Midlands Engine Investment Fund - Early Assessment Report

RESEARCH REPORT

A report from SQW Ltd

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Executive Summary

SQW, supported by the Centre for Enterprise and Economic Development Research (CEEDR) at Middlesex University, Belmana and BMG Research, has been commissioned by the British Business Bank (the Bank) to evaluate the Investment Funds across the Northern Powerhouse, Midlands Engine, and Cornwall and Isles of Scilly. This report covers the early assessment of the Midlands Engine Investment Fund (MEIF) which took place between September 2019 and March 2020.

The focus of this **early assessment** is on the processes (i.e. the customer journey, how effectively the Fund is being delivered, and how this can be improved), as well as emerging intermediate outputs/outcomes for participating businesses, and the impact on the wider finance ecosystem[1]. The evidence presented draws on an analysis of monitoring and contextual data, in-depth consultations with management, governance, delivery partners and external stakeholders, surveys with beneficiaries and non-beneficiaries[2], and case studies with 6 businesses.

An interim evaluation of MEIF is planned for 2021/22, where the emphasis will be on net impacts achieved (for beneficiaries and the wider ecosystem) and value for money.

Introducing the Midlands Engine Investment Fund

The MEIF was formally launched in August 2017[3], in response to well-documented and longstanding challenges around access to finance (see box below) and Gross Value Added (GVA) per capita, productivity[4] and enterprise rates in the Midlands that are consistently below the UK average.

Supply- and demand-side market failures

Across the Midlands, there are various supply and demand-side challenges that combine to create a “thin market” for finance. On the supply-side, a number of challenges are faced across the Midlands. For debt finance, there is a funding gap for early stage SMEs that lack collateral or a track record, often compounded by relatively low housing wealth in some parts of the Midlands (and therefore the availability of collateral), making it difficult to access finance to scale-up. The Midlands has a particularly weak private sector funding landscape, with an under-developed equity ecosystem and network of providers/advisors. The Midlands also suffers from a lack of awareness of potential

[1] It follows the development of a detailed methodology paper and logic models for the Funds, which has been peer reviewed
[2] Unsuccessful and withdrawn applicants
[3] The debt and microfinance funds were launched in August 2017, with fund managers coming online during September 2017. The equity and proof of concept funds were launched in February 2018, with the fund managers coming online during March 2018.
[4] GVA per hour worked

investment opportunities outside of London and the South East. On the demand-side, information failures mean that SMEs lack awareness of potential funding sources, ways to access finance and their likely success, and poor investment readiness inhibit SMEs from presenting their propositions to best effect.

These challenges were reflected in statistics at the time MEIF was developed (and in most recent data), underpinning its rationale:

- the Bank's Small Business Finance Markets Report in 2019-20 found the share of value of loans and overdrafts going to SMEs in the West and East Midlands lagged that of the business populations in both regions[5]
- the Bank's Equity Tracker data showed that the proportion of total UK equity investments in 2015 which went to the West and East Midlands (4% and 2.8% respectively), was substantially lower than the regions' shares of high growth businesses (8.5 and 6.5%) and of total UK private sector businesses (7.4% and 6.6%)[6]. The latest data for 2019 tells a similar story[7]
- the Bank's Business Finance Survey in 2018 found that 66% of SMEs in the Midlands were aware of venture capitalists (cf 74% in London), and only 35% of SMEs in the Midlands were aware of business angels as a form of raising external finance (cf 47% in London).

The Fund is designed to increase the supply of debt and equity finance to SMEs located in the MEIF area, enable recipient businesses to grow and innovate, and create sustainable financial ecosystems across the three areas. MEIF draws on funding from the European Investment Bank (EIB), the Bank and European Structural and Investment Funds (ESIF)/European Regional Development Funds (ERDF) committed by each LEP to the sum of £250 million. The MEIF is a "fund of funds", overseen by the Bank in close partnership with the LEPs, and delivered in each region by a series of contracted fund managers who are tasked with targeting funding towards 'SMEs with growth potential'. It offers four types of finance:

- **microfinance** (loans from £25,000-£150,000)
- **debt finance** (loans from £100,000-£1.5 million)
- **early-stage proof of concept equity** (up to £750,000), and
- **later-stage equity** (from £50,000-£2 million).

There will be a 5-year investment period, followed by a 5-year realisation and repayment period. In addition, the fund managers can provide "non-financial" support

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[5] https://www.british-business-bank.co.uk/wp-content/uploads/2020/02/Small-Business-Finance-Markets-2019-20-report-FINAL.pdf

[6] https://www.british-business-bank.co.uk/wp-content/uploads/2016/05/97-Small-Business-Equity-Investment-Tracker-Report.pdf

[7] https://www.british-business-bank.co.uk/wp-content/uploads/2019/06/Small-Business-Equity-Tracker-2019.pdf

to a small number of potential applicants, comprising up to 12 hours of advice to assist in the development of business plans or strategy.

Findings

Rationale and design

The rationale for MEIF is considered to be robust and remains highly relevant. The evidence from the survey suggests high levels of additionality. Without the intervention, a high proportion of the finance would not have been invested, and this is now being used to support improvements in performance, productivity and innovation. In particular, the rationale for providing new sources of equity funding is confirmed by the high levels of demand.

Stakeholders strongly supported the rationale, reporting that banks had remained risk averse, especially for businesses lacking a track record and/or collateral, while there was a lack of/limited awareness of other finance options. This had the reinforcing effect of leading businesses to become disillusioned with their experiences of external finance. Consultees also argued that MEIF is “filling a significant gap” in the market for small loans.

Almost all consultees highlighted the major gap in equity finance in the Midlands and considered this as a specific geographical issue. Private investors and angel investment networks have a limited presence in the Midlands, particularly in terms of early stage and patient capital investment, while poor transport connectivity and distance deters venture capitalists (VCs) from being more active in remote rural parts of the region.

The rationale for larger debt was more nuanced and this has been reflected in the slower deployment of the Funds. Whilst consultees thought there was a gap in the market, it had also become much more competitive since MEIF was announced. However, it is important in enabling the overall MEIF package.

Progress to date

By the end of September 2019, the MEIF fund managers had received 3,507 enquiries and 653 applications from SMEs. From these, MEIF made 235 investments with a total value of £43.38 million. **The figures exceed the targets (except for debt), which is a notable achievement during a period of investment uncertainty.**

However, the Fund was behind target for the *number of businesses assisted*, largely because of the slower deployment levels in the debt and small business loan funds. The introduction of a new debt fund manager is expected to improve deployment.

Demand has continued to be strong and the distribution of applications and investments across the LEPs broadly reflects the share of ERDF eligible businesses[8]. At this point, it is likely that each LEP will see investment at a multiple of the ESIF money it contributed towards the programme.

Meeting business objectives

The ultimate objective for the regional programmes is to increase economic growth in line with the Government's wider objective for all business support and access to finance programmes. The Fund aims to achieve this by improving access to finance, enabling businesses to start up, invest and grow more rapidly. Logic models in Annex A set out the ways in which the Funds are expected to generate outcomes and impacts. This section considers the evidence in relation to the main outcome indicators.

Increasing the supply of finance to viable businesses that would otherwise have problems raising finance

The Fund had invested £43.38m by September 2019 (£19.47m in loans and £23.91m in equity). Given that funding was considered additional (in some form) across nearly three quarters of survey respondents and displacement is limited, it indicates that supply has been increased. The survey evidence, along with stakeholder feedback, indicates that the Fund is financing viable businesses that would have had problems raising finance without it.

The Fund has also played an important role in levering wider finance. The beneficiary survey found that a significant number of businesses had secured other funding alongside MEIF (higher for equity cases), and that MEIF finance has had a major influence on securing this additional funding, including co-investment from other private equity providers and banks.

Improving performance of recipient businesses, particularly in terms of productivity and competitiveness related outcomes (ESIF and HM Government objectives)

The survey evidence shows that the investments have been used extensively to improve performance, research/innovation and productivity. The survey found that business investments were largely linked to productivity (such as investment in R&D, skills and process and/or product innovation), rather than business rescue.

- 65% of businesses reported that they had increased skills in their workforces
- 85% of equity investments had increased R&D expenditure (this was 44% for debt cases), which demonstrates how the Fund is contributing towards Government's objective of 2.4% of GDP on R&D

[8] i.e. the proportion of businesses in the LEP area that are eligible for support under ERDF funding criteria.

- the majority of equity investments (75% of respondents) have also enabled businesses to progress products/services towards commercialisation
- MEIF investment had led to improved processes (saving time and reducing costs) for 52%.

The survey found that among equity investments, without MEIF, half of these outcomes would not have happened at all, while for debt investments, MEIF had played a key role in accelerating outcomes.

Increasing awareness of external finance and confidence in raising finance in future across businesses supported.

Participation in MEIF has increased businesses' awareness of equity and alternative sources of finance amongst SMEs in the target area. The MEIF process has also had a very strong positive effect on businesses' confidence in raising future finance, which is likely to enable further investment in the future.

The Fund is also intended to help strengthen the wider finance ecosystem. It will take time before it is possible to observe the impact of MEIF on the wider finance ecosystem across the Midlands. However, early signs from MEIF were encouraging. MEIF is increasing the supply and choice of finance in the Midlands and is helping to simplify the finance landscape. It has also increased the capacities of some fund managers involved and allowed them to make earlier stage, higher risk investments in the Midlands. It has also led to strengthened relationships between the fund managers. However, whilst MEIF has stimulated business interest in finance, there are considerable demand-side challenges that need to be overcome to strengthen the finance ecosystem overall.

Implementation - what works and challenges

The level of demand, positive business survey results and stakeholder feedback support the conclusion that the design of the Fund has worked well. Specifically:

- MEIF was considered to offer both the scale and the capability to tailor delivery in response to local contexts, supporting a regional (rather than national) approach
- securing collaboration and financial contributions from all the Midlands LEPs has been a significant achievement and important progress in delivering the pan-Midlands Engine approach
- the Fund adopts a long-term perspective which was welcomed by stakeholders and fund managers – and quite distinctive to many other government programmes
- the shift from grants to loans and equity is a positive development for the Midlands, but requires cultural change
- the role of the fund managers has been important. This includes support from the MEIF fund manager *prior* or *during* their application (e.g. business planning and strategy development, and support to ensure the right type of finance is secured) and fund manager support *following* the finance award. The latter is

usually more intensive for businesses receiving equity finance, but debt fund managers also track progress closely and provide support/signposting

- in general, the governance arrangements for MEIF appear to be working well, with appropriate representation and good engagement on the governance boards. The Fund was also seen to be managed well by the Bank, with robust processes in place and local presence. However, there is scope to strengthen marketing activities to intermediaries as well as the SME business base.

There have been four key challenges in implementation to date:

- there has been a slower than expected deployment of the larger debt funds, which the Bank has addressed with the appointment of the FSE Group to manage £40 million in the West Midlands and East & South East Midlands
- demand for equity is greater than the available funds in some places, especially given the expected demand for follow-on investment in existing beneficiary businesses
- the challenge to balance the pressure to deploy funds quickly and ensuring “good” investments. Both external stakeholders and fund managers commented on the need to get this right
- fund managers commented on their reliance on generating their own demand relative to other sources and referrals.

There were also 5 “generic challenges” set by the environment in which MEIF operates:

- a lack of investment readiness has been a significant and persistent challenge and was raised frequently as an issue across our consultees. This includes a lack of financial literacy and experience, limited awareness of options and an inability to present propositions (especially outside of large urban conurbations) on the demand side
- a need for greater clarity around how MEIF aligns with wider Midlands Engine agendas and programmes was raised by a number of the consultees involved directly in the delivery of the programme
- many of those consulted commented on the partnership challenges faced by the Midlands Engine region, given a longstanding history of separate east/west governance structures
- skills were identified by stakeholders and fund managers as a key barrier hindering the progress/growth of businesses in the programme (and region more generally) and therefore the potential effectiveness of MEIF
- finally, the uncertainty around Brexit has led to some reluctance to invest. The effects also filter down from prime firms, limiting investment in supply chains.

Final reflections

While there is a temptation to compare the performance of MEIF with the emerging findings evaluation of NPIF, we would stress that the two geographies are different and face different challenges. However, taken together the two reports provide some consistent messages about the Regional Investment Funds as a whole. In both cases the rationale for this approach and the design is validated by the survey results and the feedback from stakeholders. The finance provided has been substantially additional and it is largely being deployed to improve the productivity and performance of businesses.

The Midlands Engine is still less recognised than the Northern Powerhouse. While this has provided challenges, it is also an opportunity for the Fund to contribute more to the development of the brand. The Fund provides an important mechanism that allows partners to work and plan together around access to finance, a central element of business and economic development.

It is too early to draw conclusions on the Funds' impacts. This will require evidence of longer term, sustained, improvements in business performance alongside the development of the wider finance landscape, but the indications from the emerging findings in both reports are encouraging.

1. Introduction

SQW, supported by the Centre for Enterprise and Economic Development Research (CEEDR) at Middlesex University, Belmana and BMG Research, has been commissioned by the British Business Bank (the Bank) to evaluate the Investment Funds across the Northern Powerhouse, Midlands Engine, and Cornwall and Isles of Scilly. This report covers the early assessment of the Midlands Engine Investment Fund which took place between June 2019 and March 2020.

- the focus of this **early assessment** is on the processes (ie the customer journey, how effectively the Funds are being delivered, and how this can be improved), as well as emerging intermediate outputs/outcomes for participating businesses, and the impact on the wider finance ecosystem
- an **interim evaluation** of MEIF is planned for 2021/22. The emphasis of this stage will be on net impacts achieved (for beneficiaries and the wider ecosystem) and value for money.

Programme overview

The MEIF was first announced in the 2016 Budget and was formally launched in August 2017[9], with the first investments made in October 2017. The Fund is designed to increase the supply of debt and equity finance to SMEs located in the MEIF area, enable recipient businesses to grow and innovate, and create sustainable financial ecosystems across the Midlands.

MEIF draws on funding from the European Investment Bank (EIB), the Bank and European Structural and Investment Funds (ESIF)/European Regional Development Funds (ERDF) committed by each Local Enterprise Partnership (LEP) to the sum of £250m. The MEIF is a “fund of funds”, overseen by the Bank in close partnership with the Local Enterprise Partnerships (LEPs), and delivered in each region by a series of contracted fund managers who are tasked with targeting funding towards ‘SMEs with growth potential’.

In the MEIF area the Fund offers:

- **microfinance** (loans from £25,000-£150,000)
- **debt finance** (loans from £100,000-£1.5 million)
- **early-stage proof of concept equity** (up to £750,000), and
- **later-stage equity** (from £50,000-£2 million).

[9] Note, Debt and Small Business Loans Fund were launched at the end of August 2017 and the Equity and Proof of Concept Funds at the end of February 2018

There will be a 5-year investment period, followed by a 5-year realisation and repayment period. In addition, the fund managers can provide “non-financial” support to a small number of potential applicants comprising up to 12 hours of advice to assist in the development of business plans or strategy.

Rationale and context

The table below provides an overview of the finance challenges faced across the Midlands that informed the rationale for MEIF.

	Challenges across the MEIF area
Economic context	• GVA per capita, productivity[10] and enterprise rates consistently below the UK average – long term challenges • Lower proportion of high growth and scale-up businesses compared to London • Access to finance identified as a significant barrier to business development and growth in the regions.

Existence of market failures at the regional level	Supply-side market failures:
	• Information failures:
	  o Lack of awareness of potential investment opportunities outside of London and the South East. This leads to a weak private sector finance landscape, with local, regional and devolved Government funds disproportionately represented
	  o Due diligence costs comparatively high for smaller equity deals. Travel costs (including time) higher for regions outside of London and the South East
	  o Relatively low housing wealth in some regions may impact on availability of collateral for accessing debt finance
	• Private sector investors cannot capture market and knowledge spill overs – social benefit is greater than private – leading to overall under-investment
	• Externality effects leads to strong clusters in London and the South East which restrict clusters developing in other parts of the country.
	Demand-side market failures:
	• Information failures: SMEs lack awareness of potential funding sources and ways to access finance, and their likely success

[10] GVA per hour worked

	• Investment readiness: SMEs not able to present propositions to best effect Supply-side and demand-side factors combine to form issues of a 'thin market' where markets work less effectively due to smaller number of providers and current deal activity. Lower business density and poorer transport infrastructure, combined with lower awareness of complex debt and equity investments, which then increase the transaction costs of undertaking deals in these areas.
Specific debt and equity issues	Debt issues: • These failures lead to a microfinance funding gap for early stage SMEs in the Midlands Engine area, without collateral or track record • These information failures also lead to established companies not being able to raise finance to scale-up Equity issues: • Demand and supply-side asymmetries, leading to equity funding gap for businesses looking for relatively small amounts of finance • Under-representation of equity investments and relatively underdeveloped equity ecosystem • Less developed networks of equity finance providers and advisors • Particularly weak private sector equity funding landscape, leading to greater reliance on debt finance than businesses in London/the South East and lack of awareness of equity finance.

Programme objectives

The ultimate objective for the Fund is to increase economic growth in line with the Government's wider objective for all business support and access to finance programmes. Economic growth is not a specific target for the Bank but an outcome from the Bank meeting its own objectives of increasing external finance where markets don't work well. The regional funds (including MEIF) contribute to the Bank's objectives by addressing the specific market issues and market failures that affect debt and equity in these areas (as described above).

Each type of finance is expected to deliver a different route to the overall objective of economic growth:

- **microfinance** will contribute to supporting an increased number and quality (through higher financial capital) of young businesses by providing loans between £25,000 and £100,000. Banks and other mainstream finance providers do not always meet the demand for loans for start-up companies due to lack of collateral, credit history and/or trading history amongst applicants, and the low margins associated with low value loans. Micro finance will support growth in young businesses and their survival, which will contribute to local economic growth through additional GVA and employment, by utilising under and unused resources (capital and labour).

- **later stage debt finance** is aimed at supporting more established businesses that may be capital constrained from mainstream finance lenders due to a lack of collateral, lack of credit history and/or being outside of a bank's defined assessment categories to scale up and to grow. Later stage debt finance supports business growth by facilitating expansion plans, funding the development of new products and enabling entry into new markets. The businesses will contribute to economic growth by increasing GVA, employing more people and by improving productivity.
- **Proof of Concept (PoC) early stage equity finance** will contribute to enabling start up and faster growth among SMEs by providing PoC finance up to £750k. Start-ups in the Midlands receive a smaller proportion of seed stage and venture stage funding than start-ups in the rest of the UK. PoC finance will support growth in the number of young businesses and their survival, which will contribute to local economic growth through additional GVA and employment.
- **later stage equity finance** provides access to capital for innovative High Growth Firms (HGFs) that are too high risk to be supported by debt finance due to their risk profile, lack of collateral and unstable cashflows. Equity finance provides access to capital in order to fund growth, but also brings significant additional management capability through investors knowledge, experience and connections. The focus is on business growth and GVA (via sales, productivity and employment and productivity), and wider economic benefits through potential innovation spill over effects and creation of new products and services (dynamic efficiency).

