



## 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 continuing unfavourable economic conditions and ongoing difficulties for business in obtaining credit facilities and traditional commercial lending, 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 £74.4m representing c68% of the total Priority 2 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 to early stage companies. This has been independently verified by a succession of leading

commentators and academic assessments. Reported progress against each of the supported VCLFs in this report is again positive and further strengthens this assertion.

**2.5** The significant Venture Capital and Loan Funds which feature in this report include;

- The West of Scotland Loan Fund
- The Scottish Co-Investment Fund II
- The Scottish Venture Fund
- The East of Scotland Investment Fund
- The Scottish Investment Bank Loan Fund

**2.6** While the level of supported VCLF activity is far greater than ever envisaged when the Programme strategy was formulated in 2006, the Committee's decision to award this unprecedented level of ERDF grant investment to one specific activity has made a significant and timely contribution to the success of those funds in assisting and sustaining many early stage and growth potential companies, and their employee base, through very difficult times.

**2.7** The following sections of the report provide a brief summary description, progress against the approved Programme targets and a graphic analysis of investee companies by geography and industrial sector for each supported VCLF.

**2.8** As regards the geographical spread of investments Committee members commented on the geographical imbalance, in particular concerning the Scottish Venture and Co-Investment Funds when the last annual report was considered by the PMC in October 2009. Members were keen to see this position corrected. Scottish Enterprise Investments and Scottish Enterprise more generally have been addressing this geographic imbalance and some progress has been achieved against historic underlying trends. However, it should be borne in mind that in the context of investment decisions the very nature of these equity funds militates against geographic targeting since investment decisions must be based on commercial considerations. Moreover, the deals are sourced and the due diligence and investment appraisal are undertaken by the private sector co-investment partners and matched by Scottish Enterprise.

### **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 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 advisers 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 From 1 April 2009 to 30 June 2010 the Fund issued loans totalling £3,775,200 to 141 businesses (SMEs). The split of loans between new and existing businesses and their forecast trading performance is provided at Tables 1 and 2.

Table 1: Investments Made in New Businesses

<b>NEW businesses supported</b>	<b>Actual to 30<sup>th</sup> June 2010</b>	<b>Target to 30<sup>th</sup> June 2010</b>
No. of new SME's supported	48	50
Value of WSLF invested	1,143,900	1,250,000
Value of Private Sector funding package	3.0 m	5.0 m
Value of Total funding package	4.3 m	7.5 m
Private Sector Leverage	1 : 2.6	1 : 4
<b>Trading performance of businesses supported</b>		
Increase in Turnover in new businesses (forecast)	£21 m	£12.5 m
Increase in Jobs in new businesses (forecast)	257	200

Table 2: Investments in Existing Businesses

<b>EXISTING businesses supported</b>	<b>Actual to 30<sup>th</sup> June 2010</b>	<b>Target to 30<sup>th</sup> June 2010</b>
No. of existing SME's supported	93	75
Value of WSLF invested	2,631,300	1,875,000
Value of Private Sector funding package	5.8 m	7.5 m
Value of Total funding package	8.8 m	11.2 m
Private Sector Leverage	1 : 2.2	1 : 4
<b>Trading performance of businesses supported</b>		
Increase in Turnover in existing businesses (forecast)	£29 m	£18.7m
Increase in Jobs in existing businesses (forecast)	408	300

