



Lowlands and Uplands Scotland ERDF and ESF Programmes 2007 - 2013 Programme Monitoring Committee

PROGRESS REPORT ON THE ASSISTED VENTURE CAPITAL AND LOAN FUNDS

1. Purpose

- 1.1 To advise Committee members of progress on the significant Venture Capital and Loan Funds supported by the Lowlands and Uplands Scotland ERDF Programme.

2. Background

- 2.1 Support for Venture Capital and Loan Funds (VCLFs) is provided for under ERDF Priority 2 – Enterprise Growth. Access to finance is one of three areas which can make a significant contribution to the aim of the Priority in improving “enterprise formation and growth rates”. ERDF Priority 2 specifically states that “development finance has been a key market failure for new and existing enterprises seeking to grow. The provision of risk capital has shown itself to be a sustainable financial instrument for supporting the creation and growth of the SME base in Scotland”. In the current economic recession and ongoing credit crunch, the role of investment finance is even more critical in sustaining and assisting the creation and growth of new and existing enterprises.
- 2.2 In view of the substantial investment of ERDF funds in the capital of a number of Venture Capital and Loan Funds under ERDF Priority 2 (currently £53m representing 52% of the total Priority allocation), it is essential that there is a level of regular performance reporting on progress in investing these funds in eligible SMEs. This is necessary in providing a level of assurance to the Programme Monitoring Committee and the European Commission that investment funds are on schedule to invest all capital by the final legal commitment date (expected December 2015) and where progress is behind schedule, to consider appropriate remedial action.
- 2.3 In addition to the annual reporting to Committee and also through the Annual Implementation Report, supported VCLFs are also required to provide financial and physical performance information on a quarterly basis. This is set out in the grant offer letter under “Project Specific Conditions of Grant”. The specific information required has been set out in a guidance note issued to all supported VCLFs. The information provided in this report is drawn from this performance monitoring information provided by the supported projects.
- 2.4 The development of significant new and novel investment vehicles such as the Co-Investment Fund and the growth of the overall investment community, in particular the angel syndicate network, and the key support measures such as investor readiness programmes over the last 10 years has placed Scotland in a leading position compared to other parts of the UK with regard to the access to and availability of risk capital and loan finance.

3. West of Scotland Loan Fund (West of Scotland Local Authorities)

3.1 Background

3.1.1 The West of Scotland Loan Fund is a unique consortium of the 12 local authorities in the West of Scotland and was incorporated as a company limited by guarantee in June 1996 following local government reorganisation. The Fund provides debt finance of up to £50k to new and existing medium sized enterprises across the West of Scotland area. The Fund operates through the network of the local authorities Economic Development units working in partnership with the Business Gateway, Scottish Enterprise and professional advisors engaged with SMEs.

3.1.2 In April 2009, the West of Scotland Loan Fund was awarded £6m ERDF grant under the Lowlands and Uplands Scotland ERDF Programme. This was matched by public sector funds totalling £4.5m and private capital from Barclays Bank Plc of £4.5m providing a total fund capitalisation of £15m.

3.2 Progress Against Forecasts, Physical Outputs, Results and Economic Impacts

3.2.1 Between 1 April 2009 and 30 September 2009, the Fund issued loans totalling £1,156,300 to 44 businesses. Loans awarded to new businesses totalled £305,000 whilst loans to existing businesses totalled £851,300. Overall, the total investment of £1.16m has attracted other public and private sector funding of £2,153,000 from a variety of other funding sources producing a leverage of 1:1.9

3.2.2 Figure 1 below provides an analysis of the investee companies by industrial sector/business activity whilst Figure 2 provides an analysis of the distribution of investee companies by local authority areas.

3.2.3 The West of Scotland Loan Fund is on course to exceed its investment target for the period April to 31 December 2009 of £1,875,000 with 30 investment opportunities currently under consideration representing £750k of loan finance proposals.

