

**Enterprise M3 Board**

**25 May 2017**

**Finance South East – Item 10**

Enterprise M3 Board is asked to:

**Note** the findings of the Evaluation of the Funding Escalator (April 2017)

**Agree** the advice of the Programme Management Group that the investment period for the funding escalator be extended for one year to end of June 2018.

**Note** the proposed next steps to ensure that Enterprise M3 continues to offer access to services products for high innovation, high growth potential businesses in the future.

**1. Background**

- 1.1 Operational since July 2014, the Funding Escalator was developed to address a funding gap for earlier stage SMEs with high growth potential. These companies typically deliver the majority of future growth and employment but often have insufficient access to traditional bank finance or private sector funding.
- 1.2 The Funding Escalator was established through Enterprise M3's Growing Enterprise Fund following a successful bid to Enterprise M3 for £5.5m. It is managed by the FSE Group on behalf of Enterprise M3 and comprises of two products aimed at early stage high growth potential companies in the Enterprise M3 area:
  - £4 million Expansion Loan Scheme providing between £50,000 and £200,000 to established SMEs.
  - £1.5m Growth Fund providing between £75,000 and £175,000 as an equity investment to earlier stage SMEs.
- 1.3 The Funding Escalator underwent significant external due diligence in 2013/14 before the fund was launched. The work of the fund is overseen by a Steering Group (Chaired by Mike Short) which comprises of two Enterprise M3 Board Members, the Enterprise M3 Director, a representative of The FSE Group and a representative from the Enterprise M3 Growth Hub. Key developments relating to the fund are reported to the Enterprise M3 Board in the Growing Enterprise Fund paper. Decisions on the companies supported are made by an independent and expert committee but the Steering Group set the criteria for investment, monitor performance and set the operating budgets for the fund. The FSE Group operate similar products for both Coast to Capital LEP and Thames Valley Berkshire.
- 1.4 The Funding Escalator was initially set up to operate with a two year investment period, with funds being returned to Enterprise M3 from year 4 onwards, with full repayment anticipated in year 7. The investment period was extended in 2016 to allow for the FSE Group to continue to make investments, given a slower than anticipated start to the fund. In December 2016, the FSE Group indicated that they would likely seek a further extension to the investment period to allow for the entirety of the £5.5m of funding to be drawn down. The Steering Group for the fund agreed that before a further extension be considered, an independent evaluation of the Funding Escalator should be carried out. This evaluation would inform the decision whether to extend the investment period but would also inform thinking about future access to finance products funded by Enterprise M3.
- 1.5 This paper reflects the comments and feedback of the PMG who considered this proposal at their meeting on 11 May 2017, noting the findings of the evaluation work and recommended that the investment period for the fund be extended by a year. The PMG also asked for further clarification about the fund, including detail on process and cashflow and this detail has been

added to the paper and will be covered by Kevan Jones (Chief Executive of FSE Group) in his presentation to the Board.

## **2. Evaluation – key findings**

- 2.1 The evaluation was conducted by Hanmer Management and the report is based upon a review of the FSE's group documentation, Enterprise M3 reports and interviews with key stakeholders. The work also included a review of recent reports on business support to provide market analysis. This paper summarises the key findings from the report but a full copy of the report can be made available by emailing Rachel Barker ([rachel.barker@enterprisem3.org.uk](mailto:rachel.barker@enterprisem3.org.uk))
- 2.2 The report found that following a slow start, the Funding Escalator is now experiencing significant momentum both in terms of enquiries and investment that has been provided. By the end of this month, the evaluation states that it is expected that 6 businesses will have secured equity funding through the Growth Fund, totalling an investment of £875,000 from an original total of £1.5m. Similarly the Expansion Loan Scheme expects to support 25 loans to 22 companies, a total investment of £3.15m from an original budget of £4.5m.
- 2.3 The evaluation found that both funds are seeing high levels of additional funding secured and high value jobs in excess of the levels predicted. Whilst the Funding Escalator is at a relatively early stage to assess outcomes (usually a minimum of 3 years is required to see the outcome of investment), forecast outcomes at this stage are significantly higher than had been initially forecast, with the products safeguarding 163 jobs and forecast to create a further 270 new jobs (with 38 created to date). There has also been significant leverage through the Funding Escalator, with £2m of additional funding achieved to date, with a further £1m forecast before the end of April 2017.
- 2.4 In terms of process and governance, the evaluation also found that the FSE Group is a “very capable organisation who manage the funds appropriately to ensure that any investments are right for the business, Enterprise M3 and the FSE Group”. Their reporting was found to be robust and their use of independent Investment and Credit Committees are a key part of the appraisal and decision making process. The evaluation also found that the individuals involved in these Committees were high calibre, experienced in their field and demanding of the applicants and FSE Fund Managers and that the rigour involved in this process should provide confidence to Enterprise M3 that the funding is being allocated appropriately and without prejudice.
- 2.5 The overall conclusion from the evaluation was positive and the following recommendations were made as suggestions for further improvements to the service:
  - i) The application process should be reviewed to ensure it is simple for businesses whilst remaining comprehensive enough for FSE. Whilst there is a ‘pre application’ on line stage, businesses should be encouraged to self-select into the programme.
  - ii) Key partners of the Growth Hub e.g. Hampshire and Surrey County Council need to be better informed about the Funding Escalator. The gap highlights that FSE should review all its partners to ensure that they are fully aware of the products.
  - iii) FSE should be using its wider partnership including the Enterprise M3 communications and Growth Hub communications team to drive awareness of the Funding Escalator.
  - iv) A simple one-page describing the Funding Escalator would be useful for partner and business awareness.
  - v) Future market conditions may have an impact on the performance of the Funding Escalator. These conditions need to be considered when reviewing performance and changes made to the Funding Escalator to make it more responsive to the prevailing market.
  - vi) Membership and attendance at the Steering Group is critical along with shorter timescales being attached to key actions.
  - vii) Ensure that the role of the Enterprise and Innovation Group is clarified with respect to the Funding Escalator. Whilst the Steering Group (and ultimately the Enterprise M3 Board) has responsibility for the management and monitoring of the programme, the Enterprise and Innovation Group should help influence future product development.