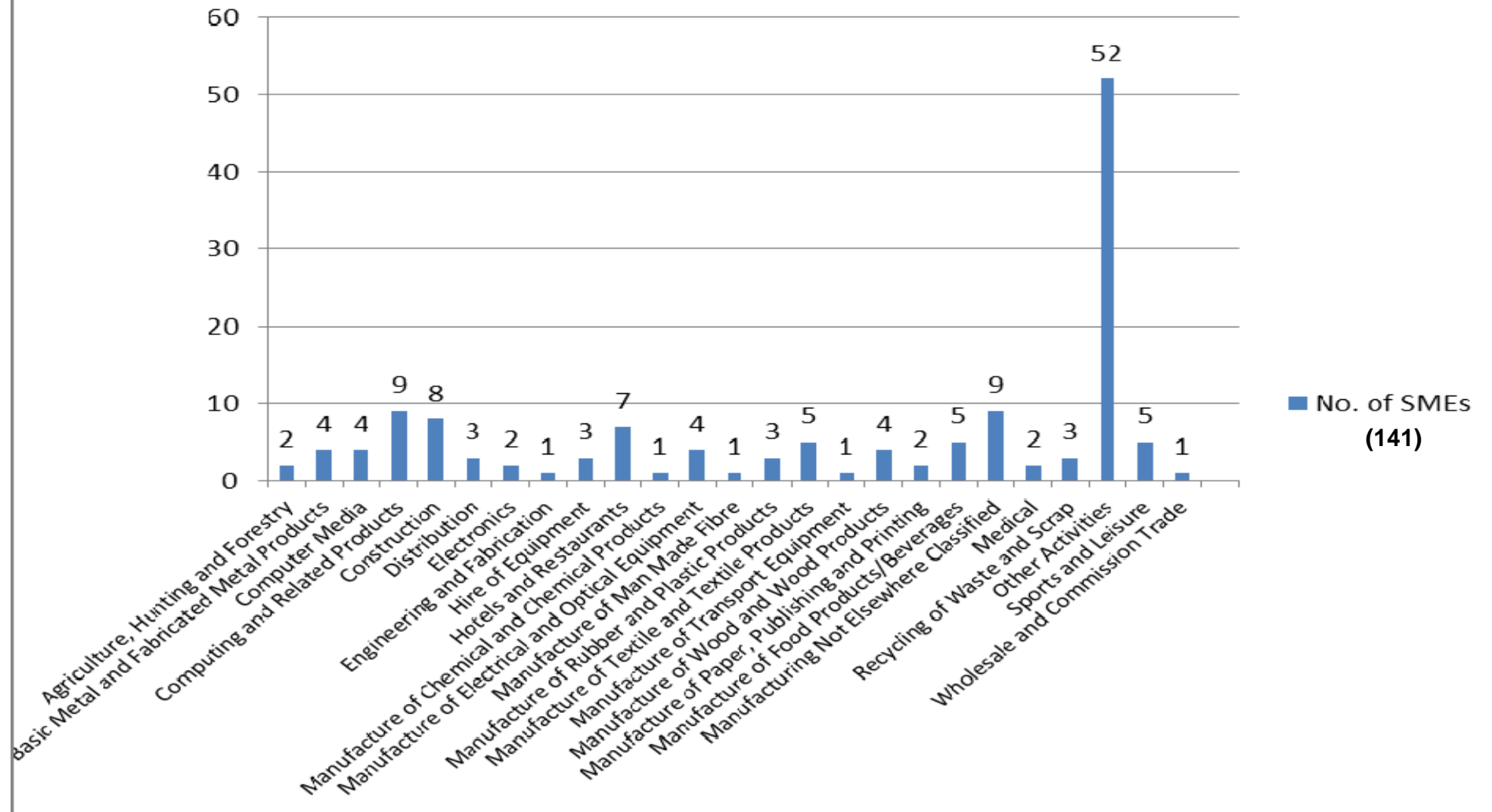
3.2.2 Figure 1 provides an analysis of the investee companies by industrial sector/business activity whilst Figure 2 provides an analysis of the distribution of investee companies by local authority areas. Whilst on a sectoral basis 'Other Activities' predominates, taken together the various manufacturing categories represent a significant 25% of the total 141 investee companies. Geographically, Glasgow has the highest activity level (36%), followed by North Ayrshire and North and South Lanarkshire.

3.2.3 While the West of Scotland Loan Fund is on target to meet the number of new businesses originally forecast it has exceeded the target for existing businesses. However, the Fund Manager will be closely monitoring the trends over the next 12 months as businesses continue to experience difficulties with raising working capital to service their funding requirement. This is also reflected in the reduction in the private sector leverage from an original forecast of 1 : 4 to an actual reported 1 : 2.6 for new businesses and 1 : 2.2 for existing businesses reinforcing the lack of credit available from commercial lending sources.