Figure 1: West of Scotland Loan Fund Ltd

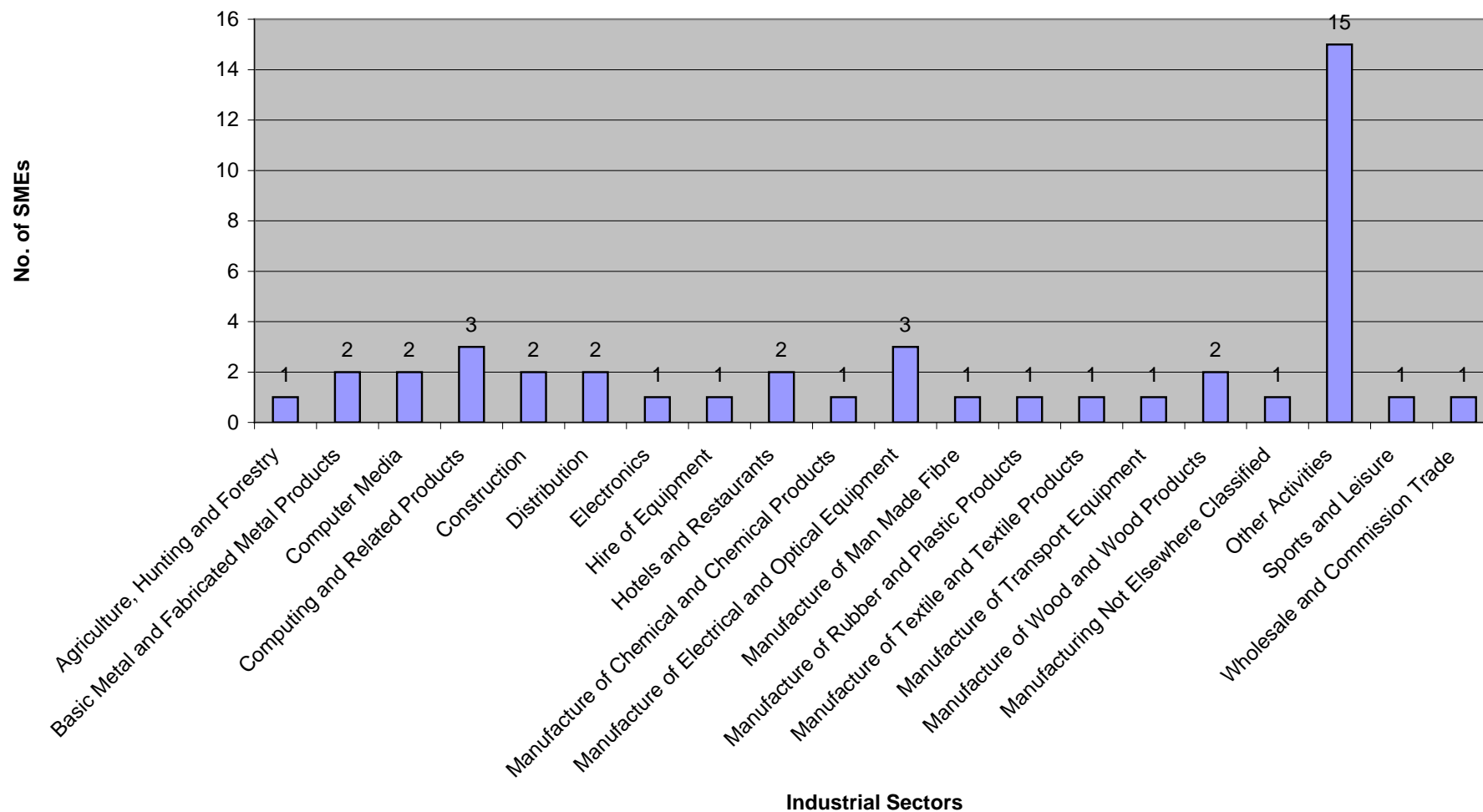
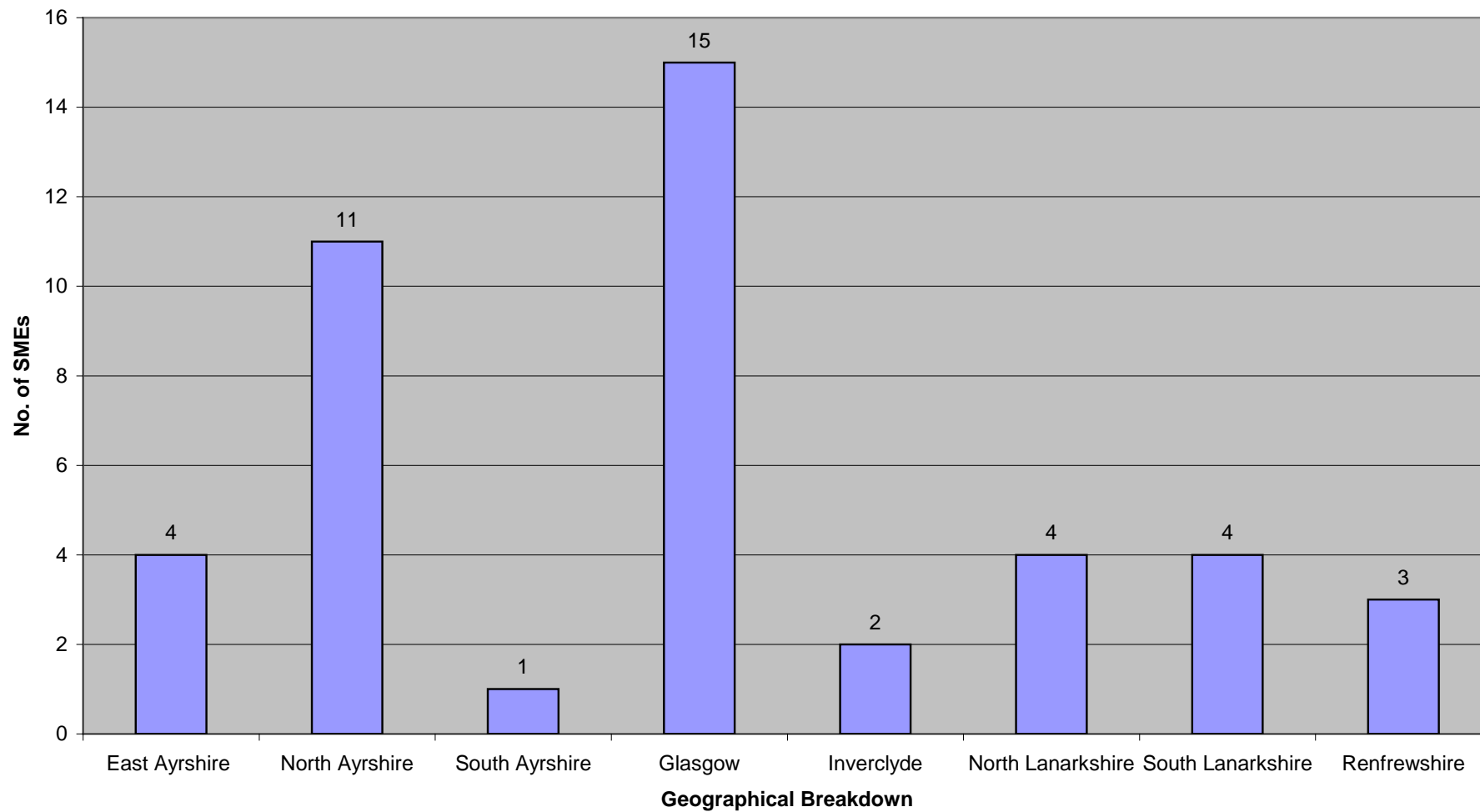


