HATCH

Evaluation of Invest NI's Loan and Equity Solutions

A Final Report by Hatch
6 April 2022

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Executive Summary

Introduction

i. Invest NI runs a range of equity and debt funds which provide commercial repayable finance (risk capital) to SMEs, ranging from start-up finance to growth finance. Currently, the model includes five funds which are in their investment period 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. A further six are in their realisation period, although a number of these (four equity funds) continue to invest through follow-on with businesses in their portfolio.

ii. Hatch was appointed by Invest NI to undertake an evaluation of their portfolio of loan and equity solutions targeted at start-ups and SMEs across Northern Ireland (NI). The evaluation focuses on the period to March 2021, however where there have been material developments whilst drafting this review Hatch has sought to reference these.

iii. The main objective of the thematic evaluation is to determine how Invest NI’s Loan and Equity Solutions operate and perform to provide evidence to help determine the optimum scope of Invest NI's Access to Finance solutions going forward. The evaluation covers the design of the funds, their continued consistency and relevance, delivery, performance and prospects, emerging economic impact and value for money.

iv. The assessment of the emerging economic impact has drawn on a number of sources of data including: fund monitoring data; a survey of investee businesses; and counterfactual impact techniques which matched investees to their administrative data held by ONS and compared their change in business performance post support to a comparable group of businesses not receiving finance from the funds. Section 1 provides more information about the evaluation objectives and methods adopted.

Conclusions

v. The evaluation has shown that Invest NI has provided significant capital support for SMEs in NI over the period from 2012 to 2021 through the public backed investment funds it established. It has enabled around £180m (an average of £18m per year) to be invested in the form of business loans and equity investment (and over £5.5m in POC grants), as well as leveraging £213m of private sector investment at the deal level. The funds have invested in at least 1,200 start-ups and existing enterprises, supporting the creation of over 5,000 jobs (to date). The funds are forecast to generate a substantial return to Invest NI (although, needless to say, subject to significant uncertainty at this stage in the life of most funds), some of which will be available for re-investment in successor funds.

vi. This investment performance must be understood in the context of the events which significantly changed the economic and financial landscape and assumptions that underpinned the original targets. The initial period covered by the funds coincided with the emergence out of recession (linked to the global financial crisis in the early 2010s) with the funds shifting towards being primary sources of funding for SMEs in NI rather than just a traditional role as a provider of gap funding. More recently the funds have been impacted by the global pandemic which has dampened economic growth, impacted on the investment rates of a number of the funds (but by no means all) due to both demand and supply factors, and probably seen some deterioration in the prospects for exits for the time being at least.

vii. Whilst some of the economic development achievements may fall short of the proportioned access to finance strategy targets at this point, this has, in part, been shaped by businesses being more focused on consolidation than growth for part of the investment period due to the recession. Should investment and realisations occur in line with expectations for the remainder of the period, these can be expected to deliver significant economic benefits for Northern Ireland in addition to those already measured.

viii. The funds have made a significant contribution to supporting the SME sector within Northern Ireland and should therefore be regarded as a success overall. The funds have provided finance to start-ups and SMEs over a period which has embraced times when conditions in the business finance market were particularly challenging, as well as the more recent period in which the UK Government's supply response to the short-term finance needs of SMEs has been unprecedented.

ix. The financial success of the funds is still very much dependant on future capital realisations. It is essential that the focus of fund managers is maintained on achieving these realisations over the remainder of the decade. It is important that the fund by fund prospects for returns back to Invest NI are clearly understood, as well as the risks inherent in the portfolios and the potential consequences of external macro-economic factors.

x. The specific conclusions, grouped by theme, are presented below. The full conclusions are presented in section 8.

Strategic Rationale and Fund Design

xi. **Conclusion 1: The Northern Ireland Access to Finance Strategy and the associated investment funds have significantly improved access to capital for SMEs in Northern Ireland.** Invest NI's approach is providing a significant amount of finance which SMEs wouldn't have otherwise been able to access, or if they had it would not have been on terms and at a cost which was comparable for many. As such, the funds have played an important role in addressing the market failure for SME financing in Northern Ireland and have established themselves as an important part of the business finance landscape in the province.

xii. **Conclusion 2: The need for public sector intervention was adequately tested for each fund, with, on balance, an appropriate scale and mix of financial instruments provided to meet the funding needs of SMEs as part of the escalator model**. The strategy has enabled the funds to deliver an investment portfolio with a sensible balance of risk and return, but which also recognises its operational obligations to the Northern Irish Government, ERDF programme, and private and other investors.

xiii. **Conclusion 3: In general, the Access to Finance strategy and the funds remain relevant, appropriate, and consistent despite the changes in economic conditions and policy**. If anything, the economic challenges presented by the consequences of EU Exit and the pandemic, as well as tightening public sector budget settlement, mean the funds are more important than ever as instruments to enable SMEs to access repayable finance.

xiv. **Conclusion 4: The equity funds are making an important contribution to addressing the needs of NI businesses for seed and development capital, but the funds in the development**

space in particular have faced challenges. There remains a great deal of uncertainty about the overall rate of return from the equity funds – this is important as they are potentially significant sources of recycled returns for use in successor funds (although not all the equity funds are expected to provide returns to Invest NI).

xv. **Conclusion 5: The debt funds are well established in the start-up, development and growth space, although the increase in availability of debt linked to the pandemic has been a key challenge for some funds.** As with equity finance, there remains a need for public sector backed debt funds which operate in the space where market failures discourage the commercial banks from operating (and intervention by the public sector offers the opportunity to secure spillover benefits for the economy). This appears to remain true despite the high street banks becoming more active in parts of the SME finance again (post financial crash) and growth of alternative lenders.

xvi. More recently, the introduction of CBILs/BBLs as a result of the pandemic has had a major impact on the demand for loan finance from SBLF II and GLF II (which is on cheaper and more flexible terms). Although demand in the market appears to be building again following the end of these national schemes, the quality of applications still lags behind that of the pre-pandemic period (and hence so does approvals).

xvii. **Conclusion 6: The funds have had the flexibility to respond to changing circumstances.** Whilst the funds each target a defined market area, they have had the flexibility through their Limited Partnership Agreements and performance frameworks to adjust their investment strategy in response to changes in the market or to practical delivery factors. This is overall seen as a strength, however there is a downside in terms of investing in fewer businesses and potential risks in terms of greater concentration (although a final conclusion on this will depend on exits and performance at the end of the funds' life).

xviii. **Conclusion 7: The use of private sector investment at fund level, alongside Invest NI's own monies, ERDF and FTC, has allowed larger overall fund sizes but imposed some restrictions.** It can be very challenging to secure private investors in public sector backed funds of this nature, so it is positive that this investment was secured at fund level in the development funds, GLF I and GFF (helping to increase the scale of the committed capital in the funds). However, it has required Invest NI to subordinate the return of their capital to the private investors, which is highly likely to diminish the eventual recycling of monies back to the economic development agency.

Overall Progress and Performance

xix. **Conclusion 8: The performance of the funds against the Access to Finance strategy targets, proportioned up to March 2021, has been mixed.** The funds have been on target in terms of the number of companies assisted (98%), although the amount of finance invested has been slightly lower (85%). This reflects lower demand for a number of funds in large part due to the impact of the introduction of CBILs and BBLs (e.g. SBLF II and GLF II), but also weaker demand in some other parts of the market compared to earlier markets assessment which informed the design of the funds. Unsurprisingly given the lower investment levels to date, the net jobs and GVA created also fell behind their targets for 2021 (58% and 37% of their respective targets).

xx. Invest NI is ahead of its proportioned target for recycled monies from the funds, mainly due to faster repayments among the debt funds (possibly in part a consequence of businesses also receiving BBLs and CBILs finance).

xxi. **Conclusion 9: There are good linkages between the funds and other forms of Invest NI business and innovation support**. A common weakness with public sector backed SME finance is the weak linkages to other forms of business and innovation support available through the public (and private) sector. However, an analysis of Invest NI data indicates that, overall, there are strong linkages between Invest NI finance and business support programmes which should help to reinforce innovation, growth and productivity improvements. The survey indicates a little over half of the investee businesses also received another form of business support, whilst Invest NI indicates R&D, innovation and technology, and international trade are key types of support. Whilst we are not able to quantify the additional business or economic benefit this may bring, we nevertheless view this as a strength of the Invest NI approach.

xxii. **Conclusion 10: The expected financial returns from the more mature funds is not always clear and their overall financial success is heavily dependent on securing good exits, which if not met, will impact on the fund's overall financial performance.** It can be difficult to predict the eventual financial outturn of the funds at this stage in their life. The fund managers' expectations of the financial outturn for the equity funds in particular are not always clear nor documented. The ability to secure the anticipated returns from the equity funds is critically dependent on the capital realisations from their portfolio. Even if a small number of realisations do not take place, have a lower value or are significantly delayed, the amount of capital to be recycled back to Invest NI could reduce significantly. Whilst the approach to valuing investments may be prudent, the ability to secure these exits is a big risk (which will be influenced by the time it will take for some investments to mature, the market conditions over the next 3-4 years, etc).

Investee Perspectives

xxiii. **Conclusion 11: The investees that responded to the evaluation survey were, overall, very positive about their experience of seeking and using finance through the funds**. However, perceptions were less favourable in some areas. Over four fifths of respondents rated very or fairly good the knowledge and professionalism of staff (88%), the overall quality of service (84%) and the speed and efficiency of administration (84%). However, equity recipients were relatively less satisfied with the overall quality of service than the average (77% vs 84%), which may reflect the greater complexity and specialist nature of equity investing.

xxiv. A significant minority (18%) would have liked more access to follow-on support after having received the finance, with POC grant and small loan recipients more likely to report wanting more access (24%). The range and flexibility of the types of finance available was also rated less satisfactorily, as only 43% of respondents appeared satisfied.

xxv. **Conclusion 12: Investee businesses and the finance industry consulted during the evaluation believe there is an important role for public sector backed SME finance in NI.** In terms of their views on access to finance in Northern Ireland, over four fifths (84%) of the survey respondents reported that publicly supported finance provision in Northern Ireland is necessary as they believe there is insufficient supply, most notably with respect to debt finance provision including start-up and small business loans. Early stage and expansion equity finance was also perceived to be insufficient, with views on the reasonableness of the cost of the available finance more divided on balance.

xxvi. In contrast, the views of advisors, investors and intermediaries are much more nuanced. Overall, the funds are viewed as important in addressing the finance gap which SMEs face, having provided considerable amounts of finance which would not otherwise have been taken up by businesses. Whilst most consultees thought the funds were having a positive benefit in terms of encouraging investors into NI, some thought that the funds providing larger amounts of equity and debt finance operated in a way which could discourage private sector investors. Also a small number of consultees expressed concerns about effectiveness of the investment and business practices of a number of funds including the underlying rationale for public sector backed investment funds.

Emerging Economic Impacts and Value for Money

xxvii. **Conclusion 13: The monitoring and survey analysis points to the Funds having a positive impact on businesses to date and whilst it is behind what might be expected it is likely to increase in the future.** The survey provides positive evidence of the extent to which businesses in receipt of finance have been achieving the objectives they wished to achieve through the use of the finance. On the basis of the £180m received by businesses up to March 2021, the modelling based on the survey suggests a gross uplift in cumulative GVA of £508.4m and a gross employment uplift of 5,000 jobs. Once additionality adjustments for attribution, deadweight and displacement are accounted for, the net cumulative GVA uplift is £198.7m and the net employment uplift is 2,200 jobs.

xxviii. There have also been a series of wider enterprise impacts, in addition to positive supply side impacts as a result of Invest NI investment. Investing in early-stage SMEs has helped to foster innovation and start-up activity. Survey evidence indicated that 97% of the respondents made progress against their innovation objectives post-investment. More broadly, the finance received through the Invest NI loan and equity solutions is reported to have supported them to enter new product/service markets, access new geographic markets, refine existing production and development processes and grow the capacity and capability of their business. Consultations with Fund Managers and strategic stakeholders suggested that by addressing regional finance gaps and attracting leverage, Invest NI has also had positive supply side impacts.

xxix. **Conclusion 14: Whilst it is still relatively early in the life of the funds, the VFM analysis suggests the value for money being provided by the funds to date is broadly on par with what recyclable finance instruments can achieve.** The assessment takes account of the business impacts which have been achieved to date given the amount of finance SMEs received up to March 2021. It draws on the survey analysis which in turn uses the self-reported information from a sample of investee businesses. As such, it is subject to a range of data limitations and needs to be treated with caution. As noted above, these impacts can be expected to increase in the future as more businesses realise the benefits of their investments, especially early-stage businesses when the benefits can take longer to materialise.

xxx. Allowing for an estimate of the expected recycled finance back to Invest NI (associated with this investment up to March 2021), the gross and net GVA per £1 of net Invest NI investment and operational cost is £9.12 and £3.57 respectively to date. This is higher for equity investment compared to grant and loans. The equivalent Invest NI investment and operational cost per gross and net job created is £11,300 and £25,100 respectively. Unlike for GVA impacts, this is lower for debt finance compared to grants and equity finance. Needless to say, there remains uncertainty about the likely level of returns which Invest NI may receive and any variation will impact on the estimates of these units costs.

Recommendations

xxxi. The recommendations which are drawn on the basis of this interim evaluation are set out below (with the full details in section 9). These should be considered by Invest NI and the Access to Finance Working Group in considering changes to the operation of the current funds and the future access to finance strategy and possible successor funds. It should be considered alongside the forward-facing review being undertaken by an independent SME finance expert.

Recommendations Relating to Current Funds

1) Invest NI needs to closely monitor the recovery in the investment rate for the SBLF II and GLF II loan funds.

2) Invest NI needs to maintain a close focus on the successful delivery of the equity funds, especially the achievement of good exits.

3) Invest NI should continue to work with the two development funds to ensure appropriate follow-on investment and successful exits.

4) Invest NI should consider the scope to enhance the advice provided to Proof of Concept grant and small loan recipients at the end of their support or loan period, in order to help them to identify additional public or private sector support which may be appropriate for them.

5) Invest NI should consider what can be done to drive-up investment penetration outside of the major urban areas in NI (this is also relevant to any future funds).

Recommendations Relating to Future Strategy and Funds

6) Access to Finance Strategy and Approach Invest NI should build on what is, overall, a strong approach to SME finance, through considering if there is a strategic case for a more radical approach to how it supports access to finance in the future. A number of examples of options are set out in section 9.

7) Whilst the evaluation concludes Invest NI is operating broadly at the correct level in terms of the amounts of finance available for investment through the mix of funds operating, there is merit in undertaking a detailed market assessment to further test if the investment ranges need to be adjusted to address the finance gaps. Testing the finance gap in the range of £2m to £3m and possibly in the £3m+ space, and critically the scale of this demand, is one aspect of this.

8) Invest NI should retain the generalist approach to any future funds unless there is a very strong justification for introducing sector specific funds (possibly associated with the sector focus of the 10X strategy for example).

9) Maximising the returns from funds to Invest NI for reinvestment in future funds needs to be a priority for Invest NI. The importance of this approach lies in the tight fiscal settlement we can expect in NI in the future and the opportunity for a well-designed

approach to these funds to provide recycled monies for use in these instruments in the long term.

10) Invest NI needs to consider the options for wider collaboration with BBB capital and the use of the recently announced regional funding. It will be important for Invest NI to consider the opportunities presented by this announcement as it may be a key source of future funding for these instruments which can complement sources from within NI.

11) Invest NI should consider additional ways of driving the performance of fund managers in the future, besides using the existing fee structure and bonus arrangements. This could include for example retaining capital (say 10-15%) for allocation to fund managers on the basis of performance in the first three years of the investment period.

12) Invest NI should retain the flexibility of the funds to respond to changes in SMEs' demand for finance in future funds, as this has been a real benefit over a tumultuous period. However, it is also important that they provide a framework to effectively performance manage the fund managers and clarify to both parties what is considered inadequate performance.

13) Invest NI, alongside the fund managers, have an important role to play in stimulating demand, given the (apparent) persistent reluctance of growth orientated businesses in NI to finance their plans through equity finance (where it is a viable and suitable option for them).

Performance Management

14) Invest NI should standardize, where appropriate, the KPIs, performance management frameworks and reporting formats across the funds and at a fund of fund level, seeking to achieve best in class standards. This will help Invest NI to aggregate the information across funds in order to ensure a full fund of fund perspective is more easily maintained.

15) Monitoring the receipt by businesses of both repayable finance and grant based support from Invest NI. This will be useful in better understanding from an Invest NI perspective the incidence, merit and benefits of businesses receiving multiple forms of public sector support (i.e. repayable finance as well as forms of grant based assistance), as well as decisions about who receives what.

16) Invest NI should track businesses receiving support in official administrative datasets, as this would enable the adoption of more robust approaches to measuring changes in the performance of businesses[1] and the counterfactual (i.e. what would have happened to beneficiaries in the absence of the Fund).

17) Invest NI should consider a more comprehensive approach to monitoring and evaluating economic development benefits, in order to ensure it is capturing the most relevant metrics (including productivity improvements, and wider measures related to innovation for example).

[1] although it should be borne in mind that some businesses will not feature in these official government datasets (such as sole proprietors), or there may be delays in terms of when they start to feature (eg new start-ups), which does limit the usefulness of this approach in these cases.

18) Invest NI should consider how the funds can play a greater role in encouraging businesses to adopt good practices linked to wider policy agendas, including equality, diversity and net zero agendas.

Finance Market Intelligence

19) Invest NI should consider conducting more regular research into the Northern Ireland loan and venture capital finance markets, building on Invest NI's existing economic research activity, including collaborations with NISRA and ONS. The Development Bank of Wales' economic and market research series could provide a comparable model.

1. Introduction

1.1 Hatch was appointed by Invest NI to undertake an evaluation of their portfolio of loan and equity solutions targeted at start-ups and SMEs across Northern Ireland (NI). Invest NI runs a range of equity and debt funds which provide commercial repayable finance (risk capital) to SMEs, ranging from start-up finance to growth finance. Currently, the model includes five funds which are in their investment period 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. A further six are in their realisation period, although a number of these (four equity funds) continue to invest through follow-on with businesses in their portfolio.

1.2 The evaluation focuses on the period to March 2021, however, where there have been material developments whilst drafting this review, Hatch has sought to reference these.

1.3 Another fund (Crescent IV Development Fund) has been terminated as it was unable to raise the necessary matching finance from private investors. A further two programmes, the Halo Business Angel Network (HBAN) and the COVID-19 Equity Investment Fund (CEIF) are to be considered as part of the overall finance strategy for Northern Ireland, but not evaluated as part of this evaluation.

Evaluation Objectives

1.4 The main objective of the thematic evaluation is to determine how Invest NI's Loan and Equity Solutions operate and perform to provide evidence to help determine the optimum scope of Invest NI's Access to Finance solutions going forward. The detailed objectives are as follows:

- To set out the objectives of each intervention and assess the extent to which it is meeting its stated objectives and all associated targets;
- To review the validity of original and ongoing rationale for the intervention, including the nature and scale of the market failures and/or equity issues that the intervention was/is seeking to correct; and to examine the degree of complementarity with other Invest NI interventions and the extent to which the intervention overlaps with or duplicates other publicly funded support;
- To assess the appropriateness of the intervention's delivery model, how this could be improved and the effectiveness of the intervention's management and operating structures;
- To compare the support offered by the intervention against similar interventions available to businesses in the UK, EU and other similar regions, identifying, where appropriate, potential service options for consideration going forward. To benchmark the management, performance and impact of the intervention against appropriate comparators;
- To review progress against the action plan relating to the recommendations arising from previous evaluations;
- To thoroughly assess the inputs, outputs, outcomes and impacts associated with the intervention, to include a detailed assessment of the overall economic and wider impacts;

- To identify the internal and external factors which have impacted upon the performance of the intervention either positively or negatively, within the period;
- To assess the gender balance of the investee companies that received (or were rejected for) investment. The assessment is based on the founding team or the executive team at the time of investment;
- To determine the Return on Investment associated with each intervention, clearly identifying actual and anticipated values;
- To assess the economy, efficiency and effectiveness with which public funds have been used on each intervention;
- To assess the extent to which each intervention represents good Value For Money (VFM) and appropriate use of public funds across the full spectrum of relevant VFM indicators;
- To present a conclusion from the evaluation on each intervention, and an overarching conclusion on both the debt and equity themes taking account of all of the evidence gathered during the assignment;
- To identify recommendations as appropriate in relation to delivery model and the ongoing monitoring of the service with a view to enhancing the economy, efficiency and effectiveness of the interventions;
- To provide a baseline analysis of the wider Northern Ireland Funding ecosystem taking account of new local and national operators in the NI Funding space.

Approach to Evaluation

1.5 To respond to the objectives outlined above, the evaluation covers the design of the funds, their continued consistency and relevance, delivery, performance and prospects, emerging economic impact, and value for money. This will provide the rounded evidence base to inform recommendations for future strategy and delivery. The themes cover:

- **Appropriateness, relevance and consistency:** the evaluation explores the appropriateness of the design and approach to delivery of the equity and loan solutions (and any subsequent changes), as well as the continued relevance and consistency of the funds in light of any changes in policy (e.g. EU Exit and the NI Protocol, the new programme for government and economic and business policy such as the 10x strategy) or economic circumstances (e.g. Covid-19 pandemic and the associated recession) during the period covered by this evaluation. The continued relevance in terms of market failures is particularly important here given some of the changes which have occurred over the last decade in the SME finance markets – hence the assessment will include analysis of the demand and supply of commercial finance for SMEs.
- **Progress:** the evaluation analyses the progress of the funds against their contractual investment, financial and output targets, the reasons for under or over performance, and the expected lifetime performance (including investment and realisation periods).
- **Delivery and management:** the evaluation explores the experiences of implementing and managing the funds, the experiences of the businesses, and the lessons which have emerged from this. The design of each fund is a key aspect of this, including the fund and fund management models, scale of funds and sources of matched funding, financial and business support offered to SMEs. This is covered in the individual fund reviews and the analysis of investee perspectives.

- **Business and economic impacts:** the evaluation assesses the emerging business and economic impacts attributable to the finance provided by the funds, including both the intended and actual outcomes and impact on a gross and net additional basis (showing the overall change in the economy). In addition to quantified measures of GVA and employment creation, it captures other benefits which are important given current policy in a more qualitative manner (e.g. encouraging enterprise and innovation, building the capacity of SME finance markets, equality and diversity).
- **Economic evaluation:** the evaluation analyses the cost-effectiveness of the funds in light of its intended and unintended outcomes and impacts, and hence its value for money to Invest NI and the Northern Ireland government (and other funding partners such as the EU and private sector). This takes account of expected future financial returns, allowing for uncertainty associated with write-offs and equity realisations.

Report Structure

1.6 The evaluation report is structured as follows, with themes specific to equity and debt finance drawn out where this is relevant:

- **Section 2. Design and Development of the Funds:** provides an overview of the rationale for the design of the funds, following a Theory of Change approach to review the intervention logic and critical analysis of the appropriateness of the design of the funds, given Invest NI's objectives. This section also reviews the development of the funds over time, the current structure, and management and governance arrangements.
- **Section 3. Continued Relevance and Appropriateness:** reviews the political, economic and market context in which the Funds have operated over their investment period, drawing on a range of public data source, supplemented by evidence from consultations with public sector bodies, business representatives and the financial community. This section will draw conclusions on the continued relevance and appropriateness of the funds in light of any changes to policy, economic and market context since the Funds were designed and launched.
- **Section 4. Performance of the Funds:** provides an overview of the overall investment, financial and economic development performance of the Funds against original assumptions, and more detailed analysis of the performance of each of the individual Invest NI loan and equity funds.
- **Section 5 Fund by Fund Perspective:** provides a summary of the performance and prospects for each fund in turn, drawing on the analysis of the fund data and consultations with the fund managers.
- **Section 6. Investees Perspective:** provides analysis and a summary of findings from the telephone beneficiary survey and a selection of case studies including details about why businesses sought finance from Invest NI loan and equity funds, how the injection of finance and any support received has impacted individual businesses and the perceived strengths and weaknesses of the Invest NI approach.
- **Section 7. Assessment of Economic Impact:** draws on evidence from the beneficiary survey, case studies, monitoring data and counterfactual impact evaluation to provide an estimate of economic impacts. This section also draws on survey evidence and counterfactual impact evaluation evidence to provide an assessment of value for money.

- **Section 8 and 9. Conclusions and Recommendations** outlines the headline findings from the evaluation, lessons learnt and recommendations for the remaining delivery period and any successor fund.

2. Design and Development of the Funds

2.1 This section describes how Invest NI's Loan and Equity Solutions was designed to respond to market failures and the associated finance gap facing start-up and established SMEs. The section explains the Fund logic model and includes critical analysis about the appropriateness of the project's design given its objectives. Information reported is based on Invest NI's Access to Finance Investment Strategy and draws on consultations with Invest NI staff and financial intermediaries.

Fund Rationale

2.2 Economic theory suggests that full economic efficiency is achieved when nobody can be made better off without anybody else being made worse off. Well-functioning markets tend to achieve efficiency – which means that there are no unexploited gains from trade. Market failure describes the situation where, for one reason or another, the market mechanism cannot achieve full economic efficiency.

2.3 In the case of external finance for SMEs, the question is whether the commercial finance markets, without public intervention, will provide sufficient debt and equity finance in order to support the survival, growth and wealth creation potential of these businesses to be realised. If there is market failure, it typically results in unexploited gains from trade – that is, there are loans and equity investments which could be profitable to both firms and investors that for some reason were not made.

2.4 Market failure in its own right does not provide a sufficient argument for the public sector to intervene. Intervention generally involves some distortion of markets and reduction in welfare (not least through taxation needed to fund it) against which the benefits need to be weighed. Public intervention to improve the supply of finance to SMEs in response to market failures may improve economic welfare overall, but only if the benefits outweigh the costs of the intervention.

Information Failure

2.5 Failure in the market for SME finance is generally understood in terms of imperfect information. Perfect and freely available information would mean investors would know the risk of each investment failing and agree a commensurate rate of return with the firm. Investors would lend to all firms where expected returns on investment were at an acceptable level in excess of costs. In reality, information is imperfect: the risk of failure and bad debt is not known by the investor and there are costs associated with gaining the information to assess these risks. Information is not only imperfect, but it is asymmetric: firms seeking finance in general know more about the true risks of failure than investors and can undertake actions that affect the chances of repayment, which the investor cannot easily or economically monitor. Imperfect or asymmetric information gives rise to a situation where the market does not provide adequate investment for firms, even when individually they might offer a good return on investment. This is known as 'credit rationing'.

2.6 Investors tend to deal with imperfect information by dividing the market into classes of investment for which average failure rates are known. Some classes of investment where average risk of failure is perceived to be too high and returns too low to justify investment, will be excluded from the market. There are likely to be many firms in this class who are profitable investment prospects, but imperfect information means they cannot be distinguished from other riskier investments.

2.7 This scenario can be used to explain why banks tend not to make unsecured loans to small start-up firms with no collateral to secure a loan or an insufficient track record to demonstrate past performance, as on average these firms represent too great a risk. It can also be used to explain why venture capital is not provided in smaller quantities, since given uncertainty over the risks of investment and the relatively high due diligence and management costs, investments below a certain size become prohibitively costly.

2.8 In both these classes of investments, there are profitable opportunities which are not realised, since lenders do not have the information to separate them from non-profitable ones. This type of market failure is commonly discussed in national and regional policy and in the formulation of SME finance initiatives. Where there is market failure of this sort, the public sector may intervene and provide finance to those excluded classes of investments. However, it is important to note that the information failure still persists and extending finance to these excluded classes of investment can only be normally achieved, overall, at sub-commercial net rates of return (allowing for risk) and hence involves a net cost to the Exchequer. In the case of debt finance, for example, lending to this class of firms would involve higher bad debt rates overall than a commercial bank would be prepared to sustain.

2.9 To judge whether a public sector backed SME finance initiative improves or diminishes overall economic welfare, it is necessary to weigh the benefits of providing additional finance against the exchequer costs to the public sector and any additional market distortions the initiative creates. This type of value for money calculation is key to determining whether a finance initiative is a worthwhile intervention, as well as judging between different approach types.

Demonstrator Effects

2.10 Where the public sector does intervene to address market failures in SME finance markets, it may take some considerable time before the typical returns that can be realised from any class of investment are established by the market. There is a high degree of uncertainty over the returns that can be expected from this market over time, in part because returns are realised over a number of years, are highly dependent on the skills of particular venture capitalists and fund managers, the strength of local markets, and may be highly variable between funds.

2.11 The public sector could in principle address this failure by working with the private sector to demonstrate that viable returns can be made from certain classes of investment which are targeted. Public sector backed provision of SME finance also attracts people with the skills to provide private SME finance into the market. This type of demonstration argument can be applied to small venture capital investments in particular.

Economic Development Benefits

2.12 There are also economic development and regeneration arguments for the public sector to address market failures in the provision of finance to SMEs. There is a generally recognised need for government to raise levels of enterprise, research and innovation, employment and regeneration in Northern Ireland. It can be argued that investments which support these types of impacts will generate what are termed positive spillovers – benefits that accrue to the wider region, above and beyond the commercial returns from just providing finance to SMEs.

2.13 Economic benefit spillovers are a type of externality, and so represent market failures as described in the HM Treasury Green Book[2]. The specific market failures facing SME finance are as follows:

- **Technology and Innovation Spillovers** – firms which develop or commercialise new technology will tend to generate economic returns beyond the firm as the technology or innovation is imitated. There is a strong rationale for supporting new or existing firms to develop and commercialise new technology.
- **Enterprise Spillovers** – enterprise, through the creation of new and innovative firms, generates benefits for the regional economy beyond those reaped by the firm. This is through spurring greater productivity, innovation and creating employment.
- **Employment and Regeneration Spillovers** – in regions where there is a need to support employment, worklessness and deprivation creates negative spillovers on others in families and communities. There is a strong market failure as well as equity argument for supporting employment in relatively deprived areas. This type of argument is likely to be more important for Funds providing mezzanine or loan finance to established firms, or non-technology start-ups rather than equity funds. It is likely to be more important in a recessionary macroeconomic climate.
- **Regional Development and Lock-In Arguments** – firms and regional economies can become 'locked into' low or high growth trajectories. This is a form of market failure, since firms which contribute to a 'better' trajectory confer benefits on others in the future. Sub-national policy is often predicated based on developing knowledge or technology-based sectors in regions with relatively low productivity, such as Northern Ireland. Publicly backed funds tend to directly support the growth of these sectors and as such are potentially valuable tools of regional economic development policy.

Invest Northern Ireland's Access to Finance Strategy

2.14 Invest Northern Ireland's latest Access to Finance Strategy covers the period 2020 to 2025[3]. It presents a continuation of the overarching Fund of Funds Strategy developed in 2010 to respond to Northern Ireland's identified £80m funding need across the equity and debt markets, identified in a European Investment Fund market gap study in 2008.

2.15 The strategy seeks to address the demand and supply side market failures that result in a finance gap for high growth, high risk companies. Such companies are often at the forefront of innovation, introducing disruptive technologies that improve economic performance. Moreover, a significant share of resulting company growth tends to come from exports and external sales. Broadly, the overarching goals of the strategy include:

- increasing the availability of risk finance for SMEs
- increasing availability of private sector funding and strengthening the SME orientated finance ecosystem which supports investment activity
- improving the financial sustainability of the public sector led model by increasing the commercial returns and less reliance on public sector funds.

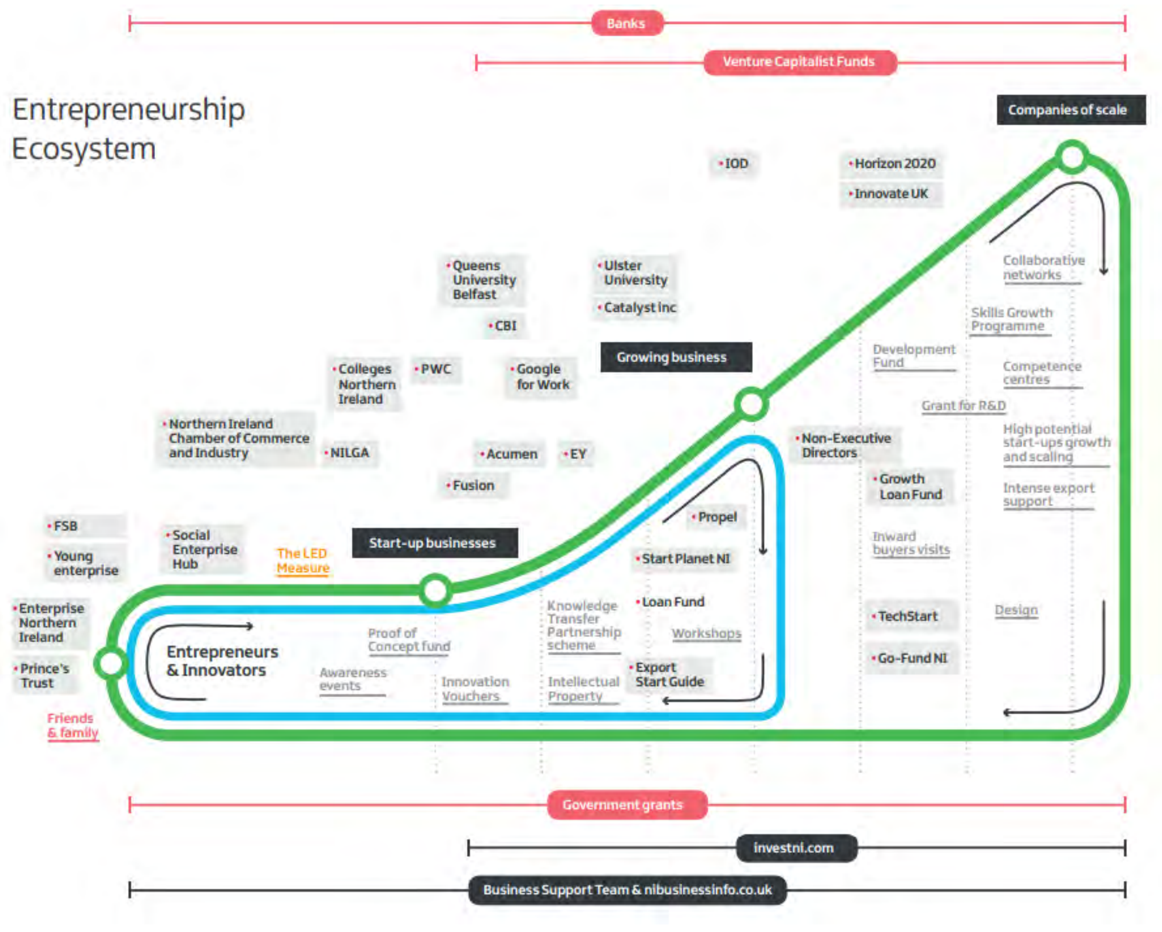
[2] HM Treasury, The Green Book: Central Government Guidance on Appraisal and Evaluation, 2020 update

[3] Invest Northern Ireland, Access to Finance Strategy, 2020

2.16 The strategy will be reviewed at the end of the 2025 and may be subject to interim changes as the overall Invest NI Business Strategy for 2022-25 is developed.

2.17 The strategy emphasises the links between the provision of SME finance and other forms of innovation and business support which Invest NI (and other agencies and providers) offer, and which can play a major part of driving innovation, growth and productivity improvement (as highlighted in the Invest NI diagram below). One of the objectives is to increase take up of Invest NI support by organising seminars where support is explained to Fund Managers, signposting Fund Managers to Invest NI website and reviewing take up of support. The incidence of the take-up of both finance and other forms of Invest NI support is outlined in section 4.

Figure 2.1 Invest NI Entrepreneurship Ecosystem



Source: Invest NI Business Strategy 2017-2021

Theory of Change

2.18 Drawing on Invest NI's Access to Finance Strategy, the intervention logic underpinning the need for Invest NI's Loan and Equity Solutions is presented in Figure 2.2. This Theory of Change diagram traces the step-by-step rationale for the programme through to its intended outcomes and impacts. Alongside a description of how the programme translates inputs to impacts and the realisation of policy objectives, the Theory of Change provides assumptions which are required to be met for the strategy and the funds to work as designed in theory. As such it is a useful tool from which to evaluate the programme, by referencing original intent compared with how the project has performed in practice.

Figure 2.2 Invest Northern Ireland Loan and Equity Solutions Theory of Change

Invest Northern Ireland Loan & Equity Solutions: Theory of Change

Overarching Objectives:

- Increased quantum of risk capital funds, including venture capital and debt finance, being available and used by SMEs
- Increased quantum of funding being provided by the private sector
- Improved sustainability of the model, with increasing amounts of exit proceeds being recycled and less reliance on public sector funding (baseline capital, ERDF / Shared Prosperity, or Financial Transactions Capital)

Assumptions:

- The underpinning evidence is an accurate and robust reflection of the factors which constrain the ability of start-ups and growing SMEs with good business propositions to secure business finance
- More specifically, changes in the economy and market have not changed the needs of businesses and the objectives of the Invest NI Loan and Equity Solution Funds

Assumptions

- Marketing is effective
- Potential benefits outweigh costs for FMs & Invest NI

- Eligibility checks are appropriate & assess need for public sector intervention
- Funding amount is appropriate for business needs across geographies & finance types

- Right needs/barriers are addressed through design of the Fund
- Beneficiary clear on T&Cs of finance and processes
- Beneficiary able to secure co-investment (as approp)

- Match funding is supplied and as a result, the private sector receives investment returns
- Private sector confidence in investing in Northern Irish SMEs increases.

- Scale of demand targeted appropriately so that provision does not crowd-out private secto
- Investment policy & KPIs ensure appropriate investment

Delivery

1. Marketing of financial support offer and information sharing on access to finance.
2. Receipt and assessment of SME enquiries and applications for funding. Business is accepted or rejected for funding based on criteria to maximise benefits of public spending and compliance with grant funding rules.
3. Investment deals are agreed, finance support (equity investment, loan or grant) is provided and level of financial support and T&Cs are appropriate and reviewed as required.
4. Reduction to investor risk by sharing between stakeholders, allowing leverage of private investment and building of a stronger commitment of the private sector in SME investment
5. Delivery of investment targets on:
   - Companies supported
   - Investment amount
   - Private sector leverage
   - Supporting companies across multiple sub-funds
   - Provision of additional support

Programme Need and Response

Development of investment funds providing finance to SMEs on commercial terms, covering firms at different stages of development in Northern Ireland.

<u>Market failures which lead to sub-commercial rates of return to investment in SMEs</u>:

- Imperfect information – investors do not know which SMEs will grow if invested in; SMEs do not understand opportunities around finance
- Asymmetric information – SMEs know more about the risks to investment than investors
- Sunk costs – in seeking investment, firms may need to undertake due diligence, demonstrate past financial performance or collateral. This may not be viable for small scale investments.

<u>Positive spillovers which occur through public intervention:</u>

- Demonstrator effects – the public sector helps to provide private sector financial intermediaries with more confidence over which investments are viable; boost SME knowledge of access to finance options
- Development of skills – undersupplied fund manager skills are developed alongside the provision of finance
- Potential impacts of SME investment – raised economic dynamism/competitiveness, raised innovation, raised employment, output and productivity and uplift of the regional growth trajectory

- Underpinning evidence & analysis is an accurate and robust reflection of market conditions and resulting rationale for public funding as outlined in the Green Book
- No change in economic circumstances which might reduce the need for the public sector intervening to secure positive externalities
- No change in factors which shape the focus on repayable finance provided on commercial terms

6. SMEs supported on growth journey and to generate economic outputs:
   - Development of new technologies (inc IP), products and services
   - Create jobs, generate GVA and improve productivity

- Finance barriers to growth are appropriately identified/dealt with
- Productivity can be improved with financial and shareholder support and is monitored against inputs
- Business committed to achieving growth
- Type and amount of finance is appropriate to needs
- Finance escalator is effective in supporting SMEs on their growth journey

Impacts

10. <u>Wider Impacts</u>
   - Uplift in the economic growth trajectory of Northern Ireland
   - Influence NI Govt policy with respect to Access to Finance interventions
   - Better matching of SME finance demand and supply through demonstration effects
   - Retention / growth of investment and fund management skills base
   - Increased private sector leverage from business angels, institutional investors and VC firms both within and outside of NI
   - Improved sustainability of the Access to Finance model

9. <u>Regional Economic Impacts:</u>
   - GVA growth
   - Additional employment growth
   - Productivity improvements

8. Return on investment to Invest NI.

7. Ongoing monitoring. Fund Managers track investment, financial and economic performance.

Assumptions

- Business growth significant enough to impact the wider Northern Irish economy and attract wider economic development enablers
- Public sector encouragement of non-grant funding helps build business & investor confidence
- SMEs have a good experience of Invest NI backed funds and this stimulates demand amongst the wider business community
- A high enough return is secured to encourage new investors to enter the market
- A wider range of investors are active in the NI market

- Intervention reduces barriers external SME finance, increases take-up & business growth
- A good level of net economic impacts are achieved for NI
- Good VFM is achieved compared to comparable A2F elsewhere

- Well designed funds and effective FM provide returns to Invest NI's capital commitments which are appropriate for the investment space targeted
- Enables longer term recycling of £s

- Targets are relevant, realistic and unambiguous
- Risks are appropriately monitored and underperformance is addressed early
- Improvements within businesses are measurable and monitoring is robust

Source: Hatch analysis of Invest NI Access to Finance Strategy

Objectives

2.19 The overarching objectives listed in the Theory of Change summarise seven fund objectives:

- Provide a continuum of risk capital funds, including venture capital and debt finance, ensuring appropriate finance is available at all stages of companies' development[4]
- Attract, retain and develop the skills and capability of risk capital fund managers based in Northern Ireland
- Improve the sustainability of the Invest NI backed Access to Finance model
- Increase private sector leverage from business angels, institutional investors and VC firms from both within and outside Northern Ireland, who are investing alongside the Invest NI backed funds both at a fund and deal level
- Increase take-up of other forms of Invest NI support by the companies accessing the various debt and equity funds established under the Access to Finance Strategy
- Support investment readiness and raise awareness of alternative finance and the benefits of their use for SMEs
- Influence NI government policy with respect to Access to Finance interventions.

2.20 The current mix of funds which are in their investment periods amounts to around £118m[5] of available capital for investment spanning start-up, early stage, development and growth phases (the total across all funds is c£280m). The amounts of finance available are tailored to the typical needs of businesses at their stage of development, informed by the analysis of market failures and finance gaps in the respective project economic appraisals. All the funds operate on a commercial repayable basis, with the charges and terms tailored to the nature of the finance and market practice. The exception to this is the Proof of Concept grant provided through Techstart.

2.21 As detailed later in the section, Invest NI's portfolio also includes a number funds which are currently in their realisation period i.e. SBLF I, GLF I, Techstart I, Co-fund I, Kernel and Crescent III (with the equity funds, bar Co-fund I[6], still investing through follow-on investment with their portfolios). It also includes a number of funds which are not the subject of a fund level review as part of this evaluation. This includes HBAN angels programme[7] and COVID-19 Equity Investment Fund which was implemented as part of Invest NI's pandemic response[8].

[4] At least in so far as these stages of development are affected by market failure, an associated finance gap and a value for money justification for the public sector intervening in a part of the finance market.

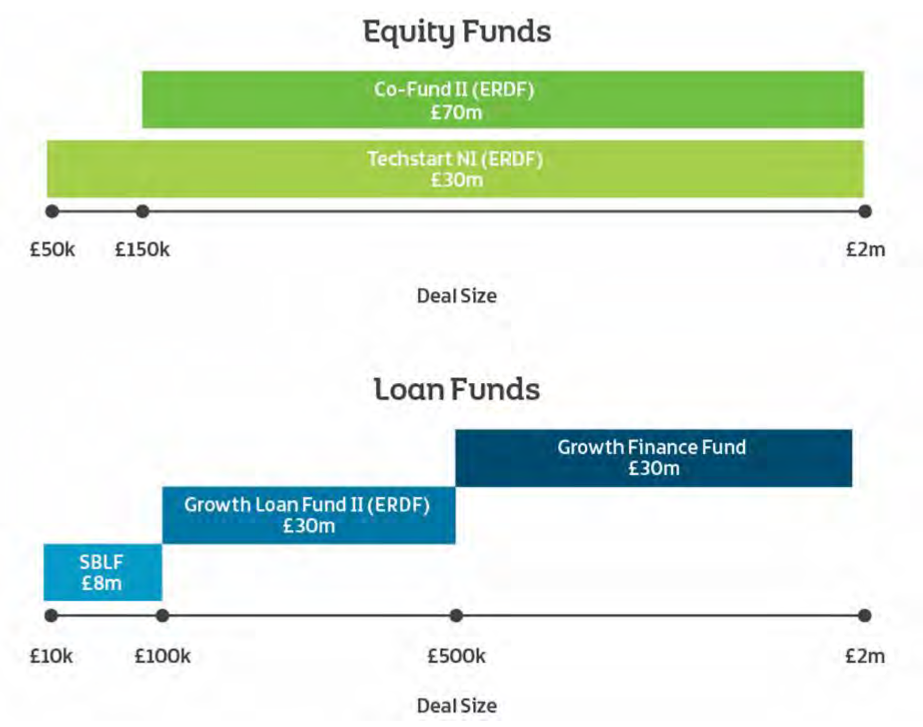
[5] £118m is based on the total allocated capital, but adjusting the available capital for Co-fund II from £70m to £20.4m to reflect the core funding from Invest NI and hence excluding deal level private investment.

[6] Co-Fund II included £5.16m funding to be used for follow on investment in Co-Fund I investee businesses

[7] Invest NI work with Enterprise Ireland and InterTrade Ireland to provide the Halo Business Angel Network (HBAN). This is an initiative delivered by Clarendon Fund Managers which seeks to develop the emerging ecosystem of private investment in seed and early stage businesses in Northern Ireland.

