, to 33 per cent in 2018-19. The average annual total investment over the period was £32 million, and the average annual Invest NI contribution was £12 million.

Figure 4-2: Access to Finance funding trends



Source: SQW analysis of Invest NI data

Exits and loan repayments

4.7 Few exits have been concluded to date, which was broadly as expected, given the time lag for such outcomes to be realised. Many of the investment funds are still active or have been fully taken up only recently. To date, exits worth c. £4.3 million have been completed, these include one exit from the techstart NI SME Equity fund[48], two exits from the Co-Fund[49], and five exits from NISPO.

4.8 Most of the loan repayments to Invest NI have also not yet commenced. As of March 2019, Invest NI had collected £0.725 million from the Small Business Loan Fund I, and is expecting to receive £3.3 million by the end of June 2023.[50] At March 2019, repayments from the Growth Loan Fund I were ongoing and the private sector investor was fully repaid in May 2019; it is expected that Invest NI will receive approximately £22 million by June 2022.[50]

Outcomes

Turnover, employment and GVA outcomes

4.9 Table 4-2 summarises the estimated turnover, employment and GVA outcomes for each of the funds. Figures are provided for net additional sales achieved and expected, net additional jobs created and expected, and net additional GVA achieved and expected, where figures have been reported. The data is sourced from the individual fund evaluation reports which cover varying time periods and do not therefore show a fully up-to-date picture.

[48] Cogent, 2018, *techstart Funds Evaluation & NISPO Impact Assessment*
[49] NIAO, 2017, *Access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland*
[50] Invest NI Access to Finance Working Group Paper, March 2019, provided to SQW by Invest NI

4.10 This data indicates that, since its implementation, Access to Finance has created significant economic impact in Northern Ireland. Under the FoF model, 1,101.5 total net additional jobs are calculated to have been created in SME beneficiaries following risk funding, and £379.9 million generated in net additional sales. The net additional GVA achieved to date is £76.7 million.[51]

4.11 When compared with the expected outcomes, outcomes achieved to date for sales, jobs and GVA are significantly lower. This is mainly because the funds are still within the expected timeframe for delivery of outcomes, or the available figures come from an evaluation undertaken within the expected timeframe. However, preliminary figures for the GLF for the period to March 2018 would suggest that net outcomes may be significantly lower than anticipated in the 2016 evaluation. This will be subject to further evaluation in 2021.

4.12 Although fund delivery is non-linear and often accelerates only after a relatively slow build-up, FoF, and Invest NI more widely, may benefit from regular data collection of fund outcomes against anticipated delivery milestones.

[51] The figures have been calculated using the mid-point where a range has been provided in the information provided by Invest NI.

Table 4-2: Turnover, employment and GVA outcomes summary

Fund	Net additional sales anticipated	Net additional sales achieved to date	Net additional jobs anticipated	Net additional jobs created to date	Net additional GVA anticipated	Net additional GVA achieved to date	Date of report and source
NISPO (x3)	£60.2-£74.6m by 2019	£30.6m-£45m (2010-2017)	230-302 by 2019	134-206 (2010-2018)	£30.6m-£37.8m by 2019	£15.6m- £22.8m (2010-2017)	May 2018[52]
Small Business Loan Fund	£68.9m-£157.2m by 2018/19	c. £26.5m (2013-2015)	619 jobs by 2018/19[53] (reported in 2017)	311 created or safeguarded[53] (reported in 2017)	£9.6m-£21.8m by 2019	£3.7m (2013-2015)	July 2016[54]
Growth Loan Fund	£880.3m-£1,023.5m by 2018/19	c. £291.4m (2012-2015)	675-768 jobs by 2018/19[53] (reported in 2017)	301 (2012-2015)	£134.9m-£156.9m by 2019	£44.7m (2012-2015)	July 2016[54]
techstart NI (x3)	£39m by 2019	£7.3m (2014-2017)	361 by 2019	185 (2014-2017)	No forecast reported	c. £3.7m (2014-2017)	May 2018[55]
Co-Fund	No forecast reported	£14.891m (2011-2015)	No forecast reported	98.5	No forecast reported	£2.993m	December 2016[56]
Development Funds (x2)	£54.1m-£85.0m by 2022	£2.3m-£6.3m (2013-2016)	89-127 by 2022	17-55 (2013-2016)	£10.2m-£21.7m by 2022	£1.1m-£3.8m (2013-2016)	October 2017[57]
Totals[58]	**£1,240.9m**	**£379.941m**	**2,174**	**1,101.5**	**£218.443m**	**£76.743m**	

Source: SQW analysis of fund evaluations and appraisals

[52] Cogent, 2018, *techstart Funds Evaluation & NISPO Impact Assessment*
[53] NIAO, 2017, *Access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland*
[54] Cogent, 2016, *NI Small Business Loan Fund & the Growth Loan Fund Joint Evaluation*
[55] Cogent, 2018, *techstart Funds Evaluation & NISPO Impact Assessment*
[56] Capaxo, 2016, *Co-Investment Fund Interim Evaluation*
[57] SQW, 2017, *Evaluation of the Development Funds*
[58] These figures have been calculated using the mid-point where a range has been provided in the information provided by Invest NI. Where no forecast has been reported the actual figure has been used. In addition, actuals are based on the Fund only partly being invested and therefore more sales, jobs, and GVA could be expected in the future.

Performance of the Fund of Funds model

4.13 At a fund level, the data collated by Invest NI indicates that performance has generally been good. Many of the funds have been fully drawn down and have leveraged significant private sector investment; in some cases, e.g. Co-Fund, over and above what was anticipated by Invest NI[59]. However, the investment period for the Development Funds has been extended, as the Funds did not meet their KPIs for total funds invested in the expected time period.

4.14 Performance is currently reviewed by Invest NI across the funds, although there is no overarching framework for the FoF model itself. This is, in part, because of the difficulty in aggregating and aligning the performance measures across the funds, given their different target markets and delivery periods. However, Invest NI representatives and other market operators suggested that a performance framework at FoF level would be useful. Based on the performance information of the existing funds, this review has developed a suite of aggregate targets and KPIs for the FoF; these are set out in Table 4-3 below.

4.15 There is evidence to suggest that the Access to Finance strategy and the pro-active role of Invest NI has enhanced the scale of risk capital activity in Northern Ireland. Prior to 2010, there were three local funds with total funding of £39.5 million, in 2019 there are six live funds with total funding of £252.2 million. The wider activity in the market, such as the pre-accelerator and the accelerator programmes led by Invest NI and other key players such as Catalyst, has been an enabling factor in supporting the number of SME investments.

4.16 However, while the market is maturing, the support from Invest NI has not yet reached the stage where the need for substantial public intervention has reduced. In the interim evaluation of the Fund of Funds in 2014, it was noted that a period of 15 years of public intervention was required in Scotland to stimulate an under-developed market and achieve a sustainable mix of investors; it is notable that while the market has matured, public sector intervention continues under the Scottish Government[60].

Performance framework and future strategy

4.17 The outputs, outcomes and impacts of the Fund of Funds model, as set out in the logic model presented in Figure 1-2, have been drawn on to define the medium and long term aims of Invest NI in developing the local risk capital industry. From this, a suite of aggregate targets has been developed for the Fund of Funds model, including financial returns and economic benefits, and are set out below.

The medium and long term aims of the Fund of Funds model

4.18 The Fund of Funds model has a central role in delivering on Invest NI's strategic objectives, as outlined in the Invest NI Business Strategy (2017-2021). The continuum of business finance available to SMEs through the FoF model supports the achievement of each of the key objectives set out in the strategy: to

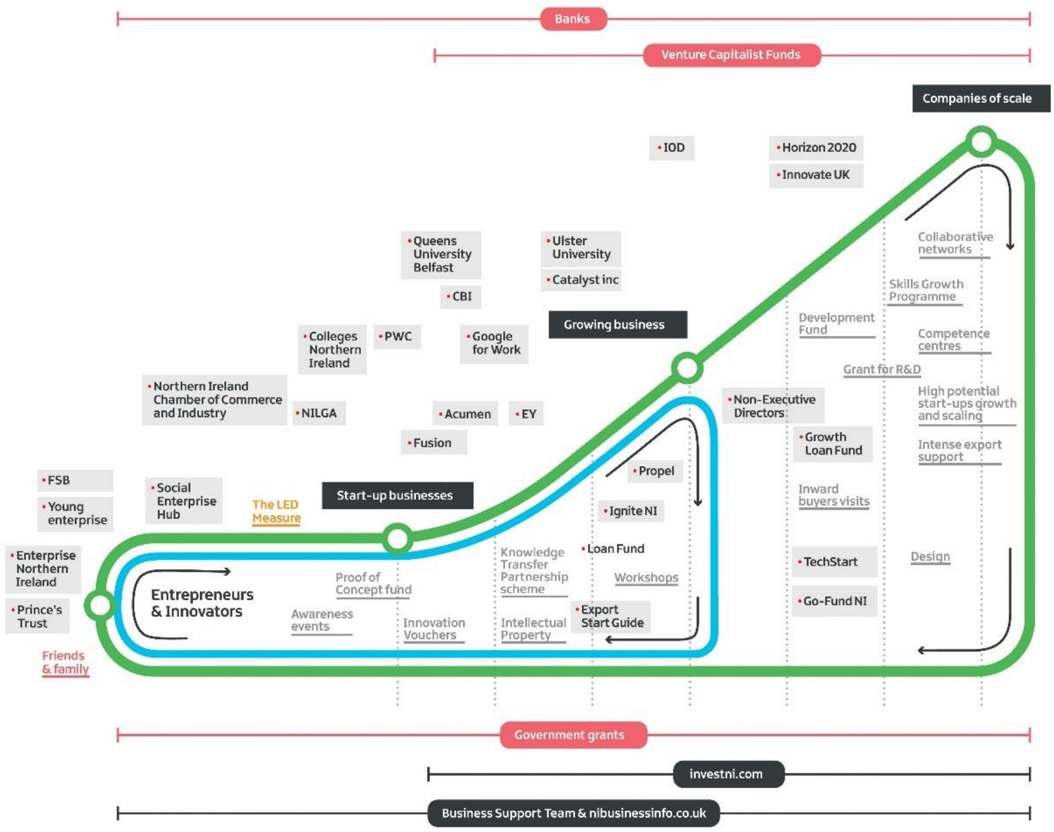
[59] Capaxo, 2016, *Co-Investment Fund Interim Evaluation*
[60] Scottish Government, 2018, *SME Holding Fund Performance Report 2017*