Figure 2: West of Scotland Loan Fund Ltd



4. Scottish Co-investment Fund (Scottish Enterprise)

4.1 Background

4.1.1 The Scottish Co-investment Fund (SCF) is a £66m equity investment fund established by Scottish Enterprise to invest from £100,000 to £1,000,000 in eligible SMEs. The SCF was awarded £26.7m ERDF grant in April 2008 and commenced making investments in November 2008. ERDF is drawn down in tranches of 20% of the total fund value with the next tranche being triggered once 75% of the initial tranche has been invested. SCF is targeted at new and emerging SMEs and with its private sector partners, adopts a novel and innovative co-investment model, investing in companies alongside private investors and established venture capital funds in an equal risk/equal reward basis (pari passu). The ERDF grant was matched by public sector funds totalling £40m providing a total fund capitalisation of £66.7m.

4.2 Progress Against Forecasts, Physical Outputs, Results and Economic Impacts

4.2.1 From the period 1 April 2008 to 25 August 2009 the Fund has invested £8,823,379 in 48 companies. This investment has been matched by private sector investment of £12,105,052 representing a leverage ratio of 1:1.4.

4.2.2 Figure 1 below provides an analysis of the investee companies by BVCA sector i.e. British Venture Capital Association industrial sector classification whilst Figure 2 provides an analysis of the distribution of investee companies by Scottish Enterprise Areas.

4.2.3 Based on current market conditions Scottish Enterprise expects the Fund to fully invest the total ERDF grant allocation within the total investment period. They are already reporting that demand exceeds supply and currently their investment system identifies significant work in progress. For example 13 deals valued at £1.5m are currently under consideration by co-investment partners. Four deals valued at £1.4m are at due diligence stage, and 7 deals valued at £1.3m are in the process of deal completion.

