

**BIS** | Department for Business  
Innovation & Skills

**REVIEW OF CAPITAL FOR  
ENTERPRISE LIMITED**

Report to the Department for  
Business, Innovation & Skills

AUGUST 2011

**SQW**

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# Executive summary

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1. This is a report conducted by SQW Limited on behalf of the Department for Business, Innovation & Skills (BIS) to review the progress of Capital for Enterprise Ltd (CfEL). The work was undertaken during August to October, 2010.
2. The purpose of the research is three-fold:
  - to review CfEL's performance management information
  - to examine the progress and achievement of CfEL since inception
  - to draw out the lessons learned for the future implementation of CfEL.

## Background to CfEL

3. CfEL was established in April 2008 "to deliver and manage the Government's financial interventions in the SME sector, applying its knowledge and understanding of SMEs and the financing environment in which they operate". Key features of CfEL are as follows:
  - it is a Non-Departmental Public Body (NDPB) set up as a limited company by guarantee, with HM Government being the sole shareholder through BIS; regulated by the Financial Services Authority (FSA) for venture capital business; and
    - it functions at 'arms length' as an autonomous entity to design, deliver and manage BIS's financial interventions (debt, equity and hybrid<sup>1</sup>) in the SME sector
    - the implementation of CfEL has resulted in the creation of two subsidiaries – Capital for Enterprise Fund Managers Limited and Capital for Enterprise (GP) Limited.
  - it is currently mostly funded by Grant-in-aid from BIS and obtains income from contracts with third parties
  - there is an independent Board of Directors which oversee and guide the activities of CfEL. This includes independent experts in company finance, a Shareholder Executive representative, a CEO and Deputy CEO
  - there are currently c. 18 full-time equivalent (FTEs) staff from the private and public sector; and a number of contractors. All staff are based at CfEL's offices in Sheffield
  - the principle investment schemes managed by CfEL on behalf of BIS and the Cabinet Office up to the end of 2009/10 include: Enterprise Finance Guarantee; Capital for

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<sup>1</sup> The NESTA & BVCA 'Thin Markets' research report (Nightingale *et al*, 2009) defines 'hybrid' funds as "arrangements where the state invests in a venture capital fund managed by a commercial venture capitalist".

Enterprise Fund; Enterprise Capital Funds; Aspire Fund; Social Enterprise Fund; UK Innovation Investment Fund; and several “legacy”<sup>2</sup> programmes.

## Methods

4. The research was conducted using the following main methods:
  - *an inception meeting with representatives from BIS* – this was held in August 2010
  - *a review of documentation and data* – this primarily included CfEL Business Plans; Framework Document; reports on Key Performance Indicators (KPIs); CfEL Management Information Reports; and other documentation
  - *primary research* – we received input from the following informants: Maven Capital Partners; Catapult Venture Management; CfEL and BIS. We also reviewed the primary research detailed in our report for BIS on improving the coherence of publicly-backed venture capital provision<sup>3</sup>.

## Performance management system

5. The data and procedures by which CfEL monitors its own performance are comprehensive and are underpinned by strong governance arrangements.
6. CfEL rigorously monitors the activities of fund managers and lenders. This includes the important ‘verification’ process undertaken by CfEL on the data/information it receives from fund managers and lenders. Feedback from fund managers indicates the monitoring procedures to be in their view sensible/appropriate and not overly burdensome.
7. The data and procedures by which BIS monitors CfEL’s performance are generally well structured with clearly defined responsibility and accountability for the various components of CfEL’s management/leadership.
8. CfEL provides substantial data and results of analyses to BIS on a regular basis and using agreed reporting templates.
9. As reporting is based on templates agreed with BIS (and therefore by implication fit-for-purpose), the greater challenges for CfEL’s management information system are associated with: (i) its ability to respond quickly and effectively to *ad hoc* requests from BIS (e.g. to support officials researching answers to Parliamentary questions); and (ii) to provide, in proactive mode, alerts to BIS on potentially contentious issues likely to be raised by for example MPs or the media. The latter is especially challenging for CfEL in that it requires ongoing management surveillance and judgement.
10. A further challenge is for CfEL to meet all the needs and expectations of BIS in terms of financial reporting to the exact (and exacting) standards that are set. Evident capability to

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<sup>2</sup> Legacy programmes are funds which no longer make new investments or loans, and include: Small Firm Loan Guarantee (SFLG); Regional Venture Capital Funds (RVCFs); UK High Technology Fund; Bridges Community Development Venture Fund (CDVF); and Early Growth Funds (EGFs).

<sup>3</sup> SQW (2010) Report for BIS. ‘Improving the coherence, co-ordination, and consistency of publicly-backed venture capital provision’.

adhere to these in timely fashion is likely to be a crucial issue whenever CfEL seeks work from other Government departments.

11. There are some variations between funds in how CfEL reports performance: in particular the description of KPIs for different funds vary in detail as does the way that performance is reported against the KPIs. This is due to the changing objectives as policy evolved over the past decade. Given the number of parameters being monitored, analysed and reported our point here is not to press for even more parameters to be introduced (indeed rationalisation should in principle be sought where possible). However, we would recommend clearer differentiation of what could be regarded as (i) ‘core’ measures, i.e. ones relevant to all funds, and (ii) ‘additional’ measures, as justified for individual funds.
12. We also see merit in a clearer distinction between measures of input, activity, output (i.e. matters that are in the control of CfEL and its fund managers and lenders) and outcomes (which are not). This applies to both individual funds and CfEL itself.
13. The data on measures reported to BIS are predominantly around financial performance. In view of our research for BIS on the coherence of publicly-backed venture capital provision, which identified the need to collect and report on economic development measures there is merit in CfEL giving more attention to these non-financial measures.

## Progress and achievement

14. In general, CfEL appears to have achieved what it was set up to do. The feedback from informants confirms that CfEL - its practices, progress and achievements to date – are viewed positively. Feedback suggests in particular that CfEL’s expert knowledge of the market for SME finance has been especially valuable to BIS during the recent time of policy changes.
15. However, only in a minority of cases has CfEL set (or been set) targets associated with its KPIs. This means that even where performance is reported using numerical information one commonly has no sense of the scale of achievement relative to initial intent or ambition, or relative to resource expended. In the absence of information on how much resource was allocated to realise its achievements, it is also not possible readily to assess matters of economy and efficiency.
16. In our review of CfEL’s own reporting of performance, we had in places to identify ‘measures’ that were implied by the description of some KPIs as none were stated explicitly. This is compounded in cases where the objectives and KPIs are framed in ways in which measures would in any event be difficult to define and quantify.
17. From limited primary research with market informants, there is a sense that whilst CfEL has productive relationships with those organisations with which it directly engages in the market, its profile in the wider SME finance market is relatively low and could, with benefit to policy implementation, be higher. This accords with feedback gained by CfEL from its own study of market perceptions reported in 2009: in this, the feedback indicated that there was not a clear view of how CfEL operates or manages its funds.
18. In what was in general the positive view of CfEL’s contributions held by our limited sample of market informants, the following additional conclusions can be drawn:

- there is no sense of crowding out in the market
  - CfEL is capable of attracting/retaining high calibre staff
  - the CfEL team provides BIS with access to a valuable pool of expert knowledge
  - CfEL is responsible for the process of procuring fund management being more ‘professional’ (albeit still too protracted)
  - CfEL has introduced a greater “customer focus” to interactions with fund managers.
19. Our wider research for BIS found that CfEL (including its delivery) has improved over time and has brought a degree of “rationalism” and “structure” to the landscape for publicly-backed equity funds. However, the same research found that CfEL could be more pro-active in the provision of national level market intelligence and in encouraging sharing of best practice. The degree to which it could perform this pro-active role effectively is perhaps dependent on the level of resource allocated to CfEL.
20. Further notable progress/achievements of CfEL include: 1) the strong performance of the EFG in terms of increased lending and reduction in the Government’s liability; high levels of satisfaction and tangible benefits experienced by recipient firms; and 2) the general positive findings relating to the Enterprise Capital Funds and Capital for Enterprise Fund as reported in the independent early assessment of the impact of BIS equity funds.

## Lessons

21. We propose the following ‘lessons’ from the review. These are primarily around, developing a monitoring and evaluation framework for the expanded remit of CfEL going forward:
- ensure greater clarity between ‘core’ and ‘additional’ parameters when monitoring equity funds
  - differentiate more clearly between parameters that describe CfEL’s inputs, activities, outputs and attributable outcomes
  - apply a more rigorous SMART test of the way CfEL’s objectives are articulated
  - re-consider the merits/de-merits of target setting for inputs, activities and outputs
  - make the chosen ‘measures’ associated with CfEL’s KPIs more explicit and avoid *unnecessary* variability in KPIs and measures for different funds
  - investigate how the value of CfEL’s knowledge and positioning in the market can be more fully recorded and assessed, i.e. the value of what CfEL does beyond managing and reporting on the equity and lending instruments it has responsibility for.