- **Support:** the FoF model supports balanced regional economic growth by providing the financial support to enable SMEs to realise their growth potential and the contribution they make to wider economic development, across all parts of Northern Ireland.
- **Scale:** the funding made available through the FoF model enables more Northern Ireland businesses to grow and succeed, and provides support to drive higher levels of innovation, increase competitiveness, increase exports, grow faster and create more, higher value, jobs.
- **Stand out:** companies and sectors are supported through the Fund of Funds to realise their potential in international export markets and attract the next generation of global investment to Northern Ireland.

4.19 This is emphasised in the entrepreneurial ecosystem in Northern Ireland, set out in Figure 4-3 below, which locates the individual funds within a continuum of business finance support "from start-up to stand out". The strategy outlines the aims of the ecosystem to:

- support more businesses with high growth potential
- help more businesses successfully sell outside Northern Ireland
- increase the number of larger and more profitable businesses in Northern Ireland.

Figure 4-3: The entrepreneurship ecosystem in Northern Ireland



Source: Invest NI Business Strategy (2017-2021)

4.20 The medium term aims of the FoF model sit within the overall goal of accelerated economic development and business growth: they focus predominantly on addressing market failure in access to finance provision for SMEs in Northern Ireland and delivering this in a cost-effective and efficient way; the main aims, as described in the FoF logic model, are set out below. It is expected that, given the long-term nature of risk capital finance, the medium term aims will be delivered over a 5-10 year period.

Medium term aims of the Fund of Funds model

- Improved provision of risk capital finance for viable SMEs at every stage of the business lifecycle for growth
- SMEs progress through finance stages, from seed/early stage funding to development funds
- Increased awareness among SMEs of the access to finance options available in Northern Ireland
- Increased SME demand for finance to support business growth
- Increased networking and knowledge sharing between fund managers, leading to increased skills and capacity and greater retention of fund managers in Northern Ireland
- Increased sustainability of the FoF models, through the recycling of financial returns
- Increased cost-effectiveness of the Fund of Funds model, in contrast to other models (e.g. JEREMIE)
- Improved management and governance of access to finance in Northern Ireland, including improved performance monitoring and target setting

4.21 Our interpretation of the long term aims of Invest NI in developing the local risk capital industry in Northern Ireland, based on the existing information from Invest NI and the FoF logic model, are: to build quantum in the access to finance market, to normalise the access to finance market, and, principally, to deliver economic growth. The detailed aims are set out in Figure 4-4. These themes align with and support the delivery of Invest NI's objectives, as detailed in the Business Strategy, to develop the local risk capital industry in Northern Ireland.

Figure 4-4: The long term aims of Invest NI in developing the local risk capital industry in Northern Ireland.

To deliver economic growth

- increase the growth of SMEs in Northern Ireland
- increase business exports to the UK and international markets
- increase the number of larger and more profitable businesses in Northern Ireland

To build quantum in the access to finance market

- provide sufficient scale and choice of access to finance to meet the explicit funding requirements of SMEs for growth.
- use public funding to stimulate the needs, and future needs, of potential growth companies and sectors.

To normalise the access to finance market

- attract and increase private sector risk capital provision
- reduce public sector intervention in access to finance, including a reduction in the level of subordination
- increase the functioning of the market to replicate access to finance markets of bigger English/UK regions, outside of London
- have recognisable and distinctive attributes, building on the sector strengths/clusters outlined in the draft industrial strategy

Source: SQW, based on the FoF logic model

4.22 These aims are expected to be delivered over 15-20 years, based on evidence of public intervention in the risk capital market development in Scotland.

Performance framework for the Fund of Funds model

4.23 In line with the anticipated outputs and outcomes to be delivered by the FoF model, a suite of aggregated targets has been developed and are set out in Table 4-3. The targets outline what the model is expected to deliver, based on the performance of the previous funds, and with consideration to the current structure of the live funds (the number of debt and equity funds). The targets are currently forecast to 2025, following which, the live funds will be completed, although the returned funds recycled are forecast to 2028. The full table of targets, including the gross number of companies supported, and the gross jobs and GVA expected are set out in Table C-1 in Annex C. Historic, aggregate data are presented for outcomes from 2009 (to 2024).

4.24 It is recommended that the aggregate targets for the FoF model are reviewed and updated following the realisation phase of the live funds (or following an evaluation), and when a new fund is launched.

Table 4-3: Aggregate targets

Cumulative target	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Net companies supported	401	539	678	819	993	1,070	1,162	1,253	1,346	1,431	1,431				
Total amount invested £m	70	100	143	189	238	275	315	358	398	417	417				
Private sector investment £m	36	54	80	109	141	157	172	192	213	234	239				
- Fund level leverage £m	13	21	33	44	57	59	63	68	74	80	80				
- Deal level leverage £m	24	32	47	64	84	98	109	123	139	154	160				
Net jobs created	570	832	1,154	1,568	2,017	2,592	2,871	3,193	3,551	3,929	4,208	4,325			
Companies receiving support from multiple sub-funds (10%)	45	60	75	91	110	119	129	139	150	159	159				
Returned funds recycled excluding FTC £m				1	2	9	13	17	20	24	28	35	42	49	54
Net GVA generated £m[61]	77	111	151	199	255	319	353	395	441	490	524	540			

Source: SQW analysis of actuals and forecasts provided in evaluations and economic appraisals of FoF sub-funds

[61] An optimism bias factor of 0.9 has been applied to the number of companies supported, the number of jobs created, and the GVA generated (£m).

Strategic alignment with other products

4.25 Most stakeholder consultees stated that the FoF model is an integral part of the strategy to develop the business growth eco-system in Northern Ireland, and at a wider UK level. Evidence from the Access to Finance Working Group Papers indicated that the work and activities taking place under Access to Finance in Northern Ireland, and comparisons with other funding at regional and UK levels, are regular agenda items.

Access to finance in Northern Ireland

4.26 From an Invest NI perspective, the FoF model is just "*one piece of the jigsaw*" supporting businesses to access finance in Northern Ireland. Invest NI delivers a range of interventions to support SMEs with growth potential, including promotional and marketing activities as well as business support programmes such as the Pre-Accelerator Programme, Propel. Feedback from Invest NI representatives suggests that there is complementarity between the range of business support available from Invest NI and the FoF model, which they argued was enhanced by delivering FoF in-house.

4.27 Invest NI and Working Group members cited other initiatives taking place in Northern Ireland, including the Ulster Bank Entrepreneur Accelerator programme, the Halo Northern Ireland Business Angels Network, and the programmes delivered, and funding supported by Catalyst. There was seen to be some cross-over with these other initiatives supporting the pipeline of growth-minded SMEs, but the FoF model was viewed as complementary to these, and to be well-aligned with the wider business support in the market. The evaluation of the JEREMIE funds in Northern England reiterated the importance of funds maintaining close links with local business support arrangements to ensure investee companies have access to the relevant support required for growth.

Access to finance in the UK

4.28 The British Business Bank offers various forms of support to SMEs, including advice and guidance on business finance options and how to access these, and financial support. There appears to be some potential overlap between the FoF funds and the level and type of finance offered by BBB, but BBB was established only late in 2014 and consultees suggested that most Northern Ireland SMEs seeking funding are unlikely to access national finance initiatives for growth.

4.29 In December 2018, BBB announced its investment in a new Growth Finance Fund in Northern Ireland which will offer loans from £500k up to £2 million to SMEs. This Fund, which has recently commenced operation, will also receive investment from Invest NI. The Growth Loan Fund II, typically offers up to £500k debt finance, but in defined situations can invest larger amounts. However, Invest NI is clear that the Growth Finance Fund will not have any operational impacts on the access to finance funds in Northern Ireland.