Figure 1: Scottish Co-Investment Fund

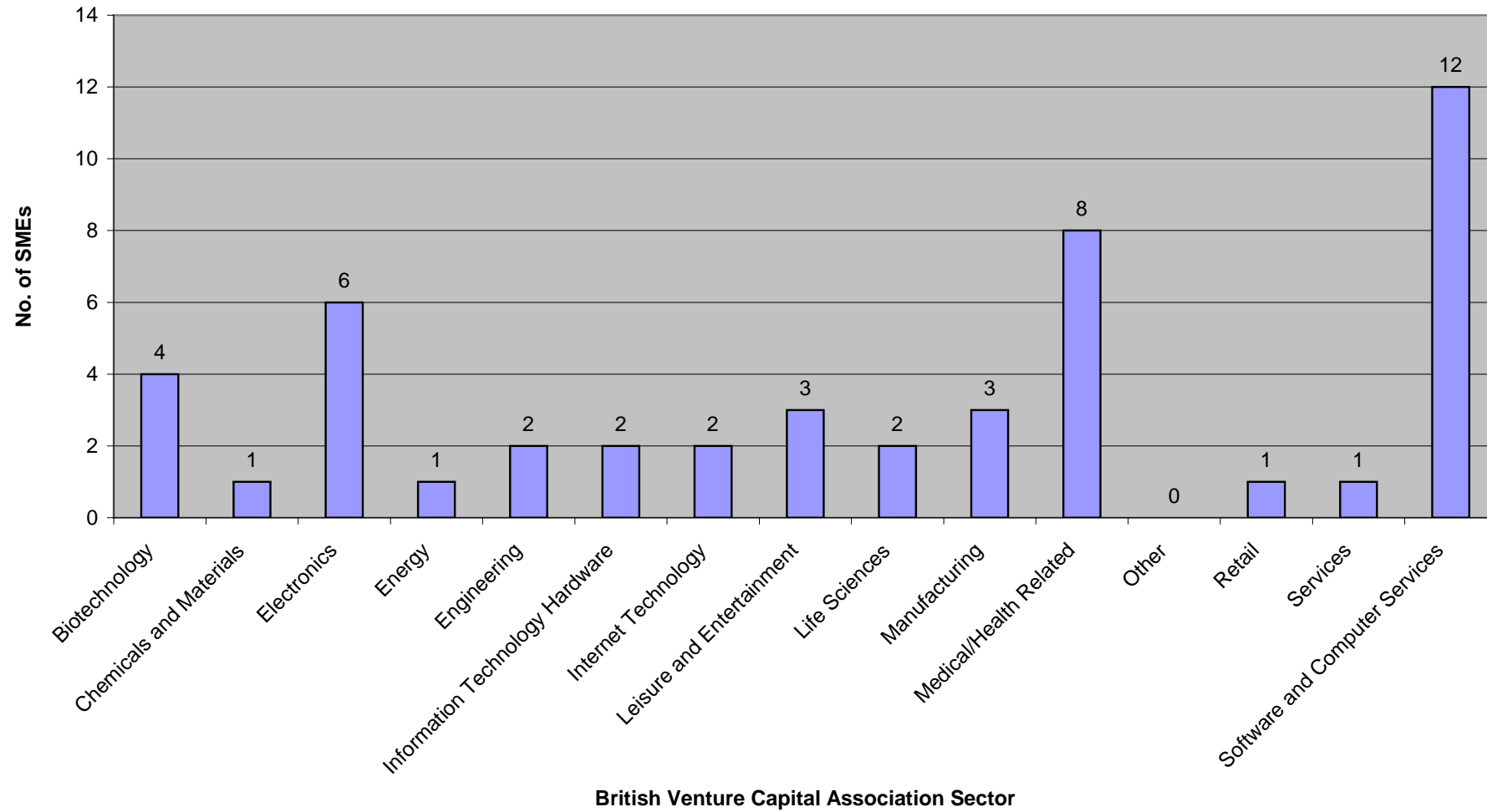