# 1: Introduction

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- 1.1 This is a report from SQW Limited on research conducted on behalf of the Department for Business, Innovation & Skills (BIS) to review the progress of Capital for Enterprise Ltd (CfEL). The work was undertaken during August to October, 2010.
- 1.2 The purpose of the research is three-fold:
- *to review CfEL's performance management information* - this includes a review of the effectiveness of CfEL's current performance framework covering (a) the data and procedures by which CfEL monitor their own performance and that of their fund managers; (b) the data procedures by which BIS monitors CfEL's performance;
  - *to examine the progress and achievement of CfEL since inception* – this is against the original objectives and Key Performance Indicators (KPIs) set by BIS, and against the additional requests made of CfEL by BIS thereafter; and
  - *to draw out the lessons learned for the future implementation of CfEL* – as a result of the above, identify any lessons to be learned for the implementation and operation of CfEL as its remit expanded to include management of the RDA activities.
- 1.3 It is worth pointing out that the focus of this report is on CfEL's role and performance, and not the impact of the various schemes and funds for which it has responsibility.

## Background to CfEL

- 1.4 CfEL describes itself as a “professional asset management company...which manages Government interventions in support of small medium sized enterprise”<sup>4</sup>. It was established in April 2008 with the purpose of supporting the strategic aims and Public Service Agreement<sup>5</sup> of BIS. The ‘Framework Document for CfEL’ identifies the strategic aims as follows:
- “to deliver and manage the Government’s financial interventions in the SME sector, applying its knowledge and understanding of SMEs and the financing environment in which they operate”; and
  - “to inform and improve the quality of Government policy initiatives through its close involvement in the market”.
- 1.5 Key features of CfEL are as follows:

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<sup>4</sup> CfEL Business Plan – Working Draft V11 2001-2014.

<sup>5</sup> The PSA included: ‘PSA1 – raise the productivity of the UK economy’; and ‘PSA 7 – improve the economic performance of all English regions and reduce the gap in economic growth rates between regions’. The activities of CfEL were also intended to further BIS’s Department Strategic Objectives (DSO) notably ‘DSO1 – promote the creation and growth of business and a strong enterprise economy across all regions’.

- it is a Non-Departmental Public Body (NDPB) set up as a limited company by guarantee, with HM Government being the sole shareholder through BIS; regulated by the Financial Services Authority (FSA) for venture capital business; and
  - it functions at ‘arms length’ as an autonomous entity to design, deliver and manage BIS’s financial interventions (debt, equity and hybrid<sup>6</sup>) in the SME sector
  - the implementation of CfEL has resulted in the creation of two subsidiaries – Capital for Enterprise Fund Managers Limited and Capital for Enterprise (GP) Limited. This is because it is also managing third party money (i.e. bank finance in the CfE Fund)
- it is currently mostly funded by Grant-in-aid from BIS and obtains income from contracts with third parties
- there is an independent Board of Directors which oversee and guide the activities of CfEL. This includes independent experts in company finance, a Shareholder Executive representative, a CEO and Deputy CEO
- there are currently c. 18 full-time equivalent (FTEs) staff from the private and public sector; and a number of contractors. All staff are based at CfEL’s offices in Sheffield
- the principle investment schemes managed by CfEL on behalf of BIS and the Cabinet Office up to the end of 2009/10 include: Enterprise Finance Guarantee; Capital for Enterprise Fund; Enterprise Capital Funds; Aspire Fund; Social Enterprise Fund; UK Innovation Investment Fund; and several “legacy”<sup>7</sup> programmes.

## Methods

1.6 The research was conducted using the following methods:

- *an inception meeting with representatives from BIS* – this was held in August 2010
- *a review of documentation and data* – this primarily included CfEL Business Plans; Framework Document; reports on Key Performance Indicators (KPIs); CfEL Management Information Reports; and other documentation
- *primary research* – we received input from the following informants: Maven Capital Partners; Catapult Venture Management; CfEL and BIS. We also reviewed the primary research detailed in our report for BIS on improving the coherence of publicly-backed venture capital provision<sup>8</sup>.

<sup>6</sup> The NESTA & BVCA ‘Thin Markets’ research report (Nightingale *et al*, 2009) defines ‘hybrid’ funds as “arrangements where the state invests in a venture capital fund managed by a commercial venture capitalist”.

<sup>7</sup> Legacy programmes are funds which no longer make new investments or loans, and include: Small Finance Loan Guarantee (SFLG); Regional Venture Capital Funds (RVCFs); UK High Technology Fund; Bridges Community Development Venture Fund (CDVF); and Early Growth Funds (EGFs).

<sup>8</sup> SQW (2010) Report for BIS. ‘Improving the coherence, co-ordination, and consistency of publicly-backed venture capital provision’.



## Structure of the report

1.7 The remainder of this report is structured as follows:

- *Section 2:* provides a review of the current performance management information
- *Section 3:* presents the progress and achievements of CfEL to date
- *Section 4:* presents our conclusions including the lessons learned for the future implementation of CfEL
- *Annex A:* provides a list of informants from our primary research
- *Annex B:* presents the type of equity data collected by CfEL.

## 2: Review of performance management information

- 2.1 This section provides a review of the effectiveness of CfEL’s current performance framework, this includes the data and procedures by which CfEL monitor their own performance and that of their fund managers. We also review the data and procedures by which BIS monitors CfEL’s performance. However, we first review CfEL’s objectives in order to inform our assessment of CfEL.

### Objectives

- 2.2 The objectives set for CfEL are articulated in the ‘Framework Document for CfEL’ as: (i) a statement of the purpose of CfEL; (ii) Terms of Reference; and (iii) overall aims. These are summarised in Table 2-1.

Table 2-1: Purpose and terms of reference for CfEL - summary

PURPOSE/TERMS OF REFERENCE	DESCRIPTION	COMMENT
Strategic aims	<ul style="list-style-type: none"> <li>Deliver and manage Government's financial interventions in the SME sector</li> <li>In so doing, apply its knowledge and understanding of SMEs and of their financing environment</li> <li>Inform and improve the quality of Government policy initiatives through CfEL's close involvement in the market</li> </ul>	<p>This is a notable mix, of:</p> <ul style="list-style-type: none"> <li>operational tasks</li> <li>provision of expert capability/capacity</li> <li>contributions to policy development</li> </ul>
Management	In particular this includes a number of “discretionary” management tasks: Enterprise Capital Funds; Small Firms Loan Guarantee (SFLG) programme; other fund investments, including Regional Venture Capital Funds, UK High Technology Funds; Community Development Venture Funds (Bridges) and Early Growth Funds	
Expert	<ul style="list-style-type: none"> <li>provide information, advice and market intelligence to Government <ul style="list-style-type: none"> <li>based on what CfEL gleans from its management activities</li> <li>based on what CfEL gleans from its presence in the market</li> </ul> </li> </ul>	There is an implication here that CfEL is expected to engage with the market for SME finance beyond what it does in pursuit of management activities
Legacy funds	<ul style="list-style-type: none"> <li>to maximise the value from a legacy portfolio of equity gap fund investments</li> </ul>	It is notable that the aim here is stated as to “maximise the value”

Source: SQW’s review of the Framework Document

- 2.3 In addition to the objectives in the Framework Document (see section 1), the objectives for CfEL are also articulated in the company’s own Business Plan. Four objectives are described:
- to provide a high level of service to BIS in the development, management and delivery of its financial instruments in the SME marketplace (going on to specify the discretionary management of five initiatives)

- *this is aligned well with the expressed strategic aim and terms of reference on management described in Table 2-1*
- to contribute to policy by providing information, advice and market intelligence to BIS arising from CfEL's presence in the market
  - *again this is aligned well with the expressed strategic aims and expert role described in Table 2-1*
- to develop additional sources of business, initially from within central Government
  - *whilst not strictly expressed in the Framework Document as an 'objective' for CfEL, this expansion of service provision to other clients does fall within CfEL's Terms of Reference*
- to prepare for the review of CfEL's NDPB status<sup>9</sup> by building a commercially managed organisation that is capable of becoming fully independent
  - *the Framework Document does not appear to reflect this objective, at least not in comparable terms. However this is covered by standard public bodies guidance produced by the Cabinet Office.*

## Data and procedures by which CfEL monitor their own performance

2.4 CfEL monitor their own performance through a number of ways<sup>10</sup>:

### **Governance**

- through the appointment of a Board of Directors which maintains a system of internal control that support the aims and objectives of CfEL
  - the Board's responsibility primarily relates to corporate governance

### **Management of risk**

- development of an internal risk register (which forms part of the risk management strategy) which allows an assessment of risk associated in the provision of public funds and how to mitigate this
  - appointment of an Internal Auditor – the same Auditor as for BIS
- the Board has established an Audit and Risk Committee which has the responsibility of supporting the CEO as Accounting Officer by monitoring and reviewing the risk,

<sup>9</sup> According to the CfEL Business Plan Outline 2009-12 & Detail 2009-10, the review of CfEL's NDPB status is to be completed in March 2011.

