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Scottish Loan Fund
Market Review and Economic Impact Assessment

FINAL REPORT TO

SCOTTISH ENTERPRISE

17th July 2014

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A EXECUTIVE SUMMARY

A1 GENERAL

This document summarises the process, conduct, findings and recommendations from a Market Review and Economic Impact Assessment for the Scottish Loan Fund (SLF).

The Review was commissioned by Scottish Enterprise (SE) and conducted by Malcolm Watson Consulting (MWC) during April 2014 and covered all of the loans completed between establishment of the SLF in March 2011 and 1st March 2014.

The SLF is a Scottish Limited Partnership with total contributions of £113m at its second closing in March 2012. The Fund was initiated by SE with contributions from Highlands and Islands Enterprise (HIE) and six commercial funders (4 banks and 2 Scottish Local Authority Pension Funds). SE and HIE funding included a European Regional Development Fund (ERDF) commitment. The SLF is managed on behalf of the contributors by Maven Capital Partners UK (MCP).

The Fund provides loans of between £250,000 and £5m to businesses located in Scotland. The SLF loans are classified as a form of mezzanine finance. Mezzanine Finance is a hybrid of debt and equity financing, normally used to finance expansion of existing companies.

A2 0BJECTIVES & METHOD

The two core objectives of the Review were to:

- Conduct a review of the *current* market conditions in the corporate finance segment within which the SLF operates.
- Provide an assessment of the economic impact generated to date by the 16 completed SLF investments.

These have been addressed through research consisting of:

- A review of information on the Fund and its client business performance.
- Consultations with Stakeholders, Funders, SLF client businesses and their SE Account Managers.
- Review and analysis of data and opinion on the market for finance for Scottish SMEs

A3 FINDINGS – SME FINANCE MARKET

From the limited secondary and primary research data available to us we are able to draw some general conclusions on the current access to finance conditions for SMEs in Scotland.

- There appears to have been a small increase in the *value* of lending to Scottish SMEs during 2013, although the number of loans is decreasing and average loan values are increasing;
- Banks are returning to the market with overall lending increasing by value after a decline in 2011 and stagnation in 2012;
- Banks still appear to be selective in the businesses and sectors they lend to preferring demonstrably viable businesses in growing sectors;
- There is some suggestion that there is low demand for finance from SMEs evidenced by reductions in the numbers of loans, reductions in net lending, active prospecting of opportunities by banks and holding of cash reserves by businesses; and
- The *potential* market for loans through the SLF is estimated by SIB, based on the available evidence from the UK Small Business Survey, as being around 100 businesses per annum.

A4 FINDINGS – ECONOMIC IMPACT OF SLF

Results from our analysis of SLF client consultations and performance data demonstrate that there is potential for significant economic impact. We have identified high levels of additionality and low levels of displacement and leakage of economic benefits. This reflects the export orientated nature of the businesses, their operation in growth markets and the issues many faced in securing finance in the period of operation of the SLF.

The headline economic impacts to date based on actual business performance and three year projections are:

- The SLF client businesses taking up loans to date are already estimated to have generated cumulative net additional GVA of £18.8m in the period up to the end of 2013.
- The SLF client businesses taking up loans to date are estimated to have the potential to generate a cumulative net additional GVA of £88m over the 10 year periods from their loan dates.
- At the end of 2013 the SLF client businesses have together employed an additional 163 people in the period since they took out their loans.
- The SLF client businesses have demonstrated both significant growth and high proportions of export sales (averaging 65% of turnover), reflecting the priorities of the Fund.

A5 TAKE-UP OF THE SLF

The Fund Managers and Limited Partners (LPs) agree that the take up to date of the Fund has been lower than anticipated. This behind profile performance has consequences for the potential of the Fund to expend its total value over its lifetime. Performance at trend to date would see the Fund wholly committed (excluding repayments and redemptions) in the third quarter of 2018. However, if performance to date on loan *expenditure* were maintained total expenditure of the Fund would be just under £80m by the last quarter of 2018. Performance behind profile has been variously ascribed to:

- The combination of a novel financing product operating in a niche market;
- Generally suppressed demand for corporate finance for SMEs; and
- Over-estimation of the potential scale of the market at establishment

The Fund managers consider that the take-up of the Fund can be improved to avoid a de-commitment of funds from the Partners. The LPs are currently not seeking a de-commitment but would not, generally, have any difficulties with this if it proved necessary.

A6 FUND MANAGEMENT

Both the SLF clients and LPs are satisfied with the performance and management of the Fund. Businesses particularly value the insight that MCP bring to their business and many discuss management issues with them on an ongoing basis. LPs value the prudence and approach to due diligence applied by MCP in appraising loans and managing risk. Returns to the LPs are at or above expectations.

Over 30% of funds committed have been repaid early and many current SLF clients have expressed a desire or intention to repay their SLF loan at the earliest opportunity afforded by business performance or re-financing.

A7 CONTINUING RATIONALE FOR SLF

Overall we conclude that there remains a continuing rationale for public sector engagement in the SLF and based on the ***two core aspects of the original rationale*** for intervention:

Aspect 1: "help viable, ambitious firms in the short/medium term by providing access to commercially priced finance that they couldn't otherwise get."

- There is evidence from the Review of the continuing failure of commercial lending providers to offer a mezzanine finance product to higher risk but viable Scottish SMEs with limited security to finance aspirations to grow and export. This is characterised as an information failure leading to risk aversion.
- High levels of additional economic impacts amongst the SLF client businesses taking out loans to date.

Aspect 2: "encourage in the medium/longer term the development of private sector supply of such products."

- There has been minimal market adjustment, with no direct competitor mezzanine finance products coming into the market, although BGF is gaining traction amongst some of the potential SLF client base.

A8 RECOMMENDATIONS

Given the foregoing our recommendations are:

- SIB, SE and the other Fund LPs should support, where possible, the Fund Managers in implementing their suggested actions to increase the run rate of enquiries and their conversion into completed loan deals.
- SIB should monitor monthly enquiries, conversions and deal flow based on suitable data submitted by the Fund Managers, and continually update projections against Fund targets up to the end of 2015.
- SE and SIB should also monitor SLF activity and forecasts to ensure achievement of required eligible ERDF *expenditure* levels.
- The Fund Managers should continue to collect data *as it becomes available* on SLF client turnover, exports, employment and information required for GVA calculation.
- SIB should continue to monitor the market for Mezzanine Finance in Scotland to assess whether existing or new providers are offering competitor products to Scottish SMEs.

1. INTRODUCTION

1.1. General

This document reports the process, conduct, findings and recommendations from a Market Review and Economic Impact Assessment for the Scottish Loan Fund (SLF).

The Review was commissioned by Scottish Enterprise (SE) and conducted by Malcolm Watson Consulting (MWC) during April 2014 and covered all of the loans completed between establishment of the SLF in March 2011 and 1st March 2014.

1.2. The Scottish Loan Fund

The SLF, established in March 2011, is a Scottish Limited Partnership with total contributions of £113m at its second closing in March 2012. The Fund was initiated by SE with contributions from Highlands and Islands Enterprise (HIE) and six commercial funders (4 banks and 2 Scottish Local Authority Pension Funds). SE and HIE funding included a European Regional Development Fund (ERDF) commitment. The SLF is managed on behalf of the contributors by Maven Capital Partners UK (MCP).

The Fund provides loans of between £250,000 and £5m to businesses located in Scotland. The SLF loans are classified as a form of mezzanine finance. Mezzanine Finance is a hybrid of debt and equity financing, normally used to finance expansion of existing companies. Mezzanine financing is debt capital with rights reserved to the lender to convert into an equity interest in the company under certain circumstances – for example if the loan is not repaid or the business is sold. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies. SLF loans typically preserve a right through warrant to share in an increase in value in the business released at exit through sale or listing. Premiums for early redemption of loans may also apply dependent upon the terms and conditions contained in each loan agreement.

To comply with ERDF eligibility requirements loans cannot be made to businesses operating in certain ineligible industry sectors referred to as "restricted sectors". The list of restricted sectors current at the date of this report is included at **Appendix 1** to this report.

SLF Loans are made to facilitate Capital Expenditure, Working Capital, Development Capital and Overseas Market Development. As of March 2014 a total of 16 loans had been made through the Fund to 15 businesses.

1.3. Review Objectives

The two core objectives of the Review were to:

- Conduct a review of the *current* market conditions in the corporate finance segment within which the SLF operates.

- Provide an assessment of the economic impact generated to date by the 16 completed SLF investments.

These have been addressed through research consisting of:

- A review of information on the Fund and its client business performance.
- Consultations with Stakeholders, Funders, SLF client businesses and their SE Account Managers.
- Review and analysis of data and opinion on the market for finance for Scottish SMEs

1.4. Review Report Structure

The remainder of this report is structured as follows:

- **Section 2** outlines the Review approach and method.
- **Section 3** traces the rationale for the SLF, its establishment, operation and performance up to the date of the Review.
- **Section 4** considers the current state of the market for Scottish SME funding, investigating market adjustment in the period since 2011.
- **Section 5** provides our assessment of the potential economic impact from SLF loans made to SMEs operating in Scotland.
- **Section 6** presents our conclusions on the operation of the Fund to date continuing rationale for public sector intervention in the funding market for Scottish SMEs through the SLF and recommendations for any future operation of the Fund.

2. REVIEW APPROACH AND METHOD

2.1. General

In this section of the report we summarise the approach and method used to conduct the Review.

2.2. Approach

Our approach to the Review identified two distinct research streams:

- **Stream 1: A review of the *current* market conditions in the corporate finance segment within which the SLF operates.**

- **Stream 2: An assessment of the potential economic impact generated by the 16 SLF investments completed to date.**

The findings from both of these research streams would provide the evidence to assess the continuing rationale for the SLF and its future potential to generate economic impact at the Scottish level.

2.3. Method: Research Stream 1: Current Market Conditions

Our method for research stream 1 consisted of:

- A review of research reports, analyses and indices on the supply and demand for SME finance in the UK and Scotland;

- Consultations with the SLF Funding Partners on the current condition of the SME finance market compared to those prevailing at the establishment of the SLF;

- Consultations with stakeholders including SE, Scottish Investment Bank (SIB), HIE and Scottish Government (SG); and

- A consultation with the SLF Fund Managers (MCP)

2.4. Method: Research Stream 2: Economic Impact

Our research amongst the SLF client businesses has focussed solely on the effects of the SLF loan on the performance of their business. We have in all cases asked the businesses to report *only the effect of the SLF loan on their business*. Our research has not touched on the additional effects of any other SE or other public sector assistance to the business.

Our method for research stream 2 consisted of:

- Analysis of baseline, projected and actual company performance and employment data for the SLF client businesses;

- Consultations with the client businesses and their Account Managers on their business projections, markets, competitors and role of the SLF loan in the development of their business; and

- Derivation of gross and net economic impact based on the findings of the foregoing using SE standard approaches and templates.

2.5. Review Research Sources

A total of 32 consultations were undertaken as detailed in **Table 2.1**.

Table 2.1: SLF Consultation Programme

Consultee Group	Telephone	Face to Face	Total
Stakeholders	1	3	4
Funding Partners	6	-	6
SLF Client Businesses	8	4	12
Account Managers	9	-	9
Fund Manager	-	1	1
All	**24**	**8**	**32**

The sources used in tracing the evolution of the SLF and its operation and performance are individually referenced in Section 3 of the report. The sources used in reviewing the market are individually referenced in Section 4 of the report.

All reference sources are listed **at the end of the report**.

3. SLF RATIONALE, ESTABLISHMENT & OPERATION

3.1. Introduction

This section of the report traces the evolution of the SLF from rationale through establishment and securing of funding calls to activities in the period up to March 2014.

3.2. Rationale and Approval

The concept of a Scottish loan fund to be established and part funded by the public sector emerged during a period which saw severe constrictions in the supply of corporate finance across the range of providers. These constraints had persisted in the wake of the global financial crisis of 2008, as large parts of the UK banking sector were bailed out by the UK Government and were required to re-build their balance sheets and restore liquidity.

The rationale for a Scottish loan fund was set out in a Paper submitted to the Scottish Enterprise Board in March 2010[1]. The paper noted that

"There has been a substantial reduction in the number of banks leading to a substantial reduction in the quantity of debt capital available with the surviving remaining banks deploying more challenging lending criteria. In this environment many companies are struggling to access the debt capital they need to grow their business".