[8] In March 2020 the Corporate Finance Team designed the £5m COVID-19 Equity Investment Fund (CEIF) to respond to an expected early stage finance gap as a result of the uncertainty facing private investors.

Figure 2.3 Invest NI Equity and Loan Finance Escalator (funds in investment period only)



Source: Invest NI

2.22 The level and mix of capital available through public sector backed funds provides a fairly comprehensive response to the market failures and finance gaps in the market for SME business finance in NI. However, the amount of finance available in comparison to other similar regions adopting a proactive response to these issues varies greatly (see Table 2.1 below which compares NI to the North East of England and Wales). The amount of finance available on an annual basis is broadly in line with the North East region, but far less than that available to SMEs in Wales.

Table 2.1 Comparison of Funds Available in Regional SME Finance Fund (only covering NI funds in current investment period)

	NI	North East	Wales
Committed capital in funds £m	118	120*	844.5**
Implied investment rate per annum	23.6	24	105
Annual GDP £m	48.6	64.3	77.5
Annual investment as a share of GDP	0.05%	0.04%	0.14%
Committed capital as % of GDP	0.24%	0.19%	1.09%

Source: Hatch analysis. Notes: * the North East is based on North East Fund **the finance available within Wales includes: £20m Tech seed; £204m Wales business fund; £50m Wales Tourism Investment Fund; £2.5m Town Centre Entrepreneurial Fund; £25m Wales Management Succession Fund; £25m Rescue and Restructuring Fund; £8m Wales Angel Co-investment Fund; £30m Wales Micro Loan Fund; £500m Wales Flexible Investment Fund. GDP data is for 2019 (source: ONS)

Activities

Development of Funds

2.23 The development of the funds has been informed by Invest NI's overarching Access to Finance strategy and Corporate Business Plan, both of which set out the priority placed on a comprehensive approach to addressing the finance gap which SMEs face as well as stimulating the development of start-up and SME finance ecosystems in NI.

2.24 The development of new funds is underpinned by a comprehensive economic appraisal[9] which considers the underpinning justification for intervention, options, impacts and value for money. These have been conducted in line with the Northern Ireland Guide to Expenditure Appraisal and Evaluation (NIGEAE). The project proposals, including a case paper and accompanying economic appraisal, are scrutinised by a Senior Executive Casework Committee and then a Board Casework Committee prior to Department of Finance and Ministerial approval where required. The economic appraisals reviewed by the evaluators as part of this assessment are judged, overall, to be fit for purpose and of a very high standard.

2.25 It has proved necessary to make some changes to the operation of a number of funds given prevailing economic and market conditions, including investment policies, investment and realisation periods, and fund management fees, as well as associated KPIs. Where appropriate these changes are accompanied by changes in the legal agreements between the partners.

2.26 The Covid-19 Equity Investment Fund (CEIF) was set up in response to the anticipated liquidity crunch caused by the escalation of the Covid-19 pandemic. It was designed to help mitigate the impacts of the economic slow-down brought on by the pandemic on early stage (pre-revenue or pre-profit) and high potential start-up (HPSU) companies. It was feared by Invest NI that these companies would be disproportionally impacted by cash-flow constraints given their tendency to rely on equity finance, including venture capital and business angel funds.

2.27 In light of the launch of Future Fund and the market being less depressed than originally anticipated, the market need for CEIF was reassessed at £5m. Moreover, the maximum investment via equity or convertible loan notes was set at £800,000, with the option to raise additional investment via commercial loans. A match funding requirement was introduced, but it was less restrictive compared to Future Fund requirements. A total amount of £6.4m was invested in 11 companies. This included £2.3m of Invest NI investment, £1.3m of Co-Fund, Techstart or Crescent Investment and £2.7m from other investors.

2.28 Since 2004, Invest NI and InterTradeIreland (ITI) have collaborated to create a robust business angel network investing in Northern Ireland companies, operating under the Halo NI banner. Following the recommendation of an economic appraisal undertaken by Cogent in 2018, Invest NI alongside ITI and Enterprise Ireland have undertaken a joint island wide initiative – the Halo Business Angel Network (HBAN) – to support early-stage entrepreneurial activity by securing equity financing from business angel investors and syndicate groups. In Northern Ireland, the programme is delivered by Clarendon Fund Managers.

2.29 The focus of the HBAN programme was to secure investment for early-stage companies and attract business angels to operate within Northern Ireland.

[9] NIGEAE guidance has been super seeded by the HM treasury Better Business Case Guidance since the 1st April 2021.

2.30 A number of the funds have been evaluated during the course of their investment with recommendations made to enhance operations, management and impact. The details of the recommendations are covered in Appendix E.

Current Structure and Characteristics

2.31 The programme delivers loan, equity and proof of concept grant funding. There are currently five funds in their investment periods and eight funds that are either in their collection or follow-on period or have been terminated. The mix of funds available has been developed since Invest NI's original 2010 Fund of Funds model which was based on the European JEREMIE model to provide recycling of funds, flexibility in the management of funds and access to capital.

2.32 Overall, the funds are designed to make approximately £274m in investment and an annual average of £22.8m, with further deal level leverage of £174m.

Table 2.2 Invest NI Loan and Equity Solutions Funds

Fund	Type	Fund Manager	Contract Period	Investment Phase
Funds in Current Investment Period				
Small Business Loan Fund II	Loan	Ulster Community Finance	2018-2028	Lending
Growth Loan Fund II	Loan	Whiterock Capital Partners	2018-2028	Lending
Growth Finance Fund	Loan	Whiterock Capital Partners	2018-2028	Lending
Techstart II	Equity & POC grant	Techstart Ventures	2019-2029	Investing
Co-Fund II	Equity	Clarendon Fund Managers	2017-2023	Investing
HBAN	Angel Equity	Clarendon Fund Managers	2018-2021	Active
Funds in Main Collection or Realisation Period				
Small Business Loan Fund I	Loan	Ulster Community Finance	2013-2023	Collection
Growth Loan Fund I	Loan	Whiterock Capital Partners	2012-2022	Collection
Techstart I	Equity & POC Grant	Techstart Ventures	2014-2024	Realisation period and selected follow-on investment
Co-Fund I	Equity	Clarendon Fund Managers	2011-2017	Realisation period and selected follow-on investment
Crescent III Development Fund	Equity	Crescent Capital	2013-2023	Realisation period and selected follow-on investment
Kernel Development Fund	Equity	Kernel Capital	2013-2023	Realisation period and selected follow-on investment
COVID-19 Equity Fund	Equity	N/A	2020- 2021	Realisation period
Other Funds				
Crescent IV Development Fund	Equity	Crescent Capital	2019-2021	Terminated after unsuccessful second close

Source: Invest NI, 2021

2.33 Invest NI's loan and equity funds are delivered by private sector fund managers whose activities are contracted and managed through Limited Partnership Agreements and Management Services Agreements. A number of the fund managers are Northern Ireland based registered companies (Crescent Capital, Clarendon Fund Managers, Techstart Ventures) and pan-Ireland based (Kernel, Ulster Community Finance), whilst others originated from outside NI but have established local offices (Whiterock Capital Partners). Techstart Ventures now also manages similar seed and early stage tech funds in Scotland.

Investment Policies

2.34 The terms of investment are set out for each fund individually within Management Services and Limited Partnership Agreements. Terms include roles of the General Partner and Fund Manager, funding contributions, investment policy, KPIs, management fees and the advisory board terms of reference. Where changes have been made to the investment terms the agreements have been updated with Deeds of Variation.

2.35 Table 2.3 summaries the main investment ranges in terms of the amounts of debt and equity finance which are available per deal. The funds currently in their investment period provide comprehensive amounts of finance up to £2m. Unlike the previous funds, larger amounts of equity (up to £5m) are no longer available through an Invest NI backed fund due to Crescent IV not proceeding. The market analysis and consultations suggest there is still a gap over £2m, although the current funds and private investors are collectively able to meet the needs of these businesses (mainly in the range £2-£4m). At the lower end of the range, the SBLF II has the flexibility to provide loans below £10k in special cases (although there are few instances in practice).

Table 2.3 Invest NI Loan and Equity Solutions Funds

Fund	Investment Range
Funds in Current Investment Period	
Small Business Loan Fund II	£10k to £100k per business with a maximum of £15k for start-ups (initially, up to £35k over multiple investments per business)
Growth Loan Fund II	£100k to £500k per deal, but by exception can invest up to £1.5m, with this also being the maximum investment per company across tranches
Growth Finance Fund	£500k to £2m with a max investment size of £2m per company across tranches
Techstart II	£50k to £750k. Max £2m in any one company including follow-on investment. POC mini grant up to £10k; standard grant up to £35k; large grants up to £75k
Co-fund II	Typically operates in deal size range of a total commitment of £150k to £2m, max £1.75m in any single company
Funds in Main Collection or Realisation Period	
Small Business Loan Fund I	£1k to £50k

Growth Loan Fund I	£50k to £500k per deal; max £1.5m per company
Techstart I	£50k to £250k per equity deal and max £1m in any one company. POC mini grant - £10k; Standard grant - £25k (reduced from £40k after July 2015)[10]
Co-Investment Fund I	£150k to £500k per deal; a max of £1m in any single company (subsequently increased to £1.25m)
Crescent III Development Fund	£450k to €1.5m per deal in any one year; a max of £3m per company.
Kernel Development Fund	£450k to €1.5m per deal in any one year; a max of £3m per company.

2.36 The table below sets out the changes to fund parameters, investment policies and KPIs during their contractual period.

Table 2.4 Key Changes in Fund Parameters During Delivery Period

	Changes in Fund Parameters	Changes in Investment Policy and KPIs
Funds in Main Investment Period		
Growth Loan Fund II	• Average loan size changed from £330,00 to range between £300,000 and £700,000	• Number of loans made per annum changed from 18 to a range of 8 to 18. • Investment amount per annum changed from £6m to a range of £4 -9m
Co-fund II	• Fund size increased from £14.7m to £20.4m	• Deal size range increased from £150k-£1m to £150k-£2m • Average investment increased from £175k to £225k per deal per annum • 65% pre-qualified private match updated to 60%
Funds in Main Collection or Realisation Period		
Small Business Loan Fund I		• Reduction of investments per annum from 132 to 75-90 • Increase in average deal size annum from £13k to £15-£25k
Growth Loan Fund I	• Extension of investment period by a year and four months from 5 to 6.33 years • Fund size increased from £50m to £55m	• Number of loans made per annum reduced from 65 to 30 • Removal of average investment size p.a. KPI
Techstart I	• Increase in capital available for POC grants from £3.6m to £3.8m	

[10] Grants of up to £60k were available in exceptional circumstances

Co-fund I	• Fund size increased from £7.2m to £18.16m (including Co-Fund I £5.16m follow-on investment fund added as part of Co-Fund II MSA) • Max investment in a single deal increased from £400k to £500k	• Investments p.a target increased from 8 to 14 in 2014 • Average investment per deal p.a increased from £150k to £170k • Max investment per deal increased to £1.25m
Crescent III Development Fund	• Extension of investment period by a year from 5 to 6 years	
Kernel Development Fund	• Extension of investment period by a year from 5 to 6 years	

Source: Hatch analysis of Invest IN and fund manager information

Inputs

Invest NI Operational Costs

2.37 The costs to Invest NI of running the SME finance activity consists of both the operational and capital costs. The annual operational costs for the years 2017/18 to 2020/21 (plus forecasts to 2022/23) are outlined below. These costs consist primarily of staff costs plus appraisal and evaluation costs (and an allowance for the costs of the internal Invest NI Communications team for marketing activity). The annual average costs to 2020/21 are £374k[11].

Table 2.5 Invest NI Corporate Finance Annual Operational Costs, 2017/18 to 2022/23

	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000
Staff Costs	287	293	316	321	329	336
Appraisal/ Evaluation costs	160	47	67	6	150	75
	447	340	383	327	479	411

Source: Invest NI. Note: it is not possible to accurately allocate per these costs to each fund and they will also be related to a number of funds which are not included in this evaluation. Cost base is current prices.

Invest NI Capital Contributions

2.38 The funds covered by the evaluation have received financial contributions at the fund level from a number of sources including the Invest NI core funding, recycled monies from earlier or current funds, the Northern Ireland ERDF programme, Financial Transaction Capital[12], British Business Bank and private investors. The chart below is based on high level funding of £275m, reflecting funds that had the ability to invest as at March 2021. Private funding is based solely on

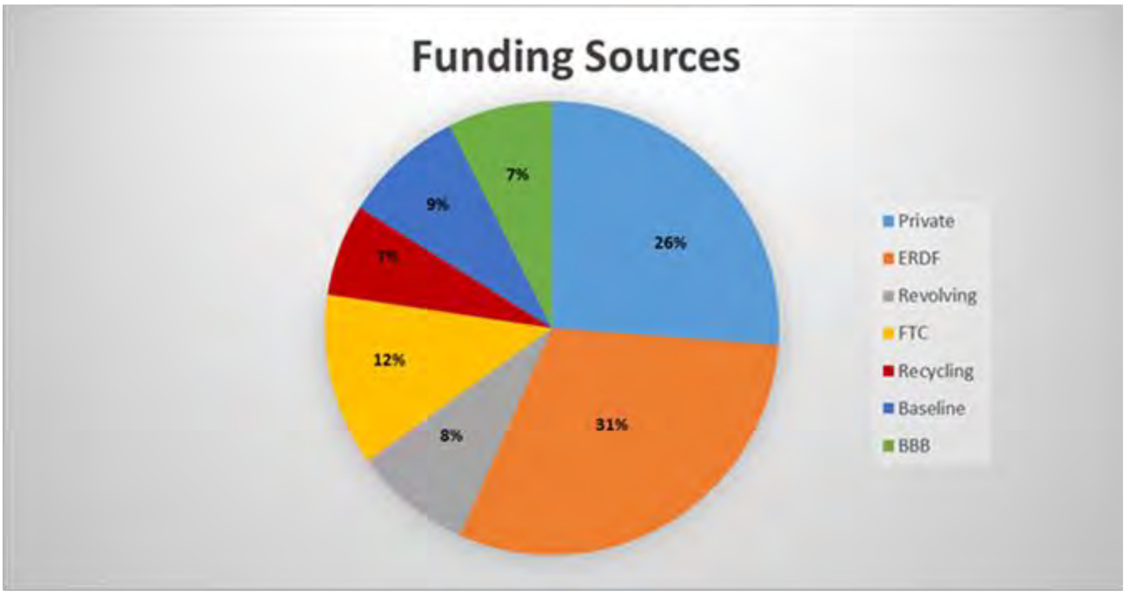
[11] only the staff and admin costs incurred by the Corporate Finance team in the design and management of these funds are included in the table.

[12] This is repayable funding from HM Treasury to the Northern Ireland Government. 80% of the capital returned to Invest NI must be returned to HM Treasury, whilst anything over and above this is retained by the Department for Economy NI.

investment at fund level, with any individual deal private leverage excluded (with the exception of the Co Fund which Invest NI has counted as 'fund level' here).

2.39 The ERDF programme, FTC and private investors are the largest sources of finance. Of the public sector sources of funding, the ERDF grant requires any recycled monies to be reused in similar financial instruments (at least at the time it is recycled). The public sector investment in the development funds is subordinated to the private sector monies, whilst the public and private investors in the Co-fund invest on a pari passu basis.

Figure 2.4 Sources of Funding for Current Invest NI Funds in Investment and Realisation Phases



Source: Invest NI; Note: the funds included are NISBLF II, GLF II, GFF, Techstart I and II, Co Fund II and the Development Funds.

Fund Management Fees and Bonuses

2.40 Table 2.6 below summarises the fund management fees and bonus arrangements for the Invest NI backed funds. Fund management fees cover two elements, namely a base fee and performance element[13]. The base fee covers costs and overheads and performance related fees provide the incentive for fund managers to manage the investments and exits profitably. Fund management fees will typically cover:

- Staff costs required to manage the fund including subsistence and expenses
- Legal and professional costs directly associated with the fund
- A contribution to the organisations overhead for accommodation costs and services such as IT systems, accounting, portfolio monitoring and auditing
- Publicity and marketing of the fund
- A profit element for the fund manager.

2.41 As well as performance-related fees, fund managers can also be rewarded through a carried interest agreement. This is a proportion of the profit share from investments to provide an

[13] This is terminology used in European Commission guidance on the fees levels and structures for public sector backed SME financial instruments, although fund managers do not tend to distinguish between the two components.

incentive to the fund manager to make sound investments and to secure good overall returns. Carried interest is usually paid once a hurdle level of returns are made (e.g. a net internal rate of return or absolute level of cash return).

2.42 The base component of the fund management fees for Invest NI typically consist of an annual rate during the investment phase followed by a lower rate during the realisation phase. The annual rates during the investment phases range from 6.9% of total commitments for SBLF II (which will have a higher % both reflecting the recycling of monies within the fund and fixed overheads) to 0.9% for Co-fund I (which reflects the lighter touch approach to investment activity within a co-fund, however it should be noted that the Co-Fund I portfolio will require further management by the Co-Fund II manager, hence costs in the Co-Fund II contract will partly relate to managing the Co-Fund I portfolio).

Table 2.6 Fund Managements Fees and Bonus Arrangement by Fund

	Committed Capital	Total FM Fees	Annual FM Fees as % of Total Commitments	Bonus Arrangement
Funds in Realisation Period:				
SBLF I	£5m (£7.6m investment target)	£2.4m	av 6.5% per year in years 1-5; 3% in years 6-10	10% on distribution between £3m and £4m; 25% on distributions in excess £4m
GLF I	£55m	£7.09m	av 1.8% per year in years 1-5; av 0.8% in years 6-10	17.5% on returns in excess of £16.5m
Techstart I	£28.75m	£6.76m	av 2% per year in years 1-5; av 1% in years 6-10	50% of returns after investors have been repaid
Crescent III	£30m	£5.86m	av 2.4% per year in years 1-5; av 1.4% in years 6-10	Amount equal to 25% of cumulative distributions after investors and Invest NI received capital and prioritised return, thereafter 20% of further returns
Kernel	£30m	£5.7m	av 2.25% per year in years 1-5; av 1.55% in years 6-10	Amount equal to 25% of cumulative distributions after investors and Invest NI received capital and prioritised return, thereafter 20% of further returns
Co-fund I	£18.16m	£1.69m	av 0.9% per year over six year investment period	No carried interest arrangement originally in place, but under consideration by Invest NI
Funds in Investment Period:				
SBLF II	£5.5m (c£10m investment Target)	£2.5m	av 6.9% per year in years 1-5; 2.2% in years 6-10	10% on returns (after capital distributions) between £3.5m and £4.5m; 25% on returns in excess of £4.5m
GLF II	£22m (£30m investment target)	£5.25m	av 3.2% per year in years 1-5; av 1.5% in years 6-10 *	20% on returns between £22m and £26m; 30% on returns over £26m

GFF	£30m	£4.85m	av 2.2% per yr in years 1-4; 1.5% in years 5-7; 1% in years 8-10.	25% of returns after all investors have received their prioritised return and all of their capital.
Techstart II	£41.3m	£7.6m	av 2.75% per year in years 1-5; av 1.9% in years 6-10	20% of returns after investors have been repaid
Co-fund II	£20.4m	£4.38m	Av £560k per year in years 1-6	As noted for CFI above, currently under consideration by Invest NI

Source: Hatch analysis of fund limited partnership agreements and management service agreements * note: this is based on £22m, rather than being based on the investment target of £30m

2.43 Benchmarking fund management fees is inherently difficult, and the reasonableness of fees should be considered on a case-by-case basis. There are several factors that will influence the suitable level of fund management fees including the type of finance, scale of the fund and approach to fund management activities. Given the variance in these factors across different funds it is often difficult to benchmark the fees charged in one fund against another.

2.44 There is limited guidance on the fees that should be charged for public sector backed funds. Also, given the commercial sensitivity of fund management fees, information is often not publicly disclosed and hence it is difficult to build a strong evidence base from which to benchmark fees. Although more information is available from private sector led funds, it is still difficult to get a clear picture on what basis the fees are being charged[14].

2.45 The reviews of fund management fees which the evaluators have previously undertaken suggest that fund management fees for public sector backed funds average 2.2% per year, with the annual fund management fees for recently launched or procured funds in the range of 1.85% to 2.75% of committed capital. There is also evidence of a slight reduction in fees over the last decade and there are recent examples of fund management fees with more sophisticated structures than flat rate annualised fees, although this may just reflect the practice of the British Business Bank which is procuring these particular funds.

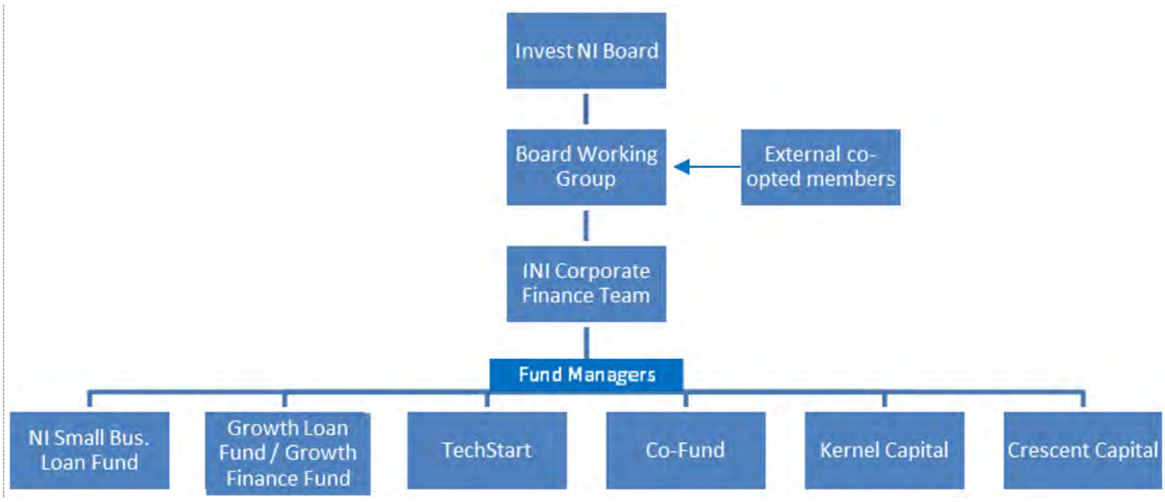
2.46 On this basis the annual fund management fees for the Invest NI backed funds appear to be at roughly the right level. Whilst the fees for the SBLF appear high, they are closer to an overall annual average of 3.1% for SBLF I when the higher investment allowed through recycling is factored in (and 2.5% for SBLF II).

Management and Governance Arrangements

2.47 Figure 2.5 shows the governance structure of the funds.

[14] Do Private Equity Fund Managers Earn their Fees? Compensation, Ownership, and Cash Flow Performance Review of Financial Studies, Robinson, D T and Sensoy, B.A, 2013

Figure 2.5 Invest NI Access to Finance Governance Structure



Source: Invest NI, Access to Finance – Board Working Group, Draft Terms of Reference, May 2020

2.48 The Invest NI Corporate Finance team is responsible for the development and updating of the Access to Finance Strategy, the development, procurement and oversight of the SME investment funds, liaison with the external fund managers, and reporting progress to senior managers and the Board Working Group. The team of three executive managers is overseen by the Director of Corporate Finance and Property Solutions.

2.49 Governance for the funds is provided in part through the Invest NI Access to Finance Board Working Group. The Access to Finance Board Working Group reports to the Invest NI Board and provides an oversight and challenge function, independently of the Invest NI Corporate Finance Team which oversees the Access to Finance strategy and the procurement and management of the fund managers who deliver the funds. The Board Working Group is made up of five Invest NI board members and two co-opted members with funding expertise.

2.50 As noted in the Invest NI Access to Finance Strategy 2020[15], a role of the Invest NI board is to establish the organisation's overall strategic direction in line with Department for the Economy policy. The strategy also recommends that Invest NI seek to influence Northern Irish government policy around access to finance interventions by providing quarterly market reports, undertaking fund evaluations, engaging annual roundtable discussions with key stakeholders, and presenting to the Department for the Economy bi-annually with suggested actions to tackle market failures[16].

Marketing

2.51 The Invest NI Corporate Finance Team help to raise awareness of investment and its benefits for SMEs, through signposting and information sharing, delivering Access to Finance workshops to local banks and membership organisations, working with partners such as the British Business Bank, Intertrade Ireland, and Catalyst, and delivering case studies and animations to explain the Invest NI Access to Finance offer.

[15] Invest NI, Access to Finance Strategy, 2020

[16] Invest NI, Access to Finance Strategy, 2020, p. 11-14

2.52 The marketing of the funds' finance offer to businesses is undertaken by the fund management teams, as is business development with the businesses and relationship development with advisors, intermediaries and investors.

Monitoring

2.53 Fund managers report quarterly to Invest NI on the performance of the funds as agreed in terms of KPIs under the fund Limited Partnership Agreement or Management Agreements. These are aligned to the key performance metrics set out in the economic appraisals (and the theory of change above), but does not typically include explicit targets for core or wider economic development benefits (which in the Corporate Finance team's view be mainly addressed through evaluation). The fund managers also report quarterly on marketing and business development, pipeline of investments, the portfolio, as well as providing an annual financial statement.

2.54 The number and format of KPIs have evolved over the course of the earlier and current funds, generally to strengthen the performance frameworks. The KPIs typically focus on the deal range, total and annual rate of investment, levels of private sector leverage and in some instances the level of write-offs. The KPIs vary across funds to reflect the nature of the finance and the fund model. In the evaluator's experience, there is greater variation in these KPIs compared to comparable public sector backed regional fund of funds.

2.55 A target for the overall level of investment deals with SMEs, write off and gross and net IRR is not included as a KPI for many of the funds, although it has been included as a metric in a number of the economic appraisals (although post-appraisal changes in the funds may make comparisons back to the appraisal metrics difficult in some instances).

2.56 KPIs are not set at the fund level for economic development metrics such as the additional GVA, job creation, business starts or R&D in the NI economy. Nevertheless the funds monitor the relevant indicators, tailored to the performance metrics needed by Invest NI and particular grant funding sources (such as ERDF). The reason for not setting economic development KPIs is that Invest NI do not wish these particular metrics to shape or influence the fund managers operating on a commercial basis. This approach is also common across other regional funds, although there are instances of regional funds which do set KPIs linked to the grant agreements and associated metrics of the English ERDF programme.

Outputs, Outcomes and Impacts

Output, Outcome and Impact Targets

2.57 The Access to Finance strategy has a set of output, outcome and impact targets. The 2020/21 targets include all funds which were 'live' at the time (i.e. in investment or realisation period) and hence includes SBLFI and SBLF II, GLF I and II, GFF, Techstart I and II, the development funds, and Co-Fund I and II. The targets are cumulative commencing in 2011.

Table 2.7 Cumulative Fund of Fund lifetime targets, 2021

Cumulative Target	2021
Net companies supported	1123
Total amount invested £m	358
Private sector investment £m	188

- fund level leverage £m	63
- Deal level leverage £m	119
Net jobs created	3120
Funds recycled back to Invest NI £m	143
Net GVA generated £m	365

Source: Invest NI Access to Finance Strategy, 2020

2.58 In terms of the underpinning assumptions for these metrics, the key points are:

- total fund investment (not including deal level leverage) of £238.7m by 2021, with an average investment per year of £23.9m (based on a 10 years period) and per SME receiving finance of £191k
- fund level leverage from the private sector of £0.40 per £1, with a further £0.40 at deal level
- fund level investment per net additional job of £76.5k and additional GVA of £0.59[17] per £1 invested by the fund.

2.59 In the evaluator's view these are broadly sensible assumptions.

Impact targets

2.60 In addition to generating output (GVA) and employment growth, the Funds seek to deliver:

- Better matching of SME finance supply and demand through demonstration effects
- Increased private sector leverage from business angels, institutional investors and venture capital firms within and outside of Northern Ireland
- Productivity improvements
- An uplift in the economic growth trajectory of Northern Ireland
- Retention and growth of the investment and fund management skills base
- Improved Northern Ireland government policy with respect to Access to Finance interventions
- Improved sustainability of the Access to Finance model.

2.61 The impact targets are assessed primarily through the evaluation of the loan and equity solutions rather than specific fund monitoring. Needless to say, given the nature of these impacts, they can be challenging to evaluate robustly.

Key Findings

There is a clear rationale and evidence underpinning the Access to Finance Strategy, with detailed economic appraisals and decision-making processes in place to ensure the funds are developed and implemented in appropriate ways which will promote value for money to the public sector.

[17] this is based on the additional annual GVA rather than cumulative over multiple years.

The lifetime targets set for the Access to Finance programme commenced in 2009 which predates the period covered by this evaluation and includes a number of funds not included here. Nevertheless, the assumptions underpinning the targets appear sensible and appropriate.

The mix of funds, type of finance and focus on businesses in different stages of development, and the finance ranges are in line with the market evidence and the evaluator’s expectations. This is also similar to other comparable regions, as is the overall scale of investment which is being made available to start-ups and SMEs through the funds. As noted in Section 4, a number of the funds have in practice experienced a level and pattern of demand (in terms of the amounts of finance being sought) from businesses that have not met expectations, which is due to a mix of external economic / market factors and also operational factors in some cases.

A number of the funds have been able to secure private sector investment at the fund level (the development funds, GLF I and GFF). Whilst this is positive, it does mean that Invest NI has had to subordinate its position as an investor to the private sector investors. However, in practice the outcome may not be very different from a scenario in which the EIB had been an investor in a fund of funds (although the opportunity to introduce private sector investors into NI would not have arisen).

Invest NI has been able to secure a mix of private sector fund managers, a number of whom were new to Northern Ireland at the time of their appointment. The consultations with investors, advisors and other stakeholders have been generally positive in terms of the skills and expertise of the fund managers and track records built over the last decade in NI, although a number have expressed concerns about the quality of their investment and fund management activities (mainly concerning the development finance side – this is expanded on in Section 4).

Benchmarking fund management fees is inherently difficult, and the reasonableness of fees should be considered on a case-by-case basis. Fund management fees for public sector backed funds average 2.2% per year, with the annual fund management fees for recently launched or procured funds in the range of 1.85% to 2.75% of committed capital. On this basis the annual fund management fees for the Invest NI backed funds appear to be at roughly the right level. The operational costs associated with the Invest NI team are very modest as a proportion of committed capital and when compared to the costs of a holding fund[18].

The funds have tailored performance frameworks. The number and format of KPIs have evolved over the course of the earlier and current funds, generally to strengthen the performance frameworks. The KPIs typically focus on the deal range, total and annual rates of investment, levels of private sector leverage and in some instances the level of write-offs.

The funds have a broadly similar set of requirements for reporting to Invest NI quarterly and annually. These are in general considered satisfactory by the evaluators and for some funds are considered to be very good (e.g. Techstart). However, the inconsistencies across funds in their reporting may make it difficult to aggregate the data in order to get a fund of funds perspective.

[18] In the evaluator’s experience, the range of holding fund fees charged by holding funds for public sector backed funds range between 0.2% and 1.2% with a weighted average of 0.8%.

3. Continued Relevance and Appropriateness

3.1 This chapter assesses Invest NI's Loan and Equity Solutions programme considering the political, economic and market context in which the Funds have operated over the last 3-4 years. We draw on a range of public data sources and supplement this with evidence from consultations with public sector bodies, business representatives and the financial community to provide a richer view of the trends and context surrounding business finance in Northern Ireland.

Policy Context

UK level policy demonstrates the continued role of finance in achieving the innovation growth pillar as well as an increased emphasis on the vision for a Global Britain.

3.2 **Build Back Better: our plan for growth**[19] was introduced in 2021 to guide wider policy across the UK, replacing the UK Industrial Strategy (2017). The strategy places increasing emphasis on sustainable, inclusive, green growth as well as on driving productivity and global competitiveness through innovation. The central role of the EU Exit and the recovery from the Covid-19 crisis on strategic planning going forward is also evident.

3.3 Namely, the policy paper prioritises growth that levels up the whole of the UK, supports the transition to net zero and supports the vision for a Global Britain. The latter entails developing a new export strategy aligning support for exporters with our plan for growth and sectoral priorities, increasing UK Export Finance lending capacity and opening UK Government trade hubs in Northern Ireland, Scotland and Wales, among others.

3.4 Innovation is one of three pillars of growth. Among the measures to unlock innovation across the UK is supporting access to finance, including through continued government support for start-ups and scale-ups via programmes such as British Patient Capital and the Future Fund: Breakthrough, and a new £375m co-investment product targeting the scale-up gap for the most innovative, R&D-intensive businesses.

3.5 The **2021 Autumn Budget and Spending Review**[20] commits to supporting SMEs to meet their finance needs. It confirms over £1.6bn of funding for the British Business Bank's regional debt and equity funds. This includes £70m to build on existing British Business Bank programmes in Northern Ireland.

Northern Ireland policy seeks to address the long-standing early stage and growth finance market gap to enable a growing base of innovative, internationally competitive businesses which respond to climate change.

3.6 Government policy in Northern Ireland also reflects the now prominent UK level priorities of sustainable, inclusive growth, innovation and global competitiveness against the backdrop of responding to the challenges of the Covid-19 crisis and EU Exit. There is however greater uncertainty around EU Exit implications for Northern Ireland given the need to maintain the Northern Ireland Protocol.

[19] Build Back Better: our plan for growth, HM Treasury, 2021

[20] HM Treasury, Autumn Budget and Spending Review, 2021

3.7 The Northern Ireland Executive is currently developing a new outcomes-based Programme for Government (PfG), as such a public consultation on the draft Outcomes Framework containing nine strategic outcomes closed on 22 March 2021.

3.8 The *'globally competitive, regionally balanced and carbon neutral economy'* outcome recognises the impacts of the EU Exit and the recovery from the Covid-19 crisis, but also the importance of sustainable growth. Its key priority areas include innovation as well as growth to attract and stimulate investment (including sustainable investment) and encouraging business start-ups.

3.9 Thus, it builds on the **Draft Programme for Government Framework 2016-21**[21] setting out 14 strategic outcomes and 42 indicators. Outcome 1 aiming for *'a strong, competitive, regionally balanced economy'* included the following among its key drivers:

- stimulating innovation, R&D and creativity.
- growing the size of our 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.

3.10 Among the five pillars of the **Economy 2030: An Industrial Strategy for Northern Ireland**[22] introduced in 2017, are accelerating innovation and research, succeeding in global markets and driving sustainable, inclusive growth. The strategy acknowledges research carried out by the Department for Enterprise, Trade and Investment in 2015 recognising that the market for early stage and growth finance in Northern Ireland continues to be relatively small and faces a number of challenges. Hence, among the steps towards achieving sustainable, inclusive growth is monitoring access to both bank and non-bank finance, including seeking to increase the supply and demand of early stage and growth finance.

3.11 **10X Economy – an economic vision for a decade of innovation**[23] (2021) envisions delivering a ten times better economy in Northern Ireland by encouraging collaboration and innovation, focusing on five priority clusters (digital, ICT & creative industries; agri-tech; fintech/financial services; advanced manufacturing & engineering; life & health sciences). Among the five steps to developing interventions to deliver this vision is funding, specifically "taking a new approach to funding interventions including Challenge Funds, better participation in funding programmes and applying conditionalities to the offer of government support". The strategy does not elaborate on the provision of finance to SMEs and the role of equity and loan solutions offered by Invest NI or the finance eco-systems for start-ups.

3.12 The **Northern Ireland Innovation Strategy 2014-2025**[24] was in place when many of the Invest NI funds in the current investment period were being developed. It envisions that 'Northern Ireland, by 2025, will be recognised as an innovation hub and will be one of the UK's leading high-growth, knowledge-based regions' and recognises access to finance as one of the barriers to innovation. Specifically, the strategy identifies a disproportionate dependence on overdrafts

[21] Draft Programme for Government Framework 2016-21, NI Executive, 2016

[22] Economy 2030: An Industrial Strategy for Northern Ireland, Department for the Economy, 2017. Whilst the UK Industrial Strategy has been withdrawn, the Northern Ireland strategy is still judged to be relevant to policy in NI and hence is covered in this section

[23] 10X Economy – an economic vision for a decade of innovation, Department for the Economy, 2021

[24] Northern Ireland Innovation Strategy 2014-2025, Department for the Economy, 2014

by many firms in Northern Ireland, which is a form of finance that is ill-suited to the growth needs of innovative businesses. The strategy aims to achieve its vision through cultural change, knowledge generation, knowledge exchange and knowledge exploitation. The latter entails more companies accessing finance enabling them to take advantage of their knowledge and IP, but also supporting high growth, high export potential companies more generally.

3.13 **Economic Recovery Action Plan: Rebuilding a Stronger Economy**[25] (2021) responds to the impacts of the Covid-19 pandemic by setting out the priorities for a more inclusive, competitive and green economy. The action plan is built around the four key pillars of R&D and Innovation, Highly Skilled & Agile Workforce, Greener Economy and Investment, and Trade & Exports. The actions taken to promote investment, trade and exports include:

- financial support to assist NI companies, particularly high growth SMEs, realise their export potential, develop export opportunities, and stimulate more companies to export to a wider range of markets.
- engaging with the British Business Bank and other relevant stakeholders, to encourage and promote alternative forms of finance, and respond to changing access to finance requirements during the economic recovery.

3.14 In line with the Economic Recovery Action Plan, Invest NI developed the Covid-19 Equity Investment Fund (CEIF) as part of its Access to Finance portfolio.

Invest NI continues to respond to an evolving policy agenda

3.15 The **Invest NI Business Plan 2021-2022**[26] bridges the gap between the conclusion of the 2017-21 Business Strategy and the development of a new longer-term strategy from April 2022, which will transform and refresh Invest NI's solutions, interventions and processes in line with the new Programme for Government (PfG) period as well as the 10X strategy.

3.16 As the 2021/22 Business Plan was largely developed in advance of the Department of the Economy's (DfE) recently launched 10X strategy, Invest NI is currently working to ensure its activity further aligns with and accelerates the strategy's ambitions, including through identifying and concentrating around strategic opportunities and interventions focused on Northern Ireland's priority technologies and clusters.

3.17 The 2021/22 Business Plan is structured around eight economic drivers, summarised in Figure 3.1. Invest NI worked closely with DfE colleagues to ensure the economic drivers lay strong foundations for the transformative growth sought in the 10X economic vision, but also contribute towards recovery from the Covid-19 pandemic, in line with the shorter-term Economic Recovery Action Plan. In light of the uncertain national and global economic outlook, the 2021/22 Business Plan is explicitly described as a 'living document' that will flex and change as the implications of Covid-19 and EU Exit evolve over the year, further highlighting Invest NI's adaptive approach to a changing landscape.

3.18 Under the Northern Ireland protocol, Northern Ireland is the only place where businesses can operate free from customs declarations, rules of origin certificates and non-tariff barriers on the sale of goods to both GB and the EU[27]. The Business Plan highlights how this presents opportunities for exporting and importing Northern Irish businesses, as well as the need for

[25] Economic Recovery Action Plan: Rebuilding a Stronger Economy, Department for the Economy, 2021

[26] Invest NI Business Plan 2021-2022, Invest NI, 2021

[27] Invest Northern Ireland website, Northern Ireland: Market Access to Great Britain and the European Union, 2021

Invest NI to ensure businesses understand the changes to policy and scope of opportunities presented by the protocol. It also notes that the protocol may benefit the business funding environment by attracting foreign direct investment into Northern Ireland.

Figure 3.1 Invest NI Business Plan 2021-22: Economic Drivers

Source: Invest NI Business Plan 2021-2022, Invest NI, 2021

3.19 The policy environment has evolved notably since the inception of the funds to respond to challenges such as the EU Exit, Covid-19 crisis and the transition to Net Zero by 2050. Invest NI remains strategically relevant as it demonstrated agility in responding to evolving policy priorities. Going forward, a successful increase in the number of innovative companies, as envisioned by policies such as the 10X Strategy, requires Invest NI to be ready to respond with a greater provision of larger sized or longer-term loans or more equity finance. More broadly, sustained efforts to expand the business base in Northern Ireland demonstrates a continued need to ensure provision of start-ups finance is sufficient to meet demand.

3.20 Whilst there is an increased emphasis on NI's 10X sectors, net zero and innovation strategies, this does not necessarily mean that Invest NI loan and equity solutions should adopt a sector-based approach for its current funds. Whilst the funds are sector generic, the investment teams will nevertheless have some of the knowledge and experience to target investment opportunities in a range of the sectors which are targeted in policy.

SME Access to Finance in Northern Ireland

3.21 Access to Finance interventions are central to the Department for the Economy's enterprise policy. Following a review of access to finance for businesses in Northern Ireland published in March 2013, DfE promoted British Business Bank products in Northern Ireland and support Invest NI's Loan and Equity programme[28].

3.22 Table 3.1 illustrates the British Business Bank products available to SMEs in Northern Ireland. In addition, SMEs will be able to access other forms of finance including senior debt, asset backed,

[28] Department for the Economy website, Enterprise Policy

trade and export finance, as well as newer alternative forms of finance such as crowdfunding and peer-to-peer lending platforms. Local banks also provide specific products targeted at early stage SMEs.

Table 3.1 Overview of British Business Bank finance available in Northern Ireland

Support provided	Eligible businesses
• Start-up loans of £500 to £25,000	• Start ups
• Covid Recovery Loans up to £1,000 - £10m via funding providers	• Businesses impacted by Covid-19
• Angel CoFund equity investment of £110k - £1m	• Businesses with strong growth potential

3.23 While these funds among others available go some way in supporting the access to finance needs of small businesses in Northern Ireland, the Invest NI Loan and Equity programme responds to objectives which other access to finance provision in Northern Ireland does not. The Loan and Equity programme bridges the finance gap resulting from the market failure of imperfect information in the private sector market (as outlined in Paragraph 2.5) while nurturing the SME A2F environment in NI by encouraging fund managers and other financial intermediaries to operate in Northern Ireland and attracting investment into Northern Ireland specifically

Economic Context

3.24 The total population of Northern Ireland in 2020 was 1.9 million[29]. This accounts for 3% of the UK population (67 million), making it the smallest region of the UK.

Northern Ireland lags behind the UK in terms of productivity

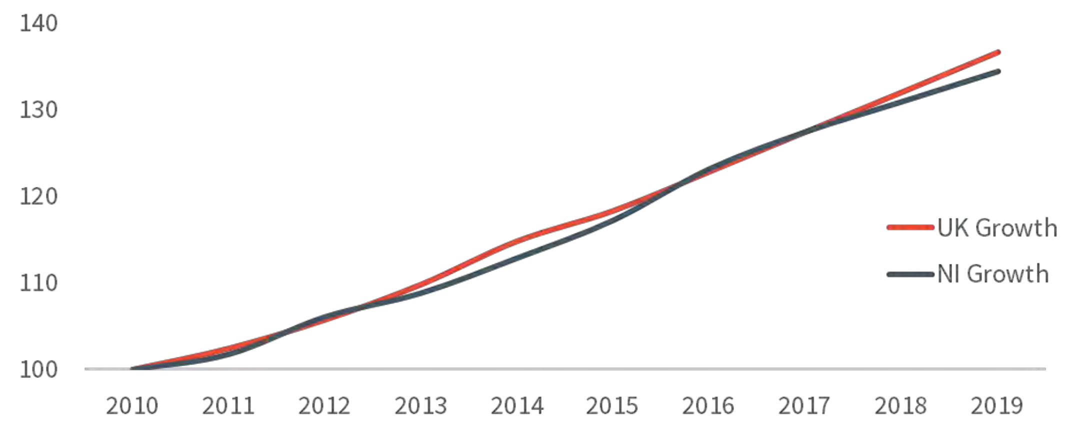
3.25 The most recent official data indicates that GVA totals £42.2bn[30] in Northern Ireland. GVA (Gross Value Added) measures the output to an economy, excluding immediate consumption. As such GVA data can be interpreted as a proxy for economic output.

3.26 Northern Ireland GVA is equivalent of 2.14% of UK GVA, lower than the population proportion. This suggests that GVA per person in Northern Ireland is lower than the UK average (although higher than the North East and Wales). Additionally, output growth since 2010 has been over two percentage points lower in Northern Ireland (34.4%) than in the UK as a whole (36.7%).

[29] ONS population estimates, 2020

[30] balanced, current price estimate, ONS 2021 (2019 latest)

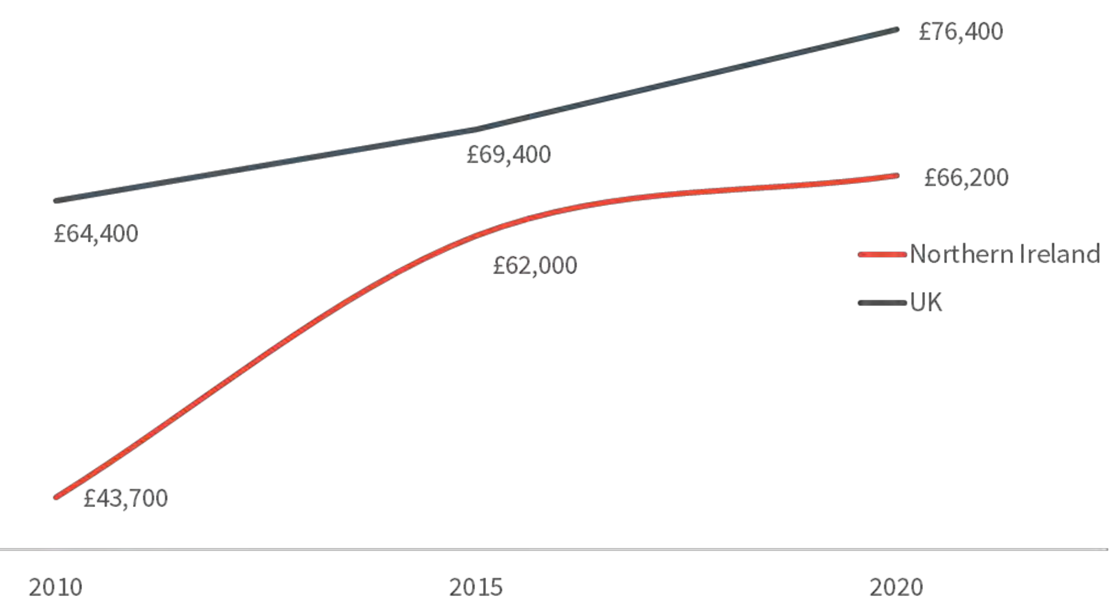
Figure 3.2 GVA Growth Index, Northern Ireland & UK (2010=100)



Source: ONS Balanced Regional GVA current price estimate, 2021

3.27 Average productivity[31] in Northern Ireland was £66,200 in 2020, 15% below the UK productivity level (£76,400). This has increased significantly from 2010-2015, closing the gap on the UK. The gap has fallen in large part due to the reduction in the gap in the employment rate between 2010-2015 (-17%[32]).