4.30 An Invest NI representative noted that in practice the advice and guidance provided by BBB to SMEs complements the Invest NI FoF model. For example, Invest NI promotes and uses

BBB's Finance Hub,[62] to help businesses determine the type and scale of finance they require, and direct them to where they can access this.

4.31 The partnership work currently taking place between Invest NI, BBB and InterTrade Ireland in Northern Ireland to support the development of the access to finance market was cited as an example of how the activities of the three organisations are working well together. InterTrade Ireland provides support to businesses to achieve growth through various methods, such as clinics and workshops; BBB provides market data and intelligence on access to finance in Northern Ireland and support with the demand agenda; Invest NI provides access to finance through the FoF model and local knowledge and networks on the ground. This collaboration on the supply side is expected to increase demand, and further the development of the market.

Wider strategic impact of the Fund of Funds model

4.32 Consultees stated that a number of wider strategic impacts have emerged or have been realised as a result of the FoF holding fund structure. These include increased partnership working and collaboration; increased business growth and focus on commercialisation and internationalisation; increased private sector investment in Northern Ireland. The evidence of strategic impact indicates progress towards the development and maturity of the wider access to finance eco-system.

Increased partnership working and collaboration

4.33 The consultations provided evidence and examples of increased partnership working across the access to finance landscape in Northern Ireland. For example, at a fund level, there is increased communication and collaboration between the Fund Managers and with other local private equity funds. Fund Managers are working much more closely with banks, and there are clear referral pathways in place between some of the banks and the funds; banks are referring SMEs to the funds where they are unable to obtain bank finance. Deals are also being done on a co-investment basis between the banks and the sub-funds.

If it's not something the [fund] can do, they will point the business in right direction. We have worked on several deals together, there is a very easy relationship there, whether it is a phone call or consultation. Even better than positive actually, the guys on the ground are really good".

[Other market operator]

4.34 At a strategic level, as noted above, Invest NI is working closely with other government bodies, such as BBB and InterTrade Ireland, to deliver interventions that aim to develop SME awareness of, and demand for, access to finance. Invest NI consultees suggested that these partnership arrangements might not have developed if Invest NI were not delivering the FoF model in-house. The partnership with BBB is considered to be mutually beneficial and aligns with the latter's regional agenda.

4.35 Other partnerships include planned increased collaboration between Invest NI, Chambers of Commerce, CBI and FSB; this is particularly in educating businesses about the finance options available to them. There are also more collaborations now taking place on risk funding

[62] https://www.british-business-bank.co.uk/finance-hub/

between Northern Ireland and the Republic of Ireland, which a Working Group member suggested Invest NI has had a notable role in driving. Invest NI's role and profile in the market was noted as instrumental in developing these relationships, and in bringing in appropriate people from industry.

"Invest NI is the glue that brought those people together, because people trust the organisation. But through their good leadership and the focus on teams working together is great".

[Access to Finance Working Group member]

Increased business growth and focus on commercialisation and internationalisation

4.36 Three consultees stated that the FoF model is having a positive impact on the growth and scale up of individual businesses in Northern Ireland. A Working Group member suggested there are numerous examples where SMEs have utilised the FoF funds and, as a result, scaled up significantly. Many of these businesses, it is suggested, would not otherwise have scaled up.

4.37 In addition, the positive examples and demonstrable impact from SMEs that have used finance to successfully grow their business further promotes the benefits of securing external finance to the next generation of SMEs. A Working Group member suggested that due to the level of support available, there is evidence of some businesses re-locating to Belfast.

4.38 Access to finance has enabled SMEs in Northern Ireland to have a greater focus on internationalisation, in terms of exporting and targeting international markets. This was noted by a Working Group member who stated that the limited customer market in Northern Ireland meant that ambitious businesses must look to external markets early and build their understanding of demand there. The Access to Finance model has ensured that investment finance and working capital facilities are in place for this, while Invest NI's educational and training activities help businesses to better understand this approach and gain international perspective.

"Access to Finance has overcome that in a lot of places, you can't internationalise on a shoe string. You have to go for a proper level of funding to address the 'J curve' needed to internationalise".

[Access to Finance Working Group member]

4.39 Two consultees said that the local universities in Belfast now have a much greater business understanding and more focus on the commercialisation of research and developing new products. This is a significant shift in priorities, one consultee noted, prompted at least in part, by the seed funding available in Northern Ireland and the increased education of SMEs. The techstart fund is increasingly working with the universities to support the transition of ideas into products and commercialisation activities; the spin outs emerging from the universities are described as strong. A Working Group member described this as an important contribution of the FoF model, in an area where there had been substantial barriers in the past.

Increased private sector investment in Northern Ireland

4.40 The FoF model was also identified as a strong stimulus in increasing the number of private investors investing in Northern Ireland, and the scale of private capital investment. There are now more players in the access to finance market, including other funds operating in Northern Ireland and more private sector investors coming in. The Co-Fund has had a significant role in this; 250 different investors have provided investment alongside the Co-Fund. While the increase in supply of finance for SMEs reduces the supply-side market failure in Northern Ireland, it further highlights demand side issues, such as SME's limited awareness of the finance available.

4.41 The private investment secured by the Co-Fund, in particular, provides evidence of increased finance and investments coming in from outside Northern Ireland on a new, higher, scale. For example, investments have been secured from VCs in England (London) and Scotland, and internationally, there have been investments from the US and Singapore. A Fund Manager suggested that it would not have been possible to attract this level of capital without the FoF model or Invest NI as an anchor.

"Certainly, without the FoF, to get going would have been very difficult to see how that level of capital has come in to the market. It is a really positive thing, even to get US money in here, it is pretty hard to get, that's been a really positive factor in the funds".

[Fund Manager]

4.42 The amount of private sector investment that has been leveraged by the FoF model and the economic benefits the funds are anticipated to generate is expected to make a significant contribution to the Northern Ireland economy.

Additionality of the FoF model

4.43 There are multiple strategic impacts that, consultees suggested, have been delivered as a result of Access to Finance, as outlined in the section above (for example, increased private sector investment). However, it is difficult to assess to what extent those impacts have been realised because of the FoF model, and whether those impacts would have been delivered by the individual funds. To ascertain this, consultees were asked about the influence of other factors, and how important the FoF model has been in achieving the impacts.

4.44 Consultees responses were mixed. Four consultees suggested that without the model, the impacts would not have been realised, particularly in relation to the development of the access to finance landscape.

4.45 However, two consultees suggested that it is likely that many of the impacts would still be achieved if the individual funds were delivered in isolation, without the FoF structure; that the FoF model is one, albeit important, contributory factor alongside others. One Fund Manager suggested that strong businesses will find ways to grow and secure the finance they need. Moreover, if the quality of businesses is good enough and there is sufficient traction and revenue, then non-NI VCs will be attracted to invest. The various other finance initiatives, delivered by BBB and Catalyst for example, also support this.

4.46 Feedback from consultees indicated that while the impacts may have been realised without the FoF structure, this would have taken much longer. Under the FoF umbrella, businesses have been helped to grow more quickly and easily than would otherwise have been the case. A Fund Manager and a Working Group member both suggested that without the FoF model, some of the wider strategic outcomes, such as increased partnership working and increased awareness of the funds in the market, would have happened only over a long period. They stated that without the individual funds and the FoF model, the access to finance market in Northern Ireland would be "*five years behind where it currently is*".

Future considerations

4.47 Following the UK referendum decision to leave the European Union in June 2016, political uncertainty remains around the UK's relationship with the EU, in which of course the land border with the Republic of Ireland is a major element. The implications of this for the FoF model and the access to finance landscape are unclear, although several risks were identified at both fund delivery level, and more strategically for access to finance in Northern Ireland.

FoF delivery

4.48 At a holding fund level, the FoF model is currently funded through four main funding streams: ERDF, FTC, baseline funding and private sector investment. Invest NI's 10-year financial plan indicates that in the short term, over a third of the funding for the model will be reliant on ERDF.

4.49 In the event that a Brexit 'deal' is agreed, ERDF funding will remain in place until 2023. The Chancellor of the Exchequer has provided a guarantee that were there to be a 'no deal' Brexit, a similar level of funding from the UK Government will be made available until 2023. In the short to medium term, it is anticipated that the European funding will be replaced by the 'UK Shared Prosperity Fund',[63] however, there is limited detail regarding this Fund, with no certainty of how much money will be available and whether this will be delivered as part of a block grant, ring-fenced for regions, or allocated at UK level through competition.

4.50 Nor is it currently known whether additional FTC will be available beyond March 2021. FTC is anticipated to provide over a quarter of the investment for the FoF model over the next ten years. Additional information is expected following the UK Spending Review in 2019. Very limited baseline monies have been utilised in the model to date.

4.51 This political uncertainty creates challenges in the forward financial planning for the FoF model, however, Invest NI is clear that the risks are being mitigated as far as possible. To this end, using the forecast data provided by each of the funds, Invest NI has developed a forecast of the anticipated financial returns over the next ten years. Invest NI will place greater emphasis on drawing on and recycling returned funds to deliver the model and it is anticipated that recycled funds will account for one fifth of the investment for the FoF model over the next ten years. Increased usage of recycled funds will reduce Invest NI's exposure to risks and uncertainty regarding external funding.