The consequence of these restrictions were assessed in the Paper as having particularly severe implications for higher risk investments in younger, ambitious businesses:

"There is an increasing gap in the supply of higher risk debt for those firms unable to satisfy the banks' now tighter risk criteria. The drive by banks to repair their own balance sheets together with the impact of further regulation makes it unlikely that they will return to serve that higher risk/return lending market at least in the medium term. The resultant reduced supply of finance is particularly impacting those cohorts of ambitious growth and exporting firms which have most to contribute to our economic recovery and growth.

The response to this restriction in supply was a proposed SIB loan fund pending return to the market by commercial lenders. This fund was intended to facilitate market adjustment by demonstrating viable demand for a higher risk debt product for use by fast growing businesses – characterised as Mezzanine Finance[2].

"The intention of the SIB loan fund is to help speed up this adjustment process by demonstrating to banks and others that there is sufficient viable demand for this type of debt product and sufficient commercial returns to be made to encourage the banks and others to again fill this space in the market. The Fund(s) will operate for a defined period that we will determine in due course but should the market adjustment happen quickly the public sector could make an early exit. Alternatively if the market failure remains beyond the term of the original fund then the proceeds of the first fund can be recycled and used to create further funds until the market adjustment takes place".

Market adjustment would occur in two stages – first through attraction of private sector funding into the SIB loan fund and secondly through demonstration to private sector providers of the viability of lending to the market targeted by the fund leading to their future direct provision to that market.

The economic development impact for the SIB loan fund was summarised in the Paper as being generated from the fund's capacity to:

- *help viable, ambitious firms in the short/medium term by providing access to commercially priced finance that they couldn't otherwise get;*
- *encourage in the medium/longer term the development of private sector supply of such products.*

These sources of impact, whilst not explicitly stated as two core objectives for intervention, encapsulate the rationale for intervention. They also form the core of this Review which is required to investigate: the scale and additionality of the economic benefits generated through the Scottish Loan Fund loans to client businesses; and the extent to which market adjustment has occurred in the SLF target market.

3.3. Establishment and Funding

Following approval by SE and the selection of MCP as fund managers the first call for funds from investors closed on 18th March 2011 with total commitments of £94.202m. A second and final call ending on 18th July 2011 brought an additional £18.987m bringing the total fund value to £113.189m.

The Limited Partners in the SLF and their respective contributions are detailed in **Table 3.1.**

Table 3.1: Limited Partner Commitments to SLF At Final Close		
Partner	**Funds committed at 31 March 2011**	
	£m	**%**
Scottish Enterprise	50	44%
Highlands & Islands Enterprise	5	4%
Clydesdale Bank	5	4%
Strathclyde Pension Fund	10	9%
RBS	11.319	10%
Lloyds	11.319	10%
Santander	9.42	8%
North East Scotland Pension Fund	10	9%
MCP Co-Invest	1.132	1%
Total commitment	**113.19**	**100%**

Following launch the first drawdown from the SLF was made on 29th July 2011 and the first loan was completed on 31st August 2011.

In its current form there is a 5 year commitment period for the SLF (March 2011 – March 2016) with a further 5 years until termination (March 2021).

3.4. Activities March 2011 – March 2014

Data provided by SIB tracks commitment of funds in the period since launch. The total committed at the time of the review in April 2014 was £39.4m – equivalent to 35% of the £113.4m total fund. Information on total funds expended (i.e. drawn down by SLF clients against the agreed total commitment) shows a lower level of take up. A graph tracking commitment and expenditure to date with trend lines is provided in **Figure 3.1**. This data excludes any re-payments or redemption of loans committed. The projections based on the trend to date suggest that the total loan fund of £113.4m would be *committed* by the last quarter of 2018 – assuming no step change in take up. However trend line projection of actual loan *expenditure* (i.e. funds drawn down by SLF client businesses) suggests that the total expenditure of the fund by the last quarter of 2018 would be just under £80m.

It should be noted that these projections are, by their nature, extrapolations of performance to date and do not take into account any future potential changes in the investment landscape. The projections also reflect any initial lag in take up of the Fund during the period of market familiarisation after launch.

We have also presented, in **Figure 3.2**, an analysis of loan expenditure to date combined with MCP's forecast take-up in the period up to Q1 2017. This suggests that by the end of this period the total loaned through the SLF, excluding repayments, would be just under £90m.

A total of 15 businesses have taken up 16 loans offered from the SLF producing an average loan commitment value *per business* of £2.6m. The average loan value committed was £2.32m whilst the average expended (i.e. drawn down by the business) was £1.60m. The median loan value committed was £2.05m and the median value expended was £1.42m. Individual loan values drawn down varied in value from £0.5m to £4m. Whilst total *commitments* from the Fund totalled £39.4m in April 2014 the total funds *drawn down* by the SLF client businesses were recorded at £27.2m – or 69% of the funds committed.

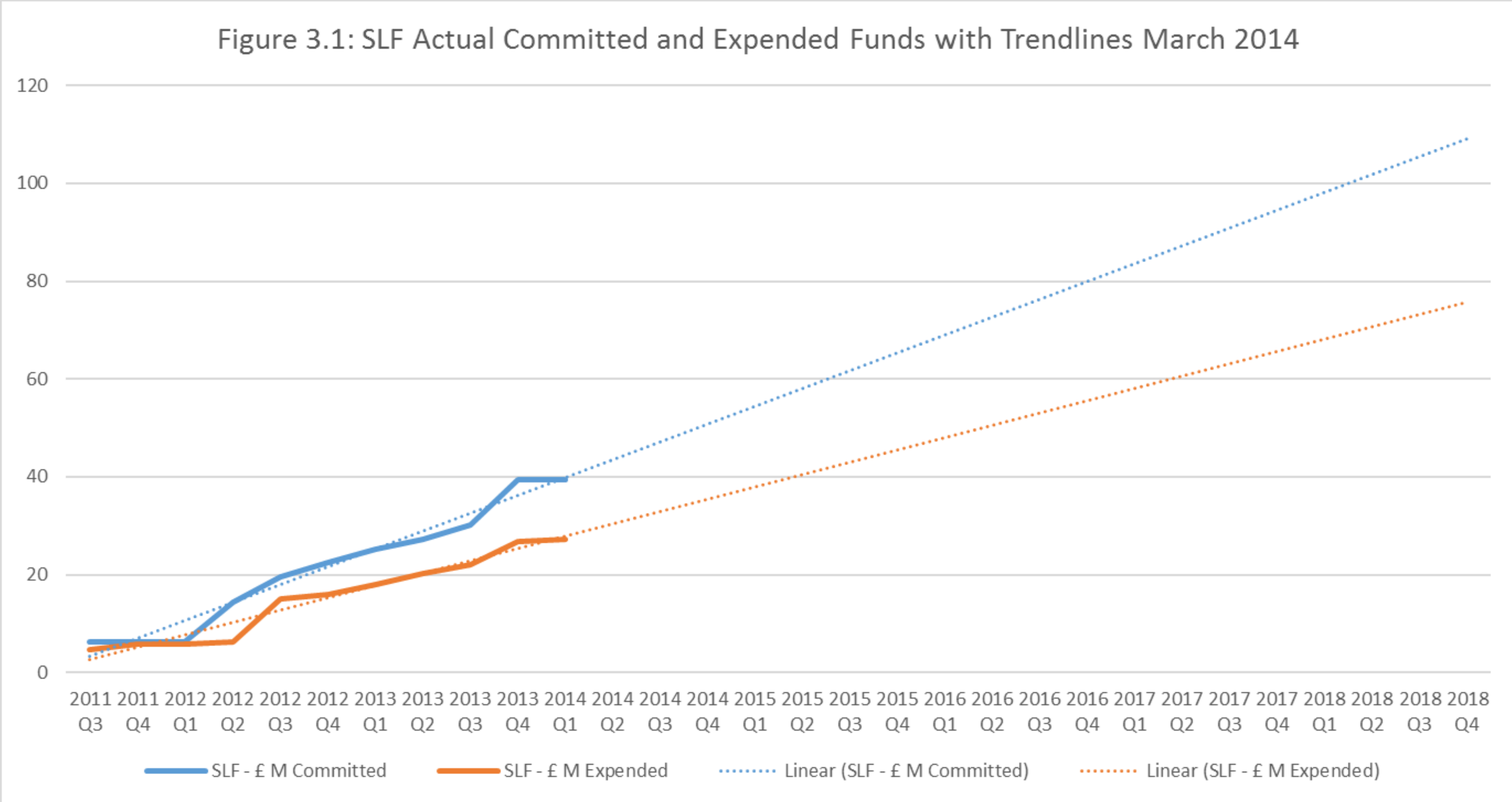


Figure 3.1: SLF Actual Committed and Expended Funds with Trendlines March 2014
120
100
80
60
40
20
0
2011 Q3
2011 Q4
2012 Q1
2012 Q2
2012 Q3
2012 Q4
2013 Q1
2013 Q2
2013 Q3
2013 Q4
2014 Q1
2014 Q2
2014 Q3
2014 Q4
2015 Q1
2015 Q2
2015 Q3
2015 Q4
2016 Q1
2016 Q2
2016 Q3
2016 Q4
2017 Q1
2017 Q2
2017 Q3
2017 Q4
2018 Q1
2018 Q2
2018 Q3
2018 Q4
SLF - £ M Committed
SLF - £ M Expended
Linear (SLF - £ M Committed)
Linear (SLF - £ M Expended)

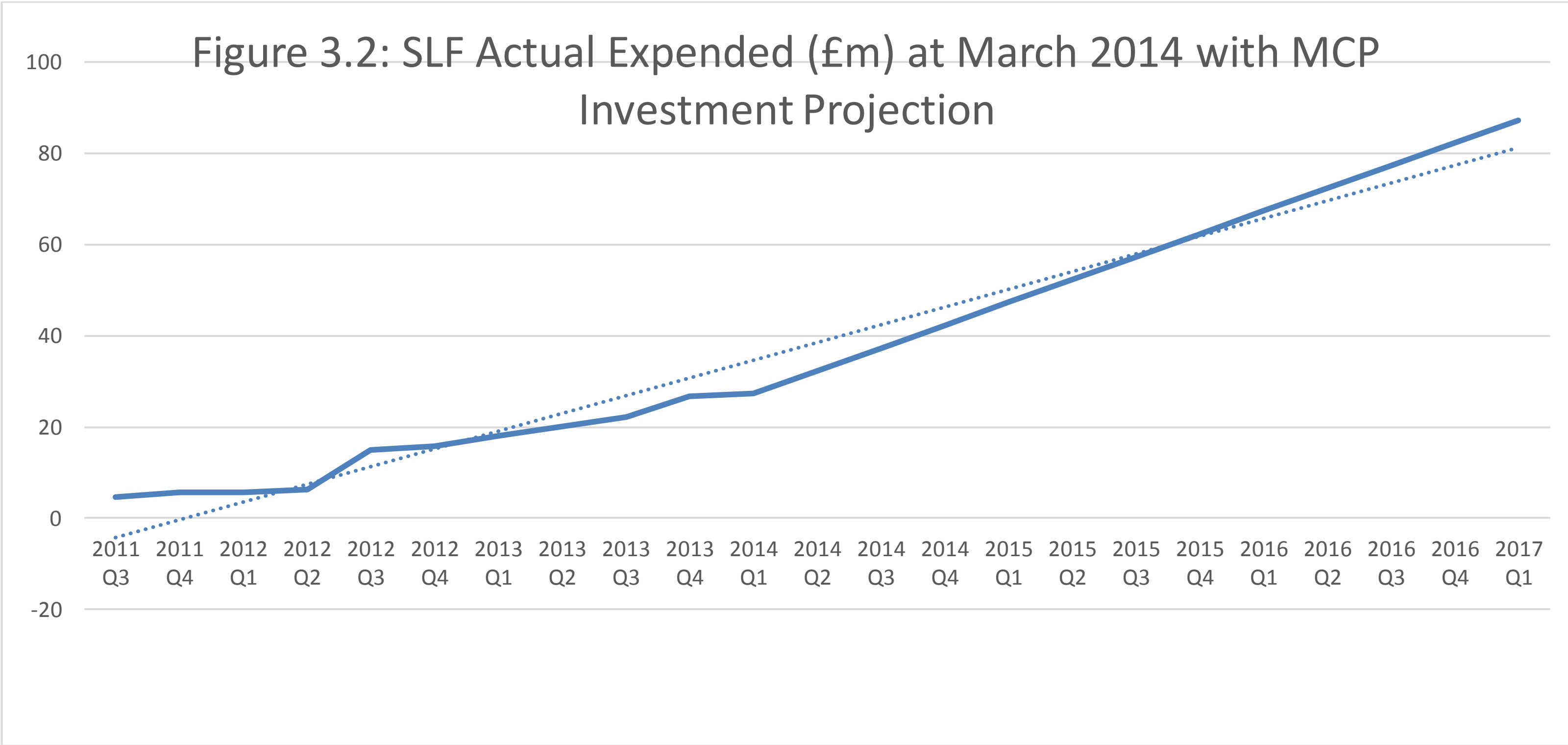


Figure 3.2: SLF Actual Expended (£m) at March 2014 with MCP Investment Projection
100
80
60
40
20
0
-20
2011 Q3
2011 Q4
2012 Q1
2012 Q2
2012 Q3
2012 Q4
2013 Q1
2013 Q2
2013 Q3
2013 Q4
2014 Q1
2014 Q2
2014 Q3
2014 Q4
2015 Q1
2015 Q2
2015 Q3
2015 Q4
2016 Q1
2016 Q2
2016 Q3
2016 Q4
2017 Q1

The loans have been provided to businesses across Scotland operating in a range of sectors as detailed in **Table 3.2**.