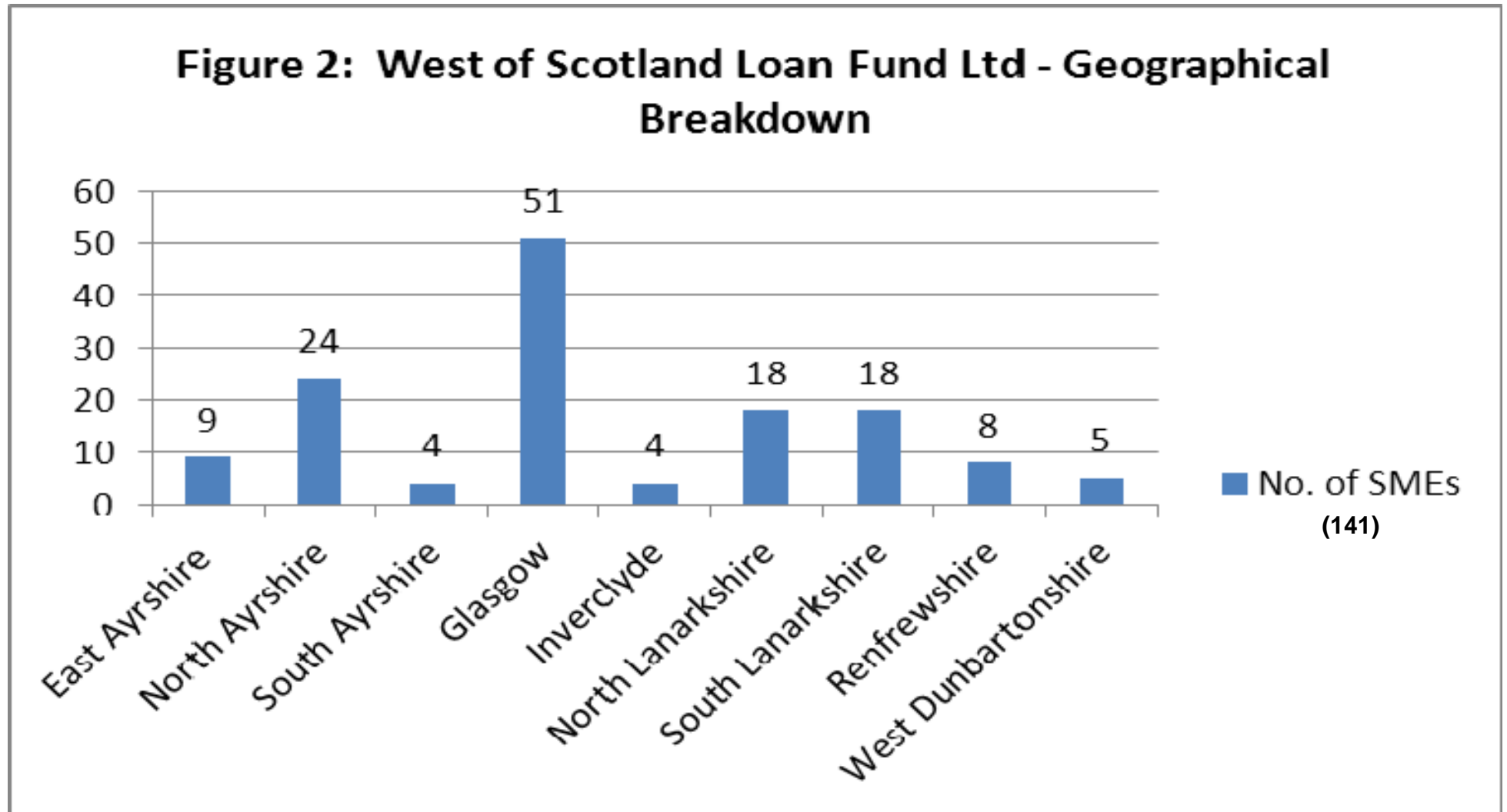
3.2.4 Overall the performance of the West of Scotland Loan Fund, measured in terms of investments made, is very encouraging and consistently above target and ahead of

schedule with £3,775,200 invested in 141 businesses to end June 2010 and with over £1million of loan funding applications in the pipeline undergoing appraisal.