Figure 3.3 Productivity per Employee, Northern Ireland & UK



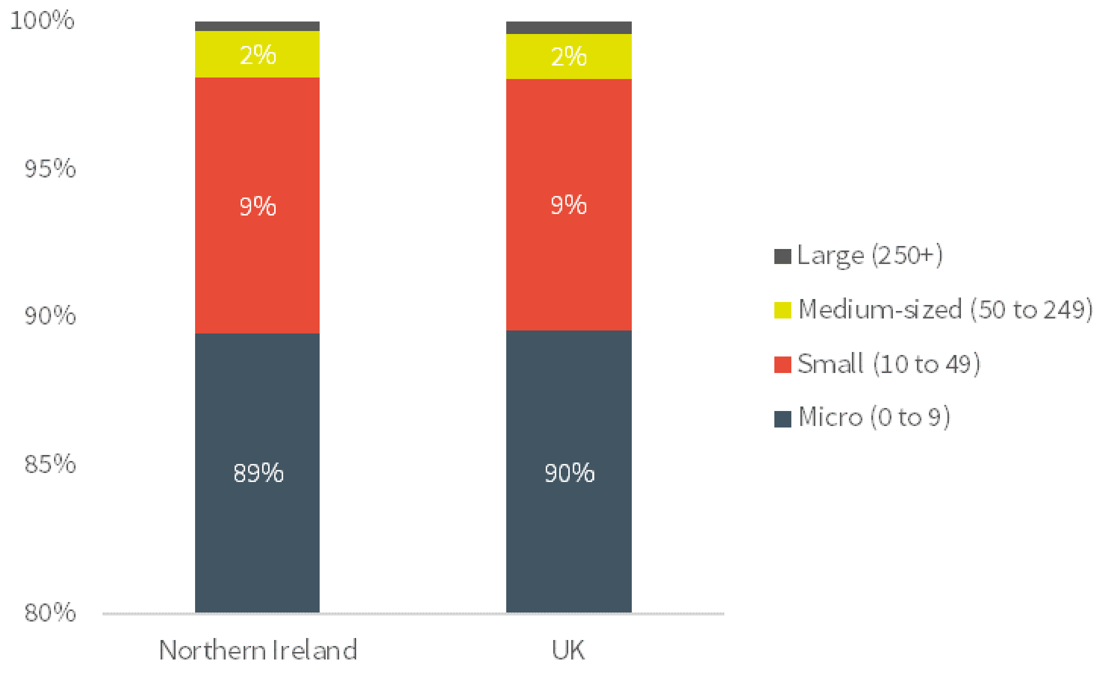
Source: ONS Balanced Regional GVA current price estimate, 2021

[31] Measured as GVA per Full Time Equivalent Employee

[32] ONS, BRES,2020

Proportions of SMEs in Northern Ireland match that of the UK, spanning across a wide range of sectors

Figure 3.4 SME Proportions



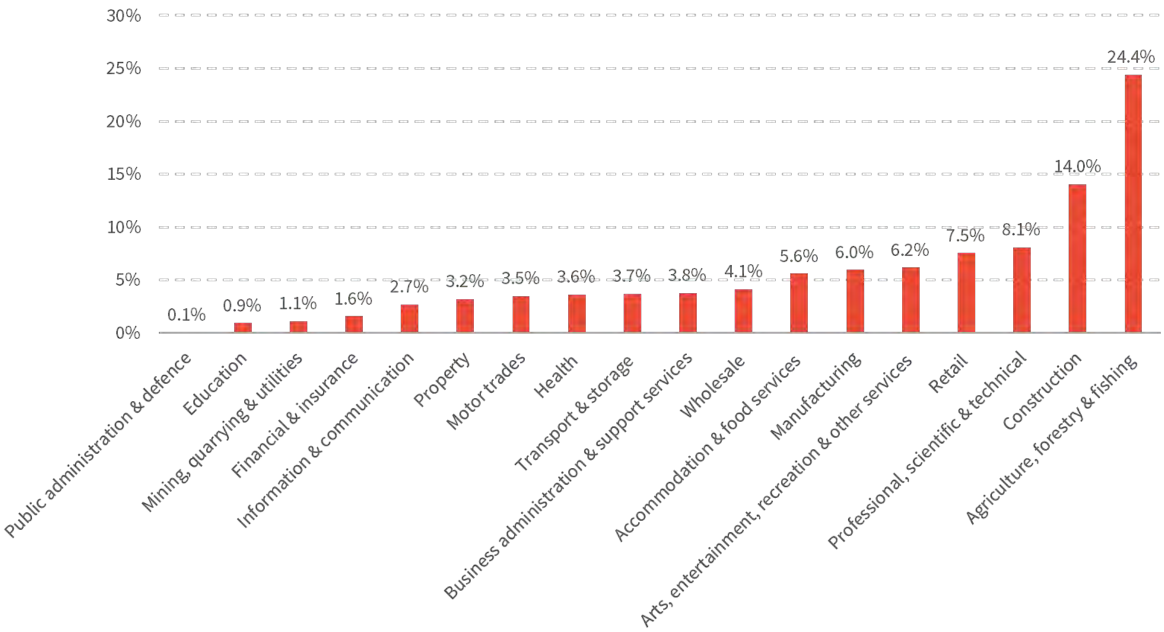
Source: ONS Business Counts, 2021

3.28 In 2020, Northern Ireland had a total of 75,180 VAT and/or PAYE registered businesses, making up 3% of UK businesses (2.7 million). This has increased by 6,655 businesses from 2010 (68,525 businesses). Micro enterprises (0-9 employees) make up 89% of Northern Ireland businesses, followed by 9% for small enterprises (10-49), 2% for medium-sized enterprises (50-249 people), 0.3% for large enterprises. Proportions of small, micro, medium and large businesses are broadly similar to UK proportions. In 2019, 12% of these SME businesses were Women-led, 3% lower than the UK figure[33].

3.29 Figure 3.5 shows SMEs in Northern Ireland to be concentrated in the sectors of agriculture, forestry & fishing, and construction.

[33] NISRA, Women in NI, 2020

Figure 3.5 SME Sectors



Source: ONS Business Counts, enterprises by industry and employment size band, 2021

SME Growth is concentrated within micro and medium businesses

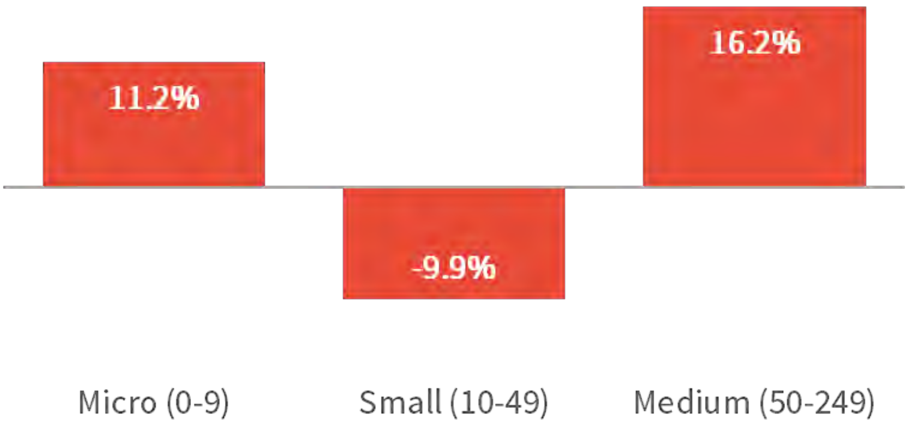
3.30 Figure 3.6 shows promising growth of micro and medium businesses by 11.2% and 16.2% between 2010 and 2020. However, small enterprises (10-49 people) have seen a contraction of 9.9%. NISRA[34] indicates there was lower 1-year survival rates of businesses over the 4-year span 2017-2020 which explains the contraction in small businesses within 2010-2020 (that is, if smaller businesses are growing into medium businesses and are not being replaced at the same rate by micro businesses that have not survived then this could explain the contraction in the number of small businesses).

3.31 Northern Ireland also has a lower 1-year baseline business survival rate compared to the UK[35].

[34] NISRA, Business Demography, 2019

[35] NISRA, Business Demography, 2019

Figure 3.6 SME growth 2010-20

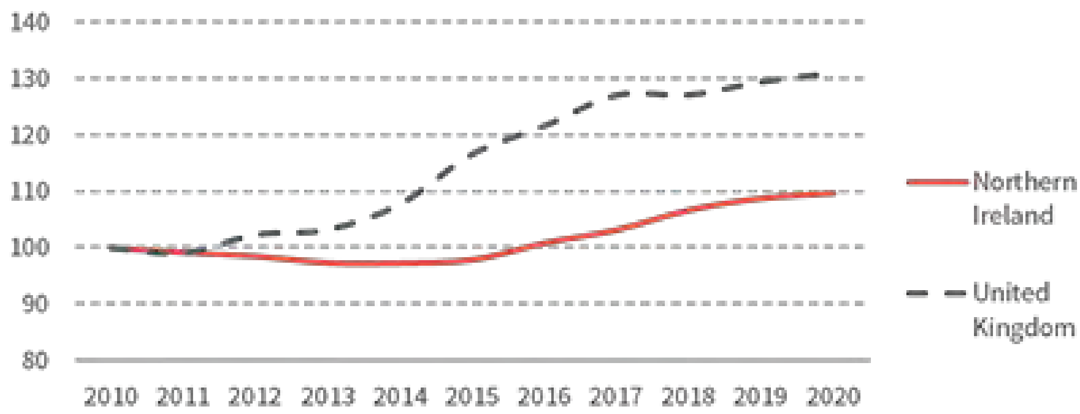


Source: ONS Business Counts, 2021

Business growth is evident within Northern Ireland, but large disparities exist between districts

3.32 During the period of 2010-2019, annual business birth rates[36] increased by 2.6% in Northern Ireland to 10.4%[37] consistently below the UK rate. Business growth between 2010 and 2019 has been highest in Belfast Council District (14.5%). The district of Ards and North Down has the lowest growth (1.5%).

Figure 3.7 Business Growth Rates 2010-2019 (Base Year=100)

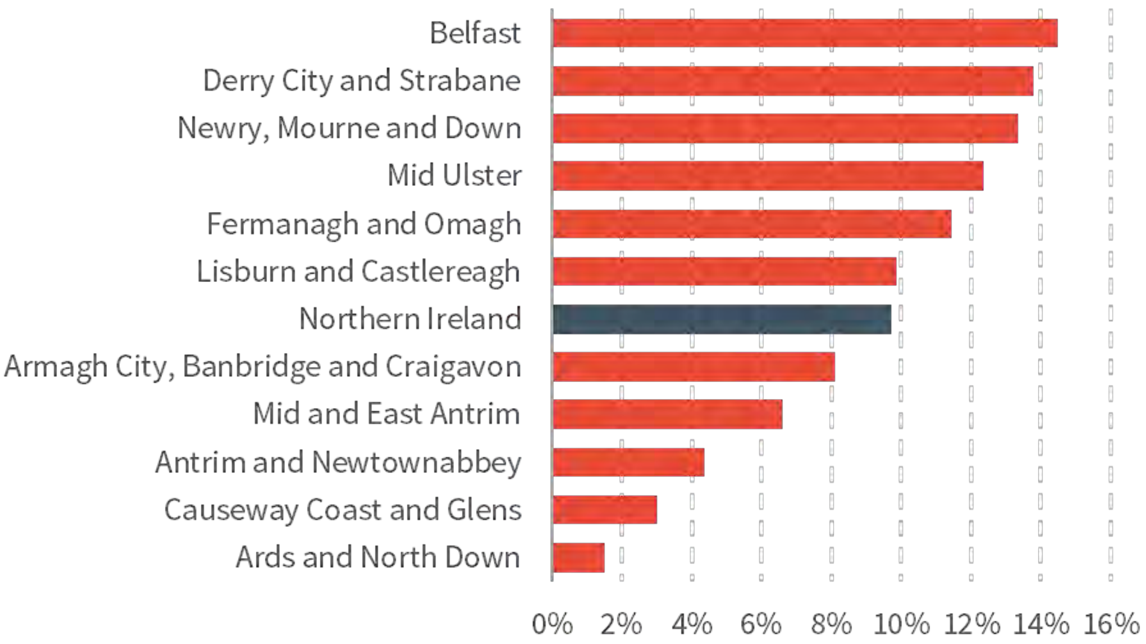


Source: ONS, UK Business Counts, IDBR ,2020

[36] percentage of new businesses to active businesses

[37] IDBR Business Demography, NISRA, 2021 (2019 data)

Figure 3.8 Business Growth Rate by District 2010-2019

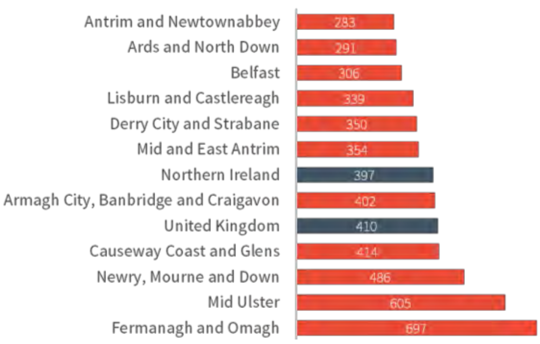


Source: ONS Business Counts, 2021

3.33 When looking at the business counts per 10,000 people (Figure 3.9), Northern Ireland as a whole and the UK show similar averages (397 and 410 respectively), but Mid-Ulster and Fermanagh and Omagh districts significantly exceed both averages.

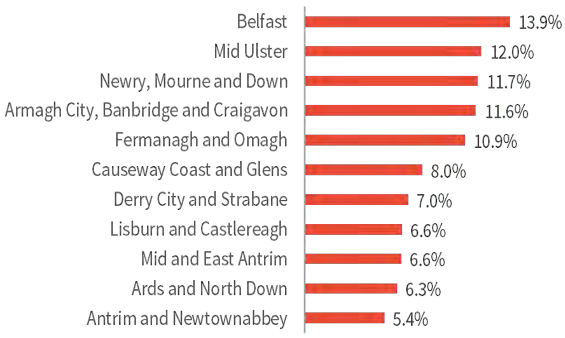
3.34 Similarly, there exists disparity in the total number of businesses across council districts . Belfast had the highest business count share (13.9%) of NI businesses, despite low numbers of business counts per head given the city's large population size.

Figure 3.9 Business Counts per 10,000 people



Source: ONS Business Counts, Population Estimates, 2021

Figure 3.10 Business Count share in NI by district, 2020



Source: ONS Business Counts, 2021

3.35 Causeway Coast and Glens are shown to already have a relatively large business base of 414 business counts per 10,000 people. Within this district, there is little business growth and the business count share of Northern Ireland is shown to be at a medium level (8% of NI businesses). Perhaps due to the large business base, there is lower incentive for business creation.

3.36 Nonetheless, other areas such as Mid Ulster and Fermanagh & Omagh, have a relatively large share of the NI business base, but still have relatively high district business growth. It may be the case that sectoral growth or contraction plays a role in determining business growth rates in districts.

COVID-19 has affected both existing and new businesses

3.37 Following COVID-19, Wales, Northern Ireland and Scotland have suffered the largest declines in business creation across all the twelve UK regions, relative to the same period last year. According to the Northern Ireland Government, the NI economy (in terms of GDP) contracted slightly more than the UK average in April 2020 (22% compared to 20% for the UK as a whole)[38].

3.38 Company registrations from 23 March 2020 to 31 May 2020 in Northern Ireland were down over 30% from the same period in the last year, with UK-wide business creation falling 25% across all major industrial sectors. The retail sector has suffered the worst, whilst mining and agriculture are more resilient. Company registrations in September 2021 are still down 21% since September 2019 with UK business creation 9.5% lower than September 2020.

3.39 According to the Northern Ireland Government, the larger decline in Northern Ireland is most likely due to having sizeable wholesale, retail and manufacturing sectors and major construction and agriculture sectors. These sectors were disproportionately hit by the lockdowns due to COVID-19.

3.40 Mid-Ulster, Newry, Mourne & Down, Causeway Coast & Glens and Mid & East Antrim are expected to see the greatest impacts from COVID-19 in their local economies in terms of GVA. This reflects the sectoral concentrations of construction, manufacturing, tourism and/or retail in these areas.

...But recovery is forecast to occur in all areas of the UK over the next two years

3.41 KPMG have forecast economic recovery (in terms of economic activity rates) for UK countries from COVID-19. Northern Ireland forecasts utilised the NICEI measure (Northern Ireland Economic activity measure). This research suggests that recovery is set to be slower than other UK areas, but still positive from 2021 onwards. With economic activity rates falling in the short run (2020), this may have implications for the previously stated productivity levels.

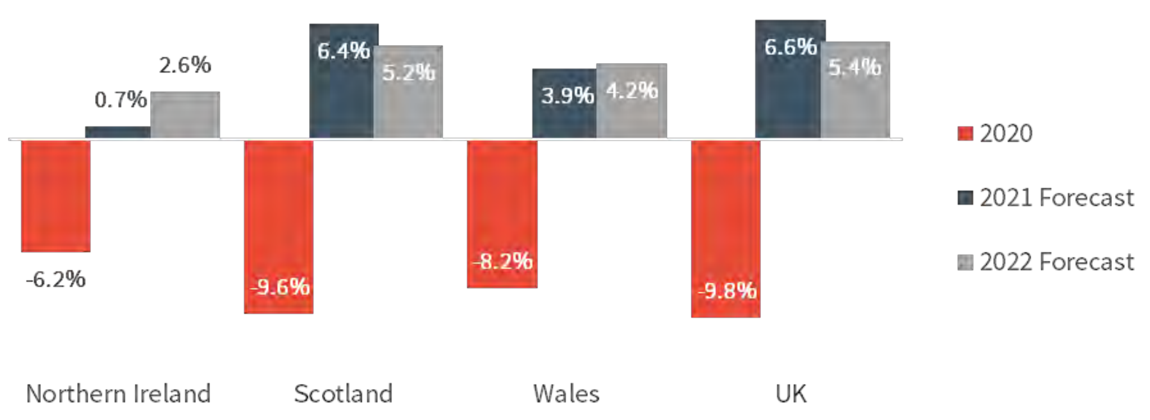
3.42 However, this forecast may be overcautious given more recent NICEI data indicates growth in Northern Irish economic output, with 3.1% increase in economic output over the quarter to June 2021 and similar growth to the wider UK over the year (23.6%)[39]. In Q3 of 2021, Northern Irish output was just 0.3% below figures at the end of 2019[40]. This was the strongest bounce-back of all UK regions.

[38] Economic Activity in Northern Ireland by quarterly NI Composite Economic Index Q1 2021, NISRA, 2021

[39] NI Composite Economic Index, NISRA,2021

[40] Financial Times, Northern Ireland has outperformed the rest of the UK, ONS figures show, 2021

Figure 3.11 Forecast Economic Recovery from COVID-19 (Northern Ireland= NICEI[41] measure, UK, Wales, Scotland- GDP)

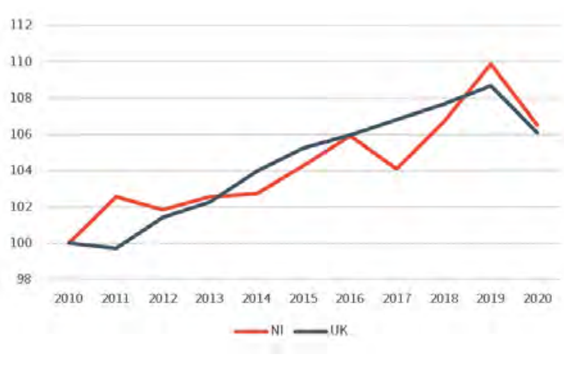


Source: ONS, Scottish Government, NISRA, KPMG,2021

Employment rate in Northern Ireland has risen accompanied by a falling unemployment rate

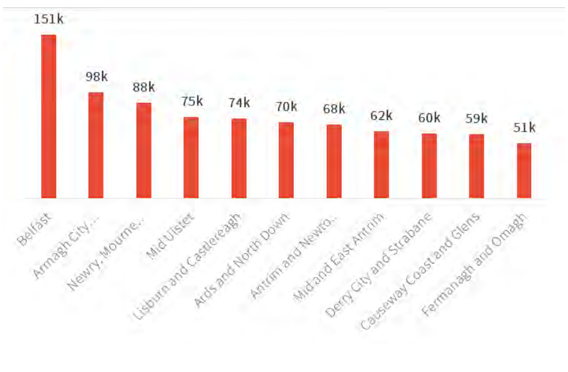
3.43 Over 2010-2019, the employment rate in Northern Ireland rose overall with slight dips in 2012 and 2017. A dramatic fall in employment rate was seen in 2020 most likely resulting from COVID-19. The UK saw less fluctuation than Northern Ireland but exhibited similar trends. Employment is heavily concentrated in Belfast, with much smaller levels across the other semi-rural and rural districts.

Figure 3.12 Employment rates 2010-2020, indexed at 2010 levels



Source: Labour Force Survey, ONS, 2021

Figure 3.13 Employment concentration in Districts, 2020



Source: Labour Force Survey, NISRA, 2021

3.44 In Northern Ireland, unemployment fell from 8% in 2010 to 2% in 2019, this closely followed UK trends, but Northern Ireland experienced a greater reduction in unemployment in recent years. Due to the pandemic, unemployment rose in both Northern Ireland and the UK. This correlated with the reduction in employment rate shown in Figure 3.12. In Q2 2021 unemployment stood at 4.1% but remained 0.4 percentage points below UK levels[42].

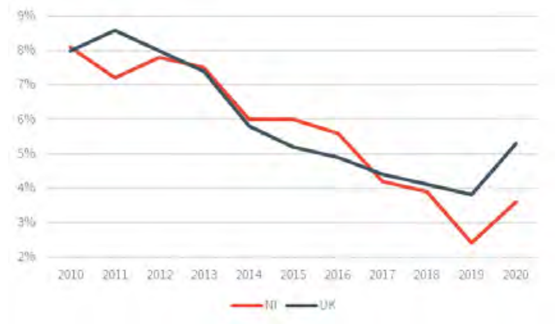
[41] Northern Ireland Composite Economic Index (NICEI), measures economic activity

[42] NISRA Labour Market Report, 2021

HATCH

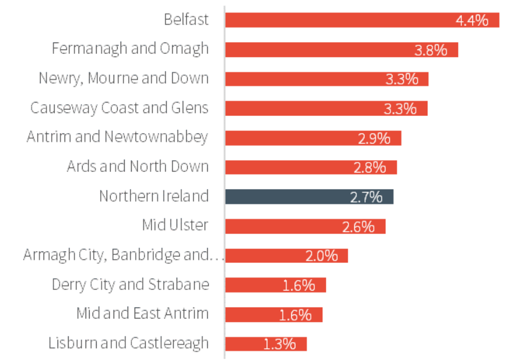
3.45 Districts vary greatly with unemployment rates being considerably higher in areas such as Belfast (4.4%) and Fermanagh and Omagh (3.8%). Economic inactivity in Northern Ireland has also shown to be consistently higher and more volatile than in the UK. As of Q2 2021 the rate of economic inactivity was almost five percentage points above the UK rate[43].

Figure 3.14 Change in Unemployment rates 2010-2020



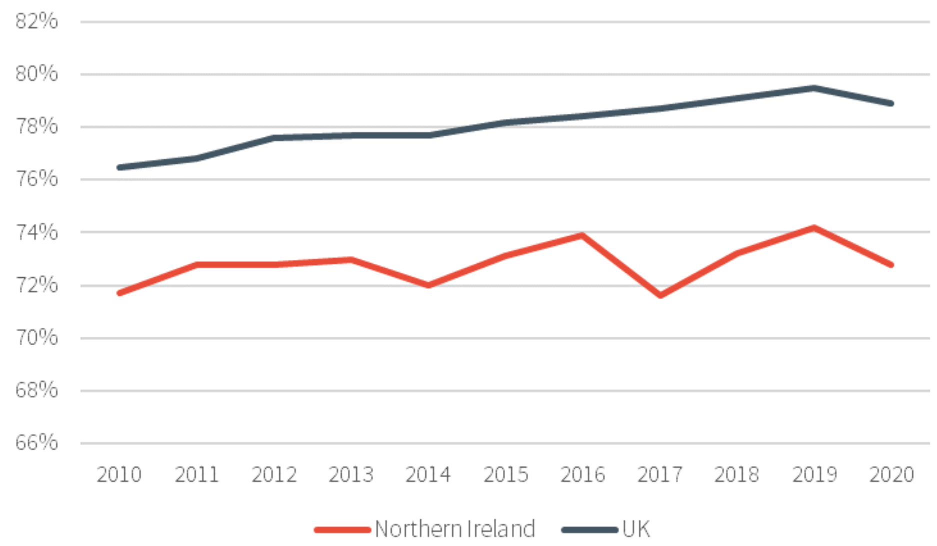
Source: Labour Force Survey, ONS, 2021

Figure 3.15 Unemployment rate (16-64) NI Districts, 2020



Source: Labour Force Survey, NISRA, 2021

Figure 3.16 Economic Activity Rates, 2010-2020



Source: Labour Force Survey, NISRA, 2021

Market Context

3.46 This section reviews trends in the demand for finance in those segments of the market in which Invest NI has been operating followed by an assessment of the respective supply for finance to identify where potential finance gaps persist in Northern Ireland.

[43] NISRA Labour Market Report, 2021

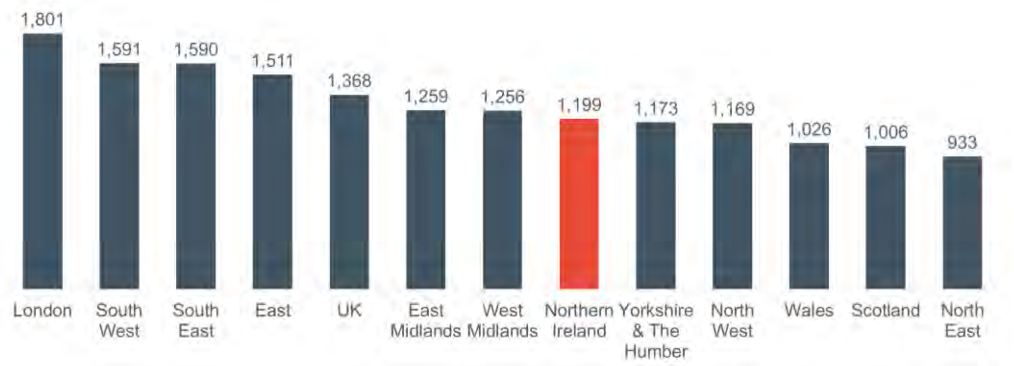
HATCH

Demand for External Finance

Increasing stock of microbusinesses and start-ups indicating growing demand for smaller amounts of finance

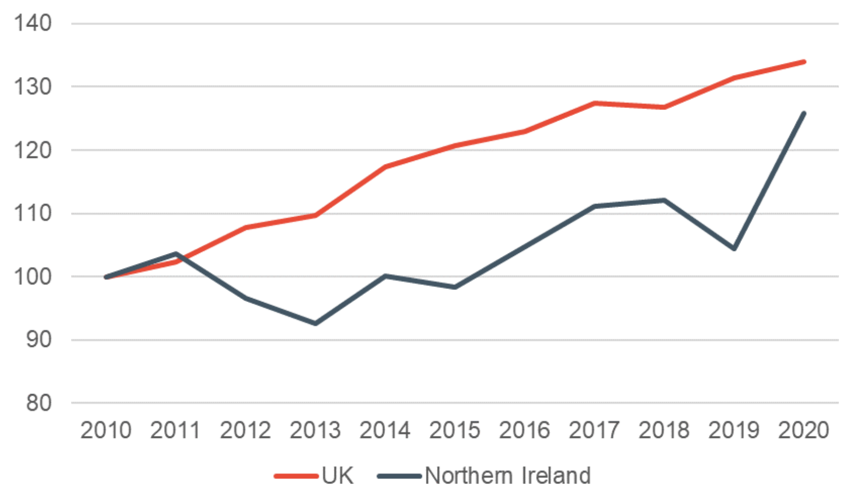
3.47 In 2020, 141,510 out of 148,300 (95%) private sector businesses[44] in Northern Ireland were microbusinesses. As shown in Figure 3.17, this translates to 1,199 microbusinesses per 10,000 working age residents, which is lower than the UK rate (1,368). Since 2010, the base of microbusinesses grew at a slightly faster rate than the total business base in Northern Ireland (+26% vs +24%). However, Figure 3.18 shows that growth in microbusinesses is still lagging behind that seen across the UK (+34%).

Figure 3.17 Microbusinesses per 10,000 Working Age Residents, by UK region, 2020



Source: Business Population, BEIS, 2020; Population Estimates ONS, 2020

Figure 3.18 Index of Growth in All Private Sector Microbusinesses (2010 = 100), 2010-20



Source: Business Population, BEIS, 2020

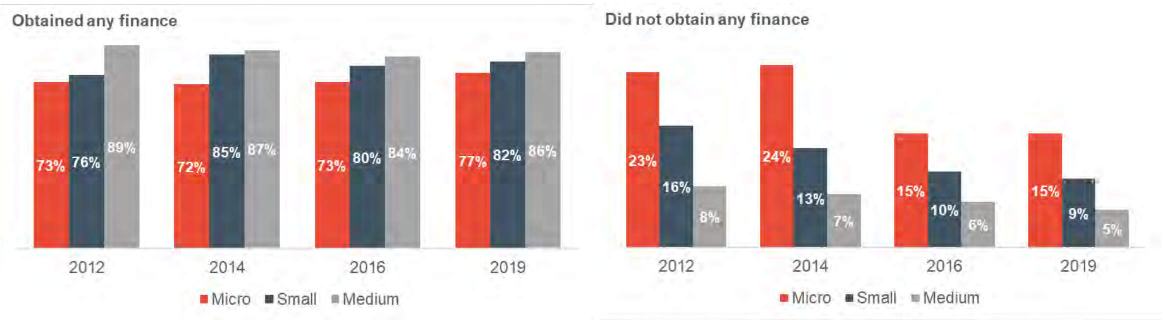
3.48 Similarly, decent overall growth in business start-ups was observed in Northern Ireland, albeit weaker compared to the UK between 2010-19 (+44% vs +66%). Notable variations across local

[44] VAT and/or PAYE registered businesses as well as an estimate of the unregistered business population.

authorities are observed, with strong performers including Newry, Mourne & Down and Belfast while Causeway Coast & Glens saw the lowest growth in start-up formation[45].

3.49 Start-ups and microbusinesses tend to require smaller amounts of start-up and early-stage finance than larger businesses, so with growing microbusinesses and start-up numbers we would expect to see an increase in demand for smaller amounts of finance. As shown in Figure 3.19, over time a smaller proportion of UK microbusinesses are not getting the finance they are seeking. However, this is most likely due to alternative finance providers being more active (including public sector backed initiatives) rather than high street banks. This could suggest a shortage of small scale and early-stage finance.

Figure 3.19 Outcome of Application for Finance by business size UK businesses, 2012-19



Source: Longitudinal Small Business Survey, BEIS, 2020. Note: The remaining share of respondents reported 'don't know/still pending/refused'.

SME demand for external finance is strong, with relatively larger amounts of funding being sought

3.50 There were 148,140 private sector SMEs[46] in Northern Ireland in 2020, a 24% increase since 2010 (relative to 33% growth UK wide)[47]. As shown in Table 3.2, SMEs in Northern Ireland were more likely to achieve a successful application for finance compared to all UK SMEs in 2019. This represents a reversal from the pattern observed in 2012 and 2014.

Table 3.2 Outcome of application for finance, Northern Ireland and UK SMEs, 2012-19

	2012		2014		2016		2019	
	UK	NI	UK	NI	UK	NI	UK	NI
Obtained any finance	75%	64%	75%	68%	75%	85%	78%	83%
Did not obtain any finance	21%	32%	21%	28%	13%	8%	14%	3%
Don't know/Still pending/Refused	4%	3%	3%	3%	12%	7%	8%	15%

Source: Longitudinal Small Business Survey, DBEIS, 2020. Unweighted sample sizes for Northern Ireland were as follows n=144 (2012), n=122 (2014), n=77 (2016), n=76 (2019). Please note that the percentages may not sum to 100% due to rounding.

[45] Business Demography, ONS, 2017 & 2020

[46] VAT and/or PAYE registered businesses as well as an estimate of the unregistered business population.

[47] Business Population, BEIS, 2020

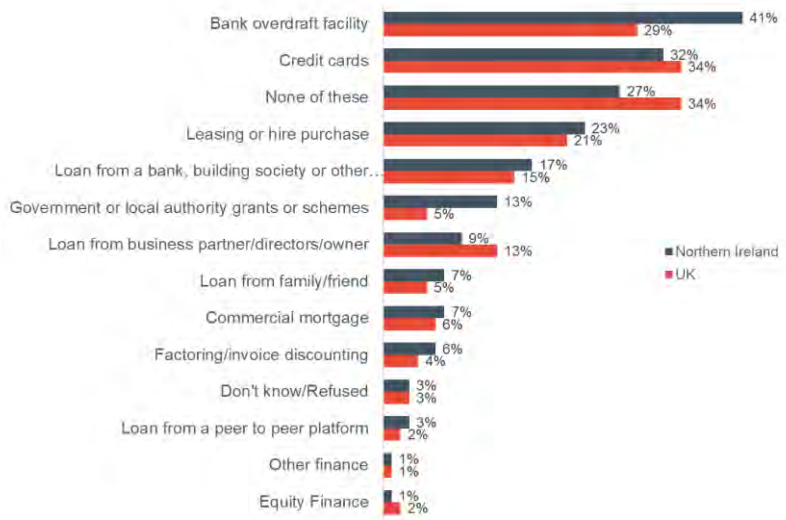
3.51 The latest SME Finance Monitor points to strong demand for external finance from SMEs in Northern Ireland, with 69% of SMEs in Northern Ireland using external finance compared to 45% across in the UK in 2019[48]. This mirrors the demand for finance of SMEs across the UK, particularly amongst SMEs starting and scaling up, given the disruption of the pandemic which led to high numbers of start-ups and growth opportunities for some businesses to scale up[49].

3.52 The 2019 Small Business Survey found that a higher proportion of Northern Ireland SMEs were accessing most forms of external finance, except for credit cards, a loan from a business partner, director or owner, and equity finance. They were notably more reliant on bank overdraft facilities than their UK counterparts (41% vs 29%), as shown in Figure 3.20. Moreover, the variance noted in the use of government or local authority grants/schemes between Northern Ireland and the UK (13% vs 5%) suggests an overreliance on grant support in Northern Ireland.

3.53 Consistently, the most popular types of external finance sought by SMEs in Northern Ireland over the year prior to 2019 included bank overdraft facilities and leasing or hire purchases, as well as loans from financial intermediaries albeit at a lower rate than nationally (Figure 3.21). The British Business Bank Regions and Nations Tracker for Northern Ireland reports that Northern Ireland is the UK's most reliant region on core debt products (overdrafts, loans, leasing and credit cards)[50].

3.54 External stakeholders operating in the financial sector that were consulted highlighted that further efforts are required to raise awareness among Northern Irish spinouts, start-ups and SMEs of where to go for investment and the types of finance available for businesses at different stages (education around the step-by-step approach from idea to market and the private and public sector finance available at each stage). It was highlighted that for businesses with an assigned Invest NI client executive, the Client Executives should also take a more proactive, holistic approach to looking at the business and making suggestions / signposting to support and funding opportunities appropriate to the stage of the business.

Figure 3.20 Types of finance currently being used, Northern Ireland and UK businesses, 2019



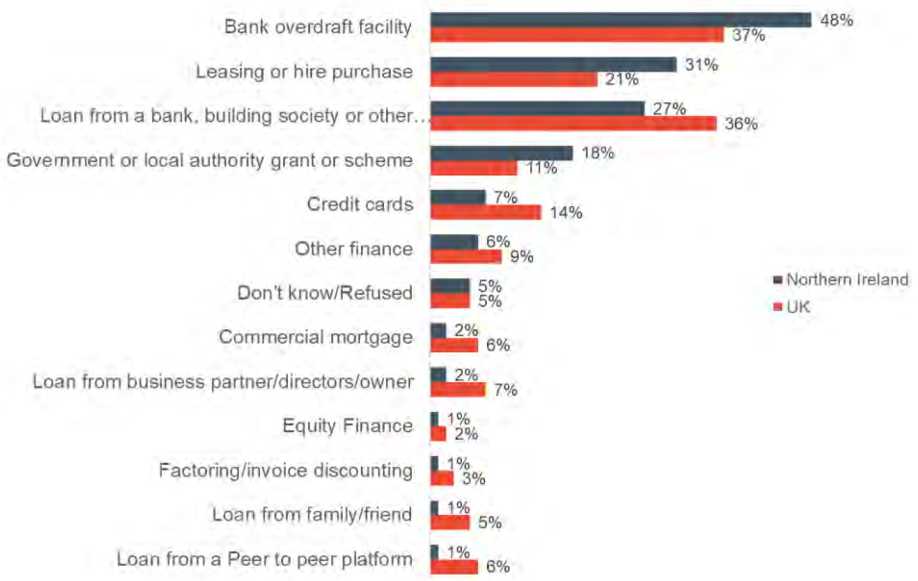
Source: Longitudinal Small Business Survey, DBEIS, 2020 (n=381 for Northern Ireland; n=8,406 for the UK)

[48] SME Finance Monitor 2019 Annual Report, BVA BDRC, 2020

[49] British Business Bank, Access to Finance Spotlight: UK Findings, Spring 2021

[50] British Business Bank, Regions and Nations Tracker for Northern Ireland, 2021

Figure 3.21 Types of external finance sought in the last 12 months, Northern Ireland and UK businesses, 2019



Source: Longitudinal Small Business Survey, DBEIS, 2020 (n=76 for Northern Ireland; n=1,245 for the UK) Note: the survey is pre-pandemic

3.55 On average, SMEs in Northern Ireland who sought external finance over the year prior to 2019 were seeking a larger amount of funding than UK SMEs (£450,310 vs £436,510). However, SMEs in Northern Ireland that were successful in obtaining finance reported amounts that were smaller compared their UK counterparts (£419,480 vs £447,870)[51]. Consultees suggest that the amounts of finance supplied to SMEs in NI are often smaller than the amounts sought or needed.

Strong demand for debt finance

3.56 Demand for debt finance by SMEs in Northern Ireland has become more prevalent over time. As shown in Figure 3.22, the share of SMEs using core finance (loans, overdrafts or credit cards) in Northern Ireland increased from 39% in 2012 to 66% in 2019, thus substantially exceeding the share seen across the UK (39%). Demand for bank loans/mortgages by SMEs was especially strong compared to UK levels. Moreover, the share of SMEs in Northern Ireland defined as permanent non-borrowers was notably lower than the UK (23% vs 42%) in 2019.

Figure 3.22 Current use of core finance, 2019

Source: SME Finance Monitor 2019 Annual Report, BVA BDRC, 2020. Please note that the percentage of SMEs using core finance does not equate the sum of its components due to overlapping use of alternative core finance products.

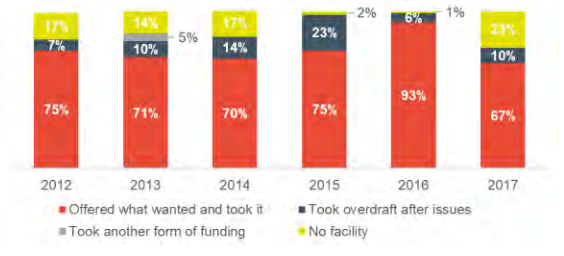
3.57 Looking at data on loans and overdrafts, which is only available up to 2017, the proportion of SMEs surveyed who successfully applied for overdrafts has improved between 2012 and 2016 but were somewhat lower in 2017 (Figure 3.23). Loan application success rates improved

[51] Longitudinal Small Business Survey, DBEIS, 2020

between 2012 and 2015, although in 2013 and 2014 notable shares took the loan after issues. Success rates fell slightly in 2016 and were substantially lower in 2017 (Figure 3.24).

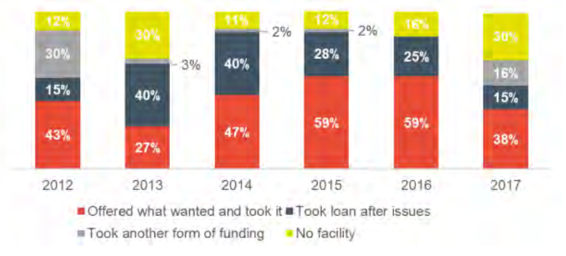
3.58 By analysing actual against predicted success rates (based on the profile of applicants), the 2017 SME Finance Monitor concludes that both overdraft and loan applicants in Northern Ireland were as successful as one would expect. Among the factors behind the declining success rates could be the potential for external shocks, like uncertainty relating to the EU Exit, adversely impacting business propositions as well as financial intermediaries' willingness to lend.

Figure 3.23 Outcome of overdraft applications in Northern Ireland



Source: SME Finance Monitor Annual Reports, BVA BDRC, 2013-18. Note Northern Ireland SME results were not recorded post-2017.

Figure 3.24 Outcome of loan applications in Northern Ireland



Source: SME Finance Monitor Annual Reports, BVA BDRC, 2013-18. Note Northern Ireland SME results were not recorded post-2017.

Securing larger amounts of early-stage equity investment becomes more important as there is a push towards more innovative enterprise activity

3.59 Total early-stage entrepreneurial activity (TEA) has been increasing across Northern Ireland and the UK. However, Northern Ireland saw lower levels of TEA than the UK in 2019 (6.6% vs 9.9%), as a persistent gap of around 2% to 3% emerged in 2011.

3.60 The attitude of non-entrepreneurially active working age individuals towards those starting a business in Northern Ireland is overall positive and comparable to the UK. However, in Northern Ireland individuals are less likely to know someone that started a business in the last 2 years or to believe that there are good start-up opportunities where they live in the next 6 months[52]. Consultees indicated that more is needed around outreach (specifically to support diversity and inclusion) to show what is possible via growing a business and support with access to finance and for further case studies to be produced to promote stories of businesses that have successfully used external finance to grow their business.

3.61 There is little directly observable evidence on the demand for early-stage equity in Northern Ireland. Northern Ireland businesses make relatively low use of equity investment. Innovative businesses tend to experience higher growth and thus greater demand for external finance, whilst the uncertain returns associated with innovative activities mean that more emphasis is placed on equity rather than debt finance. Hence, to get a fuller picture of potential demand for early-stage equity, proxy indicators are examined including the spend on R&D activity and the level of innovative business as well as trends in the stock of start-ups and spinouts.

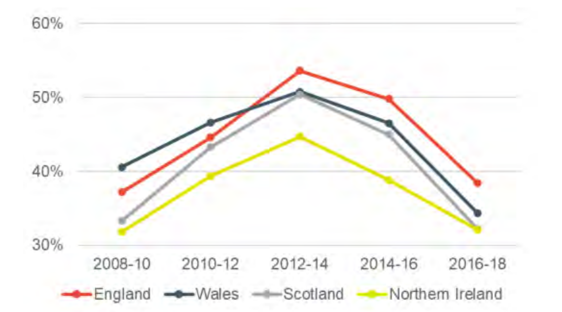
3.62 Figure 3.25 presents UK Innovation Survey data for 2016-18 suggesting that Northern Ireland, along with Scotland, had the lowest share of innovation active businesses across UK countries (32% vs 38% UK average). Over time, the share of innovation active businesses in Northern Ireland has been persistently lower than the rest of the UK. There were just 47 university spinouts

[52] GEM UK 2019 Monitoring Report, GEM, 2020

and start-ups per 1 million of working age residents in Northern Ireland in 2019/20, the lowest among UK regions[53].

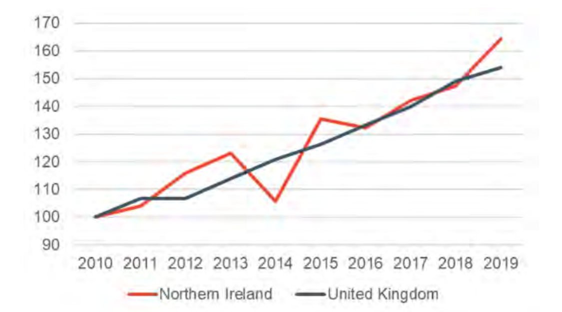
3.63 However, higher education and business sector R&D expenditure reached £779 million in 2019, a 64% increase since 2010 relative to a 54% rise in the UK as shown in Figure 3.26Figure 3.26. The success of innovative enterprises hinges on obtaining sufficient amounts of upfront investment, which can be difficult in light of the long-term nature of their returns. Given Northern Ireland's commitment to promote innovation especially in core technology sectors, as expressed in the 10X Economy Strategy[54], extending larger amounts of early-stage investment to innovative companies becomes crucial.

Figure 3.25 Innovation active businesses, 2008-10 to 2016-18



Source: UK Innovation Survey 2019, DBEIS, 2020

Figure 3.26 Higher Education & Business R&D Expenditure Index 2010=100, 2010-19



Source: Gross Domestic Expenditure on R&D by Region, UK, 2021

Lower than average demand for expansion equity

3.64 As outlined above, equity finance tends to be suitable for a small minority of firms with good long-term growth potential, but high levels of risk associated with their business plans, hence there is very little direct evidence of demand.