Table 3.2: SLF Committed and Expended Lending by Location & Sector (March 2014)									
Location					**Sector**				
	£m Committed	%	**£m Expended**	%		**£m Committed**	%	**£m Expended**	%
Aberdeen	24.275	62%	15.825	58%	Electronics	1.68	4%	1.680	6%
Ayrshire	1.150	3%	0.550	2%	Manufacturing	3.00	8%	0.900	3%
Edinburgh	1.650	4%	1.650	6%	Oil & Gas Services	24.275	62%	15.825	58%
Glasgow	5.650	14%	5.650	21%	Process Engineering	1.15	3%	0.550	2%
Lanarkshire	4.680	12%	2.580	9%	Software	2.65	7%	2.650	10%
Lothian	2.000	5%	1.000	4%	Telecommunications	6.65	17%	5.650	21%
Total	**39.405**	**100%**	**27.255**	**100%**		**39.405**	**100%**	**27.255**	**100%**

This analysis demonstrates the high proportion (by value) to date of lending which has occurred in Aberdeen (all of which has been in the Oil & Gas services sector).

A total of 4 loans with an expended value totalling £12.325m had been repaid in the period to end March 2014. This represents 45% of the total value of funds expended[1] up to this date.

The reasons for repayment of these 4 loans were:

- Financial re-structuring (3)
- Sale of business to Multi-national non SME (1)

Two of the financial re-structuring SLF loan repayments were facilitated through investments by the Business Growth Fund (BGF).

3.5. Fund Performance & Management

In the course of our research amongst the SLF Client Businesses and Limited Partners we asked about their experiences of working with the Fund Managers – MCP. The findings for each of the Groups are summarised below.

3.5.1. SLF Client Businesses

We asked the client businesses to rate a range of aspects of the SLF application and approval process against other experience they had in applying for and securing finance for their businesses. The results are presented in **Figure 3.3**

[1] Monies expended on loans taken up by SLF Clients

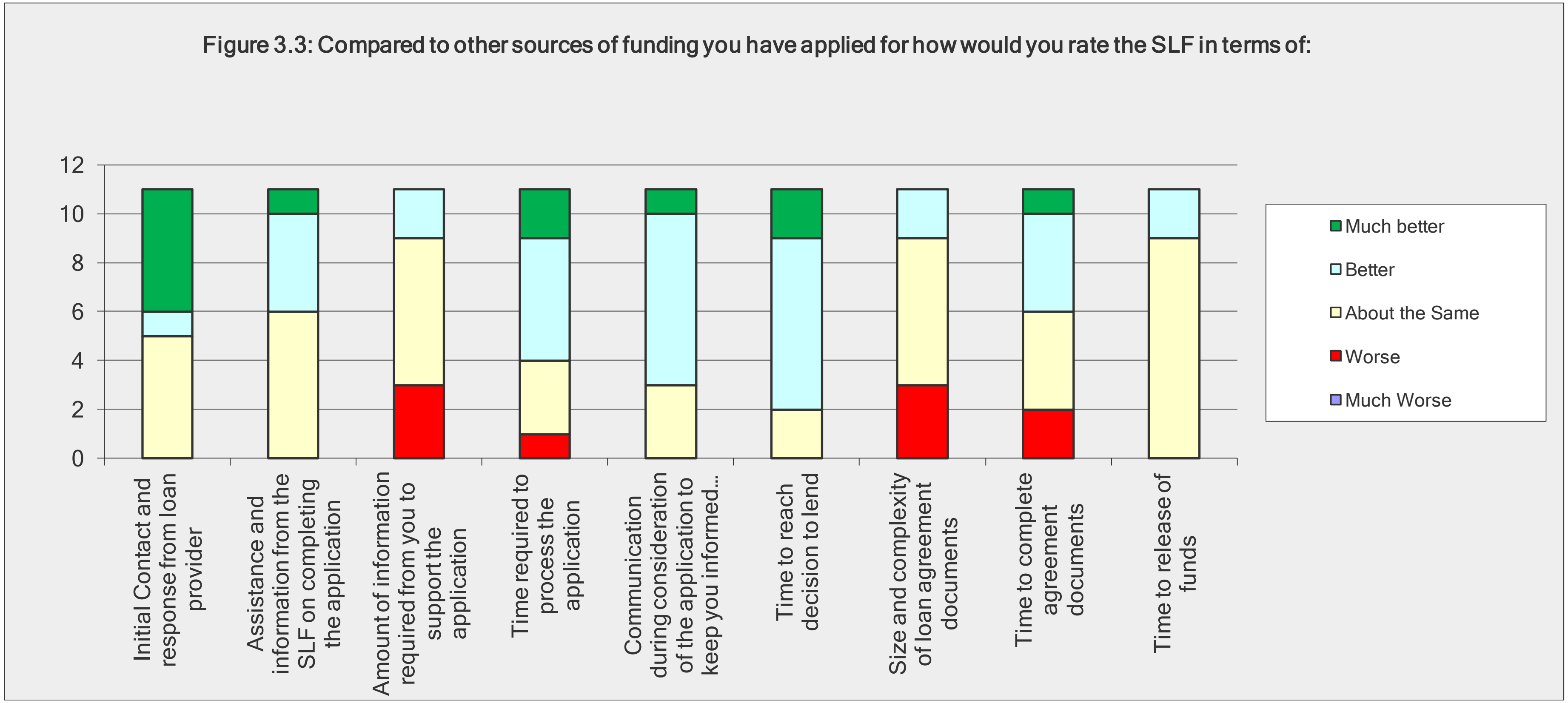


Figure 3.3: Compared to other sources of funding you have applied for how would you rate the SLF in terms of:
12
10
8
6
4
2
0
Initial Contact and response from loan provider
Assistance and information from the SLF on completing the application
Amount of information required from you to support the application
Time required to process the application
Communication during consideration of the application to keep you informed...
Time to reach decision to lend
Size and complexity of loan agreement documents
Time to complete agreement documents
Time to release of funds
Much better
Better
About the Same
Worse
Much Worse

Analysis of these responses suggests that for the majority of respondents the SLF process has been similar to that for other sources of finance they have experienced. Areas where the SLF has been noticeably better include, initial contact and response, communication during consideration of the application and time taken to reach a decision to lend. Areas where it has been perceived by some to be worse are the amount of information required to support the loan and the size and complexity of the loan agreement documents.

We also asked the SLF client businesses if they had any particular issues about the management or administration of their SLF loan. Only one business reported an issue which related to the conduct and application of due diligence investigations and follow on consequences for the selection of financial advisors to the business.

We also asked the SLF clients to highlight any aspects of their relationship with the Fund Managers which they considered to be good practice. We received positive responses from many of them. The aspects identified as good practice included:

- A relaxed and hands off approach to the business if it was performing to profile;
- A genuine interest in the performance of the business (not just the performance of the loan);
- Useful feedback on business management and key decision making from observers installed by MCP on the Boards of SLF Client businesses; and
- MCP acting as a sounding board for the Senior Management Team of the business.

When asked for suggestions to improve the loan and its administration the SLF clients responses included:

- Reducing the interest rates charged (although respondents with in-depth knowledge of corporate finance accepted that the pricing was a reflection of the nature of the product);
- Increasing the lending ceiling above the current £5m;
- Providing greater explanation of the warrant document and the potential implications for future financing of the business; and
- Relaxation of conditions requiring business to consult with lender before making business management decisions.

Several of the client businesses we spoke to stated that they would seek to re-pay their SLF loans at the first opportunity afforded by business growth or as part of a re-financing exercise. This was based on a purely commercial rationale of reducing the overall cost of capital to the business and was no reflection of their levels of satisfaction with the product or its management by MCP.

3.5.2. SLF Limited Partners

In our consultations with the Limited Partners (LPs) we asked those experienced in working with other Fund Managers to assess the relative performance of MCP in managing the SLF.

All who had this experience stated that MCP were on a par with other fund managers they used and emphasised that this was a positive statement - as all of the fund managers they used were of a high standard.

When asked to suggest particular good practice displayed by MCP the Partners identified:

- Strong due diligence and resistance to pressure to improve draw-down at risk of diminishing returns;

- Strong management team at MCP and good internal control processes; and

- Improvements in reporting as the Fund has evolved.

We specifically asked the LPs about the rate of draw-down from the Fund. All commented that the level of take up of the fund had been slower and lower than they expected and several expressed disappointment with this. Reasons suggested for the slower than anticipated take up included:

- SLF operating in a niche market (high growth, high export, limited number of sectors);

- Initial and ongoing need to educate the market (borrowers, other providers of finance and third party advisors) on the nature and application of Mezzanine Finance - which is a novel concept for many businesses;

- Initial over-estimation of the scale of the market; and

- Suppressed demand in general for corporate finance in the period during which SLF has been in the market.

We asked further about the implications of the lower levels of take up of the Fund. It was suggested by several LPs that the Fund was unlikely to be fully committed over its current lifetime. Several also did not foresee a significant increase in the rate of take up and variously put this down to a low level of demand for this niche product and an increase in availability of alternative sources of loan finance as the banks returned to the market. It was further suggested that a significant change in the take up rate would need a concentration on larger deal size.

Whilst none of the LPs suggested that a de-commitment might be necessary in the short term, and all remained committed to the SLF and its underlying rationale, there was a recognition that commitment to the Fund had opportunity costs, particularly for the banks, where the commitments reduced their regulatory capacity to lend through other avenues.

We also asked the LPs about their levels of satisfaction with the returns on their investments in the SLF. There was general satisfaction with these with performance being in line with or slightly ahead of expectations, given the risk profile of the product and market. There was also a recognition that there had not been sufficient time to fully assess the performance of the Fund in the medium term. The LPs valued the prudence of MCP in assessing and pricing risk in each of the loans and were happy to see larger deals which they perceived as lower risk, reflecting the size and age of the business and track record of their senior management teams. A larger number of smaller deals might not be possible as they might be seen as undermining the risk profile of the fund.

3.6. Conclusions

From our analysis of lending activity and consultations we can conclude that:

- There is a high level of satisfaction with the performance of MCP as Fund Managers amongst both SLF Clients and the Limited Partners;
- SLF Clients particularly value the interest from MCP in their businesses and the input from MCP to the management of their businesses;
- SLF Clients perceive the loans as expensive (though most appreciate why) and many propose to repay the loans as early as possible;
- To date 45% of funds expended by the SLF have been repaid before loan maturity;
- At the current run-rate total commitment of the SLF would occur in the third quarter of 2018, However, at the current run-rate[2] total expenditure of the SLF would be just under £80m by the end of 2018;
- LPs noted that the number of loans and value of call-downs from the Fund have been less than expected and several do not expect the Fund to commit its total value over its current lifetime;
- Whilst LPs are not currently advocating de-commitment from the Fund this would not be ruled out at a future point if take up suggested the Fund would not be fully committed;
- Returns to date for LPs have been at or above expectations; and
- There is a preference amongst LPs for higher value and lower risk loans.