<sup>10</sup> These are based on various documents and primary research: CfEL and Subsidiary Companies, Directors' Report and Financial Statements for the period ended 31 March 2009; Directors' Report and Financial Statements for the period ended 31 March 2009; CfEL Business Plan Outline 2009-12 & Detail 2009-10.

control and governance processes within CfEL. The CfEL Internal Auditor attends all Audit and Risk Committee meetings

- both the Board of Directors and the Audit and Risk Committee review the performance of the CEO and CfEL's Executive Team
- audit programme on EFG/ SFLG by external auditors
- subject to NAO audit on management of programmes for BIS

### **Financial accounts**

- publication of annual report and financial accounts in line with HM Treasury guidance as well as preparation of business plans

### **Performance reports**

- through a number of reports internal and independent reports:
  - *fund performance* – e.g. Small Firms Loan Guarantee Scheme – peer review of econometric modelling; Hermes Private Equity, UK Innovation Investment Fund due diligence report; and Aspire management report
  - *analytical reviews* – e.g. CfEL policy and desk documents
  - *stakeholder and other documents* – e.g. CfEL management reports to investors; CfEL Perception Audit Report

### **Data capture and analysis**

- by devising and establishing internal practices which allow them to extract relevant data/information from fund managers; analysing and verifying this; feeding it into an internal equity database; and using this to report to BIS on a weekly and quarterly basis (see below for further details)
- with regard to debt instruments, development of a web portal to capture the investments made into the EFG (see below for further details)
- during 2008/09, CfEL undertook a data handling review with identified various actions that CfEL is addressing in 2009/10 (e.g. training for recently appointed Information Asset Owners, development of ICT policies)
- staff training and development of processes to encourage good or innovative practices
- forecast spend on assets and liabilities managed on behalf of BIS to assist BIS to manage the budget for these items.

## **Data and procedures by which CfEL monitor the performance of their fund managers and lenders**

### *Equity*

- 2.5 In our view, an important component of CfEL monitoring its own performance and that of its fund managers is the development of a process for extracting data/information from fund managers – this is partly driven by the requirements of reporting to BIS but also include data/information which CfEL has come up with as result of their market experience (e.g. some are devised so that comparison can be made with standard market measures such as those reported by BVCA).
- 2.6 Fund managers are required to report on key data/information as stipulated by CfEL. There is a dedicated Investment Team within CfEL for both debt and equity schemes (comprising of four staff) which receives data/information and is subject to an internal audit process. Working arrangements with fund managers for monitoring activities typically include: quarterly manager reports; work-in-progress reports; weekly reports; weekly conference calls with CfEL. The data/information provided is analysed and various ‘cuts’ of the data are undertaken (e.g. location, sector, deal size etc.) to produce equity fund performance reports. This feeds into the quarterly Management Information Reports<sup>11</sup> prepared for BIS.
- 2.7 The fund data that is collected from fund managers uses a template, usually in spreadsheet format, and is divided into the following categories: ‘standard descriptive data’; ‘public sector financials and fund financials’; ‘investment activity’; ‘investment characteristics’; and ‘investment outcomes’. The type of data collected (and their definitions) is substantial and is presented in Annex B. We have been informed by CfEL that these are collated at least on a quarterly basis. It is worth stating that data/information collected may be slightly different depending on they type of fund. Fund managers provide ‘raw data’ against the relevant data type mainly in spreadsheet format and narrative reports. In addition to this, CfEL also request ‘live reports’ from fund managers - these are reports providing information on any new investments associated with a specific fund.
- 2.8 According to the CfEL Investment Team, once the data/information is received, the next step involves analysing and verifying the data provided by the fund managers e.g. to check for double counting – basically sense check the data provided. This important process is based on the value judgement of the individual member (or collectively) of the CfEL Investment Team as a result of their industry experience and/or market knowledge. The validation process is conducted for every piece of fund activity (i.e. commitments, investments, write offs, exits etc.) This is done for each individual investee portfolio company not just the total fund position.
- 2.9 After the data has been verified, it is inputted into an internal ‘equity reporting database’ in spreadsheet format. This database holds time series data on all the funds and various ‘cuts’ can be made to cater for any specific enquiry that BIS may have. The data/information from

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<sup>11</sup> BIS provided us with the following reports: CfEL Equity Management Information Report, April 2010; SFLG Quarterly Management Information Report, for January to March 2010; and Quarterly Management Information Report for January to March 2010.

this database is used for whatever reporting outputs are required – the main one being the quarterly Information Report for BIS.

- 2.10 Not surprisingly, the quarterly Management Information Reports give an indication of the key parameters which are collated from the fund managers. We have reviewed these reports and it is evident that there is plenty of quality data/information reported and analysed. Generally, this data/information presented is derived from categories of measures that have been identified above. The main areas covered for the equity funds are shown in the table below.

Table 2-2: Equity management Information reports data/information for each fund (quarterly basis)

Topic	Examples of data presented
<b>Commitment</b>	<ul style="list-style-type: none"> <li>• Commitment drawn of fund</li> <li>• Investment rate in portfolio companies</li> </ul>
<b>Investment characteristics</b>	<ul style="list-style-type: none"> <li>• Sectoral breakdown of fund investments</li> <li>• Regional distribution of fund investments</li> </ul>
<b>Valuation</b>	<ul style="list-style-type: none"> <li>• Fund value compared to drawdowns</li> </ul>
<b>Realisations</b>	<ul style="list-style-type: none"> <li>• Value of 'exist' and 'written off' investments</li> </ul>
<b>Investor return</b>	<ul style="list-style-type: none"> <li>• Fund financial performance reported as IRR</li> </ul>
<b>Investment activity</b>	<ul style="list-style-type: none"> <li>• A number of common investment activity related measures reported and which only vary slightly by type of fund e.g. fund size, Government commitment, no. of SMEs invested in, no. of investments, IRR, total return etc.</li> </ul>

Source: CfEL Equity Management Information Report, April 2010

## **Debt**

- 2.11 With regards to the data/information for debt instruments (EFG and SFLG)<sup>12</sup>, this is compiled on a web-portal. The debt lenders send their own specific data directly to the web portal which CfEL access and use. The CfEL Investment Team provided the broad headings for the data captured through the web-portal – this was comprehensive and related to eligibility, application, claims, location, sector, length of loan, interest and other standard information.
- 2.12 From the responses to the web portal, the same process is applied as for the equity funds when analysing/verifying the information. The main output is weekly EFG reports sent to BIS each week from data taken from the web portal the day before. This weekly analysis is 'cut' into varying subsets of information and is distributed to EFG lenders, RDA contacts and not just BIS.
- 2.13 We reviewed the quarterly Monitoring Information Reports for debt portfolio and can report that they provide a very comprehensive and detailed assessment of the debt fund. For example, the EFG quarterly report covers: activity to date; activity by main lender; default performance; finances and forecasting; and other operational developments.

<sup>12</sup> According to the CfEL Investment Team, the CfEL debt portfolio covers: EFG (January 2009 to present) – weekly/monthly/quarterly reporting; new SFLG (December 2005 to January 2009) – monthly/quarterly reporting; legacy SFLG (pre December 2005) - monthly/quarterly reporting.

## **View of market informants - monitoring and reporting arrangements**

2.14 Our research was also informed by consultations with a limited number of well informed stakeholders (three in total), including two fund managers<sup>13</sup> (listed in table below). We present their overall feedback on CfEL in section 3, but detail below points made by the fund managers specifically relating to monitoring and reporting arrangements for CfEL. It is relevant to make clear that whilst their input is regarded as being of high quality and value, given that only two fund managers were consulted, no statistical significance is claimed for these findings.