3.65 The 2020 Scaleup Index tracks visible scaleups across the UK. Visible scaleups are defined as those businesses which are large enough to declare their employee numbers and turnover in filed annual accounts at Companies House. There were 208 'visible' scaleups in Northern Ireland, representing 2.8% of the total visible scaleups identified. 20 visible scaleups in Northern Ireland used equity, representing about 1.2% of the total visible scale ups across the UK[55]. The proportion of Northern Ireland respondents to the Access to Finance Survey who indicated that they think that the ecosystem for SME scale-ups is inadequate exceeded the UK average (55% vs 42%)[56].

3.66 Beauhurst's 2020 update on equity investment finds that there were 23 equity deals in Northern Ireland in 2020, compared to 37 deals in 2019. Generally, equity investments have been on an upward trend since 2011, for which only 3 deals were noted. Belfast accounted for over half (52%) of the deals made in 2020, noting 12 deals worth £10.3 million in 2020.

[53] Source: HESA, 2021; Population Estimates, ONS, 2020

[54] 10X Economy – an economic vision for a decade of innovation, Department for the Economy, 2021

[55] Scaleup Index 2020, Scaleup Institute and Beauhurst, 2021

[56] Access to Finance Survey, Ipsos MORI for British Business Bank

3.67 Small Business Survey data for 2019 suggest that only 1% of Northern Ireland SMEs surveyed used equity finance compared to 2% of UK SMEs[57], suggesting that this type of finance is comparatively underused.

3.68 The 2019 SME Finance Monitor suggests there is better awareness of equity finance in Northern Ireland than the UK as a whole, with 50% of Northern Ireland SME respondents indicating awareness compared to 38% in the UK. Moreover, a larger share of Northern Ireland SMEs indicated that they are willing or plan to use equity finance in the near future than their UK counterparts (17% vs 4%).

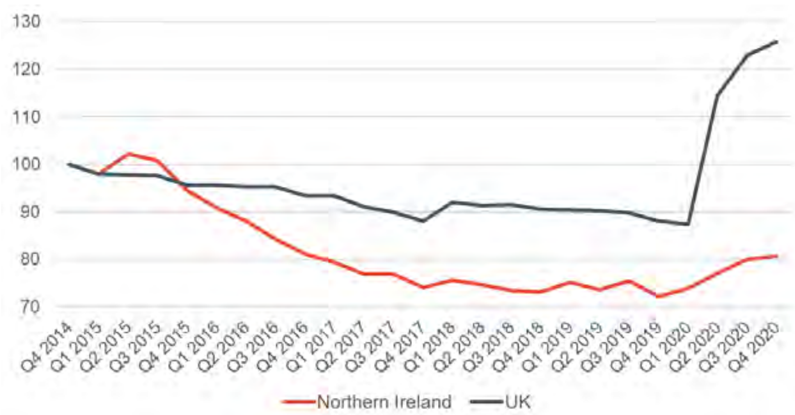
Supply of External Finance

Northern Ireland experienced a larger decline in the value of lending by high street banks pre-pandemic and a weaker increase since relative to the UK

3.69 According to the British Business Bank Regions and Nations Tracker, there were 385 banks and building society branches in Northern Ireland in 2019[58]. This translates to 52 banks and building societies per 10,000 businesses, which is the third highest density in the UK after Scotland (55) and the North East region (53).

3.70 UK Finance provides an overview of trends in loans and overdrafts to SMEs from high street lenders. The most recent figures indicate that the balance of outstanding SME lending in Northern Ireland was valued at c. £6bn in Q4 2020, representing about 14% of its GVA. As shown in Figure 3.27, a general downward trend has been observed over the six years prior to the Covid-19 pandemic (as lending continued to tighten post financial crisis), with a more pronounced decline observed in Northern Ireland compared to the UK (-26% vs -13% between Q4 2014 and Q1 2020). SME lending during the pandemic rose only slightly in NI, whilst it grew substantially in the UK (+9% vs +44% between Q1 2020 and Q4 2020).

Figure 3.27 Index (2014=100) of Quarterly High Street Bank Lending to SMEs, 2014-20



Source: SME Lending Within UK Postcodes, UK Finance, 2020; Note: lending covers both loans and overdrafts

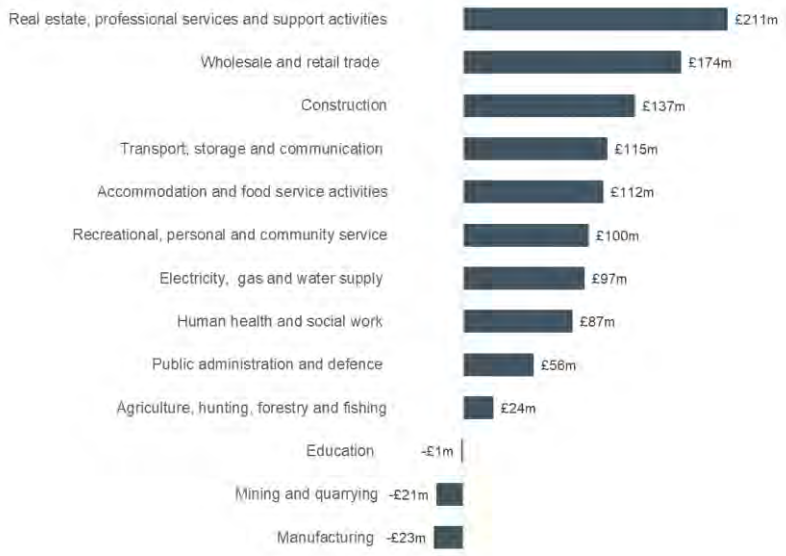
3.71 Data from the Bank of England provides an overview of the total value of financial institutions loans to UK SMEs over time. Gross flows of new lending to UK SMEs peaked in May 2020, when it was almost five times higher relative to July 2019, before falling to levels comparable to those

[57] Longitudinal Small Business Survey, BEIS, 2020 (n=381 for Northern Ireland; n=8,406 for the UK)

[58] Regions and Nations Tracker: Small Business Finance Markets 2021, British Business Bank, 2021

before the pandemic. In June 2021, gross flow of new lending to UK SMEs stood at £6.1bn, which is still 21% higher than July 2019. Figure 3.28 shows that gross lending flows increased across most sectors, with the largest increases noted in the real estate, professional services & support activities, wholesale & retail and construction sectors.

Figure 3.28 Change in monetary financial institutions' gross lending (excluding overdrafts) to UK SMEs by industry, July 2019 to June 2021



Source: Bankstats Tables, Bank of England, 2020/21

3.72 Northern Ireland SMEs have benefited from government finance schemes designed to support businesses experiencing cashflow interruptions due to the Covid-19 outbreak, which closed in March 2021. According to analysis of the final Coronavirus loan scheme data by the British Business Bank, the Bounce Back Loan Scheme (BBLS) offered 42,133 loans worth £1.28bn to Northern Ireland SMEs, representing about 3% of the volume and value of BBLS loans made across the UK. The Coronavirus Business Interruption Loan Scheme (CBILS) offered 2,440 loans worth £785m to Northern Ireland SMEs, accounting for 2% of the volume and 3% of the value CBILS loans made across the UK[59]. To set these figures in context, Northern Ireland businesses account for 3% of the UK business population. Moreover, the British Business Bank Regions and Nations Tracker suggests that 34,416 new SME loans and overdrafts were approved in Northern Ireland in 2020. Hence, there were 1.3 times as many BBLS and CBILS loans offered as new SME loans and overdrafts[60].

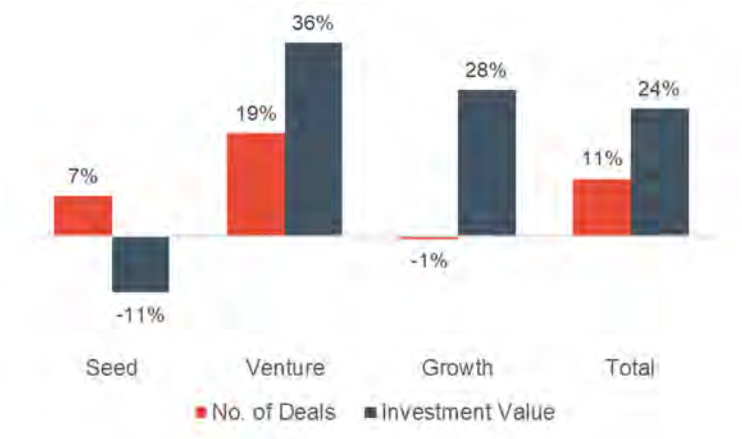
Equity activity in Northern Ireland is lagging, despite maturing equity market across other regional markets outside of London

3.73 In 2020, there were 2,044 SME equity deals in the UK amounting to a total value of £8.8bn, which implies an average deal size of £4.3m, according to the latest British Business Bank Small Equity Tracker. Figure 3.29 illustrates that the number of equity deals increased by 11% over 2018-20 whilst investment value grew by 24%. Thus, average deal size increased by 12% over 2018-20.

[59] Analysis of final Coronavirus loan scheme data shows £79.3bn of loans to 1.67m businesses, evenly distributed across whole of the UK, British Business Bank, 6 July 2021

[60] Regions and Nations Tracker: Small Business Finance Markets 2021, British Business Bank, 2021

Figure 3.29 Growth in number of UK equity deals by stage, 2018-20



Source: Small Business Equity Tracker 2021, British Business Bank & Beauhurst, 2021

Note: Seed funding is typically the first stage of funding for start-ups or SMEs and can be small in value. Venture funding provides capital for start-ups or SMEs with strong growth potential. Growth funding can be invested in relatively mature SMEs which require finance to undertake dramatic growth.

Table 3.3 Average value per UK SME equity deal by stage, 2018-20

	2018	2019	2020
Seed	£1.0m	£0.9m	£0.9m
Venture	£3.0m	£2.8m	£3.5m
Growth	£12.5m	£14.4m	£16.0m
Total	£3.8m	£4.2m	£4.3m

Source: Small Business Equity Tracker 2021, British Business Bank & Beauhurst, 2021

3.74 Overall performance in 2020 remained strong as equity activity during the second half of the year recovered rapidly from the impacts of the Covid-19 pandemic on investment in the first half of the year. Large sectoral variations were observed though, with sectors susceptible to the Covid-19 pandemic and social distancing restrictions receiving less investment. Technology and IP-based industries continued to be most popular with investors.

3.75 Consultees operating in the financial sector highlighted that Covid-19 has somewhat helped to remove geographical boundaries and that investors had been more willing to enter into initial conversations with NI founders with the option of speaking remotely via Teams/Zoom. Stakeholders stated that there is now more availability of capital and that more investors are willing to invest on the basis of Zoom calls than ever before and that NI companies are able to make more pitches per day (if carried out remotely, as no travel is required).

3.76 Concerns that the pandemic would disproportionally affect seed stage investment did not materialise. Venture stage noted the strongest growth in the number of deals and investment in 2020 out of the three stages. Growth stage equity remained strong in terms of investment, although gains in the number of deals stalled.

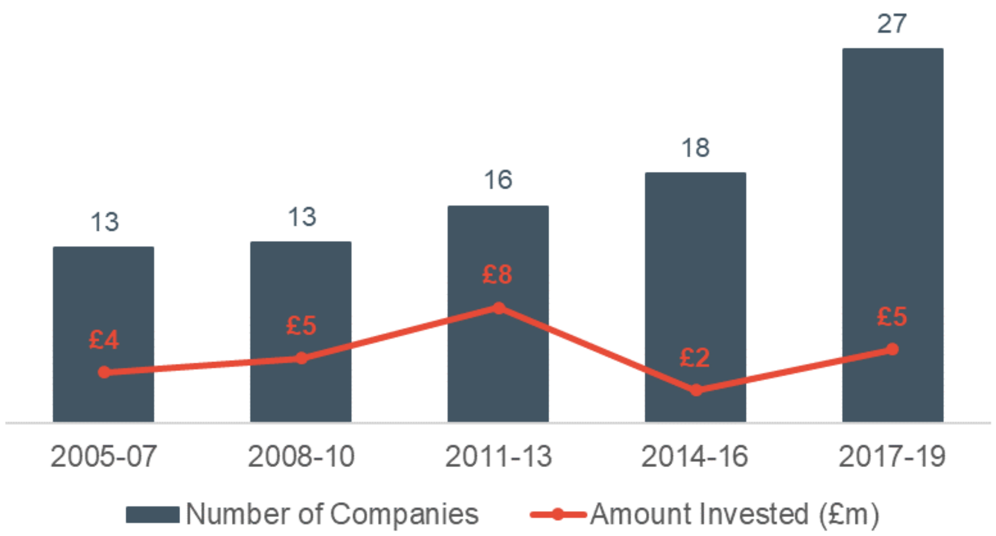
3.77 The British Business Bank Regions and Nations Tracker identified 22 equity investors in Northern Ireland over the period 2011 to Q1 2021 representing 1.6% of the UK total. The proportion of equity investors in Northern Ireland is smaller compared to areas with a comparable business base, such as the North East (2.3%) and Wales (2.1%). Similarly, angel investors in Northern Ireland account for 1.2% of the UK total relative to 1.8% in the North East. In 2020, the Tracker reported there were 24 SME equity deals, representing 1.2% of the UK total whilst the Northern Ireland business base accounts for about 3% of all UK businesses. These secured a total investment of about £20m (0.2% of the UK total), which translates to an average deal size of about £835,100[61] (of which Invest NI backed funds are likely to have accounted for a large proportion).

Increase in early-stage equity investment deals of small size in Northern Ireland

3.78 The British Private Equity and Venture Capital Association (BVCA) Investment Activity Report data can be informative in terms of equity investment trends, albeit not always accurate as it is prone to missing investment activity. In Northern Ireland, a trend towards a larger number of early-stage investments of smaller size is observed over time.

3.79 As shown in Figure 3.30, the number of companies receiving venture capital investment increased strongly, reaching a three-year average of 27 companies over 2017-19, a 113% increase since 2005-07. Among the factors behind this increase is Invest NI's Techstart fund. These elicited a three-year average of £5 million in total investment, a 45% increase since 2005-07, which translates to an average investment of £197,531, a 32% drop since 2005-07. Across the UK, 530 companies received £682m of early-stage equity on an average year during 2017-19, implying an average deal size of £1.3m. This represented a reversal from a steady decline in the volume and value of early-stage equity investment deals between 2005-07 and 2014-16, accompanied with smaller average deal sizes.

Figure 3.30 Early-stage equity investment in Northern Ireland, annual average 2005-2019



Source: BVCA Private Equity and Venture Capital Reports on Investment Activity. Note: BVCA data can be volatile year on year, therefore we have presented three-year averages to smooth out fluctuations.

3.80 The 2nd Global Alternative Finance Market Benchmarking report finds that the size of the UK alternative finance market increased consistently over time with growth carrying through 2019 and 2020 despite disruptions like the EU exit and the Covid-19 pandemic, reaching 12.6 billion USD in 2020 from 4.9 billion USD in 2015[62].

[61] Regions and Nations Tracker: Small Business Finance Markets 2021, British Business Bank, 2021

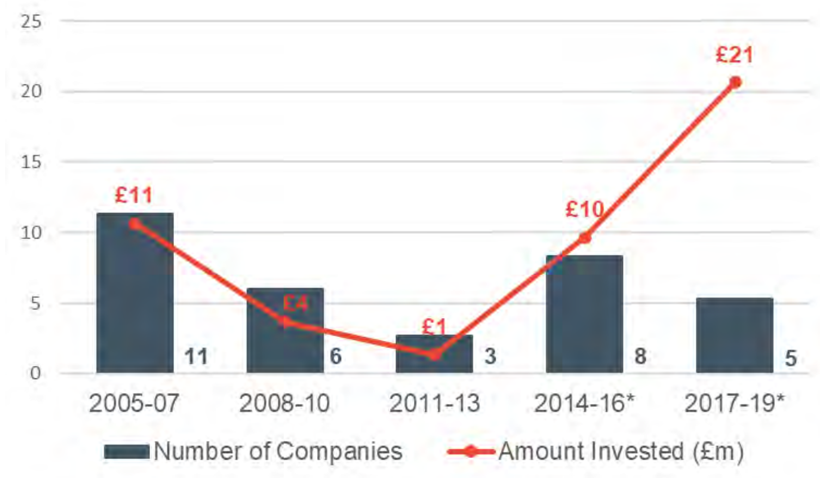
[62] The 2nd Global Alternative Finance Market Benchmarking Report, Cambridge Centre for Alternative Finance, 2021

Expansion equity market size is smaller in Northern Ireland than across the UK

3.81 Figure 3.31Figure 3.31 suggests that following a steady decline in expansion equity activity since 2005-07, activity recovered from 2011-13 onwards. However, data on expansion equity activity in Northern Ireland in 2014, 2016, 2017 and 2019 was amalgamated with other UK regions for confidentiality reasons. Hence, we cannot obtain a reliable picture of the most recent trends in growth equity capital.

3.82 Using equity expansion data for Northern Ireland between 2005 and 2018 (where available), there was an average of 6 expansion equity deals per year in Northern Ireland attracting a total investment of £7m, which implies an average deal size of £1.2m over this period. The amount of expansion equity invested as a proportion of GVA in Northern Ireland over this period is considerably lower than the UK average (0.02% vs 0.13%), suggesting a potential gap in the market.

Figure 3.31 Expansion Equity Investment in Northern Ireland, annual average 2005-2019



Source: BVCA Private Equity and Venture Capital Reports on Investment Activity. Note: BVCA data can be volatile year on year, therefore we have presented three-year averages to smooth out fluctuations. *Data on expansion equity activity in Northern Ireland in 2014, 2016, 2017 and 2019 was amalgamated with other UK regions for confidentiality reasons.

Finance Gaps

Debt Finance

3.83 Northern Ireland has an expanding base of SMEs, which encompasses a growing number of microbusinesses and small businesses. As such, the use of external finance in Northern Ireland has notably grown over time, especially the use of informal debt such as credit cards and formal debt finance such as bank overdrafts and loans.

3.84 Longitudinal Small Business Survey evidence from 2012 to 2019 indicates that the likelihood of a successful application for debt finance by SMEs in Northern Ireland has substantially improved over time (and typically larger amounts than average). However, SME Finance Monitor evidence on loan and overdraft applications, available up to 2017, pointed to a dip in success rates in 2016 and 2017.

3.85 Banks and building societies are prominent in Northern Ireland's finance ecosystem, with a relatively more limited presence of equity and angel investors. According to the British Business Bank Regions and Nations Tracker, there are 52 banks and building societies per 10,000 businesses in Northern Ireland, the third highest density in the UK. However, the proportion of equity (1.6%) and angel (1.2%) investors located in Northern Ireland is considerably smaller compared to the share of businesses operating in Northern Ireland (3%).

3.86 UK Finance data points to a historic decline in the value of lending by high street banks in Northern Ireland (linked to the financial crisis and subsequent retrenchment of high street banks and other lenders) that has been recently reversed in part due to a greater presence of alternative lenders and the increased supply of finance linked to the Government's pandemic response. Whilst this more recent increase in the value of lending appears to be to a far lesser extent than has been seen across the rest of the UK, Northern Ireland SMEs have certainly benefited from government finance schemes designed for businesses experiencing cashflow interruptions due to the Covid-19 outbreak. NI SMEs have received 42,133 BBLS loans worth £1.28bn and 2,440 CBILS loans worth £785m[63] (roughly in proportion to the size of the SME base in NI). In addition, the Future Fund data shows that 13 convertible loans were completed in Northern Ireland worth £11.6m[64].

3.87 Recent British Business Bank research suggests the gaps for debt finance which SMEs across the UK face have worsened as a result of the pandemic. This is due to an increased demand for finance (although a number of the pandemic response initiatives will have helped to address this) coinciding with increased risk aversion amongst high street banks due to the increased economic uncertainty and SMEs having taken on relatively large amounts of debt during the pandemic. A number of consultees noted that the closures of local bank branches in Northern Ireland reduced the opportunity for banks to gain a nuanced understanding of local SMEs and increased hesitancy to lend particularly in more rural or deprived areas.

3.88 Some sectors are likely to continue to face challenges which require funding to adapt to as a result of both the pandemic and EU Exit. British Business Bank[65] research suggests that sectors such as leisure, hospitality and tourism may not have been able to pivot their offer as quickly as sectors for which the pandemic presented opportunities to grow and may still need support in doing so. The survey also finds that businesses in the Northern Irish construction sector were more likely to be impacted by finance gaps and this is reflected in the high proportions of rural construction businesses injecting personal funds into their business (38% vs 27% on average)[66]. The research suggests this could be due to construction SMEs in the south of Northern Ireland being particularly exposed to cross-border trade and competition with Irish businesses.

3.89 Collectively, this evidence suggests that Invest NI has a continued role to play in the provision of debt finance up to at least £2m.

Equity Finance

3.90 The British Business Bank research noted above also suggests there are significant and persistent finance gaps across the UK in early stage equity and growth stage equity which have worsened as a result of pandemic effects. However, Northern Ireland still compares well on access to investors with 59% of businesses located within two hours of investor offices.

[63] Analysis of final Coronavirus loan scheme data shows £79.3bn of loans to 1.67m businesses, evenly distributed across whole of the UK, British Business Bank, 6 July 2021

[64] Final Future Fund data shows scheme completed £1.14bn of Convertible Loan Agreements, British Business Bank, 6 July 2021

[65] British Business Bank, Access to Finance Spotlight: UK Findings, Spring 2021

[66] British Business Bank, Regions and Nations Tracker for Northern Ireland, 2021

3.91 Equity finance tends to be suitable for a minority of high-growth, high-risk enterprises and as such there is limited evidence on demand and supply for this type of finance in Northern Ireland. Based on 2019 SME Finance Monitor data, Northern Ireland SMEs show higher than UK average levels of awareness as well as willingness to use equity finance.

3.92 The actual uptake of early and expansion equity investment by businesses in Northern Ireland has been relatively low, although it has grown over the past decade. This could be partially due to a lack of demand as highlighted below, although a survey by the British Business Bank found that respondents in Northern Ireland were twice as likely as UK respondents to report gaps in later stage equity finance (38% vs 20% of respondents)[67].

3.93 Demand for early-stage equity finance has been gauged by looking at proxy indicators, such as the number of innovation active businesses, university start-ups and spinouts and higher education and business sector R&D expenditure. Northern Ireland has a small proportion of innovation active SMEs and low levels of university start-ups and spinouts, but it experienced strong growth in higher education and business sector R&D expenditure over the last ten years. Northern Ireland has a lower incidence of highly innovative start-up and high growth companies to similar regions in the rest of the UK.

3.94 There has been a growth in the supply of early stage and equity finance in Northern Ireland over the last decade, with the Invest NI backed funds accounting for a significant proportion of the investment activity in the sub-£2m category. Despite this growth in later stage equity deals, the demand for larger amounts of development and growth investments remains fairly thin. Whilst the lack of good data makes it difficult to judge the extent to which angels and co-investors have become more active in Northern Ireland, the available anecdotal evidence suggests this has grown.

3.95 Northern Ireland is committed to promote innovation especially in core technology sectors, as expressed in the 10X Economy Strategy. Innovation intensive enterprises require substantial amounts of upfront investment, which can be difficult to obtain considering the long-term nature of their activities' return. Northern Ireland experienced an increase in early-stage equity investment deals of smaller size since 2006. In light of this, there is arguably a greater emphasis on Invest NI ensuring an adequate supply of early stage equity finance. Evidence from consultees also suggests the need for providing larger amounts of investment for these businesses to enable them to progress along their growth path. The evidence concerning demand for larger amounts of later stage growth finance is less clear cut, although some consultees suggested there is a gap at £2-£3m which is not being met by the private sector.

Key Findings

There is agreement amongst UK and Northern Irish policy on the need for provision of SME finance in order to ***both*** address market failures and the finance gap facing NI businesses, as well as achieving the key objectives of boosting innovation, encouraging global trade and levelling up agendas (and to some extent contributing to the transition to net zero). Northern Irish policy also recognises the need to grow the Northern Irish business base and attract inward investment. NI policy has also responded proactively to the uncertainty and challenges presented around EU exit and the Covid-19 recovery.

The Invest NI Business Plan is well aligned with the focus of UK and NI policy and Invest NI access to finance approach has shown agility in responding to evolving priorities. Invest NI has

[67] British Business Bank, Access to Finance Spotlight: UK Findings, Spring 2021

provided larger or longer-term finance to meet the needs of innovative businesses while also sustaining efforts to support smaller and growing businesses across eligible sectors.

The Northern Irish economy continues to face challenges compared with the UK. Northern Irish economic output and productivity remain relatively low compared to UK averages, and the productivity gap has increased since 2015. During 2020, the NI economy contracted slightly more than the UK economy, largely due to the sector makeup of the NI economy, and recovery is expected to be slower. Whilst there are some positive signs with regards to enterprise and growth sectors, NI is underrepresented in terms of high growth potential businesses (compared to the UK as a whole and comparable regions such as the North East of England and Wales). This demonstrates the continued need for good access to finance to support business growth at all stages.

During 2020, the number of start-ups and microbusinesses in Northern Ireland increased. As debt-seeking businesses experience more competition, higher gearing levels and more difficult growth conditions as a result of the pandemic, they could face a growing gap in the supply of loans.

The limited evidence on the Northern Irish equity finance market suggests there are some gaps in the supply of later stage equity finance (£2m+) and this is supported by relatively low incidences of equity finance despite high levels of awareness and willingness to use equity finance. The demand for equity finance may also increase as Northern Irish policy increases its focus on innovation. There is some recent evidence of larger investment rounds in companies funded partly by external funders (e.g. Cloudsmith, B-Secur, Selazar, Neurovalens).

Whilst the activity of Invest NI and the public sector backed funds may be helping to stimulate an interest in NI from angels, venture capitalist and private equity investors, there is still quite a limited presence of private sector investors compared to similar regions. Nevertheless, there are some strengths in angels and activity of non-NI based investors (at fund and deal level).

Overall, the evidence points to the continuation of a strong justification for targeted public sector intervention in the SME finance market in NI.

4. Performance of the Funds

4.1 This section provides an overview of overall performance across the portfolio of funds in the investment and realisation / follow-on investment phase, with more detailed individual reviews of each of the funds provided in Appendix A. The analysis draws on a variety of data sources including quarterly monitoring reports, investment and portfolio monitoring data, Limited Partnership Agreements, Management Services Agreements and Deed of Variations provided by Invest NI, in addition to performance data provided directly to us by a number of Fund Managers. The analysis looks at performance to the end of March 2021.

Overview of Fund Performance

Investment Performance

Amount of Investment

4.2 The majority of the Invest NI-backed funds have made strong investment progress to the end of Q1 2021. However, some of the debt funds (in particular SBLF II and GLF II) have struggled with lower-than-expected demand since the onset of the Covid-19 pandemic, due to the impacts of Covid-19 on SMEs and the increased availability of debt finance in the market through the CBILs and BBLs. Kernel and Crescent III have both invested in fewer businesses than anticipated, especially so for Kernel (and whilst this has been within the limits of its investment KPI, it has been the focus of on-going discussion with Invest NI as it has led to a significantly higher average investment per business and concentration of the portfolio amongst fewer businesses). Five of the funds are currently in the investment phase and six of the funds are in the realisation / follow-on investment phase.

4.3 Investment progress for the Invest NI backed funds that are in the realisation (or realisation with selected follow-on investment) phase is shown in Figure 4.1 below. This shows the proportion of capital available for investment that was invested by 31st March 2021.

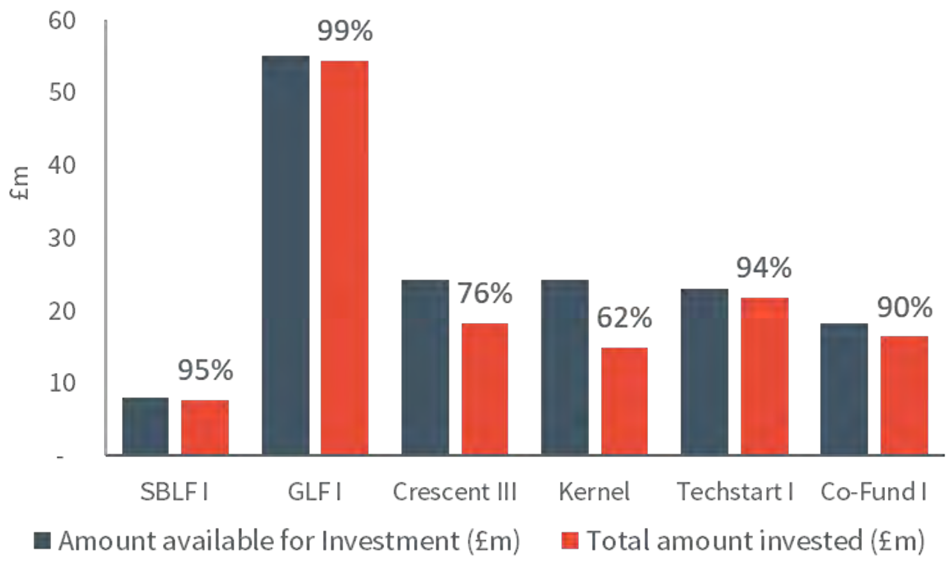
4.4 SBLF I and GLF I, launched in 2012 and 2013 respectively, are both now in their realisation phase having invested the majority of capital available for investment and performed well in terms of annual investment rates. Co-Fund I and Techstart I have also almost fully invested but are still making selected follow-on investments in their portfolio companies.

4.5 Co-Fund I launched in 2011, for a six-year investment period, however an additional £3m follow-on investment was provided for Co-Fund I companies as part of the Co-Fund II 2017 MSA (and this was further extended to £5.16m as part of a 2020 Deed of Variation). Techstart I launched in July 2014 and entered its 5-year realisation and follow-on funding phase in 2019.

4.6 Kernel and Crescent III have made significantly slower progress with investment compared to the other funds, with 38% and 24% of the total Kernel and Crescent III funding respectively still available for follow-on investments in their portfolio companies. Both funds were contracted over a ten-year period between 2013-2023, including 5-year investment and 5-year realisation periods (although both funds' investment period was subsequently amended to six years to enable the portfolio to be built up further).

4.7 Crescent III has invested £18.25m across 41 deals and 15 businesses compared to around £24.14m available for investment (i.e. 76%). Crescent Capital is confident of investing the majority of the remaining available capital in portfolio companies (taking overall investment to around 90% of the available capital). Kernel has invested £14.95m in 8 companies, through 35 investments, compared to around £24.3m available for investment (62%). Kernel's quarterly investor report for Q1 2021 indicates that £8.29m is currently planned for follow on investment. If Kernel achieves this investment, this would total £23.25m invested in portfolio companies and the estimated lifetime fund management costs of the Fund £6.65m (with only £250k of the total commitment unallocated to investees).

Figure 4.1 Funds in Realisation Phase: Proportion of Capital Invested up to 31st March 2021



Source: Hatch analysis of fund quarterly monitoring reports, MSAs, LPAs and Deeds of Variation. Note: the SBLF I amount available for investment figure used is mid-way between the range of target investment anticipated including the recycling of funds. Note: for SBLF I, the amount available for investment includes the recycling of funds and is based on the target range of investment. The minimum value of investment target for the fund (£6m) has been exceeded.

4.8 Figure 4.2 below provides an overview of the amount and value of investment to the end of March 2021 for the funds that are still in their investment phase. Techstart Ventures launched the Techstart II fund in September 2019 and was c.1.5 years into its 5-year investment period at the end of March 2021, having invested £5.17m across its SME Seed Fund and POC Grant Fund (15%) of the total £34m available for investment. This is within but at the lower end of the annual investment range. The fund managers have a good pipeline of investment and at the time of writing this had fed through into additional investments[68]. The POC grant fund has had steady interest from entrepreneurs and SMEs since its start in September 2019, with 324 applications and 93 awards totalling £1.74m in awards (45% of the available funding). This take up is slightly ahead of the relevant KPI.

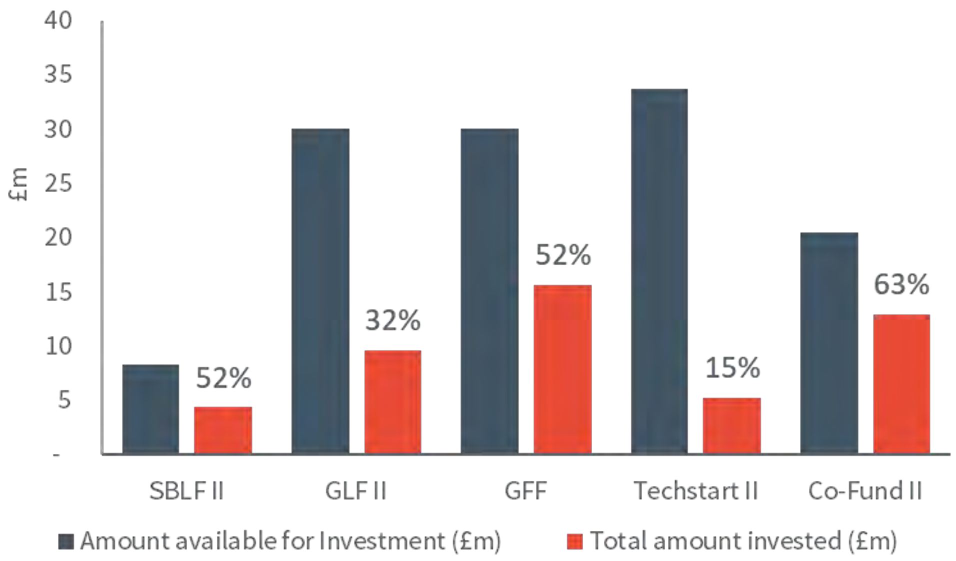
4.9 Co-Fund II has performed well to date in terms of annual rate of investment, having invested £13m by March 2021, 63% of the total available for investment. Co-Fund II launched in June 2017 and is due to invest in new companies up to 2023 (hence is 63% through its investment phase), with a follow-on investment period to 2027 and a realisation period to 2032. To date, it has met its annual investment targets, having invested in 9-15 companies per annum since the Fund launched.

[68] Since 31 March 2021 there have been seven new additions to the Techstart II portfolio at a combined cost of £2.25m and five follow-on investments totalling £1.42m. As at 31 December 2021 the number of companies in the Techstart II portfolio is eighteen.

4.10 The debt funds (SBLF II, GLF II and GFF) all launched in 2018. SBLF II and GLF II have faced challenges in terms of annual investment rate (particularly in year 3), due to the initial impact of the pandemic on the economy, the wide availability of emergency finance available through the Bounce Back Loan Scheme, and then the availability of highly competitive and lower priced CBILs loans. The SBLF II is on track to meet its minimum lifetime investment amount of £6.5m, however annual investment performance has varied, with the fund having exceeded the upper limit of £2m by £0.4m in Year 2 and missing the lower limit (implied by the KPI) in Year 3 of £1.3m by £0.5m (due to the impact of increased availability of loans through BBLS). GLF II made 19 loans totalling £9.6m to the end of March 2021, which equates to £3.8m per year to date compared to an average annual rate of £8.7m for GLF I and a targeted rate of £6m per annum.

4.11 Regarding the GFF, there have been 23 loans (including tranches) across 16 companies totalling £15.6m, representing an average of £678,000 per draw down to the end of March 2021. Unlike GLF II, GFF is CBIL approved, and this has helped maintain demand for GFF loans. As at end-March 2021, GFF had met their fund KPIs (investment hurdles, deal range size and default rate).

Figure 4.2 Funds in the Investment Phase: Proportion of Available Capital Invested to 31st March 2021



Source: Hatch analysis of fund quarterly monitoring reports, MSAs, LPAs and Deeds of Variation.

Number of Investments

4.12 In terms of number of investments to the end of March 2021, SBLF I, Techstart I and Co-Fund are on track against their respective KPIs.

4.13 While Kernel is on track in terms of the number of deals, it has invested in significantly fewer businesses than anticipated. Kernel has invested in eight companies in total, while the development funds' Economic Appraisal indicated that the Fund aimed to support 20 businesses and the Investment Policy within Kernel's LPA[69] indicates that the Fund aims to invest in approximately fifteen portfolio companies. Crescent III is on track in terms of the number of deals but has also invested in fewer SMEs than anticipated (15 compared to an indicative level of 20 portfolio companies). This suggests that there has been a lower demand for development

[69] Kernel Amended & Restated LPA – 10th February 2016, Schedule 3 Investment Policy, paragraph 4.1.

funding from SMEs in Northern Ireland than anticipated in the Economic Appraisal for the development funds.

4.14 Although GLF I has distributed £54.3m in loans across 102 SMEs during its investment phase, this was over a lower number of loans (140) compared to the total fund target of 180.

Table 4.1 Funds in Realisation Phase: Fund Performance against No. of Investments Targets to end of March 2021

	KPI: Investments per annum	Actual average investments per annum	KPI: total investments	Actual investments to date
SBLF I	75-90 (for 5 years)	76	375	378
GLF I	30 loans (first 6 years)	23	180	140
Crescent III	4 investments (first 5 years of term))	7 (6-year investment term)	20 invs in first 5 years of term (& 40 in approx. 20 companies in total)	41 deals in 15 SMEs
Kernel[70]	4 investments (first 5 years of term)	5 (over first 5 years of 6-year investment term)	20 investments (first 5 years of term)	23 over first 5 years
Techstart I: SME Seed fund	7-11 investments (years 1-5)	22	40-50	110
Techstart I: UU & QUB	Min. 1 investment (years 1-5)	4	14	18
Techstart I: POC grant	32 mini grants, 12 standard grants (years 1-5)	34 mini grants, 15 standard grants	160 mini grants, 62 standard grants	169 mini grants, 76 standard grants
Co-Fund I	8-14 investments	16 investments	48	162 investments in 37 companies

Source: Hatch analysis of fund monitoring data, LPAs, MSAs and Deed of Variations provided by Invest NI, covering the period to end of March 2021. Note: For RAG rating, green = 100+% target achieved, amber = 75%-99% target achieved, red = <75% target achieved.

4.15 As of the end of March 2021, the Invest NI-backed funds that are still in the investment period demonstrate variable progress against their KPI for number of investments. It should be noted that in the table below, where only a total number of investments KPI was mandated, the target number of investments per annum has been estimated on the basis of the total KPI divided by the number of years in the investment phase. SBLF II and GLF II have both invested at a slower rate than anticipated in the KPIs, which has been attributed by the Fund Managers to the initial impact of the pandemic on the economy and then the availability of highly competitive and

[70] Note: the FM have indicated that the specific no. of companies was not included as a KPI for Kernel; however, the LPA investment policy indicates that they aimed to support approximately 15 companies and the EA for the development funds indicated that the Fund aimed to support 20 portfolio companies. Therefore, while the fund is on track in terms of the KPI for number of deals, the Fund has invested in far fewer companies than originally anticipated.

lower priced CBILs and BBLs. The GFF and Co-Fund II have performed well against their respective number of investments KPIs.

4.16 Techstart II has made steady progress to date , with the fund having invested in 11 portfolio companies over the c.1.5 years that the fund has been investing to the end of March 2021. The fund managers have a good pipeline of investments and should be able to make this up during the remainder of the investment period, however increasing the investment rate over the next few years needs to be a priority for the fund managers. The POC grant fund has had a steady interest from entrepreneurs and SMEs since its start in September 2019 and is on track against its investments KPI.

Table 4.2 Funds in Investment Phase: Fund Performance against No. of Investments Targets to end of March 2021

	KPI: Investments per annum	Actual average investments per annum	KPI: total investments	Investments to March 2021
SBLF II	50-85 (year 1), then 65-85	48	310-425 (over 5 yr investment period)	143
GLF II	18 in aggregate (with 6-12 investments in the first year)	8	90	19
GFF	4-8	10	24	23
Techstart II: SME Seed Fund	5-12 in yr 1 then 8-14 investments p.a.	7	50 portfolio companies	11
Techstart II: POC Grant Fund	30 mini grants p.a., 15 standard grants p.a., 1 large grant p.a.	37 mini, 17 standard, 1 large	150 mini grants, 75 standard grants, 5 large grants (over 5-year period)	56 mini, 36 standard, 1 large
Co-Fund II	7 - 13 investments p.a. (which are not follow-on)	11	42	43

Source: Hatch analysis of fund monitoring data, LPAs, MSAs and Deed of Variations provided by Invest NI, covering the period to end of March 2021. Note: For RAG rating, green = 100+% target achieved, amber = 75%-99% target achieved, red = <75% target achieved.

Average Investment Rates

4.17 Table 4.3 and Table 4.4 below outline the average investment per deal to date across the funds in the realisation and/or follow-on investment phase and the funds in the investment phase. The analysis indicates that the funds are mainly investing in the right space.

4.18 The average value of investment across the two development funds and GLF II are drifting up due to market factors (outlined further in the full individual fund reviews in the Appendices). It is important to consider the implications that this may have on the balance of financial and economic development benefits / disbenefits from operating in this space. Having a higher-than-expected average value of investment may indicate a slightly lower unit cost per investment (rather than having lots of smaller deals with fixed costs). However, this also indicates that the funding is more concentrated in a smaller number of firms, so arguably, the risks are less well spread, and the investment is not being spread as far in terms of driving economic development benefits amongst SMEs.

4.19 Across the portfolio of funds in the investment period, investments range from £4k to £1.5m, with the lower amount being due to SBLF II having issued some loans which are below the target investment range (<£10k). Use of investment amounts under £10k are useful by exception, for example to provide top up loans to businesses which have previously been invested in. However keeping the lower investment target at £10k or higher helps to minimise the overlap in the loan range with the Start-up Loan Company provision.

Table 4.3 Average Investment Per Deal: Funds in Realisation/Follow-On Funding Phase, up to March 2021

Name of Fund	Average investment per deal	Target Range
SBLF I	£20,000	£1,000 - £50,000
GLF I	£388,000	£50,000 - £500,000
Techstart I (excluding POC)	£118,700 per deal / £307,000 per SME	£50,000 – £250,000 per deal, max £1m per company
Co-Fund I	£101,000	£100,000-£500k per deal, up to £1m max per company
Crescent III	£445,000 per deal / £1.1m per SME	£450,000[71] - €1.5m per company in any one year, max £3m per company
Kernel	£427,000 per deal / £1.9m per SME	£450,000 - €1.5m per company in any one year, max £3m per company

Source: Hatch analysis of Invest NI and fund manager data. Note: figures are rounded to nearest £1000.

Table 4.4 Average Investment Per Deal: Funds in Investment Phase

Name of Fund	Average investment per deal	Target Range
SBLF II	£29,000	£10,000 - £100,000
GLF II	£505,000	£100,000 - £500,000
GFF	£678,000	£500,000 - £2m
Techstart II (excluding POC)	£311,000	£50,000-£750,000, max £2m in any one company
Co-Fund II	£152,000	£150,000 - £2m per deal, up to £1.75m max per company

Source: Hatch analysis of Invest NI and fund manager data. Note: figures are rounded to nearest £1000.

[71] the £450k minimum is only for initial investment and not follow-on

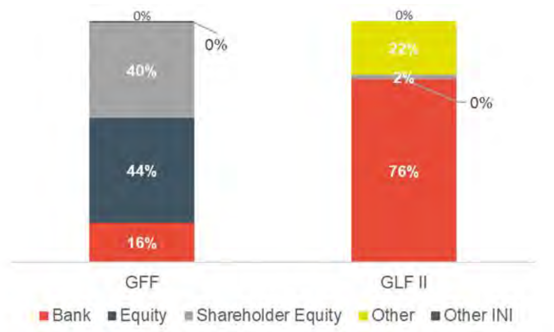
HATCH

Deal Leverage Achieved

4.20 A total of £213m[72] in investment has been leveraged at deal level as a result of Invest NI financial support. Looking at progress with leverage achieved to the end of March 2021 by the debt funds that are currently in the investment phase:

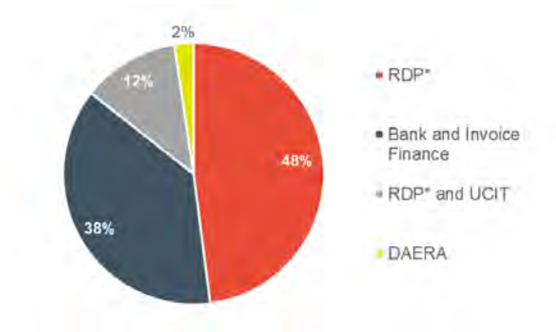
- GFF has attracted approximately £22m in total leverage (compared to £15.6m invested by the fund), of which the majority was equity investment (44%) followed by shareholder equity (40%) and banks (16%). The primary source of the leverage (90%) was Northern Ireland. Leverage ranges from £200k to just under £10m.
- GLF II has secured approximately £11m in leverage (compared to £9.6m invested by the fund), of which 76% came from banks. The primary location of 5 of 7 instances of leverage deals was Northern Ireland, one was Great Britain and one from the rest of the world. Leverage ranges from £200k to £7m.
- SBLF II raised approximately £664k in leverage (compared to £4.3m investment by the fund) primarily from rural development fund[73] (48%) and bank and invoice finance (38%). Amounts of leverage ranged from £15k to £250k.

Figure 4.3 Sources of leverage, GFF & GLF II



Source: Hatch analysis of Invest NI and fund manager data.

Figure 4.4 Sources of leverage, SBLF II



Source: Hatch analysis of Invest NI and fund manager data. Note: DAERA run the Rural Development Grant and Rural Development Programme. UCIT is the Ulster Community Investment Trust

4.21 Looking at the equity funds currently in the investment phase:

- Co-Fund II has raised approximately £52m through pre-qualified private match (£30m) and deal level leverage (£22m) alongside its own investment of £16.4m. These funds were raised from a wide range of sources, with a prominent presence from business angels but also attracting investors such as Cordovan Nominees One, First Derivatives, RGA, the Syndicate Room, Hambro Perks and ExSight Ventures.