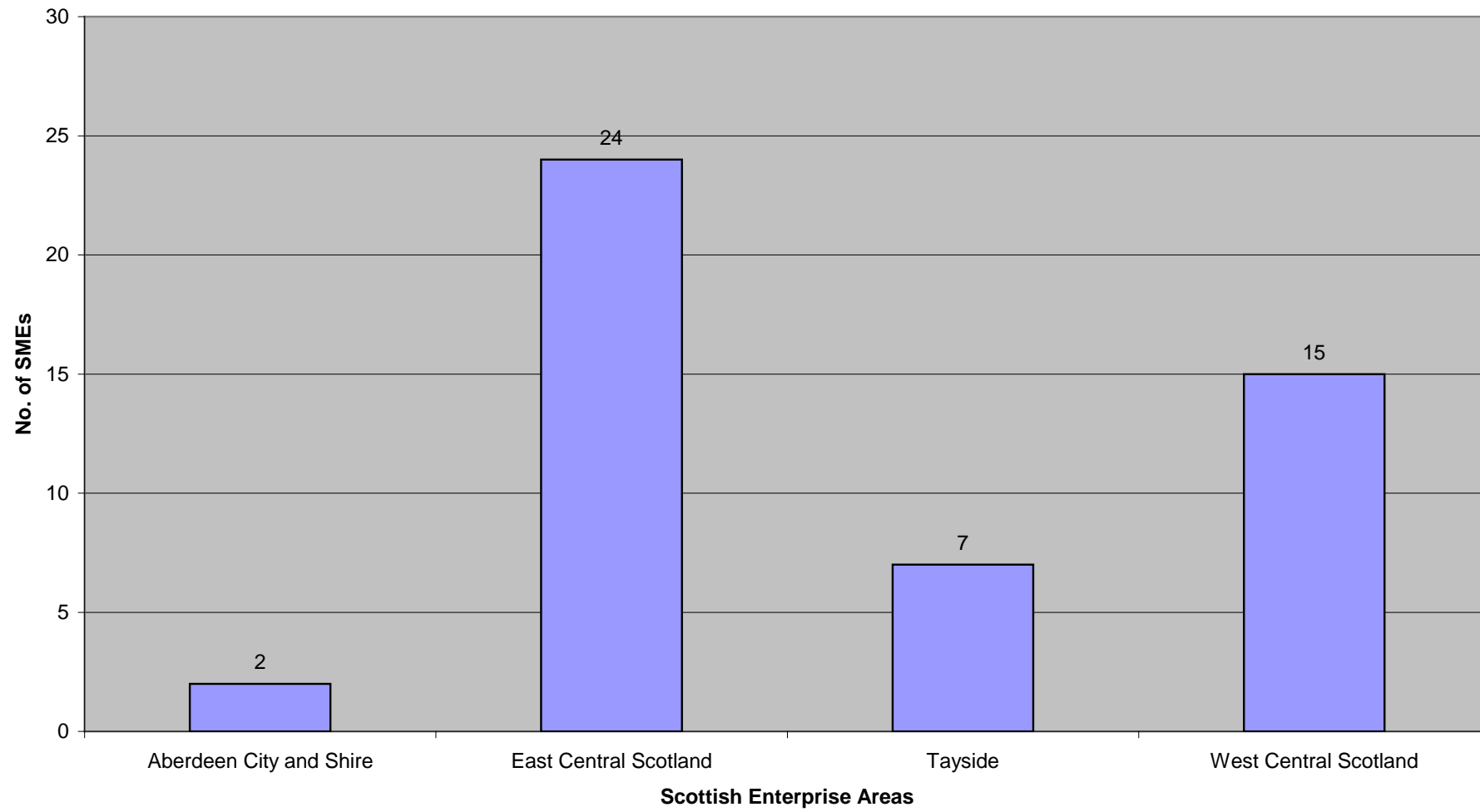