The Investment Funds have also been designed to maximise net additional outcomes and impacts through:

- **minimising deadweight in the finance** provided and outcomes achieved, leading to:
    - o finance additionality – the businesses would not have secured finance without the Fund
    - o outcome additionality – the outcomes achieved by the business would not have been possible without the Fund, or they have been brought about more quickly, to a larger scale and/or better quality.
- **minimising displacement of outcomes** from elsewhere within the target geography, and ideally, minimising displacement from elsewhere in the UK into the target area, leading to net additional growth to UK Plc (via 'new' growth, exports and/or inward investment).
- **minimising substitution** within the businesses supported, by encouraging businesses to utilise finance to grow/improve their business (now/in future), rather than using the finance to substitute another activity already taking place (with no net gain overall).
- **minimising leakage** of benefits outside of the target geographies.

Evaluation objectives and methodology

Evaluation questions

This early assessment primarily focuses on the context and rationale, processes and delivery, outputs and finance additionality, and emerging evidence on outcomes for businesses (achieved and future) and wider effects on the finance ecosystem. Given the timeframe for the Fund and the lag between funding and any impacts, there is inevitably limited evidence on impact at the early assessment stage. However, the focus will shift towards impacts between the early assessment and interim evaluation.

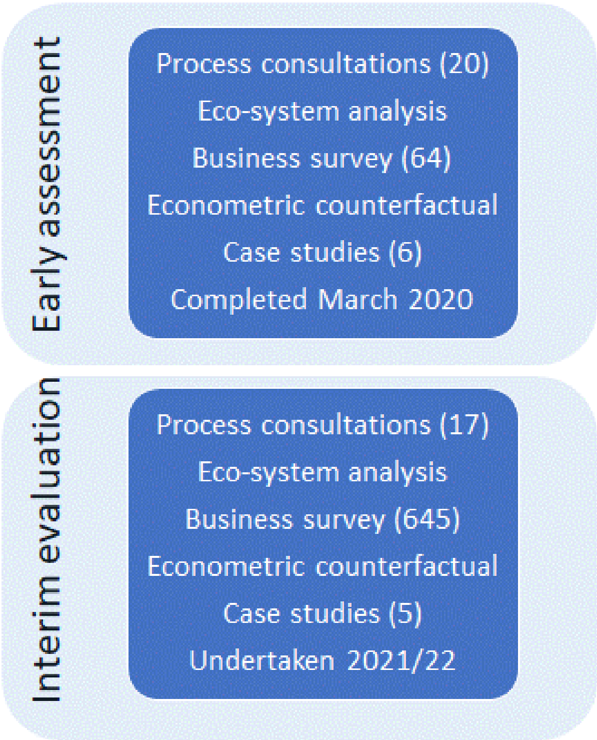
Specifically, for this early assessment, the focus is on:

- **processes of funding delivery** (on the supply side) and the relevance, ease of access and effectiveness of delivery (on the business demand side). This will cover the customer journey (including marketing and alternative sources of funding considered), as well as management, governance, delivery and monitoring arrangements, how effectively these are being delivered, what is working well (or not) and why, lessons and good practice, and how processes could be improved.
- **the additionality of the funding** (ie how the Fund has enabled businesses to secure finance and how they are using it) and any emerging intermediate outputs/outcomes for beneficiary businesses achieved to date and/or expected in future as a result of the Fund support (noting it is unlikely that there will be significant changes in individual business performance within the first year).
- **emerging impacts on wider eco-system**, including views on funding gaps and changes in the regional context, the role of the Fund, lessons from delivery to date, and views on the efficacy of this regional approach.

Overall approach

The overarching approach to the evaluation draws on mixed methods to collect data, in order to test progress and performance against the logic model and theory of change and logic models established in Annex A. Figure 1-1 shows the main strands of the evaluation and their timing, for MEIF. It also shows (in brackets) the target number of interviews for each element.

Figure 1-1: Summary of main strands of research and timing



Source: SQW

Approach to this early assessment

The evaluation has sought to reconcile the different data collected through the various sources and tools outlined below.

Data analysis

We have analysed monitoring data on implementation of the Fund to characterise the profile of applicant firms, alongside initial analysis by Belmana.

Consultations

In-depth consultations were held with 20 representatives from the following organisations to discuss MEIF's design/model, position and value within its SME target market, the effectiveness of delivery to date and how it could be improved, and initial impacts of the scheme, both on the SMEs involved and the wider economy:

- the Bank and representatives from the MEIF governing boards including the Strategic Oversight Board (SOB) and Regional Advisory Boards (RABs), which include LEP members.
- funders, including the Department for Business, Energy and Industrial Strategy (BEIS), and the Ministry of Housing, Communities and Local Government (MHCLG).
- all fund managers involved in the delivery of MEIF
- wider stakeholders, including intermediaries.

Business survey

A telephone survey was undertaken by BMG, targeting 70 interviews with MEIF beneficiaries. The interviews focused on businesses' rationales for seeking MEIF and other finance options considered, feedback on their MEIF experience, outcomes observed to date (compared to what might have happened otherwise) and future expected impacts.

Overall, the number of interviews achieved was marginally below target, with 63 of the 162 contacts provided by fund managers. This is a 39% response rate and represents 27% of the MEIF beneficiary population and 33% of MEIF investments[11]. Equity cases were slightly over-represented compared to the background population of deals and investment amounts, slightly higher than the number of cases. Throughout the analysis, debt and equity responses were disaggregated where appropriate. Of the 20 firms with MEIF equity deals, seven (58%) were established companies experiencing rapidly growing sales but are not yet profitable.

Table 1.1: Type of finance based on beneficiary survey responses (63) and population (235)

	Survey (Number of achieved interviews)		Total MEIF population (ie exited and live) by end Sept 2019	
	Number	%	Number	%
Debt	43	68%	173	74%
Equity	20	32%	62	26%
Total Debt and Equity Base	**63**	**100%**	**235**	**100%**
Gross Investment Amount	£14.3m	27%	£43.4m	33%

Source: SQW analysis of MEIF survey and the Bank's monitoring data

The survey respondents were broadly representative of the population and achieved a good spread across the MEIF geography, as illustrated below (further detail is presented in Annex B). The main differences are an over-sampling from the West Midlands Equity Fund and under-sampling from the West Midlands Small Business Loans Fund.

[11] Business contact data was provided to SQW by the fund managers, and due to GDPR/consent issues, data available from some funds was very limited.

Table 1.2: Geographical sample structure based on beneficiary survey responses (n=63) and population (235)

	Survey achieved interview sample		Overall MEIF company population (i.e. live and exited deals) by end Sept 2019	
	Count	%	Count	%
WM Small Business Loans	20	32%	84	36%
ESEM Small Business Loans	15	24%	52	22%
ESEM and WM Debt	8	13%	37	16%
WM Equity	7	11%	15	6%
ESEM Equity	5	8%	18	8%
WM and ESEM PoC	8	13%	29	12%
Base	**63**	**100%**	**235**	**100%**

Source: SQW analysis of MEIF survey and the Bank's monitoring data

Non-beneficiary survey

A telephone survey was also completed with 28 non-beneficiaries (compared to a target of 20 interviews). Non-beneficiaries were those businesses that had applied for MEIF funding and were rejected or withdrew from the Fund before receiving funding or received "non-financial support". These 'near miss' examples of applicants provide a form of counterfactual. However, given the small sample size, comparison between beneficiary and non-beneficiaries cohorts is qualitative. Interviews focused on businesses' rationales for seeking MEIF and other finance options considered, feedback on their MEIF experience, and progress made in securing finance and business growth since outcomes observed to date (compared to what might have happened otherwise) and future expected impacts. Overall, a 14% response rate from the 195 viable contacts provided by fund managers was achieved, which represented 9% of the MEIF non-beneficiary population.

Case studies

Six case studies have been undertaken with beneficiaries (against a target of five) spread across the West (4) and East Midlands (2). The case studies provide in-depth qualitative evidence of funding additionality, performance changes, and the factors that have contributed to these changes. They are intended to be illustrative rather than representative and have been selected in discussion with the Bank to provide a range of experiences in terms of debt/equity, finance additionality and leverage, outcomes observed, location and sector.

Plans for the interim evaluation

During the interim impact evaluation, in addition to the tasks above, 2 additional workstreams will also be undertaken:

- **baseline update** on the contextual conditions and change since MEIF was launched, to inform our assessment of MEIF's impact upon the wider finance eco-system.
- **data-linking and econometric analysis** to assess the changes in performance of MEIF beneficiaries and unsuccessful applicants against matched counterfactual groups. This involves Propensity Score Matching, linking into the ONS Business Structure Database and other databases, and econometric analysis to inform our assessment of *net* additional impact on jobs and turnover for beneficiary businesses.

Also, given that the Fund receives European funding, the evaluation must adhere to the **EU's summative assessment guidance**[12] and good practice set out in the Magenta Book[13]. This applies to the interim evaluation where there will be a greater focus on outcomes, impact and value for money[14].

Report structure

This report is structured as follows:

- **Section 2** provides an overview of the Fund to date, the effectiveness of delivery processes and how these could be improved
- **Section 3** presents evidence on outcomes observed to date, including finance additionality and business level benefits
- **Section 4** outlines emerging impacts for businesses and the wider finance ecosystem
- **Section 5** presents conclusions and recommendations, and plans for the next phase of the evaluation

The report is supported by two in-depth annexes: **Annex A** provides the logic models for the Funds; **Annex B** presents further details on the surveys undertaken.

[12] https://www.gov.uk/government/publications/evaluation-of-the-european-regional-development-fund-2014-to-2020
[13] https://www.gov.uk/government/publications/the-magenta-book
[14] Summative assessments are required at the end of the grant period

2. Assessment of delivery

Key messages

- By the end of September 2019, the MEIF had received 3,507 enquiries. Of these 653 (19%) reached application stage and 235 investments were made (36% of applications) to 205 SMEs.
- The total value of investments was £43.38m, which exceeded the cumulative plan of deploying £41.84 million. This was £19.47m in loans and £23.91m in equity. The average investment is c.£210,000 per SME, higher than anticipated (c.£160,000).
- However, the Fund was behind the target for the number of businesses assisted with finance, largely because of slower deployment levels in the debt and small business loan funds. The introduction of a new debt fund manager is expected to improve deployment.
- The distribution of applications and investments across the LEPs broadly reflects their shares of ERDF eligible businesses, although there are some differences in the speed of investment/loan deployment.
- The survey found that businesses that received MEIF funding are much more likely to be exporters than the overall business population. A high proportion of firms were investing in growth and productivity improvements through recruitment/training, marketing, new products, services and processes.
- Support to new SMEs[15] is below target. This is important given the Midlands lower than average start-up rate.
- Among businesses, MEIF scores highly against most aspects of delivery, particularly in communication with the fund manager and time from application to decision. Marketing and promotion was less strongly rated by beneficiaries, although feedback from consultees suggest awareness is improving.
- Consultees consider the rationale for MEIF was robust and that it offers scale and a welcome long-term perspective.
- In general, the governance arrangements for MEIF appear to be working well, however, some consultees felt the functions of the two boards could be clarified and made more distinct. There is a need for greater clarity around how MEIF aligns with wider Midlands Engine agenda.
- There are also important contextual issues. The demand for equity is likely to be greater than the available funds in some places, while a lack of investment readiness has been a significant and persistent challenge.

[15] This indicator covers enterprises that were not trading and registered at Companies House for less than 12 months before assistance provided, or a Business locating to the agreed geographic area for the first time to start trading.

Programme portfolio

Scale, nature and geography of applications and awards

The MEIF was announced at the Budget in March 2016. The debt and microfinance funds were then procured and launched at the end of August 2017[16] with the first investments made in October 2017. By the end of September 2019, the MEIF had received 3,507 enquiries[17]. Of these:

- 653 (19% of enquiries) reached application stage
- 235 investments were made (36% of applications)[18].

By the end of September 2019, **the value of investments was £43.38m**, which exceeded the cumulative plan of deploying £41.84 million by 4%. The Fund has **provided finance to 205 SMEs[19],** below the ERDF target of 266.64 by the end of September 2019. This means the average investment is £211,595 per SME, higher than anticipated (at c.£160,000).

The fund managers for the debt and microfinance funds were contracted by September 2017, but the procurement process for equity and proof of concept funds was delayed to February 2018. Partly reflecting the lag between announcing the Fund and it becoming operational, the programme had a slow start and it has taken time to embed in the market. This caused some frustration amongst consultees that felt that some of the initial profile raised by the MEIF announcement had dissipated by the time the fund managers were appointed. However, despite this, consultees were in general agreement that the Fund had now built momentum, especially in the six months leading up to this evaluation. They observed strong demand for small loans, equity and PoC finance, and were confident this would continue at a similar level looking forward.

Table 2.1: Investments and value to End of September 2019

	Number of investments to date	Total investment value
Total, of which:	**235**	**£43.38m**
...loans	173	£19.47m
...equity	62	£23.91m

Source: SQW analysis of data provided to SQW by the Bank. Note a small proportion of equity investments are quasi-equity investments

[16] Note: the start was delayed by six months, but the ERDF output targets were not adjusted to reflect this
[17] Figures exclude enquiries for non-financial support
[18] According to the Bank’s monitoring data, the main reasons for declined applications were deal quality and/or risk as opposed to eligibility across equity. A trend is less evident for debt.
[19] Some SMEs have received more than one investment, i.e. follow on or tranched funding.

Investments have been made across each of the 10 LEP areas involved in MEIF, and across the fund managers involved, as illustrated below. Each area (and the associated fund manager covering the respective geography) has a different contracted target “plan” for the investment value and number of SMEs supported each quarter and for the Fund’s lifetime. The targets depend on the size of the Fund and the LEP’s contribution. Whilst MEIF was exceeding its overall quarterly investment target by the end of September 2019, there was greater variation between each of the funds.

The equity funds, including PoC, were exceeding their quarterly investment value, whilst the debt funds (excluding ESEM Small Business Loans) were considerably below target. The performance of the debt funds in part reflects the delays in fund manager mobilisation. To increase deployment levels, the Bank has recently procured an additional Midlands-wide debt fund manager at the time of the evaluation.

The distribution of applications and investments across the LEPs broadly reflects their shares of ERDF eligible businesses[20]. However, there are some differences in the speed of investment/loan deployment. In Greater Lincolnshire, the Black Country, Leicester & Leicestershire and D2N2, investment is exceeding their shares of ERDF businesses, while deployment in Stoke & Staffordshire LEP and in SEMLEP has been slower, relative to the number of eligible businesses.

[20] i.e. the proportion of businesses in the LEP area that are eligible for support under ERDF funding criteria.

Table 2.2: Investments and value to End of September 2019

Fund	Fund manager	Geographical coverage	No. of loans/ invest ments	Actual amount loaned/ invested	Target (% of target to date)
WM Small Business Loans	BCRS	West Midlands	84	£2.82m	£3.40m (▼83%)
ESEM Small Business Loans	Enterprise Loans	East and South East Midlands	52	£3.29m	£2.60m (▲126%)
WM Debt	Maven	West Midlands	21	£7.74m	£14.15m (▼55%)
ESEM Debt	Maven	East and South East Midlands	16	£5.63m	£11.32m (▼50%)
WM Equity	Midven	West Midlands	15	£6.21m	£3.86m (▲161%)
ESEM Equity	Foresight	East and South East Midlands	18	£11.14m	£3.86m (▲289%)
WM and ESEM PoC	Mercia	Whole MEIF geography	29	£6.56m	£2.66m (▲247%)
Total			235	£43.38m	£41.84m (▲104%)

Source: SQW analysis of MEIF monitoring data provided to SQW by the Bank

Business characteristics

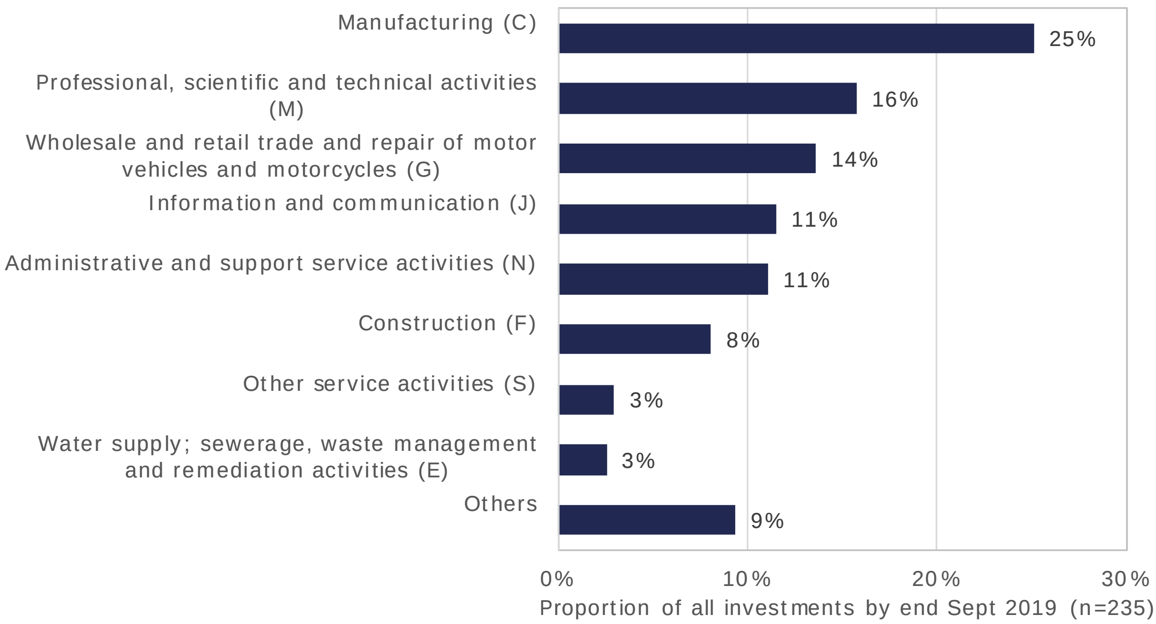
Based on the Standard Industrial Classifications (SIC) provided in monitoring data, the top 5 sectors supported by MEIF to date (up to end September 2019) are: **manufacturing (25% of SMEs), professional, scientific and technical activities (16%), wholesale trade and vehicle repair (14%), information and communication (11%), and administrative and support services (11%).** In comparison, the top sectors across the overall Midlands Engine business population are professional, scientific and technical activities (15%), construction (13%), business administration and support (9%) and retail (8%)[21]. These sectors are prevalent across the MEIF population (but differ) across the different types of finance, with several notable exceptions:

- the proportion of SMEs that are in the manufacturing and information and communication sectors is particularly high for the PoC fund (38% and 31% respectively)

[21] Nomis, UK Business Counts 2019

- the proportion of SMEs that are in the wholesale trade and vehicle repair sector is particularly high for the East and South East Midlands equity fund (33%)
- the proportion of SMEs that are in the information and communication sector is particularly low for the small business loans funds (5% and 6% of West Midlands and East/South East Midlands small business loans funds)
- no deals done to date for the West Midlands debt fund in the professional, scientific and technical activities sector or for the PoC fund in the administrative and support service activities sector.