**Figure 1: West of Scotland Loan Fund - Industrial Sectors**



**Figure 2: West of Scotland Loan Fund Ltd - Geographical Breakdown**



## 4. Scottish Co-investment Fund II (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.

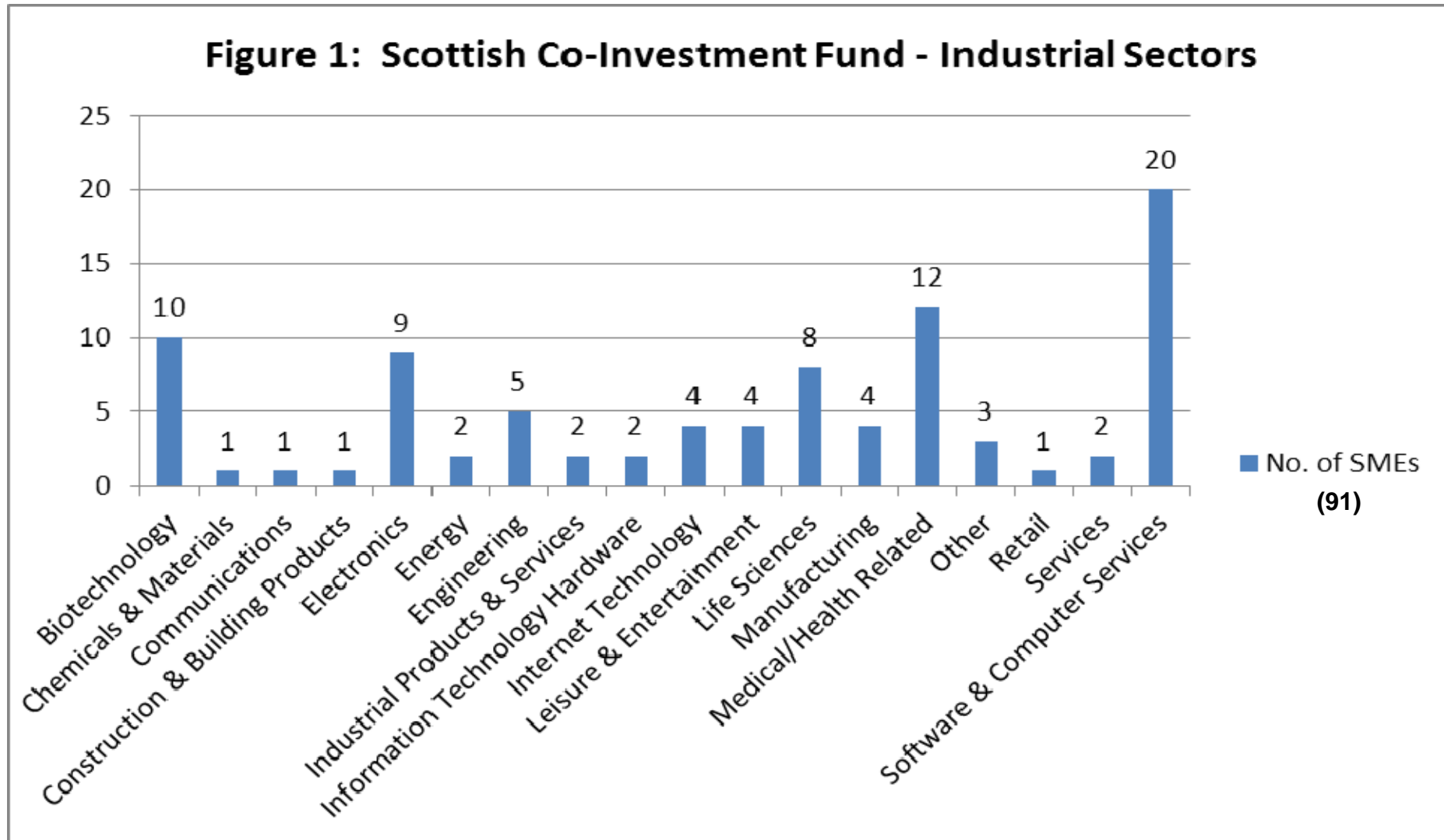
### 4.2 Progress Against Forecasts, Physical Outputs, Results and Economic Impacts

4.2.1 Overall to date (April 2008 to September 2010) the Scottish Co-Investment Fund has invested a total of £22,684,649 in 91 companies with a significant number of individual investments representing a second round of funding for the investee company. This investment has been matched by private sector investment of £33.4m representing a leverage ratio of 1 : 1.46.