Access to Finance landscape

4.52 Considerations of the impact of Brexit on the access to finance landscape in Northern Ireland centre largely on the economic impacts and consequences of this for businesses. Many consultees suggested that this may create difficulties in accessing both debt and equity finance, as in the context of an economic downturn, commercial lending is likely to contract. A reduction in bank finance was regarded as the greatest concern. The latest SME Finance

[63] https://researchbriefings.parliament.uk/ResearchBriefing/Summary/CBP-8527

Survey[64] asked whether SMEs thought Brexit would have an impact on their ability to access finance. Just over a third thought that it would either be a lot or a little more difficult to obtain debt and equity finance.

4.53 Concerns were raised by all consultees regarding the potential loss of existing private investors in funds; it was suggested that additional government funding might be required to facilitate the same level of support to businesses.

4.54 One Working Group member suggested that the changes in the funding environment could increase demand among SMEs for alternative finance and see greater demand in the FoF model. However, BBB's Small Business Finance Report (2019) states that SME confidence levels have reduced due to Brexit uncertainties, and this may cause a reduction in demand for finance, as investment plans are delayed.

[64] British Business Bank, 2019, *Small Business Finance Markets 2018/19*

5. Conclusions and recommendations

5.1 The conclusions from the interim evaluation are set out in Table 5-1, in line with the terms of reference for the evaluation and the relevant NIAO recommendation/s.

Overall assessment

5.2 This study has found evidence that the access to finance market in Northern Ireland is showing some positive signs of increasing maturity, in terms of the level of the private investment leveraged and the number of deals undertaken (as outlined in Table 2-1). However, compared to other UK markets outside the South East (including Wales and North East England), the Northern Ireland market continues to be relatively flat. Therefore, under current market conditions, and in the context of continued economic and political uncertainty going forward, continued intervention is required to stimulate the market and the rationale for the FoF model remains valid.

5.3 The FoF structure was found to provide a robust mechanism to deliver and manage a suite of access to finance funds in Northern Ireland, at a relatively low cost. It enables Invest NI to maintain strategic oversight of the access to finance funds, to facilitate market growth, and to report systematically and coherently against a detailed set of measures. It provides a useful forum for the exchange of information on the activities across the suite of funds both for Invest NI and for the NI Department for Economy (DfE), the sponsor Government Department.

5.4 The Invest NI FoF model has delivered outcomes for businesses in Northern Ireland and for the local access to finance eco-system. However, it is difficult to disentangle those outcomes that have been realised as a result of the holding fund structure, from the outcomes that would have been realised through the delivery of individual funds with no formal coordination. Without the FoF model, the funds would have still produced notable economic outcomes, and Invest NI would have maintained an overview of the funds' role within a changing access to finance landscape.

5.5 However, the evidence from consultees is clear that the FoF model and mechanism has helped to give confidence to both public and private investors, and some believed that FoF had enabled more funding than would have been possible otherwise[65]. In addition, the management and governance structures implemented as a result of the FoF model have meant that the implementation of new funds, and approval for funding extensions have been expedited. Thus, while many of the benefits would have been realised without the FoF model, it has enabled processes to happen more smoothly, quicker, and probably on a slightly bigger scale. Wider strategic outcomes, such as increased partnership working and increased awareness of the funds in the market could have been realised without the FoF structure, but this would have been delivered with more difficulty, and over a longer period (consultees suggested this would have taken 5-10 years longer).

5.6 As the UK prepares for its departure from the EU, the political and economic conditions moving forward are uncertain, and European funding cannot be assumed after 2023. To address this, Invest NI should continue to work towards co-investment arrangements and

[65] This is a key finding of the Interim Evaluation of the FoF model which took place in 2014.

increase the proportion of private sector funding in the model. There is also potential for Invest NI to use a greater proportion of FTC funding in the model, however the availability of FTC funding beyond March 2021 is uncertain at this stage. If European funding is withdrawn in the future, replacement funding will need to be sourced elsewhere for the model to continue to operate at the same scale (for example, from DfE or the UK government/BBB); alternatively, the scale of the access to finance provision delivered by Invest NI could be reduced significantly. While the proportion of legacy funds available for recycling is forecast to increase, this is not currently expected to be at a sufficient level to replace European funding.

Table 5-1: Interim evaluation findings against the objectives set out in the terms of reference

Objectives for the interim evaluation	Relevant NIAO Recommendation	Findings	Reference to report section (page number)
1. Briefly review the strategic context under which the Fund of Funds model has operated and assess whether the model remains valid. Review the operational fit of the Fund of Funds with the objectives of the current Invest NI Business Strategy, as well as the Invest NI / DfE corporate plans/strategies in place since 2014.		• Evidence of economic recovery in Northern Ireland and across UK – increased commercial lending and focus on A2F • SME funding, especially equity, in NI remains relatively sluggish • On-going need for A2F strategy, continuum of public funds with co-investment where possible • FoF demonstrates alignment with broader NI economic strategies • FoF structure provides for overseeing role, and potential to align Funds' activities and outcomes more closely with NI economic strategies	9-13, 21
2. Review the ongoing rationale for the Fund of Funds, through a review of the SME financing environment, including the nature and scale of the market failures that it is seeking to address.	*(2) The Department should review the SME financing environment every three to five years to assess the extent of market failure and the need for public sector intervention.*	• Ongoing rationale for the FoF remains valid • There is not yet adequate private investment to support a continuum of risk capital finance, to meet SME demand for finance • Market failure is greater at the lower level of funding (seed/start-up) in contrast to the higher level (development funds), however some level of public sector intervention is still required, at the higher level, to meet market demand	21-22
3. Quantify the current SME funding gap in Northern Ireland. This should incorporate a view as to the overall quantum of the Fund of Funds (currently £252.2m) and other funds that are currently being planned, to determine whether the continuum is complete or if further types of funds which should be considered. (Recommendation 1 – NIAO Report).	*(1) The Department for the Economy should work with other key stakeholders to measure the demand for, and supply of, finance in the SME sector, and develop a methodology for quantifying the SME funding gap in Northern Ireland.*	• The risk business finance offer is comprehensive in Northern Ireland, particularly at the seed/start-up level, mainly due to the continuum of finance provided by the FoF model. • There is limited availability of finance above £5 million, although consultees suggest there is provision available at this scale in wider UK markets. The evidence of demand for deals about £5 million in Northern Ireland is limited, and thus we consider that public-sector intervention at this level is not currently validated. • This review has calculated, based on various assumptions and our work in other areas, that the total funding gap in Northern Ireland is approximately £89.1 million per annum. This is split to a notional equity funding gap of £39.1 million and a debt funding gap of £50 million; an indicative calculation which it is anticipated will be refined through a more robust market-based methodology going forward.	20-21 18

Objectives for the interim evaluation	**Relevant NIAO Recommendation**	**Findings**	**Reference to report section (page number)**
4. In completing objective 3 above, the following must also be addressed: • The NIAO Report suggested that DfE would benefit from a wider range of information to feed into its policy decisions. It was recommended that DfE work with other stakeholders to establish a formal and ongoing means of measuring the demand and supply of finance in the SME sector, and to develop a methodology for quantifying the SME funding gap in Northern Ireland. The steps to practically address this recommendation should form part of this review. (Recommendation 1 – NIAO Report); and • The NIAO Report highlighted that co-investment arrangements offer a number of advantages to Invest NI, and it should seek to maximise this type of activity within its Access to Finance strategy. This evaluation should review the benefits and disadvantages of co-investment activity to date and assess the scope for delivering future planned funds through co-investment arrangements. (Recommendation 9 – NIAO Report).	*(1) The Department for the Economy should work with other key stakeholders to measure the demand for, and supply of, finance in the SME sector, and develop a methodology for quantifying the SME funding gap in Northern Ireland.* *(9) Co-investment arrangements offer advantages, including the equal sharing of investment risk and returns, a focus on investments led by the private sector and lower fund management fees. Invest NI should seek to maximize the level of co-investment activity within its Access to Finance Strategy and assess the scope for delivering future planned funds through co-investment.*	• A robust mechanism or methodology does not currently exist to quantify the SME funding gap in Northern Ireland • This report has set out a proposed methodology, using secondary data, to estimate the funding gap in Northern Ireland. The principal steps in quantifying the approximate scale of the finance gap are to: ➢ develop an estimate for the number of companies that considered and/or sought external finance in the last year ➢ quantify the amounts of equity/loan sought, and how much was obtained – calculate the difference between what was sought and what was obtained (*viable demand* for finance) ➢ in addition to (full and partial) unmet demand where equity/loan finance was sought, take into account data on number of companies requiring but not applying for finance, and the amounts sought (*unmet demand* for equity/loan finance) ➢ draw the evidence together, to estimate the finance gap for finance based on the business survey data of unmet demand – using survey data to estimate effective/viable demand, including those discouraged from seeking finance. • This approach could be augmented with accurate data, specific to Northern Ireland. To achieve this, DfE should work with BEIS to utilise the regional data from the Longitudinal Small Business Survey, and if possible to increase the sample size of SMEs in Northern Ireland. • Co-investment arrangements offer multiple benefits including increased private investment, *pari passu* public sector investment (with no subordination), and reduced management costs • In the context of reduced European funding and uncertainty around future FTC funding, the financial benefits offered by co-investment are important for Invest NI • Co-investment arrangements for the Development Funds have been explored by Invest NI. However, this was not progressed as notable risks were identified with raising private funding for investments and lower economic benefits were forecasted on those terms. There was also limited interest from fund managers to bid for such a fund. Leverage at deal level is now stipulated for all funds, encouraging co-investment. This approach will continue to be explored in the structure of future funds.	18-20 38