Figure 2.1: SIC Classification of SMEs in receipt of MEIF investments/loans



Source: SQW analysis of MEIF monitoring data provided to SQW by the Bank

In terms of investment stage, the Bank's monitoring data shows that:

- 6% of SMEs are "start-ups" (prior to the first commercial sale)
- 27% are "early stage" SMEs (operating in any market for less than 7 years)
- 6% are "expansion" SMEs (new markets or products)
- 61% are "growth" SMEs (companies with strong growth prospects that are not classed as start-ups, early-stage or expansion companies).

In general, **equity finance investments are predominately comprised of early stage SMEs, whereas debt deals are more common amongst growing SMEs**. Across the other two investment stages, investments are distributed across the equity funds (including PoC) for start-ups, and for expansion, investments are distributed across debt and equity (but not PoC).

Monitoring data on the size of SMEs at the time they were awarded MEIF does not have full coverage [22], but suggests that the **majority of businesses supported to date are**

[22] Data is not available for 60% of SMEs supported

micro (1-9 employees, 51%) **or small** (10-49 employees, 31%) rather than medium-sized (50-249, 7%). In comparison, the Midlands Engine business population as a whole has a higher proportion of micro SMEs (89%), and a smaller proportion of small (9%) and medium-sized businesses (2%)[23].

Exporting

The business survey provided some evidence of the extent to which MEIF businesses are exporters[24]. In the sample, 58% of firms with debt and 30% of equity firms export. This compares with national estimates varying from 9%[25] to 20%[26] for all SMEs. The businesses that receive MEIF are much more likely to be exporters than the overall business population (which may reflect the sectoral spread of beneficiaries and the propensity of those sectors to export[27]). **This also increases the likelihood that any new sales that are enabled through the Funds are exported**.

As shown in Table 2.3, of the MEIF businesses who export, the majority stated that less than 50% of turnover is generated by exports. The Bank's UK SME exporting trends report (2020[28]) found that exports account for approximately 10% of SME turnover, below the average for all businesses (16%).

[23] Nomis, UK Business Counts 2019

[24] Exporters at the time of the survey, rather than at the time MEIF finance was secured

[25] BVA BDRC. (2019a). SME Finance Monitor; Department for Business Energy & Industrial Strategy. (2019a). Business Population Estimates for the Uk and Regions 2019. Also see British Business Bank, 2020, UK SME exporting trends: finance and trade

[26] BEIS, 2019, Longitudinal Small Business Survey 2018: SME Employers (Businesses with 1-249 Employees) – figure unchanged from 2017

[27] For example see: ONS, 2018, UK trade in goods and productivity: new findings (https://www.ons.gov.uk/economy/economicoutputandproductivity/productivitymeasures/articles/uktradeingoodsandproductivitynewfindings/2018-07-06) or BEIS, 2019, Longitudinal Small Business Survey 2018: SME employers which shows that by sector, exporters were most likely in manufacturing (41%), information/ communication (34%), followed by retail/wholesale (28%) and professional/scientific (27%).

[28] British Business Bank, 2020, UK SME exporting trends: finance and trade

Table 2.3: The proportion of turnover generated by exports among businesses in the survey

	Debt (n=24)		Equity (n=10)		Total (n=35)	
	Count	%	Count	%	Count	%
0%	10	42%	7	70%	17	50%
1% - 25%	7	29%	0	0%	7	21%
26% - 50%	3	13%	1	10%	4	12%
51% - 75%	2	8%	1	10%	3	9%
76% - 99%	1	4%	1	10%	2	6%
100%	1	4%	0	0%	1	3%

Source: SQW analysis of MEIF survey base = 63. Excludes n=1 blank. Note, question not asked to beneficiaries who stated a turnover of zero/not applicable

Performance against ERDF output targets

At the end of September 2019, the Fund was behind the ERDF target for the number of businesses assisted with finance, largely driven by the slower deployment levels in the debt and small business loan funds compared to forecast. The introduction of a new debt fund manager is expected to improve deployment. Despite this, the Fund was performing well in terms of jobs and innovation outputs to date (both for new to market and new to company products/services). The forecast number of jobs associated with the 235 investments is 1,409 (against a lifetime target of 3,833 to 2023) which should provide a buffer during the remainder of the Fund[29].

There is room for improvement in terms of performance against the target to support new SMEs[30]. This support to new SMEs is important given the Midland's lower than English average enterprise start-up rate. Performance has been particularly driven by the microfinance funds delivering fewer C5 assists (new SME assists) than anticipated, however, the fund managers are aware of the opportunities to create C5s via C3s (SME financial assists) and C4s (SME non-financial assists). The availability of Start Up Loans (which is delivered by some small business loan fund managers in MEIF) will also impact upon the delivery of new SME assists via MEIF.

[29] Forecast jobs are the number of new, paid, full time equivalent (FTE) jobs expected to be created due to the support under the ERDF project at the time of application/investment. Lifetime target sourced from full term MHCLG Contract to December 2023.

[30] This indicator covers enterprises that were not trading and registered at Companies House for less than 12 months before assistance provided, or a Business locating to the agreed geographic area for the first time to start trading.

Performance against private sector leverage targets varies by finance type and geography. Whilst, the East and South East Midlands equity fund is behind target for private sector leverage (62%), the West Midlands equity fund is ahead of target at 124%. This reflects data in the Small Business Equity Tracker (2019) showing that the West Midlands receives a higher share of equity deals compared to the rest of the Midlands[31]. However, this figure is anticipated to increase following the completion of second round equity deals. Securing private sector match has been less of a challenge for debt finance, nevertheless the funds were marginally below target at September 2019.

Table 2.4: Output performance by end September 2019[32] towards End of Investment Window Targets (December 2023)

Output categories	Achieved at end Sept 2019	Target[33] (and % of target) at end Sept 2019
C1: SME assist	354	378.1 (▼ 94%)
C3: SME assist (financial support)	205 (235 instances of support to 205 unique businesses)	266.6 (▼77%)
C4: SME assist (non-financial)	149	111.5 (▲ 134%)
C5: new SME assists	58	114.5 (▼ 51%)
C7: private sector leverage (£m)	£24.31m	£45.56 (▼ 53%)
C8: new jobs	411	412 (▲100%)
C28: new products/service to market	42	No target to date (▲lifetime target is 15)
C29: new products/services to the company	46	4.4 (▲1,045%)

Source: SQW analysis of MEIF monitoring data provided by the Bank

Process evaluation: delivery and implementation

The following paragraphs present feedback from stakeholders and businesses consulted on the design, delivery, management and governance of MEIF to date, and highlight key factors that have helped and hindered successful implementation.

[31] https://www.british-business-bank.co.uk/research/small-business-equity-tracker-2019/
[32] Outputs achieved are 100% attributable to ERDF. Data not tracked on intensity of support (beyond C4 outputs)
[33] This is the projected work in progress target rather than the final programme target.

Programme design, rationale and fit

In terms of the design of MEIF, consultees were in general agreement that:

- **the original rationale for MEIF was robust and – in the main - remains highly relevant**: Stakeholders on the ground argued that banks had retreated and remained risk averse, especially for businesses lacking a track record and/or collateral. Consultees highlighted low volumes in the bank referral platform, a lack of/limited awareness of other finance options, or how some businesses were resorting to finance with "cripplingly" high costs, leaving businesses disillusioned with their experiences of external finance. As a result, consultees argued that MEIF is "filling a significant gap" in the market for small loans. Some suggested that MEIF was providing a local solution to a national issue.
- **multiple consultees also highlighted the major gap in equity finance in the Midlands, and that this was more explicitly a geographical issue**. Private investors and angel investment networks had a limited presence in the Midlands, particularly in terms of early stage and patient capital investment. Transport connectivity across the Midlands was a challenge, and some more rural/remote parts of the region were deemed highly unlikely to attract VCs. Where private finance was available, it often took a shorter-term view, which creates issues for businesses with early stage R&D or longer term phased growth plans, and/or was risk averse. Moreover, the private sector offer was very fragmented, creating a "highly complex" finance landscape that was difficult for businesses to navigate. There was concern that businesses who were seeking equity finance would move out of the region to get the finance they need. In the main, consultees thought that the upper threshold for equity investments via MEIF (of £2m) was appropriate to fill the gap. Whilst there was some overlap with other providers at the lower end of the MEIF equity range, but the supply of equity at this level was still insufficient to meet demand and this was actually quite helpful to co-finance initial/follow-on deals (discussed in more detail below).
- **the feedback on larger debt was more nuanced**. Whilst consultees thought there was also a gap in the market for this type of finance, many also highlighted how the market had become much more competitive since MEIF was announced. This has had implications for uptake, as we discuss in more detail below.
- **overall, MEIF is seen to fill a major gap on the supply side**. However, consultees emphasised that market failures exist on the demand side too. For example, consultees described how businesses do not understand the types of funding available, lack financial literacy, and encounter challenges in identifying and developing investable opportunities (especially for equity). We return to issues around investment readiness below.
- **MEIF offers both scale and the ability to tailor delivery in response to local contexts, supporting the regional (rather than national) approach**: The scale of MEIF has been important; it is much larger than previous schemes. Consultees thought this was helpful in a number of ways: by bolstering the credibility of the fund; providing economies of scale and leverage (e.g. from the EIB); and simplification (e.g. marketing the offer as a collective whole). At the same time, sub-regional coverage by fund managers - with their local networks, knowledge and presence - means that the offer can be differentiated effectively in response to local needs and strategic priorities. Securing collaboration and

financial contributions from all of the Midlands LEPs was also highlighted by one senior stakeholder as a “significant achievement”.

- **in addition to scale, MEIF adopts a long-term perspective, which was welcomed by stakeholders and fund managers** – and quite distinctive to many other government programmes. With its five-year initial investment period and a portfolio period for a further five years to 2027, consultees felt that MEIF provides a more appropriate length of time to invest optimally in SMEs (with the capability for follow-on investment). As one consultee argued, this extended timescale is critical in a context where early stage projects can take 10-15 years to develop.
- **the shift from grants to loans and equity was a positive move for the Midlands**, but this requires cultural change. A number of consultees argued that the Midlands relied heavily on grant-based support in the past, and that the introduction of MEIF would help to encourage a migration from grant dependency to other types of finance. One stakeholder suggested that grant support was not always “taken seriously” by businesses, whereas loans/equity were more likely to encourage greater responsibility.
- **the importance of the fund manager role in the way in which MEIF was designed**. Consultees expect the fund managers to play a critical role in ensuring that the right type of finance is provided to businesses, as well as providing support/signposting to the businesses during the investment process if needed. In this way, the fund is “buying in” softer support, which should ultimately lead to greater chances of success (for the investment and the business).

Consultees also highlighted some inherent tensions in the way in which MEIF has been designed. For example, with a regional programme of this kind and LEP financial contributions, geographical reach is important, including into areas experiencing more significant market failure. Also, that the programme is designed to support propositions with a higher risk profile (than the private sector is willing to take). However, at the same time, fund managers are under pressure to make “good” investment decisions and generate a positive return on investment in order to repay the EIB loan and create a positive legacy for the Midlands. Some consultees (both local stakeholders and fund managers) would also like to have seen greater consultation and dialogue with the Bank during the design of MEIF[34].

Use of MEIF

As noted above, the purpose of MEIF is to provide finance for investment in business improvement. It is encouraging to see a **high proportion of firms investing in growth *and* productivity improvements** through recruitment/training, marketing, new products, services and processes – particularly for equity finance, but also for debt (Table 2.5).

[34] Note: Fund managers could not be involved in shaping the Fund due to the OJEU procurement process.

Table 2.5: Intended use for MEIF finance, based on beneficiary survey responses (n=63)

	Debt	Equity
Working capital, i.e. to grow or expand the business	72%	65%
Staff recruitment, training or development	65%	90%
Investment in new or significantly improved goods or services	53%	70%
Marketing	49%	85%
Investment in new or significantly improved processes	44%	65%
Acquisition of capital equipment or vehicles	23%	30%
Starting up business	16%	5%
Buying, renting, leasing or improving buildings or land	14%	15%
Any other type of investment	7%	10%
Don't know	0%	0%
Refused	0%	0%
Total (n)	**43**	**20**

Source: SQW analysis of MEIF survey base=63

Effectiveness of delivery and the customer journey

Overall, the Fund delivery scores highly against most aspects of delivery so far (see Table 2.6 below). Communication with the fund manager throughout the process, along with the time between application and decision, scored highly. Feedback on marketing and promotion scores relatively lower, although this is a more subjective measure depending on how they first became aware of the Fund.

Table 2.6: Beneficiary feedback on elements of delivery so far, rated on a scale of 1 to 5, where 1 is very poor and 5 is very good (n=63)

	Score out of 5					
	1	2	3	4	5	Don't know/not applicable
Marketing and promotion of the Fund	3%	13%	25%	30%	14%	14%
Communication with the fund manager throughout	0%	2%	10%	30%	59%	0%
The application process relative to other finance providers	3%	5%	19%	33%	33%	6%
Time between application and decision	2%	11%	13%	33%	41%	0%
The terms and conditions offered relative to other finance providers in the market offering similar products	3%	10%	25%	41%	16%	5%
Ongoing support and advice since finance awarded from [FUND MANAGER]	6%	6%	19%	35%	33%	0%

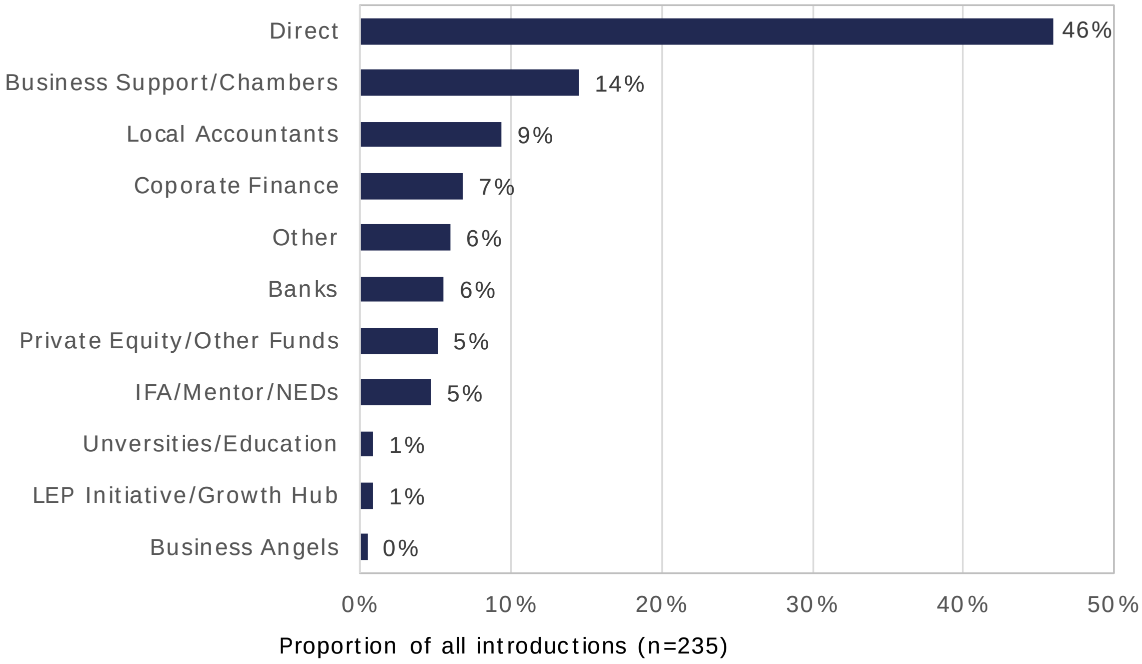
Source: SQW analysis of MEIF survey base=63

Marketing and promotion

As illustrated in Figure 2.2, just over a third of businesses were introduced to the Fund by banks, local accountants, business support/chambers or corporate finance. Given that most established SMEs would go to their bank first for finance[35], the level of referrals from banks (6%) is also low.

[35] See Owen et al 2017 Longitudinal Small Business Survey (LSBS) report and also Owen et al 2018 Institute for Small Business and Entrepreneurship (ISBE) paper on regional finance, and BEIS LSBS employer SME reports

Figure 2.2: Monitoring data on introducer type (n=235)



Source: analysis of MEIF monitoring data provided by the Bank

As noted above, marketing and promotion was rated less strongly by beneficiaries (with a higher proportion of respondents saying "don't know"). This is corroborated by feedback from fund managers and external stakeholders, who suggested that **awareness of MEIF was gradually improving – most notably through the work of the Bank and fund managers on the ground – but there was scope for improvement.** Consultees argued that MEIF needs to widen its geographical reach across the region (especially into rural and peripheral areas) and improve the dissemination of collateral (e.g. case studies) through networks and publications. One senior stakeholder also suggested more could be done to promote MEIF to potential in-movers, as a mechanism to attract inward investment.

Consultees felt that MEIF was communicated and marketed effectively by the Bank, both through marketing materials and their local presence and visibility on the ground. The latter has been particularly important and proved very effective where Bank representatives are well known and connected locally. That said, consultees reiterated the point above relating to the loss of momentum and awareness when there was a significant gap between announcing MEIF and becoming operational on the ground. Some consultees also suggested that the Bank was initially slow to release case studies and "good news stories".

There was consensus across the consultations –those based within and outside the Midlands – that the Midlands Engine branding is not as "coherent" or "strong" as Northern Powerhouse, and less well known across the business community. That said, fund managers have found Midlands Engine backing helpful when engaging with intermediaries and attending events.

A strong presence of fund managers on the ground has played an important role in stimulating demand – this is supported by both the data and consultations. Some of the fund managers had a longstanding presence in the region and were therefore very well-known and embedded in local networks. This has been important in more rural parts of the Midlands where an established local presence and reputation has facilitated engagement with the business base. For those who were new to the Midlands, it has taken longer to raise their profile.

It was originally anticipated that LEPs and Growth Hubs would also play a central role in promoting MEIF (in addition to enabling the demand side). However, LEPs/Growth Hubs account for only 1% of all introductions to the Fund, suggesting more could be done. There was some concern regarding the understanding of non-grant finance and a lack of capacity within some Growth Hubs to promote it. As a result, some fund managers were receiving very few and/or inappropriate referrals. Relations appeared to be improving at the time of the evaluation, and Growth Hubs were beginning to receive more case study material to disseminate to businesses and improve their own understanding of the offer.

Intermediaries also play a key role in raising awareness of the Fund. As illustrated in Figure 2.2, just over a third of businesses were introduced to the Fund by banks, local accountants, business support/chambers or corporate finance. There was mixed feedback from consultees on the extent to which intermediaries were (a) aware of MEIF themselves, and (b) promote MEIF to the businesses they engage with. One equity fund manager had some success in generating referrals from business coaches, universities and science parks. However, on the whole, intermediary awareness was thought to be "patchy" and needed to be strengthened. This was considered particularly important to reach SMEs who do not typically attend regional awareness raising events.

Application process and negotiation

Just over a quarter of beneficiaries surveyed (27%) had received **non-financial support from the MEIF fund manager prior or during their application.** This predominantly focused on business planning, followed by strategy development. Nearly half of the respondents that had received this type of support rated it 5 out of 5 in terms of usefulness, and a further two fifths rated it 4 out of 5.

As noted above, fund managers are tasked with delivering against ERDF output targets for 12-hour business assists, but beyond this formal activity, fund managers can play an important role in assessing (and where necessary challenging) business plans and assumptions, encouraging businesses to reflect, and strengthen their proposals. It also helps ensure MEIF finance is invested appropriately (both for the business and in line with MEIF's goals).