[2] Continuation of lending activity performance at the historic rate of lending activity

4. CURRENT MARKET FOR SME FINANCE IN SCOTLAND

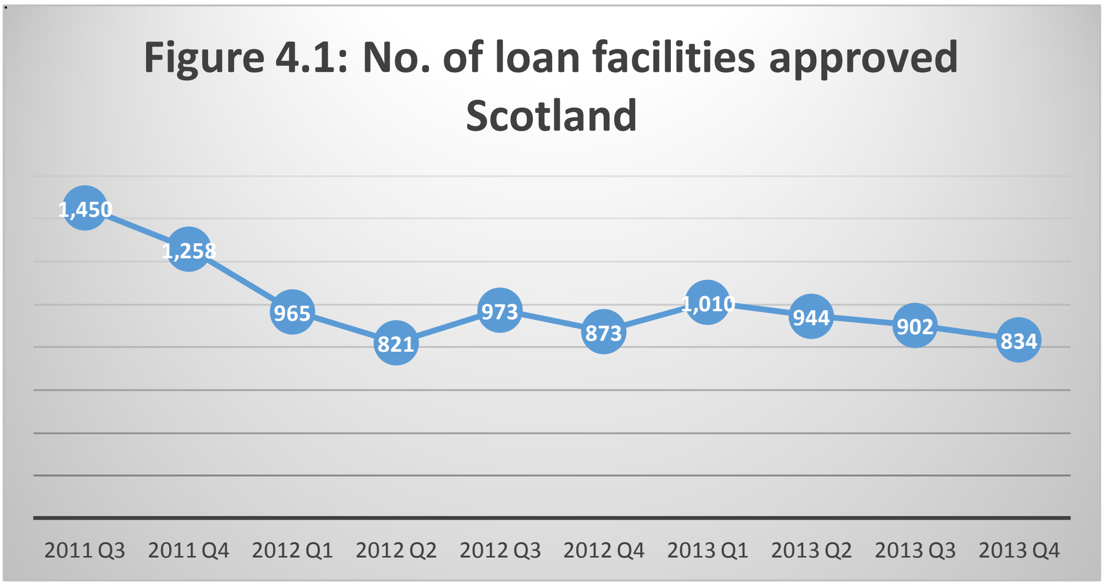
4.1. Introduction

In this Section of the report we consider the current market for finance for SMEs based in Scotland. This research provides context for consideration of the continuing rationale for the SLF as a specific product within this market. The research has been informed through desk research by SIB and the Consultants along with our primary research amongst the SLF Limited Partners, the Fund Managers, the SLF client businesses and the SE Account Mangers and SIB Investment Managers of these businesses. The SIB research is included at **Appendix 2** and we make reference to this appendix where required.

Where possible we have provided comparative assessment between current assessments of the market and the corresponding evidence for 2010, which shaped, in part the focus and criteria for SLF lending.

4.2. Lending to SMEs in UK and Scotland

We have reviewed the most recent evidence on the current state of the lending market for SMEs. The British Bankers' Association (BBA) provides quarterly data on the volume and value of lending to SMEs by its members. This data is available for UK regions and Scotland from Quarter 3 2011. Figures 4.1 and 4.2 present the comparative figures for the UK and Scotland on the numbers of loans approved.



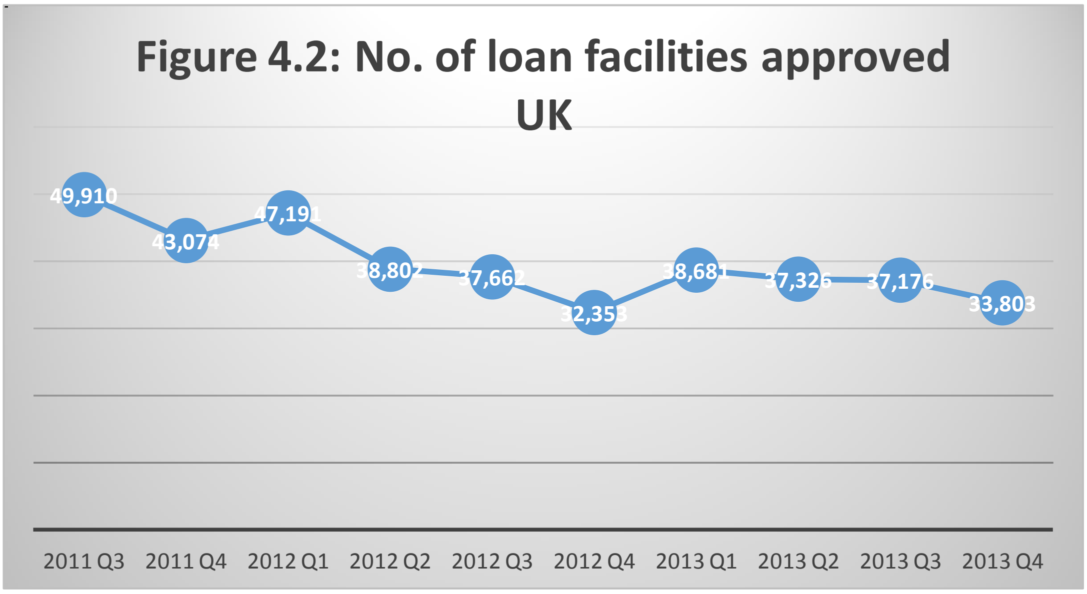


Figure 4.2: No. of loan facilities approved UK

This data demonstrates an overall decline of almost 74% in the number of loans approved in Scotland per quarter over the period compared to a 50% decline in the UK as a whole. The value of loans approved per quarter also fell by 58% in Scotland over the same period compared to a 27% decline in the UK over the same period (Figures 4.3 and 4.4). The average quarterly value of all loans approved in Scotland between 2011 and 2013 was £302m. This represented 5.6% of the quarterly average value of loans across all of the UK over the same period. This proportion can be compared against Scotland's 6.8% share of the total number of SMEs in the UK.

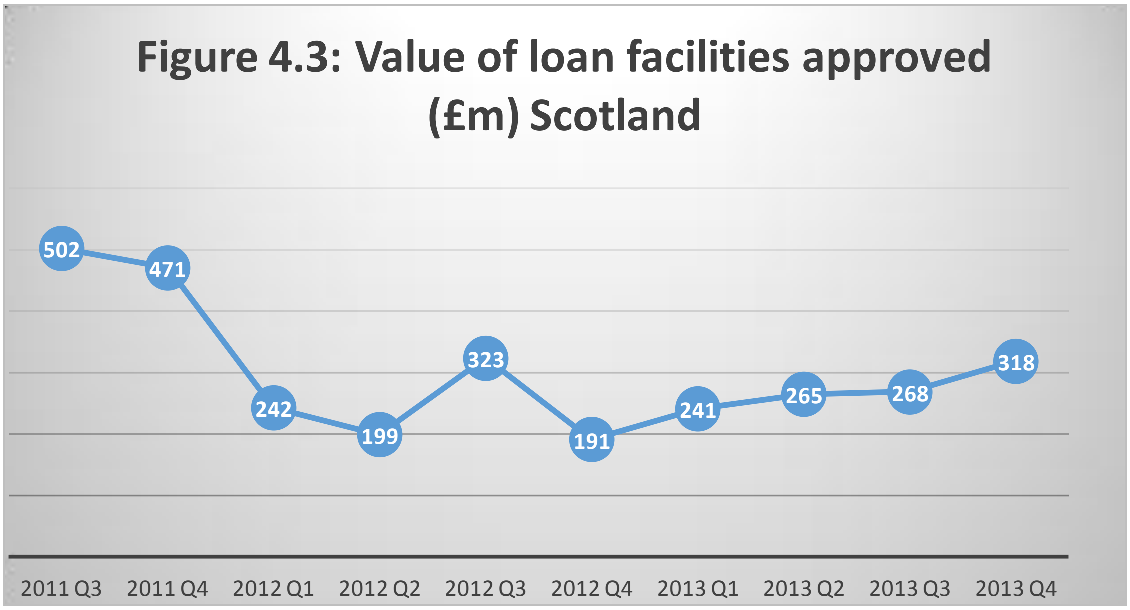


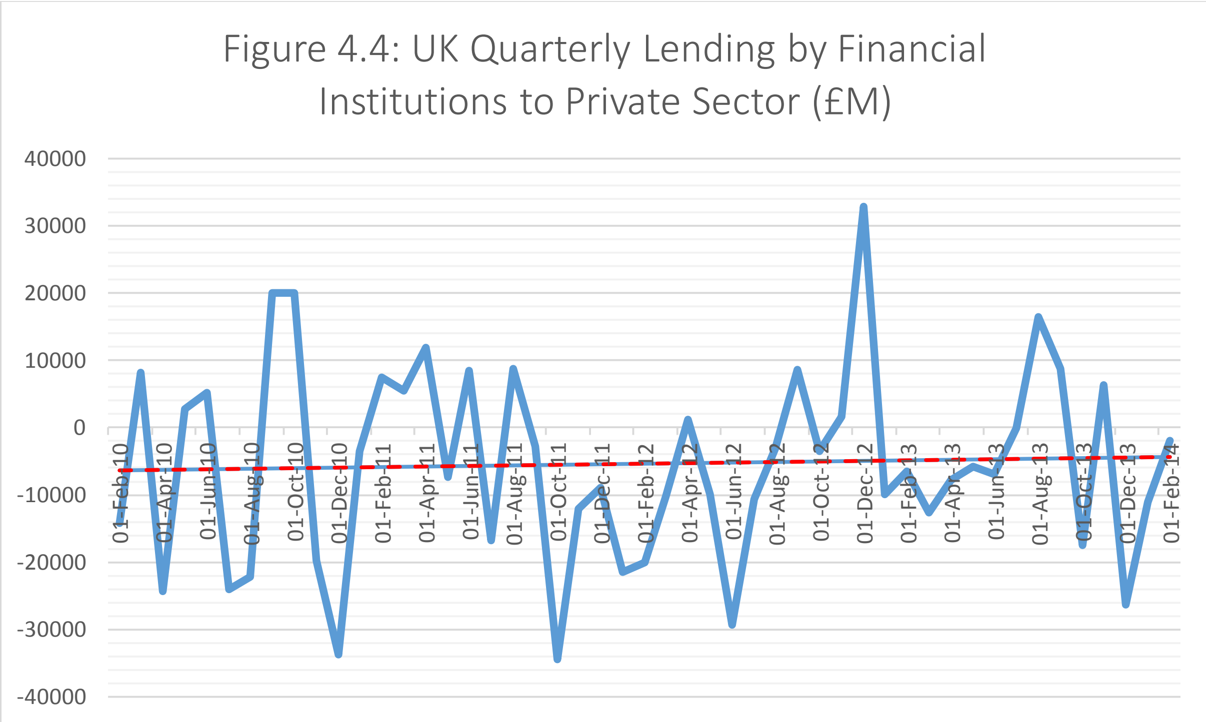
Figure 4.3: Value of loan facilities approved (£m) Scotland

BBA figures also suggest that the overall levels of indebtedness of Scottish SMEs appear to be relatively stable (Figure 4.5) and averaging £4.4 bn between 2011 and 2013.

Analysis of the figures for number and values of loans in Scotland (Figures 4.1 and 4.3) suggest an increase in the value of loans approved in the year to Q4 2013 with a slight decrease in the number of loans over the same period. This implies that average loan values in Scotland are increasing.

More recently, the BRDC SME Finance Monitor 2013 Quarter 4 survey[3] has demonstrated continuing suppressed demand for finance from SMEs. Of the SMEs surveyed 79% stated that they had not sought finance, nor had anything prevented them from doing so.

Further context to the overall lending to the private sector by financial institutions in the UK is provided by monthly data from the Bank of England. This is summarised for the period between February 2010 and February 2014 in **Figure 4.4**.



Whilst demonstrating considerable variation from month to month, with a significant positive spike in December 2012, trend-line analysis of this data suggests that the overall level of indebtedness of businesses has been reducing over the period. The net flow in lending in the periods from February to February in the period 2010 to 2014 is summarised in **Table 4.1**.