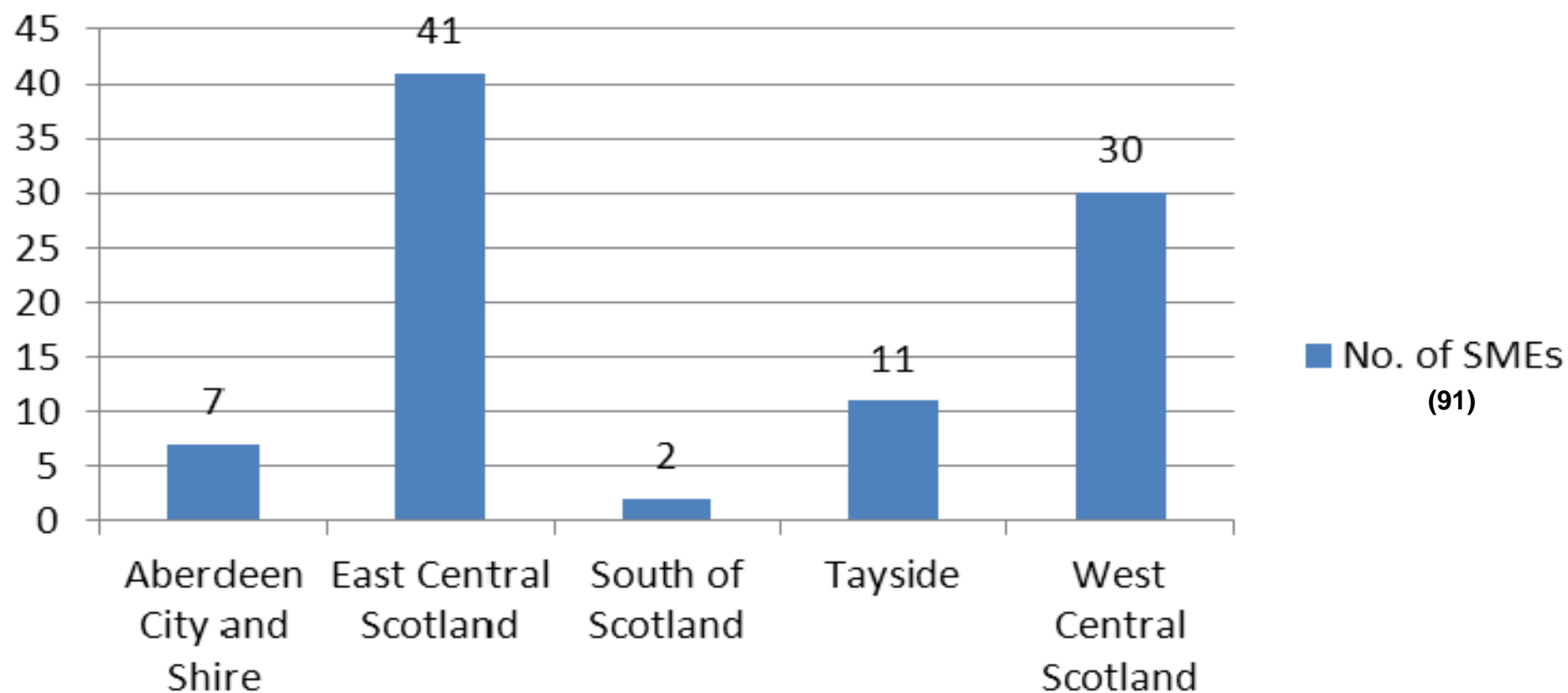
4.2.2 Figure 1 below provides an analysis of the investee companies by BVCA sector i.e. British Venture Capital Association industrial sector classification whilst Figure 2 provides an analysis of the distribution of investee companies by Scottish Enterprise Areas. The analysis of investments at Figure 1 shows a spread of investments across the BVCA sectors with Software and Computer Services featuring strongly, closely followed by Medical/Health Related and Biotechnology. Figure 2 shows that the majority of deals (>50%) are still located in the east of Scotland area. Scottish Enterprise Investments is involved in ongoing work internally within Scottish Enterprise and externally (e.g. through the LINC network) to engage with investee companies, Investment Partners, including angel groups and the wider market to encourage activity throughout Scotland. The Fund currently has 37 approved Investment Partners and it is these Investment Partners who source and bring deals to the Fund.