Fund managers argued that investment readiness support is a critical aspect of their work – and one that has required much greater resource and attention than anticipated. This was particularly the case for large debt but was also raised by other fund managers. It does suggest, though, that the deals done have a greater likelihood of being additional, given the level of support required (and compared to support that banks, for example, would be able/willing to offer). It also demonstrates how fund managers invest time in fully understanding the business and its finance needs, and ensuring the business applies for the most appropriate type of finance.

It was also noted that fund managers can provide a substantial amount of support to businesses to prepare them for investment that is not reflected in the output figures.

This is because if a business goes on to receive MEIF finance, the non-financial support provided to that business is not counted as a non-financial support output (this is only possible for those who do *not* go on to receive MEIF finance).

Table 2.7: Beneficiaries in receipt of Non-financial support, based on survey responses (n=63)

	Debt	Equity	All cases
Yes	12	5	17
No	31	13	44
Don't know	0	2	2
Base	43	20	63

Source: SQW analysis of MEIF survey base=63

Table 2.8: Satisfaction with Non-financial support, rated on a scale of 1 to 5, where 1 is very poor and 5 is very good (n=17)

	Debt	Equity	All cases
1	0	0	0
2	0	0	0
3	1	0	1
4	6	1	7
5 - Very useful	5	3	8
Don't know	0	1	1
Base	12	5	17

Source: SQW analysis of MEIF survey base=17

As expected, the process of securing debt finance has been faster than equity given the greater due diligence required for equity investments, with 60% of debt applications completed within 2 months and 100% within 6 months. In comparison, no equity deals were secured before two months and 70% of equity finance was secured within 6 months. There were, however, some aspects of the application process that respondents felt could be improved, particularly in terms of having more transparent terms and conditions upfront (including interest rates) and speeding up the process from initial introductions to receiving the finance.

Table 2.9: Time taken from first looking for finance to securing MEIF, based on beneficiary survey responses (n=63)

	Debt	Equity
Up to a month	30%	0%
1 to 2 months	30%	0%
3 to 6 months	40%	70%
7 months to 1 year	0%	20%
More than 1 year but less than 2 years	0%	0%
Base	43	20

Source: SQW analysis of MEIF survey base=63

Fund manager involvement following finance award

On the whole, **feedback from businesses on the involvement and support provided by fund managers has been positive.** As shown above, 89% of the beneficiaries surveyed rated communication with the fund manager throughout as good/very good, and 68% rated ongoing support and advice since finance awarded from the fund manager similarly.

In addition to monitoring progress after finance has been awarded, fund managers provide direct advice/support and act as a "sounding board", signposting to other specialist services/support, and provide access to networks, other investors or potential markets. As one stakeholder commented, this "aftercare is essential" both for the business and the MEIF investment. In this respect, another consultee argued that MEIF is quite different to many other forms of finance that are more "transactional" (e.g. funding circle). External stakeholders commented on how fund managers "*work really hard to find a finance solution for the client*", sometimes in partnership with local intermediaries which demonstrates collaboration across the local finance network.

For small business loans, fund managers described their typical involvement with businesses as "light touch" after an award has been made (for example, via quarterly monitoring). However, if businesses are struggling, the fund managers intervene quickly and provide advice and/or signposting to relevant support to ensure their investments keep on track. Looking forward, one fund manager is developing their internal capacity to create investment manager roles to enable closer client and portfolio management (for example, through more frequent visits to the business).

For equity and PoC, most fund managers are on business boards, although the level of engagement depends on the needs of the company. One fund manager holds strategy days with their businesses' management teams, focusing on performance and exit objectives, and ensuring the firm is on track or takes appropriate remedial actions to improve if necessary; other fund managers have assisted with recruitment (e.g. NEDs, part-time finance directors or a Chairman) and provided mentoring support.

There was more mixed feedback from businesses receiving equity on the support from fund managers, although the sample size is small. Almost all survey respondents (9 out of 10 equity recipients responding to the question) said the fund manager is an observer on their board. Of these, 3 said this had made moderate improvements to the management performance of the business, but 6 said that this had made matters a little worse. On the latter, this may reflect the “check and challenge” role played by fund managers to ensure that progress remains on track.

Case study example

A female-founded training provider received £50k debt funding from MEIF. The business was seeking investment to accelerate growth; they had just been awarded a contract offering new opportunities for expansion, but to capitalise on the opportunity the business needed to increase its sales and marketing activity both in the UK and internationally. It was unlikely that the business would have been able to secure similar finance, within the same timescale, elsewhere. The debt funding it received from MEIF came after a period of unsuccessful fundraising from the private sector.

The business was satisfied with the overall quality of the MEIF customer journey. The quality of communication throughout the process was very high. It was assigned a fund manager contact who supported it throughout the application and assessment process. The two parties were well matched in terms of expertise and working styles, and the assigned contact genuinely understood the business. The relationship was “a big conduit for making [MEIF funding] work for us”. The fund manager’s site visits helped to develop good mutual understanding of what the fund could offer and what the business was hoping to achieve. This was important to the business who had struggled to find funders who understood and valued what it was working towards.

The MEIF experience improved the founder’s confidence in her own capabilities and the business overall. She referenced the loneliness associated with being a sole business owner and highlighted the importance of external validation. Her relationship with the fund manager contact was critical to her personal development: the meetings provided constructive guidance and reassurance. In addition, their meetings were productive and led to tangible outcomes, such as a refined business plan and improved knowledge of fund managers.

In the absence of MEIF funding, the business would not have been able to raise its profile, unlock private investment or meet its growing demand as quickly. The business would have continued to grow but it would have been self-funded and therefore much slower. The personal relationship between the founder and the fund manager contact was the most important enabling factor for the programme. In the business’ view this is the most key lesson for MEIF: providing a strong, personal relationship alongside the funding itself will help to maximise the returns on their investment.

Governance, management and monitoring arrangements

The Funds are managed by the Bank on a day-to-day basis, working in close partnerships with LEPs. Monies are then allocated to underlying ‘sub-funds’ delivered by the fund managers. The Funds are overseen by a Strategic Oversight Board (SOB) representing the participating LEPs and Government, which is supported by 2 Regional Advisory Boards (RABs)[36] focusing on operational performance. In addition, the Bank provides 2 regional relationship managers to support the fund managers and LEPs.

The governance arrangements for MEIF appear to be working effectively. Representation on the 2 boards is appropriate, with complementary skills and experience from board members involved, and good engagement during meetings. However, consultees – including those involved in governance and programme delivery – felt the functions of the 2 boards needed to be clarified and more distinct, with better communication between the two. The SOB and RAB provide challenge to the fund managers to ensure value-for-money and that performance remains on track. That said, some consultees suggested a more collaborative dialogue between fund managers and the SOB/RAB, including more feedback/support and proactive use of their own networks to champion the programme and stimulate demand.

Consultees felt that **the Fund was well managed by the Bank**. In addition to the Bank’s local presence on the ground (as discussed above), management processes were considered to be very robust and the Bank had responded to implementation challenges effectively (for example, by introducing a second fund manager for the larger debt fund). However, a small number of fund managers would appreciate **more of a “partnership approach”** to their relationship with the Bank. Fund managers were also looking for **clearer guidance with regards to aspects of the MEIF eligibility** criteria (or even just reassurance). At present, some of the guidance is could be clearer and there are differences in opinion amongst the auditors[37]. In the absence of support from the Bank, fund managers are having to make their own assessment of some criteria and carry the risk of doing so.

Feedback from stakeholders involved in governance was also positive in relation to monitoring arrangements. The fund managers provide a detailed understanding of fund performance, lead flow and reasons for over/under performance. Some consultees would like to see more data on the businesses declined in order to fully assess risk appetite (and understand whether this is a barrier to delivery) and to ensure these businesses are being referred on/picked up by local support (one consultee was concerned that this was dependent upon personal relationships with fund managers, which were perceived to be variable across the region). On the latter, there was also some frustration amongst LEPs regarding the ability of MEIF to share business information (due to client confidentiality constraints) to ensure that support was fully joined up.

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[36] One for the West Midlands and one for the East and South East Midlands

[37] Guidance for the ERDF 2014 – 2020 programme is provided by MHCLG and the auditors are from the MHCLG Internal Audit team and the Government Internal Audit Agency

Implementation challenges

Feedback on the delivery of MEIF is very positive. However, there have been four key challenges in implementation to date:

- **the slower than expected deployment of larger debt funds.** Consultees suggested a number of reasons for this, including the increasingly competitive nature of this market (and the growth of peer-to-peer lending), issues around local experience/networks and capacity, and risk appetite. Also, the restrictions of MEIF (i.e. buyouts and refinancing are not eligible) were seen as restrictive, given the competition. Whilst there is still a gap in larger debt finance, consultees indicated that the scale of the gap is not as large as initially expected. Some of the stakeholders consulted would like to see the debt fund adopting a broader risk profile – whilst they recognised the importance of due diligence and the need to invest a publicly funded programme sensibly, they argued that the overarching rationale for MEIF is to provide finance to higher risk propositions that cannot secure finance from private sector sources. That said, some argued that the greater competition may lead to higher additionality anyway (as it encourages a shift toward higher risk propositions).
- **demand for equity is greater than the available funds in some places**, especially given the expected demand for follow-on investment in existing beneficiary businesses. In some investments, fund managers have phased their MEIF equity investments to lever in other private equity in the second round. By doing this, they are able to strengthen the final return, thus optimising returns to the public purse. This high demand for equity raises the question around the overall balance between debt and equity in the programme, which in part is driven by the need to repay the EIB loan. In this context, 40% equity was the maximum share possible in order for the fund to work as a package, despite the significant equity gap in the Midlands.
- **there is a challenge balancing the pressure to deploy funds quickly and ensuring "good" investments.** Both external stakeholders and fund managers commented on the way in which the fee structure and performance metrics are geared towards "getting the money out of the door quickly" – whereas the programme is also seeking to maximise the prospect of a return. Sometimes the two aims of MEIF can conflict in practice.
- There was a common message across the fund managers consulted on their **reliance on self-generated demand.** Intermediary awareness is variable, the pipeline from universities is lower than expected in parts of the region, and referrals from LEPs/Growth Hubs has been variable (as noted above). In addition, one stakeholder argued that the Midlands has a limited number of strong incubators or accelerators. The region was considered to have suffered from limited innovation support infrastructure and advice for many years. As a result, generating a pipeline for equity and PoC from these sources has been more challenging than expected.

Environment challenges

There were also 5 "generic challenges" set by the environment in which MEIF operates:

- **the lack of investment readiness has been a significant and persistent challenge**, and was raised frequently as an issue across our consultees. This includes a lack of financial literacy and experience, limited awareness of options and an inability to present propositions (especially outside of large urban conurbations) on the demand side. Support available to businesses outside of MEIF was described as "very variable", "patchy" and in places wholly inadequate. Some LEP areas provide dedicated access to finance champions and/or investment readiness support programmes, whereas other parts of the region offer very little. Consultees also noted the lack of high quality intermediaries in some places. There is a historical grant dependency in the Midlands - illustrated by one fund manager who often finds that businesses assume MEIF is grant funding – and it is taking time to change perceptions and cultures locally.

- **there was a lack of clarity amongst consultees around how MEIF aligns with wider Midlands Engine agendas and programmes.** Even those involved directly in the delivery of the programme were unclear how MEIF integrated with the wider work of the Midlands Engine (e.g. business start-up and growth, or internationalisation agendas), and none of the consultees were able to point to evidence of synergies. This is potentially a missed opportunity for the region.
- **many of those consulted commented on the "dynamics" at play within the region.** This included references to more "fractious" relationships (compared to the Northern Powerhouse, for example), fragmentation, competition and a longstanding history of separate east/west governance structures. While this means that it may be more challenging for MEIF, there is also an opportunity for it to be more instrumental in developing and supporting the Midlands Engine.
- **skills were identified by stakeholders and fund managers** as a key barrier hindering the progress/growth of businesses in the programme (and region more generally) and therefore the potential effectiveness of MEIF. This related to both general business and leadership skills (e.g. management and leadership, financial skills) and technical skills (e.g. digitech, software). In this context, one senior stakeholder emphasised the importance of creating an effective ecosystem for growth and enterprise, which joins together finance with mentoring, skills development etc. Some parts of the Midlands performed better than others in this respect.
- **finally, uncertainty around Brexit had led to some reluctance to invest**. For example, one fund manager has observed large manufacturing firms pausing large-scale investments, which has filtered down to the local supply chain who are then holding off investments.

3. Assessment of outcomes to date

This Section is divided into 2 parts:

- first, we present evidence on finance additionality (i.e. would this have been secured in the absence of MEIF) and leverage.
- second, we describe the business outcomes achieved to date, as a result of MEIF investment, and the extent to which these are additional.

Key messages

- The MEIF finance was considered additional, in some form, across nearly three quarters of survey respondents[38] and this was supported by the stakeholder consultations, across all types of finance
- A significant number of businesses secured other funding alongside MEIF (27 out of 63). In almost half of the equity cases this was be attributed entirely to MEIF
- Among equity beneficiaries, 95% reported that the funding led to greater confidence in their ability to raise funding from private sector sources in the future. This was 75% among debt beneficiaries
- Overall, the Fund is generating significant outcomes to date, particularly among equity beneficiaries. The investments are largely linked to productivity (such as investment in R&D, skills and process and/or product innovation), rather than business rescue:
  - 65% of businesses reported that they had increased skills in their workforces
  - 85% of equity investments had increased R&D expenditure (this was 44% for debt cases)
  - MEIF investment had led to improved processes (saving time and reducing costs) for 52%.
- The survey found that among equity investments, without MEIF, half of these outcomes would not have happened at all, while for debt investments MEIF had played a key role in accelerating outcomes.

[38] Note, this excludes n=7 respondents who answered don't know to the question.

Finance additionality

A key question for this early assessment of MEIF is the extent to which the Fund is providing finance to businesses which would not have been secured anyway, testing the rationale set out in Section 1.

Findings from the beneficiary survey are encouraging: funding was considered additional, in some form, across nearly three quarters of survey respondents[39]. However, there are some key differences between debt and equity investments:

- full additionality is slightly higher for debt investments[40] (39% probably/definitely would not have secured finance anyway) compared to equity (30%)
- partial additionality, whereby finance would have been secured at a later date and/or at a smaller scale, is more evident for debt compared to equity investments (30% vs 15% respectively). Across debt, most respondents thought it would have taken up to 6 months longer to secure finance[41]
- deadweight (i.e. businesses would have secured finance anyway, at the same speed and scale) is higher for equity investments (at 35%) compared to debt cases (23%).

This positive feedback on additionality was supported through the stakeholder consultations, across all types of finance. This was driven partly by the lack of supply in the Midlands (especially for small business loans and equity) and/or the prices charged by MEIF fund managers (as one consultee argued, if businesses could secure the finance elsewhere they would do), as well as the demand-side challenges discussed above (limiting awareness or ability to apply for external finance).

The level of full additionality achieved by MEIF (39% for debt and 30% for equity) is notably higher than benchmarks from similar programmes. For example, other evaluation evidence[42] found that the proportion of respondents that definitely/probably would *not* have raised finance from other sources is as follows:

- 6% (1 out of 16 recipients) for the UK Innovation Investment Fund (UKIIF)[43]

[39] Note, this excludes n=7 respondents who answered don't know to the question.
[40] Note, 12 of the 17 debt respondents reporting full additionality received small business loans
[41] Feedback was very variable on the scale of finance that could have been secured without MEIF
[42] Reported in Owen R, North D and Mac an Bhaird C (2019) The role of government venture capital funds: Recent lessons from the U.K. experience, in Strategic Change. 2018;1–14. Note, the three programmes were for finance additionality qualitatively at comparable early stages of delivery, and therefore are similar to MEIF and the current phase of evaluation. As the comparator programmes were at early stages of delivery, response numbers are relatively low. That said, results are quite consistent for ECF and ACF (less so for UKIIF because this has some more established business cases and greater emphasis on scale and timing).
[43] UKIIF (£330m, including £150m UK government from 2009 - to date) is a fund of funds targeting VC at key long horizon sectors, including health and some infrastructure (e.g. energy/low carbon) venture projects from early to later stage development.

- 16% (2 out of 12 respondents) for the Enterprise Capital Funds (ECF)[44]
- 22% (3 out of 15 respondents) for the Angel Co-investment Fund (ACF)[45]

Table 3.1: In the absence of the funding from MEIF, do businesses think they would have been able to obtain similar finance elsewhere?

	Debt		Equity		MEIF total	
	Cases	%	Cases	%	Cases	%
Would have secured finance anyway – in same time and scale	10	23%	7	35%	17	27%
Would have taken longer	10	23%	0	0%	10	16%
Would have been less	2	5%	1	5%	3	5%
Would have taken longer and been less	1	2%	2	10%	3	5%
Probably would not have secured	13	**30%**	4	**20%**	17	**27%**
Definitely would not have secured	4	**9%**	2	**10%**	6	**10%**
Don't know	3	7%	4	20%	7	11%
Total	43	100%	20	100%	63	100%

Source: SQW analysis of MEIF survey base=63

The MEIF survey evidence shows that 81% of respondents considered alternative sources of finance at the time they applied to MEIF, but **only around a quarter of all respondents actually applied to alternative sources of finance** (n=63) (Table 3.2). This may point towards investment readiness issues as discussed above. For both debt and equity, where beneficiaries had applied, this was mainly a loan from a bank, building society or other financial institution), but for equity beneficiaries also included other equity investors (VC/private equity funds).

[44] In further detail, ECFs (£840m UK government funding, 2006-to date) are the main public co-financing scheme with private VCs to encourage early stage investing, including seed investment (eg Passion Capital) and specialist early stage and sector investment (eg Oxford Technology Management Fund for medical sector) typically ranging between £50k and £2m.

[45] The ACF (£100m since 2011) is directly managed by the Bank and match funds up to 49% (from £100k up to £1m) business angel syndicate funding rounds in early stage ventures.

Table 3.2: Beneficiaries that considered and applied for other forms of funding, at the time of their MEIF application

	Debt	Equity	All
All MEIF beneficiaries	43	20	63
All that *considered* alternatives	33	18	51
All that *applied* for other finance	11	6	17

Source: SQW analysis of MEIF survey base=63

Of those who applied for other finance:

- **around a quarter were offered the full amount** of finance from an alternative source (4 out of 17), and none were offered a partial amount
- **and over half of the applications were rejected** (11 out of 17), most often because of an insufficient business record, too early stage, lack of security or they were given no reason.

The main reasons cited for choosing MEIF over other sources were:

- reputation, credibility, knowledge/expertise, local presence and additional support from the fund manager (n=20)[46]
- MEIF offered competitive rates/terms and conditions (n=13)
- good fit between MEIF objectives and business goals, and good understanding of business needs (n=13). For example, as one beneficiary argued, the fund manager "understood the business plan and why we need the funding"
- the ease of the application/process (n=11)
- an existing relationship/previous investment from the fund manager (n=9).