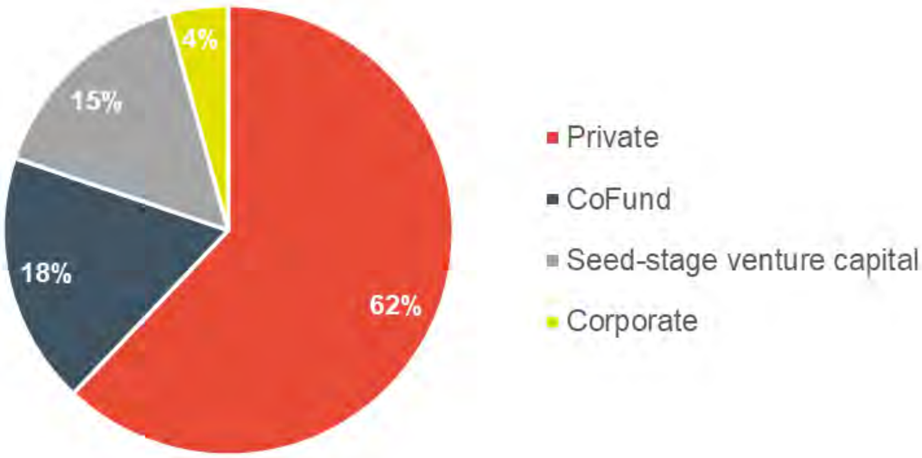
- Techstart II equity investments have secured about £2m from other investors (on basis of its investment of £3.4m), of which 62% came from private angel investors, 18% from

[72] This figure excludes pre-qualified private match funding secured through Co-Investment Fund I & II. The total leverage secured rises to £260m when the pre-qualified private match from Co-Investment I & II is included. The figure also includes deal level co-investment from Invest NI backed investment funds.

[73] this is part of the the Northern Ireland Rural Development Programme 2014-20 which is part-funded by the Department of Agriculture, Environment and Rural Affairs (DAERA) and the European Union (EU).

Invest NI's Co-Fund, 15% from a seed-stage venture capital company and 4% from a corporate investor. The primary location of 62% of leverage deals was Northern Ireland. Leverage ranges from £100k to £750k, whilst investment amount per investor ranged from £20k to £200k. Investors have mainly been from the UK and US, as well as Ireland, France and Spain.

Figure 4.5 Sources of Leverage, Techstart II

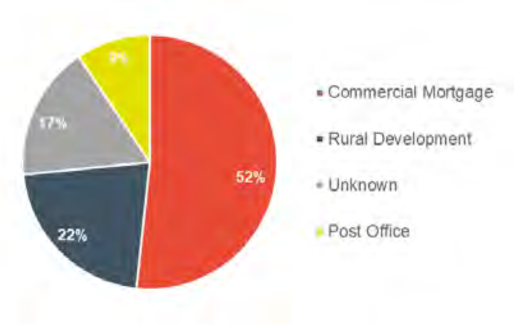


Source: Hatch analysis of Invest NI and fund manager data

4.22 Looking at progress with leverage achieved between the end of March 2017 and March 2021 by the debt funds that are currently in the realisation phase:

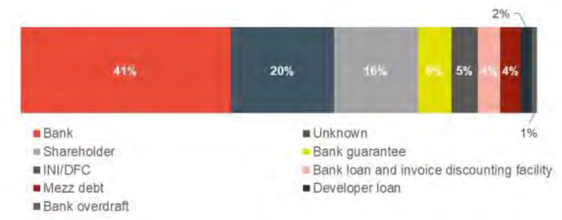
- SBLF I investees received a further £280,500 in leverage, its primary source being a commercial mortgage (52%) but also Rural Development Programme funds (22%). Leverage amounts ranged from £25k to £145k.
- GLF I investees received about £23m in leverage using a variety of finance types, but predominantly bank (41%) and shareholder (16%) finance. Leverage was secured from a single investor in the majority of cases (63%), but there were also two instances of two investors, one instance of 4 investors while no information is available in four cases. The primary country of incorporation of leverage deal level investors was the UK in all cases where information was available. Leverage ranged widely from £100k to £6m.

Figure 4.6 Sources of Leverage, SBLF I



Source: Hatch analysis of Invest NI and fund manager data. Note: Leverage for investments completed outside the evaluation period (before the end of March 2017) are not considered in this chart.

Figure 4.7 Sources of Leverage, GLF I

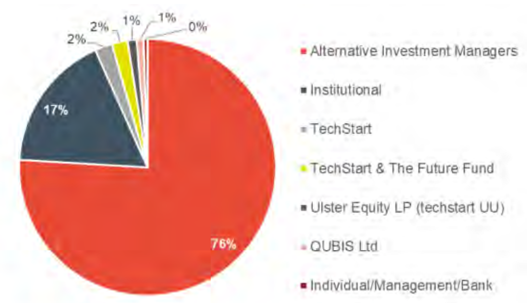


Source: Hatch analysis of Invest NI and fund manager data. Note: Leverage for investments completed outside the evaluation period (before the end of March 2017) are not considered in this chart.

4.23 Similarly, looking at equity funds currently in their realisation phase:

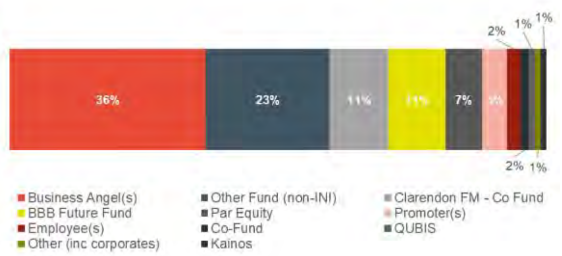
- Crescent III investees received about £28m in leverage, with deal size ranging widely from £35k to £21m. Namely, more than three quarters (76%) of the total leverage secured stemmed from one deal (with co-investment of £21.35m) whilst an additional 17% came from one deal funded by an institutional investor. Only a small portion (4%) of total leverage investment came from Techstart or a combination of Techstart & The Future Fund funding, but they were reported as the source of leverage in 6 and 2 instances respectively. Northern Ireland is the country of incorporation of deal level investors in all but one case, where the country of incorporation is Northern Ireland and Great Britain.
- Kernel investees received about £19m in leverage, with deal sizes ranging from £100k to £3.6m and individual investor contributions ranging from £6.6k to £2.8m. More than a third (33%) of total leverage investment came from business angels, while financing secured from Funds other than Invest NI accounted for slightly below a quarter (23%) of that total. The source of more than three fifths (65%) of leverage secured was Northern Ireland, whilst the remaining 35% was Great Britain.

Figure 4.8 Sources of Leverage, Crescent III



Source: Hatch analysis of Invest NI and fund manager data. Note: Leverage for investments completed outside the evaluation period (before the end of March 2017) are not considered in this chart.

Figure 4.9 Sources of Leverage, Kernel



Source: Hatch analysis of Invest NI and fund manager data. Note: Leverage for investments completed outside the evaluation period (before the end of March 2017) are not considered in this chart.

- Co-Fund I secured about £23.6m in pre-qualified private match (£17m) and leverage investment (£6.6m). Business angel investment was prominent in the composition of pre-qualified private match and leverage investment secured, while financing from INI and other Funds also made a sizeable contribution. Looking at the size of leverage deals, it ranged from £8k to £2.4m.
- The equity investment undertaken by Techstart I raised £79m in deal level leverage, with deal size ranging from £10k to £6.9m and investment amount per investor ranging from £133k to £4.5m. Other Invest NI backed investment funds (mainly Co-fund I and Crescent) and private investor financing were the primary sources of leverage investment, with finance also raised from investors such Macquarie Investment Bank, IQ Capital and Wharton Asset Management.

Table 4.5 Summary of Deal Leverage Achieved

Funds in Investment Phase	
GFF	£21.71m
GLF II	£10.84m
SBLF II	£0.66m
Co-Fund II**	£21.72m
Techstart II	£2.32m
Funds in Realisation Phase	
SBLF I	£0.28m
GLF I	£23.14m
Crescent III	£28.16m
Kernel	£19.08m
Co-Fund I**	£6.58m
Techstart I	£78.93m
Total*	£213.41m

Source: Hatch analysis of Invest NI and fund manager data. *The figures include deal level co-investment from Invest NI backed investment funds. **This figure excludes pre-qualified private match funding secured through Co-Investment Fund I (£17m) & II (£30m). The total leverage secured rises to £260m when the pre-qualified private match from Co-Investment I & II is included.

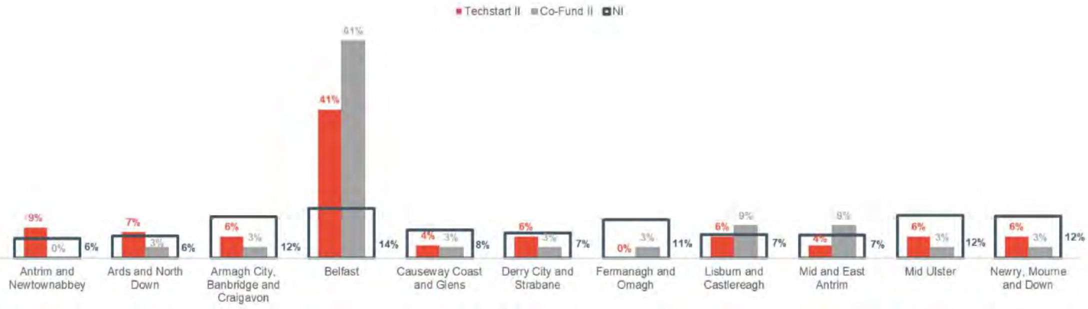
Spatial Pattern of Investment

4.24 The analysis of the spatial pattern of investment across Northern Ireland indicates that equity fund investment has been heavily skewed to the Belfast local authority district, accounting for 61% and 41% of Co-Fund II and Techstart II investment up to the end of March 2021. Whilst this is well above the district's share of all NI businesses, Belfast has a much higher share of innovation and growth orientated businesses which will be seeking equity investment compared to other districts. Nevertheless, the question it raises is whether any good investment opportunities are being missed in areas outside of Belfast.

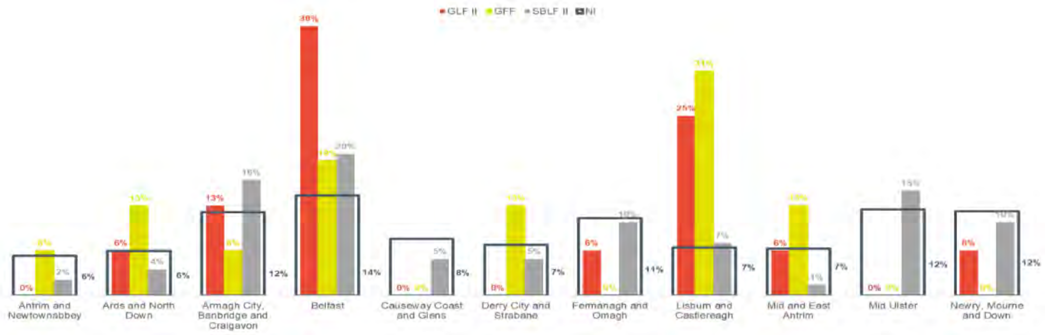
4.25 The distribution of loan take-up more closely reflects the distribution of businesses across NI, especially for small loans. This reflects the more generic nature of this form of finance compared to equity finance.

Figure 4.10 Spatial Pattern of SME Fund Investment (funds in current investment period)

Equity Funds



Loan Funds



Source: Hatch analysis of Invest NI and fund manager data; Note: the blue boxes indicate the proportion of SMEs in each local authority district; the analysis is of investment up to end Match 2021.

Cross Funding of Businesses

4.26 The extent to which businesses receive funding from multiple Invest NI backed funds in the same funding round, or receive consecutive funding from different Invest NI as the business grows and the finance requirements evolve, is of interest for a number of reasons:

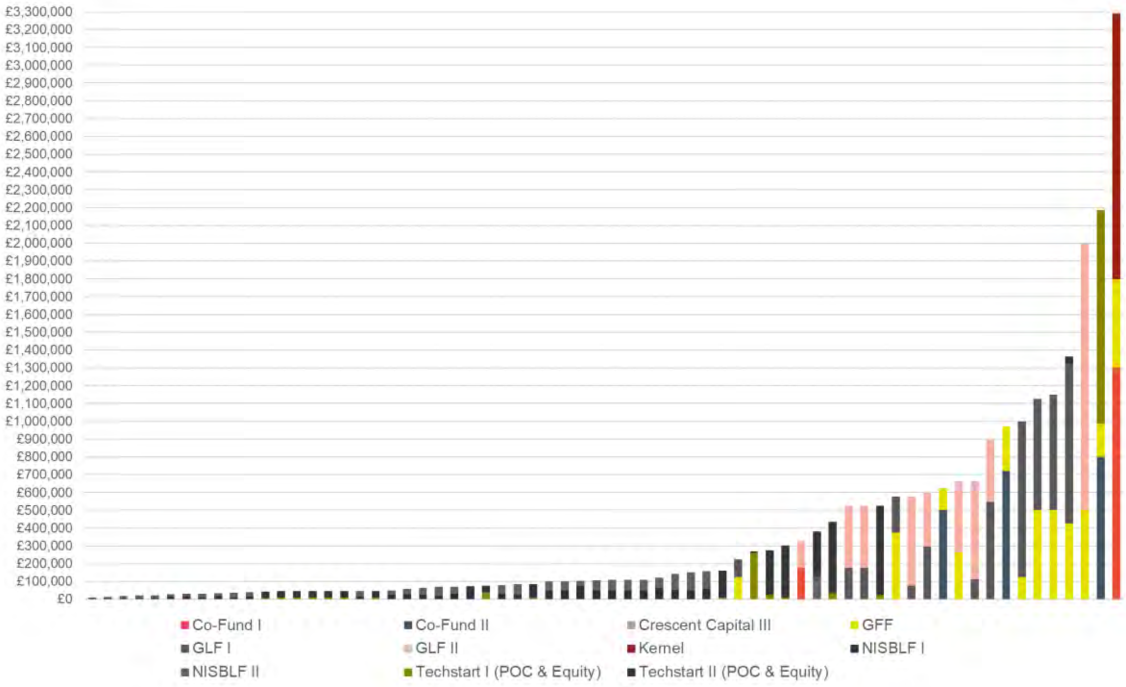
- Cross-funding can help to spread the risks between public sector backed funds, fill gaps that the private investors may not be willing to fund and bring in relevant expertise not available from one fund. But it can also lead to a concentration of investment from public sector backed funds and may crowd out the private sector.
- Consecutive funding may be an indication that the escalator of finance is working well in NI, with different public sector backed funds providing the finance that a business needs on its growth journey.

4.27 The analysis indicates the extent to which co-investment and consecutive investment is occurring between public sector backed funds in NI. It is based on beneficiaries that received investment from at least one of the five Funds that are currently in their main investment phase. There are over 50 businesses which have received finance from multiple Invest NI funds from which there are a couple of investment patterns that stand out:

- A large number of businesses have received smaller amounts of debt finance from SBLF I and II
- A sizeable number of businesses have received finance from GLFI and GLFII, as well as some of these going on to receive finance from GFF

- A number of Techstart supported businesses have received investment from both the first and successor fund, as well as the growth loan funds
- A small number of businesses have received substantial amounts of investment across these multiple funds which we assume is linked to good prospects for growth and exits.

Figure 4.11 Analysis of Joint and Consecutive Investment Across Invest NI Funds, as at end March 2021



Source: Hatch analysis of Invest NI and fund manager data

Financial Performance

4.28 The debt funds in their realisation phase have varied performance to date, with NISBLF I performing in line with targets in terms of repayments, defaults and provisions, while GLF I is slightly behind target:

- For NISBLF I, the rate of defaults and provisions currently stand at 13%, compared with a lifetime default rate KPI of 23%. The fund is making good progress on repayments with a remaining loan book of £1.6m (including interest).
- GLF I is performing less well against its defaults KPI, with a default rate of 14.82% which is 2.3 percentage points higher than the KPI target of 12.5%. Of the 140 loans made, 72 have been repaid in full. The value of the loan book stands at £9.8m and the Fund Manager expects a further £2.7m will be paid in interest. The Fund Manager is forecasting that Invest NI will receive back more than originally expected, so overall a good result is anticipated.

4.29 In terms of the debt funds in their investment phase, GLF II, NISBLF II and GFF are performing relatively well to date in terms of arrears, provisions and defaults although all are at an early stage in their fund life. It is worth noting that:

- Although NISBLF II was initially performing well to date and is broadly on target in terms of its overall investment targets, the Fund Managers report that some businesses have used Covid-19 loans to repay Fund loans and so these figures may increase over time as businesses with existing or new loans are impacted by the longer term consequences of the pandemic and other economic turbulence.
- As of the end of March 2021, GLF II has no bad debt. £618k has been made in provisions which represents 6.4% coverage on committed facilities, significantly lower than the KPI lifetime default rate target of 14% at this stage in the life of the fund.
- GFF has no bad debt as of the end of March 2021. The Fund Managers have allocated £414k in provisions, which represents 2.66% of drawn facilities and 2.83% on outstanding capital balance. £2m has been received in capital and interest repayments, of which £0.8m was in interest payments. No business has fully repaid their loan to date.

Table 4.6 Financial Performance to Date: Debt Funds

	Capital available for loans		Repayments		Loan Book	
	Target £	Actual £	Capital	Interest	Value	Anticipated interest repayments
NISBLF I	£6-£10m	£7.6m	£6.3m	£1.6m	£1.3m	£0.3m
GLF I	£55m	£54.3m	£38.6m	£16.6m*	£9.8m	£2.7m
NISBLF II	£7.7-£10.6m	£4.1m	£1.6m	£0.2m	£2.5m	£1.05m
GLF II	£30m	£9.6m	£1.3m	£1.1m	£8.3m	£2.6m
GFF	£30m	£15.6m	£1.0m	£1.0m	£14.6m	£3.5m

Source: Hatch analysis of Invest NI and fund manager data * includes interest payments, profit share and arrangement fee income.

4.30 There has been mixed performance to date in terms of realisations and the value of the remaining portfolio across the equity funds:

- Techstart I has invested £17.97m and achieved realisations of £3.61m (compared to the investment of £1.78m in these businesses). The value of the current Techstart I portfolio is £12.18m against the investment in these businesses of £15.74m. The lower portfolio valuation reflects a number of sizeable provisions against three investments which have also received loans or equity from the UK Government's Future Fund or Invest NI's CEIF (to reflect the first call that these funds have on the businesses).
- The value of the Techstart II portfolio currently stands at £3.17m against an investment cost of £3.43m following provisions against two of the eleven portfolio companies[74]. There have been no exits to date given the current age of the fund (c.1.5 years as of the end of March 2021) at the time of writing, although a significant sale subsequently occurred.[75]

[74] Since 31 March 2021 there have been seven new additions to the Techstart II portfolio at a combined cost of £2.253m and five follow-on investments totalling £1.425m. As at 31 December 2021 the number of companies in the Techstart II portfolio is eighteen.

[75] In December 2021 one company was successfully sold to a buyer. he value of the remaining portfolio stood at £10.2m on the basis of £6.4m investment cost.

- Kernel has invested £14.95m in total to the end of March 2021 with total drawdowns of £19.97m and, with no exits to date, the portfolio is currently valued at £17.32m, which is currently a gross Total Value to Paid-In capital (TVPI) of 0.87x.
- Crescent III had secured three exits as of the end of March 2021 with proceeds of £3.9m compared to an investment cost of £3.42m (a gain of £0.47m, at a multiple of 1.14 and an IRR of 3.6%). The remaining portfolio shows an overall increase in value with a valuation of £16.22m compared to an investment cost of £14.83m (an increase of £1.71m or +12%). The uplift in value is driven by larger multiples attached to a small number of the portfolio businesses.
- Co-Fund I has achieved three successful exits, achieving exit multiples of 2.6 – 4.6. However, as of the end of March 2021, a significant proportion of the portfolio companies were in liquidation (27% / 10 companies) or had provisions (40% / 15 companies). Across the portfolio of 37 companies (including the realisations), Clarendon FM assesses the total value to be £18.17m compared to the investment cost of £16.41m. Taking account of the realisations to date, the remaining portfolio value is assessed to be £13.79m compared to an investment cost of £14.80m.
- Co-Fund II has achieved one exit to date, for which the returns are almost double the investment cost. As of March 2021, one company was in liquidation, 3 companies had provisions, 31 were assessed by Clarendon FM to be at cost and 7 were assessed as having a positive revaluation. The investment cost across the remaining portfolio (not including the company that has exited) is £12.79m, and CFM currently value the remaining portfolio at £13.17m.

Table 4.7 Financial Performance to Date (up to March 2021): Equity Funds

	Investment to Date		Realisations		Remaining Portfolio	
	Target £	Actual £	Investment Cost	Return	Investment Cost	Current Valuation
Techstart I: SME Fund	£17m	£15.06m	£1.73m	£2.69m	£13.33m	£9.95m
Techstart I: UU Fund	£1.5m	£1.41m	0	0	£1.41m	£1.17m
Techstart I: QUB Fund	£1.5m	£1.5m	£0.5m	£0.92m	£1.0m	£1.06m
Co-Fund I	£18.16m	£16.4m	£1.61m	£4.38m	£14.80m	£13.79m
Crescent III	£24.14m	£18.25m	£3.42m	£3.90m	£14.83m	£16.22m
Kernel	£24.3m	£14.95m	0	0	£14.95m	£17.32m
Techstart II: SME Seed Fund	£30m	£3.43m	0	0	£3.43m	£3.17m
Co-Fund II	£20.4m	£12.89m	£100k	£200k	£12.79m	£13.17m

Source: Hatch analysis of Invest NI and fund manager data.

Fund Management Fees Drawn Down

4.31 The draw down of fund managers fees are broadly in line with the progress that the funds have made. The earlier loan funds have nearly drawn down all of the fee allocation given the progress and structure of the quarterly fee payments. The earlier equity funds have drawn down roughly four fifths of fees, which is in line with their current respective position in the realisation period.

4.32 The younger funds are all at slightly different points in their draw down of fees, reflecting the nature of the fund and fee structures. Despite slower progress amongst a number of the debt funds, this has not led to fee payments being withheld as Invest NI has recognised that BBLs and CBILs had an impact on demand for these Funds. Invest NI continue to closely monitor the demand for both these funds.

Table 4.8 Fund Management Fees Drawn Down Compared to Agreed Lifetime Fees, at March 2021

	Agreed Lifetime FM Fees	FM Fees Drawn Down
Funds in Current Investment Period		
Co-Fund II	£4.38m	£2.49m (57%)
Techstart II	£7.55m	£1.31m (17%) [76]
Growth Finance Fund	£4.85m	£1.52m (31%)
Growth Loan Fund II	£5.25	£1.76m (33%)
Small Business Loan Fund II	£2.5m	£1.15m (46%)
Funds in Main Collection or Realisation Period		
Co-Fund I	£1.69m	£1.69m (100%)
Crescent III Development Fund	£5.86m	£4.75m (81%)
Kernel Development Fund	£5.7m	£4.67m (82%)
Techstart I	£6.09m	£5.19m (83%)
Growth Loan Fund I	£7.09m	£6.92m (98%)
Small Business Loan Fund I	£2.4m	£2.27m (94%)

Source: Hatch analysis of Invest NI and fund manager data

Distributions of Paid in Capital to Invest NI

4.33 Invest NI has committed capital contributions of £109.45m to the funds which are currently in their realisation period and a further £92.2m has been already made or is committed to the funds which are in their investment period. It is expecting to receive £143.8m back from the funds through the distribution of its paid in capital.

4.34 Up to the end of March 2021, Invest NI had received £24.1m back from the funds in their realisation phase (and a further £0.2m for Co-fund II), with the majority of this being from the debt funds. The equity funds, subject to their performance, usually take longer to distribute paid in capital to the public sector funders. Although difficult for the evaluators to judge whether this is a reasonable pace of return at this point in the life of these particular funds, it is slightly ahead of Invest NI's own analysis of the return level (£13.7m in March 2021 compared to an estimated £10.8m by the end of 2020).

4.35 Not all of these monies will be available for recycling by Invest NI as £10.6m of the £24.3m recycled at March 2021 is the Financial Transaction Capital. Under the agreement with the

[76] excluding POC related management fees

Department for the economy for the use of FTC monies, none of this is retained by Invest NI (i.e. the initial 80% of the sum is returned to HM Treasury, whilst anything additional over and above this retained by DfE/DoF).

Table 4.9 Distribution of Paid in Capital to Invest NI, up to 31st March 2021 £m

	NISBLF I	GLF I	Techstart I	Co-Fund I	Co-Fund II	Total
Invest NI Capital Commitments	£5.0m	£27.5m	£28.8m	£18.2m	£20.4m	£99.9m
Returns to Invest NI	£2.8m	£15.1m	£1.7m	£4.5m	£0.2m	£24.3m
.... of which FTC monies	£1.0m	£9.6m	-	-	-	£10.6m

Source: Hatch analysis of Invest NI data

Lifetime Outturn Prospects

4.36 The funds do not provide Invest NI with estimates of their expected lifetime financial performance as part of their standard quarterly or annual monitoring. Also the extent to which the fund managers were able or willing to share these estimates with the evaluators varied. Consequently, the data reported below varies between the funds reflecting the information we have access to.

4.37 NISBLF I and II are expecting a 62% and 56% return paid on capital to Invest NI respectively. While this could be considered low compared to comparable regional small loan funds, it is not a great deal lower and also the alternative source of finance for these types of businesses would be a grant which would not offer returns.

4.38 Whiterock expect the return to Invest NI to rise to 92% (of its capital contribution) for GLF I by the end of the Fund's life. For GLF II, it is still early in the life of the fund to assess, but the fund manager is anticipating that they will distribute £22.6m to Invest NI at the end of the fund's life (slightly above £22m commitment). For GFF, Whiterock currently anticipate that Invest NI will receive a very good total return of £10.5m against a commitment of £7.5m.

4.39 For the majority of the equity funds, the outturn prospects are less certain at this stage. For Kernel, Crescent and Co-Fund I, the expectations of eventual lifetime outturn are heavily dependent on a small number of portfolio companies achieving large multiples on their investment cost. In the case of Co-Fund I, the FM noted that this is not unusual for early stage VC funds. Co-Fund I has achieved three successful exits to date (with exit multiples of 2.6 to 4.6), however a large proportion of the portfolio is in liquidation or has provisions (67% in total). In the case of Kernel, no exits have been achieved to date and the fund has only invested 63% of the total available for investment, but it is nevertheless forecasting an ambitious lifetime return. Techstart I has what looks like a strong portfolio, however it has few exits to date. For all of these funds, the FMs will need to focus on supporting portfolio companies to drive successful exits.

4.40 With regards to Techstart II, the fund is still at an early stage in its investment period, so it is too soon to judge the outturn prospects. Co-Fund II has a target IRR of 0%, but Clarendon FM are expecting the fund to make a commercial return to investors (Invest NI included) over a 12–15-year return cycle. It is still relatively early in the life of the fund, but the fund managers indicate that they are targeting a 2-2.6 multiple return on investment cost across the portfolio.

Economic Development Performance

4.41 Based on the monitoring data provided by the Fund Managers, economic development performance has varied across the funds. Businesses receiving finance from GLF I appear to have been particularly successful in terms of their growth in gross jobs, with 1,332 jobs created since investment (at a cost of £41k average investment per job created). The average investment per additional job created in businesses receiving finance from the development funds has been particularly high and the number of jobs created is lower than anticipated in the Economic Appraisal for these funds (which anticipated an increase of 750 jobs in investee companies). This may also reflect the lower than anticipated number of companies supported by these funds.

4.42 The businesses receiving finance from the Kernel fund have experienced a large decrease in gross GVA (-£4.03m), however it should be noted that this is due to the companies in Kernel's portfolio all requiring funding for R&D and, as they raise and spend this funding, the change in their EBITDA is negative and has widened over time. While this indicates growing losses in accounting terms, the value of the company (and of the investment) may simultaneously be increasing, as the invested money in R&D can deliver shareholder value greater than its cost (which is reflected in an increasing share price).

Table 4.10 Economic Development Performance of Funds in Realisation Period, at March 2021

	SBLF I	GLF I	Crescent III	Kernel	Techstart I	Co-Fund I
No. of companies supported	375	140	17	8	299	37
Gross jobs created*	1,416*	1,332	75	127	380	159
Gross GVA generated £m	22	81.5	8.43	-4.03	0.16	12.7
Av investment per company supported	£16k	£38k	£1.07m	£1.87m	£73k	£443k
Total investment per gross job created	-	£41k	£243k	£118k	£57k	£103k

Source: Hatch analysis of Invest NI and fund manager data. *Note: SBLF I figure refers to job years rather than gross jobs. 'Job years' counts each job generated each year.

4.43 Economic development performance has been weaker than anticipated amongst the businesses supported by the majority of funds currently in their investment period. However, this is likely to reflect that several of the funds are early in their investment period (and the time required, particularly for equity investment, to translate investment into employment growth). This is likely to also reflect the period in which the funds have been operating, where many businesses have been impacted by the Covid-19 pandemic. Techstart II has demonstrated reasonable growth in GVA and gross job creation metrics even though it is still early days in the life of these investments, and they are starting from a low baseline. While GVA had decreased among GFF portfolio companies (possibly reflecting factors such as the short term impacts of new investment activity on investee performance or business failure), more promisingly, businesses in aggregate are employing 160 more staff representing an increase of 28% against the baseline. Co-Fund II appears to be going against the trend, with quite strong gross employment and GVA growth among portfolio companies since investment. The reason for the fall in employment amongst the companies receiving GLFII loans is not clear, although this may be a consequence of the short term effect of the pandemic on business performance and may well recover over the next 12 months.

Table 4.11 Economic Development Performance of Funds in Investment Period, at March 2021

	SBLF II	GLF II	GFF	Techstart II	Co-Fund II
No. of companies supported	143	19	23	104	43
Gross jobs created	32	-32	160	50	168
Gross GVA generated £m	No data available	1.2	-1.1	1.67	22.2
Av investment per company supported	£29k	£505k	£678k	£50k	£300k
Total investment per gross job created	£134k	-	£98k	£103k	£77k

Source: Hatch analysis of Invest NI and fund manager data

Links to Other Invest NI Innovation and Business Support

4.44 As noted in Section 2, one of the priorities of Invest NI's Access to Finance Strategy is to ensure that SMEs receiving finance through the loan and equity funds are also encouraged and able to access other forms of innovation and business support. An analysis of Invest NI data indicates that, overall, there are strong linkages between Invest NI's Access to Finance funds and other business support programmes which should help to reinforce innovation, growth and productivity improvements.

4.45 A little over a half of the investee businesses also received another form of business support (55% overall, with 42% of loan recipients and 93% of equity recipients). Main types of support accessed were (based on Invest NI data):

- Support to develop innovation and technology through programmes such as innovation vouchers and knowledge transfer partnerships (39%), plus grant support to invest in R&D (21%)
- Support developing overseas trade capability (28%)
- Assistance with workforce development (21%) and job creation (33%).

4.46 Whilst the evaluators view this as a real strength of the Invest NI approach compared to many other regions of the UK, Invest NI need to be mindful of creating an over reliance amongst SMEs in NI on public sector backed business support and finance.

External Stakeholder Views

4.47 The external perspectives regarding the Invest NI backed investment funds based on consultations with financial intermediaries, external private sector finance providers and business representative organisations are summarised below:

- Techstart are effectively addressing a gap in the market and are now well established in the NI market. Stakeholders emphasised that there is still an early-stage equity gap and that this type of public-sector backed fund (both proof of concept and early-stage equity finance) would be required going forward. It was however highlighted that accessing Techstart funding can be very highly competitive given the demand. A number of consultees noted that there can be a long wait for grants to be approved, businesses often receive little support alongside the grant, and they only receive funding after having defrayed the money which can be challenging for start-ups.

- Clarendon FM were also highlighted as being well-known in the marketplace and as being recognised as being good to deal with.
- A small number of industry consultees had a negative view of Crescent, which appeared to be based on a perception of the fund manager providing an inadequate service to some of its investee businesses. It was also shaped amongst some consultees in the investment community by the failure of Crescent IV to achieve its second close and hence to ultimately be withdrawn.
- Growth Loan Fund I has a positive perception in the market, particularly in addressing market failures and helping evolve the finance market for other debt funds and funders, beyond the reliance on traditional forms of debt. GLF I, II and GFF are considered externally to possess a healthy pipeline and deal count but there are mixed views about the extent of their investment activity beyond Belfast.
- Whiterock are considered professional, experienced fund managers and well known in the industry, particularly being praised for their outreach and regular communications with intermediaries. A number of consultees suggested the fund manager could do more to raise awareness for other Invest NI funds and wider economic development programmes.
- There is more of a gap where companies are looking to raise £1-2m+ but some stakeholders considered that businesses at this stage should be able to raise funds from investors based outside of NI (e.g. capital available for those businesses from GB or RoI-based investors and funds but that the market is too small for there to be local fund) and that there isn't a need for public sector intervention.
- Several stakeholders highlighted that a more passive co-investment approach, which was private-sector led, as opposed to the more proactive approach which has been adopted by Co-fund in practice, would help to attract further private sector equity investment into Northern Ireland. It was emphasised that Invest NI should be encouraging as many equity investors as possible to come into NI. However, it is worth noting that despite the approach adopted, Co-Fund has achieved strong levels of leverage.
- There has been increasing acknowledgement that early-stage rounds need to be bigger, and as a result there is increasing cross-investment from Invest NI backed funds (e.g. Techstart, Co-Fund, Kernel) and Angel investors and a move towards pooling resources to allow companies to raise larger amounts at seed stage.
- While some stakeholders criticised the preferred position of the private sector fund managers in a number of the equity funds (as their terms and Invest NI's subordinated position provides them with a competitive advantage compared to other private investors), others recognised that it has been a realistic approach for the Northern Ireland market where there is still a fairly limited presence of private sector investors compared to similar regions.
- Many praised Invest NI for their contributions in introducing alternative finances and maturing the market, which has given external funders the confidence to enter. As the market evolves there was a view that Invest NI and their funds and policies will also need to do so. This evolution should be informed by greater and more frequent engagement with the sector, both demand and supply side operators. Elsewhere there were suggestions Invest NI could provide non direct funding support in the form of part funding non-executive directors for SMEs, issue requests for proposal for private market

to identify case for intervention and solutions and help underwrite deals to entice more external funders into Northern Ireland.

- Several stakeholders mentioned that the current Invest NI portfolio of funds do not embed wider economic development goals into their delivery. More could be done to encourage greater equality and diversity goals, which will feed into diversity of investment, as well as the adoption of low carbon agenda through the investment activities of the funds. Suggestions as to how this could be implemented include seeking fund managers with more female investment managers, introducing impact investment funds, introducing specific funds to support the green economy, developing KPIs which reflect these goals, ensuring fund managers sign up to certain diversity codes including investing in women code and issuing specific calls for applications from female founders, green economy focused businesses etc[77].
- There was a general theme around education arising from consultations. That is to improve the knowledge of front-line workers, including those working within Invest NI and fund managers, around access to finance so that businesses can make better informed decisions.
- Going forward, Invest NI should look for opportunities to further align the funds with Northern Ireland's strategic direction (i.e. the 10x Strategy).

Key Findings

4.48 Invest NI has provided significant capital support for SMEs in Northern Ireland through the public backed investment funds it has established. It has enabled around £180m (an average of £18m per year) to be invested in the form of business loans and equity investment (and over £5.5m in POC grants), as well as leveraging significant private sector investment at the deal level. The funds have invested in at least 600 start-ups and enterprises supporting an increase in GVA and employment growth for the Northern Ireland economy. The funds are forecast to generate a return to Invest NI, which will be available for re-investment in successor funds.

4.49 The financial success of the funds is still very much dependant on future capital realisations. It is essential that focus is maintained on supporting portfolio companies to achieving successful realisations. It is important that the overall and fund by fund prospects for returns to Invest NI are clearly understood, as well as the risks inherent in the portfolios and the potential consequences of external macro-economic factors.

RAG Ratings for Overall Performance by Fund

4.50 The table below outlines the performance of each of the Invest NI funds evaluated, providing a summary of the key findings and a RAG rating based on each fund's investment performance, financial performance and outturn prospects.

[77] TechStart POC launched a recent initiative targeting female founders (Dec 2021) Female Founders Funding Opportunity | Techstart Ventures Grants Northern Ireland (techstartgrants.com)

Table 4.12 Overall Fund Performance RAG Rating

	Investment Performance	Financial Performance	Lifetime Prospects
NISBLF I	• Did not meet all KPIs in each year, but overall when aggregated, within the ranges specified • Exceeded lower limit investment target in terms of amount and number of investments. But on track overall in terms of no of investments and average investment value per deal	• Making good progress in terms of repayments, with defaults expected to remain below target	• Expected distribution of capital to Invest NI is £3.2m returned on a £5.0m investment, a return paid on capital of 64%. Although this is not a particularly strong return, it is not uncommon for small business loan funds and preferable to grant alternative. • The casework submission assumed a £3.9m return on a £5.0 investment, however, this was on the assumption of £8.8m total loans (including recycled monies), whereas total loans was actually only £7.6m.
GLF I	• Distributed £54.3m of £55m investment target • Lower number of loans (140) than fund target (180) made.	• Default rate a concern, appears to go against the trend seen among other similar funds for decreasing default rates	• Whiterock expect the return to Invest NI to rise to 92% (of its capital contribution) by the end of the Fund's life. GLF I is expected to yield an IRR of 1.62% by the end of fund life
Kernel	• On track against all KPIs, but appears to be less demand than originally anticipated with the fund only investing in 8 portfolio companies, so expected to be at top end of investment range per company • Slower investment rate than anticipated (c.63% of total capital available invested) but remaining funds have been notionally allocated • Investment period was extended by a year due to the fund lagging investment	• No exits to date, but agreed exit strategy and M&A advisors appointed for three portfolio companies • Covid-19 pandemic has had negative impact on two portfolio companies, FM monitoring closely • Current valuation of portfolio implies a negative overall net IRR for the Fund at this stage	• FM driving all portfolio companies to achieve full exits during years 8-12, are aiming to achieve a gross IRR of 16% which is arguably very optimistic. • However, no exits have been achieved to date and risk associated with portfolio due to concentration of investment in very small number of portfolio companies

	Investment Performance	Financial Performance	Lifetime Prospects
	rate at the end of the original five year investment period.		
Crescent III	• After a slow start, the fund has made reasonable progress • Investment period was extended by a year due to the fund lagging investment rate at the end of the original five year investment period. • Only expecting to invest 90% of available capital	• Significant provisions marking down value of portfolio • Current valuation of portfolio implies a negative overall net IRR for the Fund at this stage • Three exits by end of March 2021 with proceeds of £3.9m compared to an investment cost of £3.42m.	• Expectations around eventual lifetime outturn dependent on small no. of companies achieving multiples of over 2-3x the investment cost
Techstart I	• The fund has effectively invested in what is a challenging investment space and is in line with investment targets • 25 of the POC grant recipients have gone onto receive equity investment from Techstart I	• Progressing well in realisation period. SME Fund has made positive returns on exits to date and remaining portfolio has potential for growth. • UU fund has a number of sizeable provisions against three (out of 7) investments • QUB fund has had two successful realisations and remaining portfolio is showing slight uplift in value against cost.	• What looks like a good portfolio, however limited exits to date; the FMs will need to focus on supporting portfolio companies to drive successful exits
Co-Fund I	• Run rate at start of life of fund higher than at the end, due to an element of that fund needing to be reserved for follow-on capacity for the existing portfolio between the Co-Fund I activity and Co-Fund II becoming operational • Average investment based on initial investments slightly below target, but meeting other KPIs	• Three successful exits achieved to date, with exit multiples of 2.6-4.6 • Large proportion of the portfolio has failed or has provisions (27% in liquidation, 40% with provisions) so current value of remaining portfolio is below investment cost (but current value including exits above cost)	• FM expects a 2-2.5 multiple return on the Co-Fund I portfolio once all investments are realised • Expectations around outturns based on relatively small number of portfolio companies achieving large multiples on investment but this is not unusual for early-stage VC funds.
NISBLF II	• Underperformed to date as a result of Covid-19 pandemic and investments have not yet recovered. Extension to	• Arrears, provisions and defaults remain low	• Still relatively early in life of fund • If investment rate picks up the fund outturn prospects are reasonable at this

	Investment Performance	Financial Performance	Lifetime Prospects
	investment period may be required to meet targets	• Too early to assess, but current indicators are positive	stage with a 56% return of funds to Invest NI expected
GLF II	• Slower investment rate than anticipated as a result of Covid-19 impacts on economy and availability of lower priced CBILs. • Investment rate required to meet lifetime target will be challenging to achieve and an extension to investment period may be required	• No bad debt to date, provisions of £618k (6.4% coverage on committed facilities), which is currently lower than KPI default rate target of 14%	• Still early in life of fund but fund manager is anticipating that they will distribute £22.6m to Invest NI at the end of the fund's life (slightly above £22m commitment) • Heavily dependent on achieving an improvement on the quality of the businesses which are currently applying for loans and increasing investment rate.
GFF	• GFF was CBIL-approved and has demonstrated stronger performance than NISBLF II and GLF II during the Covid-19 pandemic. Whiterock are confident of achieving lifetime investment target	• On track with repayments. £414k in provisions and no bad debt (2.66% drawn facilities)	• Based on current FM's expectations, it is anticipated that Invest NI will receive a very good total return of £10.5m (including initial commitment) against a commitment of £7.5m.
Techstart II	• Fund is meeting its KPIs and has made reasonable initial progress with investment to date. • Investment rate is within but at lower end of KPI profile range , but with a strong pipeline of follow-on and new investments.	• Value of SME Seed Fund portfolio currently stands at £3.17m (-7%) following provisions against two of the eleven portfolio companies. Given the current age of the fund, there have been no exits to date [note: as footnoted above, new investments and a good exit were achieved following the drafting of evaluation report].	• Too soon to judge, as still at early stage in investment period. • Annual investment rate will need to be increased to achieve target, but currently in a reasonable position. FM is prioritising marketing, business development and pipeline development, including hiring a marketing manager.
Co-Fund II	• On track or ahead of all KPIs, other than annual investment rate but expected to be on target with this by end of investment period.	• One exit to date, for which the returns are almost double the investment cost	• Co-Fund has a target IRR of 0%, but FM expecting the fund to make a commercial return over time to

HATCH

	Investment Performance	Financial Performance	Lifetime Prospects
	• Strong investment rate to date.	• Remaining portfolio performing well, low number of provisions and business failures. Current value of remaining portfolio £13.17m, compared to £12.79 investment cost.	investors (Invest NI included) over 12–15-year return cycle. • Still early in life of fund, but FM indicated that they are targeting the Fund to return a 2-2.6 multiple return on investment cost.

Source: Hatch analysis of Invest NI and Fund Manager data, Hatch consultations with Fund Managers and Invest NI Corporate Finance team

4.51 The funds have performed well in terms of the number of companies supported to the end of March 2021. The proportioned cumulative target for 2021 for the number of companies supported was 1,248 compared to an estimated 1,208 businesses that received finance or grants. Invest NI fell short of its total investment cumulative investment target with £180.8m (85% of the target) invested up to March 2021. The shortfall is mainly due to a fall in loans made by SBLFII and GLFII and lower than anticipated investments by the Development Funds. This suggests that overall the average investment per businesses was smaller than expected (£150k compared to £191k), although this investment amount was far higher for some funds.

4.52 Invest NI is ahead of its proportioned target for recycled monies from the funds (we assumed due to a faster rate of repayments amongst a number of the debt funds). £13.8m has been returned (excluding FTC) to date compared to the expected £10.8m.

Table 4.13 Overall Progress against Access to Finance Strategy Targets, March 2021

	Cumulative Target, 2021[78]	Performance to the end of March 2021	
		No	%
Gross companies supported	1,248	1,208	n/a
Total amount invested £m	£212.26[79]	£180.8	85%
Returned funds recycled excluding FTC £m	£10.8	£13.7	127%

Source: Targets – Invest NI Access to Finance Strategy, 2020 / Performance proportioned to the end of March 2021 – Hatch analysis of Invest NI and Fund manager data: (i) number of companies and investment secured cover the Kernel Development Fund, Crescent III Development Fund, Co-investment Fund I & II, TechStart I & II, Small Business Loan Fund I & II, Growth Loan Fund I & II and Growth Finance Fund; (ii) returned funds recycled excluding FTC cover Co-investment Fund I & II, Growth Loan Fund I, Small Business Loan Fund I and TechStart I. * The figures for net jobs and GVA generated are best estimates derived by Hatch using Hatch/Beaufort Beneficiary Survey 2021 data. The sample level estimates were scaled up to the population of beneficiaries using the comparative value of investment across finance types.

[78] This HBAN and the Covid 19 Equity Fund

[79] excluding deal level investment

5. Fund by Fund Perspective

5.1 This section provides a summary of the performance and prospects for each fund in turn. It draws on the analysis of the fund data and consultations with the fund managers.

Small Business Loan Fund I

5.2 The Small Business Loan Fund filled a funding gap in the small business finance market by providing finance to high-risk businesses which the private sector is not incentivised to invest in. It has also played a role in introducing small businesses to debt finance, encouraging a move away from the grant funding culture observed at its inception.

5.3 The fund exceeded its lower limit investment targets in terms of the amount and number of investments. Although it did not meet all investment KPIs in each year, the total amount and number of investments were within the ranges specified by aggregating the annual KPIs. It is also making good progress in terms of repayments, with defaults expected to remain eight percentage points below target at 15% compared to a target of 23%, and 62% of paid in capital expected to be returned to Invest IN.