4.2.3 Based on current market conditions and evidence of demand, Scottish Enterprise Investments expect the Fund to fully invest the total ERDF grant contribution within the approved investment period. There is currently a pipeline of investment deals with a total value of £6m in the system seeking of the order of £2m from the Fund.

**Figure 1: Scottish Co-Investment Fund - Industrial Sectors**



**Figure 2: Scottish Co-Investment Fund - Scottish Enterprise Areas**



## **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.

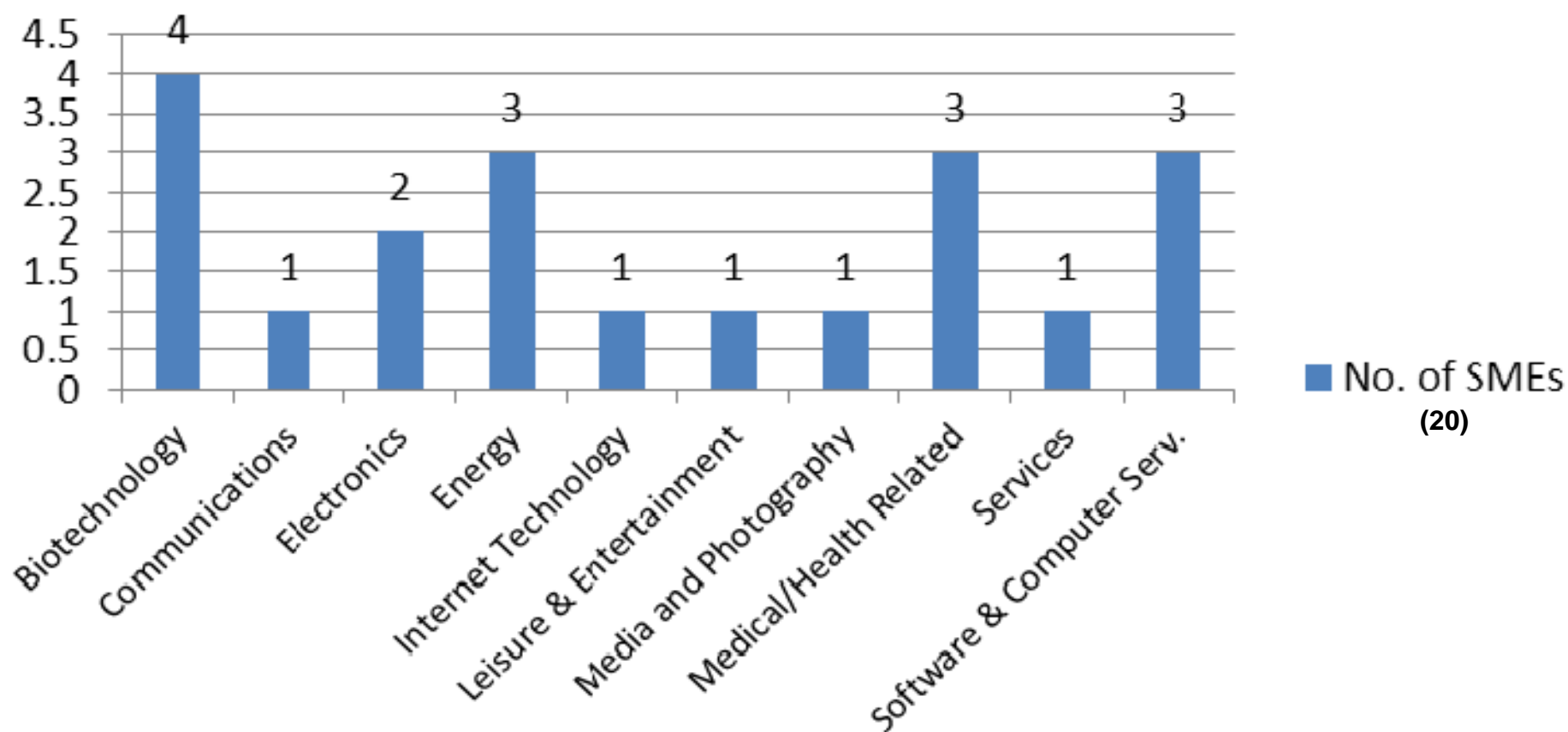
### **5.2 Progress Against Forecasts, Physical Outputs, Results and Economic Impacts**

5.2.1 From the launch of the Fund to the end of August 2010, Scottish Enterprise Investments has invested £19,480,687 in 20 companies from the Scottish Venture Fund. This investment has been matched by private sector investment from Scottish Venture Fund partners of £41m representing a leverage ratio of 1 : 2.1.