[46] Quality of fit and investor support are important additionality factors – likely to lead to a more successful outcome for the business and economy (see Owen et al, 2019)

Case study example

Co-founded by a female entrepreneur in 2014, this disruptive software technology company received a £250k equity investment from MEIF in February 2019. It is unlikely that the business would have been able to obtain similar finance elsewhere due to the internal capacity constraints. The business had considered crowdfunding, but it didn't seem like the right fit at the time and debt finance was not considered because "*there is almost no talk of it in start-up circles*". Following MEIF investment, the business secured an additional £250k funding; the business considered MEIF critical to leveraging this additional funding.

Implementation of MEIF finance has included opening a new office, recruitment of five additional staff, marketing, and covering overheads and business travel. Without MEIF finance it is likely that these activities would have taken at least twice as long to progress. The MEIF funding has also enabled to the business to grow more strategically; "*without funding, you're always thinking of ways to get money through the door, so a lot of companies end up doing consultancy or other random activities.*"

The fund manager has been closely involved with the business providing support across different areas of business development including defining KPIs and facilitating introductions with potential contacts/client. *"Within the world of startup, you are under the impression that the investor is going to be less of a partner, and more of a watchdog. [fund manager] is a real partner."*

Non-beneficiary progress

As part of the survey with non-beneficiaries (i.e. those who were unsuccessful or withdrew from the application process), respondents were asked whether they had been able to secure finance anyway. The findings, shown in the following box, should be treated with caution given some of the very small sample sizes.

Non-beneficiary survey

- 28 non-beneficiaries responded to the survey, of whom, 12 had applied for MEIF funding and were rejected or withdrew. The remaining 16 non-beneficiaries had received non-financial support only.
- 3 out of 12 respondents who applied for funding turned down their MEIF offer, and the reasons given were unattractive terms/conditions and strategic concerns regarding personal guaranties. 5 out of 12 were rejected by MEIF.
- **Half have gone on to secure finance anyway** (6 out of 12 that answered the question), including from other equity and loan sources, and most (5 out of 6) at the same scale as their MEIF application and on better terms. Of these, 4 had been reject and one turned down the MEIF offer.
- Of those that secured finance anyway, all 6 are using the finance for entirely the same types of activities as proposed in the MEIF application.
- **Not securing MEIF finance has had an impact on the activities undertaken by businesses, particularly in terms of innovation**. For example, 5 non-beneficiaries had planned to invest working capital, and without MEIF, 3 of these have delayed or reduced the scale of their plans. Similarly, 3 businesses had planned to invest in new/improved goods or services, but 2 have delayed plans.

- Not securing MEIF has impacted negatively on business development for a small number of respondents (5 out of 12), either by **slowing / holding back growth or putting business survival at risk.**

Leverage

The beneficiary survey also found that a significant number of businesses had secured other funding alongside MEIF (27 out of 63). This tended to be higher for equity cases (55%) compared with debt (37%). Leverage included both equity finance and loans from business partner/directors/owners.

The results show that the MEIF finance had a major influence on securing this additional funding (see Table 3.4). In the equity cases, 45% of respondents thought that the additional funding could be "entirely" attributable to MEIF, whilst 45% thought that it contributed to raising the additional funding to a "considerable" or "large" extent. No beneficiaries felt MEIF had not contributed. For debt, 50% thought it had contributed at least to a moderate extent, however 44% felt it had not contributed.

This finding was corroborated through consultations with fund managers, who argued that MEIF enabled co-investment and access to other finance from a range of other sources (through the Enterprise Investment Scheme and VCs). They have also found that MEIF is seen as a respected funder and has encouraged banks to co-fund small business loans by diluting the risk or providing finance post-MEIF once the business has demonstrated their ability repay loans.

Table 3.3: Did you also secure funding from elsewhere for these activities?

	Debt		Equity	
Yes	16	37%	11	55%
No	27	63%	9	45%
Base	43		20	

Source: SQW analysis of MEIF survey base=63

Table 3.4: To what extent did the funding contribute to bringing in this additional funding?

	Debt	Equity
Entirely	13%	45%
To a considerable extent	0%	9%
To a large extent	25%	36%
To a moderate extent	13%	9%
To a small extent	6%	0%
Not at all	44%	0%
Don't know	0%	0%
Base	16	11

Source: SQW analysis of MEIF survey base=63

Case study example

This innovative medtech business founded in 2002 initially started as a small-scale business producing highly specialised products, but since 2013 has embarked on a journey of product development.

The business received two equity investments from MEIF: £150k in April 2019 and £200k in September 2019. Finance additionality is high despite the MEIF fund manager being an existing investor. The business stated that it was unlikely that similar finance would have been obtained elsewhere at the time because the business was going through a difficult phase due to a protracted research and development programme which was running over a year behind the original timings due to supplier issues. Therefore, investment was perceived as too risky for the VC community and existing investors were also hesitant to invest because their previous funding had not yet sufficiently de-risked the technology.

The MEIF funding was complemented by funding from existing investors totalling £1.45m (£450,000 in April 2019 and £1m in September 2019). The business believed that the other investors would have been unlikely to invest without the “strong lead” from MEIF, which was crucial for signalling confidence to others who were concerned about delays in development but lacked technical knowledge about the subject area to assess the technology’s potential.

The funding from MEIF (and other investors) has helped the business to progress the development of the technology and it is intended that the remaining investment will be used to fund clinical trials shortly. Activity additionality is high, because without the investment from MEIF, it is likely that the business would have closed because the revenue stream from selling its original products was insufficient to keep the business going, and so none of the activities would have progressed.

Benefits of MEIF to date include increased skills in the existing workforce (e.g. project management and quality control), increased investment in R&D (+£450k), progressing the technology towards commercialisation (from formulating the technology concept to testing it in a simulated environment) and introducing more efficient processes. The business has also established a closer relationship with the fund manager and is now more confident in seeking further finance from private sector sources. Without MEIF these outcomes would not have been achieved.

Confidence in raising future finance and awareness of finance types

Participating in the MEIF process has also had a **very strong positive effect on businesses’ confidence.** Among equity beneficiaries 95% reported that the funding has led to greater confidence in their ability to raise funding from private sector sources in the future, 75% among debt beneficiaries.

Table 3.5: Do you feel that funding has led to greater confidence in your ability to raise funding from private sector sources in the future?

	Debt	Equity	All
Yes	79%	95%	84%
No	16%	5%	13%
Don't know	5%	0%	3%
Base	43	20	63

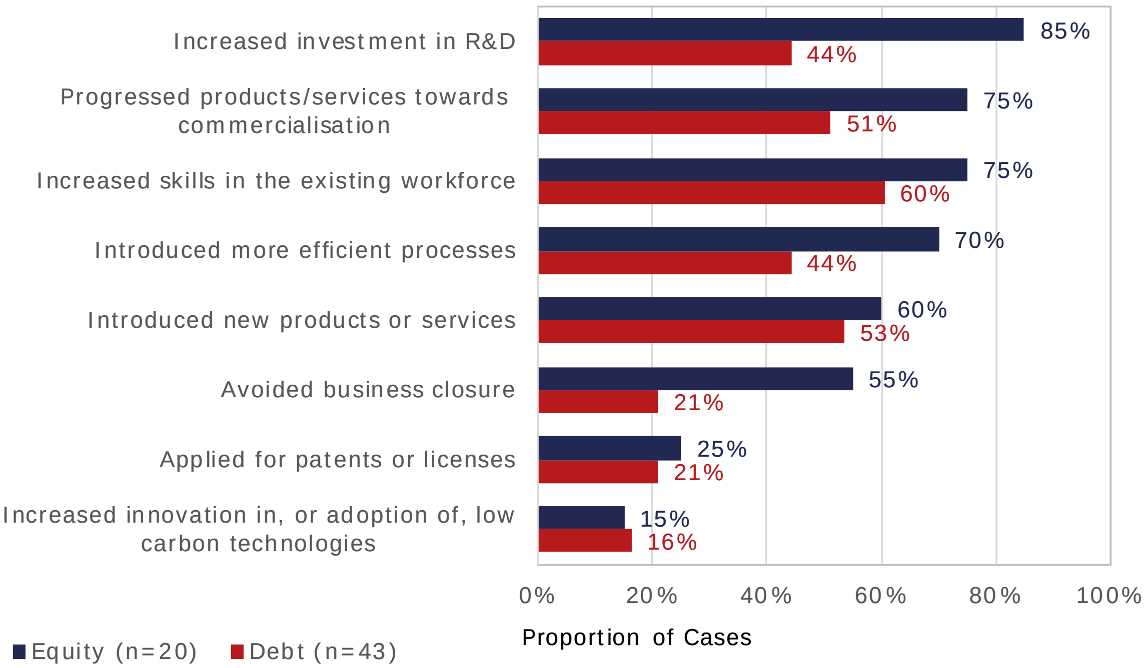
Source: SQW analysis of MEIF survey base=63

Business level outcomes arising from MEIF

Businesses were asked to report on the types of outcomes they have experienced as a result of receiving the finance. The results are summarised in Figure 3.1.

Overall, the Fund is performing well against outcomes to date, particularly among equity beneficiaries. **Outcomes are largely linked to productivity** (such as investment in R&D, skills and process and/or product innovation), rather than business rescue. In the sub-sections that follow, we discuss the key outcomes observed to date in more detail.

Figure 3.1: Outcomes achieved as a result of receiving MEIF finance



Source: SQW analysis of MEIF survey base=63

Skills development

Across all cases, 65% of the businesses reported increased skills in their workforces. An additional 21% of businesses expect this outcome in future. These businesses were asked whether this had, or would, lead to any new qualifications, either academic, vocational or company-specific (Table 3.6). Across both debt and equity cases, the funding had most commonly led to vocational and company-specific qualifications. However, overall, most beneficiaries reported 'other' responses with no formal qualifications.

Table 3.6: % of businesses reporting qualifications achieved as a result of MEIF

	Debt (n=35)		Equity (n=19)		Total (n=54)	
	Count	%	Count	%	Count	%
Academic	8	23%	1	5%	9	17%
Vocational	11	31%	2	11%	13	25%
Company-specific	11	31%	3	16%	14	26%
Other	11	31%	14	74%	25	47%
Don't know	6	17%	1	5%	7	13%
Refused	0	0%	0	0%	0	0%
Base	35		19		54	

Source: SQW analysis of MEIF survey base=63

Most of these businesses have developed **technical and specialist knowledge and skills** (26 out of 54 observing/expecting skills benefits) that are industry specific and spanned a wide range of activities, from *"driver training skills" and "developing system skills",* through to *"catering skills", "building techniques", and "engineering skills".* Businesses have often developed these types of skills by **recruiting new employees** who were highly skilled and/or completed training when they started their new role. In addition, two of the beneficiaries reported that they trained apprentices.

Other examples of skills development included:

- **improved marketing, sales and customer service skills** (19) which has involved upskilling existing marketing and sales staff and hiring additional staff
- **improved business/project management skills and capacity** (10), for example: by hiring a *"new CEO with much more business experience"*
- **digital skills** (4), for example: improving basic IT skills, digital design or graphic design
- **improved HR and administration capacity** (2), for example: *"disability awareness, cyber security and [becoming] payment card industry compliant".*

Innovation

The MEIF finance has also led to additional investment in R&D, especially for equity (85%) but also debt (44%). Of the 36 businesses reporting this outcome, 28 were able to estimate the scale of this additional investment – at an aggregate increase of £5.4 million. Furthermore, 44 businesses[47] expected R&D spending to increase over the next 3 years and, of those that were able to quantify it (35), this was estimated as a total of £30.6 million in additional expenditure.

The majority of equity investments (75% of respondents) have also enabled businesses to progress products/services towards commercialisation (and 51% for debt cases). The proportion of cases that had **introduced new products and services was similar for businesses involved in equity deals** (60%) and businesses receiving debt finance (53%), reflecting considerable new innovative activity stimulated by MEIF. A further 16% of debt respondents and 25% of equity respondents expect to introduce new products and services in future.

Table 3.7 provides details of the proportion of new products and services that are new to the market, or just new to that business. **For equity, the majority of businesses (82%) reported that at least some new products and services were new to market**. **For debt, an equal proportion of products or services innovations are new to market or new to business.**

Table 3.7: Proportion of products or services innovations that are new to *the market*, and/or new to *the business*, based on survey responses

	Debt (n=30)		Equity (n=17)		Total (n=47)	
	Count	%	Count	%	Count	%
At least some new to the market	14	47%	14	82%	28	60%
All just new to the business	14	47%	3	18%	17	36%
Don't know	2	7%	0	0%	2	4%
Base (all innovation)	30		17		47	

Source: SQW analysis of MEIF survey base=63

Examples of products/services taken to market as a result of MEIF investment included:

- **digital or communication software** (n=15): a new search engine for digital design images, a validation and online market system, new software services, e-commerce platforms, and API products and analytic solution[s]

[47] Including the 36 respondents who have already increased their investment in R&D as a result of MEIF

- **new engineering and architectural solutions** (n=10): solar lighting products, a mobile robotics, and sensors and hardware for corrosion monitoring
- **health / med tech devices and products** (n=7): virtual reality therapies, trays that hold syringes in theatre, medical devices for diagnosis of patients with strokes, and technologies for gene therapy
- **consumer goods (n=5):** a new clothing brand, a new car seat and pram for children, new furniture products for children, and extension of a shampoo product range.

Case study example

This business founded in 2014 specialises in the development of environmental solutions. In 2019, the business received a £300k Proof of Concept equity investment from MEIF. The business felt that the MEIF investor *"wanted to do the right thing for the company",* compared with other potential investors they approached at the time. In addition to the funding from MEIF, the business secured £400k equity investment from a consortium of investors. However, without MEIF the business explained that it was unlikely investments would have been secured from these investors.

Without the current CEO joining the company (from an introduction agreed by the fund manager) the business would have continued to explore a wider range of business development activities; rather MEIF has allowed the business to grow in a more strategic way by focussing on only one key market.

MEIF investment was used to cover the period between the end of existing grant funding until the business made its first commercial sale. By that point, the business had already developed its initial technology, so funding was used to cover staff costs and get through the final *"demonstration period"* to prove that the system works reliably. Activity additionality is high. The business stated that without MEIF investment it is likely they would have closed. If the business had received investment from the other two potential investor consortia, it probably would have created fewer jobs and not had the same environmental focus.

Outcomes for the business include opening a new office, recruiting five employees (plus two FTEs to date, and a further 19 expected in the MEIF area) and progressing the technology towards commercialisation. By enabling the business to commercialise its technology, MEIF has also had a wider impact on the sustainability of the target market and the technology is expected to have long term environmental benefits.

Improved processes

Across the sample, MEIF investment **led to improved processes for 52% (n=33)** of survey respondents. Within the cases observing/expecting improvements (n=46), the result is:

- reduced costs for 89%
- saved time for 89%
- improved the quality of their output for 83%.

The findings were similar for both debt and equity respondents and suggest that MEIF is leading to improvements in productivity.

Avoided business closure

A notably higher proportion of equity respondents reported the MEIF investment had prevented business closure, possibly reflecting the “all or nothing” approach to these deals. Of the 11 equity recipients who argued that MEIF had prevented closure, 6 said the business would have closed already, 1 said it would have closed in the next 12 months, 1 said it would have closed further in the future, and three were unsure.

Unanticipated benefits

Consultees also highlighted unexpected benefits arising from some of the businesses supported by MEIF, particularly those relating to agendas that are strategically important nationally (and perhaps more so now than when MEIF was designed). For example, two consultees referred to green investments, where PoC and equity funds are being invested into new technologies that should bring about direct environmental benefits.

Outcome additionality

As part of the survey, beneficiaries were asked whether they would have been able to achieve the same outcomes (described above) in the absence of MEIF. Overall:

- the level of deadweight is low
- full additionality is particularly high for equity beneficiaries: nearly half of outcomes would not have happened at all
- for both debt and equity, MEIF has played a key role in accelerating outcomes: in around half of cases the outcomes would have taken longer.

Table 3.8: Would the same outcomes have been achieved without access to MEIF?

	Debt	Equity	All
The benefits would have happened anyway, over the same time period and at the same scale, without (fund manager)	9%	0%	6%
The benefits would have happened anyway, but they would have taken longer to achieve	51%	47%	50%
The benefits would have happened anyway, but at a smaller scale	23%	26%	24%
None of these benefits would have happened	26%	42%	31%
Don't know	3%	5%	4%

Source: SQW analysis of MEIF survey base=63

4. Assessment of emerging impacts

Key messages

- The Fund has a direct impact on business performance, including on productivity and exporting. Specifically:
    - the Fund has increased productivity for 63% of the businesses and a further 21% expect to do so, as a result of the investment
    - 27% had increased exports and a further 21% expected to do so
    - 81% have increased employment and 63% had increased sales.
- While equity deals have had the greatest impact on productivity and employment, debt has contributed more significantly to profitability at this early stage
- Although the majority of the new jobs are in production, administration, logistics, sales and customer service functions, there are also a substantial number of new R&D jobs (20% of the total)
- These jobs are also generally well paid with a third paying above the £36,500[48] a year (the top quartile income of income) and a third paid less than the median income (£23,300). Equity beneficiaries were slightly more likely to create higher paid jobs.
- Across the 33 cases (from 40) that quantified the impact of MEIF on turnover, firms estimated a combined increase of £17 million.
- Of the 49 businesses that provided details of the distribution of customers, around 53% of the value of all sales was made outside the UK.
- Consultees felt that it will take time before it is possible to observe the impact of MEIF on the wider finance ecosystem across the Midlands. However, early signs were encouraging. On the supply side, consultees felt that MEIF is beginning to make a difference in terms of:
    - increasing the supply of finance
    - simplifying the finance landscape
    - increasing capacity and changing behaviour
    - strengthening relationships and networks
    - encouraging greater activity from other finance providers within/into the region. e.g. Barclays has promoted their own Midlands funding for SMEs.