Table 2-3: List of consultees

<b>Name, affiliation</b>	<b>Relationship with CfEL</b>
Andrew Craig, Partner, Maven Capital Partners	Fund manager: Capital for Enterprise Fund
Rob Carroll, Director, Catapult Venture Management	Fund manager: Regional Venture Capital Fund and an Enterprise Capital Fund.

2.15 Fund managers were asked to comment on the efficacy or otherwise of the monitoring and reporting arrangements operated by CfEL.

- working arrangement for monitoring activities typically include: quarterly manager reports; work-in-progress reports; weekly conference call with CfEL (until June 2010)
- the monitoring data/information put in place by CfEL include: types of investment; location; sector; deal size and other standard indicators
- whilst monitoring and reporting requirements of CfEL add to fund managers' work most of the information would be collected by them anyway. Therefore generally the monitoring and reporting requirements are considered to be reasonable and not overly onerous
  - according to one informant, CfEL actually has 'draconian' powers to use if required.

2.16 Whilst the metrics used to monitor individual fund performance are largely acceptable, one informant argued strongly that metrics imposed by the European Regional Development Fund (ERDF) 'muddy the waters': according to this informant, "they introduce silly reporting". There was a plea for CfEL to use its influence to change these.

2.17 Finally, one Fund Manager noted that whilst appropriate KPIs have been put in place by CfEL for its fund managers, no specific targets are set by CfEL relating to these KPIs. The issue of target setting can be difficult and not always appropriate.

<sup>13</sup> It is worth mentioning that one was a fund manager of a 'legacy' fund and the other was of a 'newer' fund.

## Summary assessment

- 2.18 **Comment:** *the data and procedures by which CfEL monitors its own performance are comprehensive and underpinned by strong governance arrangements. We understand that the data and procedures are fit-for-purpose for the various auditing requirements which CfEL is subject to. However, the NAO report<sup>14</sup> found there to be limited formal “levers” for detecting underperformance by fund managers, while recognising CfEL’s ability to take corrective action. Our review has found that formal practices are in place which address this issue as is evident by the ‘verification’ process undertaken by CfEL on the data/information it receives from fund managers and lenders. The feedback from fund managers indicates that the monitoring procedures are sensible/appropriate and not overly burdensome.*

## Data and procedures by which BIS monitors CfEL’s performance

### **Governance and accountability**

- 2.19 The Framework Document spells out a set of governance and accountability arrangements. On accountability, the Framework sets out the following:
- the responsibilities of the CEO:
    - for accounting to Parliament
    - to BERR (now BIS)
    - to the CfEL Board
  - the responsibilities of the CfEL Board:
    - to the Secretary of State or responsible minister and to BERR (now BIS)
    - as company Directors with fiduciary responsibility
  - the responsibilities of the Chair of the CfEL Board:
    - to the Secretary of State or responsible minister and to BERR (now BIS)
  - the responsibilities of individual Board members
  - the responsibility to:
    - publish an annual report with audited accounts
    - establish and maintain arrangements for an *internal audit* in accordance with HM Treasury’s Government Internal Audit Standards
  - to be subject to an *external audit* by the Comptroller & Auditor General whose report is laid before Parliament.

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<sup>14</sup> National Audit Office (2009) Venture capital support to small businesses. Report by the Comptroller and Auditor General, HC 23.



## Reporting performance

- 2.20 The Framework Document set out the responsibilities of CfEL’s management concerning reporting performance to BERR (now BIS). This reporting covers both financial and non-financial performance, including “performance in helping to deliver Ministers’ policies”: it refers to reporting against budgets and targets set out in the CfEL business plan.
- 2.21 The reporting framework described in Appendix 3 of the Framework Document has a five-fold purpose:
- to demonstrate financial propriety
  - to facilitate accurate forecasting
  - to provide timely information to inform policy analysis
  - to provide assurance that CfEL is properly fulfilling its obligations in line with policy objectives
  - to ensure that CfEL maintains records and data which would be useful to BERR (now BIS) analyses.
- 2.22 Elements of the reporting framework are summarised in Table 2-4.

Table 2-4: Elements of CfEL’s reporting to BERR (now BIS)		
TYPE	SUBJECT	DESCRIPTION
Financial reporting	<ul style="list-style-type: none"> <li>• on capital investment</li> <li>• on SFLG</li> </ul>	<ul style="list-style-type: none"> <li>• quarterly reporting</li> <li>• quarterly reporting in advance on Grant-in-Aid forecasts for SFLG</li> <li>• monthly reporting in advance on Grant-in-Aid forecasts for equity capital</li> </ul>
	On ECF – use of agreed reporting template, including summary of funds and activities; BERR (now BIS) profit share of each ECF; IRR since inception of each fund; number of SMEs invested in.	<ul style="list-style-type: none"> <li>• quarterly reporting</li> </ul>
Operational reporting for policy analysis:	On RVCFs – use of agreed reporting template, including summary of funds and activities and include IRR since inception of each fund	<ul style="list-style-type: none"> <li>• quarterly reporting</li> </ul>
	On EGFs – use of agreed reporting template, including summary of funds and activities	<ul style="list-style-type: none"> <li>• six monthly reporting</li> </ul>
	On Bridges and UK High Tech Fund – use of agreed reporting template, including summary of funds and activities	<ul style="list-style-type: none"> <li>• six monthly reporting</li> </ul>
	On all equity programmes – summary of data on parameters reported quarterly, audited fund valuations; analyses of investments by stage, region and sector; ‘diversification matrix’ for ECFs; value and distributions against drawn down capital	<ul style="list-style-type: none"> <li>• annual reporting</li> </ul>
Assurance - equity	On SFLG – agreed reporting template	<ul style="list-style-type: none"> <li>• quarterly reporting</li> </ul>
	Market context, commentary of investment patterns; recommendations on ECF development; data for ECFs; commentary on funds and their mandates;	<ul style="list-style-type: none"> <li>• annual reporting (accompanies annual report on equity)</li> </ul>

TYPE	SUBJECT	DESCRIPTION
	update on Investment and Advisory Committee; ECF programme progress; commentary on any complaints against CfEL	programmes)
Assurance - SFLG	Commentary on market context; review of Graham Review Success Criteria, commentary on strategic relationship with lenders; lender audit cycle context of default rates	<ul style="list-style-type: none"> <li>annual reporting</li> </ul>
Ad-hoc requests	To CfEL from BERR (now BIS), including to answer Parliamentary questions, Ministerial correspondence and ad hoc investigations.	<ul style="list-style-type: none"> <li>as required</li> </ul>

Source: SQW's review of the Framework Document

### Key Performance Indicators

2.23 Whilst the Framework Document sets out in some detail the accountability, monitoring and reporting arrangements it does not explicitly set KPIs for CfEL. Nor does it explicitly set quantitative measures or targets for performance. However, the CfEL Business Plan does list a set of KPIs (in its Appendix 1). These KPIs are summarised in Table 2-5.

Table 2-5: Purpose and terms of reference for CfEL - summary

Description of the KPIs	Measures/ Numerical targets set in Business Plan
<b>Enterprise Finance Guarantee</b>	
Lenders signed up to provide EFG and demonstrably using the scheme	<b>Measure:</b> Number of lenders signed up <b>Target:</b> 25
Lenders assisted	
Lenders actions monitored and audited	<b>Measure:</b> Internal checks and audit used to demonstrate performance. An agreed evaluation process used to demonstrate performance.
Lenders performance monitored and inconsistent performance investigated	<b>Target:</b> None
Premiums and payments correctly calculated and accounted for	
<b>Capital for Enterprise Fund</b>	
Arrangements put in place to enable up to £55m investment to be made in investment period	<b>Measure:</b> <ul style="list-style-type: none"> <li>fund managers appointed</li> <li>legal and process frameworks established and monitored</li> <li>helpline established</li> <li>progress monitored</li> </ul> <b>Target:</b> By implication, progress towards draw down of £55m fund
Assistance to fund managers; monitoring and audit of fund managers' actions undertaken; investment performance monitored' audit of sums paid/received undertaken	<b>Measure:</b> Contacts with fund managers. And by implication: <ul style="list-style-type: none"> <li>number of assists</li> <li>monitoring actions and outputs</li> <li>audit actions and outputs</li> </ul> <b>Target:</b> None