5.4 Evidence of economic impact of the fund undertaken prior to the survey and counterfactual analysis detailed in Chapter 7 of this report is limited. However, conservative estimates undertaken during its investment period in 2016 suggest a GVA impact of £22m.

Growth Loan Fund I

5.5 Growth Loan Fund I provided secured and unsecured mezzanine debt finance to growth orientated SMEs, considered too risky to the existing senior debt providers and who struggled to obtain finance, at a time when the NI market presented limited options.

5.6 The Fund is in its realisation period and has distributed £54.3m of the £55m investment target to 102 SMEs across 140 loans against the loan target of 180. By the end of March 2021, GLF had received £55.3m in collections (capital repayments, interest, profit share and arrangement fees). There remains £9.8m on its loan book and the fund managers anticipate a default rate of up to 16% by the end of the fund life, equivalent to writing off £8.7m in investments.

5.7 To date, NILGOSC have received their full initial capital investment and 7% per annum coupon on funds invested, whilst Invest NI have received 55% of its investment (£15.1m[80]). Whiterock expect the return to Invest NI to rise to 92% (of its capital contribution) by the end of the Fund's life (which may need to be extended). GLF I is expected to yield an IRR of 1.62% by the end of the Fund, which is considered fairly likely given Whiterock's close monitoring of their loan book and regular contact with remaining loanees.

5.8 Although the Fund has not set any formal economic development targets, intended outcomes include improving productivity (as measured by GVA per employee), employment and R&D. Metrics collected show the fund is making strong progress with turnover, GVA and employment, all increasing (by +116%, +111% and +50%) in aggregate compared to the baseline position.

[80] plus a further £4.29m in the financial year 2021/22 to date

Crescent III

5.9 After a slow start the fund has made reasonable progress investing £18.25m of the available £24m through 41 deals and 15 SMEs. A one year extension to the investment period was sought and the fund manager was able to make investments in new businesses during this period.. Crescent went on to make three new investments and close out two others which were in progress in the extended investment period.

5.10 The Fund has made a positive return on its realisations as at end March 2021. Three exits had been secured with proceeds of £3.9m compared to an investment cost of £3.42m (a gain of £0.47m, at a multiple of 1.14x and an IRR of 3.6%). Since March 2021 a further exit has been secured.

5.11 The Fund has built up a portfolio of businesses in which it will continue to invest through follow-on investments. The Fund Manager doesn't currently expect to invest the full amount of available capital, potentially reaching about 90% of the available capital. The level of provisions are fairly high, although the current valuation of the portfolio is boosted by a few companies with anticipated multiples of over 2 times investment cost.

5.12 The eventual lifetime outturn will depend critically on the prospects of the remaining portfolio businesses and the fund manager's ability to secure good exits and to limit losses. Whilst this is highly uncertain at the current time, based on current valuations and drawn amounts all private investors would receive their full capital commitment (£11.8m) and 12% return (£12.6m). Invest NI is currently not projected to receive any return.

Kernel

5.13 Kernel has invested £14.95m to the end of March 2021 (c.62% of the total available for investment) in 8 companies. It was originally anticipated that the Fund would invest in 15 companies. This suggests that the average value of investment per company has been far higher than anticipated and whilst these could be very good investments, the level of concentration of investment in a fairly small portfolio presents risks.

5.14 The fund manager is confident about investing the remaining capital (c£8.3m) available with its portfolio companies through follow-on investment making, although this appears challenging given the investment rate achieved to date. The fund managers may seek an extension for an additional year's follow-on investment and the scope to exceed the £3m (10%) cap in a single company to enable it to achieve this (although a formal request has not yet been received by Invest NI). Kernel noted that it had advised the limited partners of its intention to request an extension of the cap on investment per company from 10% to 15% and that other LP's have indicated they are supportive.

5.15 Taking into consideration the additional investment planned for follow-on, the Fund will be systematically operating at the upper end of the investment range where, if the market and finance gap analysis is correct, the private sector is more likely to be operating in its own right.

5.16 The level of leverage at the deal level has been strong, including a mix of private investment from a variety of sources, as well as other public sector backed funds in the region.

5.17 The Fund is making steady progress in terms of employment and turnover generated among portfolio companies since investment, although at this stage employment is below the levels which were set in the economic appraisal. The GVA across the portfolio has decreased from baseline levels. This reflects the nature of the Fund, which has focused on investing in companies that require significant funding for R&D and is not necessarily the best measure of business performance for these types of companies at this stage.

5.18 One company in the portfolio has failed to date (following a tragic fatality). The Fund Managers are driving the remaining seven portfolio companies to achieve full exits in years 8 to 12 and have agreed exit strategies with three companies which have M&A advisors appointed. Kernel is aiming to return cash to its limited partners of over £42m, equating to a Gross IRR of 16%. To put this in context the current valuation of the portfolio is £17.31m (on the basis of an investment of £14.95m) and no exits have been achieved to date. Whilst it is too early to judge whether this is achievable in practice, it is worth noting that this level of return would buck the trend for public sector backed funds in this investment space and should be viewed as ambitious.

5.19 The comparison in the performance and prospects of Kernel and Crescent III is important given that both funds are operating in the same investment space, with the same targets and timescales. Whilst both funds have faced challenges, Crescent III has achieved a higher level of investment which is closer to the intent of the investment policies (£18.25m invested in 17 SMEs against a target of 20 compared to £14.95m in 8 SMEs for Kernel against a target of 15), achieved exits to date with a positive IRR (£3.9m compared to no exits for Kernel) and is performing better in terms of the economic development benefits. The current portfolios are performing similarly in terms of their valuations, although arguably Kernel has the stronger of the two portfolios in terms of future returns.

Techstart I

5.20 The Fund has effectively invested in what is a challenging investment space (and is in line to achieve its lifetime investment targets), establishing itself as an important player within Northern Ireland early-stage VC market.

5.21 The level of leverage at the deal level has been very strong, including both a mix of private investment from angels, other investors in NI and outside the region, as well as other public sector backed funds in the region.

5.22 The POC grant has been a feed source of early-stage equity investment for Techstart. However, it is unclear what outcomes the other recipients will achieve and the value for money this presents to Invest NI.

5.23 Although the Fund is progressing reasonably in the realisation period in terms of progressive follow-on investment, it is still highly uncertain what the lifetime financial outturn will be. The worst case appears to be a return to investors – Invest NI primarily and QUB and UU – of £15m. It is critically important at this stage that Techstart Ventures successfully drive exits over the remaining life of the fund, using follow-on investment and on-going support for management teams, to help achieve this.

5.24 The Fund is making steady progress in terms of the economic development outcomes which are monitored, although at this stage this is behind the levels which were set in the economic appraisal (more so for GVA than employment). To some extent this reflects the nature of these investments and the current stage in the life of the fund.

Co-Fund I

5.25 CFM has taken a more active approach than originally intended in supporting companies to find additional private funders to contribute towards funding rounds, in supporting the private investors in setting the deal terms and managing the portfolio. Co-Fund I has invested £16.4m in

37 companies (as of the end of March 2021). There is evidence that the Fund has helped to address the equity gap in NI and to upskill private investors in the region.

5.26 Co-Fund I has been successful in attracting a range of investors into its portfolio. Deal level investors listed in monitoring data include a large number of business angels, in addition to corporate investors, institutional investors, other public sector provides, VC funds, and other private investors. Of the deal level investment for which the country of location of the investor was reported, the majority (c.60%) of investment was from NI-based investors (note: this includes public sector funds), but the portfolio has also attracted significant investment from outside of NI (e.g. from Great Britain, Singapore and US-based investors, which each accounted for 9-10% of the total deal level investment).

5.27 The Fund is making strong progress in terms of the economic development outcomes which are monitored. The portfolio companies have achieved a gross increase of 4.3 FTE jobs on average compared to pre-investment baselines.

5.28 Co-Fund I has achieved three successful exits, achieving exit multiples of 2.6 – 4.6. To date, there are ten portfolio companies in liquidation, 15 companies with provisions, 4 companies at cost and 5 companies with upward revaluations. Based on deals in progress and expected to progress, CFM expects to pay back £12m from the Co-Fund I portfolio by year 11. CFM indicated that they expect a 2-2.5 multiple return on the Co-Fund I portfolio once all investments are realised (by year 15). Given that 27% of the portfolio companies are in liquidation, and a further 40% have provisions against them, this suggests that the expected returns are dependent on a small proportion of the of the portfolio companies performing well which brings some risk to the forecast returns, but is not unusual for early stage VC funds.

Small Business Loan Fund II

5.29 The NISBLF II succeeded NISLBF I in seeking to fill a continuing gap in small amounts of debt finance for SMEs and micro businesses. Compared to the NISLBF I, the fund offers higher amounts of finance, up to £100k rather than £50k, to ensure a coverage of funding gaps for businesses not eligible for Growth Loan Fund investments of over £100k.

5.30 While the fund achieved its pro rata investment amount target over its first three years, the fund has underperformed as a result of the Covid-19 pandemic and investments have not yet recovered. It is likely to be difficult for the fund to achieve its overall investment targets at the current rate of investment recovery.

5.31 Although it is too early to assess investment performance and economic development outputs current indicators are positive. The fund manager was unable to provide a lifetime investment forecast due to the current volatility in the small loans market as a consequences of the pandemic and the impact of government interventions such as BBLs). The fund outturn prospects for investment made up to March 2021 are reasonable at this stage, with a 56% return of capital to Invest NI expected. An extension of the investment period by a year may be necessary to enable the fund to meet investment targets and generate performance and economic development outputs.

Growth Loan Fund II

5.32 GLF II was established following an economic appraisal of a successor fund to GLF I, to provide unsecured loan finance to SMEs showing growth potential. It is noted that the Fund Manager does seek security, which typically will rank behind senior debt. Compared to GLF I, the fund size was reduced to £22m, given the introduction of Growth Finance Fund at the same time, and ability to recycle returns during the investment period, enabling loans of £30m to be made.

5.33 GLF II launched in October 2018 and halfway through its investment period has had 19 loan drawdowns totalling £9.6m (and has leveraged £10.8m in additional investment), against a target of £22.5m (49% of target). The slower investment rate than anticipated against the KPI target of 8 - 18 per annum, has been attributed by the fund managers to the initial impact of the pandemic on the economy and then the availability of highly competitive and lower priced CBILs loans. In line with adjusted KPI targets, given revealed market demand after the launch of fund, investments have averaged £506k in loan size.

5.34 The Fund Managers remain confident, given the rise in enquires and end of CBILs, related drawdowns in August 2021 that GLF II will be able to invest at a rate during the remainder of the investment period that will achieve the overall investment target. However, with two and half years remaining on the investment period, GLF II will need to average £8.2m investment per annum to meet the lifetime target. This is more than the highest drawdown financial year to date (£5.25m), but less than the average achieved for GLF £8.7m. It is noted that loan drawdowns of £4.8m have been achieved in the four months following the last drawdowns under CBILs to December 2021. The FM is considering requesting an extension of the investment period by a couple of months closer to the time in order to reach £30m in drawdown.

5.35 Although still early in the life of the fund, the fund manager is currently anticipating that they will distribute £22.6m to Invest NI at the end of the fund's life (slightly above its £22m commitment) and after investing £30m in NI SMEs.

Growth Finance Fund

5.36 A British Business Bank initiative, the GFF is sector agnostic and provides growth loan finance (with mezzanine features) to SMEs. The intention to launch GFF followed BBB's "Analysis of the UK Smaller Business Growth Market" in 2015 which found a market failure and need for growth loan funds.

5.37 Unlike GLF II, the GFF was CBIL approved and by the end of March 2021, it has distributed 23 loans (including tranches) across 16 companies, totalling £15.6m, representing an average of £678,000 per draw down. There remains £14.6m in GFF's loan book which is anticipated to yield £3.5m in interest repayments. To date, the fund has met all its KPIs around deal size, investment hurdles and default rate.

5.38 Looking ahead, between May and December 2021, the Fund Managers anticipated nine additional drawdowns totalling £7.5m, which would bring total drawdowns to £23.6m. With the investment period ending in November 2022, FM expect the programme will distribute its full funds. Actual drawdowns as at 31st December 2021 were £20m and total loans committed were £23.1m

5.39 Against a modelled 8.4% default rate, the expected lifetime write-offs stand at £2.6m and therefore £27.4m in principal repayment and £16.35m in interest and annual fees. Based on current FM's expectations, it is anticipated Invest NI will receive a good total return of £10.5m (including initial commitment) against a commitment of £7.5m. By the end of the fund's life, fund manager estimates GFF will deliver an IRR of 5.8%.

Techstart II

5.40 Techstart II has been able to build on the profile and reputation which Techstart I and Techstart Ventures built up. It is targeting a higher amount of overall investment in the seed and early-stage space, as well as a higher investment amount per deal and per SME, reflecting the perceived need of businesses to receive multiple rounds of investment and the fund managers to follow their money.

5.41 The portfolio businesses are achieving a good level of deal level leverage and also attracting investors from outside of Northern Ireland.

5.42 Whilst the fund has made steady progress with investment to date, the annual rate should increase through the combination of new and follow-on activity. This should, we would expect, enable the year 5 investment KPI to be achieved. Whilst the Fund is meeting its KPIs, the annual investment rate needs to be increased if it is to achieve its five-year investment target. To achieve this, the Fund Managers are prioritising marketing, business development and pipeline development, including recruiting a marketing manager.

5.43 It is far too early to judge the potential of the portfolio to secure exits. There have been no events to justify uplifts in the value of portfolio businesses and just fairly modest provisions (£256k against two companies). [note: further investments were made and a major exit was achieved after the completion of the review].

Co-Fund II

5.44 Co-Fund II has been able to build on the profile and reputation which Co-Fund I and CFM have built up. It is targeting a higher investment amount per deal, reflecting the demand for larger amounts of investment and the perceived need of businesses to receive multiple rounds of investment and the fund managers to follow their money.

5.45 The portfolio businesses are achieving a good level of deal level leverage and also attracting investors from outside of Northern Ireland.

5.46 Whilst the fund is meeting the majority of its KPIs, the average investment rate needs to be increased if it is to achieve its overall target.

5.47 The Fund has achieved one exit to date, for which the returns are almost double the investment cost. As of March 2021, one company was in liquidation, 3 companies had provisions, 31 were assessed by Clarendon FM to be at cost and 7 were assessed as having a positive revaluation. The investment cost across the remaining portfolio is £12.79m, and CFM currently value the portfolio at £13.17m.

5.48 CFM indicated that they are targeting the Fund to return a 2-2.6 multiple on the fund investment. Due to being less than four years into the investment period, it is too early to judge the potential of the portfolio to secure exits and returns. [note: although outside the reporting period, two exits were achieved from Co Fund II later in 2021].

6. Investee Perspectives

6.1 This section sets out the results of a survey of Invest Northern Ireland investees undertaken in September and October 2021. The purpose of the survey was to capture data on the characteristics of investees, their motivations for seeking finance from Invest NI, the view of investees on the service received and the impacts of the finance on their business.

Investee Journey

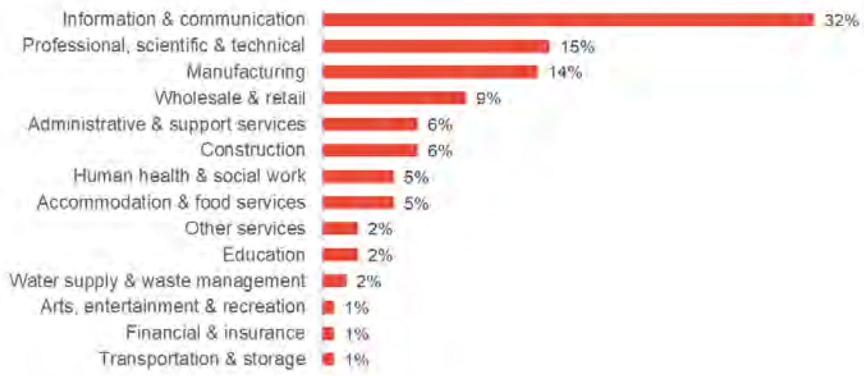
6.2 This section presents the results of the survey, including:

- the characteristics of beneficiaries
- motivations for seeking finance and routes followed in seeking finance
- views on the support received.

Business background

6.3 Respondents operated across a range of sectors, as shown in Figure 6.1. However, there was a higher concentration of information & communication (32%), professional, scientific & technical (15%) and manufacturing (14%) businesses.

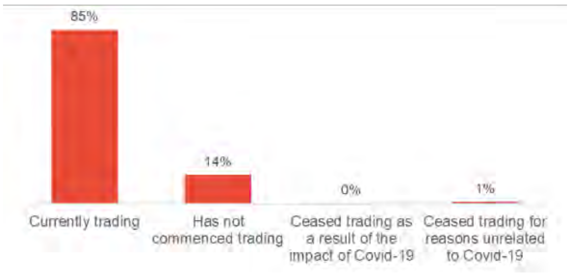
Figure 6.1 Sector profile, percentage (%) of respondents



Source: Hatch/Beaufort Research Beneficiary Survey (n=129)

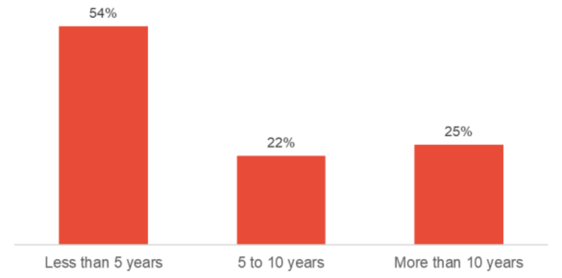
6.4 Figure 6.2 shows that 85% of the respondents were trading at the time of survey, whilst 14% had not commenced trading. Only one business has ceased trading, for reasons unrelated to the Covid-19 pandemic. As shown in Figure 6.3, 59 of 110 respondents (54%) were young businesses trading for less than 5 years. An additional 22% where trading for 5 to 10 years, with remaining 25% trading for more than 10 years.

Figure 6.2 Currently trading, percentage (%) of respondents



Source: Hatch/Beaufort Research Beneficiary Survey (n=129)

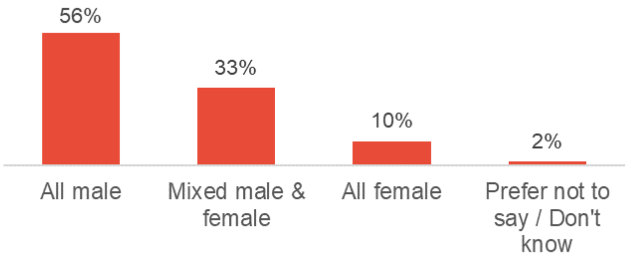
Figure 6.3 Years trading, percentage (%) of respondents



Source: Hatch/Beaufort Research Beneficiary Survey (n=110)

6.5 More than half (56%) of the respondents indicated that the senior management team of their business was all male at the time the company was founded, whilst 33% reported mixed senior management teams and 10% had an all female team.

Figure 6.4 Gender profile of senior management team when the business was founded, percentage (%) of respondents

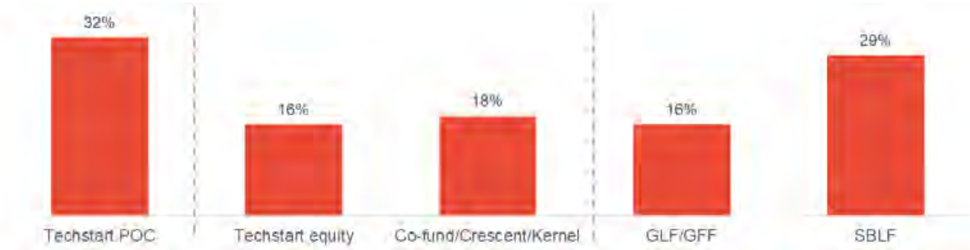


Source: Hatch/Beaufort Research Beneficiary Survey (n=129)

Type of finance received

6.6 Under half (45%) of the 129 respondents received loan finance, almost a third (32%) received grants and the remaining 27% obtained equity investment. Figure 6.5 shows the distribution of respondents across Invest NI fund streams.

Figure 6.5 Profile of beneficiaries by Invest NI fund streams, percentage (%) of respondents

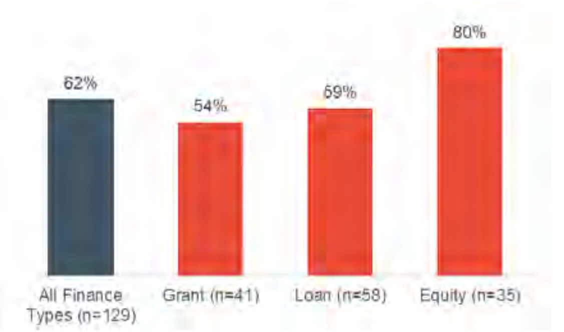


Source: Hatch/Beaufort Research Beneficiary Survey (n=129)

6.7 Overall, more than three fifths (62%) of the respondents indicated that the investment they received from Invest NI was part of a larger financial or investment package, possibly part-funded by the beneficiary as well as other investors. However, these varied across finance types, from 54% of grant beneficiaries surveyed to 80% of equity beneficiaries, as shown in Figure 6.6.

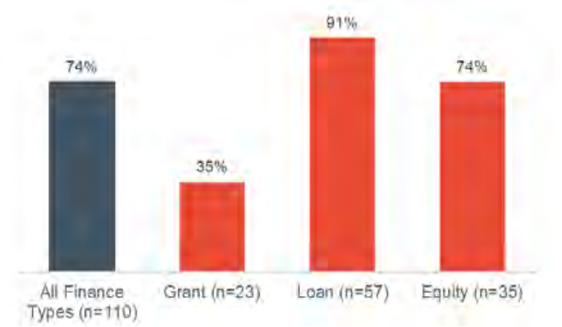
6.8 Moreover, Figure 6.7 shows that almost three quarters (74%) of beneficiaries indicated they received Covid-19 financial support from the Northern Ireland or UK government. Businesses benefiting from Invest NI loan finance solutions were more likely to have received Covid-19 support (91% of respondents).

Figure 6.6 Was this investment part of a larger financial or investment package? – Yes, percentage (%) of respondents



Source: Hatch/Beaufort Research Beneficiary Survey

Figure 6.7 Have you received any Covid-19 financial support from either the Northern Ireland or UK government? – Yes, percentage (%) of respondents

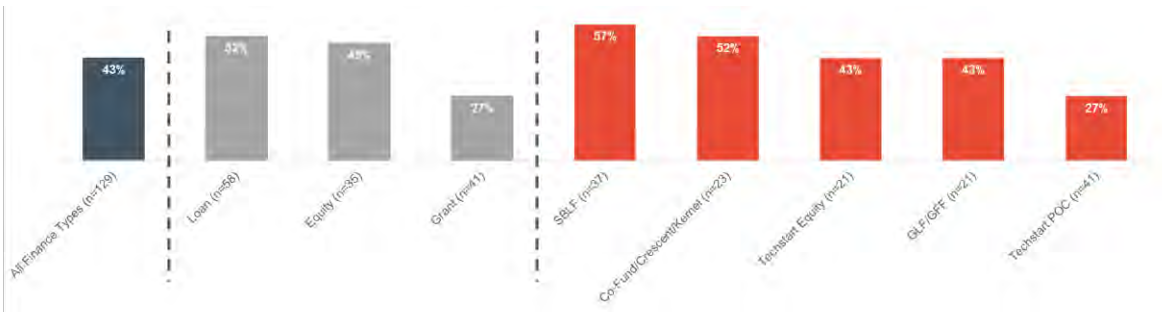


Source: Hatch/Beaufort Research Beneficiary Survey

Associated support received

6.9 Overall, 43% of respondents received support in the preparation of their application for finance, but this ranges considerably across finance types, as shown in Figure 6.8. Looking across the different fund streams, more than half of SBLF (57%) and Co-Fund/Crescent/Kernel (52%) respondents reported receiving pre-application support. Far fewer businesses using the POC grant received this initial guidance as the application process is more straight forward.

Figure 6.8 Did you receive any assistance in the preparation of your application for finance? – Yes, percentage (%) of respondents

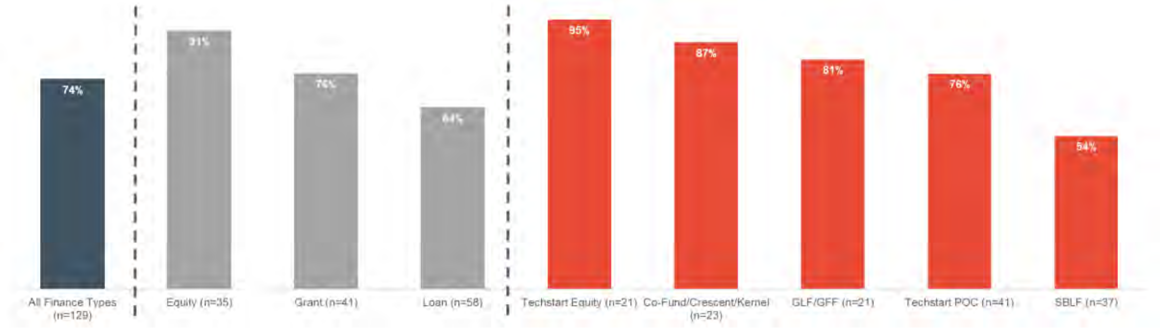


Source: Hatch/Beaufort Research Beneficiary Survey

6.10 The pre-application support provided was reported as quite or very helpful by 98% of respondents. Whilst all beneficiaries applying for loans and grants have found the pre-application support provided helpful to an extent, a minority of equity finance applicants reported it was not very helpful (6%). Specifically, respondents receiving Techstart equity support were more likely to find pre-application support not very helpful than Co-Fund/Crescent/Kernel support recipients although the difference is small (11% vs 8%).

6.11 Slightly below three quarters (74%) of respondents indicated that they received follow-on business support (i.e. advice and guidance). Equity finance investees were more likely to report that they benefited from follow-on support (91% of respondents) compared to grant (76%) and loan (64%) finance recipients. However, the latter masks a notable variation between GLF/GFF (81%) and SBLF (54%) recipients, as shown in Figure 6.9.

Figure 6.9 Investee take-up of follow-on business support from Invest NI, percentage (%) of respondents



Source: Hatch/Beaufort Research Beneficiary Survey

6.12 Invitations to events and seminars was the most frequently accessed form of follow-on business support across equity (71%), grant (44%) and loan (38%) recipients. Other forms of assistance that were popular across finance types include referrals to other sources of business advice, provision of ad hoc business advice and referrals to other sources of business finance.

6.13 Flexibility around the terms of finance was the second most popular form of support among loan recipients (31% of respondents), but of relatively lesser importance to equity and grant beneficiaries given the nature of this finance type. Moreover, a notably higher proportion (46%) of equity finance investees reported receiving additional support in the form of further loan or equity finance, including follow-on finance, relative to grant (17%) and loan (17%) beneficiaries.

6.14 The range of follow-on support provided by Invest NI to equity and loan finance investees was perceived overall as sufficient, with a respective 89% and 69% of respondents across the two finance types indicating that there was not any other advice or assistance they would have liked to receive. This appears to be less true with respect to grant finance recipients, more than half (51%) of whom indicated that they were interested in other follow-on support (whilst this could in practice range from straight forward sign-posting to more substantive assistance, the survey did not capture this information).

Experiences and motivations for seeking finance

6.15 The Chamber of Commerce (23% of respondents) and one of the HEIs in Northern Ireland (19%) were the most popular routes into Invest NI. Overall, over a tenth (13%) of respondents first heard of the programme though a lender or financial intermediary. However, this was a more common introduction to Invest NI for equity (20%) and loan (17%) recipients rather than grant beneficiaries (2%). Instead, grant recipients were more likely to be referred to Invest NI by a friend or family (10% vs 5% overall).

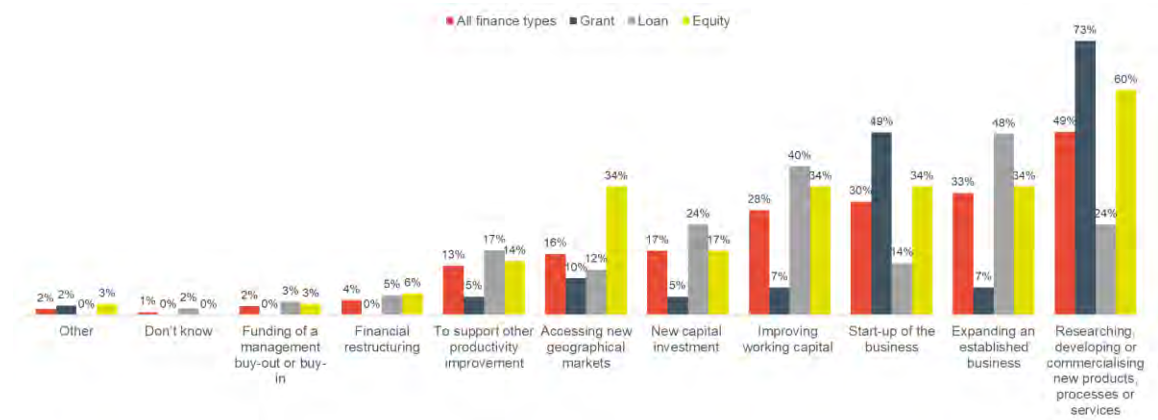
6.16 Less than a tenth (7%) of the surveyed beneficiaries were directly approached by one of the funds, but this varies from 4% of Co-Fund/Crescent/Kernel recipients to about a tenth of Techstart equity (10%) and SBLF (11%) beneficiaries. Moreover, almost a quarter (24%) of

GLF/GFF respondents indicated that they had previous knowledge, compared to 5% or less across the other funds on offer.

6.17 The leading motivations for approaching Invest NI for finance include R&D or commercialisation of new products, services or processes (49% of respondents), investment to expand an existing business (33%) or to fund its start-up phase (30%). However, their relative importance in seeking finance varies across finance type, reflecting their relative appropriateness for funding different types of business activities:

- The *grant recipients* surveyed primarily sought investment for R&D or commercialisation of new products, services or processes (73% of respondents), whilst almost half (49%) of the respondents sought funding for the start-up of their business.
- The majority of *loan recipients* surveyed sought investment to expand an established business (48%) or improve working capital (40%). New capital investment and R&D or commercialisation of new products, services or processes were also prominent reasons for approaching Invest NI for finance (24% of respondents each). But, GFF/GLF beneficiaries were more likely to seek finance from Invest NI for innovation purposes than SBLF participants (48% vs 11% of respondents).
- Three fifths (60%) of *equity recipients* surveyed sought funding for R&D or commercialisation of new products, services or processes. Expanding an established business, start-up of the business, improving working capital and accessing new geographical markets were also often cited objectives (34% of respondents each). However, Co-fund/Crescent/Kernel beneficiaries were more likely than Techstart equity recipients to be seeking finance for growing their business (48% vs 14%). Reversely, a relatively higher proportion of Techstart equity respondents sought investment for the start-up of their business (48% vs 13% for Co-fund/Crescent/Kernel).

Figure 6.10 Objective in seeking finance from Invest NI, percentage (%) of respondents



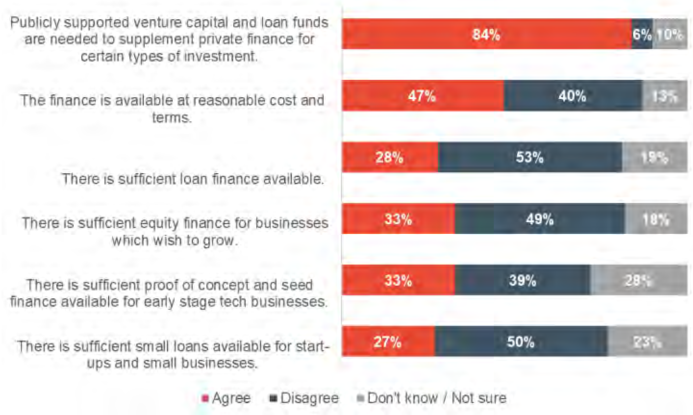
Source: Hatch/Beaufort Research Beneficiary Survey (n=129 for all finance types, n=41 for grant, n=58 for loan, n=35 for equity)

6.18 Prior to investment, 68% of the respondents seeking funding for innovation purposes were at the initial concept development stage, while a third (33%) were testing or prototyping their innovation in the real world. A relatively smaller proportion of businesses approached Invest NI at the stage of trying to commercially launch their innovation (17%) or to expand the market for a product, service or process already launched (22%).

6.19 Grant recipients were more likely to be at the initial concept development stage (87% of respondents), than equity (48%) and loan (50%) recipients, which reflects the very early stage focus of the POC grant. Co-fund/Crescent/Kernel respondents were notably more likely to be at the testing or prototyping in the real world (60% vs 33% average) or commercial launch (47% vs 17% average) stages.

6.20 The surveyed businesses were asked about their views on access to finance in Northern Ireland more generally. The overwhelming majority (84%) of respondents indicated that publicly supported finance provision in Northern Ireland is necessary. Specifically, beneficiaries recognise a gap in loan finance provision in general (53% of respondents), but also specific to start-ups & small businesses (50%). Although a third see provision of early stage and expansion equity finance as sufficient, the majority disagree with that view (39% for early-stage and 49% for expansion equity). Moreover, more respondents deem cost of financing as reasonable, opinions are divided on the balance (47% agree vs 40% disagree).

Figure 6.11 Investee's views on supply of SME finance in Northern Ireland, percentage (%) of respondents



Source: Hatch/Beaufort Research Beneficiary Survey (n=129)

6.21 The beneficiaries were asked to consider different aspects of their experience engaging with fund managers. Over four fifths of respondents rated very or fairly good the knowledge and professionalism of staff (88%), the overall quality of service (84%) and the speed and efficiency of administration (84%).

6.22 Satisfaction with the knowledge and professionalism of staff was slightly above average across loan beneficiaries (93% vs 88%). Equity recipients were relatively less satisfied with the overall quality of the service as well as the speed and efficiency of administration than the average (77% vs 84% for both), which may reflect the greater complexity and specialist nature of equity investing.

6.23 Although over half (57%) of respondents deemed the availability of advice and guidance after the receipt of finance very or fairly good, a relatively high share (18%) nevertheless appeared dissatisfied with this aspect of the service. Specifically, a higher share (24%) of grant finance recipients considered this aspect of the service very or fairly poor, which is in contrast to just 10% of Techstart equity beneficiaries who were of this view.

6.24 A similar pattern was observed for assistance in putting together a financial package, with 57% of respondents deeming it very or fairly good whilst 15% of respondents considered it very or fairly poor. However, dissatisfaction with this aspect of the service varies widely across funds from 3% of SBLF respondents to 30% of Co-fund/Crescent/Kernel respondents.

6.25 The range and flexibility of the types of finance available was also rated less positively than other aspects of the funds, with only 43% of respondents indicating that it was very or fairly good. Overall, 16% of respondents thought it was very or fairly poor, but this varied from 5% of Techstart equity beneficiaries surveyed to a fifth or more of grant (20%) and Co-fund/Crescent/Kernel (22%)[81] respondents.

Figure 6.12 Beneficiary views on the following aspects of service received from fund managers, percentage (%) of respondents

Source: Hatch/Beaufort Research Beneficiary Survey (n=129)

6.26 Overall, 64% of respondents said the service offered by the Funds could be improved. Grant recipients were the most likely to suggest that improvements could be made (76%) followed by equity (63%) and loan (55%) recipients, with a disparity noted between GLF/GFF beneficiaries (62%) relative to SBLF ones (51%).

6.27 A range of suggestions for improvement were identified. More follow-up after the funds were received was the most often cited one (14% of respondents) but was predominantly driven by SBLF beneficiaries, followed by a smaller number of grant recipients.

6.28 More than a tenth (12%) of respondents indicated that they would like to see better interest rates/cheaper finance. Unsurprisingly, loan recipients were more likely than equity investees to raise this point (28% vs 5%). Notably, GLF/GFF beneficiaries proposed this suggestion more often than SBLF ones (46% vs 16%).

6.29 More support, guidance and advice was also a suggestion proposed by more than a tenth (12%) of respondents. Grant recipients were relatively more likely to suggest this improvement (19%), which is in line with previous observations.

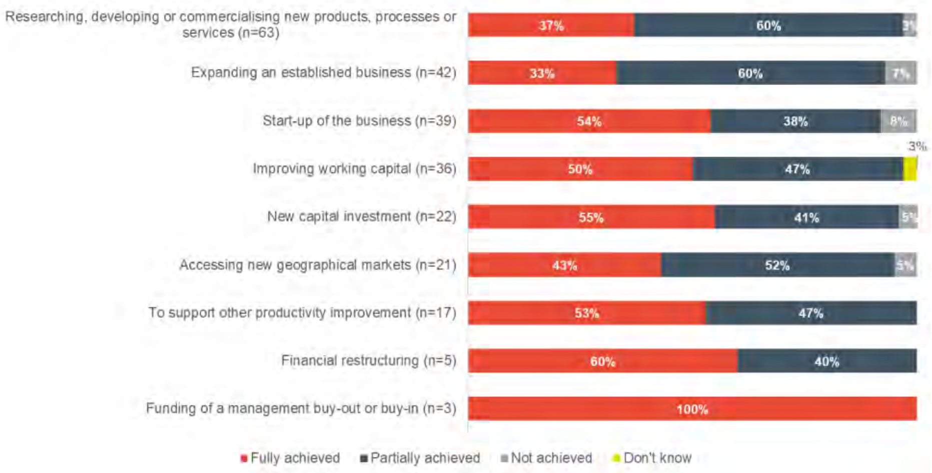
Business outcomes

6.30 Overall, beneficiaries indicated that they have made progress in achieving their objectives. Focusing on the leading motivations for seeking finance from Invest NI, although the majority of beneficiaries reported that progress has been made in achieving innovation and business growth related objectives (97% and 93% of respondents respectively), they predominantly reported only <u>partially</u> achieving these objectives (60% in both cases). Similarly, over nine tenths

[81] Kernel scored less well in this regard compared to the other equity funds, although there is a need for caution due to small sample sizes.

(92%) of respondents that sought finance for starting-up their business indicated that they achieved their goal to an extent, but more than half (54%) report that this objective was fully achieved.

Figure 6.13 Extent to which objective has been achieved, percentage (%) of respondents



Source: Hatch/Beaufort Research Beneficiary Survey (n=129)

Case Studies

6.31 The case studies shown in Figures 6.14 to 6.21 provide insights into the impact of Invest NI Loan and Equity Solutions for individual beneficiaries. The businesses consulted with were chosen based on having benefited from the funding and from a range of sectors and funding types received to explore the mechanisms through which support was effective for different types of businesses.

6.32 The beneficiaries have highlighted that investment combined with wider business support from the fund managers or Invest NI has helped them to launch or grow their business, often through supporting their innovation and product development objectives. Businesses expect sustained turnover and employment growth, including through expanding into overseas markets in several cases. The beneficiaries also recognised that the financial support received has enabled them to pursue follow-on funding.

6.33 Generally, the beneficiaries have not identified major limitations or challenges to the offer and instead indicated that it has helped them to overcome obstacles in the marketplace, such as the informational burden associated with fund raising and the Covid-19 pandemic. However, some consultees have indicated that further pre-application support and guidance could be beneficial especially for business seeking finance for the first time.

Figure 6.14 Case Study 1

Neurovalens Limited (R&D intensive medical devices company)

Area: Belfast
Sector: MedTech
Type of Funding Received: £800k of Co-Fund II investment raised across two fundraising rounds securing £9m of wider investment, including institutional, business angel, TechStart, BBB Angel Fund and BBB Future Fund investments

- **Apr 2013** – Business Registered
- **By 2015** – Business Launched
- **Jan 2019** – Co-Fund II Investment
- **Jul 2020** – Co-Fund II Follow-on Investment
- **By early 2021** – 2 Clinical Trials completed

Expecting first FDA approval within the next two years

Follow-on investment could be pursued as the business is expanding into new areas of medical market research sooner than anticipated

How the business heard about Invest NI funding: Neurovalens is a Belfast based business with an international outlook. It sought Invest NI investment to finance clinical studies in the US, aiming to gain FDA approval for medical devices targeting metabolic diseases. The business was not initially expecting to receive wider business support.

Benefits

- The initial round of funding enabled R&D on metabolic diseases. Realising there was scope to expand into R&D on type II diabetes, a second round of funding was secured.
- Aimed to conduct 3 to 4 clinical studies in the US. Two clinical studies were completed ahead of targets.
- Ongoing wider business support is provided by board observer through regular meetings.
- Wider business support is beneficial in terms of strategic planning, medical market and regulatory environment awareness, identifying and hiring local talent and identifying future sources of funding.
- The team grew from 12 to 17 staff with this funding.

Limitations/ Challenges

- In response to Covid-19 limitations, the business was able to pause recruitment for the third trial, and in collaboration with the FDA, restarted recruitment remotely. Completion of this trial is expected later this year.
- The funding secured provided a safety net against Covid-19 related uncertainty.

Future ambitions

- Rapid business growth, with first FDA approval expected in the coming year.
- The business is expanding into new areas of medical market research, with clinical trials into areas such as anxiety, insomnia and PTSD expected to start in the foreseeable future both locally and in the US. Seeking multiple FDA approvals puts the business on a stronger footing.
- The business hopes to be in a position to seek follow-on growth capital investment from Invest NI in around a year's time.

"Overall, Neurovalens' experience was very positive. The additional funding allowed us to expand much more rapidly into other areas of research."

Source: Hatch, December 2021

Figure 6.15 Case Study 2

RE-KKUR (NI) Ltd (manufacturer of building products using post-industrial recycled uPVC)

Area: Fermanagh and Omagh
Sector: Manufacture of builders' ware of plastic
Type of Funding Received: £775,000 of Growth Loan Fund investment, raised across two tranches of Growth Loan Fund I investment (£225) and two tranches of Growth Loan Fund II investment (£550,000)

- **June 2012** – Business Created
- **Jan 2015** – GLF I Investment
- **Nov 2016** – GLF I Follow-on Investment
- **Oct 2019** – GLF II Investment
- **Mar 2021** – GLF II Follow-on Investment
- **Today** – Turnover & EBITDA more than double

£0.5m-£1m in revenue over next 12 months from the purchase of polymer processing equipment

Expect sustained turnover and employment growth over the next few years

How the business heard about Invest NI funding: the business was receiving wider business support from Invest NI before seeking finance from the Growth Loan Fund. The business has the potential to scale-up globally and needed investment to fund its business growth, including by expanding its workforce and manufacturing team.

Benefits

- Polymer processing equipment purchased with GLF II investment
- Follow-on business support from Invest NI, including through the Accelerator programme (marketing, R&D support, skills & jobs support)
- Capital investment combined with relevant technical advice enabled the development of innovative raw material (recycled uPVC), which would not have otherwise been possible
- Experienced strong turnover and employment growth, fully attributable to Invest NI support

Limitations/ Challenges

- Provision of additional capital expenditure support through extending the range of grant support categories available would be a welcome future development
- In terms of wider business support, additional business financial planning support and guidance on providing relevant information for grant support applications would have been beneficial

Future ambitions

- £0.5-1m of additional revenue expected over the next 12 months from the new polymer processing equipment
- Recycled uPVC responds to the need for sustainable construction materials, insulating the business from structural shifts in the industry
- Scope for growth by marketing/selling recycled uPVC to other UK and EU companies
- The business expects sustained turnover and employment growth over the next few years

"Invest NI provided a wide range of financial and non-financial support to RE-KKUR. The scale of growth the company has seen over the last seven years would not have been achieved otherwise."

Source: Hatch, December 2021

Figure 6.16 Case Study 3

RESPONSIBLE Circular economy streetwear service

Area: Belfast
Sector: Technology and Logistics
Type of Funding Received: £35k POC grant from Techstart; £250k equity investment from Techstart. Has since reached a seed round with an advanced subscription agreement with Techstart for £300k

November 2020	December 2020	July 2021	September 2021	*Complete seed round of investment, acquire customers and brand partners, grow revenues and carbon emission savings*
Business created	Techstart POC grant and equity investment received	Validated the business concept	Fully established leadership team	

How the business heard about Invest NI funding: was aware of Techstart and got in touch about a proof of concept grant to enable validation of the business concept. The fund manager then recommended the option to capitalize the business with Techstart equity funding. The purpose of the funding was to launch the business, grow the employee base, attract top brand partners and establish the leadership team.

Benefits

- The investments allowed the business to start up by validating the business concept and then to grow by making connection with partner organisations and successfully hiring staff.
- Within just one year, the business has proven its concept, launched its services, hired 23 employees and established a full leadership team. Techstart funding has enabled this by providing funding accessible via a funding application which meets the needs of start up businesses.
- The business has benefitted from its involvement in the community of Techstart beneficiaries which provides peer support and advice. This group includes businesses supported by Techstart Ventures outside of the Techstart fund.

Limitations/ Challenges

- There were no limitations or challenges to the offer.
- Often the process for gaining support as a start up can require more information than a start up could be expected to provide, however the consultee described the Techstart support as 'completely seamless and professional'.

Future ambitions

- Currently closing the seed round of funding, the business plan is to continue to acquire customers and brand partners, grow revenues and deliver carbon emission savings.
- The Techstart fund manager remains as an observer on the company board, and it is anticipated this arrangement will continue to bring advice and connections.
- There is a possible role for Invest NI in providing further finance or co-investment and technical guidance.

"The funding has enabled the business to start up and grow. The service Techstart provided is well suited to start ups and offers fair and effective terms. "

Source: Hatch, December 2021

Figure 6.17 Case Study 4

FUSION (Research organisation providing antibody engineering services for drug development)

Area: Belfast
Sector: Lifesciences
Type of Funding Received: £350k Co-Fund equity investment, £300k Crescent equity investment

Nov 2000	May 2012	Jan 2013	Oct 2014	Dec 2017	Oct 2021
Business Created	£90k Co-Fund investment	£193k Co-Fund investment	£65k Co-Fund investment	£300k Crescent III investment & listing as a public company	Recruited 55 employees drawing on local and national talent & signed $1.3m contract with a key client

How the business heard about Invest NI funding: Had a long standing relationship with Invest NI having previously received grant funding. At the time of seeking Crescent III investment, they were seeking to expand the company, improve lab facilities, invest in further R&D and develop new in-house services.