[48] Survey of Personal Incomes, HMRC 2016, Table 3a Percentile points from 1 to 99 for total income before tax (taxpayers only), top 25%

Emerging and expected impacts

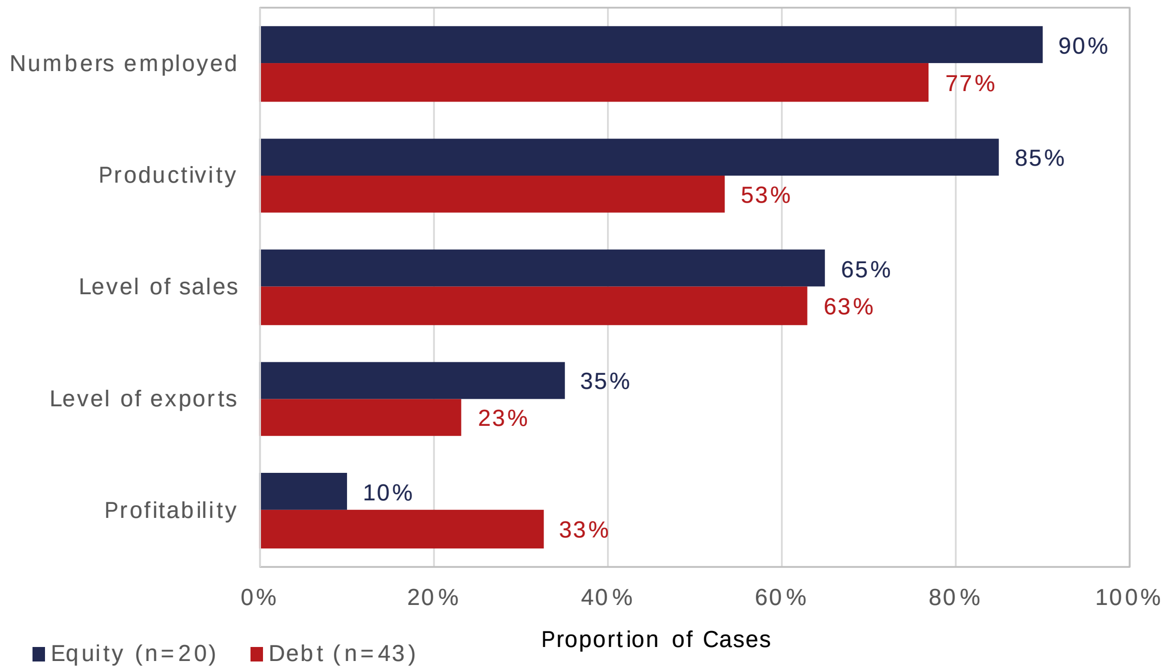
Business employment and turnover growth

In addition to the qualitative outcomes described above, beneficiaries were also asked whether MEIF investment had impacted upon business performance to date (Figure 4.1).

The Fund has increased employment for the majority of equity beneficiaries (90%), and amongst debt beneficiaries (77%). The figures for productivity were 85% and 53%. The figures for turnover were similar across debt and equity cases at 63% and 65% respectively. There were 23% of the debt and 35% of equity cases that thought that the finance had increased exports

These are significant changes in performance enabled by MEIF. The fact that a majority of businesses reported increases in productivity already is encouraging and reflects the high proportion investing in skills and new products/processes. The difference between debt and equity in regard to profitability is also interesting, this reflects the stronger improved sales performance amongst debt beneficiaries but may also be indicative of shorter-term business plan objectives. It is also unsurprising that most equity cases have not yet seen profitability increase (while investment has been in increasing employment).

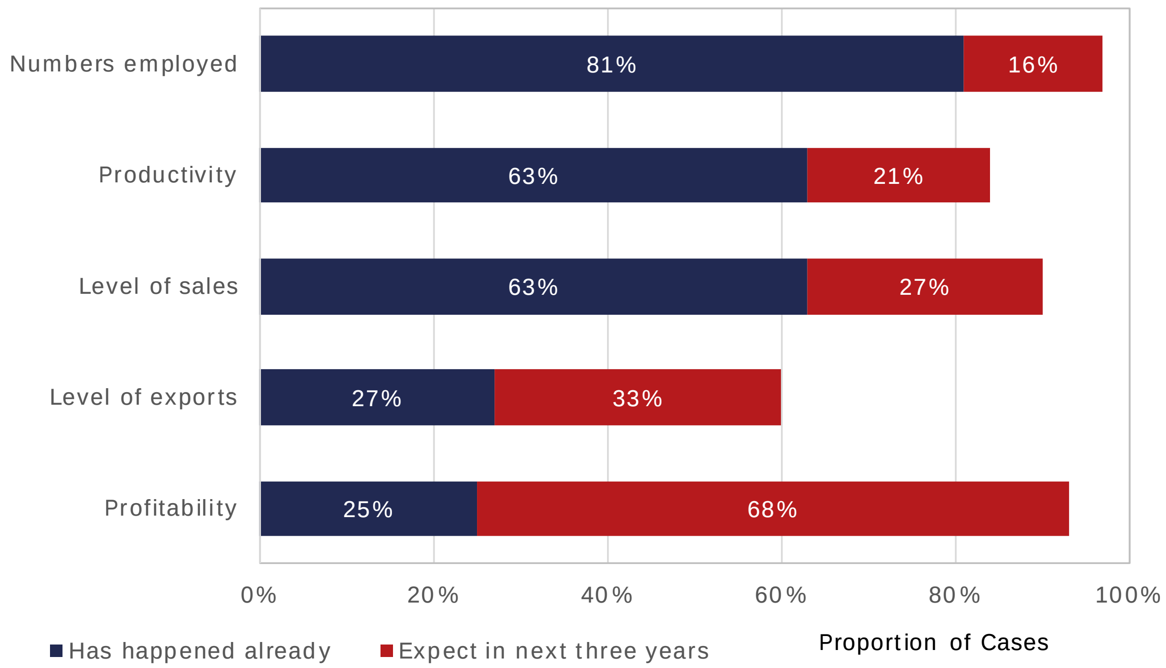
Figure 4.1: As a result of the finance you have received, has there been any change to your business performance?



Source: SQW analysis of MEIF survey base=63

The results can be extended to show the proportion that are *expecting changes in the next 3 years.* For employment and sales, a large proportion of the impacts have happened already, while for profitability, and to a lesser extent exports, there are more benefits expected in the future (Figure 4.2).

Figure 4.2: Changes to your business performance to date and in the next 3 years



Source: SQW analysis of MEIF survey base=63

Number of jobs created

The survey asked businesses to report the number and types of jobs that had been created as a result of receiving MEIF funding. The results show a positive impact on employment. In total, 51 of the firms have increased employment to date (81%). Of these **50 firms provided estimates of additional employment, totaling 196 jobs (124 through debt and 72 equity).** Mean employment has also increased from 21 (debt) and nine (equity) employees at the application stage, to 22 (debt) and 12 (equity) employees at the time of the survey. Similarly, median employment has increased from six (debt) and eight (equity) employees at the application stage, to eight (debt) and 12 (equity) at the time of the survey.

Table 4.1: Changes to employment as a result of receiving MEIF funding

	Debt (n=43)		Equity (n=20)		Total (n=63)	
	Count	%	Count	%	Count	%
Higher because of funding from MEIF	33	77%	18	90%	50	79%
Lower because of funding from MEIF	0	0%	0	0%	0	0%
The same- funding made no difference to sales	10	23%	1	5%	11	17%
Don't know	0	0%	1	5%	2	3%

Source: SQW analysis of MEIF survey base=63

Quality of jobs

The survey also asked businesses to report the types of jobs that had been created as a result of receiving MEIF funding. While the majority are in production, administration and logistic functions (such as process, plant and machine operatives) and sales and customer service functions, there are also a substantial number of R&D jobs (20%) (see Table 4.2).

Table 4.2: Types of additional jobs generated by MEIF investments

Type of jobs	% of jobs
Directors and Senior Official	7%
Research and Development	20%
Sales and Customer Service functions	26%
Production, administration and logistic functions e.g. Process, Plant and Machine Operatives	27%
Other	20%
Base (all reporting additional employment)	196

Source: SQW survey of beneficiary businesses base = 196 jobs

A third were jobs that paid more than £36,500[49] a year, while a third were paid less than the median (£23,300)[50]. The median values for the regions in the Midlands are substantially lower than this level (£22,355 in the West Midlands, and £21,486 in the East Midlands). Therefore, it suggests that these jobs created by MEIF funding are contributing to increasing the wages in these areas. This is also likely to mean that the jobs being supported are higher productivity (GVA per head) than the median.

Equity beneficiaries were slightly more likely to create high paid jobs in this bracket (46% equity compared to 32% debt).

Table 4.3: Income levels from the additional jobs supported

	Debt (n=32)		Equity (n=18)		Total (n=50)	
Jobs with salaries or wages (before tax) of...	Count	%	Count	%	Count	%
less than £23,200 a year	45	36%	17	24%	62	32%
more than £36,500 a year	40	32%	33	46%	73	37%
All jobs	124		72		196	

Source: SQW survey of beneficiary businesses base = 196 jobs

[49] Survey of Personal Incomes, HMRC 2016, Table 3a Percentile points from 1 to 99 for total income before tax (taxpayers only), top 25%
[50] Median value from Survey of Personal Incomes, HMRC 2016

Case study example

This long-established business founded in 1998, was awarded a significant investment in early 2019. The business was looking to expand but found it difficult to secure finance from traditional methods such as bank loans. The MEIF investment has been used for marketing, exhibitions and promotion, upskilling the exiting workforce and employing new employees.

The business has already experienced a number of direct benefits as a result of the funding. These included personnel benefits such as the recruitment of seven FT employees (across sales, social media and business specific roles) and upskilling the workforce (for example, through HR management and leadership training). Other benefits include introducing more efficient processes (for example, through outsourcing workload where appropriate and investing in new HR management software) and progressing the video interpretation application into new markets.

The business has also experienced a £400k increase in sales from a turnover of £1.4m prior to MEIF to £1.8m (latest financial year). Looking forwards, the business is projected to continuing growing, with turnover expected to increase to £2.3m by July 2021.

Outcome additionality is partial. The business believed that outcomes may have been achieved anyway, but they would have taken longer (two to three years). Without MEIF investment it is likely the business would have experienced some growth, however, there would have been significant “hurdles” along the way.

The business has a proportion of its MEIF debt investment remaining, because initial investment has enabled the business to grow quickly and increase cash flow simultaneously. Therefore, going forward the plan is to use both the MEIF investment and revenue growth effectively to drive business growth; there is no plan at this stage to seek further investment.

Turnover

MEIF finance has boosted turnover for 63% of beneficiaries surveyed (63% for debt and 65% of equity cases). **Mean turnover has increased from £3.52 million (debt) and £666,000 (equity) at the application stage, to £3.73 million (debt) and £743,000 (equity) employees at the time of the survey.** Similarly, median turnover has increased from £175,000 for equity at the application stage, to £270,000 at the time of the survey. However, for debt beneficiaries, median turnover has remained static between application stage and the time of the survey at £750,000[51].

[51] Note, figures include turnover of respondents who have not completed a full financial year post MEIF investment. Mid points were taken where turnover was provided as a range.

Table 4.4: Changes to turnover as a result of receiving MEIF funding

	Debt (n=43)		Equity (n=20)		Total (n=63)	
	Count	%	Count	%	Count	%
Higher because of funding from MEIF	27	63%	13	65%	40	63%
Lower because of funding from MEIF	2	5%	0	0%	2	3%
The same-funding made no difference to sales	10	23%	6	30%	16	25%
Don't know	4	9%	1	5%	5	8%

Source: SQW analysis of MEIF survey base=63

Across the 33 cases (from 40) that quantified the impact of MEIF on turnover, firms estimated a combined increase of £17 million. The scale of impact varies across the sample, with nearly half of these firms estimating an impact of between £100,000 and £499,000 and three cases estimating over a £1 million.

Ten respondents who reported an increase in turnover were also exporters, and of these ten, **eight (80%) said some or all the increase was accounted for by exports.**

Case study example

This business founded in 2010, received a £1m debt investment through MEIF in 2019. MEIF investment aligned with the company's financing requirements at the time because they were seeking a large cashflow for stock and refinancing of shareholders. At the time of the MEIF application, the business had applied for finance from their bank but were unsuccessful.

Finance additionality is partial. The business believed that they would not have secured finance within the same timescales in the absence of MEIF (it would have taken 1-2 years longer). The MEIF investment has been used to purchase more stock, service customers more rapidly and increase production.

Since MEIF investment, employment has increased by 15 FT employees in the UK, taking total employment to 128 FTE. Turnover has also increased substantially by £6m to £28m. Growth has been more rapid than expected and the business is now on track to achieve £37m+ turnover by 2020 and £50m within 3 years. Exports have contributed a higher proportion of growth (up 35%) compared to the UK market (up 25%), with exports expected to make up 70% of total growth.

Other benefits to date include better shareholder relationships (having reduced their debts), increased stock holding to service global clients more efficiently - *"we were actually surprised that productivity increased so fast, resulting in doubling of capacity within 3 months"* – and there has been reduced unit cost of air freight (costs have reduced by half from over £15,000 to under £10,000 per month).

The business is now more confident that they will be able to raise the additional £2m debt required from the private market within the next 6-12 months. The business stated that *"the loan provided a good bridge to a more efficient form of debt finance, in moving from equity to senior debt."*

Within the sample, 54 (86%) of the businesses thought that the funding through MEIF would lead to an increase in their sales *over the next 3 years*. Of these, 42 provided quantified estimates with an **aggregate total of £158 million**[52].

Customers and displacement

Displacement occurs when an intervention leads to one company benefiting at the expense of a competitor elsewhere in the target area. For example, if finance helped one firm grow, but this growth was entirely achieved by capturing market share from existing competitors, there would be no overall gain. In practice this concept does not easily reflect changes in quality or innovation and should be treated with caution. Export

[52] Note, mid points were taken where turnover was provided as a range.

sales and new products are usually less likely to cause displacement among local businesses.

A reasonably high number of firms do some exporting (51% of the sample), which is reflected in the value proportion of all sales. Of the 49 businesses that provided details of the distribution of customers, around 53% of the value of all sales was made outside the UK (Table 4.5). Just 17% of sales made are to customers within the Midlands Engine area.

Table 4.5: Distribution of customers and % of sales by value

Customer area	Aggregated % of sales
In the Midlands Engine area (East and West Midlands)	17%
In the rest of the UK, but outside the Midlands Engine area	30%
Elsewhere in the EU	20%
In countries outside of the EU	33%
Base	49

Source: SQW analysis of MEIF survey base=49

Businesses were asked whether, if you were to cease trading tomorrow, would competitors take up your current sales over the next year. Among the businesses receiving both debt and equity finance, similar proportions considered that all their sales would be replaced by competitors (43% debt vs. 42% equity). This is a slightly surprising finding given the higher levels of innovation among equity cases identified earlier.

Emerging impacts on the wider ecosystem

On the whole, consultees felt that it will **take time before it is possible to observe the impact of MEIF on the wider finance ecosystem across the Midlands**. As one consultee argued, the programme needs to be sustained over a long period before the full demonstrator effect is visible (e.g. exits/returns). This is supported by the literature which shows that developing an ecosystem is a long-game and driven by success stories (Lerner, 2010; Hwang and Horowitt, 2012), while major investment exits can take a long time to appear (Owen and Mason, 2019).

However, **early signs from MEIF were encouraging**. On the supply side, consultees felt that MEIF is beginning to make a difference in terms of:

- increasing the supply of finance: the presence of MEIF itself has helped to increase the supply and choice of finance in the Midlands in absolute terms
- simplifying the finance landscape: consultees argued that MEIF provides a more co-ordinated and joined-up offer. Intermediaries have found it easier to refer

clients into the programme (previously they were much more dependent upon personal contacts, which was variable)

- increasing capacities and changing behaviours of fund managers involved in MEIF: All fund managers have increased their presence and capacity in the Midlands to deliver MEIF. Two fund managers have been encouraged to make earlier stage investments in Midlands (and have recruited specialists to do so) and adjust their risk profile. Without MEIF, they would not be doing this in the Midlands. A further two fund managers said they have strengthened their investment decision-making and monitoring processes as a result of MEIF. For example, one fund manager described how delivering MEIF – and the emphasis it places on outcomes and creating a sustainable fund has influenced the way in which they operate, leading to more robust due diligence processes, more regular monitoring and quicker responses to under-performance, closer engagement with businesses, and a more commercial approach to investment decisions
- strengthening relationships between fund managers involved in MEIF: some of the fund managers consulted argued they are working more collaboratively than would otherwise have been the case because of MEIF. For example: in the East Midlands, the fund managers are in regular dialogue and meet quarterly to discuss businesses engaged through MEIF, cross-refer and share good practice. One of the fund managers involved commented on how they are now able to see how their finance offer fits with the wider finance landscape, whereas previously they tended to operate in isolation. There were also examples of the equity/PoC fund managers work closely together across the Midlands, and cross-referral between East and West Midlands small business loans where appropriate
- strengthening networks across the wider finance ecosystem: MEIF has proved helpful in opening doors to influential introducer networks and co-funders. The programme has hosted events to bring together funders and intermediaries to help co-ordinate and strengthen their networks. More broadly, one consultee explained how MEIF has encouraged LEPs to collaborate on finance issues and share best practice. For example, through monitoring MEIF performance at RAB meetings, LEPs have had more open discussions around how each area approaches their finance challenges. Following on from this, LEP officers responsible for investment readiness now meet quarterly in the sub-region to share knowledge and learning
- encouraging greater activity from other finance providers within/into the region: One fund manager cited a small number of cases where other finance providers have been encouraged into the Midlands to co-fund alongside MEIF, and they argued this would not have happened without MEIF to share the risk.
- one fund manager suggested there has been some reaction to MEIF from the banks (e.g. Barclays has promoted their own Midlands funding for SMEs)

On the demand-side, consultees thought MEIF had stimulated interest in finance and was helping to build businesses' experience in financial markets, but there are still considerable challenges to overcome in this respect (as discussed in Section 2).

5. Conclusions

This final Section presents our conclusions, including an assessment of progress against MEIF's stated objectives, and challenges that the Bank may wish to reflect on as the Funds progress.

Validity of Fund's rationale

The rationale for MEIF is considered to be robust and remains highly relevant. The evidence from the survey suggests high levels of additionality. Without the intervention, a high proportion of the finance would not have been invested, and this is now being used to support improvements in performance, productivity and innovation. In particular, the rationale for providing new sources of equity funding is confirmed by the high levels of demand.

Stakeholders strongly supported the rationale, reporting that banks had remained risk averse, especially for businesses lacking a track record and/or collateral, while there was a lack of/limited awareness of other finance options. This had the reinforcing effect of leading businesses to become disillusioned with their experiences of external finance. Consultees also argued that MEIF is "filling a significant gap" in the market for small loans.

Almost all consultees highlighted the major gap in equity finance in the Midlands and considered this as a specific geographical issue. Private investors and angel investment networks have a limited presence in the Midlands, particularly in terms of early stage and patient capital investment, while transport connectivity to some more rural/remote parts of the region were deemed highly unlikely to attract VCs.

The rationale for larger debt was more nuanced and this has been reflected in the slower deployment of the Funds. Whilst consultees thought there was a gap in the market, it had also become much more competitive since MEIF was announced. However, it is important in enabling the overall MEIF package.

Validity of Fund design in meeting objectives

The level of demand, positive business survey results and stakeholder feedback support the conclusion that the design of the Fund has worked well. Specifically:

- MEIF offers both scale and the ability to tailor delivery in response to local contexts, supporting the regional (rather than national) approach: The scale of MEIF has been important; it is much larger than previous schemes. This has helped to bolster the credibility of the fund, provide economies of scale and leverage (e.g. from the EIB), and simplified the offer (e.g. marketing the offer as a collective whole). At the same time, sub-regional coverage by fund managers - with their local networks, knowledge and presence - means that the offer can be differentiated effectively in response to local needs and strategic priorities.

- securing collaboration and financial contributions from all the Midlands LEPs has been a significant achievement and important progress in delivering the pan-Midlands Engine approach
- the Fund adopts a long-term perspective which was welcomed by stakeholders and fund managers – and quite distinctive to many other government programmes. With its five-year initial investment period and a portfolio period for a further five years to 2027, consultees felt that MEIF provides a more appropriate length of time to invest optimally in SMEs (with the capability for follow-on investment). As one consultee argued, this extended timescale is critical in a context where early stage projects can take 10-15 years to develop.
- the shift from grants to loans and equity is a positive move for the Midlands, but requires cultural change
- the role of fund managers was considered important in ensuring that the right type of finance is provided to businesses, as well as providing support and signposting to the businesses during the investment process as needed. This should ultimately lead to greater chances of success (for the investment and the business).