Description of the KPIs	Measures/ Numerical targets set in Business Plan
<b>Enterprise Capital Funds</b>	
Allocations made to new funds; advisory and investor meetings attended; monitoring undertaken	<b>Measure:</b> High quality applicants for the ECF programme. Broad portfolio of ECFs created.
Compliance with legal documents	Favourable industry and media comment. Also, by implication: <ul style="list-style-type: none"> <li>• funds allocated</li> <li>• number of meetings attended</li> <li>• monitoring actions and outputs</li> </ul> <b>Target:</b> None
<b>Aspire</b>	
Fund marketed/promoted; investments achieved in 2009-10; engagement with investment readiness community (IRC); ensure signposting to sources of help/advice	<b>Measure:</b> Investments concluded (or reasons for under achievement). Also, by implication: <ul style="list-style-type: none"> <li>• marketing/promotion outputs</li> <li>• IRC engagements</li> <li>• signposting activities</li> </ul> <b>Target:</b> 4 investments in year
<b>Legacy schemes</b>	
Monitoring undertaken; assurance on appropriate actions by investors and banks; accurate/timely information on assets and liabilities provided	<b>Measure:</b> By implication: <ul style="list-style-type: none"> <li>• fund managers and lenders engagement – evidence of quality and volume of resource deployed</li> <li>• monitoring actions and outputs</li> <li>• information provided</li> </ul> <b>Target:</b> None
<b>General</b>	
Guidance to BIS on new products	<b>Measure:</b> By implication the guidance outputs provided <b>Target:</b> None
Provision of financial forecasts; appropriately/effectively addressed accounting issues	<b>Measure:</b> By implication: <ul style="list-style-type: none"> <li>• forecasts as outputs – and their ‘quality’</li> <li>• actions and outputs on accounting matters</li> </ul> <b>Target:</b> None
Other public bodies in receipt of CfEL marketing information; other public bodies in receipt of bids for work from CfEL	<b>Measure:</b> Work managed by CfEL for other public bodies. Also, by implication: <ul style="list-style-type: none"> <li>• marketing outputs – and to whom</li> <li>• bids to other public bodies</li> </ul> <b>Target:</b> None

2.24 From the information summarised in Table 2-5, we draw the following points:

- for the majority of KPIs no numerical targets are set, the few cases where targets exist relate to the number of Aspire investments and new EFG lenders signed up. We are not able to comment on whether these targets were stretch targets or not
- one important KPI concerns the expert guidance and advice provided by CfEL to BIS. In Table 2-5 this is largely captured as providing ‘guidance to BIS on new products’. There is no further narrative on this within the CfEL report on KPIs. We consider that more attention should be given in future reporting to the nature and value of CfEL’s expert input based on its management activities and its presence in the market.

## Summary assessment

2.25 *Comment: the data and procedures by which BIS monitors CfEL’s performance are generally well structured with clearly defined responsibility and accountability for the various components of CfEL’s management/leadership. The reporting framework uses agreed (with BIS) templates which are fit-for-purpose and are populated on a frequent basis for both types of reporting – financial and operational. We understand that the more challenging aspect of reporting relate to the ad-hoc requests from BIS (or others) as it requires the ability to respond quickly and effectively. We note that the data on measures reported to BIS are predominantly around financial performance. In view of our research for BIS on the coherence of publicly-backed venture capital provision, which identified the need to collect and report on economic development measures (e.g. job creation, GVA), there is merit in CfEL giving more attention to these non-financial measures.*

2.26 *There is some variation between funds in how CfEL reports performance to BIS: including the description of KPIs for different funds varying in detail. More importantly, we found that the majority of KPIs were not assigned specific numerical targets.*

## 3: Progress and achievements

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- 3.1 In this section, we review the main activities, outputs and achievements associated with CfEL since its introduction in April 2008. This is primarily based on documentation<sup>15</sup> provided by CfEL, BIS, and wider desk research. We also report on the views received from consultees during a limited programme of primary research before providing a summary of our conclusions.

### CfEL's key activities, outputs and achievements since inception

- 3.2 Broadly the main activities associated with CfEL can be categorised as follows<sup>16</sup>:
- structuring interventions
  - manager/operator selection and negotiation
  - support for manager/operator including mentoring and coaching
  - collection and collation of data/information for reporting purposes
  - consolidation (i.e. analysis and interpretation) and evaluation
    - of what is going on within each of the funds
    - maintaining an understanding of venture capital market issues
    - understanding of significance of market issues in order to respond to BIS policy feedback requirements.
- 3.3 The main specific activities, outputs and achievements are presented below.

#### ***Investment schemes managed by CfEL***

- ***SFLG***: CfEL developed an integrated web portal and database system to track lending under the scheme (as highlighted in section 2) and which assisted in the reporting to BIS. CfEL also introduced statistical modelling techniques to develop a new forecasting model to forecast SFLG expenditure. CfEL was able to secure six new lenders to the SFLG scheme in 2008/09 and continue working with all the banks/lenders to reduce the Government's exposure from potential default on existing loans<sup>17</sup>
- ***Enterprise Finance Guarantee (EFG)***: the announcement in the Pre-Budget report of November 2008 for a new guarantee capability to support financing of SMEs (up

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<sup>15</sup> This includes: CfEL Business Plans; CfEL Financial Statements; and CfEL's own reporting on its KPIs (dated August 2010).

<sup>16</sup> This is based on primary research involving CfEL.

<sup>17</sup> We understand that CfEL monitors claims closely to ensure validity. As a result of this monitoring a large sum has been recovered at one particularly bank.

to £1.3bn) led to CfEL in collaboration with BIS and principal lenders designing the EFG which was launched in early 2009. CfEL's input included providing advice on the parameters of EFG; design of training material and seminars; development of the web portal; establishing a weekly reporting system (activity reports provided to BIS, lenders, RDAs and others); development of a lender manual; ongoing management using agreed procedures with internal checks and audits. There has also been on-going support in responding to requests for SMEs and organisations in the financial sector to develop the design of the EFG to include invoice discounting and overdrafts

- CfEL disseminated expertise and experience relating to the loan guarantee scheme to help DCLG in the design of support to homeowners through mortgage lenders
- CfEL's achievements (and by implication performance against the KPIs) are evident from the following:
  - the demand for EFG has been strong with higher lending than under SFLG (three-fold increase). CfEL has also increased the number of accredited lenders (over 40 parent organisations were signed up as lenders to provide EFG as at March 2010). We note that this exceeds the target set of 25. Between January 2009 and 31<sup>st</sup> March 2010 8,346 loans had been drawn upon with a value of £850.7m. Extensions to the EFG programme were announced whereby the programme will support lending of up to £700m over the period 1 April 2010 to 31 March 2011. The Government's liability under the EFG has declined compared to under SFLG
  - the success of the EFG is pointed out in an independent study by Durham University which reported: "*generally high levels of satisfaction and evidence of tangible benefits realised by recipient firms, for example in terms of jobs saved and created and improved business prospects. Altogether the evidence indicates that EFG has been well received by businesses and that the speed of lending and overall satisfaction has improved over the course of delivery*"<sup>18</sup>
  - weekly activity reports, CfEL's internal checks and audit being used as evidence.
- **Enterprise Capital Funds (ECFs):** since the establishment of CfEL in April 2008, discussions have been held with over 35 prospective bidders and due diligence has been undertaken with a number of fund managers. To date nine ECFs have been awarded with a total fund size of £239m (Government commitment of £156.2m). Regular meetings have taken place with ECF Fund Managers to monitor performance and CfEL has developed reporting systems to keep track of fund performance and for reporting to BIS (including quarterly and annual reports provided to BIS); draw-down procedures documented and adhered to; and issues managed relating to compliance with legal documents. Information also reported includes investments made in 72 companies and first exit made from one specified Fund

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<sup>18</sup> CfEL Business Plan – Working Draft V11 2011-2014.