Table 4.1: Lending to Private Sector by UK Financial Institutions	
Period	**Net Lending (£m)**
Year to Feb 2011	-63,772
Year to Feb 2012	-89,140
Year to Feb 2013	-38,561
Year to Feb 2014	-58,671
All	**-250,144**

This data suggests that at the UK level the trend has been for businesses to reduce their level of indebtedness year-on-year over the past 4 years, with an overall reduction in that period of £250 Bn.

Further analysis of this dataset in the SIB report in Appendix 2 illustrates that the average net monthly flow remained slightly negative in the first two months of 2014. The pace of decline in the stock of lending to UK businesses has eased slightly since the start of 2013. The SIB research also cites the latest survey by the Bank's network of agents which indicates that credit availability had eased for firms of all sizes and sectors.

Specific current data on access to finance and the performance of the lending market in Scotland is limited. The 2014 Scottish Parliament Economy, Energy and Tourism Committee[4] referred to the now historic 2012 Scottish Government Access to Finance survey in its assessment of the situation. However, it also quoted more recent evidence from RBS and Bank of Scotland provided in a synopsis to the Committee:

"*In their evidence to the Committee, representatives of the Royal Bank of Scotland (RBS) and the Bank of Scotland (BoS), who together account for some 70% of business lending in Scotland in 2012, indicated that by late 2013, they were seeing signs of recovery and other positive signs, with BoS reporting that its half-year lending to the summer of 2013 was up 5.6% year-on-year.*"

However, the most recent SIB research in Appendix 2 uses data from the SME Finance Monitor survey[5] of 1601 Businesses located in Scotland to provide some further insight to the lending market. The full analysis is included in Appendix 2 and the summary findings suggest that:

- Scottish SMEs had a similar propensity to use external finance to businesses across the UK;
- Use of external finance by Scottish SMEs had declined by more than that across the UK in the period between 2011 and 2013; and
- Overdraft and loan applicants in Scotland were significantly more likely to have been successful than applicants elsewhere (although this was more likely to reflect the nature of the lending proposition than location in Scotland per-se).

Other recently published information identified in the SIB research in Appendix 2 indicates that that Scotland is estimated to have had 6% of Britain's SME turnover and 8% of Britain's SME lending. This is based on figures from the six banks: RBS, Lloyds, Clydesdale, HSCB, Barclays and Santander.

4.3. Evidence from Review Research

As part of our primary research amongst the SLF Limited partners, Fund Managers, SLF Client businesses and SE Account Managers we asked about their interpretation of the current condition of the market for SME finance in Scotland. Our analysis of the responses we received from each of these groups is presented below.

SLF Limited Partners

Four of the LP consultees, as commercial banks, were actively involved in the SME finance market in Scotland.

The general consensus amongst these consultees was that supply of finance to SMEs was considered to be improving, with some lenders regaining an appetite for risk.

However, this improvement was not considered to be universal across all areas and sectors. Lenders would respond to good quality opportunities from viable businesses. It was suggested that the low levels of SME lending in the period from 2010 to 2013 were in part due to the recession dampening demand from businesses for finance. It was also noted that some SMEs were currently cash rich and not actively seeking finance to invest.

SLF Fund Managers

In the course of our consultation with MCP we invited them to comment on the current market conditions for provision of finance to SMEs based in Scotland.

They considered that whilst there was some activity and modest growth returning to the market, traditional bank lending to SMEs remained low. This was a particular issue for businesses wishing to finance cash flow to facilitate growth where security was limited. Regulatory provisions on bank lending was maintaining risk averse attitudes within the banks who were restricting lending to strong, viable propositions with adequate security.

SLF Client Businesses

We asked the SLF client businesses if they had more recent experience of accessing finance for their business (other than their SLF application).

Approximately half of the businesses we consulted had explored the market for finance in the period following provision of their SLF loan. Of these, two thirds considered that the market had not changed in its willingness to provide finance for their business. One considered that the finance terms quoted remained a constraint on their taking up the finance and one other felt that finance providers were now more willing to consider applications for funds.

SE Account Managers

We asked the SE Account Managers (AMs) we consulted about the current state of the market for loan finance. The consensus was that accessibility had improved – but many considered this a slight improvement. It was suggested by several AMs that whilst the banks were returning to the market they were being selective in their lending and avoiding certain sectors. Another reported banks actively prospecting for lending opportunities amongst stronger businesses and sectors. There was also a suggestion that lenders were requiring significant work from borrowers in advance of a decision to lend with one AM citing a BGF application which had taken 6 months to get to an offer of funds.

We also asked the AMs about changes in access to finance conditions for <u>all</u> of the businesses they managed in the period between 2010 and 2014. Just under half of the AMs suggested there had been a *slight* improvement in access to finance, with a third suggesting that conditions remained about the same. A minority felt that there had been a definite improvement and none of the AMs suggested a worsening in access to finance.

4.4. Potential Market for SLF

The SLF is a niche and novel product with a limited market scale. The progress to date of the Fund in providing loans remains the most reliable barometer of *expressed demand* within the Mezzanine Finance market in Scotland. Determining the scale of the *potential market* for a Mezzanine Finance product in Scotland was challenging inadvance of the launch of the SLF, and remains so.

The SIB has, however, conducted a review of the potential market for funding through the SLF based on an analysis of:

- data for Scotland from the UK Small Business Survey (2012) extracted by Scottish Government; and

- survey data from SE Account Managed businesses.

The SIB paper at Appendix 2 concludes that the potential market for finance through the SLF might be in the region of 100 discrete new client businesses every year (allowing for sector restrictions). This suggests that at its historic run-rate of around 6 loans per annum the Fund is addressing 6% of its potential target market for loan finance.

4.5. Conclusions

From the limited secondary and primary research data available to us we are able to draw some general conclusions on the current access to finance conditions for SMEs in Scotland.

- There appears to have been a small increase in the *value* of lending to Scottish SMEs during 2013, although the number of loans is decreasing and average loan values are increasing;

- Banks are returning to the market with overall lending increasing by value after a decline in 2011 and stagnation in 2012;

- Banks still appear to be selective in the businesses and sectors they lend to preferring demonstrably viable businesses in growing sectors;

- There is some suggestion that there is low demand for finance from SMEs evidenced by reductions in the numbers of loans, reductions in net lending, active prospecting of opportunities by banks and holding of cash reserves by businesses; and

- The *potential* market for loans through the SLF is estimated by SIB, based on the available evidence from the UK Small Business Survey, as being around 100 businesses per annum.

Relative to the period when the SLF was launched in 2011, there appears to have been a modest improvement in access to finance for SMEs as evidenced by responses from the SLF limited partners and SE Account Managers. However, the majority of the businesses we consulted perceived little change in the attitude of finance providers to their approaches to them.

5. POTENTIAL ECONOMIC IMPACT OF SLF

5.1. Introduction

In this section of our report we present our assessment of the potential economic impact of the SLF[3]. At this stage in the life of the SLF our assessment method needs to reflect the fact that:

- The SLF has been in existence for a relatively short period (3 years)
- 85% (by committed value) of loan agreements have been completed in the past two years
- 35% (by committed value) of loan agreements have been completed in the last year
- Four of the loans drawn down to date have been re-paid in full.

5.2. Factors Influencing Economic Impact

Demonstration of a positive economic impact from the securing of SLF funds by a business is dependent upon:

- **Identifying *Additionality*** - by determining that there was no viable alternative source of funds for the business in the absence of the SLF – *at the time the SLF loan was secured*. We have done this by asking the SLF client businesses about other sources of finance they investigated and had offered to them in advance of their securing SLF funds.

- ***Scaling and measuring the additionality*** by considering how the business might have performed if it had not received the SLF loan. We have done this by asking the client businesses how they considered their business might have performed if they had not received the SLF loan at the time they did. (The focus was solely on understanding the contribution of the loan not about any other support)

- Considering the potential for ***Displacement*** – the reduction in business turnover of Scottish based competitors of the SLF funded businesses caused by any increase in the turnover of the SLF client business. We have done this by asking about the location of the SLF client businesses' competitors and about the rate at which the market for their product or service is growing.

- Assessing the potential for ***Leakage*** where the benefits from any increase in business are delivered outside Scotland. We have done this by asking the SLF client businesses about the extent of their employment in Scotland and the amount of turnover generated by employees located in Scotland.

There are likely to be variations in the duration and persistence of any benefits generated. The securing of a SLF loan may have facilitated a step-change in the

[3] Most companies in receipt of SLF go onto become Account Managed and will consequently benefit from the wider support that Scottish Enterprise Account Management offers. Account Management, however, will still be in the early stages for these companies and as such it is too soon to determine resulting impact. The impact to date in this report is therefore attributed to SLF support only. In future evaluations, the effects of any Account Management support along with SLF Future impact, will need to be considered when assessing impacts.

performance of a business or allowed it to realise an opportunity for market or product development which was only available within a limited timeframe. This might generate a competitive advantage which persists for a number of months or years or facilitate a market leading position which is unassailable by competitors in the medium to long term.

The persistence and decay of benefits will also reflect the application of the loan funds in the recipient businesses. If applied to a capital investment with a lifetime of 15 years (e.g. an offshore support vessel) the potential duration of benefit to the business can be significant. In contrast, application of funds to product development in a rapidly evolving area of technology may only confer an advantage for a few months.

5.3. Impact Assessment Method

We have used an economic impact calculator prepared by the SE Appraisal and Evaluation team in conjunction with the SIB, to arrive at an estimate of the potential economic impact of SLF activity to date. At this relatively early stage in the life of the fund and the majority of deals having been completed in the last 12-18 months there is limited data on actual performance.

The calculation uses the most recent actual data available from the businesses in conjunction with the forecast performance data provided as part of the SLF application where this is still relevant. Forecasts become irrelevant where actual performance exceeds original projections, and in these cases we have assumed continued performance at the most recent actual level up to a period of 4 years (appreciate this may vary by company – key point is that we are using what is available).

We have been prudent in our application of the evaluation research findings to this model and have:

- Not projected benefits to the end date of the loan agreement and not projected benefits beyond the period for which forecasts of business performance are available (based on the data made available by Maven and the companies this is typically one year from the date of the last posting of actual performance figures);

- Restricted lag effects (where the business reports it would have grown more slowly in the absence of the SLF loan) to a period of two years after receipt of the SLF loan;

- Derived estimates of deadweight, displacement and leakage from individual businesses' assessments of the availability of alternative finance at the time of securing the SLF loan, the performance of the business in the absence of the SLF, the location of the businesses' competitors, the businesses' assessment of market growth and the location of their employees; and

- Included the loans at full value expended, despite the expectation, and actuality to date, of loans being fully repaid to the Fund inclusive of a commercial rate of return.

- SE's impact model profiles impacts over 10 years. As it is unlikely that companies will have metrics for this time a simple rule of thumb is to decay the final year's net impact by 20% and so on until the tenth year. The net GVA values can then be discounted by 3.5% per year to give a Present Value. In the SLF analysis the decay is applied to the remaining period where there are no forecasts available. The five and ten year cumulative GVA figures sum GVA from the date of provision of the SLF loans to the individual businesses.

A detailed method statement for the EIA is included at **Appendix 3**

5.4. Estimated Economic Impact

The detailed results of our assessment of economic impact on a case-by-case basis have been provided to SIB, subject to restrictions on commercial confidentiality. The aggregated headline results for the Fund investments to date are summarised in **Table 5.1**.

We have identified separately the potential benefits generated by four loans repaid at the time of conducting the impact assessment. These repaid loans could have potentially generated a stream of additional benefits facilitated by SLF availability at the time of lending, which will continue following the sale or re-financing of these businesses. These b3nefits will have been secured at no cost to the SLF as all funds and interest were reimbursed on closure of the loan.

Table 5.1: Economic Impact Summary			
Summary Results	**All Live Cases (n=12)**	**Repaid Cases (n=4)**	**All Cases (n=16)**
	£,000	£,000	£,000
GVA Generated to Date[1]	14,901	3,911	18,813
Cumulative 5 year net GVA impact (with SLF)[2]	46,841	11,197	58,037
Cumulative 10 year net GVA impact (with SLF)[2]	72,071	16,401	88,471
Gross Turnover With SLF[3]	437,398	261,386	698,784
Gross Turnover Without SLF	319,151	226,672	545,823
Gross Turnover Attributable to SLF	118,248	34,714	152,962
Value of SLF Loans (Expended)	21,580	75	21,655
Discounted Value of SLF Loans	18,097	573	18,670

1. GVA is presented to end of 2013 reflecting availability of individual business financial performance data at time of evaluation.
2. 5 and 10 Year GVA figures represent the 5 and 10 year periods from the date of the SLF loans to each business.
3. Turnover Figures are cumulative for the period for which actual and projected turnover figures were available. For most cases this is 3 years with a few older loans incorporating 4 years of turnover.