Objectives

The ultimate objective for the regional programmes is to increase economic growth in line with the Government's wider objective for all business support and access to finance programmes. The Fund aims to achieve this by improving access to finance enabling businesses to start up, invest and grow more rapidly. Logic models in Annex A set out the ways in which the Funds are expected to generate outcomes and impacts. This section considers the evidence in relation to the main outcome indicators.

Increasing the supply of finance to viable businesses that would otherwise have problems raising finance

The Fund had invested £43.38m by September 2019 (£19.47m in loans and £23.91m in equity). Given that funding was considered additional, in some form, across nearly three quarters of survey respondents. With limited displacement, it indicates that supply has been increased. The survey evidence, along with stakeholder feedback, indicates that the Fund is financing viable businesses that would have had problems raising finance without it.

The Fund has also played an important role in levering wider finance. The beneficiary survey found that a significant number of businesses had secured other funding alongside MEIF (higher for equity cases), and that MEIF finance had a major influence on securing this additional funding. This included co-investment from other private equity providers and banks.

Improving performance of recipient businesses, particularly in terms of productivity and competitiveness related outcomes (ESIF and HM Government objectives)

The survey evidence shows that the investments have been used extensively to improve performance, research/innovation and productivity. The survey found that business investments were largely linked to productivity (such as investment in R&D, skills and process and/or product innovation), rather than business rescue.

- 65% of businesses reported that they had increased skills in their workforces
- 85% of equity investments had increased R&D expenditure (this was 44% for debt cases)
- the majority of equity investments (75% of respondents) have also enabled businesses to progress products/services towards commercialization
- MEIF investment had led to improved processes (saving time and reducing costs) for 52%.

The survey found that among equity investments, without MEIF, half of these outcomes would not have happened at all, while for debt investments MEIF had played a key role in accelerating outcomes.

Increasing awareness of external finance and confidence in raising finance in future across businesses supported.

Participation in MEIF has increased businesses' awareness of equity and alternative sources of finance amongst SMEs in target area. The MEIF process has also had a very strong positive effect on businesses' confidence in raising future finance, which is likely to enable further investment in the future.

Early signs are encouraging on MEIF's potential influence on the wider ecosystem, particularly on the supply side

It will take time before it is possible to observe the impact of MEIF on the wider finance ecosystem across the Midlands. However, early signs from MEIF were encouraging. There is emerging evidence to show how MEIF is increasing the supply and choice of finance in the Midlands and is helping to simplify the finance landscape. It has also increased the capacities and changing behaviours of some fund managers involved (e.g. encouraging earlier stage, higher risk investments in the Midlands), and strengthened relationships between the fund managers. However, whilst MEIF has stimulated business interest in finance, there are considerable demand-side challenges that need to be overcome to strengthen the finance ecosystem overall.

What is working well and what could be improved?

Setting up and delivering the Funds has worked well, particularly given the range of partners and the uncertain landscape for investing. The main findings are:

What is working well

In addition to strong performance against the programme's objectives, as outlined above, the implementation of MEIF is working well in terms of:

- the role of the fund managers has been important. This includes support from the MEIF fund manager *prior* or *during* their application (e.g. business planning and strategy development, and support to ensure the right type of finance is secured) and fund manager support *following* the finance award. The latter is usually more intensive for businesses receiving equity finance, but debt fund managers also track progress closely and provide support/signposting

- in general, the governance arrangements for MEIF appear to be working well, with appropriate representation and good engagement on the governance boards. The Fund was also seen to be managed well by the Bank, with robust processes in place and local presence. However, there is scope to strengthen marketing activities to intermediaries as well as the SME business base.

Implementation challenges

On the whole, feedback on the delivery of MEIF is positive. However, there have been four key challenges in implementation to date:

- there has been a slower than expected deployment of the larger debt funds, which the Bank has addressed with the appointment of the FSE Group to manage £40 million in the West Midlands and East & South East Midlands
- demand for equity is greater than the available funds in some places, especially given the expected demand for follow-on investment in existing beneficiary businesses
- the challenge to balance the pressure to deploy funds quickly and ensuring “good” investments. Both external stakeholders and fund managers commented on the need to get this right
- fund managers commented on their reliance on generating their own demand relative to other sources and referrals.

Environment challenges

There were also 5 “generic challenges” set by the environment in which MEIF operates:

- a lack of investment readiness has been a significant and persistent challenge and was raised frequently as an issue across our consultees. This includes a lack of financial literacy and experience, limited awareness of options and an inability to present propositions (especially outside of large urban conurbations) on the demand side
- a need for greater clarity around how MEIF aligns with wider Midlands Engine agendas and programmes was raised by a number of the consultees involved directly in the delivery of the programme
- many of those consulted commented on the partnership challenges faced by the Midlands Engine region, given a longstanding history of separate east/west governance structures
- skills were identified by stakeholders and fund managers as a key barrier hindering the progress/growth of businesses in the programme (and region more generally) and therefore the potential effectiveness of MEIF
- finally, the uncertainty around Brexit has led to some reluctance to invest. The effects also filter down from prime firms, limiting investment in supply chains.

Implications for the MEIF interim assessment

Generally, the evaluation process has worked well and produced evidence on the performance of the Funds. There has been a considerable effort to develop and agree the methodology paper and logic models, which has been peer reviewed by the BEIS Evaluation panel. This forms the basis for the wider evaluation of the Bank's Regional Funds.

We also suggest including additional questions around the low carbon outcomes such as removing waste, increasing recycling and adopting circular economy solutions.

Final reflections

While there is a temptation to compare the performance of MEIF with the emerging findings evaluation of NPIF, we would stress that the two geographies are different and face different challenges. However, taken together the two reports provide some consistent messages about the Regional Investment Funds as a whole. In both cases the rationale for this approach and the design is validated by the survey results and the feedback from stakeholders. The finance provided has been substantially additional and it is largely being deployed to improve the productivity and performance of businesses.

The Midlands Engine is still less recognised than the Northern Powerhouse. While this has provided challenges, it is also an opportunity for the Fund to contribute more to the development of the brand. The Fund provides an important mechanism that allows partners to work and plan together around access to finance, a central element of business and economic development.

It is too early to draw conclusions on the Funds' impacts. This will require evidence of longer term, sustained, improvements in business performance alongside the development of the wider finance landscape, but the indications from the emerging findings, in both reports are encouraging.

Annex A

Regional Programmes Overall Objectives

The higher-level regional programmes logic model provides reference to how the programmes will work overall. This logic model specifies how the performance of the geographic programmes will be assessed against key performance metrics. The objectives are specified within a hierarchy in order to identify the impact pathway as outlined in the 'theory of change', and who is responsible for meeting each objective. The regional programmes contribute to meeting the Bank's own objectives[53], wider Government objectives and in line with the programme using ERDF funding, ERDF reporting measures.

The ultimate objective for the regional programmes is to increase economic growth in line with HMG's wider objective for all business support and access to finance programmes. Economic growth is not a specific target for the Bank but an outcome from the Bank meeting its own objectives of increasing external finance where markets don't work well. Economic growth has a significant time lag and will only emerge after several years, and can only be measured indirectly, using an economic evaluation. The intermediate objectives are the steps along the way that contribute to achieving the ultimate objective and will be measured by programme MI systems and economic evaluations throughout of the life of the programme. The immediate and intermediate objectives contain the core targets set to fund managers to deliver the programme and for the Bank, who has responsibility for managing the regional programmes.

Performance metrics are broken down into objectives and aspirations:

- **Objectives: Measures that determine the success of the programme. These must be met for the programme to be judged to be successful**
- **Aspirations: Measures that are desirable but are not under the direct influence of the programme, eg positive spill-over effects. Failure to achieve an aspiration does not imply the programme has been unsuccessful.**

Colours are used to distinguish between objectives and ambitions within the overall logic model, with blue text being an object, whilst red text signals an aspiration.

[53] The regional programmes all contribute to the following Bank objectives:

- Increase the supply of finance available to smaller businesses where markets don't work well
- Reduce imbalances in access to finance for smaller businesses across the UK

The specific ERDF output indicators are included within the logic model in line with the Bank's obligation to report on ERDF reporting requirements[54]. The geographic programmes contribute to meeting ERDF objectives set out in 2014-2020 European Growth Programme document.

MEIF and the other regional programmes will specifically target and address the following priority areas (ESIF Operational Programme Priority Axis) as specified by the 2014-2020 European Growth programme:

- **Priority Access 1– Promoting Research and Innovation**
- **Priority Access 3– Enhancing the Competitiveness of SMEs**
- **Priority Access 4– Supporting the shift towards a low Carbon Economy in All Sectors**

Measuring the success in achieving immediate and intermediate output measures enable some assessment to be made of efficiency in delivery and which can also aid in the assessment of whether the programme is on track to achieving its ultimate objective.

The higher-level programme level logic model specifies the key performance measures used to assess the overall success of the regional programmes. The logic models for the individual finance types (micro-finance, debt, equity and proof of concept equity) included in this report provides greater detail on the mechanisms by which the regional programme works for each type of finance, <u>but they should not be used to measure the performance of the programme overall</u>.

[54] ERDF is focused on supporting growth in local areas, overcoming market failure and addressing key bottlenecks in specific sectors and geographies. https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/719940/ESIF-GN-1-002_ERDF_Output_Indicators_Definition_Guidance_v6.pdf

Figure A-1: Regional Programmes Higher Level Logic Model: Key Performance Measures (Objectives and Aspirations)

INPUTS	IMMEDIATE OUTPUTS	INDICATOR	INTERMEDIATE OUTCOMES	INDICATORS	ULTIMATE HMG OUTCOME	INDICATOR
EIB loan ERDF allocation The Bank's matching loan BEIS/HMT grant funding (the Bank's running costs) Plus: The Bank's organisational resource and Fund manager resource	**Supply of finance** Increased debt and equity finance available to SMEs in the target areas Increase the fund manager operating resources within the target area	**Supply of finance** Total number and value of investments made by fund for each type of finance: Programme successfully established with fund managers appointed.	**Supply of finance** Increase the supply of finance to viable businesses that would otherwise have problems raising finance	**Supply of finance** Finance flows to SMEs in target area narrowed compared to London Leverage additional private sector funding at time of funding and future funding rounds: C7: Private investment matching public support to enterprises (Private Sector Leverage) Increased awareness of equity and alternative sources of finance amongst SMEs in target area [measured through the Bank's Business Finance Survey]	To contribute to long term economic growth of target areas through additional economic output or improvements in aggregate productivity of businesses funded (not at the expense of other geographic areas)	The NPV of additional GVA generated by recipient businesses in the target area over the life of the fund should be greater than the economic cost of delivering the fund. Ie economic cost benefit analysis is positive in target area [This will only be measured at the interim and final economic evaluation stage]
	Business Level Businesses use funding to fund growth, innovation or move to low carbon in line with ERDF Priority Axis[55]	**Business Level** The following business indicators are recorded against one of the following 3 Priority Axis: C1: Number of enterprises receiving support (C3 + C4)	**Business Level** Increase performance of recipient businesses Finance enables investment by businesses in R&D, product development	**Business Level** Additional employment increase since receiving funding C8: Employment increase in supported enterprises Propensity to create high quality jobs Finance used to support innovation:		

[55] Each loan, equity investment or non-financial assistance undertaken is recorded against one of the three Priority Axis categories. There are no specific targets for Priority Axis 4. Supporting Low carbon sectors and projects is a by-product of increasing the supply of finance to SMEs.

		C3 Number of enterprises receiving financial support (loans and investments) C4: Number of enterprises receiving non–financial support (12-hour support) C5: Number of new enterprises supported	Increase innovation in, and adoption of, low carbon technologies	C28: Number of enterprises supported to introduce new to the market products C29: Number of enterprises supported to introduce new to the firm products Additional turnover increase since receiving funding Productivity Increase since receiving funding Propensity to export Increase number of high growth businesses in target area		
	Exchequer Related Fund managers selected are best able to cost effectively operate the fund to meet policy objectives Effective management of Portfolio in line with best practice High quality and timely monitoring information reported	**Exchequer Related** Correct and transparent fund application and selection procedures are followed Reporting undertaken to agreed Bank/ MHCLG timescales Write-offs and financial returns in line with expectations Annual operating costs agreed with stakeholders	**Exchequer Related** The target financial performance for geographic funds is comparable to other funds of similar type.	**Exchequer Related** The target financial performance for the funds meets the targets set by Fund managers in their original proposals to the Bank.		

Microfinance loans: £25k-£150k in MEIF

Rationale: Market Failure

There are several well-established market failures affecting the supply and demand for microfinance for start-ups and smaller businesses leading it to be underprovided in the market.

Supply-side:

- Information asymmetries between financial institutions and small businesses on the potential viability of the loan applicant lead to a debt funding gap for businesses seeking microfinance. There are high transactions costs to lenders (relative to the loan amount sought) associated with generating and appraising deal flow and providing lending and aftercare support, which can make it financially unviable for commercial providers to deliver small loan finance.
- There may also be wider social externalities arising from microfinance, where the social returns from small loan finance exceed the private returns available to lenders.

Demand-side market failures and barriers:

- Information gaps:
  - Information failure on the part of potential loan applicants who are unaware of the financing options available and/or have negative perceptions of mainstream finance providers (eg banks).
  - Investment readiness – Entrepreneurs and small business owners may be unable to present their lending opportunities to best effect, which is particularly acute for businesses likely to be seeking microfinance; they are also more likely to lack financial/business management/planning skills typically required to secure commercial finance.

Figure A-2: Logic model – Microfinance loans: £25k-£150k in MEIF

Delivery		Benefits		
Inputs	**Activities**	**Outputs**	**Intermediate outcomes**	**Final outcomes/impacts**

Overall funding of:
• £20.2m* committed to date in NPIF (sourced from CLG/BIS legacy, ESIF, EIB, and the Bank)
• £30m committed in MEIF (sourced from ESIF, EIB, ERDF legacy)
• TBC in CIoSIF (sourced from ERDF)
 	
Plus:
• The Bank organisational resource
• Fund Manager organisational resource
 	
** Note: only 75% of available funding has been committed to date*
	Fund manager activities:
	• Awareness raising of loans and marketing and promotion of microfinance (esp. to start-ups/young SMEs)
	• Pre-application and application support
	• Provision of microfinance loans
	  o £25k-£100k in NPIF
	  o £25k-150k in MEIF
	• Mentoring of applicants
	• Monitoring of activities
	• Technical and credit assessment of applications
	• Contracting between providers and successful applicants
	• Loan book management
	• Monitoring of loans
	
	The Bank activities:
	• Procurement of fund managers
	• Marketing and awareness raising of programme brand
	• Website creation & management
	• High level monitoring
	• Overarching fund of fund management
		Enquiries/applications – conversion rates
		
		Number and value of microfinance loans (£), gross
		
		ERDF outputs:
		• C1 – Number of enterprises receiving support
		• C3 – Number of enterprises receiving financial support other than grants
		• C4 – Number of enterprises receiving non-financial support
		• C5 – Number of new enterprises supported
		• C7 – Private investment matching public support to enterprises (non-grants), equivalent to private sector leverage
		
		Geographical spread of lending across LEP areas
			For business beneficiaries:
			
			Additionality of finance secured (full and partial)
			
			Leading to additional investment in:
			• business start up
			• expansion
			• internationalisation
			
			• Leading to additional:
			  • new firm start-up and survival
			  • new products/services (C28/29) and processes
			  • new jobs created (MI data/ERDF output - C8)
			  • leverage of co-investment and follow-on funding.
			
			For Eco-system:
			• Increase in the number of alternative sources of finance amongst SMEs in target areas.
			
			For the Bank:
			• Interim repayments on loans (MI data)
				For business beneficiaries
				• Business growth:
				  • Impact on turnover and employment, including new and high quality jobs created
				
				For the regions
				• Economic growth in target area as measured by increases in business GVA
				
				For Eco-system:
				• A better functioning and sustainable finance ecosystem in target areas.
				
				For the Bank:
				• Meet expected level of write offs and financial return

Lending: 2017-2021 Portfolio management up to 2026		Intermediate outcomes potentially from 2-3 years after lending through to 5-10 years after lending Final outcomes: 5-10 years (+) after lending		

Source: SQW, drawing on documentation and scoping consultations with the Bank

Debt: Later stage loans from £100k-£1.5m (MEIF)

Rationale: Market Failure

Market failures exist in the supply of and demand for debt finance, which can prevent some viable businesses from raising finance. A lack of access to debt finance can be a barrier to growth potential SMEs.

Supply-side market failures and barriers:

- Information asymmetries between financial institutions and small businesses lead to a debt funding gap for businesses looking to grow. To avoid the costs associated with gathering this information, lenders often require borrowers to provide evidence of a financial track record and/or collateral to act as security for the loan. Therefore, a market failure exists because the financial institution's decision to lend is based on collateral and track record, rather than the economic viability of the business. This is particularly the case for new, innovative or creative businesses activities which do not have a proven track record or enough collateral to use as security or fit outside of bank's existing lending criteria (and which require further verification).

Demand-side market failures and barriers:

- Information gaps:
    - SMEs do not fully understand the benefits of accessing finance for growth (preferring to grow from retained profits)
    - Unable to present investment opportunities to best effect. These issues are particularly acute for smaller growth businesses with limited financial/business management/planning skills required to secure commercial finance.