- an independent early assessment of the impact of BIS equity funds<sup>19</sup> including the ECF indicated generally positive benefits as reported by recipient businesses and fund managers
- **Capital for Enterprise Fund (CfEF):** established in April 2009 with a fund size of £75m (£50m Government commitment and a further £25m from four banks). CfEL initiated the procurement process for selecting the Fund Managers in relation to two tranches of the Fund. A due diligence process was undertaken by CfEL to select quality fund managers. These have now been appointed with legal agreements signed off. A helpline was established; monitoring reports supplied (quarterly and annually) to BIS plus reports to investors; guidelines issued and draw-down procedures documented and adhered to; meetings attended and contacts maintained. The third tranche of the Fund was managed directly by CfEL (co-invest alongside other fund managers) who also developed a capability to make a small number of direct investments. It is purported by CfEL that this has been advantageous to CfEL - as a fund-of-funds manager, CfEL can work with a fund manager on a specific transaction. CfEL also provided policy analysis to consider the long term need for capital of the nature being invested under CfEF
- CfEL with respect to the CfEF has performed generally as planned with the first two exits from the Fund reported and the reports (monitoring and investor) being produced used as evidence. It is also worth noting that the early assessment of the impact of BIS equity funds including the CfEF was generally positive
- **Regional Venture Capital Funds (RVCF):** as the funds were established in 2002/03 prior to the creation of CfEL and now closed to new investments, CfEL's role has been to see through the Government's interest in the RVCF. During 2009, CfEL undertook an exercise with the RVCF Fund Managers to identify the strengths and weaknesses of individual portfolios and also finalised a 'programme of agreements' to increase the amount of investment RVCFs could make in individual companies and in calculating fees during the post-investment period
- CfEL (as with all the legacy schemes) also examined the reporting information received from fund managers; documented and adhered to the draw-down procedures; produced quarterly and annual reports for BIS. These reports are being used as evidence
- **Early Growth Funds (EGF):** These funds were established over 2002-04. CfEL provided support to individual fund managers so that sufficient resource was available for the investment realisation period of the EGFs. During 2008/09, CfEL reached an agreement with two EGF fund managers to secure additional finance (ERDF)
- **Aspire Fund:** CfEL was involved in the design, launch and marketing of this £25m co-investment fund in 2008/09. CfEL dealt with the interest from female entrepreneurs and worked with co-investors. CfEL recruited an experienced fund

<sup>19</sup> Middlesex University Business School (2010) 'Early Assessment of the Impact of BIS Equity Fund Initiatives' for BIS.

manager to its investment team to manage the Aspire Fund and develop CfEL's own capability. Specific activities and outputs included: production of web site and brochure; delivery of mail-shots; presentations at events; general PR and press coverage; sponsorship of events; attendance at networking events; engagement with investment readiness community

- the first investments through the Aspire Fund were made in 2009/10 and five investments were concluded (as at March 2010) exceeding the target of four investments. However, there was no numerical information from CfEL's own reporting relating to promotional activities
- the Aspire Fund was also included in the early assessment of the impact of BIS equity funds and received encouraging feedback from the market. It is important to point out that CfEL were tasked with delivering a fund for women entrepreneurs on behalf of BIS
- **UK High Technology Fund:** The fund was established in 2000. During 2008/09 CfEL contributed to discussions with BIS the venture capital industry and others for the need to introduce a successor fund
- **UK Innovation Investment Fund (UKIIF):** this fund was established in 2009. CfEL advised on the development of the £325m UKIIF (fund-of-funds) and lead on the selection and appointment of two fund managers
- **Office of the Third Sector (OTS):** CfEL established a fund for social enterprises on behalf of OTS. CfEL undertook due diligence and fund manager selection during 2008/09
- **Bridges Community Development Fund:** this fund was established in 2002. CfEL renegotiated with Bridges Ventures the terms of the Government's interest in the fund.

#### *Funds under transition/development*

- **RDA managed funds:** CfEL is currently undertaking a 'fact-finding' mission with all the RDAs to assist with the transition to CfEL of the regional funds previously managed by the RDA, which are to be abolished
- **Business Angel Fund:** in late 2010, CfEL began preparing a bid, with private sector partners, to the Regional Growth Fund for a Business Angel co-investment fund

#### **Other activities and outputs associated with CfEL**

- provision of guidance on the design of new products (e.g. ongoing development of EFG and design of ECF) and responding to bespoke enquires from BIS at various levels



- provision of financial forecast reports (for BIS) and addressing budgeting and accounting issues. CfEL held a risk management workshop and we understand that CfEL are working with BIS to continually improve the financial forecasts
- provision of CfEL marketing information to other public bodies and preparing bids to other public bodies for work from CfEL. The input from CfEL includes: Stakeholder Plan created and updated; submission to RDAs offering support with fund creation and management appointments; quarterly e-mailing process established (first Purdah and then a ban on marketing expenses has terminated this) web site updated; and new company presentation created
- working with other government departments and devolved administrations, such as assisting the Scottish Government to establish a loan fund
- contribution to the research on the coherence of publicly-backed venture capital provision in England and also worked with BIS on the consideration of Rowlands Growth Capital Review including the proposed creation of a Growth Capital Fund<sup>20</sup>
- recruitment and development of high-calibre, experienced individuals to CfEL from the private and public sector.

## Views of market informants

- 3.4 The assessment of CfEL’s performance to date is also informed by consultations with a number of well informed stakeholders. This includes the Fund Managers identified in section 2 plus the Chair of CfEL (see table below). It is relevant to make clear that whilst their input is regarded as being of high quality and value, given that only three were consulted, no statistical significance is claimed for these findings.

Table 3-1: Consultee

Name, affiliation	Relationship with CfEL
David Quysner, Chair of Abingworth and of CfEL	Involved with DTI and its successors in this subject for c. 4 years (i.e. before CfEL’s formation). Member of Advisory Board which influenced the set-up of CfEL.

*Note: Fund managers consulted are identified in Section 2.*

### **Relationships**

- 3.5 On the role and relationships CfEL has with respect to Government, its Fund Managers and the wider market, the following views were expressed:
- in its operations CfEL is perceived to act independently of Government but it is also acknowledged to be well positioned to inform policy development and to ‘calibrate’ lobbying of Government
  - in its relationship with Fund Managers, CfEL does not ‘interfere’ inappropriately

<sup>20</sup> Investment for Growth Capital Fund has been recently confirmed by the Government.

- from a perspective based on knowledge of the wider membership of the British Venture Capital Association (BVCA), in general CfEL is viewed positively by the market within the context of “probably 60% positive and 40% negative in terms of views on publicly-backed funds” and “the negative 40% are very unlikely to alter their stance”.

3.6 We conclude from this evidence that CfEL is regarded as having appropriate and positive relationships.

### ***Approach to meeting its objectives***

3.7 In delivering to its objectives set by Government, CfEL is considered to apply appropriate professional, commercial rigour in its dealings with fund managers.

### ***Overall views on progress and achievements to date***

3.8 In what was in general a very positive view of CfEL’s contributions, the following specific points were made:

- in making very good progress to date against its objectives, its main achievement has been in filling the gap to address a need in the market which is not being met by the private sector on its own
- attracting/retaining knowledgeable staff in CfEL has resulted in better access to the networks in the VC industry
- CfEL has succeeded in providing BIS with a pool of expert knowledge upon which it can draw: CfEL’s management has brought valuable knowledge to the implementation of publicly-backed equity funding - “CfEL provides a centre of excellence”
- as a result of CfEL’s efforts, the process of procuring fund management is now viewed as more ‘professional’, albeit still more protracted than fund managers would like it to be - CfEL is better informed about the market and available fund manager capability; its due diligence is much more thorough and professional – it looks for fund managers with a commercial track record
  - as an important added benefit, it is argued that these characteristics of CfEL’s work are attracting higher quality people to manage PBFs
- it is viewed as playing a “policy feedback” role i.e. CfEL is seen as more than a ‘delivery vehicle’: indeed one informant argues that “it may not be able to attract/retain the same high calibre of staff if it was *only* a delivery vehicle”
- operationally, the creation of CfEL has brought greater stability in the staff complement – when in DTI, the civil servants regularly were moved elsewhere
- CfEL has brought a greater “customer focus” to interactions with fund managers – bringing greater clarity over the interests of BIS as the prime funder to discussions

- according to one informant: “ CfEL is likely to get the balance between fund manager and investor (i.e. government) interests over things like re-negotiation of management contracts right more often than civil servants with less market knowledge may have been able to do”.

3.9 In the recent past, it is perceived that CfEL has had a positive influence on Government thinking and action to improve on a situation of high variability in effectiveness and management quality amongst regional publicly-backed equity funds: it is perceived to have provided Government with the solution for what to do with the role of the RDAs with respect to SME finance.

3.10 Notwithstanding this range of positive comments, one Fund Manager perhaps ‘dampened’ the case by stating that he had experienced no “real step-change for Fund Managers of publicly-backed funds since before CfEL was formed, although the performance metrics have become more formalised”.

### ***Strengths, weaknesses and lessons for future development***

3.11 Asked to identify any particular strengths or weaknesses in the performance of CfEL to date, the following views were obtained:

- its due diligence process when procuring fund management, its market intelligence capabilities and the depth of experience of its team are all considered to be particular strengths
- CfEL is considered to have a lower profile than it should have, including amongst politicians – “it is an under-utilised asset”
  - CfEL is encouraged to establish a higher level of involvement with BVCA even though it is essentially a ‘funder of funds’ and BVCA is largely supported by fund managers<sup>21</sup>
  - also, CfEL has had to operate in an environment perceived to have too many Government initiatives in the access to finance policy domain: in this context, communication on the role and intentions of the public sector needs to be improved
- the time taken to procure fund management services is too protracted – one informant regards the reason as the under-resourcing of CfEL.