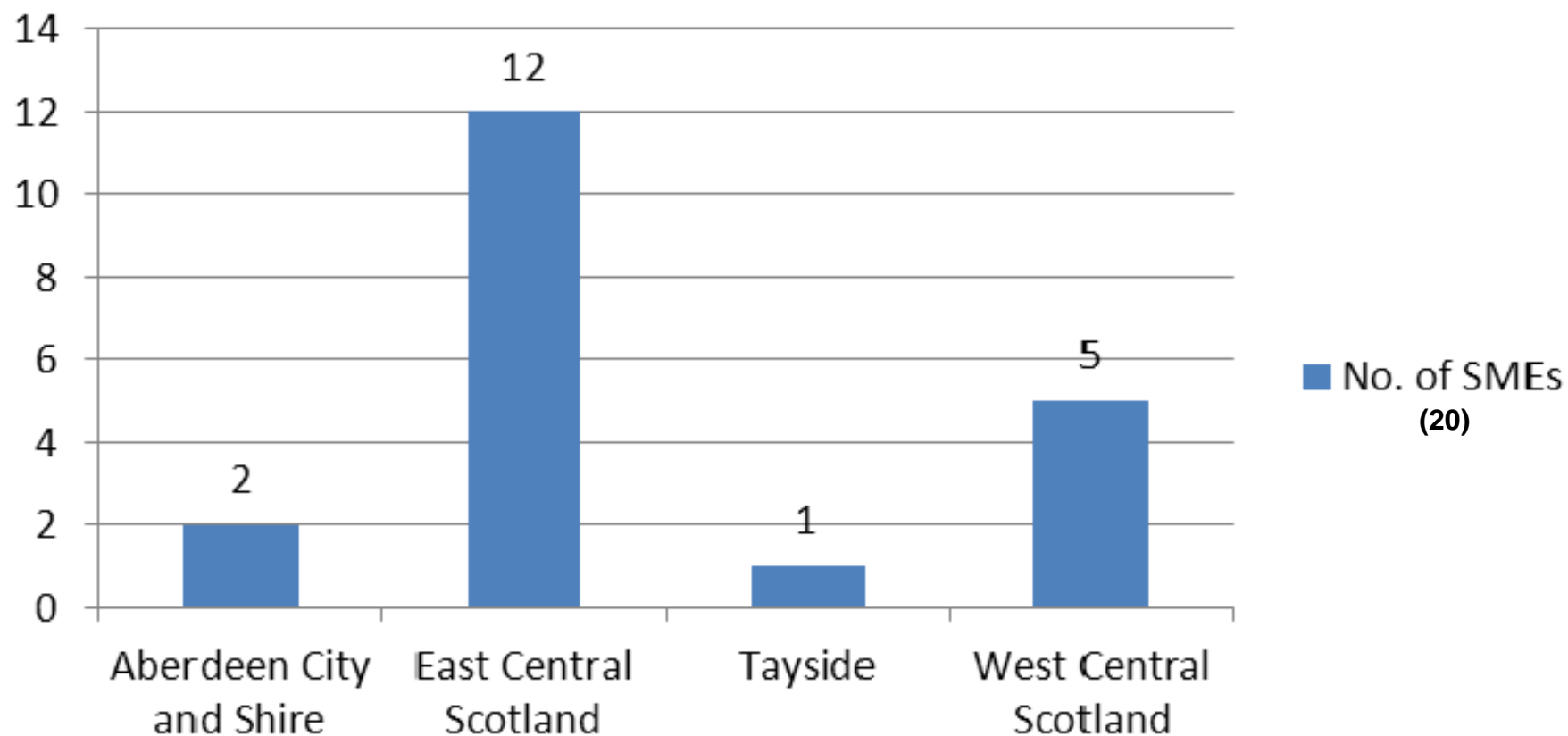
5.2.2 Figure 1 below provides an analysis of the investee companies by BVCA sector from the launch of the Fund to the end of September 2010, while Figure 2 provides an analysis of the distribution of investee companies by Scottish Enterprise area. The analysis at Figure 1 shows a reasonable spread across the BVCA sectors with Biotechnology, Medical/Health Related, Energy and Software and Computer Services featuring slightly ahead of the others. As regards the geographic spread and as with the Co-Investment Fund the majority (60%) of the investment deals are in the east of Scotland. Scottish Enterprise Investments however report that in the last 12 months the position has improved slightly to a figure of 52%. Again, and as an approved co-investment fund model, the investment partners of Scottish Venture Fund source and bring investment deals to the Fund.