The economic impact calculator does not provide for the assessment of gross or net additional employment. However, the SLF Fund Managers report on current gross employment in the SLF client businesses and corresponding employment levels at the date of the first advance on the loan. The data from the most recent quarterly management report for the period to end December 2013 indicates 163 gross additional employees within the SLF client businesses (excluding the three businesses which had repaid their loans at that date).

We have also assessed the export intensity of the SLF client businesses and, based on actual figures for the businesses in the year they received their loans, export sales outside Scotland accounted for 65% of turnover.

5.5. Value for Money Assessment

At this stage in the life of the SLF we cannot draw firm conclusions on the VFM likely to be generated by the SLF given that:

- Only around one quarter (24.1%) of the SLF has to date been expended on loans;
- A significant proportion of the SLF loans have several years to run to maturity; and
- The SLF will continue to lend until the end of 2015.

The VFM generated by the SLF is also dependent upon the *actual cost* of the Fund to SE. As a commercial fund set up to deliver a return to investors the SLF may be revenue neutral or revenue positive to SE. Actual VFM will reflect the performance of the loans in the repayment of capital and interest and the levels of default or under payment within the SLF client businesses. To date there have been no defaults on SLF loans and payments including interest are on schedule.

The total expended on all loans to date by the SLF (including loans now re-paid) is assessed at £27.2m (Table 3.2). These loans are funded pro-rata by the Fund investors and the SE and HIE share of loans expended to date is 48% or c £13m. However, for this cost to be borne in full by SE all of the SLF clients would need to default – which is patently unlikely to occur.

Given the 10 year cumulative Net Additional GVA benefit of £88.4m (including benefits from repaid loans) and potential maximum SE exposure to a cost of £13m (in the unlikely event of all SLF Client businesses defaulting) the current SE cost to GVA ratio is 6.8:1. However, this benefit ratio is subject to potential variation because:

- If SLF client businesses do fail the benefit stream from that business might also fail to materialise as currently forecast - depending on whether the business survived the default; and
- Conversely, if no businesses default, the cost of the intervention to SE would reduce to zero, or result in a return to SE with the forecast benefits still being delivered.

We can only conclude at this point that the SLF loans to date are on course to generate an estimated £88.4m of net additional GVA at no cost to SE on the assumption that the current default rate is maintained. Ongoing monitoring of the GVA generated and loan repayment performance is required to indicate whether this strong performance is being maintained as the Fund progresses to maturity.

5.6. Conclusions on Economic Impact

- The SLF client businesses have demonstrated both significant growth and high proportions of export sales (averaging 65% of turnover), reflecting the priorities of the Fund.
- There have been instances of absolute additionality with 31% of businesses considering they would not have grown in the absence of the SLF.
- There have also been instances of time additionality with 46% of businesses stating that the SLF loan has allowed the business to grow sooner than would otherwise have been the case.
- Only 23% of business stated that they would have grown at the same rate if they had not received the SLF loan (although this would have been achieved using an alternative sub-optimal source of funding) .
- Most of the businesses face limited competition from other Scottish businesses and most operate in markets they consider to be growing or growing rapidly – limiting the potential for displacement.
- The potential for leakage of benefits is also limited as most businesses record all of their employees as located in Scotland and only one business has a large proportion of employees outside Scotland.
- The SLF client businesses are estimated to have the potential to generate a cumulative net additional GVA over 10 years of £88m.
- At the end of 2013 the SLF client businesses have together employed an additional 163 people in the period since they took out their loans
- There is potential for high levels of VFM on SE investment in the SLF if current returns on SLF loans and default rates are maintained.

6. CONCLUSIONS AND RECOMMENDATIONS

6.1. Introduction

In this final section of our report we consider the extent to which there remains a continuing rationale for the SLF by reflecting on:

- Demand for and take up of loans through the Fund to date;
- The Performance & Management of the Fund;
- The Economic Impact to Date of the Fund; and
- The potential future demand for loans through the Fund

6.2. Demand for and Take-up of SLF Loans

The Fund Managers and Limited Partners agree that the take up to date of the Fund has been lower than anticipated. This behind profile performance has consequences for the potential of the Fund to expend its total value over its lifetime. Performance at trend to date would see the Fund wholly committed (excluding repayments and redemptions) in the third quarter of 2018. However, if performance to date on loan *expenditure* were maintained total expenditure of the Fund would be just under £80m by the last quarter of 2018

Performance behind profile has been variously ascribed to:

- The combination of a novel financing product operating in a niche market;
- Generally suppressed demand for corporate finance for SMEs; and
- Over-estimation of the potential scale of the market at establishment

The Fund managers consider that the take-up of the Fund can be improved to avoid a de-commitment of funds from the Partners

The LPs are currently not seeking a de-commitment but would not, generally, have any difficulties with this if it proved necessary.

6.3. Performance and Management of the Fund

Both the SLF clients and LPs are satisfied with the performance and management of the Fund.

Businesses particularly value the insight that MCP bring to their business and many discuss management issues with them on an ongoing basis.

LPs value the prudence and approach to due diligence applied by MCP in appraising loans and managing risk. Returns to the LPs are at or above expectations.

Over 30% of funds committed have been repaid early and many current SLF clients have expressed a desire or intention to repay their SLF loan at the earliest opportunity afforded by business performance or re-financing.

6.4. Economic Impact to Date

Results from our analysis of SLF client consultations and performance data demonstrate that there is potential for significant economic impact. We have identified high levels of additionality and low levels of displacement and leakage of economic benefits. This reflects the export orientated nature of the businesses, their operation in growth markets and the issues many faced in securing finance in the period of operation of the SLF.

The headline economic impacts to date based on actual business performance and three year projections are:

- The SLF client businesses taking up loans to date are already estimated to have generated cumulative net additional GVA of £18.8m in the period up to the end of 2013.

- The SLF client businesses taking up loans to date are estimated to have the potential to generate a cumulative net additional GVA of £88m over the 10 year periods from their loan dates.

- At the end of 2013 the SLF client businesses have together employed an additional 163 people in the period since they took out their loans.

- The SLF client businesses have demonstrated both significant growth and high proportions of export sales (averaging 65% of turnover), reflecting the priorities of the Fund.

6.5. Potential Future Demand for SLF

There are a number of factors which will determine the future demand for the SLF.

The underlying conditions determining access to finance for rapidly growing businesses remain challenging with banks generally confining their SME lending activities to well secured and viable opportunities. There is some evidence of an easing in the market and the Business Growth Fund (BGF) is also beginning to gain traction in Scotland.

There are also suggestions that the demand for corporate finance has been suppressed over the period in which the SLF has been in existence, with recession dampening demand, and businesses postponing investment and choosing to pay down debt.

The Fund Managers anticipate an increase in demand for the SLF as economic growth returns, businesses seek to fund growth and traditional bank lending remains suppressed by regulation and risk aversion.

There is no evidence of the banking LPs moving into the Mezzanine Finance market and market adjustment in the form of banking sector provision of mezzanine finance is limited to pre-existing products at the time of the introduction of the SLF.

The BGF is becoming a player in the market and can fund growth in the sectors ineligible for provision through the SLF. Whilst the BGF is not a direct competitor to SLF (it is primarily an equity product rather than a debt product) it does offer an alternative source of finance for those businesses seeking to release capital from their business, and can also fund larger deal sizes (up to £10m).

There remains a small but viable market for the SLF. Both SLF clients and the private sector LPs favour larger deals, which are perceived to be less risky and there is also evidence that the corporate finance market in general in Scotland is moving to larger deal sizes. Larger deals also offer opportunities for economies of scale in due-diligence.

Our consultations with the Fund Managers and LPs revealed low levels of cross referral from the LPs to the SLF and these referrals have not been a significant source of introductions for MCP.

In our consultations with SE Account Managers we asked if there were other businesses within their portfolios which might be potential future clients of the SLF. Of the nine Account Manager respondents, seven did not consider any of their portfolio businesses as being potential SLF clients in the near future. Several also commented that they had sufficient insight to the SLF to be able to identify potential clients and refer these to SIB/MCP as and when they arose. There were also several historic instances reported of a lack of communication between SIB and Account Managers with, in one instance an Account Manager only learning at a meeting with one of their businesses that the SLF loan had been repaid. Whilst it was acknowledged that communications between SIB and the Account Managers had improved over the past 18 months there was still considered to be a lack of transparency on SE systems on the involvement of SIB with Account Managed businesses.

Whilst significant proportions of SLF loans have been made to businesses in the Oil Services sector (all based in NE Scotland) this may reflect the fact that there are many fast-growing export-orientated businesses in the sector. We would expect the SLF to remain opportunity-driven in order to maximise economic impact for Scotland – regardless of the geographic location of those opportunities.

Irrespective of the foregoing the SLF will need to experience a step change in demand if it is to become fully committed within its current lifetime. This may require the LPs to consider a de-commitment or alterations to deal scale criteria to ensure the Fund is expended. As part of our analysis of the Fund Performance in Section 3.2 we produced a series of trend projections of take-up based on funds committed and expended to date. These suggested that take-up by the end of 2015, (when the Fund is currently configured to cease lending activity) would reach around £42m based on amounts expended to date. Projections prepared by MCP based on accelerated rates of fund lending activity suggest reaching £60m of expenditure by the end of 2015.

Failure to meet draw-down profile is a particular concern for the public sector LPs in the SLF, due to partial funding through European Structural Funds (ERDF). ERDF contributions have strict criteria on defrayment within set time limits, which if not met can lead to withdrawal of funds and transfer of liability for payment to the applicant (SE).

6.6. Continuing Rationale for SLF

Overall we conclude that there remains a continuing rationale for public sector engagement in the SLF and based on the two core strands of the rationale for intervention identified in Section 3.2.

help viable, ambitious firms in the short/medium term by providing access to commercially priced finance that they couldn't otherwise get.

- Continuing evidence from the Review of the failure of commercial lending providers to offer a mezzanine finance product to higher risk but viable Scottish SMEs with limited security to finance aspirations to grow and export. This is characterised as an information failure leading to risk aversion.

- High levels of additional economic impacts amongst the SLF client businesses taking out loans to date.

encourage in the medium/longer term the development of private sector supply of such products.

- Minimal market adjustment with no direct competitor mezzanine finance products coming into the market, although BGF is gaining traction amongst some of the potential SLF client base.

In addition the SLF has been shown to be an ***effective mechanism for the delivery of this intervention*** with demonstration in the Review of:

- High levels of satisfaction with the SLF product and process amongst the SLF client businesses;

- Continuing support and engagement from the LPs who perceive a continuing rationale for their own involvement based on lack of alternative provisions and sound commercial returns;

- Evidence that the SLF client businesses in general have highlighted core characteristics of projected (and actual) high levels of growth and high intensity of export sales; and

- Demonstration of the potential to deliver significant value for money to SE given SLF client business performance and zero default rates to date.

The Fund's effectiveness in addressing the underlying rationale for intervention would be further strengthened through a step-change in take-up to ensure the Fund is fully committed within its designated lifetime.

6.7. Recommendations

Given the: continuing rationale for intervention through the Fund; the potential scale of economic impact and value for money; and the interim nature of this Review, our recommendations are:

- SIB, SE and the other Fund LPs should support, where possible, the Fund Managers in implementing their suggested actions to increase the run rate of enquiries and their conversion into completed loan deals;
- SIB should closely monitor the monthly enquiries, conversions and deal flow based on suitable data submitted by the Fund Managers, and continually update projections against Fund targets up to the end of 2015;
- SE and SIB should also monitor SLF activity and forecasts to ensure achievement of required eligible ERDF *expenditure* levels;
- The Fund Managers should continue to collect data *as it becomes available* on SLF client turnover, export performance, employment and accounting information required for the calculation of GVA (Employee Costs, Operating Profit, Depreciation and Amortisation); and
- SIB should continue to monitor the market for Mezzanine Finance in Scotland to assess whether existing providers are gaining traction or new commercial providers are offering competitor products to Scottish SMEs.