Objectives for the interim evaluation	Relevant NIAO Recommendation	Findings	Reference to report section (page number)
5. Assess the appropriateness and effectiveness of the Fund of Funds model adopted by Invest NI, including: • A review of performance to date of Fund of Funds against the original objectives and, if appropriate, identify reasons for any divergence; • An assessment of the operation and management arrangements adopted for the Fund of Funds and determine their effectiveness in meeting Invest NI strategic objectives; • An examination of the degree of complementarity with other Invest NI products and any other relevant publicly funded products, including funding supported by the British Business Bank; • An identification of the main risks that have emerged during the operation of Fund of Funds model to date and any actions taken to reduce these risks. Assess whether the overall approach to risk management is robust and proportionate; • Providing an assessment of the longevity of the structure of this Fund of Funds model; • A review of Invest NI's approach to seeking funding approval for individual fund	*(5) Invest NI to continue to ensure that fund manager fees broadly align with industry benchmarks and to reduce costs where possible. Invest NI to clearly demonstrate steps taken to minimise fee levels, liaising with other UK agencies, including the British Business Bank, on best practice in establishing fund manager fees.* *(6) Invest NI and Fund Advisory Committees to identify changes in the levels of investment, including spikes in activity, and challenge fund managers to demonstrate that investment decisions have been appropriate.* *(7) The selection and on-going work of fund managers is critical to the success of funds. Invest NI must ensure that all appointments follow rigorous testing*	• The FoF is making strong progress against the original objectives of the model. • The first objective has been met. There is evidence of notable progress towards the second objective, however, there is scope for this to be developed further. The FoF model is delivering against the final objective, however, some stakeholders perceived there to be limited progression, as they see the same limited number of key actors, as the funding partners are the same. However, evidence from Invest NI shows that new individuals are entering the market and being trained, as, through the access to finance funds, more activity is now taking place. • The management processes in place for the funds under the FoF model are effective and deliver on Invest NI's strategic objectives. • Performance is reviewed by the Corporate Finance Team on a monthly basis and poor performance is identified and addressed swiftly. This includes monitoring changes in investment, and challenging fund managers on decisions where appropriate. • The FoF model aligns well with the other Invest NI products, such as the pre-accelerator programme, and in-house delivery enables Invest NI to have strategic oversight over a range of complementary access to finance products. • The model is positioned well with other access to finance initiatives in the market; while on paper there appears to be some overlap, in practice, these are complementary. The scale of the recently launched Growth Finance Fund in Northern Ireland will offer loans from £500k up to £2 million to SMEs. The GLF II, typically offers up to £500k debt finance, but in defined situations can invest larger amounts. However, Invest NI is clear that the Growth Finance Fund will not have any operational impacts on the access to finance funds in Northern Ireland. • The main risks that have emerged during the operation of the FoF model are in relation to fund manager performance. For example, in 2014, Invest NI had significant concerns about NISPO fund manager performance and were unable to address this appropriately due to lack of clarity in the contractual clauses. Since the FoF model commenced, Invest NI has sought professional legal advice and tightened contractual clauses.	25-29 33-35 **Error! Bookmark not defined.**-42, 53 35-36

Objectives for the interim evaluation	Relevant NIAO Recommendation	Findings	Reference to report section (page number)
interventions, giving consideration to other options including a more holistic approach; and • Highlighting any lessons learned for the future architecture of Fund of Funds.	*procedures, and that its oversight of funds managers will identify any emerging issues, with action taken to tackle poor fund manager performance.*	• The overall approach to risk management is robust and proportionate at a fund level. However, at a strategic level, while there is evidence of risks being discussed at the Working Group meetings, there is no clear risk strategy in place in regard to the performance and financial sustainability of the FoF model.	
		• Market failure in access to finance continues to exist in Northern Ireland and it appears to be unlikely that the gaps in access to finance will be addressed by the market in the foreseeable future. Evidence from the Scottish market suggests this could take up to 15 years. • Invest NI should continue to take a long-term approach to the Fund of Funds model and this should remain in operation until at least 2023, when ERDF will cease. The amount of returned funds is expected to have increased by this stage, but other sources will need to be explored to ensure continuity of provision.	57-58
		• Invest NI's current approach for funding approval from DfE operates at the level of individual funds, rather than the umbrella fund approval e.g. in NPIF. This has distinct advantages but means that the flexibility to re-allocate funding is limited. Invest NI are clear that the implementation of a reserve fund has been explored, however, it was considered that this would add limited value, over and above the existing structures and processes in place, and that it would be difficult to gain Department approval for this.	40-41
6. Assess how Fund of Funds has contributed to the strategic aims, objectives, targets and actions of the Draft NI Programme for Government (PfG), DfE and Invest NI. This assessment should draw upon evidence on the contribution made to date or anticipated.		• FoF has made notable contributions to the strategic aims, objectives and targets of the Draft NI Programme for Government (PfG), the DETI Corporate Plan 2011-15 and Invest NI's Business Strategy, as set out in the body of the report. For example, from 2010 to 2018, the FoF has increased investment in Northern Irish businesses by £252.2 million.	29-30
7. Assess the impact of Fund of Funds model in increasing equity and debt investment in SMEs (the		• The amount of equity and debt investments in SMEs in Northern Ireland since 2014, has increased less than in most other UK regions. However, over this period, the FoF model has facilitated a significant amount of	43

Objectives for the interim evaluation	Relevant NIAO Recommendation	Findings	Reference to report section (page number)
strategic objectives). Assess the extent to which Fund of Funds has directly and indirectly generated other outcomes and impacts, including wider and regional economic benefits. These benefits should be quantified as fully as possible where relevant, or if quantification is not possible, a qualitative analysis should be presented of their scale and persistence.		equity and debt investment in SMEs; in December 2018, this totalled £251.5 million. This is a multi-fold increase from the total funding available through three Invest NI funds in 2010, namely £39.5 million. • It is not possible to assess whether investments in SMEs would have been at a similar level without Access to Finance and the FoF model; on the evidence available, we believe that it would have been much lower. • The FoF model has delivered numerous wider and regional impacts. The model has facilitated the long-term management of the access to finance funds and, through this, has increased the scale/quantum of public sector investment in risk capital funds. The scale of the funds has significantly increased private sector interest and investment in Northern Ireland, both from domestic private investors and international investors. • The FoF has increased partnership working and collaboration at fund level and at a strategic level and with other public sector agencies such as BBB. The wider and regional economic benefits that follow are anticipated to be realised over the next five to ten years, and further observed in the development of an increasingly mature access to finance market.	54-56
8. An assessment of whether the Fund of Funds architecture will deliver more incremental outcomes (qualitative) as compared to individually managed debt and equity funds.		• In contrast to delivering and managing the funds individually, the FoF structure has unlocked Departmental and Ministerial approval for a larger quantum of funding than would have been the case had the funds been operated and managed in silos. The scale of the model (£252.2 million) and the level of public sector investment has built greater confidence in the market as a place to invest and has reduced the risk for investors; which would not be possible on the same scale were the funds to be delivered individually. • The flexibilities offered by the FoF structure have not been fully utilised to date, however, it is anticipated that the recycling of returned funds will increase the financial sustainability of the model. • Many of the outcomes achieved by the model are likely to have been delivered through the individually managed funds; however, the model has enabled the scale of funding to be significantly greater, and has enabled processes, such as funding approval, to happen more smoothly and efficiently. Some of the outcomes achieved, such as partnership development, are expected to have taken significantly longer to be realised without the structure.	25 31-32 56

Objectives for the interim evaluation	Relevant NIAO Recommendation	Findings	Reference to report section (page number)
9. Review Invest NI's approach to performance monitoring and target setting and consider what the key performance indicators and outcomes of Fund of Funds should be: • Clearly articulate what the overall strategy is expected to deliver and establish a suite of aggregated targets for key areas including financial returns and economic benefits. The targets should take account of the continuum nature of the model (e.g. a company may avail of funding from several sources), and therefore the targets may take the form of a range. (Recommendation 8 (part)); • Review the appropriateness of the establishment of indicators/targets for future levels of private investment leverage and subordination. (Recommendation 8 (part) and 10 (part) – NIAO Report); and • Out of this exercise, define the medium and long term aims of Invest NI in developing the local risk capital industry. (Recommendation 10 (part) – NIAO Report).	*(8) Invest NI should review its approach to performance monitoring and target setting in the light of experience and assess whether initial targets for individual funds require revision. Invest NI should also articulate what the overall strategy is expected to deliver and establish a suite of aggregated targets including overall financial returns and wider economic benefits.* *(10) Invest NI should clearly define the medium term and long-term outcomes it aims to achieve in developing the local risk capital industry. In particular, it should establish indicators or targets for future levels of private investment leverage and subordination.*	• The performance monitoring processes for the individual funds is strong. However, at a strategic level, there is no clear performance framework for the FoF model and thus there is some ambiguity around what the model is expected to deliver and how well it is performing. A logic model for the FoF has been developed, which sets out the medium and longer term aims of the model in developing the risk capital industry. The detailed medium-term aims are set out in the body of the report. • Our interpretation of the long term aims of Invest NI in developing the local risk capital industry in Northern Ireland, based on the existing information from Invest NI and the FoF logic model, is: to build quantum in the access to finance market, to normalise the access to finance market, and, principally, to deliver economic growth. • In line with the anticipated outputs and outcomes to be delivered by the FoF model, a suite of aggregated targets has been developed, which sets out what the model is expected to deliver, based on the performance of the previous funds, and with consideration to the current structure of the live funds (the number of debt and equity funds). The targets are set out in Table 4-3, and are currently forecast to 2025, following which, the live funds will be completed[66].	48-51

[66] The aggregate targets will need to be revised if/when additional funds are included in the model.