Benefits
- A fund manager of Crescent Capital is a valued member of the company board by challenging decisions and providing business experience and reputation. They have been instrumental in refinancing and developing the business plan.
- Crescent Capital supported the company through the challenge of listing as a public company by advising on the costs/benefits and compliance requirements. This is a rare experience for a NI company, so it would have been difficult to get this advice elsewhere.
- A critical aspect of the Crescent III investment was its large value which allowed the company to invest in a large, globally competitive technological development and see it through to market.

Limitations/ Challenges
- The funding was fit for purpose and there were no limitations encountered with the INI funding offer.
- The sector is still wary of a Belfast based R&D company, however listing as a public company has helped to reassure investors and clients of the strength of the company.

Future ambitions
- The company will launch a new globally competitive technology and is seeking to grow its market share and global visibility.
- Having strongly invested in R&D the company is expecting to generate profit in the medium term and will continue to seek advice and network introductions from Crescent Capital.

"We couldn't have achieved the growth we have without the support. Invest NI provided keystone funding which we have been able to raise other funds around, and the knowledge and experience of Crescent Capital and Clarendon was essential to the growth of the company."

Source: Hatch, December 2021

Figure 6.18 Case Study 5

Humain **Creator of 3D character assets for video game developers**

Area: Belfast
Sector: Creative industries
Type of Funding Received: £450k of Crescent equity investment and £320k of Techstart and University of Ulster investment.

Jun 2016	Aug 2017	Oct 2021	*Supply high quality character assets & continue to attract major entertainment technology companies*
Business Created	Started trading and received a round of £770k including £450k Crescent funding	Team reached 30 employees	

How the business heard about Invest NI funding: They first heard of Crescent funding through contacts at Catalyst (formally NI Science Park). Having struggled to gain seed funding for over a year, the business owner attended an introductory meeting with Crescent Capital. They were hoping this would lead to Series A funding in the future, however Crescent Capital encouraged them to apply for Crescent funding at the Seed stage.

Benefits
- The business owner used the funding as planned to build the team and develop the product.
- The funding also boosted the company's credibility in the market.
- The funding was integral to the development of the company.
- Through this the company has been able to attract new and significant customers and grow revenue sales.
- Crescent Capital also helped to develop the Executive Team by recommending a contact who has provided expert guidance to the board.
- Business adviser introductions have also been highly valued.

Limitations/ Challenges
- During their Seed Round, the business owner felt it was important to have a diverse set of opinions at board level from two different funders; TechstartNI, whom they had an existing relationship with as well as Crescent. Having multiple funders complicated and therefore extended the deal making process.

Future ambitions
- The aim is for the company to supply the best character assets to the top entertainment technology companies in the world, and to continue attract major entertainment technology companies to work in Northern Ireland.
- They are currently in conversation with customers about large scale contracts.
- The company may require further funding from Invest NI funds but this will depend on the availability of funding elsewhere and balance the need to retain equity share for any future investors.

"Without Invest NI funding the company would have struggled to get up and running. We certainly would not have achieved the level and growth and impact we are having without the Crescent and TechstartNI funding."

Source: Hatch, January 2022

Figure 6.19 Case Study 6

Cirdan Medical device imaging company

Area: Lisburn
Sector: Healthcare
Type of Funding Received: £1.5m Growth Finance Fund investment received in 2019.

May 2010 – Business Created
Jun 2019 – 1st tranche of Growth Finance Fund loan received
Dec 2019 – 2nd tranche of Growth Finance Fund loan received
Jun 2020 – Additional 30 employees in team & 12% revenue growth
Seek further funding, grow revenue, and become IPO ready

How the business heard about Invest NI funding: The company originally sought R&D grants and innovation vouchers from Invest NI. Then when they were looking for investment to expand the business discovered the Growth Finance Fund as a means of gaining greater investment amounts without the bureaucracy costs of R&D grants and innovation vouchers.

Benefits
- The Growth Finance Fund investment allowed the company to further develop their product and invest in additional employees, which in turn enabled them to win new business.
- The Funding Manager was diligent in supporting the business ambitions.
- The funding is well thought out and straightforward to access.

Limitations/ Challenges
- There were no limitations or challenges encountered.

Future ambitions
- The company will need significant new funding as it continues to grow, Invest NI funding options will be considered.
- If market conditions allow, in 2023 the company aims to be IPO ready.
- Within 5 years the company is aiming to reach revenue of £75m.

"David McCurley and the team at WhiteRock have been a pleasure to work with, they are open, honest, and flexible in their approach to making this type of financing accessible to more companies like Cirdan who are ambitious and have identified clear opportunities for significant growth."

Source: Hatch, January 2022 Cirdan has also received £3m equity funding from Kernel and c£1.5m from Co-Fund.

Figure 6.20 Case Study 7

Datactics (software technology business offering enterprise data management services)

Area: Belfast
Sector: Computer software & services
Type of Funding Received: £897k of Kernel investment raised across three fundraising rounds securing £3.7m of wider investment; £897k of Co-Fund I investment raised across nine fundraising rounds securing £6.4m of wider investment

Sep 1999 – Business Created
Sep 2012 to Apr 2018 – Earlier Co-Fund I investment received
Apr 2018 – £249k Kernel investment received
Apr 2019 – £271k Kernel investment received
Mar 2020 – £157k Co-Fund I investment received
Mar 2021 – £377k Kernel investment received
30 new employees over 36 months
Expect 60%-70% year-on year turnover growth over the next two years

How the business heard about Invest NI funding: Datactics had a long-standing relationship with Invest NI prior to seeking investment from the Kernel Development Fund. The business was going through a growth phase and needed equity capital to fund its expansion.

Benefits
- The investment enabled the team to grow from 30 to 60 members over the last 36 months, of whom 20 were hired over the last 12 months
- New hires included senior sales representative, business development personnel and technologists
- Experienced significant growth in sales pipeline opportunities
- The FM provided advice through a board nominee and additional support was received from Invest NI (marketing, research in software R&D, sponsorship for market events)

Limitations/ Challenges
- Although there were no limitations or challenges to the offer, it would have been helpful to have access to client networks in the Republic of Ireland as part of the wider support.

Future ambitions
- Continue growing the sales pipeline to achieved sustained turnover growth
- £2.5m revenue achieved in the most recent financial year, expected to grow to £4.3m next year and £7m in two years time

"The Invest NI investors were knowledgeable and made the funding process straightforward."

Source: Hatch, January 2022

Figure 6.21 Case Study 8

Clogher Valley Precision (manufacturer of components for a range of industries)

Area: Fermanagh & Omagh
Sector: Other manufacturing n.e.c.
Type of Funding Received: £50k SBLFII debt investment, which leveraged an additional £43k from the Rural Development Programme

July 2004	December 2018	June 2018
Business Created	£50k SBLFII investment received	Additional employee hired

The purchase of new machinery means long-term productivity, turnover and profitability gains for the company.

How the business heard about Invest NI funding: Clogher Valley Precision's first engagement with Invest NI dates to the time the company was set up, around 2006. The business sought investment to finance the purchase of new automated machinery.

Benefits
- The purchase of new machinery has increased productivity and has led to the addition of a new team member.
- In addition to increasing production capacity, the new machinery ensures production continuity in the case of breakdown (as no spare equipment was previously available).
- The business gained exposure by engaging in an SBLF promotional video.
- The business' loan repayment is recycled back to the fund, thus representing a re-investment into one's community.

Limitations/ Challenges
- No limitations or challenges to obtaining the funding, as everything was smooth and professional.
- Better promotion of the availability of SBLF finance to reach a wider base of businesses.

Future ambitions
- The new machinery has a life-span of about 10 years. Thus, it will generate sustained productivity, turnover and profitability gains for the business.
- The business does not currently require any additional funding. However, it will not hesitate to contact Invest NI if investment is needed in the future, as a result of its positive experience with the SBLF.

"The SBLF was very professional in their approach to dealing with Clogher Valley Precision and I would have no hesitation of recommending them to any other small rural business, like mine."

Source: Hatch, January 2022

Key Findings

Although Invest NI supported businesses operate in an array of sectors, almost a third of survey respondents came from the information & communications sector. Beneficiaries tended to be younger companies and to have a senior management that was all male at the time the company was founded. The majority of respondents received debt finance (45%), followed by grants (32%) and equity investment (27%). However, equity accounts for 64% of the total investment received by respondents, followed by loans (33%) and grants (3%). Over three fifths (62%) of beneficiaries received Invest NI investment as part of a larger financial or investment package, but this was more likely for equity beneficiaries. Loan and equity recipients were more likely to have also obtained Covid-19 financial support.

In terms of their views on access to finance in Northern Ireland, over four fifths (84%) of respondents reported that publicly supported finance provision in Northern Ireland is necessary as they believe there is insufficient supply, most notably with respect to debt finance provision including start-up and small business loans. Early stage and expansion equity finance was also perceived to be insufficient, with views on the reasonableness of the cost of the available finance more divided on balance.

The Chamber of Commerce and Northern Ireland HEIs were common routes to the funds, with lender or financial intermediary referrals also being particularly popular among equity and loan recipients whilst grant beneficiaries were more likely to be referred to Invest NI by a friend or family member. The most common motivations for seeking finance from Invest NI funds included innovating (49%), expanding an existing business (33%) or funding a business start-up (30%). However, their relative importance varies across different finance types, reflecting their relative appropriateness for funding different types of business activities. Loan recipients were most often motivated by business growth related objectives, while equity and grant recipients were more likely to pursue finance for innovation purposes.

Overall, respondents indicated that they have made progress in achieving their objectives. Focusing on their primary objectives, over nine tenths of beneficiaries reported that at least some progress has been made in achieving their innovation (97%), business growth (93%) or business start-up (92%) objectives. However, beneficiaries are more likely to have partially achieved the former two (60% in both cases), whereas more than half (54%) report that their business start-up objective was fully achieved.

Pre-application support was received by over two fifths (43%) of beneficiaries and was most likely among the SBLF and Co-Fund/Crescent/Kernel beneficiary groups. Overall, respondents thought this support was helpful, with a small minority of equity finance beneficiaries reporting otherwise. Follow-on support was received by almost three quarters (74%) of beneficiaries, with heavier concentrations seen within the equity and GLF/GFF beneficiary groups. There were common popular forms of assistance accessed by beneficiaries across finance types, most prominent being invitations to events and seminars. Loan and equity beneficiaries also accessed some forms of assistance more specific to their needs. Equity and loan beneficiaries deemed the range of follow-on support provided sufficient, but this is less true of grant beneficiaries where more than half (51%) of which would be interested in other follow-on support.

Asked about their experiences with different aspects of Invest NI support, over four fifths of respondents rated very or fairly good the knowledge and professionalism of staff (88%), the overall quality of service (84%) and the speed and efficiency of administration (84%). However, equity recipients were relatively less satisfied with respect to the latter two than the average (77% vs 84% for both), which may reflect the greater complexity and specialist nature of equity investing.

Although over half (57%) of beneficiaries were satisfied with follow-on support, a relatively high share (18%) appeared dissatisfied. In line with views on the range of support provided, grant finance recipients were more likely to rate this aspect of the service very or fairly poor (24%). A similar pattern was observed for assistance in putting together a financial package, but dissatisfaction with this aspect of the service varied widely across fund streams. The range and flexibility of the types of finance available was also rated relatively poorly, as only 43% of respondents appeared satisfied. The availability of follow-on assistance was seen as poor by a very small minority of Techstart equity beneficiaries (5%) compared to a much bigger minority for POC grant (20%) and Co-fund/Crescent/Kernel (22%) beneficiaries (Kernel was perceived less positively amongst these equity funds).

7. Assessment of Economic Impact

7.1 This section provides a summary of the gross and net additional economic impacts that Invest Northern Ireland Loan and Equity Solutions has provided to date. The assessment draws on evidence from the fund managers own monitoring of the change in business performance post investment, a survey of investee businesses and counterfactual impact analysis.

Survey Impact Evidence

7.2 This section sets out the impact estimates which have been calculated on the basis of evidence gathered through the survey of investee businesses undertaken in September and October 2021. The purpose of the survey was to capture data on the characteristics of investees, their motivation for seeking finance from Invest NI, the views of investees on the service received and the impacts of the finance on their business. A copy of the questionnaire is provided in Appendix C. In total, 129 interviews were undertaken, a response rate of 28% (±7% margin of error at the 95% confidence level).

Limitations of the Survey Analysis

7.3 The impact and value for money estimates are based on self-reported perceptions of firms on how the support is enabling them to grow their business. It is important to recognise there are a range of limitations in undertaking an assessment of this nature to consider when reviewing the findings of this assessment.

Challenges in Self- Reporting Survey Approaches

7.4 Given that the impact estimates are based on self-reported perceptions of the firms, a key limitation is around businesses' willingness to provide the information required for economic impact modelling. For example, businesses can be sensitive about revealing information on company turnover.

7.5 To reduce this risk, the survey asks businesses to estimate turnover either through a best approximation or within given ranges, which tends to increase the response rate. With less specific information on turnover pre- and post-support however, simplifying assumptions have to be used to estimate gross turnover change, which weakens the quality of the data.

7.6 A second related limitation is that in order to model factors such as deadweight and displacement, beneficiaries are asked a series of questions which require the businesses to consider a hypothetical situation or seek indirect rather than direct evidence about these factors such as what they believe would have happened had the support not been available. There are inherent difficulties that businesses will face in attempting to answer such questions, which again affect the quality of the data.

Timing of the analysis

7.7 The survey asked businesses about the business benefits they expected to achieve over a three year period post investment and then the extent to which they have achieved this in practice. Due to the timing of the investments, many of the businesses surveyed may still be within this three year period. In this instance, they are asked about their expectations of achieving their initial benefits ambitions.

7.8 It is also important to note that the survey was undertaken in September and October 2021, a time when beneficiaries are still navigating the impacts of the Covid-19 pandemic. Over the past 20 months, a large proportion of businesses would have been experiencing interruptions to normal business, difficult trading conditions, potential disruptions to their supply chains, potentially have had employees on furlough etc. These effects are likely to have impacted the reported uplift in turnover and employment of the businesses surveyed.

Confidence intervals

7.9 In grossing up the data in the survey sample to all beneficiaries supported, we make the assumption that the information provided by the sample beneficiaries is representative of information that would be provided by the broader population. Analysis of the survey sample relative to the whole client base provided in Table 7.1 - this concludes that the survey sample is reasonably representative of the whole client base in terms of business characteristics.

Table 7.1 Confidence intervals

Indicator	Sample size	Grossing up level	Population size	Confidence Interval
Turnover/GVA	79	Grossed up by factor of finance received to 31st March 2021	457	+/-10%
Employment	76	Grossed up by factor of finance received to 31st March 2021	457	+/-10%

7.10 At the 95% confidence level, these findings suggest that any data generated by the survey could be 10% higher or lower for the population as a whole than was found in the survey sample. Given that several pieces of information from the survey are used together in the modelling, this uncertainty is further increased. Again, this points to the important caveat outlined above that the impact assessment figures presented should only be considered as indicative.

Impacts on Business Performance

7.11 Survey respondents were asked to report the change in business performance they expected, at the time of receiving finance, as a result of the investment. This was reported in terms of absolute and percentage change in the value of annual turnover and employment numbers. They were then asked what proportion of this change has since been realised and what would have happened without the investment from Invest NI. This data has provided the basis for an assessment of the total gross impacts and net impacts allowing for their deadweight and displacement of the investments made.

7.12 While the evidence from the telephone survey is the most accessible and practical means of gathering data about the current and expected impact of finance on business performance, there are some limitations to using this survey data. These include the size of the sample, its representativeness and the accuracy of the data:

- Sample size: the survey achieved a sample of 129 interviews from estimated 457 beneficiary businesses (28%) which received investment between April 2017 and March 2021.
- Sample representativeness: Although the sample was broadly representative of the population, it has proven difficult to achieve proportional representation for certain investment types and fund streams. For example, SBLF loans were made to 48% of the

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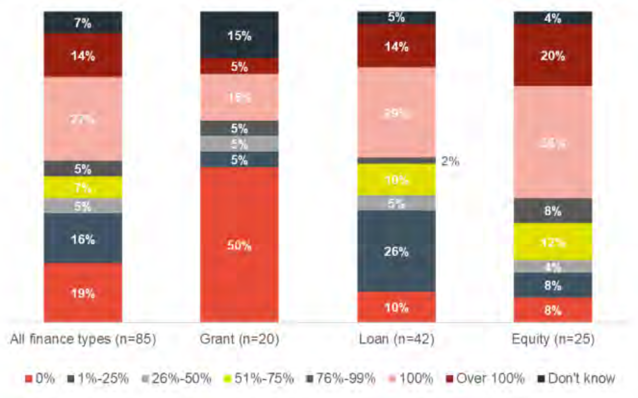
population of beneficiaries over the period considered but these businesses make up 29% of the sample.

- Accuracy and reliability of the data: the analysis of economic impact in this chapter is dependent on the accuracy and reliability of the impacts reported by investees to the survey. Sense checks have been applied to the data to identify and exclude any outlier results where we have reason to suspect that the impacts reported could be erroneous. It is not however possible to systematically allow for optimism or pessimism bias for investees' responses on questions of impact.

Gross impacts realised to date

7.13 Overall, 19% of the respondents reported that none of their expected turnover change was achieved, but a large disparity was noted between grant beneficiaries (50%) relative to equity (8%) and loans (10%) beneficiaries. Equity recipients were the most likely to have fully realised (36% vs 27% average) or exceeded (20% vs 14% average) their expected change in turnover. Although the share of loan recipients reporting that the expected turnover change was fully realised was above average (29%), most loan recipients have partially achieved the turnover change they expected (43% vs 33% average). A distinction was noted among recipients of SBLF and GLF/GFF debt finance. The former were more likely to report that the expected turnover change has not materialised (15% for SBLF vs 0% for GLF/GFF), whilst a notably higher share of GLF/GFF beneficiaries had fully achieved their expected turnover change (47% vs 19% for SBLF).

Figure 7.1 Expected turnover change achieved to date



Source: Hatch/Beaufort Research Beneficiary Survey

7.14 Beneficiaries were more likely to have achieved the change in employment they expected, which reflects the time lag in turnover impact realisation. Slightly over three fifths (61%) of beneficiaries realised 100% or more of their expected employment change, whilst 15% reported that none of the expected change was achieved. The variations observed across finance types and fund streams were similar to the patterns observed for the uplift in turnover achieved to date.

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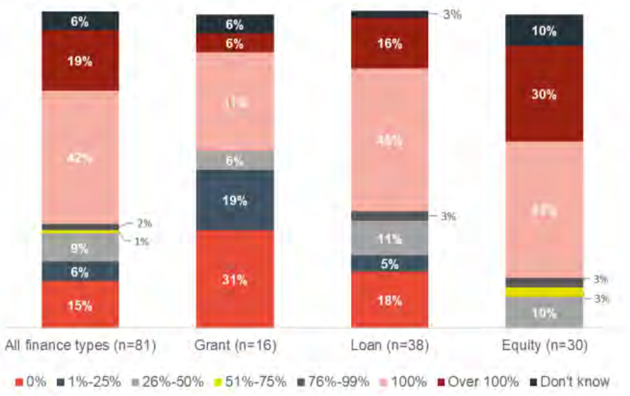
Figure 7.2 Expected employment change achieved to date



Source: Hatch/Beaufort Research Beneficiary Survey

7.15 Respondents indicate that at the time of receiving the finance they expected an aggregated annual turnover uplift of £96 million and employment increase of 797, as a result of the investment facilitated by Invest NI. Based on responses to questions about expectations of business impacts and the impacts to date, we estimate that at the aggregate level the survey beneficiaries have achieved £42 million or 43% of the expected annual uplift in turnover and 587 jobs or 74% of the increase in employment.

7.16 We can estimate gross cumulative GVA and employment impacts realised to date amongst all businesses which received finance between 2012 and March 2021 by scaling up the survey findings based on the comparative value of finance received. Table 7.2 summarises the realised gross cumulative GVA and employment impacts by finance type. It should be noted that the analysis is sensitive to the assumption used to convert turnover to GVA. Thus, this impact should be seen as providing an indicative order of magnitude.

7.17 This analysis suggests a **gross uplift in cumulative GVA[82] of £508.4m and a gross employment uplift of 5,000 jobs** across the population of businesses receiving finance between April 2012 and March 2021. The gross cumulative impact realised to March 2021 ranges from £24.5m for grants to £311.5m for loans and the gross employment impact ranges from 200 jobs for grants to 3,700 for loans.

Table 7.2 Realised gross cumulative GVA and employment impacts by finance type, March 2021 (for all finance provided during 2012 and March 2021)

	All	Grant	Loans	Equity
Cumulative GVA (£m)	£508.4	£24.5	£311.5	£172.4
Employment (Jobs)	5,000	200	3,700	1,100

Source: Hatch analysis based on Hatch/Beaufort Beneficiary Survey. Note: Cumulative GVA impacts are rounded to the nearest 100,000 and employment impacts are rounded to the nearest 100.

7.18 Table 7.3 provides an indication of the distribution of realised gross cumulative GVA and employment impacts by fund by considering the total amount of investment that has taken place across funds up to March 2021.

[82] Cumulative GVA impacts refer to the aggregate of annual GVA impacts over beneficiaries' realisation period. A linear growth path over the realisation period has been assumed.

Table 7.3 Realised gross cumulative GVA and employment impacts by fund stream, March 2021 (for all finance provided during 2012 and March 2021)

	Cumulative GVA (£m)	Employment (Jobs)
SBLF	£40.6	500
GLF	£217.8	2,600
GFF	£53.2	600
Crescent	£37.5	200
Kernel	£30.7	200
Techstart (Equity)	£44.0	300
Co-Fund	£60.2	400
Techstart (POC)	£24.5	200

Source: Hatch analysis based on Hatch/Beaufort Beneficiary Survey. Note: Cumulative GVA impacts are rounded to the nearest 100,000 and employment impacts are rounded to the nearest 100. Figures may not add up due to rounding.

Net impacts realised to date

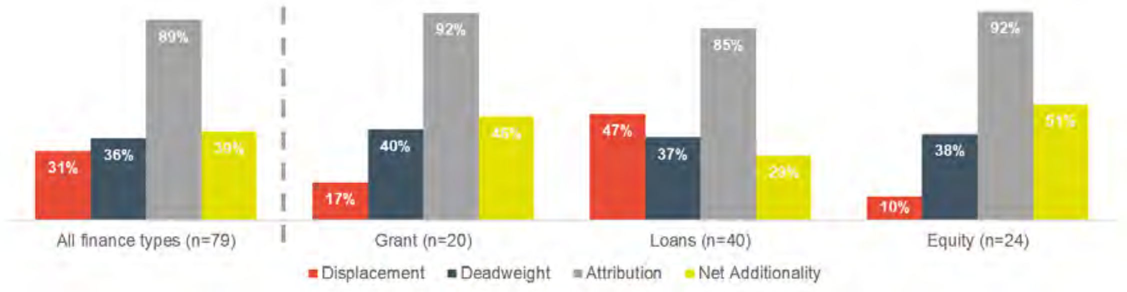
7.19 Additionality adjustments to account for attribution, deadweight and displacement were applied to gross impacts where possible. The additionality factors rely on the businesses' own perceptions which they are asked about in the survey.

- **Attribution:** assess the importance of Invest NI investment in achieving the expected change in turnover and employment.
- **Deadweight:** to account for changes in business performance that beneficiaries would have realised anyway without the Invest NI investment.

  Displacement: the extent to which growth in the beneficiaries is likely to have occurred at the expense of other businesses in Northern Ireland.
- The assessment takes account of a three year period post investment over which the surveyed businesses expected to secure their bottom-line impacts and allows for the build-up of these based on their actual experience to date. In the case of the estimation of GVA, the assessment does not allow for the persistence and decay of this impact beyond this three year period. The reason for this is that there is insufficient information about the manner in which the impacts persist to allow estimation and hence the impact calculation should be considered a conservative estimate. The true impact is likely to be higher than this.

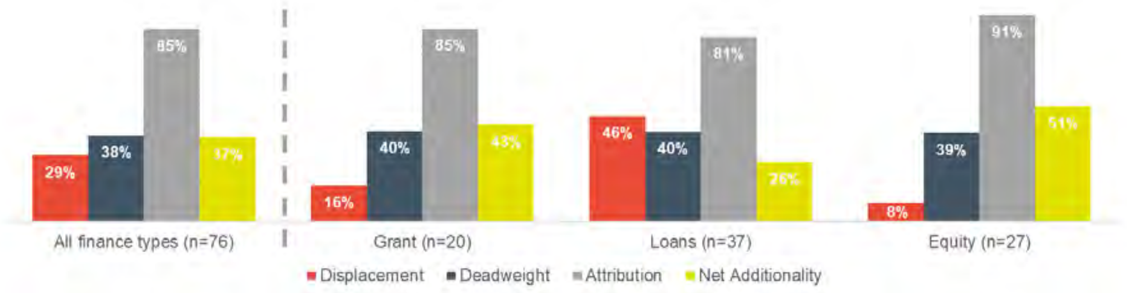
7.20 Figure 7.3 and Figure 7.4 show the mean attribution, deadweight and displacement observed from GVA and employment impact calculations. These in combination determine the overall additionality factors.

Figure 7.3 Additionality factors in GVA impact estimations, mean percentage (%)



Source: Hatch/Beaufort Research Beneficiary Survey

Figure 7.4 Additionality factors in employment impact estimations, mean percentage (%)



Source: Hatch/Beaufort Research Beneficiary Survey

7.21 Table 7.4 summarises the expected and realised net cumulative GVA and employment impacts by finance type. Once additionality adjustments are taken into account, **the net cumulative GVA uplift is £198.7m and the employment uplift is 2,200 jobs** across the population of businesses receiving finance up to March 2021. The net cumulative impact realised to March 2021 ranges from £11.8m for grants to £116.7m for loans and the net employment impact ranges from 100 jobs for grants to 1,600 jobs for loans.

Table 7.4 Realised net cumulative GVA and employment impacts by finance type, March 2021 (for all finance provided between 2012 and March 2021)

	All	Grant	Loans	Equity
Cumulative GVA (£m)	£198.7m	£11.8m	£116.7m	£70.3m
Employment (Jobs)	2,200	100	1,600	500

Source: Hatch analysis based on Hatch/Beaufort Beneficiary Survey. Note: Cumulative GVA impacts are rounded to the nearest 100,000 and employment impacts are rounded to the nearest 100.

Counterfactual Impact Evaluation Evidence

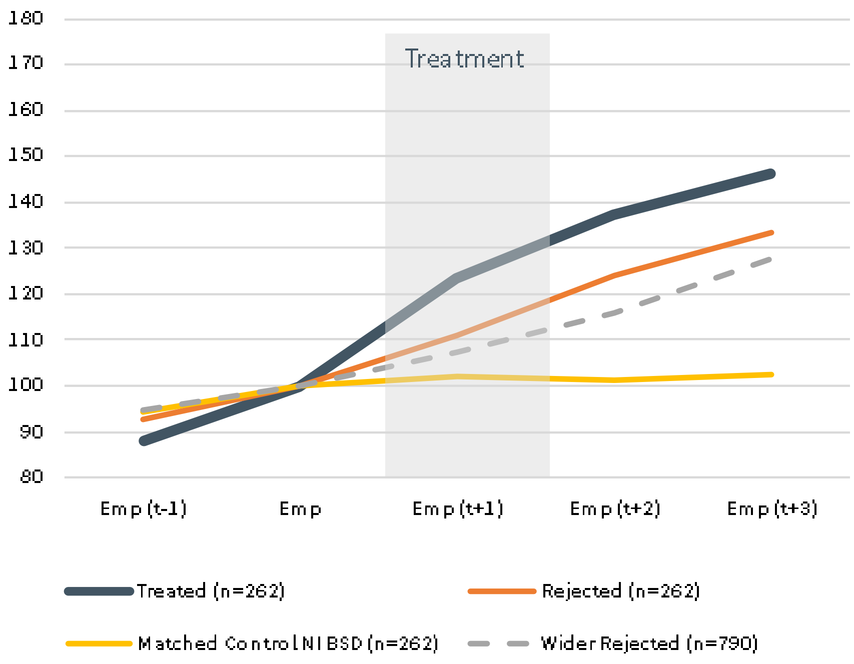
7.22 The counterfactual impact analysis (CIE) looks at firm-level employment and turnover impacts, focusing on businesses receiving finance through the Invest NI funds that are on ONS business registers. As well as understanding the performance of the businesses receiving this finance post investment, evidence about what would have happened without support is compiled by looking at comparable but unsupported businesses as a benchmark.

7.23 Businesses included in the CIE analysis were first supported in financial years from 2012 until the end of March 2021. These businesses have been linked to ONS firm-level data, called the Business Structures Database (BSD), where this was feasible. The annual BSD snapshots reflect employment and turnover during a financial year (April to March), centring on end September. This evaluation presents results for two periods of support: April 2012 to March 2021 and second short period from April 2015 to March 2021.

- The main findings from the analysis are summarised below (the fuller analysis is presented in Appendix C). For the shorter period there were 1,110 investments worth £96m across 843 businesses. Allowing for some businesses not being included in the ONS datasets (e.g. sole traders) and gaps in the data needed for this analysis, 262 businesses were included in the analysis. The comparable number for businesses included in the CIE analysis over the longer period was 345. Hence most of the businesses (~67%) receiving investment through the Invest NI funds were supported in the shorter of the two periods of analysis.
- Supported businesses which were matched to the ONS data differ from the wider business population: they tend to be larger in terms of size of employment and real turnover. They are also more focused in the high-tech and manufacturing sectors.
- Statistical matching is used to find businesses which did not received investment from the Invest NI funds but which are similar in characteristics to those which did. Matching is performed separately for the two different periods of support. The non-treatment group for the businesses receiving finance in the short period is based on businesses which applied for but did not receive investment from the funds[83]. For the longer period, it was not appropriate to use businesses which applied but did not receive finance as many had gone on to receive finance from the funds in a later period. Consequently, the matched group of non-treatment businesses were drawn from the Northern Ireland based wider BSD. In each, care is taken to incorporate appropriately the rejected applicants that subsequently received support.
- For the 262 matched supported businesses in the period 2015 to 2021, employment increased by 964 in the years after support. The CIE analysis indicated that 32% of the employment growth was additional in not being seen in the comparable businesses and therefore, this equates to an additional 309 jobs, an average of 1.2 jobs per enterprise. Estimates are statistically significant for some estimates.

[83] they may have been rejected, turned down on offer or withdraw from the application process.

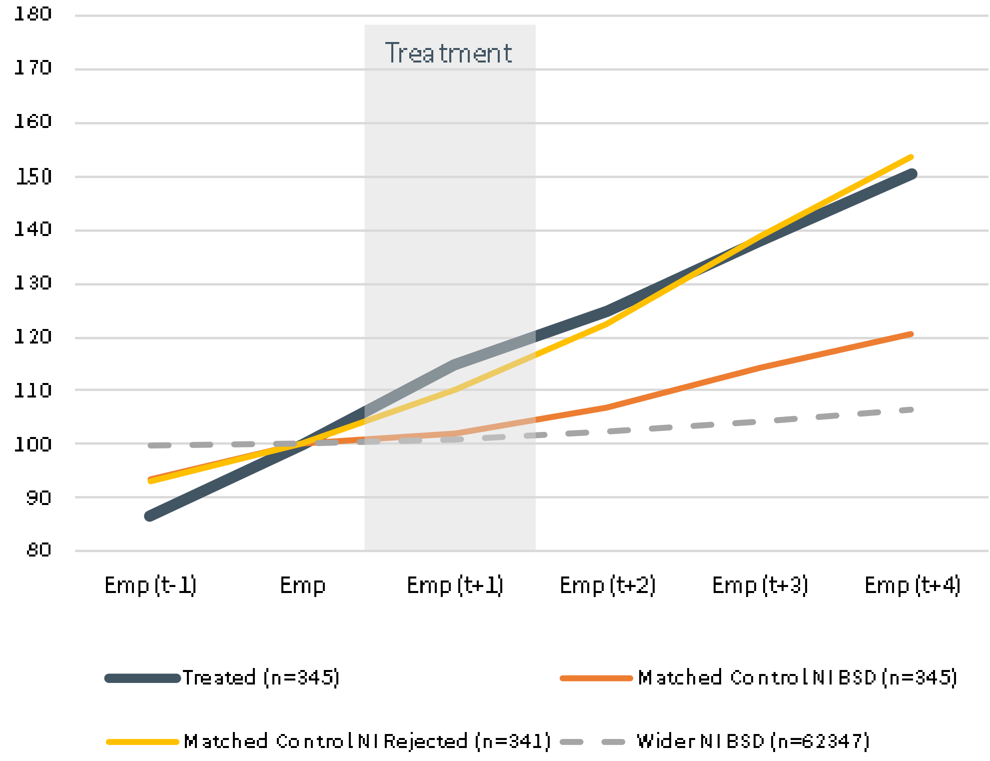
Table 7.5 Employment change after support, April 2015 to March 2021



Source: Analysis of BSD linked to INI beneficiaries and other datasets; Employment estimates with *t* before support then businesses are treated in a year-long financial year centring on *t+1*. Points *t* +2 and *t* +3, representing two and three years after the pre-support point; employment estimates centre on September in each year. At t+3, sample size has reduced to 167. Rejected applicants in this modelling were used in matching all cohorts of the supported businesses, hence sample sizes higher and businesses could be used more than once in the counterfactual.

- For the 345 matched businesses supported in the period 2012-2021, employment grew by 1,252 in the 6 years after support. The CIE analysis indicated that 751 (60%) of these jobs were additional, an average of 2 jobs per enterprise.

Table 7.6 Employment change after support, April 2012 to March 2021



Source: Analysis of BSD linked to INI beneficiaries and other datasets; Employment estimates with *t* before support then businesses are treated in a year-long financial year centring on *t+1*. Points *t* +2 and *t* +3, representing two and three years after the pre-support point; employment estimates centre on September in each year. At t+3, sample size has reduced to 260.

7.24 For both periods of support, INI beneficiaries also experienced growth in real turnover. For the shorter period of analysis, business turnover increased by £432.7m amongst the 262 supported businesses included in the CIE analysis. Using the average additionality estimate of 37%, this suggests additional turnover of £160m and a cumulative average per business of £611k over the post investment period. For the longer period of analysis, turnover grew by £601m for the 345 treated businesses over the years post support. Using the average additionality measure of 94%, total additional turnover is £565.6m and a cumulative average per beneficiary business of £1.6m over the period post investment for these businesses.

Comparison of Impact Estimates

7.25 The table below provides a comparison of the GVA and job creation impact estimates based on the investment up to March 2021 which have been drawn on different sources of evidence and methods of analysis. The basis of the calculations highlighting the different approaches, are summarised below.

Table 7.7 Methods of Calculating Economic impacts by Source

	Amount of Investment Covered	Method and Data	Period Covered
Invest NI A2F Strategy Targets	£212.26m	Based on economic appraisals, which have	2011 to Q1 2021

		tended to be based on previous Invest NI delivery experience and benchmarking against comparators	
Fund Monitoring Data	£180.8m	Data gathered from investees. Only includes GVA and jobs change over pre-investment baseline captured up to March 2021. GVA reported is the aggregate for the latest financial year available.	2011 up to March 2021, but dependent on latest monitoring point for business
Survey Analysis	Grossed up to £180.8m	Self-reported evidence gathered from investees by sample survey. Assesses GVA and jobs over 3 yr post - investment period. If period not complete, investees asked to estimate benefit over remainder of period. GVA is multi-annual increase over three year period	Survey covered businesses receiving finance between April 2017 and March 2021, but grossed up to amount invested between 2012 to March 2021
CIE Analysis	£67.2m	Only includes GVA and jobs change over baseline captured up to March 2020 (given availability of admin data). GVA is multi-annual additional change over whole period	Investment from 2012 to Q1 2021

7.26 Unsurprisingly given the lower investment levels to date, the gross and net jobs and GVA created estimates from the fund monitoring data and the survey-based analysis is less than the pro-rated targets from the A2F strategy. However, the survey based analysis has provided higher estimates of impact compared to the fund monitoring data (allowing for the two methods estimating gross and net impacts respectively), although it is important to note that the survey based approach includes an element of future business impact (i.e. if the businesses have not yet realised all of their expected business benefits over a three year post investment period). The CIE analysis has produced lower impact estimates although this is based only on businesses which could be matched in the ONS datasets. Allowing for differences in investment levels covered, it is broadly similar to the estimates derived from the survey analysis.

7.27 However, the underperformance noted for these estimates of impact compared to the A2F strategy pro-rated targets is more pronounced than the lower level of investment, especially in the case of net GVA generated. This is partially attributed to lags associated with the realisation of economic impacts post-investment, especially where GVA impacts are concerned. The impact of Covid-19 on business operations could also be among the factors that have hindered the creation of jobs and GVA over the recent years. It could also be due to different impact assessment methods used in the estimation of the targets compared to this evaluation.

Table 7.8 Comparison of Economic Impacts from Different Methods, March 2021

	Gross GVA £m	Net GVA £m	Gross Jobs	Net Jobs	Gross GVA/Job (£100k)	Net GVA/Job (£100k)
Invest NI A2F Strategy Targets		£364.65		3118.7		£0.12
Fund Monitoring Data (covering period from 2011 up to March 2021)	£146.73	N/A	3867*	N/A	£0.04	N/A
Survey Based Analysis	£508.4**	£198.7	5,000	2,200	£0.10	£0.09
CIE Analysis	£240.7	£90.8	1,252	751	£0.19	£0.12

Source: Hatch analysis; Note: * the estimate of gross jobs overstates the true figure due to the SBLF I jobs estimate provided by the fund manager being based on job years rather than actual FTE jobs; ** The survey analysis is based on £180.8m of investment with businesses from the funds, whilst the CIE analysis is based on £67.2m.

Value for Money Assessment

7.28 At this stage the value for money (VFM) assessment has only been estimated using the survey data. The estimates use two cost bases:

- Invest NI's capital contribution (totalling £112.5m) to the amount of investment businesses received up to March 2021 (totalling £180.8m), plus the operational costs of its Corporate Finance team (totalling £3.7m over the period) and fund management fees (totalling £30.68m)
- the base set out above less a best estimate of the future recycled monies associated with this investment (including FTC) up to March 2021 (£91m).

VFM Estimated Based on Survey Evidence

7.29 Simplified value for money estimates have been made for the GVA and employment created by the businesses in receipt of Invest NI finance to the end of March 2021, subject to the following caveats:

- The data is based on estimates made at the point in time when the survey was undertaken. There are likely to be lags in the rate at which turnover and employment increases are realised after investment.
- The outputs reported may also have been impacted by the Covid-19 crisis although it is not possible to confirm this based on the data available.
- Given that estimates of jobs created are based on beneficiary reported changes in employment numbers since receiving the investment, this method does not account for jobs safeguarded. Accounting for jobs safeguarded would increase the estimated impact.

7.30 The total gross GVA impact per £1 of gross public sector cost[84] to the end of March 2021 is estimated at £3.46, but the value reduces to £1.35 when attribution, deadweight and additionality are accounted for. The highest net GVA impact per £1 of gross public cost was achieved for grants (£2.52) followed by loans (£1.61) but falls to £1.01 for equity investment.

Table 7.9 GVA impact per £1 of gross public sector cost, March 2021 (for all finance provided during 2012 and March 2021)

	All	Grant	Loan	Equity
Gross Cumulative GVA per £1 of gross public sector cost	£3.46	£5.22	£4.31	£2.47
Net Cumulative GVA per £1 of gross public sector cost	£1.35	£2.52	£1.61	£1.01

Source: Hatch analysis based on Hatch/Beaufort Beneficiary Survey.

7.31 The gross public sector cost per gross job created to the end of March 2021 was £29,700 rising to £66,200 for every net job created. The gross public cost of creating net job was the lowest for grants (£44,800) followed by loans (£45,800) but rises substantially for equity investment (£131,100).

Table 7.10 Gross public sector cost per job creation, March 2021 (for all finance provided during 2012 and March 2021)

	All	Grant	Loan	Equity
Gross public sector cost per gross job created	£29,700	£24,400	£19,800	£63,600
Gross public sector cost per net job created	£66,200	£44,800	£45,800	£131,100

Source: Hatch analysis based on Hatch/Beaufort Beneficiary Survey. Note: Figures are rounded to the nearest 100.

7.32 Once future recycled monies (including Invest NI returns and FTC monies) are accounted for, the net GVA per £1 of net public sector cost[85] rises to an estimated £3.57, with a more pronounced increase seen for equity (309%) relative to loans (113%). The net GVA impact per £1 of net public sector cost for equity (£4.12) surpasses that for loans (£3.43) and grants (£2.52).

Table 7.11 GVA impact per £1 of net public sector cost, March 2021 (for all finance provided during 2012 and March 2021)

	All	Grant	Loan	Equity
Gross Cumulative GVA per £1 of net public sector cost	£9.12	£5.22	£9.16	£10.11
Net Cumulative GVA per £1 of net public sector cost	£3.57	£2.52	£3.43	£4.12

Source: Hatch analysis based on Hatch/Beaufort Beneficiary Survey.

7.33 Similarly, the net public sector cost per net job created falls to £25,100, with a higher fall observed for equity (76%) compared to loan (53%) investment. The net public sector cost of

[84] Gross public sector cost includes the grant contribution via Invest NI to SME investment, Invest NI Corporate Finance Team costs and Fund Manager fees.

[85] Net public sector cost deducts recycled monies from the gross public sector costs (including the grant contribution via Invest NI to SME investment, Invest NI Corporate Finance Team costs and Fund Manage fees). The recycled monies deducted include both Invest NI returns and FTC monies.

creating a net job is the lowest for loans (£21,500), whilst the unit cost of equity (£32,000) falls below that for grants (£44,800).

Table 7.12 Net public sector cost per job creation, March 2021 (for all finance provided during 2012 and March 2021)

	All	Grant	Loan	Equity
Net public sector cost per gross job created	£11,300	£24,400	£9,300	£15,500
Net public sector cost per net job created	£25,100	£44,800	£21,500	£32,000

Source: Hatch analysis based on Hatch/Beaufort Beneficiary Survey. Note: Figures are rounded to the nearest 100.

7.34 Overall, the net GVA impact generated by £1 of net (gross) public sector cost was £3.57 (£1.35) while the net (gross) public sector cost per net job created was £25,100 (£66,200). Recycled monies play a critical role in the unit cost performance of different types of financial support, especially where equity finance is concerned. Grant finance surpasses the performance of loan and equity in terms of net GVA impact per £1 of gross public sector cost. However, once recycled monies are accounted for, equity performs comparatively better than loans and grants in terms of this metric. Moreover, loan finance, as well as equity finance, surpass the performance of grants in terms of net job creation once recycled monies are factored in.

Wider Impacts

7.35 In addition to the core economic impacts, there are a series of wider enterprise and innovation benefits to the beneficiary companies and hence the region as a result of the Invest NI Loan and Equity solutions, as well as positive supply side impacts in terms of finance ecosystems.

Enterprise Impacts

Innovation

7.36 A large proportion of the overall funds has been invested in early-stage SMEs, helping to foster start-up and innovation activity in the region. Whilst there is little recorded information on innovations, there are numerous examples of SME beneficiaries who have, as a result of investment received, introduced innovative new technology and products to markets.

7.37 When asked what their motivation was for seeking finance in the beneficiary telephone survey carried out for the evaluation, the leading motivation for approaching Invest NI for finance was for R&D or commercialisation of new products, services or processes (49% respondents indicated this).

7.38 Prior to investment, 68% of the respondents seeking funding for innovation purposes were at the initial concept development stage, while a third (33%) were testing or prototyping their innovation in the real world. A relatively smaller proportion of businesses approached Invest NI at the stage of trying to commercially launch their innovation (17%) or to expand the market for a product, service or process already launched (22%).

7.39 Beneficiaries were then asked the extent to which they had achieved their objectives, following the receipt of investment from the Invest NI Loan and Equity Solutions. 97% of respondents indicated that they had made progress towards their innovation objectives of researching, developing or commercialising new products, processes or services (with 37% respondents having fully achieved this goal and 60% having partially achieved it). This indicated that the funds have been successful in supporting innovation activity in the region.

7.40 Alongside securing new innovation, the Invest NI loan and equity funds have allowed SMEs to enter new markets through the development of new products, the refinement of existing production and development processes, as well as growth in the capacity and capability of businesses. Of the survey respondents that sought finance to enable them to access new geographical markets, 95% had fully or partially achieved this aim.

Business Start-Up

7.41 Half (50%) of beneficiary survey respondents indicated that there is a gap in the provision of finance for start-ups and small businesses in Northern Ireland, and 30% of the respondents indicated that they approached Invest NI for finance to fund their start-up phase. The figure was significantly higher for POC grant recipients where almost half (49%) sought finance to support this objective.

7.42 The Invest NI Loan and Equity Solutions has provided a significant amount of early-stage investment in the region. The market assessment in Section 3 of this report indicated that the number of start-ups and microbusinesses in Northern Ireland has increased during 2020. Consultations with stakeholders operating in the financial sector indicated that funds such as Techstart I and II have played an important role in fostering start-up and innovative activity in the region. Whilst the activity of Invest NI and the public sector backed funds may be helping to stimulate an interest in NI from angels, venture capitalist and private equity investors, there is still a fairly limited presence of private sector investors compared to similar regions and the Invest NI loan and equity solutions have played an important role in addressing that gap.

Business Growth

7.43 It is clear from the survey responses that many of the businesses that have received investment through the Invest NI loan & equity solutions sought investment to help fund growth in the business. 33% of survey respondents indicated that they intended to use the investment to expand their business. Of those businesses that indicated that this was their aim, 83% reported that they had either partially or fully achieved this aim of expanding their established business.

