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# Mid-Term Evaluation of the Wales JEREMIE Fund

A Final Report by  
Regeneris Consulting, Old  
Bell 3 and Neil Kemsley



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# **Mid-Term Evaluation of the Wales JEREMIE Fund**

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## Executive Summary

- i. Regeneris Consulting, with Old Bell 3 and Neil Kemsley, were commissioned by Finance Wales to carry out the mid-term evaluation of the Wales JEREMIE Fund. The evaluation was guided by a Steering Group consisting of Finance Wales, the Welsh Government and Welsh European Funding Office.
- ii. The Wales JEREMIE Fund was the first of its type to be launched in the UK and one of the first in the European Union. It became operational in 2009 and makes available £150 million in loan, mezzanine and equity finance for Welsh small and medium sized enterprises (SMEs). The Fund secured a £75 million loan from the European Investment Bank, a £60 million grant contribution from the ERDF Convergence and Competitiveness Operational Programmes and a £15 million contribution from Finance Wales. The Fund is managed and delivered by Finance Wales, a subsidiary of the Welsh Government.
- iii. The JEREMIE Fund is expected to make an important contribution to the vitality of Wales' base of SMEs. Its primary purpose is to invest in new and established SMEs to produce good commercial returns for the Fund, and generate a substantial legacy fund for Wales. The Fund is expected to support more than 800 businesses over its five year investment period to 2014, to lever in significant amounts of new private sector investment and contribute to the creation of around 15,500 new jobs across Wales.
- iv. The objectives for the evaluation were set by the Steering Group consisting of:
  - (1) An assessment of the continued strategic need and fit of the JEREMIE Fund
  - (2) A comprehensive assessment of the performance of the Fund and prospects over the investment and recovery period
  - (3) An interim assessment of the economic and business impacts of the Fund
  - (4) A review of the adequacy of the governance and management arrangements
  - (5) Recommendations to strengthen the operation and management of the Fund and to guide the future approach to FEIs in Wales.

### Main Conclusions

- v. Finance Wales and the JEREMIE Fund have become key assets for the Welsh economy. Finance Wales has established itself as a critical part of the business finance landscape, steadily building a strong profile with an expanding network of intermediaries and a growing reputation as a professional and commercial facing operation. The scale of funding it makes available to Welsh SMEs at a time when the economic climate and conditions in the business finance market are particularly challenging mean that the rationale for its existence has strengthened further since the Fund's development.
- vi. The evaluation evidence suggests that the mix of financial instruments available through the JEREMIE Fund, its investment strategy and its individual investment portfolios are

## ● Mid-Term Evaluation of the Wales JEREMIE Fund ●

appropriate to the market and the needs of Welsh SMEs. It is underpinned by a clear rationale to correct the market failure in terms of the supply of venture capital on a commercial basis to Welsh SMEs, rather than to provide cheap finance or support business propositions which are weaker/riskier than those that would be acceptable to commercial lenders and venture capitalists in more well-supplied parts of the UK. The investment strategy is enabling the Fund to deliver an investment portfolio which offers the required level of investment risk and reward, but which also recognises its obligations to the European Investment Bank and to the Welsh ERDF programmes.

- vii. The development process for the Fund is assessed as being largely sound and prudent. The exception to this assessment is that the target set for gross job creation in the business plan was set at too high a level. The evaluation recognises that the approach to forecasting job creation outputs, using past achievements of Funds in the Objective 1 programme, may have appeared reasonable at the time the business plan was prepared.
- viii. Overall, the evaluation has concluded that the Fund is being implemented and managed effectively. Investment targets through the first period of its operations have largely been met, while both the investment strategy and the Fund's operations have been adjusted and strengthened in response to emerging patterns of investment activity and performance. By September 2011 the Fund had invested £74m through 493 investments (compared to a target of £70m and 466 investments).
- ix. The overriding message about Finance Wales' approach to the Fund is of an organisation that is committed to lesson learning and improvement. This is recognised by the organisation's network of external partners who have a positive view of the expertise and professionalism of its fund management, and who have been largely positive about its investment decision making process.
- x. Looking forward, the Fund is on target to meet its lifetime investment, realisation and repayment targets. Finance Wales has revised its initial business plan targets and, whilst still subject to much uncertainty, is hopeful of repaying the initial £60m ERDF investment. Whilst Finance Wales is right to be cautious in making these predictions, on balance the evaluation concludes that the Fund's investment and realisations targets are achievable given the way that it has built and manages its portfolio.
- xi. Although most of the investments are at an early stage, there is some evidence that the expected economic development impacts have already started to come to fruition. However, the evaluation has pointed to a need to revisit its job creation target. The target was set at a time when Wales and the UK economy had experienced several years of job growth in an expanding economy. The depth and duration of the current recession has inevitably made many SMEs more cautious about both investment for expansion and recruitment, and the investee survey (and follow-up qualitative research) for this evaluation would seem to confirm this. With three years remaining of the Fund's investment period, this would be an appropriate time to use the evidence of performance to date and the forecast evidence to review the target.
- xii. The market failures that were central to the rationale for the scale and composition of the Wales JEREMIE Fund remain and in some respects have intensified as an exceptional set of circumstances continue to affect SMEs and the financial services sector. The evaluation has concluded that the case for large scale resources will continue to be strong through the