Objectives for the interim evaluation	**Relevant NIAO Recommendation**	**Findings**	**Reference to report section (page number)**
10. Determine if the JEREMIE model remains valid following the UK referendum decision to exit the EU. If so, benchmark the Fund of Funds against two benchmarking examples. It is anticipated that these will be JEREMIE models from elsewhere in the UK. Specifically, the consultants should consult with the British Business Bank with regard to the Northern Powerhouse Investment Fund and the Midlands Engine Fund. If applicable, benchmark the incremental costs and benefits of the Fund of Funds model and the JEREMIE model to determine which mechanism represents the most appropriate means of delivering future access to finance activities. (Recommendation 3 – NIAO Report).	*(3) Invest NI should benchmark the costs and benefits of its Fund of Funds model and the European JEREMIE model to assess the most appropriate mechanism.* *(4) Invest NI should identify the funding shortfall which is likely to arise following the future loss of EU funding and quantify the level of additional baseline expenditure which will be required to deliver its operations.*	• There is no formal agreement in place between the UK Government and the European Investment Bank (EIB) on what the future relationship will be. Existing finance and loan arrangements with UK funds will be delivered as agreed, but it is not yet clear whether EIB funding will be accessible in the UK in the future, and thus whether the JEREMIE model will remain valid. • The Invest NI FoF is largely reliant on ERDF which is expected to cease in 2023. While Invest NI's 10-year financial plan for the model incorporates this reduction in funding, it is based on the delivery of the current funds and does not include consideration of future funds, which are not currently scheduled until 2023. It is not clear whether other sources of funding will be secured and/the amounts; therefore, the future scale and delivery of the Invest NI FoF model is uncertain. • The management costs for the Invest NI FoF are low relative to the North of England JEREMIE funds. This is predominantly due to reduced holding fund management costs, the Invest NI holding fund management costs are less than half of each of the 3 JEREMIE funds. It is not possible to benchmark the benefits of the Invest NI FoF model with the JEREMIE funds as, the aggregated fund outcomes for the Invest NI FoF relate to different time periods.	57 36
11. Identify lessons learned and highlight aspects of Fund of Funds design and delivery which could/should be incorporated in the future. This should draw on the Northern Ireland context and evidence from the benchmarking exercise. Present a succinct set of conclusions from the evaluation, taking account of all of the evidence gathered during the assignment. Recommendations should be numbered, concisely worded and be Specific, Measurable, Achievable, Relevant and Time-Bound (SMART).		• Invest NI's decision to deliver the model in-house has proved to be beneficial. While the management of the model is arguably more light-touch than the JEREMIE models, this is at a significantly less cost, and there is no evidence to suggest this has had a detrimental impact on the outcomes achieved by the FoF model. Invest NI should seek to retain responsibility for the FoF model to continue to realise these benefits. • Invest NI's bottom-up approach to the delivery of the model presents some limitations. The focus on the delivery of individual funds, each with specific LPs, creates difficulties in utilising the flexibility in the model to reallocate funding, where necessary. It is not possible to assess the performance of the FoF model at a strategic level, as there is no start and end date and the funds deliver to varying timescales. Due to this, economic appraisals and evaluations are undertaken at a fund level, and it is not possible to assess market demand across the whole structure simultaneously. Where possible, delivery periods should be aligned in the future, and, depending on the overall funding position, consideration might be given to	37 32-33

Objectives for the interim evaluation	Relevant NIAO Recommendation	Findings	Reference to report section (page number)
		implementing a top-down approach at the end of the current funding period (2023).	
		• The flexibility to recycle returned funds in the model has not yet been utilised fully, however this is still considered to be a key strength for the sustainability of the model. This benefit will be greater realised as returns increase, and this feature should be retained in future models.	31-32
		• Invest NI has experienced difficulties in managing poor fund manager performance in the past, due to insufficient clauses in fund manager contracts. This has now been rectified, following legal advice, and the management processes in place, through the Advisory Boards and the Corporate Finance Team, are stringent and effective. This structure should be maintained in the future.	35-36
		• Invest NI has facilitated the inclusion of external, private sector experts in the governance of the FoF model. This has been advantageous in bringing credibility to the model, both from an internal and external perspective, and in building private sector confidence in the delivery. External input on the strategic objectives of the model has not been fully utilised to date. The involvement of external experts should be capitalised further in the future, by changing, or clarifying, the remit of the Working Group to have a greater strategic focus.	39-39
		• Co-investment has resulted in a significant increase in private investment in Northern Ireland and has supported progress towards a maturing access to finance market. As per the NIAO recommendation, continued consideration should be given to increasing co-investment funds in Northern Ireland; as is evidenced in the economic appraisals of the relevant funds.	38

Source: SQW based on the evidence from the interim evaluation

Recommendations

5.7 The findings from this interim evaluation, as summarised in Table 5-1, above, are broadly positive: their implications point towards a renewed strategic focus for the FoF model, which can help continue the progress achieved to date towards greater market maturity, albeit in uncertain economic conditions.

5.8 The findings highlight that the FoF model is operating effectively, and only relatively minor operational changes are recommended to improve join up and collaboration across the eco-system and to increase the profile of the model. This will deliver improved strategic understanding among stakeholders, particularly as the use of the flexible features in the model are increased, such as the recycling of returned funds and the reallocation of funding between funds.

5.9 The evaluation identifies thirteen recommendations for Invest NI and other stakeholders which are set out in Table 5-2; eight directly relating to the FoF model, five to the wider growth business support and risk finance eco-system. The recommendations from the first interim evaluation in 2014 have been revisited, and where still relevant, they are detailed in the table.

Table 5-2: Recommendations for the FoF model and Access to Finance ecosystem

#	Recommendation	Justification	Relevant recommendation from 2014 interim evaluation
Fund of Funds Model			
1	**While there are practical difficulties in implementing a reserve fund under the FoF's current operating conditions, it remains a valid consideration. Invest NI should review the practicalities of implementing a reserve fund in the future, as the FoF model evolves/matures.**	This feature was considered relevant when the model was initially designed in 2010, based on the JEREMIE structure. However, the evidence from this review suggests that this feature has not been utilised to date, and that there is limited demand for this feature at the moment. Evidence from other fund of funds models (e.g. North East JEREMIE model) indicates that a reserve fund can enable greater flexibility in the delivery of a holding fund model, particularly in 'topping up' funds in response to economic demand.	Linked to the 2014-2020 European Structural Funds programme, if practically possible Invest NI should seek approval to establish a flexible risk capital pot of between £5-10 million that could be allocated rapidly to an individual fund in response to market signals. This would reduce the time associated with securing separate approvals to extend a fund.
2	**Invest NI should develop a communication strategy for the Access to Finance funds to raise greater awareness of the continuum of funds among SMEs, professional advisers, and, in some cases, other Fund Managers. This should include a two-staged approach: greater education regarding equity finance for SMEs, and promotion of the Access to Finance funds.**	Stakeholder consultations demonstrated a lack of awareness of the FoF model. Finance Wales and the Scottish Investment Bank demonstrate the value of marketing the model as a brand in increasing stakeholder knowledge and awareness of the model.	Invest NI should undertake an early review of its communications strategy relating to the Fund of Funds. This should include exploring the potential to develop the use of the Invest NI brand as the primary gateway for those businesses seeking access to finance rather than rely on the marketing activities of the individual funds.
3	**Invest NI should implement a risk strategy for the FoF model, to be reviewed and updated on annual basis. The Access to Finance Working Group should have responsibility for managing this.**	A risk strategy for the FoF does not exist, and it is not currently possible to assess how well risk is being managed. This will provide a clearer framework for managing risk and better evidence of risk management taking place.	
4	**Invest NI should continue to explore co-investment in the economic appraisal of the individual funds, with a view to increasing private investment in the model and attracting skills and expertise to NI.**	Evidence from the evaluation of the Co-Fund and stakeholder consultations shows that co-investment arrangements are effective in increasing private sector investment and presents cost efficiencies for Invest NI.	
5	**Invest NI should identify opportunities to align the delivery timeframe for the debt and equity funds, respectively; with a view to facilitating a robust economic assessment of the rationale**	The evaluation evidence of each of the funds does not temporally align, and thus it is not possible to aggregate the outcomes to assess the performance of the model, nor benchmark this with other Fund-of-Funds models.	