### *Lessons/recommendations*

3.12 The time lag between when a fund is first announced and the actual first investment gives an inaccurate picture of the lifespan of the fund and can have implications for managing the

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<sup>21</sup> We recognise that CfEL engages with a number of other organisations e.g. British Business Angel Association, Confederation of Business Industry and Federation of Small Business.

expectations associated with fund performance. Ideally funds would be announced once fund raising and fund manager negotiations have been completed. However it is recognised that this is beyond the control of CfEL. Market informants have acknowledged that as a result of CfEL's efforts the process of procuring fund management is viewed as more professional and their due diligence process is considered to be one of their strengths. However, where possible CfEL could seek to identify any further actions it can take to improve the process further.

### ***Wider research***

3.13 Through our work for BIS on improving the coherence of publicly-backed venture capital provision, we received feedback from public and market stakeholders which indicates the achievements (or otherwise) of CfEL. The main findings are summarised as follows:

- the involvement of CfEL has brought a degree of “rationalism” and expertise from the private sector. As a result, the landscape is considered to be more “structured”
- it is widely thought by market informants that CfEL and its delivery of PBFs has improved over time including in procurement, due diligence, assessment of risk and practice of engaging of the private sector
- fund management market is wary of CfEL due to its multiple roles of: being close to policy making; holder of funds (funder of funds); and also a fund manager making its own investments
- most informants see no conflict between CfEL and the RDAs and it is noted that CfEL attends the RDA/BIS working group on ‘access to finance’. There is also a general view that more sharing of information between CfEL with RDAs would help in gaining a fuller picture of market demand and dynamics
- perceptions of communication levels between regional stakeholders and CfEL vary from “limited” to “reasonable”. There has been limited joint working or cross-referral between regional stakeholders and CfEL. It is recognised that the abolition of the RDAs and CfEL being asked to manage the funds going forward there has been much closer working including for example seconding a person from one of the RDAs to work alongside CfEL on this task
- to improve the PBF landscape, CfEL could be more pro-active in providing national level market intelligence on activities and trends; encourage sharing of best practice between CfEL and RDAs, and their fund managers
- proposals for the roles that CfEL could play can be captured under the banner of a ‘centre of excellence’ on the characteristics of effective and efficient publicly-backed equity provision and its positioning in the wider investment market.

3.14 In addition to our own primary research, CfEL conducted an independent ‘perception audit’<sup>22</sup> of themselves with a small group of key stakeholders, during 2009. Telephone interviews

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<sup>22</sup> Champollion (2009) Capital for Enterprise Perception Audit Report.

were conducted with 25 Director level (or equivalent) staff from the following types of organisations: business and banking; trade organisations; think tanks and academia; media; and politics. We have reviewed the findings and highlight the following main points:

- nearly all informants were aware of CfEL and its general purpose but did not have a clear view of how it operates or manages its funds. There is agreement on the quality of the contact between CfEL and informants
- CfEL is viewed as ‘expert’; ‘relevant’; ‘useful to government’; and ‘commercial’. However it is not seen as ‘dynamic & forward thinking’; ‘well resourced’; ‘influential’ and ‘authoritative’. Informants are of the view that CfEL should be all of these but not be seen as ‘independent’
- the majority of informants agree that CfEL has an important role in encouraging the development of venture capital funds and supporting SMEs to grow
- majority of informants would like to see more reference to CfEL in the trade and mainstream media. It should also be more involved in events (hosting or attending) and the majority wish to have further direct contact with CfEL.

## Summary assessment

- there is certainly a plethora of activities and outputs associated with the funds under the remit of CfEL and which appear to be performing as planned. In the few cases where numerical targets have been set, CfEL has exceeded its targets. Notable progress/achievements of CfEL include:
  - the performance of the EFG in terms of increased lending and reduction in the Government’s liability. This is supported by independent research which found high levels of satisfaction as well as evidence of tangible benefits experience by recipient firms
  - the general positive findings relating to the ECF and CfEF as reported in the independent early assessment of the impact of BIS equity funds
  - well informed advice/know-how used in the development/structuring of new funds (e.g. UKIIF) and generally enhancing the wider knowledge-base on market issues by contributing to policy research
- in many cases, reports produced by CfEL are referred to in its reporting of achievements under various KPIs. Whilst these outputs are a key element in the monitoring of CfEL’s activities and in the delivery of its services to BIS, the true test of achievements is arguably not the report as an output in its own right but rather the efficacy of the reporting as viewed by the intended users of these reports
- from our limited primary research with market informants we received positive feedback on CfEL’s practices, progress and achievements to date, particularly with respect to CfEL’s expert market knowledge. However, whilst CfEL has productive relationships with those organisations with which it directly engages in the market

- our wider research for BIS found that CfEL and its delivery has improved over time and has brought a degree of “rationalism” and “structure” to the landscape for publicly-backed funds. However, CfEL could be more pro-active in the provision of national level market intelligence and in encouraging sharing of best practice.

## 4: Conclusions

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### Performance management system

- 4.1 The data and procedures by which CfEL monitors its own performance are comprehensive and are underpinned by strong governance arrangements.
- 4.2 CfEL rigorously monitors the activities of fund managers and lenders. This includes the important ‘verification’ process undertaken by CfEL on the data/information it receives from fund managers and lenders. Feedback from fund managers indicates the monitoring procedures to be in their view sensible/appropriate and not overly burdensome.
- 4.3 The data and procedures by which BIS monitors CfEL’s performance are generally well structured with clearly defined responsibility and accountability for the various components of CfEL’s management/leadership.
- 4.4 CfEL provides substantial data and results of analyses to BIS on a regular basis and using agreed reporting templates.
- 4.5 As reporting is based on templates agreed with BIS (and therefore by implication fit-for-purpose), the greater challenges for CfEL’s management information system are associated with: (i) its ability to respond quickly and effectively to *ad hoc* requests from BIS (e.g. to support officials researching answers to Parliamentary questions); and (ii) to provide, in proactive mode, alerts to BIS on potentially contentious issues likely to be raised by for example MPs or the media. The latter is especially challenging for CfEL in that it requires ongoing management surveillance and judgement.
- 4.6 A further challenge is for CfEL to meet all the needs and expectations of BIS in terms of financial reporting to the exact (and exacting) standards that are set. Evident capability to adhere to these in timely fashion is likely to be a crucial issue whenever CfEL seeks work from other Government departments.
- 4.7 There are some variations between funds in how CfEL reports performance: in particular the description of KPIs for different funds vary in detail as does the way that performance is reported against the KPIs. This is due to the changing objectives as this policy evolved over the past decade. Given the number of parameters being monitored, analysed and reported our point here is not to press for even more parameters to be introduced (indeed rationalisation should in principle be sought where possible). However, we would recommend clearer differentiation of what could be regarded as (i) ‘core’ measures, i.e. ones relevant to all funds, and (ii) ‘additional’ measures, as justified for individual funds.
- 4.8 We also see merit in a clearer distinction between measures of input, activity, output (i.e. matters that are in the control of CfEL and its fund managers and lenders) and outcomes (which are not). This applies to both individual funds and CfEL itself.
- 4.9 The data on measures reported to BIS are predominantly around financial performance. In view of our research for BIS on the coherence of publicly-backed venture capital provision,

## Progress and achievement

- 4.10 Our assessment here is based on a critical review of documentation provided by CfEL and BIS. This is supplemented by our report for BIS on the ‘coherence’ of publicly-backed venture capital provision, wider desk research, and with information obtained through consultations with a small sample of ‘market’ informants, including fund managers.
- 4.11 In general, CfEL appears to have achieved what it was set up to do. The feedback from informants confirms that CfEL - its practices, progress and achievements to date – are viewed positively. Feedback suggests in particular that CfEL’s expert knowledge of the market for SME finance has been especially valuable to BIS during the recent time of policy changes.
- 4.12 However, only in a minority of cases has CfEL set (or been set) targets associated with its KPIs. This means that even where performance is reported using numerical information one commonly has no sense of the scale of achievement relative to initial intent or ambition, or relative to resource expended. In the absence of information on how much resource was allocated to realise its achievements, it is also not possible readily to assess matters of economy and efficiency.
- 4.13 In our review of CfEL’s own reporting of performance, we had in places to identify ‘measures’ that were implied by the description of some KPIs as none were stated explicitly. This is compounded in cases where the objectives and KPIs are framed in ways in which measures would in any event be difficult to define and quantify.
- 4.14 From limited primary research with market informants, there is a sense that whilst CfEL has productive relationships with those organisations with which it directly engages in the market, its profile in the wider SME finance market is relatively low and could, with benefit to policy implementation, be higher. This accords with feedback gained by CfEL from its own study of market perceptions reported in 2009: in this, the feedback indicated that there was not a clear view of how CfEL operates or manages its funds.
- 4.15 In what was in general the positive view of CfEL’s contributions held by our limited sample of market informants, the following additional conclusions can be drawn:
- there is no sense of crowding out in the market
  - CfEL is capable of attracting/retaining high calibre staff
  - the CfEL team provides BIS with access to a valuable pool of expert knowledge
  - CfEL is responsible for the process of procuring fund management being more ‘professional’ (albeit still too protracted)
  - CfEL has introduced a greater “customer focus” to interactions with fund managers.
- 4.16 Our wider research for BIS found that CfEL (including its delivery) has improved over time and has brought a degree of “rationalism” and “structure” to the landscape for publicly-