remainder of this ERDF programme and probably well beyond that. Early consideration by the Welsh Government, working with Finance Wales, of successor arrangements to the current JEREMIE project is essential. This needs to continue to emphasise the balance to be struck between providing investment to SMEs to address market failures and delivering economic development benefits.

## Recommendations For the Current Fund

- xiii. The evaluation makes a series of recommendations which identify actions that Finance Wales, WEFO and the Welsh Government should consider over the remainder of the Fund's investment period, and which are intended to assist in shaping future access to finance policy. We have therefore grouped the recommendations into those concerned with the operation of the current fund, as well as those which are concerned with broader policy and future delivery issues.

### Recommendation 1: Maintain the Focus on the Successful Delivery of the JEREMIE Fund

- xiv. We have concluded that Finance Wales is currently doing a good job in delivering the current JEREMIE Fund. Whilst no major changes are required to the investment and delivery strategy (bar a number of recommendations which follow), there is the need to maintain a clear focus on the successful delivery of JEREMIE Fund during the investment and realisation phases.
- xv. Finance Wales are very much aware of some of the key risks which could undermine this focus, including the following: (i) the challenging economic conditions and the implication in terms of a dampening of future demand for equity finance and the need to ensure a sensible risk profile for new investments; (ii) the increased supply of finance to SMEs in Wales (eg. through the launch of a new SME fund), although these will not start investing until much later in 2012 and the SME fund has been designed to avoid sectoral overlap; (iii) there is also the risk the new Finance Wales funds may divert corporate management and fund management resources away from the implementation of the JEREMIE Fund, although it should be able to adapt effectively having created two new teams serving other UK markets.

### Recommendation 2: Retain Flexibility to Respond to SME's Demands for Finance and Related Risks

- xvi. One of the key aspects of the JEREMIE Fund's performance to date has been the strong demand for debt finance, driven to a large extent by the sharp fall in bank lending (though there are signs that there could be a recovery in supply). Whilst demand for risk capital investment held up strongly up to the end of 2010, it has fallen back during the first two quarters of 2011/12.
- xvii. There is no need at the current time to change the balance between loan and equity based investment and indeed the implications of such a step would need to be very carefully considered and justified. However, there is a need to keep a very careful watch on these trends and risks, including a commentary in Finance Wales' quarterly monitoring report to investors. On a related note, if the investment rate is less than expected in the coming years, Finance Wales will need to consider extending the investment period into 2015.

### Recommendation 3: Retain Microloans as a Key Element in the JEREMIE Fund

- xviii. Micro-loan finance is critical from the perspective of the Welsh economy and the JEREMIE Fund is a key aspect in the provision of this finance. However, Finance Wales' approach places a strong emphasis on lending money to sound commercial propositions and delivering this in a cost-effective manner, which can be at odds with the aspirations of some partners.
- xix. The fact that WEFO has clarified that the Local Investment Funds (LIFs) cannot be used to match JEREMIE Fund investments is clearly a major issue in terms of stimulating demand for the microloan fund. While it is essential that business owners themselves share the risk of making new investments (and has become a condition of the microloans fund itself), we welcome plans to provide further information on how grant schemes and JEREMIE can make complementary investments in the same business.