Figure A-3: Logic model – Debt: later stage loans from £100k-£1.5m (MEIF)

Delivery		Benefits		
Inputs	**Activities**	**Outputs**	**Intermediate outcomes**	**Final outcomes/impacts**

Overall funding of:
• £153.8m* committed to date in NPIF (sourced from CLG/BIS legacy, ESIF, EIB, and the Bank)
• £90.91m committed in MEIF (sourced from ESIF, EIB, ERDF legacy)
• TBC in CIoSIF (sourced from ERDF)
	Fund manager activities:
	• Awareness raising of loans and marketing and promotion of later stage debt for growth (targeting established SMEs with high growth potential)
	• Pre-application and application support
	• Provision of later stage loans
	  o £100k-£750k in NPIF
	  o £100k-£750k in MEIF
	• Mentoring of applicants
	• Monitoring of activities
	• Technical and credit assessment of applications
	• Contracting between providers and successful applicants
	• Loans and guarantee book management
	• Monitoring of loans
		Enquiries/applications – conversion rates
		Number and value of later stage loans (£), gross
		ERDF outputs:
		• C1 – Number of enterprises receiving support
		• C3 – Number of enterprises receiving financial support other than grants
		• C4 – Number of enterprises receiving non-financial support
		• C5 – Number of new enterprises supported
		• C7 – Private investment matching public support to enterprises (non-grants), equivalent to private sector leverage
			For business beneficiaries:
			Additionality of finance secured (full and partial)
			Leading to additional:
			• expansion
			• investment in skills, R&D, production and process development
			• internationalisation
			• Leading to additional:
			  • new products/services (C28/29) and processes
			  • new jobs created (MI data/ERDF output - C8)
			  • exporting
			  • leverage of co-investment and follow-on funding.
				For business beneficiaries:
				• Business growth:
				  • Impact on turnover and employment, including new and high quality jobs created
				  • Efficiency/productivity/probability
				  • Additional scale up businesses
				For the regions
				• Economic growth in target area as measured by increases in business GVA
				• Number of high growth businesses
				• Supply chain impacts and knowledge spillovers from R&D activity
				• Reduce regional economic performance gap with London

Plus: • The Bank organisational resource • Fund Manager organisational resource	The Bank activities: • Procurement of fund managers • Marketing and awareness raising of programme brand • Website creation & management • High level monitoring • Overarching fund of fund management	Geographical spread of lending across LEP areas	For Eco-system: • Increased awareness of alternative sources of finance amongst SMEs in target areas	For Eco-system: • A better functioning and sustainable finance ecosystem in the regions
** Note: only 75% of available funding has been committed to date*			For the Bank: • Interim repayments on loans (MI data)	For the Bank: • Meet expected level of write offs and financial return
Lending: 2017-2021 Portfolio management up to 2026		Intermediate outcomes potentially from 2-3 years after lending through to 5-10 years after lending Final outcomes: 5-10 years (+) after lending		

Source: SQW, drawing on documentation and scoping consultations with the Bank

Later stage equity, £50k-£2m (MEIF)

Rationale: Market Failure

Access to equity finance for innovative high growth potential SMEs varies greatly across the country with evidence that this is a result of both supply and demand failures, and their interaction causing a thin market. Specifically:

Supply-side market failures and barriers:

- Imperfect information – Assessing the quality of SME proposals and associated risks is difficult and leads the investor to incur transaction costs of undertaking due diligence. These transaction costs are generally fixed and do not greatly vary with the size of the equity deal. Transaction costs are therefore higher as a proportion of smaller deals. These due diligence costs are proportionally higher when fund managers are based in different geographies from where their investments are located due to additional time and travel costs.
- Strong network externalities lead to clusters[56] of equity activity concentrated in London and the South East, which makes it difficult for them to develop elsewhere. Although clusters of deals activity are developing in the NPIF and MEIF areas, it is still relatively low which makes it more difficult for markets to function.
- Private investors cannot capture the positive spill over effects (externalities), eg innovation and knowledge transfer that are associated with young innovative companies. If left to the private sector, these are underprovided by the market.

Demand-side market failures and barriers:

- Information gaps:
    - SMEs do not fully understand the benefits of using equity to unlock growth (preferring to grow from retained profits)
    - Unaware of how/where to access equity or the likely success of securing it
    - Unable to present investment opportunities to best effect [issues particularly acute for smaller growth businesses with limited financial/business management/planning skills required to secure commercial finance].

This leads to underinvestment in potential high growth SMEs, holding back their growth and the economic performance of the region.

[56] Equity deals tend to be grouped into geographic clusters where innovative companies, skilled labour and equity investors locate close together. SBFM 2016/17 showed this was also the case for the US where 60% of all US VC deals (78% by investment value) in 2015 were made in just three states (California, New York and Massachusetts)

Figure A-4: Logic model – Early stage and later stage equity, £50k-£2m (MEIF)

Delivery		Benefits		
Inputs	**Activities**	**Outputs**	**Intermediate outcomes**	**Final outcomes/impacts**

Overall funding of:
• £116.75m committed to date in NPIF (sourced from CLG/BIS legacy, ESIF, EIB, and the Bank)
• £69m committed in MEIF (sourced from ESIF, EIB, ERDF legacy)
• TBC in CIoSIF (sourced from ERDF)
 	
Plus
• The Bank organisational resource
• Fund Manager organisational resource
	Fund manager activities:
	• Awareness raising and promotion of equity investment among SMEs, intermediaries and investors (esp. high growth potential)
	• Pre-application and application support
	• Provision of equity investment
	  o £50k-2m in NPIF
	  o To £2m in MEIF
	• Mentoring of potential investees
	• Monitoring of equity landscape
	• Technical and credit assessment of potential investments
	• Contracting between investors and successful SMEs
	• Investment book management
	• Monitoring of equity investments
	• Mentoring of investee businesses
		Enquiries/applications – conversion rates
		
		Number and value of equity investments (£), gross
		
		ERDF outputs:
		• C1 – Number of enterprises receiving support
		• C3 – Number of enterprises receiving financial support other than grants
		• C4 – Number of enterprises receiving non-financial support
		• C5 – Number of new enterprises supported
		• C7 – Private investment matching public support to enterprises (non-grants), equivalent to private sector leverage
		
		Geographical spread of funding across LEP areas
			For business beneficiaries:
			
			Additionality of finance secured (full and partial)
			
			Leading to additional:
			• expansion
			• investment in skills, R&D, production and process development
			• development and application of low carbon technologies
			• internationalisation
			• management capability
			
			Leading to additional:
			• New products/services (C28/29) and processes
			• TRL progression towards commercialisation, IP etc
			• New jobs created (MI data/ERDF output - C8)
			• Exporting
			• Leverage of follow-on and co-investment funding.
				For business beneficiaries:
				
				• Business growth:
				  • Impact on turnover and employment, including new and high quality jobs created
				  • Productivity
				  • Profitability/firm value
				
				For the regions:
				• Economic growth in target area as measured by increases in business GVA
				• Number of high growth businesses
				• knowledge spillovers from R&D activity
				• Reduce regional economic performance gap with London

			For Eco-system: • Increased awareness of equity finance amongst SMEs in target areas • Overall growth in follow-on and co-investment funding	For Eco-system: • A better functioning and sustainable finance ecosystem in the regions
** Note: only 75% of available funding has been committed to date*	The Bank activities: • Procurement of fund managers • Marketing and awareness raising of programme brand • Website creation & management • High level monitoring • Overarching fund of fund management		For the Bank: • Value of equity (MI data)	For the Bank: • Meet expected level of write offs and financial return
Lending: 2017-2021 Portfolio management up to 2026		Intermediate outcomes potentially from 2-3 years after lending through to 5-10 years after lending Final outcomes: 5-10 years (+) after lending		

Source: SQW, drawing on documentation and scoping consultations with the Bank

PoC early stage equity funding up to £750k (MEIF only)

Access to equity finance for innovative high growth potential SMEs varies greatly across the country with evidence that this is a result of both supply and demand failures, and their interaction causing a thin market. Specifically:

Supply-side market failures and barriers:

- Imperfect information – Assessing the quality of SME proposals and associated risks is difficult and leads the investor to incur transaction costs of undertaking due diligence. These transaction costs are generally fixed and do not greatly vary with the size of the equity deal. Transaction costs are therefore higher as a proportion of smaller deals. These due diligence costs are proportionally higher when fund managers are based in different geographies from where their investments are located due to additional time and travel costs.
- Strong network externalities lead to clusters[57] of equity activity concentrated in London and the South East, which makes it difficult for them to develop elsewhere. Although clusters of deals activity are developing in the MEIF area, it is still relatively low which makes it more difficult for markets to function.
- Private investors cannot capture the positive spill over effects (externalities), eg innovation and knowledge transfer that are associated with young innovative companies. If left to the private sector, these are underprovided by the market.

Demand-side market failures and barriers:

- Information gaps:
    - SMEs do not fully understand the benefits of using equity to unlock growth (preferring to grow from retained profits)
    - Unaware of how/where to access equity or the likely success of securing it
    - Unable to present investment opportunities to best effect [issues particularly acute for smaller growth businesses with limited financial/business management/planning skills required to secure commercial finance].

This leads to underinvestment in potential high growth SMEs, holding back their growth and the economic performance of the region.

[57] Equity deals tend to be grouped into geographic clusters where innovative companies, skilled labour and equity investors locate close together. SBFM 2016/17 showed this was also the case for the US where 60% of all US VC deals (78% by investment value) in 2015 were made in just three states (California, New York and Massachusetts)

Figure A-5: Logic model – PoC early stage equity funding up to £750k (MEIF only)

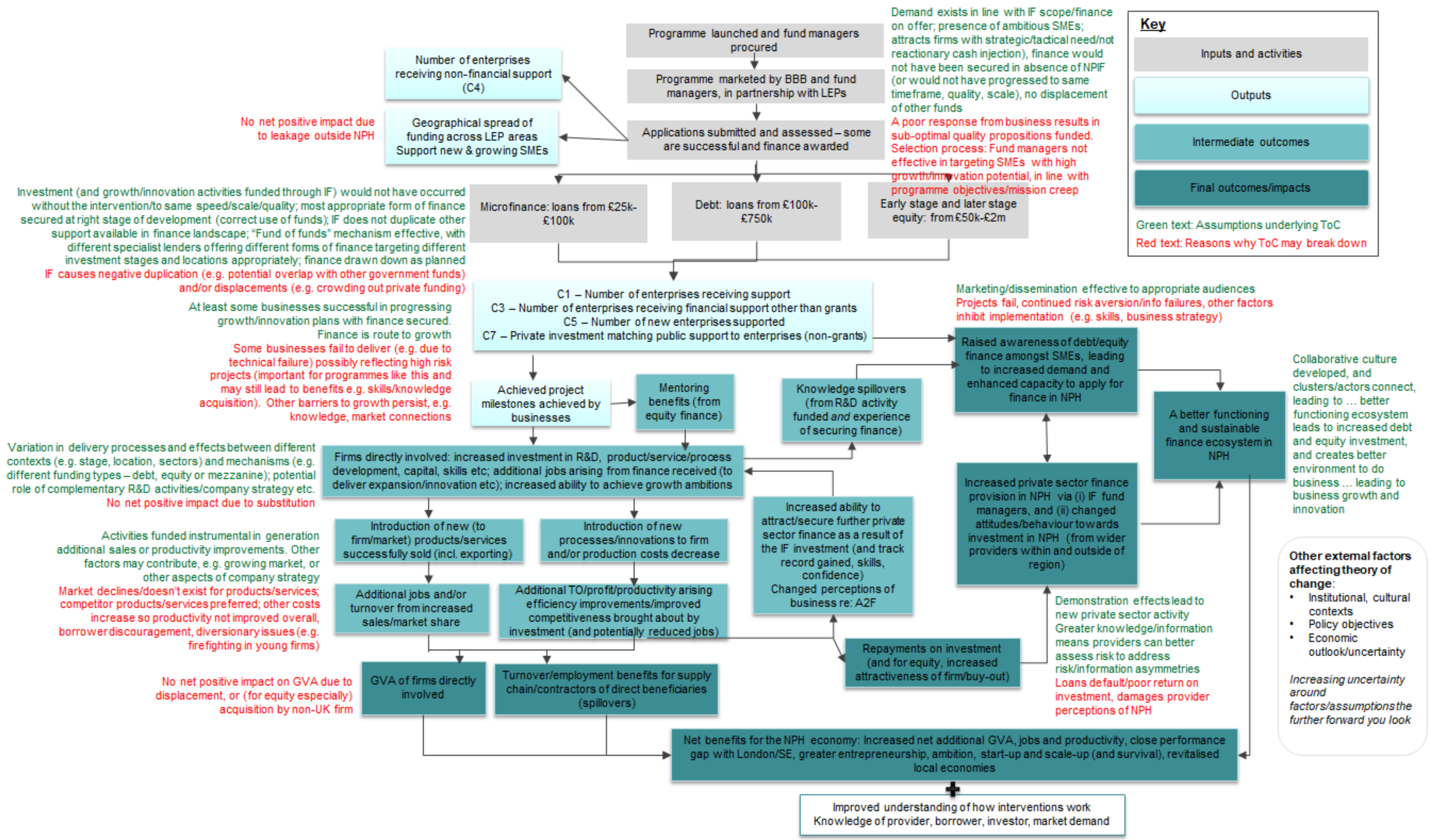
Delivery		Benefits		
Inputs	**Activities**	**Outputs**	**Intermediate outcomes**	**Final outcomes/impacts**

Overall funding of:
• £23m committed in MEIF (sourced from ESIF, EIB, ERDF legacy)
 	
Plus:
• The Bank organisational resource
• Fund Manager organisational resource
	Fund manager activities:
	• Awareness raising and promotion of PoC equity investment among SMEs, intermediaries and investors
	• Pre-application and application support
	• Provision of equity investment
	  ○ To £750k in MEIF
	• Mentoring of potential investees
	• Monitoring of equity landscape
	• Technical and credit assessment of potential investments
	• Contracting between investors and successful SMEs
	• Investment book management
	• Monitoring of equity investments
	• Mentoring of investee businesses
		Enquiries/applications – conversion rates
		
		Number and value of equity investments (£), gross
		
		ERDF outputs:
		• C1 – Number of enterprises receiving support
		• C3 – Number of enterprises receiving financial support other than grants
		• C4 – Number of enterprises receiving non-financial support
		• C5 – Number of new enterprises supported
		• C7 – Private investment matching public support to enterprises (non-grants), equivalent to private sector leverage
		
		Geographical spread of funding across LEP areas
			For business beneficiaries:
			
			Additionality of finance secured (full and partial)
			
			Leading to additional investment in:
			• investment in R&D, product development and testing, market testing
			• development and application of low carbon
			• management capability
			
			Leading to additional:
			• Prototypes, demonstrators
			• TRL progression towards commercialisation, IP etc
			• New products/services (C28/29) and processes
			• New jobs created (MI data/ERDF output - C8)
			• Exporting
			• Leverage of co-investment and follow-on funding.
				For business beneficiaries:
				
				• Business growth:
				  • Impact turnover and employment, including new and high quality jobs created
				  • Firm value
				
				For the regions
				• Economic growth in target area as measured by increases in business GVA
				• knowledge spillovers from R&D activity
				• Reduce regional economic performance gap with London

	The Bank activities: • Procurement of fund managers • Marketing and awareness raising of programme brand • Website creation & management • High level monitoring • Overarching fund of fund management		For Eco-system: • Increased awareness of equity finance amongst SMEs in target areas • Overall growth in follow-on and co-investment funding For the Bank: • Value of equity (MI data)	For Eco-system: • A better functioning and sustainable finance ecosystem in the regions For the Bank: • Meet expected level of write offs and financial return
Lending: 2017-2021 Portfolio management up to 2026		Intermediate outcomes potentially from 2-3 years after lending through to 5-10 years after lending Final outcomes: 5-10 years (+) after lending		

Source: SQW, drawing on documentation and scoping consultations with the Bank

Figure A-6: Theory of Change



Source: SQW, drawing on documentation and scoping consultations with the Bank

Logic model clarifications

Fund type focus	Outcome indicators	Source / description
For businesses		
All	Additionality of finance secured	Measured through business survey (what proportion would have been secured from other sources)
All	R&D, product development and testing, market testing	From business survey – Has the funding led to new R&D investment, new product development and/or testing
All	Management capability	From business survey – impact on perceived management capabilities
PoC	New prototypes, demonstrators	From business survey – has the firm developed new prototypes or demonstrators
Early stage debt, equity and PoC	TRL progression towards commercialisation, IP, licensing	From business survey record new IP and progress through TRLs
All	New products/services (C28/29) and processes	From business survey – new products/services or processes
All	New jobs created (MI data/ERDF output - C8)	From business survey – has funding led to increase in employment
All	Exporting	From business survey – has funding led to new exports
All	Leverage of follow-on and co-investment funding	From business survey and FMs – has funding led to further follow on investment (report value and type)
Microfinance	Number of new firm start-ups	From business survey – has funding enabled start up
All debt	Number of firms surviving	From business survey – has funding enabled survival
Microfinance	Investment in start ups	From business survey and FM feedback
All debt	Working capital	From business survey – has funding been used for working capital

Fund type focus	Outcome indicators	Source / description
All	Expansion projects, premises, assets, etc.	From business survey – has funding been used for expansion projects
All	Investing in new skills	From business survey – has funding been used for training
For Eco-system		
Equity, PoC	Greater awareness of equity among SMEs, providers and intermediaries	Consultations with FMs and other stakeholders – has the Funds activities changed willingness to consider offering and selling equity more widely
Later stage debt	Greater awareness of later stage debt among SMEs, providers and intermediaries	Consultations with FMs and other stakeholders – has the Funds activities changed willingness to consider offering and taking on later stage debt
Microfinance	Greater awareness of microfinance debt among SMEs, providers and intermediaries	Consultations with FMs and other stakeholders – has the Funds activities changed willingness to consider offering microfinance debt
All	Increase in the number of investors and value of investments for each type of finance	Data from the Bank together with feedback from FMs and stakeholders on number and value of investments made compared with pre-Fund
All	Reduced funding gap for potential high growth firms	Data from the Bank's surveys, consultations with FMs and other stakeholders
Equity	Stronger demand from firms for equity investment	Consultations with FMs and other stakeholders – has the Fund changed demand for equity deals. Also, data from the Bank/Beauhurst on number of deals
All	Increased diversity of funding options for SMEs	Data from the Bank's surveys, consultations with FMs and other stakeholders on whether range of options has developed over time
All	Better investment cases put forward by SMEs	Consultations with FMs and other stakeholders on quality of cases

Fund type focus	Outcome indicators	Source / description
All	For the Bank's Value of equity (MI data)	Value of equity from the Bank's monitoring data
Business growth		
All	Impact on GVA/ turnover/employment, including high(er) quality jobs	Business survey and econometrics to determine change in GVA, turnover and employment attributable to the funding Use data from business survey to evidence types of jobs created
Not priority for microfinance and PoC	Impact on productivity	Use econometrics to determine changes in ratio of GVA to employment among beneficiary firms
At regional level		
All	GVA, jobs and productivity	ONS data for areas
All	Number of new, start up businesses	BEIS business data
All	Number of scale up businesses	ONS
All	Supply chain impacts and knowledge spillovers from R&D activity	Use data from business survey to determine whether spillovers within the region are likely (not quantified)
All	Narrow regional performance gap with London and SE	Compare ONS data
All	Narrow finance gaps with London and South East	Data from the Bank's surveys
All	A better functioning and sustainable finance ecosystem in the regions with:	Data from the Bank's surveys, consultations with FMs and other stakeholders -
Equity	Meet target return for the Bank and fund managers	From the Bank's Monitoring data

Fund type focus	Outcome indicators	Source / description
All debt	Interim repayments on loans (MI data)	From the Bank's Monitoring data

Annex B

Beneficiary survey – additional information

Age sample structure based on beneficiary survey responses (n=63)

Age of business	Survey sample: Debt	Survey sample: Equity	Survey sample: Total
1 to 5 years	56%	45%	52%
6 to 9 years	16%	35%	22%
10 years or more	28%	20%	35%
Base	43	20	63

Source: SQW survey base = 63

Non-beneficiary survey – additional information

Non-beneficiary respondents were predominantly C4s (non-financial support). However, there was coverage across all fund managers in the sample.

	Survey respondents (n=28)		Sample available for survey (n=195)		Overall population (n=480)	
	Count	%	Count	%	Count	%
Equity finance	6	21%	17	9%	216	45%
Debt finance	2	7%	96	49%	112	23%
Non-financial	20	71%	82	42%	152	32%
Total	**28**	**100%**	**195**	**100%**	**480**	**100%**

*Source: SQW survey base = 28. *Note some non-beneficiaries have applied for both debt and equity*

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