Figure 2: Scottish Co-Investment Fund



5. Scottish Venture Fund (Scottish Enterprise)

5.1 Background

5.1.1 The Scottish Venture Fund (SVF) is a £50m evergreen fund established to address the early stage equity gap for ambitious young growth companies. As with the Scottish Co-investment Fund, the SVF forms contractual partnerships with active venture capital fund managers, corporate venturers and business angel syndicates to invest in the range of £500k to £2m per transaction in high-growth SMEs. SVF also invests on a pari passu basis with co-investment partners within a deal ceiling in the range of £2m to £10m.

5.1.2 The Scottish Venture Fund was awarded £20m ERDF grant in April 2009 and this is matched by £30m from public sector sources.

5.2 Progress Against Forecasts, Physical Outputs, Results and Economic Impacts

5.2.1 Investments made in the period 1 April 2009 to 25 August 2009 amount to £6,553,376 in 10 companies. This investment has been matched by private sector investment from SVF partners of £9,238,305 producing a leverage ratio of 1:1.4.

5.2.2 Figure 1 below provides an analysis of the investee companies by BVCA sector, whilst Figure 2 provides an analysis of the distribution of investee companies by Scottish Enterprise areas.

5.2.3 Based on current market conditions, Scottish Enterprise expects the Scottish Venture Fund to fully invest ERDF grant allocation within the agreed investment period and report that demand still exceeds supply. This is evidenced by the fact that their investment system identifies a significant level of work in progress involving 11 possible deals valued at £13.3m; 7 deals valued at £3.1m at due diligence stage and 5 deals valued at £3.9m in process of completion.