5.2.3 Based on current market conditions, Scottish Enterprise Investments expects the Fund to fully invest the total ERDF grant allocation within the approved investment period. There is currently an investment pipeline of possible deals to the value of £17m involving a potential Scottish Venture Fund contribution of £7.5m.

**Figure 1: Scottish Venture Fund - British Venture Capital Association Sectors**



**Figure 2: Scottish Venture Fund - Scottish Enterprise  
Areas**



## **6. East of Scotland Investment Fund (East of Scotland Local Authorities)**

### **6.1 Background**

- 6.1.1 The East of Scotland Investment Fund is a consortium of 9 local authorities in the East of Scotland. The Fund will provide loan finance up to £50,000 to new and existing businesses (SMEs) across the member local authority areas.
- 6.1.2 In March 2010 the East of Scotland Investment Fund was awarded £1.78m ERDF grant under Priority 2 of the ERDF Programme, which with £1.73m co-finance from the member local authorities and £1.5m from the Royal Bank of Scotland provides a total fund capital of £5m.
- 6.1.3 The East of Scotland Investment Fund Ltd was incorporated on 10<sup>th</sup> December 2009 as a company limited by guarantee. A Board of Directors will meet quarterly and will be responsible for the governance, strategy and management of the company. In addition the Board has set up a corporate working group to support the Board with its responsibilities including the development of policies and strategies as well as items of business requiring attention outwith the normal quarterly board meeting cycle. An Officers Group, comprising staff from each of the member authorities has been established to deal with the day to day operational matters including performance, sharing good practice, training, marketing and monitoring.
- 6.1.4 The tender for the provision of 'Fund Management' services was won by WSLF Management Services Ltd, a wholly owned subsidiary of the West of Scotland Loan Fund Ltd. There are currently 11 applications valued at £310,000 either at the appraisal or approved stage. It is anticipated the Fund will start making investments in new and growing businesses in the east of Scotland by the end of October 2010.

## **7. Scottish Investment Bank Loan Fund (Scottish Government)**

### **7.1 Background**

- 7.1.1 The Scottish Investment Bank Loan Fund was launched in April 2010. This is a £50m loan fund providing unsecured and mezzanine debt finance to established growth and exporting businesses in the range of £250,000 to £2m on a fully commercial basis. The SIB Loan Fund received £20m ERDF in the third round following a presentation to the PMC at its meeting in March 2010.
- 7.1.2 The process of procuring the Fund Manager is at an advanced stage and it is hoped that the contract will be in place before the end of 2010.
- 7.1.3 The joint Scottish Enterprise and Scottish Government project team meets on a regular basis to monitor progress in implementation and to address other key operational issues such as private sector investment and market analysis. With regard to private sector investment, negotiations are progressing well with good prospects of achieving additional private sector finance alongside the £50m public sector capital in the Fund. The market gap analysis provided with the original ERDF application is being updated based on current research and this will be reported to Committee in due course.

**8. Recommendations**

**8.1** The Committee is invited to:

- 8.1.1 note the excellent investment performance and progress to date in the West of Scotland Loan Fund and the Scottish Co-investment Fund and the Scottish Venture Fund supported by the LUPS ERDF Programme,
- 8.1.2 note that all three funds continue to report significant demand for investment finance both debt and equity, and
- 8.1.3 note that the East of Scotland Loan Fund and the Scottish Investment Bank Loan Fund are making good progress in establishing the necessary fund management arrangements and will be investing in eligible businesses by the end of the year.

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