### Recommendation 4: Establish a Clearer Consensus between Finance Wales and Welsh Government on the Market Failure Finance Wales is Addressing and Improve Communications

- xx. In many regards the relationship between Finance Wales and Welsh Government has been very productive, indeed being an important consideration in the successful approval and launch of the first JEREMIE fund in the UK and one of the first in the EU as a whole. However, there are also a number of respects in which there has been a lack of clarity about the strategic role of Finance Wales and the progress in the delivery of JEREMIE as a key strand of the Welsh Government's enterprise strategy.
- xxi. There needs to be a better shared understanding of the rationale which underpins the Fund's structure and approach to what is both a complex and unusual aspect of economic development policy. Finance Wales needs to more effectively communicate the successes which it achieves in helping to stimulate enterprise, innovation and economic growth across Wales. Welsh Government needs to ensure continuity in its liaison with Finance Wales at a senior officer level, something which is vital to a productive partnership approach.

### Recommendation 5: Establish an Accurate Analysis of the Cost Base for the JEREMIE Holding Fund

- xxii. The evaluation has concluded that the annual allowance in the holding fund costs of £900,000 for its share of the costs of Finance Wales plc is an underestimation of true costs of services and support it receives from Finance Wales plc. The allowance appears to be lower than the comparable costs for the English JEREMIE Funds. Finance Wales has already examined this issue and there is merit in reaching as realistic an assessment as possible of what these true costs are. As discussed later in this section, it will help to inform future delivery approaches. Also from an evaluation perspective, this will be particularly helpful in providing a more robust and accurate basis for judging value for money.

### Recommendation 6: Make Minor Changes in the Fund's Indicator Set

- xxiii. While the evaluation has not identified a particular need for the Fund to report additional KPIs to the ERDF programmes, there would be some benefit in Finance Wales reviewing how the data it collects is used. Turnover and profit data relating to individual investees is provided prior to the investment decision, and is monitored routinely as part of the Fund's

## ● Mid-Term Evaluation of the Wales JEREMIE Fund ●

work with its portfolio. This would offer both baseline data and could be used to inform simple measures of turnover and profit growth of the businesses supported. However, the rigorous assessment of gross and net measures of the impact on bottom-line business performance (such as turnover, gross value added and profits) will need to be part of the Fund's final evaluation (although the baseline data will inform this).

### Recommendation 7: Review the Fund's Gross Job Creation Target

- xxiv. Reflecting on this emerging evidence, we recommend that Finance Wales and WEFO reassess the Fund's lifetime job creation target. This should include a thorough review of the position on monitoring returns from investee businesses to assess the potential uplift in the total associated with returns that currently are not being provided, and an assessment of the extent to which investees that are reporting job creation may see an increase in employment over the remaining investment period and the realisation period. In recessionary conditions, it is reasonable to anticipate some significant lags in the translation of investment into new jobs. Many businesses may well see substantial increases in their order books once conditions improve, with JEREMIE Funds providing a platform for expansion.

### Recommendation 8: Annualise KPI Data Collection From Investee Firms

- xxv. A comprehensive set of data for baseline purposes is important if the impacts of the Fund are to be accurately assessed. The Fund should ensure that it is securing the most comprehensive reporting data possible on the number of jobs in investee businesses at the time the investment is made and annually thereafter. Finance Wales has already recognised that its initial approach to the collection of jobs data has not proved effective, and the shift of responsibility to its Investment Executives is part of a process of further tightening its approach to implementation.

### Recommendation 9: Review Progress on the Collection and Reporting of Data on the Cross-cutting Themes

- xxvi. It is understood that an Equality Impact Assessment of the JEREMIE Fund has pointed to Finance Wales being effective in meeting its requirements on equality and diversity through its investment activity. Nevertheless, Finance Wales could be more proactive in its approach to the environmental sustainability systems CCT, both in terms of its reporting and monitoring processes, as well as sign-posting investees to suitable specialists providers where relevant. While no target has been set for the CCT indicators, there are sound reasons for Finance Wales to adopt a more proactive approach to pushing the low carbon and equality and diversity agendas.

### Recommendation 10: Refocus the Monitoring Reports

- xxvii. To date Finance Wales has produced detailed quarterly monitoring reports to its investors. As the fund evolves, in particular growing its loan book and portfolio of investments, it needs to increase the forward looking aspects of the monitoring report. By the end of 2011/12, the inclusion of a commentary in the monitoring reports on the Fund's income and realisations forecasts (in broad terms), specific provisions and defaults, legacy and KPIs would help give a more rounded picture of performance.