2.6 We are in discussion with the FSE Group on the recommendations listed above and an associated action plan will be developed. It is noted that a number of these recommendations relate to communications activity and are in the process of being addressed through the appointment of Enterprise M3's new Communications and Engagement Manager.

### **3. Proposed extension to the Investment Period**

- 3.1 The evaluation report supports a proposed one year extension to the Investment Period and highlights the risk in leaving a 'gap' in the market in terms of access to finance support, particularly as neighbouring LEPs continue to provide this service.
- 3.2 The extension will allow for all of the £5.5m of allocated funding to be drawn down (currently £2.08m remains in Enterprise M3's accounts, allocated to the Expansion Fund) and to support businesses. It is expected that the full funding will be drawn down in 2017.
- 3.3 The extension will mean that there will be a one-year delay in the repayment of funds back to Enterprise M3, with repayments of £750k anticipated in July 2023 and 2024 and the balance of remaining funds in July 2025.
- 3.4 The Steering Group agree the budget for the Expansion Fund on an annual basis and this operates on an open-book basis. It is estimated that costs associated with the extension for a further year will be approximately £275k with an estimated income of £175k, leaving a cost to Enterprise M3 for operating this fund for a further year of approximately £100k. The intention is that the full £5.5m will be returned to Enterprise M3 in July 2015 but this cannot be guaranteed due to the nature of the scheme. The Expansion Fund Steering Group monitor fund performance on a regular basis.
- 3.5 If the Board agree the proposed extension to the Investment Period, we will instruct our Accountable Body to prepare a Deed of Variation to the original Agreement to reflect this change.

### **4. Next Steps**

- 4.1 We will be working in the coming weeks on an action plan setting out the proposed response of Enterprise M3 and the FSE Group to the recommendations highlighted in the report. The Chief Executive of the FSE Group will be attending the Board Meeting to present on the recent progress of the Funding Escalator.
- 4.2 Given that a number of the recommendations link to communications activity, we will also be working to ensure that we communicate the positive news from this evaluation report. A key part of this communications material will be the case studies from the companies that have secured support from the Funding Escalator and we will be ensuring that these are used widely in Enterprise M3 communications, including our website.
- 4.3 Finally, the evaluation highlights that the requirement to support early stage, high growth businesses is ongoing and this has not changed since the Funding Escalator was established in 2014. The report highlights that a failure to provide such funds could potentially lead to slower economic growth and lower levels of high value job creation and could lead to businesses relocating to where funding is available (including neighbouring LEP areas and London). It is therefore considered important that early consideration is given to what might replace the Funding Escalator when the investment period ends in June 2018 (assuming the proposed extension is agreed by the Enterprise M3 Board in May 2017). A formal procurement exercise will be required to test the market and identify potential suppliers and this would need to take account of the SEP refresh which is scheduled to conclude in September 2017. The Enterprise M3 team are currently discussing how this work can be resourced as past OJEU procurement exercises have been resource-intensive. These discussions are mindful that in order for there not to be a 'gap' in the market from 1 July 2018, an OJEU advertisement must be placed at the start of November 2017.

Rachel Barker  
15 May 2017