#	Recommendation	Justification	Relevant recommendation from 2014 interim evaluation
	and demand for the suite of Invest NI funds and assessing the performance of the FoF model. Moving forward, consideration might be given to implementing a top-down approach at the end of the current funding period (2023).	This is in line with Invest NI moving towards theme-based evaluations.	
6	**Invest NI should develop a long-term strategy for the FoF model which includes the aims and objectives in line with the long-term vision for A2F. This should be developed with the Access to Finance Working Group, and the strategy should then be owned and reviewed by the Working Group.**	Stakeholder consultations and evidence presented in the NIAO report highlighted the need for greater clarity around the long-term outcomes anticipated from the model. It is not possible to make a robust assessment of the model without a benchmark to assess against.	Invest NI should seek to extend the remit of the Fund of Funds Committee beyond oversight of the performance of the individual funds. Alongside this, the Committee should develop a more strategic role, focusing on longer term demand and supply-side issues.
7	**Invest NI should agree and implement a performance framework for the FoF model, over a ten-year period, based on the targets developed by SQW. This should be reviewed annually to assess the impact of the model at a strategic level.**	Evidence from the document review and the stakeholder consultations show that there is ambiguity around what the model is expected to deliver within a specified timeframe. Performance information is not collected and reported at a holding fund level.	To support the Fund of Funds Committee in implementing recommendations 1 and 2, Invest NI and DfE should draw together a series of existing indicators reflecting market trends in demand for and the supply of SME finance. These should be presented on a quarterly basis.
8	**Following recommendation 7, Invest NI should look to develop targets that provide an indication of market conditions, and the overall quality of outputs, to better assess the overall contribution of the FoF model to the Northern Ireland economy. For example, to what extent are job or GVA outcomes realised in strength sectors recognised in the Draft Industrial Strategy; to what extent is knowledge and skills being developed and retained in the access to finance landscape in Northern Ireland.**	Stakeholder consultations and the document review indicate that the current performance information reported on the FoF provides limited insight or evidence in regard to the overall impact of the FoF model on the Northern Ireland economy.	Building on the material presented in Appendix 1 of this report, Invest NI should develop aggregated KPIs at Fund of Funds level to feed in to the Corporate Plan cycle. These could include target number of investments/deals, amount invested, and jobs created, cumulated at Fund of Funds level and reported annually. The GVA target for each fund should be assessed at the end of the 10-year operational period through Post Project Evaluation.
9	**Invest NI should systematically record the number of firms that receive follow up investments from alterative access to finance funds, on an annual basis.**	Stakeholder consultations demonstrated a lack of awareness of the FoF model and the strategic aims. This is impacting negatively on referrals between funds and subsequent deal flow in the model. Invest NI should	

#	Recommendation	Justification	Relevant recommendation from 2014 interim evaluation
		monitor deal flow to better understand the frequency of which it is taking place, and to establish whether further intervention from Invest NI is required.	
Access to finance eco-system development			
10	**Building on existing initiatives, Invest NI should work with regional partners in Northern Ireland to develop educational activities, tailored to the local business population, to support SMEs to understand the range of access to finance options available.**	Stakeholder consultations highlighted that the biggest barrier in access to finance in Northern Ireland is SME demand and greater resources should be made available for educational initiatives, particularly outside of Belfast.	
11	**Invest NI should work with Fund Managers to increase the promotion of examples of successful SMEs that have utilised access to finance funds to achieve growth, particularly examples of small deal sizes.**	Stakeholder consultations showed that seeing positive examples of businesses securing finance for growth is an effective way to increase SME demand. There are examples of this happening at the larger deal sizes, however increased promotion is required for smaller deals to engage SMEs with smaller growth potential.	
12	**DfE should seek to establish more robust, local data on SME demand for finance in Northern Ireland. This includes working with BEIS, in the first instance, to explore the viability of regional data from the Longitudinal Small Business Survey, or commission a biennial survey[67] of SMEs in Northern Ireland.**	A methodology to capture the level of demand for finance and assess the gaps in provision does not currently exist in Northern Ireland; this is an aim of this review (as set out in the ITT). Stakeholder consultations suggest that this information is valuable to inform current provision and to assess how the market in Northern Ireland is developing. This information is necessary to calculate the SME funding gap in Northern Ireland, as set out in SQW's proposed methodology.	
13	**In light of new Fund-of-Funds delivery arrangements in the UK (e.g. NPIF) and the anticipated changes to EIB funding, Invest NI should review the FoF delivery model every three-to-four years to benchmark against best practice, and identify areas for further development.**	The FoF model was developed nearly ten years ago, at a time when many Fund-of-Funds models were utilising the JEREMIE structure. Reviewing the model regularly in contrast to developments taking place in access to finance provision will ensure that the Invest NI model reflects best practice.	Invest NI should continue to review the Fund of Funds delivery model every three years, benchmarking the approach against best UK and European best practice. The review should test the costs and benefits of the current approach against those of an independently managed holding fund.

[67] Invest NI should design the survey with reference to the analysis required to quantify these gaps, benchmarking the questions where possible/ appropriate with the surveys undertaken by BEIS and the Government of Ireland.

Source: SQW and the Fund of Funds Interim Evaluation (2014)

Annex A: Study objectives

Strategic Context and Rationale

- Briefly review the strategic context under which the Fund of Funds model has operated and assess whether the model remains valid. Review the operational fit of the Fund of Funds with the objectives of the current Invest NI Business Strategy, as well as the Invest NI / DfE corporate plans/strategies in place since 2014.
- Review the ongoing rationale for the Fund of Funds, through a review of the SME financing environment, including the nature and scale of the market failures that it is seeking to address.
- Quantify the current SME funding gap in Northern Ireland. This should incorporate a view as to the overall quantum of the Fund of Funds (currently £194.2 million) and other funds that are currently being planned, to determine whether the continuum is complete or if further types of funds which should be considered. (Recommendation 2 – NIAO Report).
- In completing objective 3 above, the following must also be addressed:
    - The NIAO Report suggested that DfE would benefit from a wider range of information to feed into its policy decisions. It was recommended that DfE work with other stakeholders to establish a formal and ongoing means of measuring the demand and supply of finance in the SME sector, and to develop a methodology for quantifying the SME funding gap in Northern Ireland. The steps to practically address this recommendation should form part of this review. (Recommendation 1 – NIAO Report); and
    - The NIAO Report highlighted that co-investment arrangements offer a number of advantages to Invest NI, and it should seek to maximise this type of activity within its Access to Finance strategy. This evaluation should review the benefits and disadvantages of co-investment activity to date and assess the scope for delivering future planned funds through co-investment arrangements. (Recommendation 9 – NIAO Report).

Design, Operation and Delivery of Fund of Funds

- Assess the appropriateness and effectiveness of the Fund of Funds model adopted by Invest NI, including:
    - A review of performance to date of Fund of Funds against the original objectives and, if appropriate, identify reasons for any divergence;
    - An assessment of the operation and management arrangements adopted for the Fund of Funds and determine their effectiveness in meeting Invest NI strategic objectives;
    - An examination of the degree of complementarity with other Invest NI products and any other relevant publicly funded products, including funding supported by the British Business Bank;
    - An identification of the main risks that have emerged during the operation of Fund to Funds model to date and any actions taken to reduce these risks. Assess whether the overall approach to risk management is robust and proportionate;
    - Providing an assessment of the longevity of the structure of this Fund of Funds model;
    - A review of Invest NI's approach to seeking funding approval for individual fund interventions, giving consideration to other options including a more holistic approach; and

  - Highlighting any lessons learned for the future architecture of Fund of Funds.

Performance and Impact (including Value for Money)

- Assess how Fund of Funds has contributed to the strategic aims, objectives, targets and actions of the Draft NI Programme for Government (PfG), DfE and Invest NI. This assessment should draw upon evidence on the contribution made to date or anticipated.

- Assess the impact of Fund of Funds model in increasing equity and debt investment in SMEs (the strategic objectives). Assess the extent to which Fund of Funds has directly and indirectly generated other outcomes and impacts, including wider and regional economic benefits. These benefits should be quantified as fully as possible where relevant, or if quantification is not possible, a qualitative analysis should be presented of their scale and persistence.

- An assessment of whether the Fund of Funds architecture will deliver more incremental outcomes (qualitative) as compared to individually managed debt and equity funds.

- Review Invest NI's approach to performance monitoring and target setting and consider what the key performance indicators and outcomes of Fund of Funds should be:

  - Clearly articulate what the overall strategy is expected to deliver and establish a suite of aggregated targets for key areas including financial returns and economic benefits. The targets should take account of the continuum nature of the model (e.g. a company may avail of funding from several sources), and therefore the targets may take the form of a range. (Recommendation 8 (part));

  - Review the appropriateness of the establishment of indicators/targets for future levels of private investment leverage and subordination. (Recommendation 8 (part) and 10 (part) – NIAO Report); and

  - Out of this exercise, define the medium and long term aims of Invest NI in developing the local risk capital industry. (Recommendation 10 (part) – NIAO Report).