7.44 Without the Invest NI loan and equity funds, many of these businesses would not have been able to access the external finance they needed from other sources given the lack of alternative providers in the market. Consultations with financial intermediaries also indicated that many businesses have benefitted from the Invest NI investment funds' existence and that many businesses would not have got the funding they required without these funds. The overwhelming majority (84%) of beneficiary survey respondents indicated that publicly supported venture capital and loan funds are needed to supplement private finance for certain types of investment.

Supply Side Impacts

7.45 The Invest NI Loan and Equity Solutions have also had an impact to the supply side of the local economy. This refers to impacts on the wider SME community and ecosystem that may not have directly received investment from the fund.

Increased Investment Activity

7.46 Consultations with the financial and business advisories, fund managers and strategic stakeholders indicated that the Invest NI Loan & Equity Solutions have been invaluable in addressing the finance gaps in the region, particularly with regards to early-stage equity, and to increasing investment activity in Northern Ireland.

7.47 The fund of funds approach to the delivery of the Invest NI loan and equity solutions has enabled multiple fund managers that have been brought in to deliver the funds. This has meant that there was an immediate increase in activity in the start-up and SME finance market. This included attracting fund managers that were not previously operating within Northern Ireland (e.g. Kernel).

7.48 Funds such as Co-Fund I have reportedly helped to upskill private investors through providing guidance on setting terms and valuations, helping them to understand that the Fund can provide leverage and enabling them to have follow-on investment in those portfolio companies, which has helped to drive a large increase in angel investment activity in the region. Techstart has attracted a large number of angels investors, as well as VC and private equity investors from outside the province (including from the UK, ROI, the US and parts of Europe).

7.49 However, a number of consultees expressed a minority view that the funds have had a negative impact on private investors willingness to invest in NI, both at the fund and deal level.

Move towards Repayable Finance and Reducing the Reliance on Grants

7.50 Funds such as the NISBLF I and II have encouraged small businesses to use debt finance rather than grants, which compared to grants, will provide some return to Invest Northern Ireland which can then be recycled and reinvested into the market. The FMs have also provided informal mentoring about taking on debt.

7.51 The funds play an important role of investing in opportunities which are not attractive to most private investors due to the high levels of risk of investing in relatively small or young businesses. The debt funds also enable banks to provide additional finance options and can share risk by co-investing with private sector investors where there is the opportunity to do so.

Attracting Significant Amounts of Leverage

7.52 Across the debt funds currently in the investment phase (GFF, GLF II and NISBLF II), approximately £33.67m in total deal leverage has been achieved by the end of March 2021. A large proportion of this leverage has come from equity investment, shareholder equity, banks and invoice finance. Between 2017-2021, a further c.£23.28m leverage was achieved by the debt funds currently in the realisation phase (SBLF I and GLF I).

7.53 Looking at the equity funds currently in the investment phase, Co-Fund II has raised c.£52m as pre-qualified match and deal level leverage, and Techstart II equity investments have secured c.£2m from other investors. Co-Fund I also secured around £23.6m from pre-qualified private match and leverage investment. The equity investment undertaken by TechStart I raised £79m in deal level leverage, with deal size ranging from £10k to £6.9m and investment amount per investor ranging from £133k to £4.5m. Jointly, the development funds (Crescent III and Kernel) received c.£47m in leverage.

7.54 Whilst leverage figures are reported differently by fund (with some including matched and unmatched leverage, and some including other public sector and other Invest NI funds within the totals, further details provided within Section 4 of this report), this represents a large amount of investment that has been leveraged into Northern Ireland businesses by the funds.

Key Findings

The gross and net additional economic impacts that Invest Northern Ireland has provided to date are assessed by drawing on multiple sources of information, including monitoring data on business performance post-investment, survey evidence and counterfactual impact analysis.

The beneficiary survey collected information on the impacts businesses expected to experience as a result of Invest NI financial support, as well as what proportion of those have been achieved to date. But there are some limitations to using survey evidence, including the size and representativeness of the sample as well as the accuracy and reliability of the data. Hence, the impact assessment figures derived on this basis should only be considered indicative. It should also be noted that the impacts of the Covid-19 pandemic may have dampened the benefits experienced in recent years.

Beneficiaries were more likely to have achieved the change they expected in employment compared to turnover, which reflects the time lag in turnover impact realisation. Grant recipients were the most likely to have achieved none of their expected impacts, while equity recipients were the most likely to have fully realised or exceeded them. Loan recipients tended to have partially achieved their expected impacts, with GLF/GFF beneficiaries more likely to have realised them than SBLF ones.

The modelling exercise suggests **a gross uplift in cumulative GVA of £508.4m and a gross employment uplift of 5,000 jobs** across the population of businesses receiving finance between April 2012 and March 2021. Once additionality adjustments for attribution, deadweight and displacement are accounted for, the **net cumulative GVA uplift is £198.7m and the net employment uplift is 2,200 jobs**. The survey-based analysis has provided higher estimates of impact compared to the fund monitoring data (allowing for the two methods estimating gross and net impacts respectively).

Unsurprisingly given the lower investment level to date, the gross and net jobs and GVA created estimates fell behind their targets. But the underperformance noted was more pronounced relative to that for the total value of investment, especially in the case of net GVA generated. This might be attributed to a number of reasons, including lags in the realisation of economic impacts post-investment (especially in the case of GVA), the impact of the Covid-19 pandemic or methodological differences in the estimation of targets compared to this evaluation.

The CIE analysis, based on the use of official business admin datasets, broadly confirms the conclusions about the order of magnitude of economic impacts from the survey and monitoring data analysis (taking account of differences in measurement approaches between methods).

The value for money assessment (VfM) has only been estimated using the survey-based impact figures. The assessment is made against two cost bases: (a) Invest NI’s capital contribution to the amount of investment businesses received up to March 2021 plus fund management fees incurred plus the operational costs of its Corporate Finance team (all counted up to March 2021); (b) less a best estimate of the recycled monies (including Invest NI returns and FTC monies) associated with this investment.

Overall, **the estimated net GVA impact generated by £1 of net (gross) public sector cost was £3.57 (£1.35) while the net (gross) public sector cost per net job created was £25,100 (£66,200)**. The estimated recycled monies which will return to Invest NI play a critical role in the unit cost performance of different types of financial support, especially where equity finance is concerned. Grant finance surpasses the performance of loan and equity in terms of net GVA impact per £1 of gross public sector cost. However, once recycled monies are accounted for, equity overperforms loans and grants in terms of this metric. Moreover, loan finance, as well as equity finance, surpass the performance of grants in terms of net job creation once recycled monies are factored in.

However, there is the need for caution in interpreting these results as they are just a snapshot at a point in time and may not capture all impacts which can be expected to arise over a longer time period.

There have also been a series of wider enterprise and innovation as well as positive supply side impacts as a result of Invest NI investment. Investing in early-stage SMEs has helped to foster innovation and start-up activity. Survey evidence indicated that 97% of the respondents made progress against their innovation objectives post-investment. More broadly, Invest NI intervention has allowed them to enter new markets, access new geographic markets, refine exiting production and development processes but also grow the capacity and capability of their business. Consultations with Fund Managers and strategic stakeholders suggested that by addressing the regional finance gap and attracting leverage Invest NI has had positive supply side impacts. These translated to benefits for the wider SME community and ecosystem that may not have been directly supported through investment.

8. Conclusions

8.1 Invest NI has provided significant capital support for SMEs in NI over the period from 2012 to 2021 through the public backed investment funds it has established. It has enabled around £180m (an average of £18m per year) to be invested in the form of business loans and equity investment (and over £5.5m in POC grants), as well as leveraging £213m[86] of private sector investment at the deal level. The funds have invested in at least 1,200 start-ups and enterprises, supporting the creation of over 5,000 jobs (to date). The funds are forecast to generate a return to Invest NI, which will be available for re-investment in successor funds.

8.2 This investment performance must be understood in the context of the events which significantly change the economic and financial landscape and assumptions that underpinned the original targets. The initial period covered by the funds coincided with the emergence out of recession (linked to the global financial crisis) with the funds shifting towards being primary sources of funding for SMEs in NI rather than just a traditional role as a provider of gap funding. More recently the funds have been impacted by the global pandemic which has dampened economic growth, impacted on the investment rates of a number of the funds due to both demand and supply factors (but by no means all) and probably seen some deterioration in the prospects for exits for the time being at least.

8.3 Whilst some of the economic development achievements may fall short of the proportioned access to finance strategy targets at this point, this has, in part, been shaped by businesses being more focused on consolidation than growth for part of the investment period due to the recession. Should investment and realisations occur in line with expectations for the remainder of the period, these can be expected to deliver significant economic benefits for Northern Ireland in addition to those already measured.

8.4 The funds have made a significant contribution to supporting the SME sector within Northern Ireland and should therefore be regarded as a success overall. The funds have provided finance to start-ups and SMEs over a period which has embraced times when conditions in the business finance market were particularly challenging, as well as the more recent period in which the UK Government's supply response to the short-term finance needs of SMEs has been unprecedented.

8.5 The financial success of the funds is still very much dependant on future capital realisations. It is essential that focus is maintained on achieving these realisations over the remainder of the decade. It is important that the overall and fund by fund prospects for returns to Invest NI are clearly understood, as well as the risks inherent in the portfolios and the potential consequences of external macro-economic factors.

Strategic Rationale and Fund Design

Conclusion 1: The Northern Ireland Access to Finance Strategy and the associated investment funds have significantly improved access to capital for SMEs in Northern Ireland.

8.6 Invest NI's approach is providing a significant amount of finance which SMEs wouldn't have otherwise been able to access, or if they had it would not have been on terms and at a cost which

[86] This figure excludes pre-qualified private match funding secured through Co-Investment Fund I & II. The total leverage secured rises to £260m when the pre-qualified private match from Co-Investment I & II is included. This includes deal level co-investment from Invest NI backed investment funds.

was comparable. As such, the funds have played a vital role in addressing the market failure for SME financing in Northern Ireland and have established themselves as an important part of the business finance landscape in the province. The funds have been flexible enough to adapt in the face of economic challenges associated with the economic cycles and economic shocks, and the implications of these for the demand for SME finance (and indeed more recent changes in supply through the introduction of CBILs and BBLs).

8.7 The sector generalist approach and ability to invest across all eligible market sectors has been a strength, improving the scale of capital available for investment and flexibility of investing.

Conclusion 2: The need for public sector intervention was adequately tested for each fund, with, on balance, an appropriate scale and mix of financial instruments provided to meet the funding needs of SMEs as part of the escalator model.

8.8 The mix of financial instruments available has been underpinned by a clear rationale to address the market failure in terms of the supply of financing to SMEs and the associated risk. The strategy has enabled the funds to deliver an investment portfolio with a sensible balance of risk and return, but which also recognises its operational obligations to the Northern Irish Government, ERDF programme, and private and other investors.

8.9 The equity funds have been well designed in terms of the availability of follow-on finance, both for early-stage innovation and later stage finance. The use of POC grants within the innovation fund has also been fairly effective in generating demand for seed or early-stage equity investment (c10% of grant recipients).

Conclusion 3: In general, the Access to Finance strategy and the funds remain relevant, appropriate, and consistent despite the changes in economic conditions and policy. If anything, the funds are needed more now than ever.

8.10 The funds were developed as the economy emerged from a deep recession brought about by the financial crisis with public sector funds of the type implemented in NI shifting towards being primary sources of funding for SMEs rather than just a traditional role as a provider of gap funding. More recently the funds have been impacted by the global pandemic which has significantly dampened economic growth, but also seen an unprecedented response by the UK government in providing financial support including repayable finance to SMEs. Whilst these factors will have impacted on the performance and prospects of the funds (some more than others), they remain relevant and appropriate instruments through which to provide much needed finance to SMEs. Arguably, they are more important now than they have ever been in sustaining and supporting the growth of local businesses.

Conclusion 4: The equity funds are making an important contribution to addressing the needs of NI businesses for seed and development capital, but the funds in the development space in particular have faced challenges.

8.11 There remains a need for public sector backed equity finance due to the market failures associated with this type of investment, especially the risker investment categories. There has been fairly strong demand for seed investment through the Techstart funds and sub-£500k equity investment through the Co-fund funds (with the more recent funds demonstrating an ability to operate at higher levels of investment (c £1.5m and occasionally above). The volume of demand for investment from the two development funds, which can operate up to £3m, has been less than anticipated.

8.12 The scope to secure fund level investment from the private sector, enabling larger funds or lower participation from the public sector, continues to be very difficult in this space. The ability to secure this investment from the private sector for seed funds is very limited. Only the development funds secured fund level investment and the successor Crescent IV development fund failed to secure its second close. These fund raising challenges are not likely to change (including subordination of Invest NI's investment where the private sector does invest alongside it) and will continue to limit the scope of Invest NI to launch successor funds into this space.

8.13 Although the angel and VC investor market in Northern Ireland remain weak compared to some other similar regions, there is evidence of a growing presence amongst investors from GB and the Republic of Ireland who are investing alongside the Invest NI backed funds especially Techstart and Co-fund. This is helping to build confidence of the investment community in the potential of NI businesses and developing a supply of co-investment monies from a more diverse range of investors.

8.14 There remains a great deal of uncertainty about the overall rate of return from the equity funds and potential to recycle Invest NI's original investment into successor funds. Much will depend on the returns secured on exits, where this is feasible, in the coming years.

Conclusion 5: The debt funds are well established in the start-up, development and growth space, although the increase in availability of debt from other public sector backed sources linked to the pandemic has been a key challenge over the last 18 months

8.15 As with equity finance, there remains a need for public sector backed debt funds which operate in the space where market failure discourage the commercial banks from operating (and intervention by the public sector offers the opportunity to secure spillover benefits for the economy). This appears to remain true despite the high street banks becoming more active in parts of the SME finance again (post financial crash) and growth of alternative lenders.

8.16 The Invest NI backed funds have effectively established themselves in the loan range from £10k to £1m, with the GFF now extending this to £2m. At the lower end of the range (up to £25k), the SBLF II overlaps with the Start-up Loan Company, although the fund nevertheless has strong demand at this level from NI businesses. Although the SBLF II invests below £10k in some instances, avoiding smaller investments other than as follow-on to existing investments helps to reduce the overlap with Start-up Loan Company provision. The introduction of CBILs/BBLs as a result of the pandemic has had a major impact on the demand for loan finance from SBLF II and GLF II (which is on cheaper and more flexible terms). Although demand in the market appears to be building again following the end of these national schemes, the quality of applications still lags behind that of the pre-pandemic period (and hence so does approvals).

8.17 As with the equity funds, it has been challenging to secure fund level co-investment from the private sector. Where it has been secured, for example with BBB investment in the GFF, it requires Invest NI to subordinate its investment. At the deal level, there has been strong interest from investors (especially for the larger deals through GFF and GLF II) that are seeking to balance their risks through co-investing alongside the Invest NI backed funds.

8.18 Loan funds in general provide greater certainty over returns to their investors, including Invest NI. Of the £24.1m which Invest NI has received back from the funds, the majority of this to date being from the debt funds.

Conclusion 6: The funds have had the flexibility to respond to changing circumstances

8.19 Whilst the funds each target a defined market area, they have had the flexibility through their LPAs and performance frameworks to adjust their investment strategy in response to changes in the market or to practical delivery factors. This is overall seen as a strength, however there is a downside in terms of investing in fewer businesses and potential risk in terms of greater concentration (although a final conclusion on this will depend on exits and performance at the end of the funds' life).

Conclusion 7: The use of private sector investment at fund level, alongside Invest NI's own monies, ERDF and FTC, has allowed larger overall fund sizes but imposed some restrictions

8.20 Private sector investment has been used at fund level in the development funds, GLF I and GFF, helping to provide the needed match and also to increase the scale of the committed capital in the funds. It can be challenging to secure private investors in public sector backed funds of this nature, so this is positive in its own right. It has also not unduly influenced the investment policy or risk profile of the funds.

8.21 However, it has required Invest NI to subordinate the return of their capital to the private investors, which is highly likely to diminish the eventual recycling of monies back to the economic development agency. An alternative would have been an EIB loan although this might well have come with other drawbacks (including an impact on the risk profile due to the need to service debt, returns being subordinated to the EIB loan and also a potential impact on the NI Departmental Expenditure Limit).

Overall Progress Against Targets

Conclusion 8: The performance of the funds against the Access to Finance strategy targets, proportioned up to March 2021, has been mixed

8.22 The funds have been on target in terms of the number of companies assisted (98%), although the amount of finance invested has been slightly lower (85%). This reflects lower demand for a number of funds in large part due to the impact of the introduction of CBILs and BBLs (e.g. SBLF II and GLF II), but also weaker demand in some other parts of the market compared to earlier markets assessment. Whilst the overall average amount of finance has fallen compared to expectations, some funds have provided much larger amounts of finance due to the combination of a lower number of SMEs seeking finance but those which did sought higher amounts (e.g. especially for Kernel).

8.23 Unsurprisingly given the lower investment levels to date, the net jobs and GVA created also fell behind their targets for 2021 (70% and 54% of their respective targets). However, the underperformance noted for these indicators was more pronounced relative to that for the total value of investment, especially in the case of net GVA generated. This is explored in more detail later in this section.

8.24 Invest NI is ahead of its proportioned target for recycled monies from the funds (due to faster repayments among the debt funds). £13.8m has been returned (excluding FTC) to date compared to the expected £10.8m.

	Cumulative Target, 2021[87]	Performance to the end of March 2021	
		No.	%
Gross companies supported	1,248	1,208	98%
Total amount invested £m	£212.26[88]	£180.8	85%
Net jobs created	3,100	2,200*	70%
Companies receiving support from multiple sub-funds	125 (10%)	n/a	n/a
Returned funds recycled excluding FTC £m	£10.8	£13.7	127%

[87] This excludes HBAN and the Covid 19 Equity Fund

[88] excluding deal level investment

Net GVA generated £m	£364.65	£198.7*	54%

Note * estimated on the basis of the survey of investee companies grossed up to the level of investment up to March 2021

Conclusion 9: The funds are largely on track against investment KPIs

8.25 The majority of the funds in their realisation / follow-on investment phase have invested in line with their KPIs and have made reasonable progress with investment. While NISBLF I did not meet all KPIs in each year, overall, when aggregated, the fund has performed in line with expectations. GLF I has only slightly fallen short of its investment target (distributing £54.3m of £55m investment target).

8.26 The development funds made a slow start with investment and have faced various challenges. Kernel has only invested 63% of the total available for investment to date but has provisionally fully allocated the remaining funds (although this is dependent on an uplift in the 10% cap to achieve this given the far fewer companies it has invested in), while Crescent only anticipates investing 90% of the available capital. Kernel especially has invested in fewer portfolio companies than originally anticipated.

8.27 Techstart I has effectively invested in what is a challenging investment space and is in line with their investment targets. In terms of the Techstart I POC grant, this has provided a good feeder into the SME seed fund, with 25 of the POC grant recipients having gone on to receive equity investment from Techstart I. Co-Fund I has also performed well, having generated significant leverage for portfolio companies and is meeting all KPIs (other than the average investment based on initial investments falling slightly below target).

8.28 Regarding the equity funds in their investment phase, Techstart II is meeting its KPIs and has made reasonable initial progress with investment to date. The fund demonstrates a strong pipeline of investment and further investments worth £3.7m have been secured since the review was completed. The Fund Manager is nevertheless prioritising marketing, business development and pipeline development, including hiring a marketing manager. Co-Fund II has demonstrated a strong investment rate to date and is on track, or ahead of all KPIs, other than annual investment rate (but is expected to be on target with this by the end of its investment period).

Conclusion 10: The demand for NISBLF II and GLF II has been impacted by the availability of Covid-19 government backed loan schemes

8.29 Both NISBLF II and GLF II have had a slower investment rate than anticipated, underperforming to date, which is largely attributed to the impacts of the Covid-19 pandemic on the economy and the increased availability of debt finance through the introduction of BBLs and CBILs. The investment rate required to meet lifetime targets for both funds will be challenging to achieve and a slight extension to the investment period may be required to allow the funds to achieve their investment targets. Comparatively, GFF was CBIL-approved and has demonstrated stronger performance than NISBLF II and GLF II during the Covid-19 pandemic. Whiterock are confident of achieving lifetime investment targets for the GFF.

Conclusion 11: There are good linkages between the funds and other forms of Invest NI business and innovation support

8.30 A common weakness with public sector backed SME finance is the weak linkages to other forms of business and innovation support available through the public (and private) sector. Efforts to improve these linkages in order to drive business innovation, growth and productivity improvements often achieve little real change.

8.31 An analysis of Invest NI data indicates that, overall, there are strong linkages between Invest NI finance and business support programmes which should help to reinforce innovation, growth and productivity improvements. The survey indicates a little over half of the investee businesses also received another form of business support, whilst Invest NI indicates R&D, innovation and technology, and international trade are key types of support. Whilst we are not able to quantify the additional business or economic benefit this may bring, we nevertheless view this as a real strength of the Invest NI approach.

Financial Performance

Conclusion 12: The expected financial returns from the more mature funds is not always clear and their overall financial success is heavily dependent on securing good exits, which if not met, will impact on the fund's overall financial performance.

8.32 It is difficult to predict the eventual financial outturn of the funds at this stage in their life. The fund managers' expectations of the financial outturn for the equity funds in particular are not always clear nor documented. For a number of the funds (mostly the equity funds), the ability to secure their, and Invest NI's anticipated returns, is critically dependent on the capital realisations from their portfolio. Even if a small number of realisations do not take place, have a lower value or are significantly delayed, the amount of capital to be recycled could reduce significantly. Whilst the approach to valuing investments may be prudent, the ability to secure these exits is a big risk (which will be influenced by the time it will take for some investment to mature, the market conditions over the next 3-4 years, etc).

Investee Perspectives

Conclusion 13: The investees that responded to the survey were, overall, very positive about their experience of seeking and using finance through the funds. However, perceptions were less favourable in some areas.

8.33 Over four fifths of respondents rated very or fairly good the knowledge and professionalism of staff (88%), the overall quality of service (84%) and the speed and efficiency of administration (84%). However, equity recipients were relatively less satisfied with respect to the latter two than the average (77% vs 84% for both), which reflects the greater complexity and specialist nature of equity investing.

8.34 A significant minority (18%) would have liked more access to follow-on support after having received the finance, with POC grant and small loan recipients more likely to report wanting more access (24%). A similar pattern was observed for assistance in putting together a financial package, but dissatisfaction with this aspect of the service varied widely across fund streams.

8.35 The range and flexibility of the types of finance available was also rated less satisfactorily, as only 43% of respondents appeared satisfied. Dissatisfaction among Techstart equity (5%) beneficiaries was relatively lower compared to grant (20%) and Co-fund/Crescent/Kernel (22%) beneficiaries (with relatively higher dissatisfaction amongst the Kernel investees interviewed compared to the other funds).

Conclusion 14: Investees and the finance industry believe there is an important role for public sector backed SME finance in NI

8.36 In terms of their views on access to finance in Northern Ireland, over four fifths (84%) of the survey respondents reported that publicly supported finance provision in Northern Ireland is necessary as they believe there is insufficient supply, most notably with respect to debt finance provision including start-up and small business loans. Early stage and expansion equity finance was also perceived to be insufficient, with views on the reasonableness of the cost of the available finance more divided on balance.

8.37 In contrast, the views of advisors, investors and intermediaries are much more nuanced. Overall, the funds are viewed as important in addressing the finance gap which SMEs face, having provided considerable amounts of finance which would not otherwise have been taken up by businesses. Whilst most consultees thought the funds were having a positive benefit in terms of encouraging investors into NI, a small number thought the way the funds providing larger amounts of equity and debt finance in particular were positioned and operated discouraged private sector investors. Also a small number of consultees expressed concerns about effectiveness of the investment and business practices of a number of funds (which these individuals have shared with Invest NI previously) including the underlying rationale for public sector backed investment funds.

Conclusion 15: There is some evidence that the gender diversity of the leadership teams of the businesses receiving finance from the funds has improved

8.38 The survey provided some limited evidence of an improvement in the gender diversity of the leadership teams of the businesses receiving finance. At the time of investment 56% of leadership teams were all male, whilst at the time of the survey this had fallen to 36%. The fall was due to an increase in mixed gender teams, rather than a change in all female teams. Recipients of equity finance were more likely to have experienced an increase in gender diversity, although this was from a lower base compared to businesses receiving debt finance.

Emerging Economic Impacts

Conclusion 16: The monitoring and survey analysis points to the Funds having a positive impact on businesses to date and whilst it is behind what might be expected it is likely to increase in the future

8.39 The survey provides positive evidence of the extent to which businesses in receipt of finance have been achieving the objectives they wished to achieve through the use of the finance. On the basis of the £180m received by businesses up to March 2021, the modelling based on the survey suggests a gross uplift in cumulative GVA of £508.4m and a gross employment uplift of 5,000 jobs. Once additionality adjustments for attribution, deadweight and displacement are accounted for, the net cumulative GVA uplift is £198.7m and the net employment uplift is 2,200 jobs.

8.40 The CIE analysis, based on the use of official business administrative datasets, broadly confirms the conclusions about the order of magnitude of economic impacts from the survey and monitoring data analysis (taking account of differences in measurement approaches between methods).

8.41 Unsurprisingly given the lower investment level to date compared to the target, the gross and net jobs and GVA created estimates are behind the Access to Finance strategy targets (proportioned for the period). But the lower economic impacts to date was more pronounced relative to the lower value of investment, especially in the case of net GVA generated. This might be attributed to a number of reasons, including lags in the realisation of economic impacts post-investment (especially in the case of GVA), the impact of the Covid-19 pandemic or methodological differences in the estimation of targets compared to impact estimates made in this evaluation. These business and economic impacts may well increase in the coming years as the businesses continue to innovate and grow.

8.42 There have also been a series of wider enterprise impacts, in addition to positive supply side impacts as a result of Invest NI investment. Investing in early-stage SMEs has helped to foster innovation and start-up activity. Survey evidence indicated that 97% of the respondents made progress against their innovation objectives post-investment. More broadly, the finance received through the Invest NI loan and equity solutions is reported to have supported them to enter new product/service markets, access new geographic markets, refine existing production and development processes and grow the capacity and capability of their business.

8.43 Consultations with Fund Managers and strategic stakeholders suggested that by addressing regional finance gaps and attracting leverage, Invest NI has also had positive supply side impacts. These translated to benefits for the wider SME community and ecosystem that may not have been directly supported through investment. The funds are reported to have contributed towards increased investment activity and to have helped to upskill business angels and drive further angel investment activity in Northern Ireland. It is also noted that the funds have helped to encourage a move towards repayable finance (and reduce SME grant-dependency). This has in turn resulted in recycled returns which can then be reinvested to support a larger number of SMEs.

Value for Money

Conclusion 17: Whilst it is still relatively early in the life of the funds, the VFM analysis suggests the value for money being provided by the funds to date is broadly on par with what recyclable finance instruments can achieve

8.44 The assessment takes account of the business impacts which have been achieved to date given the amount of finance SMEs received up to March 2021. It draws on the survey analysis which in turn uses the self-reported information from a sample of investee businesses. As such, it is subject to a range of data limitations and needs to be treated with caution. As noted above, these impacts can be expected to increase in the future as more businesses realise the benefits of their investments, especially early-stage businesses when the benefits can take longer to materialise.

8.45 Allowing for an estimate of expected recycled finance back to Invest NI (associated with this investment up to March 2021), the gross and net GVA per £1 of net Invest NI investment and operational cost is £9.12 and £3.57 respectively to date. This is higher for equity investment compared to grant and loans. The equivalent Invest NI investment and operational cost per gross and net job created is £11,300 and £25,100 respectively. Unlike for GVA impacts, this is lower for debt finance compared to grants and equity finance.

Overview of Economy, Efficiency and Effectiveness

Conclusion 18: the Invest NI backed funds are achieving economy, efficiency and cost-effectiveness to different degrees; the greatest uncertainty at this stage in the life of the funds is the extent to which the recycling of returns back to Invest NI will contribute to a reduction in the lifetime cost-effectiveness and hence VFM of the funds

8.46 **Economy** is achieved where the cost of resources is minimised, whilst **efficiency** is where the activity or output is achieved at minimum cost. As outlined in Section 4, the capital allocations made by the debt and equity funds have been in line with the expenditure approvals. Where additional capital has been allocated to funds, this has been justified by market need and subject to economic appraisal and board approval.

8.47 The capital contributions that Invest NI makes to funds reflects the nature of the finance being provided and the scope to secure fund level contributions from the private sector (e.g., Crescent, Kernel, GLFI and GFF). In the instances where there is fund level co-investment, Invest NI's returns have needed to be sub-ordinated to the private investors. However, Invest NI has used the competitive procurement process to minimise the degree of subordination that fund managers provide as part of their overall commercial offer.

8.48 Likewise, the competitive procurement of fund managers should have also helped to minimise fund management fees. Whilst the evaluation has not considered this process, the review of fund management fees suggests that these are broadly in line with similar regional debt and equity funds. The costs of the Invest NI Corporate Finance team are also in line with expectations given the size and salary costs of the team (2% of investment with SMEs up to March 2021).

8.49 **Effectiveness** considers the extent to which the intended benefits set out in the objectives were achieved. The monitoring data suggests that considerable levels of debt and equity finance have been provided to SMEs in Northern Ireland. Whilst the level of investment is slightly behind target (c£30m) at this point in the life of the funds, due mainly to the impact of the pandemic and the associated government interventions on the demand for debt finance (and to a lesser extent equity), this gap may well be closed in the next 2-3 years (and further research is being undertaken to test this).

8.50 The survey of investee businesses and the CIE analysis provides strong evidence that this investment is helping businesses to achieve their objectives and is supporting additional business growth which would not have occurred otherwise. The evidence suggests that the impacts is greater for debt finance than equity, although this balance may change in the future as early-stage businesses achieve their growth potential. The survey evidence suggests the impact on the Northern Ireland economy is dampened to some extent by a proportion of the businesses who believe that they are able to access alternative finance at similar costs and terms (which may be influenced by the loans available through Covid-19 response, which have now been withdrawn however), as well as the extent to which the growth of these businesses may be displacing the trade of other businesses in NI. But this is to be expected of this type of intervention and is broadly in line with the evidence from other regional investment funds.

8.51 There is also good evidence that the Invest NI backed funds are helping to secure a wider set of spillover effects, including innovation and enterprise, as well as building the capacity and capability of the finance ecosystem in Northern Ireland.

8.52 **Cost effectiveness** considers the outcomes or impacts achieved for a given level of cost. As described above, the evaluation has considered the value for money in terms of the unit costs for GVA and job creation arising from the investments which has been made with start-ups and SMEs between 2012 and March 2021. These measures take account of the costs to Invest NI both in gross and net terms (including allowing for the recycling of its capital contribution back to it through the returns from fund managers).

8.53 Whilst there is limited comparable data in the public domain for similar investment funds, in the evaluator's experience the unit costs are broadly comparable in terms of GVA impacts at this stage in the life of the funds, whilst being slightly higher for employment impacts (but this difference may not be statistically significant given the robustness of the survey data and differences in the methods used in the evaluation of other financial instruments). Over time, we would expect the unit costs and hence the VFM to improve (but it should be borne in mind that it is challenging to reliably measure the full extent of these longer term impacts in practice through monitoring and evaluation methods).

9. Recommendations

9.1 The recommendations which are drawn on the basis of this interim evaluation are set out below. These should be considered by Invest NI and the Access to Finance Working Group in considering changes to the operation of the current funds and the future access to finance strategy and possible successor funds. It should be considered alongside the forward-facing review being undertaken by an independent SME finance expert.

Recommendations Relating to Current Funds

1) **<u>Invest NI needs to closely monitor the recovery in the investment rate for the SBLF II and GLF II loan funds.</u>** A number of the debt funds in their current investment phase (SBLF II and GLF II) are at a critical stage in terms of ramping up the annual investment rate and getting back on track in terms of overall investment. Given the uncertainty over the speed at which demand may bounce back (given the end of BBLs and CBILs, but the possibility of the persistence of strong balance sheets amongst some businesses), Invest NI should work with the fund managers to monitor the strength and quality of the pipeline. Whilst it is too early to decommit capital from the funds, this should be reviewed by the end of quarter one 2022 (note: a demand assessment is currently being undertaken by Invest NI). There may be a case for extending the investment period by 6 to 12 months for these funds.

2) **<u>Maintain a focus on the successful delivery of the equity funds in particular, especially the delivery of good exits</u>**. A number of the older equity funds are now in a critical phase in terms of both follow-on investment and driving exits. Given the importance of these exits to the overall financial rate of return and the prospects for recycling returns back to Invest NI, it needs to work closely with the fund managers to: assess where follow-on investment is most likely to be effective across their portfolios; the opportunities for exits; the projected fund outturns; and the amount and timing of the recycling of monies. There is a case for Invest NI to push for a more common approach to assessing these considerations across funds, enabling it to assess the overall position and prospects of the funds and to report this to the Access to Finance Working Group.

3) **<u>Continue to work with the two development funds to ensure appropriate follow-on investment and successful exits.</u>** The two development funds are both seeking to use follow-on investment with their portfolio businesses to drive successful exits, although a number of these companies offer no or limited opportunity to return their investment. In the case of Kernel, the fund manager has raised the possibility of an extension of a further year to facilitate follow-on investment in order to secure the ambitious exits it is targeting (which Invest NI will need to continue to closely scrutinise). If it wishes to pursue this, then it needs to make its case on the basis on the benefits it will secure in terms of the quality of the investment and the additional financial and economic returns it will need to help to secure.

4) **<u>Consider the scope available to enhance the follow-on support provided to grant recipients and recipients of small loans in particular.</u>** The survey indicated that the level of satisfaction with the service provided by the funds was viewed, overall, very positively. But the evidence indicates that there is scope for the funds to improve the sign-posting they provide for businesses to follow-on support especially those receiving

small loans and POC grants. These are lighter touch / lower value interventions which do not involve as much one to one contact as the other funds. It is in this context that the businesses may benefit from sign-posting or further guidance. Invest NI should explore with the fund managers what scope there is to enhance this within the bounds of their current LPAs/MPAs.

5) **Consider what can be done to drive-up investment penetration outside of the major urban areas.** The existing funds (with the exception of SBLFII and GLFII which achieve a wider take-up spatially) in their investment phase should consider whether there are additional promotional activities they can undertake which can encourage the take-up of investment in areas which are under-represented given the size and type of business base. This also applies to funds in their investment period and to new funds which may be procured in the future. It may be appropriate for fund managers to have (or share) an office outside of Belfast.

Recommendations Relating to Future Strategy and Funds

Access to Finance Strategy and Approach

6) **Invest NI should build on what is, overall, a strong approach to SME finance**. There are many positives of Invest NI's approach to addressing the finance gap and providing public sector backed financial instruments in order to provide finance to SMEs. The evaluation has not provided any evidence to suggest that the current mix of small business, innovation seed and early stage, development and growth finance does not continue to be an appropriate approach given the needs of businesses in NI. Invest NI should develop the successor funds on a similar basis but subject to the more detailed recommendations below.

7) **Invest NI should nevertheless consider if there is a strategic case for a more radical approach to how it supports access to finance in the future**. As noted above, Invest NI could continue with its existing model of providing capital and procuring independent EDOs to deliver fund managements services. However, the changing public sector funding landscape and challenges of securing sufficient capital for future funds may be more challenging. Options could include for example:

- **Constrained future funding with a continuation of the fund of fund model**: a continuation of the existing fund of funds model but with smaller funds (and hence less investment to SMEs) being the result of less capital being available to Invest NI. This approach may require Invest NI to consider how to use its available capital most effectively, which could include a decision not to procure some funds (eg where the finance gap is smaller, market and investors more active or the VFM is weaker).
- **Constrained future funding with a shift to greater co-investment approaches where feasible:** Invest NI's success in introducing alternative finance into the market (through the Co-fund model for example) could enable it to reduce the presence it has in the market, instead seeking external funders to fill market gaps in NI with Invest NI underwriting a certain % to entice these investors (an approach encouraged by BBB).
- **Seeking long term sustainability through a greater focus on maximising recycling of return**: it may be appropriate at this point for Invest NI to raise its

ambitions in terms of the amount and breadth of investment activities in order to drive increased scale, increased efficiency and sustainability of the funds in the long term. If this is the case, it could achieve this through procuring and managing the funds with a greater focus on maximizing the recycling of returns across the combination of debt and equity funds.

- **Step change approach requiring higher long term funding**: finally, it may be appropriate to consider a radically different approach which involves different operational, delivery and management models and is likely to require a substantially higher level of capital and revenue funding (at least in the short term). A development bank model falls within this category.

8) **Invest NI is operating broadly at the correct level in terms of the amounts of finance available for investment.** Notwithstanding the strategic point in (2) above, the evaluation has not identified a strong case for significantly changing the level of capital available for investments on an annual basis, nor radically changing the investments ranges across the existing funds. However, we recommend undertaking a detailed market assessment which will help to inform and support the preparation of economic appraisals for new funds in due course (see recommendation below). This needs to allow for the uncertain economic conditions which can impact on demand and investment activity over an economic cycle and retain the flexibility to respond to changes in SMEs' demand for finance.

9) **Invest NI should retain the generalist approach to the funds unless there is a very strong justification for introducing sector specific funds**. There is a stronger focus on a range of target sectors in the Northern Ireland's latest economic policies. Whilst there may be a temptation to introduce sector specific funds, the evaluators believe this should be resisted. It is easier to operate funds efficiently and effectively at scale if they are generalist in nature, although this should not preclude recruiting investment managers with sector expertise if it is appropriate to target selected sectors as part of this generalist approach. The sector generalist approach also provides flexibility to adapt to changes in market conditions.

10) **Invest NI should consider its options for working with external fund level investors**. The use of private sector fund level investment has been important for some funds in securing a greater level of capital commitment and hence money available for investment, however it has had disadvantages in terms of the need for Invest NI to subordinate its own returns to these investors. It may be harder to secure similar investment in the future due to the perception amongst some of the potential investors about the ability of these funds to deliver good returns. Invest NI should look to alternative options for financing these funds in the future.

11) **Maximising the returns from funds to Invest NI for reinvestment in future funds needs to be a priority.** A key priority for Invest NI in updating its access to finance strategy should be to maximise the return it secures on the capital its commits to these funds. This means that Invest NI should avoid subordinating its own investments to private investors or other parts of the public sector where it can, as well as designing the funds in ways which will reduce risks and optimise returns. The importance of this approach lies in the tight fiscal settlement we can expect in NI in the future and the opportunity for a well-designed approach to these funds to provide recycled monies into the future. This could be achieved through Invest NI increasing its own capital

contribution from central government grant or other UK economic development sources if this is feasible (although we recognize that this may be challenging to achieve in the current public sector funding climate). Alternatively, it could potentially be achieved through a co-investment fund, with minimum percentage leverage at deal level.

12) **Invest NI to consider the options for wider collaboration with BBB capital and the use of the recently announced regional funding.** It will be important for Invest NI to consider the opportunities presented by the recent announcement about the availability of BBB funding for future regional funds in Northern Ireland. This should include the implications in terms of the costs of this investment and associated terms and conditions, investment policy, fund management and governance.

13) **Invest NI should undertake a detailed market assessment to test the need for a future development fund**. The market analysis and consultations have suggested that there is a need for another development fund, however there are concerns amongst some consultees that the existing development funds have struggled to secure the volume of quality investments that were expected, have to some extent shifted to larger average investment sizes than originally anticipated, and have possibly been displacing private investors (the latter being the view of a small number of consultees). Before developing a new development fund, Invest NI should undertake a market assessment to further test the finance gap in the range of £2m to £3m and possibly in the £3m+ space, and critically the scale of this demand.

14) **Invest NI, alongside the fund managers, have an important role in stimulating demand.** Linked to the above point, there is a need to stimulate demand for later stage equity finance amongst SMEs. The evaluation has evidence of the difficulties in supporting established SMEs' growth plans through equity finance, due to prevailing attitudes amongst SMEs as well as the number of suitable propositions. There is a need for a more collaborative approach between fund managers to identify these opportunities alongside efforts to educate SMEs on the suitability and benefits (and risks) of this type of equity funding.

15) **Consider ways of driving the performance of fund managers**. The existing fee structure includes bonus arrangements which are fairly standard for the sector. As a mechanism to drive the investment performance of future funds, it may be appropriate to not allocate a proportion of the overall total capital available for investment in the next investment period (say 10-15 %) for use by the funds which have demonstrated a strong demand for investment from SMEs in the first three years of the investment period.

16) **Retain the flexibility of the funds to respond to SMEs' demand for finance**. The flexibility of the Invest NI backed funds to adjust their investment strategy to changes in the market has been a real benefit over the past 2-3 years. Future funds should retain the flexibility which the existing framework of KPIs provide to fund managers and/or the scope to adjust these targets in response to changing market conditions and appropriately reallocate resources to where they will be used most efficiently. However, it is also important that they provide a framework to effectively performance manage the fund managers and clarify to both parties what is considered inadequate performance.

17) **Consider what can be done to drive-up investment penetration outside of the major urban areas.** The relevance of this recommendation to the existing funds has already been made above. In terms of the new funds which may be launched and any future

update of the access to finance strategy, Invest NI should consider ways in which its strategy and approach to procurement and fund delivery can drive higher take-up outside of the major urban centres across NI. This is particularly the case where the provision of finance links to other business and economic development priorities which have a spatial dimension (and links to the 10X strategy). For example, it may be appropriate for fund managers to have (or share) an office outside of Belfast in the future.

Performance Management

18) **Invest NI should standardize, where appropriate, the performance management and reporting formats**. There is a need to adopt a more standardized approach to setting the performance frameworks for funds and reporting to Invest NI by the fund managers. Whilst this will need to continue to be tailored to some extent to the type of finance and requirements of each fund, greater standardization will help to ensure Invest NI are receiving reports in common formats, structures and KPIs. This will help Invest NI to aggregate the information across funds in order to ensure a full fund of fund perspective is more easily maintained.

19) **Working towards a more standardized approach to KPIs for the funds**. The KPI frameworks have in general worked well, providing a focus for performance management and a sufficient amount of flexibility to enable the fund managers and Invest NI to manage performance issues. However, there is merit in adopting a more standardized set of KPIs (including their format) across the funds (although allowing for differences between fund types where this is necessary), including the inclusion of certain metrics which are not systematically included in funds (eg write-offs/provisions). There is also a case for the inclusion of targets for the overall rate of return for funds and the recycling of returns back to Invest NI (even if an explicit target is judged not to be appropriate, there should be an agreed methodology for forecasting the lifetime rate of return and distributions).

20) **Monitoring the receipt by businesses of both repayable and grant finance from Invest NI**. As part of their monitoring and evaluation effort, Invest NI should monitor the businesses that receive both repayable investment from their funds as well as other forms of grant funded business support from the agency. This will be useful in better understanding from an Invest NI perspective the incidence, merit and benefits of businesses receiving multiple forms of public sector support (i.e. repayable finance as well as forms of grant based assistance). It may also help to inform decisions about how to direct businesses to the most suitable form of support and the merits of charging businesses for some forms of business support in certain circumstances (eg where they have already accessed a form of support and wish to further support).

21) **Invest NI should track businesses receiving support in official administrative datasets**. It should also explore the practicality of annual tracking these businesses in ONS's administrative business datasets as a way of more robustly monitoring the change in business performance (eg turnover, employment and simple measures of productivity). This would supplement the monitoring and analysis undertaken at a fund level. It would also enable the adoption of more robust approaches to measuring

changes in the performance of businesses[89] and the counterfactual (i.e. what would have happened to beneficiaries in the absence of the Fund).

22) **<u>Invest NI should consider a more comprehensive approach to monitoring and evaluating economic development benefits and transparently benchmarking all future strategy level targets.</u>** The emerging picture from this evaluation is that the economic development targets which were set at the fund of fund level may be unrealistically high. This is not an uncommon finding from other evaluations of public sector backed SME funds and may be due to impacts of a number of economic shocks over the last decade (as well as the possibility that the metrics aren't capturing the most appropriate indicators such as productivity, return on capital). Invest NI should consider this issue in choosing economic development metrics for future funds and setting the targets for these.

23) **<u>Consider broadening the monitoring framework for economic development benefits to capture wider measures</u>**. Consideration should also be given in the monitoring and evaluation framework to ensuring that the range of wider economic development benefits from investment activity are captured. For early stage companies in particular, an assessment of commercialisation through R&D and innovation are stronger measures. On a related note, the POC grant is the only grant element included in any of the funds. The fund manager currently gathers and reports minimal information on the business activities and outcomes of this funding. It would be useful to fill this gap in the monitoring and reporting for the successor to Techstart II.

24) **<u>The Funds have a role to play in encouraging businesses to adopt good practices linked to wider policy agendas, including diversity and net zero agendas.</u>** The current funds do not systemically embed wider agendas into investment activity nor KPIs, although a number of funds achieve some of these benefits indirectly (eg Techstart supporting businesses which are focused on products and services related to net zero and the energy transition) due to their investment focus. Invest NI should consider ways in which they can promote these wider policy agendas eg seeking fund managers with female investment managers, encouraging funds managers and investee businesses sign up to diversity codes (including investing in women code).

Finance Market Intelligence

25) **<u>Consider conducting more regular research into the Northern Ireland loan and venture capital finance markets.</u>** There is merit in Invest NI investing in an enhanced intelligence function focused on SME finance including: tracking the supply of, and demand for, finance across NI; identifying and addressing SME finance data gaps; creating innovative ways of measuring, interpreting and tracking SME data; improving the understanding of Invest NI's impact on SME finance and the wider economy. This could build on Invest NI's existing economic research activity, including collaborations with NISRA and ONS. The Development Bank of Wales economic research unit could provide a comparable model.

[89] although it should be borne in mind that some businesses will not feature in these official government datasets (such as sole proprietors), or there may be delays in terms of when they start to feature (eg new start-ups), which does limit the usefulness of this approach in these cases.

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