Figure 1: Scottish Venture Fund

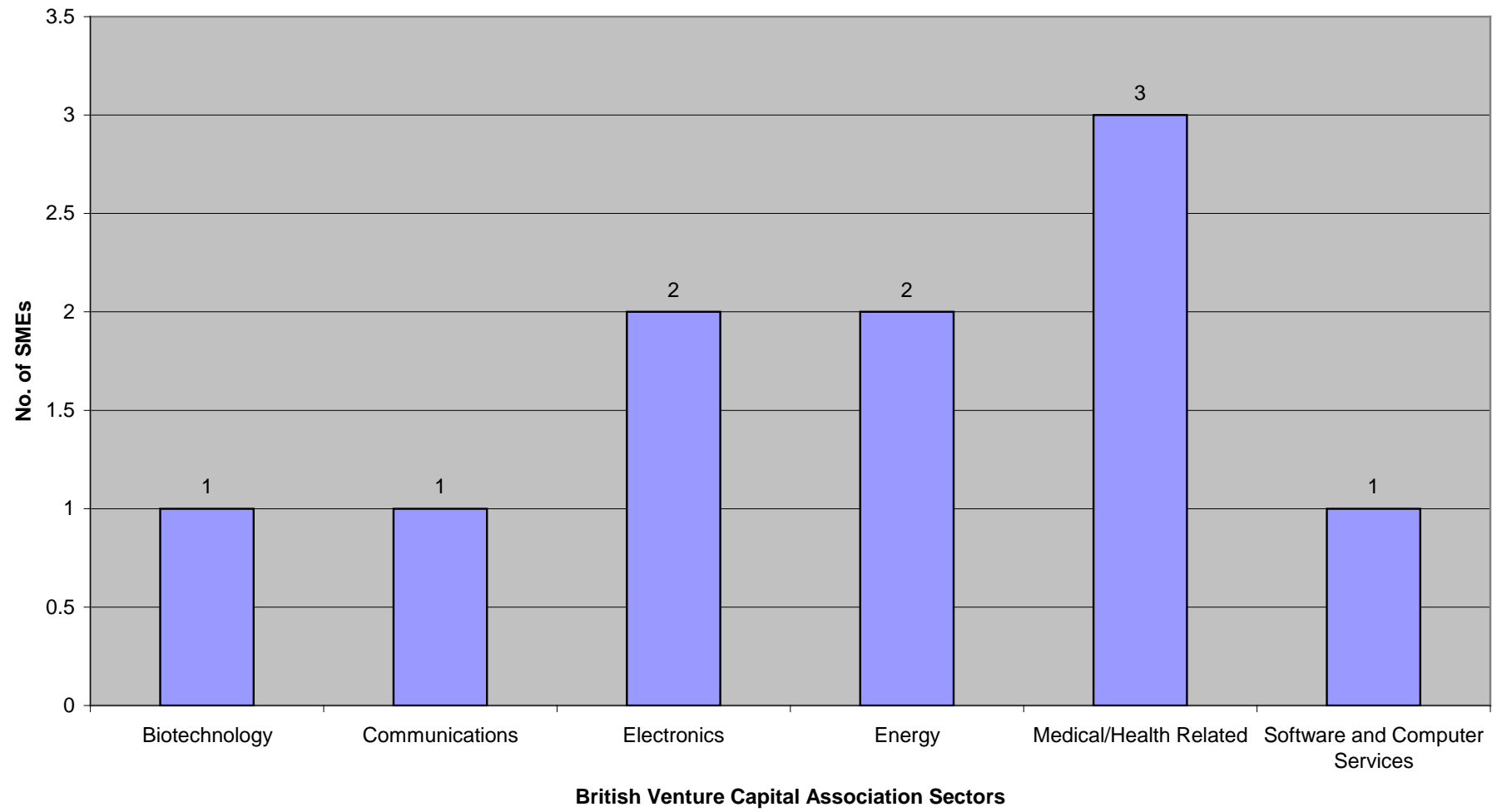
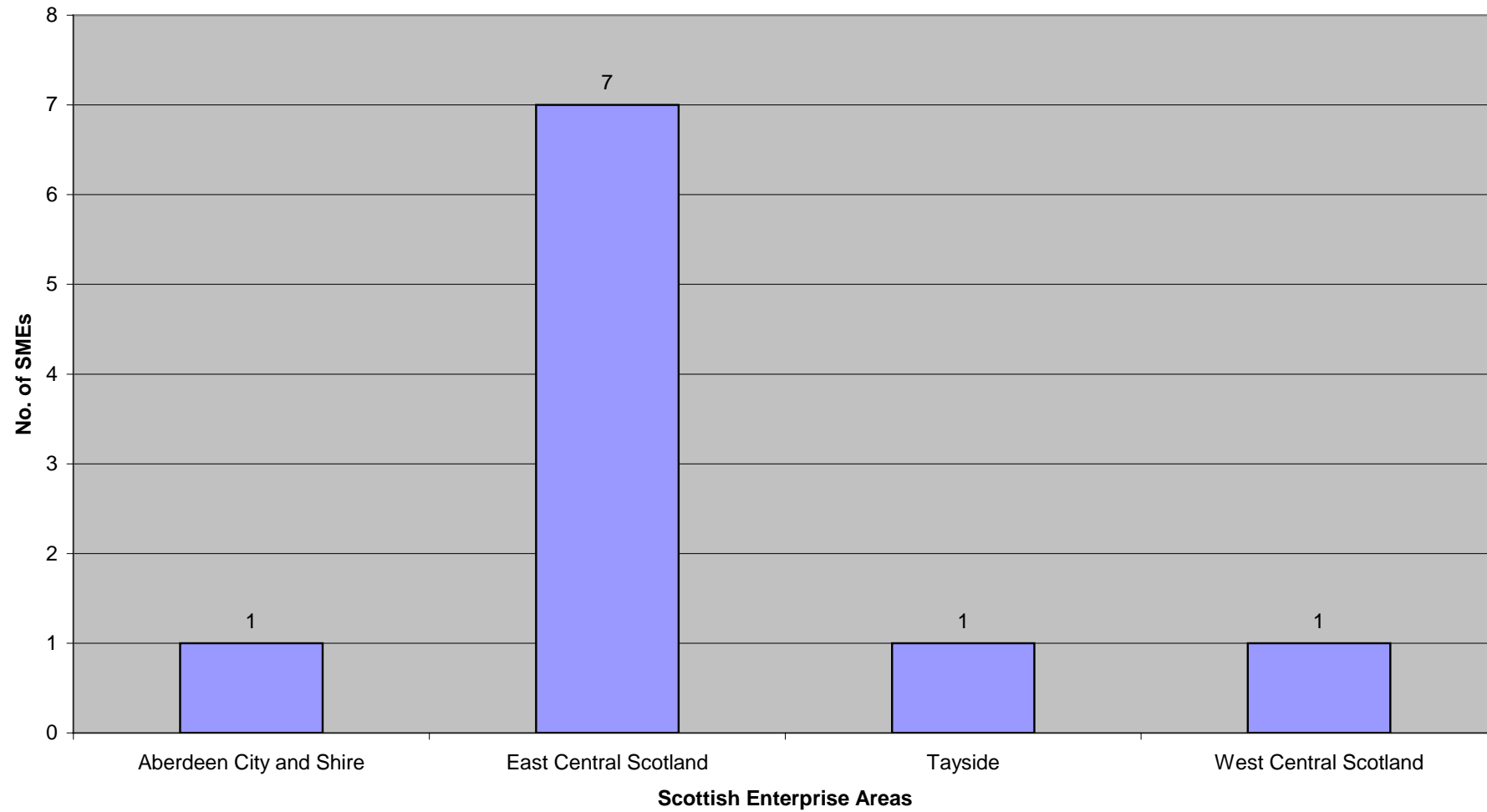


Figure 2: Scottish Venture Fund



6. Recommendations

6.1 The Committee is invited to:

- 6.1.1 note the excellent progress achieved to date in the current VCLFs supported by the LUPS ERDF Programme and,
- 6.1.2 note that all three Funds are reporting significant demand for investment finance both debt and equity,
- 6.1.3 note that the Managing Authority will continually review this information and will bring forward a proposal to increase ERDF investment in VCLFs if this appears justified over a longer period. This will of course be subject to the availability of ERDF resources and match funding.

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September 2009