- Determine if the JEREMIE model remains valid following the UK referendum decision to exit the EU. If so, benchmark the Fund of Funds against two benchmarking examples. It is anticipated that these will be JEREMIE models from elsewhere in the UK. Specifically, the consultants should consult with the British Business Bank with regard to the Northern Powerhouse Investment Fund and the Midlands Engine Fund. If applicable, benchmark the incremental costs and benefits of the Fund of Funds model and the JEREMIE model to determine which mechanism represents the most appropriate means of delivering future access to finance activities. (Recommendation 3 – NIAO Report).

Overall Assessment and Lessons Learned

- Identify lessons learned and highlight aspects of Fund of Funds design and delivery which could/should be incorporated in the future. This should draw on the Northern Ireland context and evidence from the benchmarking exercise. Present a succinct set of conclusions from the evaluation, taking account of all of the evidence gathered during the assignment. Recommendations should be numbered, concisely worded and be Specific, Measurable, Achievable, Relevant and Time-Bound (SMART).

Annex B: Key Performance Indicators of funds

B.1 The table below outlines the KPIs for the individual sub-funds. The KPIs are sourced from the sub-funds evaluation reports and economic appraisals provided to SQW by Invest NI.

Table B-1: Key Performance Indicators

Fund	KPIs
Small Business Loan Fund	• Complete at least 132 investments per annum for the first five years of the term • Operate in the deal size range of a minimum of £1k and a maximum of £50k • Make average investments from the Partnership Funding of £13k per deal per annum • Make investments applying interest rates that reflect the risk involved in each case, but in order to adhere to State Aid rules, the interest rate margin must be at least the levels prescribed in the EU Journal (in addition to the reference rate based on 1 year IBOR of 1.5%) but with the option to charge higher interest rate if the manager deems this to be appropriate • Make investments over the first five years of the term and no less than £1.2m and no more than £2m per annum • Achieve a default rate of less than 23%[68]
Small Business Loan Fund II	Fund Manager: • Operate in the deal size range between £10k and £100k (offering loans of less than £10k by exception) • Invest at least £1.65m per annum over the first five years • Make at least 65 loan advances per annum over the period • Make investments at interest rates that reflect the risk involved in each investment, but that are at an appropriate premium above the interest rates applicable to the typical rates charged by the local banking sector for funding and are in line with EU State Aid guidelines • Achieve a loan default rate of less than 20% • Market and promote SBLF II to all regions across Northern Ireland Promoter: • Achieve an average net increase in employment of 0.29 jobs per loan, equating to 102 jobs over the period of the fund • Achieve an average gross increase in employment of 0.62 jobs per loan, equating to 213 jobs over the period of the fund • Achieve an average net increase in GVA of £9,315 per loan, equating to £19.3m over the period of the fund • Achieve an average gross increase in GVA of £19,536 per loan, equating to £40.4m over the period of the fund[69]
Growth Loan Fund	• Complete 65 investments per annum for the first five years of the term (this target was reduced to 30 for the 2015/16 year) • Operate in the deal size range of a minimum of £50k and a maximum of £500k • Make an average investment from the Partnership Funding of £150k per deal • Make investments at interest rates that reflect the risk involved in each investment, but that are at an appropriate premium above the interest

[68] Cogent, 2016, *NI Small Business Loan Fund & the Growth Loan Fund Joint Evaluation*
[69] ASM, 2017, *Economic and Financial Appraisal of Potential Successor Fund(s) to the Northern Ireland Small Business Loan Fund*

Fund	KPIs
	rates applicable to the typical rates charged by the local banking sector for senior secured finance • Invest £50m over the first five years of the term and no less than £8m and no more than £15m per annum • Achieve a default rate of less than 12.5%[70]
Growth Loan Fund II	• Make at least 90 loan advances (between 12 and 24 per annum) over the five-year investment period • Invest £30m over the first five years of the loan fund and no less than £4m and no more than £8m per annum • Apply an interest rate in compliance with the appropriate EU Reference Rate and the Brandenburg Methodology; the fund will be able to provide loans to appropriate businesses which are ineligible to apply for funding from the BBB Pilot Loan Fund due to the State Aid • Leverage at least £22.5m additional funding at deal level[71]
techstart NI – SME Equity	• Make 7-11 investments per annum in companies not already a portfolio company for the first five years of the term • Operate in the deal size range of £50k to £250k • Drawdown and invest 70% (minimum) of investment commitment over the first five years, drawdown and invest the remaining 30% between year six and eight (8%-12% per annum) • Invest in companies that are at seed and early stage • Invest in 40-50 new companies over the first five years of the term • Make investments only within the investment area • Ensure the key executives devote substantially all of their working hours to the management and control of the partnership whilst in the employ of the manager[72]
techstart NI – University Equity	• Complete at least 1 investment per annum in companies not already a portfolio company for the first five years of the term • Operate in the deal size range of a minimum of £50k and a maximum of £250k • Make 7 investments over the first five years of the term (in new companies) • Drawdown and invest at least 70% of the loan commitment of the universities over the first five years of the term • Drawdown and invest the remaining loan commitment of the universities between year six and the end of year eight of the term • Make investments only within the investment area • Complete at least 1 investment per annum in companies not already a portfolio company for the first five years of the term[73]
techstart NI – POC	• Award 36-44 mini grants in the first year, 26-34 over next four years • Award 24-32 standard grants in the first year, 6-10 over next four years • Commit £1,320k-£1,720k grant funding in the first year • Commit £450k-£550k grant funding in years 2-5 • Commit £3.6m grant funding over five years[73]
Co-Fund	• Complete 14 investments per annum • Typically operate in the deal range of £150k - £1m, with an average investment of £170k

[70] Cogent, 2016, *NI Small Business Loan Fund & the Growth Loan Fund Joint Evaluation*
[71] ASM, 2018, *Economic and Financial Appraisal of Potential Successor Fund(s) to the Northern Ireland Growth Loan Fund*
[72] Cogent, 2018, *techstart Funds Evaluation & NISPO Impact Assessment*
[73] Cogent, 2018, *techstart Funds Evaluation & NISPO Impact Assessment*

Fund	KPIs
	• Make investments on substantially the same terms as pre-qualified investors and to contribute no more than 50% of the funding in any one round and to achieve a ratio of 55:45 private to public funding over the portfolio • Invest £12.5m over the term and no less than £2m per annum in years 4-6 • Pre-qualify no less than 12 private investors[74]
Development Fund	• Complete at least four investments per annum for the first five years • Operate in the deal size range of a minimum of £450k and a maximum of €1.5m[75]; this relates to initial investment deal size only • Make investments with an aggregate subscription equal to 15% of the Partnership Funding in each year of the investment period; this relates to 15% of the funding expected to be invested in the first five years (i.e. not including follow-on investments thereafter) • Make 20 investments over the first five years of the term • Make investments only within the investment area (ultimately contracted as just within NI)[76]

[74] Capaxo, 2016, *Co-Investment Fund Interim Evaluation*
[75] €1.5m is the upper limit for any one transaction per the 2008 General Block Exemption Regulation. The Development Funds are permitted to provide investment of up to £3m over a number of investments rounds.
[76] SQW, 2017, *Evaluation of the Development Funds*

Annex C: Aggregate targets

Table C-1: Aggregate Fund of Funds targets

Cumulative target	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028
Companies supported	27	68	127	198	328	446	598	753	910	1,104	1,189	1,291	1,393	1,495	1,590	1,590				
Net companies supported	25	61	114	178	295	401	539	678	819	993	1,070	1,162	1,253	1,346	1,431	1,431				
Total amount invested £m	1	3	7	22	44	70	100	143	189	238	275	315	358	398	417	417				
Private sector investment £m	0	1	3	8	22	36	54	80	109	141	157	172	192	213	234	239				
- Fund level leverage £m	0	0	0	1	7	13	21	33	44	57	59	63	68	74	80	80				
- Deal level leverage £m	0	1	3	7	15	24	32	47	64	84	98	109	123	139	154	160				
New jobs created	9	17	52	132	343	634	925	1,282	1,742	2,241	2,880	3,190	3,548	3,946	4,365	4,676	4,806			
Net jobs created	8	15	47	119	308	570	832	1,154	1,568	2,017	2,592	2,871	3,193	3,551	3,929	4,208	4,325			
Companies receiving support from multiple sub-funds (10%)	3	7	13	20	33	45	60	75	91	110	119	129	139	150	159	159				
Returned funds recycled excluding FTC £m									1	2	9	13	17	20	24	28	35	42	49	54
Additional GVA generated £m	1	3	8	21	48	86	124	168	221	284	354	393	439	490	544	582	600			
Net GVA generated £m	1	3	7	19	43	77	111	151	199	255	319	353	395	441	490	524	540			

Source: SQW analysis of actuals and forecasts provided in evaluations and economic appraisals of FoF sub-funds

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