APPENDIX 1

SLF RESTRICTED SECTORS (Current May 2014)

The SLF is open to all eligible businesses with no sectoral focus meaning it invests in both manufacturing and service businesses. However it is prohibited from providing funding into certain restricted sectors. Funding therefore cannot be provided to companies that operate in, one of the following activities:

- Retail
- Motor vehicles
- Real estate/property development
- Social and personal services
- Pubs, clubs and restaurants
- Local services
- Banking and insurance
- Nuclear decommissioning
- Professional services

Source: SE Website:
http://www.scottish-enterprise.com/services/attract-investment/scottish-loan-fund/are-you-eligible

APPENDIX 2

SIB REPORT

SLF MARKET OVERVIEW

Appendix 2

The Scottish Loan Fund: Market Overview

1. Introduction

This paper summarises the latest available market evidence on both the supply and demand for SME loan Finance. This based on the most recently available published data; however, this is often in relation to a much wider market than that targeted by the Scottish Loan Fund (SLF), and is based on estimates of demand. This is similar to the situation when the original SLF market gap analysis was prepared and various assumptions and caveats were applied to the data. The one key difference is that we now benefit from the experience of the SLF and a better understanding of the profile of companies securing this finance.

This overview will include:

- A summary of the latest trends in the supply and demand of and for SME lending
- Evidence of demand from growth and export SMEs – drawing on the latest available Small Business Survey Data (2012). What are the components making up the market for the SLF?
- Evidence of changes in the market – when compared with the original market gap analysis
- SLF performance – what is this telling us about market demand

Background
There is an ongoing debate in the UK about the willingness or otherwise of traditional banks to lend to SMEs. Despite repeated efforts by the Government and the Bank of England to stimulate lending, net lending to SMEs has been steadily falling. Research indicates that most SMEs do not wish to borrow from a bank and of those that do, the vast majority have no problems securing the financing they want. If most SMEs have no immediate ambitions to grow, Demos argue that the focus should be on those businesses with the will and potential to deliver significant growth in the future regardless of size. Even if most growth businesses are SMEs (which is not certain) it does not mean most SMEs are growth businesses[4].

Access to affordable finance for business is crucial to achieving economic recovery and supporting jobs in the short term and to delivering longer term sustainable economic growth. However, the lending landscape has changed with banks using stricter lending criteria and accessing finance to support growth is now more challenging for some commercially sound propositions. While Scotland is currently limited in its powers in this area, particularly with regard to bank finance, the Scottish Government remains committed to encouraging lenders to increase the supply of affordable finance to support the financing needs of viable Scottish businesses with good prospects and to encourage more diversity and competition to allow businesses greater choice[5].

[4] Freeman, A (2013) Challenging myths about the funding of small businesses, *Finance for Growth*, London: Demos

[5] Adapted from SME Access to Finance and Bank Lending, *Internal Paper*, Scottish Government Business Directorate, March 2014

2. Summary of Latest Trends in SME lending

Since the financial crisis there has been a significant fall in lending to SMEs. Part of this reflects a decrease in demand. There is also evidence of market failure with viable firms often unable to secure funds at affordable rates. The key market failure is asymmetric information where it is difficult for lenders to distinguish between high risk and low risk companies and their activities[6]. However, it is not possible to provide a robust estimate, from available sources, on the extent of unmet and viable demand. These challenges are even more pronounced when we are looking at a specific cohort of SMEs, for example growth and export.

The following market overview is to present the latest evidence concerning the supply and demand for finance - relevant to growth and export SMEs - and to use this evidence base to assess the latest demand evidence for a specific financial product, The Scottish Loan Fund.

Bank of England Trends in Lending

The annual rate of growth in the stock of lending to SMEs has been negative for the past 4 years. The stock of lending to small and medium-sized enterprises (SMEs) — of which the ten largest lenders accounted for over 80% — contracted in the three months to February 2014. Net lending to SMEs, defined as gross lending minus repayments, was close to zero in 2013 Q4 having been negative in the same quarter a year ago. The average net monthly flow was slightly negative in the first two months of 2014. The pace of decline in the stock of lending to UK businesses has eased slightly since the start of 2013[7]. The latest survey by the Bank's network of agents indicates that credit availability had eased for firms of all sizes and sectors.

SME Finance Monitor

The SME Finance Monitor[8] includes a Scottish breakdown based on 1601 business interviews, with results weighted to a total population of 318,419 SMEs (less than 250 employees).

Scottish SMEs were more likely to plan ahead with 36% having a business plan (UK: 32%) while 44% produced regular management accounts (UK: 42%). They were as likely to be an international business (13% v 13% in UK). For 2011, 8% were international (UK: 11%) and for 2012, 9% were international (UK: 10%).

When it comes to the use of external finance, SMEs in Scotland were as likely to be using external finance (41% v 41% for UK). Use of external finance in Scotland has fallen by slightly more (from 48% in 2011 to 41% in 2013). In terms of permanent non-borrowers Scotland has witnessed an increase from 29% (2011) to 37% (2013), compared to the UK increase of 34% to 40% over the same period. Some 78% (UK: 77%) were deemed happy non-seekers of finance over 2013 compared to 68% (UK: 68%) over 2012 (definition changed slightly). They were as likely as others to have been would be seekers of finance (5% v 6%) which is lower than 2012 (10% v 10%; again, slight change in definition).

In relation to borrowing events, 17% (UK: 17%) of Scottish SMEs reported an event which is lower than 2012 (22% v 23%). 39% reported an injection of personal funds (UK: 39%) and this is down from 2012 (43%). 17% reported this was something they had chosen to do while 22% felt they had had no choice.

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[6] Department for Business, Innovation and Skills (January 2012), SME Access to External Finance, BIS Economics Paper 16

[7] http://www.bankofengland.co.uk/publications/Pages/other/monetary/trendsinlending.aspx

[8] SME Finance Monitor Annual Report for 2013, BDRC Continental, April 2014

More applicants in Scotland were likely to be renewing a facility for the same amount (50% v 45%) and least likely to be applying for their first ever overdraft (22% v 30%). This has varied little over time. Scotland has come into line with UK in relation to the seeking of advice for an overdraft (13% compared to 6% in 2011. UK has been stable at around 11%). 80% of overdraft applications were successful (UK: 73%). Over time, success rates in Scotland have been consistently above average.

Those applying for a loan were also less likely to be a first time applicant (35% v 41%). 8% of the recent applicants were looking to re-finance onto cheaper deals (UK: 3%). They were as likely to be seeking a new loan (39% v 37%) and this has been a significant increase from 2011 (21% in Scotland).

In summary, overdraft applicants in Scotland were significantly more likely to have been successful than applicants elsewhere. Loan applicants in Scotland were also statistically significantly more likely to have been successful than applicants elsewhere. Here, the actual success rate was also significantly higher than the predicted success rate for loans, based on the profile of applicants in the region (which was itself higher than average). These differences are unlikely to be caused by them being in Scotland per se, and instead will be a reflection of other factors about the business. On a limited base size, would be seekers were less likely to have felt discouraged from applying (34% v 43%). 45% mentioned the process of borrowing (expense and hassle) had put them off applying (UK: 35%).

SMEs were also asked about the outlook for the coming year. In Q4 2013, SMEs in Scotland were less optimistic than others about their growth prospects for the coming year with 44% planning to grow (UK: 48%). However, the pattern in Scotland has improved from a 2012 low of 38% (UK: 44%).

23% rated the current economic climate as a major obstacle for the next year (UK: 21%). The pattern in Scotland has improved from 36% in 2012 and 25% back in 2011.

Reflecting on their plans for the next 3 months, 68% were happy non-seekers (UK: 68%). This has hardly changed over the last 3 years.

SMEs in Scotland were as likely as their counterparts to apply for or to renew facilities (14% v 15%) and this has remained stable over the last 3 years.

Over time, the proportion of would be seekers of finance has declined (21% in 2011 to 17% in 2013, and similar to UK levels). Economic climate was cited most and 10% felt discouraged from applying (UK: 13%), all of it indirect.

Awareness of Funding for Lending actually decreased in Scotland from 25% to 22% (UK: 23% to 29%). Scotland had one of the lowest regional scores when asked if such schemes would encourage them to apply for finance (11% v 20%). 20% were aware of a network of business mentors (UK: 21%); 12% were aware of the Business Growth Fund (UK: 14%) and; 11% of the independent appeals process (UK: 12%).

Better Business Finance Programme

In January 2014, the BBF (Better Business Finance programme) launched a year-long campaign that aims to raise awareness among businesses and entrepreneurs that they are a lot more likely to secure bank finance than they think. While only 38 per cent of SMEs believe that they will be approved for finance by their bank, actual approval rates are a lot higher at almost 67 per cent. The campaign also seeks to provide supportive tools and information for businesses, and highlight the

Appeals Process for businesses to challenge a bank's decision to turn down a loan or other type of finance (some 40% of appeals are successful)[9].

It is estimated that Scotland has 6% of Britain's SME turnover and has 8% of Britain's SME lending[10]. This is based on figures from the six banks: RBS, Lloyds, Clydesdale, HSCB, Barclays and Santander. RBS was found to be the largest lender in Scotland, accounting for 50% of lending, followed by Lloyds Banking Group which accounted for 30% of lending to SMEs in Scotland. Around 48% of lending to SMEs in Scotland by all banks was to SMEs in Glasgow (18%), Edinburgh (16%), and Aberdeen (14%).

As a result of awareness raising to build confidence and to provide support to business seeking bank finance, it is evident that more businesses are taking the opportunity to launch an appeal with their banks. At the same time the overturn rate has declined with the suggestion that this is a positive reflection of improved banking procedures. This could be further interpreted as an indication that more "viable" businesses are securing bank finance.

Evidence – Demand Evidence – The UK Small Business Survey
An analysis of the UK Small Business Survey[11] (SBS) indicates that despite well documented evidence of suppressed demand (for example the ERC White Paper discussing discouraged borrowers[12]) there remains active demand for finance. The main findings are set out in *Figure 1*.

For the purpose of this analysis, Scottish Government (who have access to the underlying database) has prepared a cut of data from the SBS which best approximates the target market of the SLF.

In summary, this involved the following key steps:

Quantifying unmet demand for debt finance by SMEs
Source: OCEA analysis of Small Business Survey

	With sole traders included	With sole traders excluded
Metric	**Value**	**Value**
Core group – SMEs that could not secure any finance		
1. No of SMEs in Scotland	341,000	100,000
2. % that are growth/export oriented	54%	70%
3. No. of Scottish SMEs that are growth/export oriented	184,000	70,000
4. % of Scottish growth/export SMEs seeking external finance	27%	31%
5. No. of Scottish growth/export SMEs seeking external finance	49,000	22,000
6. % of Scottish growth/export SMEs seeking finance that could not raise any finance	40%	28%
7. No. of Scottish growth/export SMEs that could not raise any finance	20,000	6,000

9 https://www.bba.org.uk/news/statistics/high-street-banking/february-2014-figures-for-the-high-street-banks/

10 https://www.bba.org.uk/news/statistics/postcode-lending/

11 https://www.gov.uk/government/collections/small-business-survey-reports

12 http://enterpriseresearch.ac.uk/publications/erc-research-papers/

8. % of all Scottish SMEs (where 'all' is the total population at 1 above) that are growth/export oriented and could not raise any finance	6%	6%*
9. % of these SMEs with viable business plans	20%	20%
10. No. of Scottish growth/export SMEs unable to access any finance with viable business plans	4,000	1,000
Additional group – SMEs receiving only part of the finance they were looking for		
11. % of Scottish growth/export SMEs seeking finance that only received some of the finance	2%	5%
12. No. of Scottish growth/export SMEs seeking finance that only received some of the finance	1,000	1000
13. % of these SMEs with viable business plans	20%	20%
14. No. of Scottish growth/export SMEs receiving some of the finance with viable business plans	200 (nearest hundred)	200 (nearest hundred)

- *The 28% of growth/export SMEs that could not raise any of the finance they were seeking corresponds to 6% of the total population of SMEs as recorded in row 1.*

However, these results are extremely tentative – they are based on previous survey evidence and on estimates and may not provide a true representation of viability of a lending proposal. As such, these results should be used with caution and with the caveats provided. Two further steps would provide a closer approximation of demand:

- The first would involve undertaking analysis to remove the SLF excluded sectors. On the advice of Scottish Government this has not been undertaken as it would impact on the overall sample size for growth and export businesses. A further tentative exercise suggests that the 1,000 estimate (Metric 10 in Figure 1 above) for SMEs (excluding sole proprietors) unable to access any finance with viable business plans, may reduce to 700 if only SLF eligible sectors are considered. On the same basis the 200 that only received some of the finance sought reduces to 100 when considering eligible sectors only.

