



Northern Ireland Audit Office

## ***MEDIA RELEASE***

### **Access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland**

The Comptroller and Auditor General, Mr Kieran Donnelly, today published a report examining access to finance for small and medium-sized enterprises (SMEs) in Northern Ireland. The report's primary focus is on Invest NI's progress in implementing its Access to Finance Strategy, which commenced in 2009, and which currently comprises seven funds mainly making investments and loans to SMEs. The funds, which are managed by independent fund managers, will operate until 2024. They are providing total support of £181million (£104 million from Invest NI, and £77 million private investment), £124 million of which has been invested in SMEs to date. More generally, the report also assesses local SME demand for finance, the finance available, and the potential funding gap (the difference between demand and supply).

Mr Donnelly said:

***"The Access to Finance strategy is providing an important source of finance to local SMEs. However, it is a long term initiative, involving inherently high risk investment activity, and whilst there is potential for longer term success, sufficient evidence is not yet available to demonstrate that it is delivering value for money".***

***"A number of key measures will determine the strength of performance achieved, including the financial returns realised by Invest NI, the extent of growth and wider economic benefits achieved by supported businesses, and the strategy's contribution to developing the local risk capital industry".***

***"Invest NI can take steps to help assist the future performance of funds. It should ensure that fund managers are actively and judiciously managing investments to maximise potential fund returns. It should also more clearly define what the overall strategy is expected to deliver, set aggregated targets for key areas, and identify the specific outcomes which would demonstrate that the strategy has helped develop the local venture capital industry".***

## **Main Findings**

### **Strategy Development and Implementation**

Whilst the quality of data on SME demand for, and supply of, finance has recently improved, there has been very limited assessment of the local SME funding gap. Estimates of unmet applications for bank finance in 2015 have produced significantly different findings (£23 million and £92 million). The report highlights that further work is required to produce a more robust and complete funding gap estimate.

Two major reviews of economic policy in 2008 and 2009 attributed the historically low levels of local venture capital activity to low demand from businesses. Despite this, Invest NI considered that strong evidence existed of market failure in the supply of finance, and set about developing its access to finance strategy.

Invest NI is centrally managing its funds through an in-house approach, which has substantially lower administration costs than those associated with an alternative European Investment Bank (EIB) model. However, the European model may have enabled Invest NI to have secured EIB investment funding at lower interest rates than it is currently paying to private investors in the strategy funds. The report emphasises the need for a full analysis of costs and benefits when planning future access to finance funds.

### **Fund Management**

In addition to its £104 million investment funding, Invest NI will pay approximately £24.7 million in fees to the fund managers who are overseeing the individual strategy funds. Although fees for some of the smaller funds are above industry norms, overall costs are in line with these levels.

The report concludes that the fee structures provide little incentive for fund managers to deliver strong financial and economic outcomes, and instead focus heavily on the number and value of investments made. In overseeing the funds, it is therefore important that Invest NI strikes a balance between ensuring that investment targets are on schedule, whilst not pressurising fund managers to make poor investment decisions.

For one of the strategy's earliest funds<sup>1</sup>, Invest NI sought to withhold fees from the fund manager (E-Synergy) in September 2014. However, following mediation, Invest NI subsequently re-commenced paying fees, and its ability to legally withhold these was never proven. In November 2014, Invest NI issued legal proceedings in an attempt to have the fund manager contract terminated. However, neither parties' arguments were tested in court, as they reached a mutual agreement in January 2017 whereby E-Synergy voluntarily resigned.

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<sup>1</sup> Northern Ireland Spin Out Funds (NISPO).

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Between April 2009 and January 2017, E-Synergy received management fees of £2.75 million, and under the mutual agreement, was also paid a settlement fee of £0.45 million. Invest NI also incurred legal costs of £0.24 million. For subsequent contracts, Invest NI has inserted clauses which it believes has strengthened its ability to withhold fees, and to terminate contracts.

### **Fund Performance**

The significant risk and uncertainty over how the strategy's investments will perform makes it difficult to forecast the total financial returns which the funds may eventually achieve. However, on the basis of information available, Invest NI could potentially recoup £73 million of its £101 million investment (a loss of £28 million), whilst private investors could receive £121 million for their £77 million investment (a return of £44 million).

The differing potential returns are largely because, for some funds, Invest NI is subordinating its funding to help lever private finance. As a result, private investors fully recoup their investment and are paid a financial return before Invest NI recovers any of its investment. Whilst this exposes public funding to high risk, Invest NI considers that the strategy's primary focus is to stimulate economic growth and benefits among supported SMEs, rather than achieving a narrow commercial return.

The £35.7 million of investments which Invest NI has made to date in the venture capital and equity funds are currently valued at £29.9 million (i.e. a deficit of £5.8 million). For the strategy's two loan funds, Invest NI could incur a deficit of £5 million on its £30 million investment, but final outcomes will depend on default levels by funded SMEs.

As Invest NI may face a challenge in securing financial returns from some funds, the extent of growth and economic benefits achieved by supported SMEs will be critical in measuring the value for money delivered by this initiative. An initial evaluation has estimated that SMEs supported by the two loan funds could generate between £145 million and £175 million of Gross Value Added by 2018-19. However, the report highlights that final performance reporting must be based on robust evidence of actual outcomes achieved.

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**NOTES FOR EDITORS:**

1. The Comptroller and Auditor General is Head of the Northern Ireland Audit Office (NIAO). He and the NIAO are totally independent of Government. He certifies the accounts of Government Departments and a range of other public sector bodies. He has statutory authority to report to the Assembly on the economy, efficiency and effectiveness with which departments and public bodies use their resources. His reports are published as Assembly papers.
2. Small and medium-sized enterprises (SMEs) are businesses with up to 249 employees.
3. As well as the central management of the seven Strategy funds (referred to as holding fund management) which Invest NI carries out internally, the individual funds are managed by fund managers accredited by the Financial Conduct Authority.
4. Gross Value Added is used in the measurement of productivity, and at a company level is expressed as the sum of wages and profits.
5. Background briefing can be obtained from the Audit Office by contacting Paul Turley (028 9025 1018) or Janet Sides (028 9025 1118).