- 4.17 Further notable progress/achievements of CfEL include: 1) the strong performance of the EFG in terms of increased lending and reduction in the Government's liability; high levels of satisfaction and tangible benefits experienced by recipient firms; and 2) the general positive findings relating to the ECF and CfEF as reported in the independent early assessment of the impact of BIS equity funds.

## Lessons

- 4.18 We propose the following 'lessons' from the review. These are primarily around, developing a monitoring and evaluation framework for the expanded remit of CfEL going forward:
- ensure greater clarity between 'core' and 'additional' parameters when monitoring equity funds
  - differentiate more clearly between parameters that describe CfEL's inputs, activities, outputs and attributable outcomes
  - apply a more rigorous SMART test of the way CfEL's objectives are articulated
  - re-consider the merits/de-merits of target setting for inputs, activities and outputs
  - make the chosen 'measures' associated with CfEL's KPIs more explicit and avoid *unnecessary* variability in KPIs and measures for different funds
  - investigate how the value of CfEL's knowledge and positioning in the market can be more fully recorded and assessed, i.e. the value of what CfEL does beyond managing and reporting on the equity and lending instruments it has responsibility for.

## Annex A: List of informants

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Table A-1: Informants

**Market:**

Andrew Craig, Partner	Maven Capital Partners
Rob Carroll, Director	Catapult Venture Management
David Quysner, Chair of Abingworth & CfEL	Abingworth & CfEL

**Public:**

Richard Hepper, Deputy CEO	CfEL
Jason Middleton , Portfolio Manager	CfEL
Emma Squire, Head of SME Finance	BIS

*Source: SQW; Note: in addition to our market informants, we also wish to acknowledge input from CfEL and BIS.*

## Annex B: Equity data collected by CfEL

- B.1 The tables below provide examples of the general type of data collected by CfEL as part of their monitoring of the individual equity and debt funds. It is worth noting that data/information collected may be slightly different depending on they type of fund.

### Standard descriptive data

Table B-1: Fund data collected – standard descriptive data

Data collected	Definition
<b>Date of first close of fund</b>	'First close' for fund raising is technically the date that a fund becomes open for investment
<b>Type of fund</b>	Investment model: direct investment, co-investment, fund of funds; and risk sharing model
<b>Investment objectives and restrictions</b>	Work in progress
<b>Other objectives of fund</b>	Work in progress
<b>Length of time fund in existence</b>	Months since date of first close of fund
<b>Total fund size</b>	Total amount of finance committed to the fund by all investors
<b>Underlying investors: share of the fund</b>	Names of investors and percentage contribution to total fund size
<b>Investment period</b>	The date from which the fund will stop taking on new investments and length of this period
<b>Post-investment period</b>	The date from which the fund will solely be undertaking follow on investments and realising investments; and length of this period
<b>Management fees and expenses</b>	The agreed management fees and expenses as set out in the contract with fund managers expressed as a total amount or proportion of capital under management as appropriate
<b>Reporting schedule</b>	Date of year end; frequency of reporting; how long after end of quarter/year is data provided by the fund manager

Source: CfEL

### Public sector and fund financials

Table B-2: Fund data collected –public sector and fund financials

Data collected	Definition
<b>Public sector financials:</b>	
<b>Government commitment</b>	Amount committed by government to the fund
<b>Government commitment drawn down at reporting date</b>	Work in progress
<b>Government commitment remaining at reporting date</b>	Work in progress
<b>Government commitment period</b>	The total length of time that government has committed its capital to the fund

<b>Data collected</b>	<b>Definition</b>
<b>Fund financials:</b>	
<b>Total commitment drawn</b>	Total amount drawn down from all underlying investors
<b>Total commitment remaining</b>	Work in progress
<b>Gross investments</b>	The total amount invested or loaned by the fund in its portfolio companies. A cumulative total over the lifetime of the fund
<b>Value of unrealised investments</b>	A snapshot measure of the estimated value of the companies in the portfolio as of the date of reporting
<b>Original cost of unrealised investments</b>	The total amount of capital invested in the companies by the fund
<b>Total return on realised investments</b>	The total capital sum received in by the fund on exiting investments A cumulative total over the lifetime of the fund
<b>Original cost of realised investments</b>	The total capital sum received in by the fund on exiting investments A cumulative total over the lifetime of the fund
<b>Net profit/loss on realised investments</b>	Total net profit is a cumulative measure over the lifetime of the fund
<b>Distributions to Government</b>	Capital paid to Government both within a quarter and a cumulative total
<b>Management fees paid to date</b>	Cumulative total
<b>Total overhead costs</b>	Total costs of management fees plus expenses. A cumulative total
<b>Overhead costs per £ invested</b>	Total over head costs divided by value of gross investments
<b>Total return to HMG investor (Gain/Loss)</b>	Total returned plus value of share of fund compared with the amount invested
<b>Fund return</b>	The fund multiple as of date. Fund return expressed as an IRR

Source: CFEL

## Investment activity

Table B-3: Fund data collected – investment activity

<b>Data collected</b>	<b>Definition</b>
<b>Number of applications made to the fund</b>	Work in progress
<b>Number of investments made</b>	This is the number of new investments committed to. It does not could count as separate investments a deal that is 'sliced' into tranches of finance linked to milestones. A deal structured in this way would count as one investment.
<b>Total number of SMEs invested</b>	Cumulative total of the number of investee companies
<b>Total number of SMEs in current portfolio</b>	That is number of companies still actively managed in the portfolio, i.e. excludes exits and write offs
<b>Average amount invested per SME</b>	Gross investments divided by total number of SME invested
<b>Average size of investment</b>	Gross investments divided by total number of investments
<b>Investment leverage</b>	Work in progress

<b>Data collected</b>	<b>Definition</b>
<b>Number of exists</b>	The number of companies where the fund has exited from the investment. This does not include 'write offs'. A cumulative total over the lifetime of the fund
<b>Number of write-offs</b>	Number of companies where the fund managers have written off their investments. A cumulative total over the lifetime of the fund

Source: CfEL

## Investment characteristics

Table B-4: Fund data collected – investment characteristics

<b>Data collected</b>	<b>Definition</b>
<b>Breakdown of number of companies by stage: (seed/early/development/MBO)</b>	BVCA definitions of stage to be used. Number of companies in each stage and number expressed as a percentage of the total number
<b>Breakdown of value of investments by stage: (seed/early/development/MBO)</b>	BVCA definitions of stage to be used. Amount invested in each stage and amount expressed as a percentage of the total amount invested
<b>Breakdown of number of companies by sector</b>	BVCA definitions of sector to be used. Number of companies in each sector and number expressed as a percentage of the total number
<b>Breakdown of value of investments by sector</b>	BVCA definitions of sector to be used. Amount invested in each sector and amount expressed as a percentage of the total amount invested
<b>Breakdown of number of companies by region</b>	Number of companies in each region and number expressed as a percentage of the total number
<b>Breakdown of value of investments by region</b>	Amount invested in each region and amount expressed as a percentage of the total amount invested
<b>No of businesses invested in that are women led</b>	Work in progress
<b>No of businesses invested in that are ethnic minority led</b>	Work in progress

Source: CfEL

## Investment outcomes

Table B-5: Fund data collected – investment outcomes

<b>Data collected</b>	<b>Definition</b>
<b>Number of companies with profitable exits</b>	A cumulative total over the lifetime of the fund
<b>Number of jobs created</b>	A cumulative total over the lifetime of the fund
<b>Measure on turnover growth as an interim economic outcome measure</b>	Work in progress

Source: CfEL

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