- The second step would be to factor in the sub set of companies who would be seeking loan finance. For the high growth segment the SBS survey suggests that of those seeking finance, 24% is loan finance. This is a very wide definition of loan finance and mezzanines would be a small subset. The SE Account Management review suggests around 15% of companies were seeking term loans.

SE Account Management Portfolio
An analysis of Scottish Enterprise's Company Relationship Management database provides an insight into the scale of the potential target market for a mezzanine product. However, this does not provide any indication of potential demand.

This analysis thus provides data on what may constitute the target market, defined as larger firms (by turnover and exporting activity):

- 1282 Account Managed Growth or Early Stage Growth (excluding Important to the Economy (I2E)) companies have turnovers of £1m+.

- That is 70% of the 1831 Account Managed Growth (AMG) or Early Stage Growth (ESG) companies in the portfolio.

- Of those 1282 companies, 774 (60%) are active exporters.

- The total number of active exporters in the portfolio, excluding I2E, is 951 or 52% of the total 1831 (AMG and ESG) companies in the portfolio at the end of March 14.

SE Quarterly Reviews of Account Managed Companies

Scottish Enterprise's latest review of Account Managed firms[13] covers the period from July to December 2013, with a total of 853 individual reviews being conducted in that period. A change to the questions limits our ability to compare results from earlier reviews.

The key findings to emerge from the latest Account Management review are:

- 35% of firms had sought to access new funding in the previous six months. When firms that were reviewed in both July to December 2012 and July to December 2013 were considered, the proportion of firms that sought new funding fell from 42% to 32%.[14]

- Of those firms reviewed in the July to December 2013 period who had sought to access new funding in the previous six months, 70% were successful in raising the funding they required. On a comparative basis, the success rate rose from 71% in the July to December 2012 period to 74% in the July to December 2013 period.

- The median level of funding sought in the July to December 2013 period was approximately £375,000.

- The source of finance most commonly sought in the July to December 2013 period was public sector grants (38%), followed by overdraft facilities (24%), term loans (24%), equity financing (23%), asset-based financing (21%) and internal group funding (11%).

- From the survey it is apparent that companies seeking public sector grants is the largest proportion. Only 9% (26 companies) sought purely private sector funding. A further 26% (74 companies) sought a combination of external private sector funding and public sector grant. These figures become significantly smaller, and should be treated with caution, when broken down into the types of private finance. For example, only 15% of companies who sought purely private sector funding, were looking for term loans.

- Where firms[15] had a review in both July to December 2013 and July to December 2012 then comparisons have been made between the results for that cohort of firms seeking public sector grants in these two time periods. 46% of these firms sought external sources of finance in addition to public sector grants in their first review, while a lower 17% of companies sought external sources of finance as well as public sector grants in their second review.

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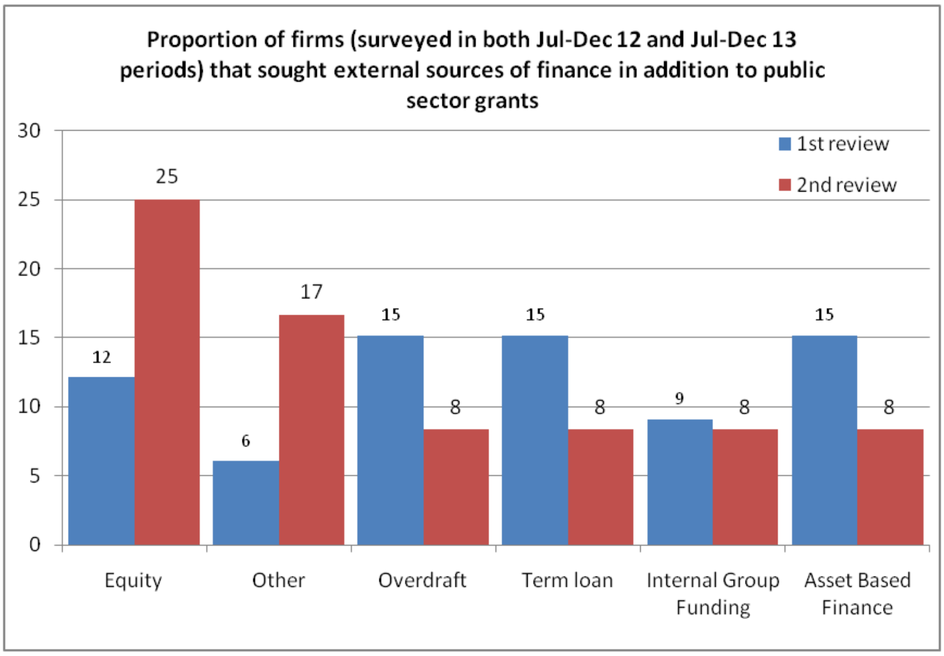
13 Economic Trends, Access to Finance Report July 2013 – December 2013, *Internal Report*, 20 February 2014

14 This may be due to some companies surveyed during the July – December 2012 period securing funding resulting in them no longer requiring financial support during the July – December 2013 period.

15 71 companies



Note
The above sources of evidence that seek to quantify the target market and to get a better understanding of the scale of demand should be seen in the context of wider economic conditions, the viability of applications for loan finance, and the impact suppressed demand on the appetite to seek loan finance. A further important factor is the extent to which companies are aware and understand mezzanine finance and how this source of finance can support their growth ambitions.

3. Evidence of Changes in the Market

A detailed market gap analysis was undertaken during 2010 which provided the evidence base to support the SLF. This drew on analysis undertaken as part of the Scottish Government Access to Finance summaries. The model developed at the time brought together various strands of data and key assumptions to provide an estimate of potential unmet viable demand.

This concluded that there could potentially be up to 110 firms per annum that represent unmet viable demand within the target population. This was presented as an opportunity gap in terms of companies who fit the growth and export profile, who could potentially benefit from this type of finance if it were available in the market Place.

If the most recent data is considered there is a potential target market of 1,000 companies seeking growth finance, reducing to 700 if we adjust for eligible sectors. This is not to say that all these companies are aware of the SLF or would consider this an appropriate source of funding. If we factor in the proportion of companies seeking a loan as opposed to other forms of external finance such as overdraft or equity, then the figure reduces to circa 105-168 per annum (taking into account sector exclusions).
[6]

4. SLF Performance

From a review of the 15 companies that have received SLF funding it is apparent that these are ambitious companies on a steep growth trajectory based on export sales. Given these characteristics it is not surprising to find a sector and geographic concentration of deals.

5. Conclusions

In summary, the potential demand is relatively small, and is likely to be a subset of the figures quoted above when compared to the SME growth and export population as a whole. There is evidence that growth and export SMEs continue to experience difficulties in securing the finance they need. This is consistent with the findings in the original Market Gap Analysis prepared in 2010 in support of the SLF. The key point is that there continues to be evidence that viable growth and export SMEs which could benefit from this type of finance continue to experience difficulties in securing the finance they need.

With an improvement in economic conditions it is not unreasonable to expect more companies seeking to implement ambitious growth plans and requiring external finance. However, this in turn could be counter balanced by some evidence that SME lending and credit conditions are beginning to improve. Related to this is a recommendation to improve understanding of the role of mezzanine finance and how this can support a particular cohort of SMEs with growth and international ambitions.

APPENDIX 3

ECONOMIC IMPACT
ASSESSMENT METHOD STATEMENT

Scottish Loan Fund
Economic Impact Assessment (EIA)
Method Statement

EIA Focus

The EIA was specified on commissioning as assessing *only* the economic impact of the provision of finance by the Scottish Investment Bank (SIB) through the SLF to the SLF client businesses. Some of the SLF businesses were Scottish Enterprise (SE) Account Managed before or after receipt of the SLF loan and this assistance may or may not have generated an economic impact. The EIA, however, focused on as assessing only the economic impact of the provision of finance by the Scottish Investment Bank (SIB) through the SLF to the SLF client businesses, and the review methodology reflected this. A review of the SE Customer Relationship Management system at the outset of the evaluation showed that none of the SLF client businesses which were then Account Managed had accessed any of the SE Account Management Products. We are therefore confident that the impacts quoted are due to the SLF alone.

Information and Data

The evaluation has been informed from *a number of sources*.

<u>SLF Application and Loan Performance Monitoring</u>

Data on turnover, profit, cost of sales, depreciation, employee costs and export intensity has been collected and provided by the Fund Managers, Maven Capital Partners, (MCP). This Data is, depending on the timing of the loan:

- The most recent *actual* business performance data collected by MCP
- Business performance forecasts provided to MCP as part of their SLF application
- Latest forecasts provided by Maven/investee companies – limited in all cases to one full year.

Actual performance data is used in all cases where it exists for the period in question.
Where actual performance has exceeded projections in the application, future performance is assumed to continue at the actual levels recorded but is not subject to projection above the actual level.
MCP do not currently collect rolling projections of future performance.

<u>Consultation with SLF Client Businesses</u>

Information has also been collected from face to face and telephone consultations with the SLF client businesses. This has included:

- Rationale for financing their business through the SLF
- Alternative sources of finance available to their business at the time of taking out the SLF loan
- Likely performance of their business if they had not received the SLF loan
- Market and Competitor locations
- Employee Locations
- Experience in applying for SLF and ongoing management of the loan and other input from MCP.

Collation and Interpretation of Data and Information

Data and information from the above sources has been collated in a series of **Case Books** (one for each SLF client business) which have been provided to SIB but are not included in the report as they contain commercially confidential data and responses to non-attributable consultations.

The case book also provides range estimates *for each business* of:

- Deadweight (based on consultation responses on alternative source of finance available at the time of taking up the SLF loan, and on performance of business in the absence of SLF)
- Displacement (based on consultation responses on locations of markets and competitors). The greater the share of potential exports relative to domestic sales and the greater the growth in the markets which the company is targeting then the lower will be the displacement
- Leakage (based on responses on location of business HQ and location of employees}
- Substitution effects are assumed across the Fund as zero because: the SLF is offered on commercial terms; and because businesses would need to fundamentally re-structure their business to access SLF if they did not meet criteria on sectors, growth and export-orientation.
- Multiplier effects are estimated using Type 1 and 2 Combined Tables prepared by Scottish government for the sector each business operates in.

Calculation and Presentation

The data and estimates of core adjustments to gross economic impact from the Case Books are incorporated in the **EIA Excel template previously prepared by SE Appraisal and Evaluation in conjunction with SIB for use in investment interventions**.

A separate template is prepared for each business and results aggregated to reach an assessment of the economic impact to date for the Fund.

The template provides for calculation of cumulative 5 and 10 year GVA values.
Assumptions on Optimism Bias (50%) and decay factor (the rate at which benefits reduce year on year) (20%) are included as default values in the template.

We have not projected turnover for SLF client businesses beyond the period where the business has provided projections either in their application or in the course of consultations.
Where businesses have stated that they would *not have grown* in the absence of SLF we have maintained performance *in the absence of the SLF* at the current level presented in their application.

Where businesses have stated that they would have grown *more slowly* than they actually did in the absence of SLF we have held performance at the current level presented in their application for a period of two years before re-alignment with any higher actual performance recorded.

REFERENCES

[1] Scottish Enterprise Board SE (10)37. March 2010

[2] Mezzanine Finance is a hybrid of debt and equity financing normally used to finance expansion of existing companies. Mezzanine financing is debt capital with rights reserved to the lender to convert into an equity interest in the company under certain circumstances – for example if the loan is not repaid or the business is sold. It is generally subordinated to debt provided by senior lenders such as banks and venture capital companies.

[3] http://www.sme-finance-monitor.co.uk/

[4] Scottish Parliament: Economy, Energy and Tourism Committee. 3rd Report, 2014 (Session 4) Access to Finance and Alternative Financing Models. http://www.scottish.parliament.uk/parliamentarybusiness/CurrentCommittees/74286.aspx

[5] SME Finance Monitor Annual Report for 2013, BDRC Continental, April 2014

[6] This range is based on the percentage of companies seeking loan finance in the SBS and the SE Account Management Review (15% and 24% respectively).