### Recommendation 11: Consider Carrying Out Additional Research into Changes in the Welsh Loan Finance Market

- xxviii. It is widely recognised that there is limited accurate data available on the scale, characteristics and pattern of changes in the Welsh debt finance market. Commercial sensitivity clearly plays a part here, since banks and other finance providers tend to be reluctant to share data on their loan books. However, this represents an important gap in the ability of Finance Wales and its partners to assess the case for intervention, to establish the Fund's impacts on the debt finance market and to plan for future interventions. Consideration could be given to carrying out new research, perhaps based on a confidential survey of Finance Wales' intermediary network, to explore the current characteristics of the debt market and expectations about future changes in this market.

### Recommendations for Future Funds

#### Recommendation 12: Recognise that there will be a Need for Public Sector Backed Financial Engineering Instruments in the Future

- xxix. The evidence examined during the course of the evaluation has very clearly demonstrated that there will be a continuing need for public sector backed financial engineering instruments over the course of the next decade. Whilst substantive market failures persist, this must not however be taken as an open-ended demand upon the public purse to fund finance initiatives aimed at SMEs. Public backed funds need to demonstrate their capacity to generate reasonable returns based upon commercial terms.
- xxx. There is continuing uncertainty about the ability of many ERDF backed funds to secure sufficient legacies to enable them to move closer to long term sustainability. Finance Wales is certainly clear in its strategy to establish a sustainable model which enables it to reduce the need for substantial or even any public sector capital support to pump prime new funds on an on-going basis. Indeed, it is taking the necessary steps to secure the cost base, the skills sets and systems and approaches to maximising realisations, which will also support this model. However, it is unlikely to achieve this in the immediate future and the legacy returns it will generate from the Interim Fund, the current JEREMIE fund and the new SME Fund, will be vital in generating the capital necessary to underpin a sustainable model in the future.

#### Recommendation 13: Begin the Development and Delivery of a Future ERDF Backed Fund

- xxxi. There remains a lot of uncertainty about the next ERDF Structural Fund programme, how it will apply in Wales and the ways in which support for financial engineering instruments such as JEREMIE might be pursued through the ERDF regulations. Subject to this uncertainty, we believe that there are very good reasons for Wales to pursue an umbrella fund (or fund of funds), which could again offer the potential economics of scale benefits of a large and coherent investment fund, as well as efficient investment mechanisms and fund management services. However, the ability to achieve a similar fund size to the current JEREMIE fund would depend crucially upon the involvement of other major investors such as the EIB.

## ● Mid-Term Evaluation of the Wales JEREMIE Fund ●

- xxxii. The development of a preferred approach is complex and we suggest Welsh Government, which leads in this policy area, work with Finance Wales as a key practitioner in SME funds to inform the development of future financial engineering instruments.
- xxxiii. If there is to be a successor to the current JEREMIE Fund on a similar scale, there is a strong case for all key aspects of fund management and delivery to be competitively tendered whatever model is eventually adopted. Whilst this will have merit in driving efficiency and value for money for the public sector, it will also stimulate other private sector providers to look to Wales for new opportunities. In the context of a JEREMIE type fund this approach would involve the competitive tendering of both the holding fund and fund management activities. However, if the holding fund activity is to be tendered, it is vital that this strand is completed at an early stage, including the provision for the appointed holding fund manager to undertake the substantive fund development activity and the procurement of the fund managers.

### Recommendation 14: Review the Future Revenue Grant Funding of Finance Wales

- xxxiv. As highlighted earlier, one of the conclusions from the evaluation is that whilst the rationale for the provision of revenue funding from Welsh Government to Finance Wales is clear, the way in which this supports the operating costs of the current JEREMIE fund is far less clear. In general, it is considered good practice to have clarity in terms of the provision of public sector revenue grant funding and the range and scale of outputs which are being delivered in return. But also, if a more market led approach is to be adopted to the commissioning of future holding fund services, there will be the need for clarity on the fee structure and associated terms for the provision of these services. The revenue grant provided to Finance Wales for any on-going services it provides on behalf of Welsh Government would need to be revised in light of this arrangement.

### Recommendation 15: Remain Mindful of the Lessons and Good Practice in Developing and Implementing Financial Engineering Instruments.

- xxxv. The lessons and aspects of good practice in the design and implementation of public sector backed financial engineering instruments need to be taken into account in designing and delivering any new FEIs. There needs to be clarity in terms of the skills and expertise required to design a new fund, including business development, corporate finance, and economic development policy, delivery and funding.
- xxxvi. Many of these skills reside with Finance Wales, and the relationship between WEFO, the Welsh Government and Finance Wales which has steered the development and delivery of the JEREMIE Fund to date, should have an important part to play in shaping future arrangements.



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