ICAEW

REPRESENTATION 42/18

EUROPEAN AND STRUCTURAL INVESTMENT FUNDS INQUIRY

Issued 13 April 2018

ICAEW welcomes the opportunity to comment on the European and Structural Investment Funds inquiry published by the Economy, Jobs and Fair Work Committee of the Scottish Parliament on 15 February 2018, a copy of which is available from this link.

This response of 13 April 2018 has been prepared on behalf of ICAEW by the Corporate Finance Faculty, drawing also on views of members operating in Scotland.

Recognised internationally as a source of expertise on corporate finance issues and for its monthly Corporate Financier magazine, the Corporate Finance Faculty is responsible for ICAEW policy on corporate finance issues including submissions to consultations. The Faculty's membership is drawn from professional services groups, advisory firms, companies, banks, private equity, brokers, law firms, consultants and academics.

ICAEW Scotland has over 1,500 members who live and work in Scotland. ICAEW Scotland represents the views of ICAEW members who work in Scotland for local, national and international organisations across the private and public sectors.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 150,000 chartered accountant members in over 160 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

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Focus of response

1. ICAEW has a strong record in helping support UK businesses to access the right form of finance for their stage of growth - both by way of policy work and directly through our members who operate, advise or invest in businesses across the home nations. On the theme of future programmes, we share relevant recommendations we have made for UK national policy (paragraphs 7 to 12). On the theme of current processes and spending, we refer to feedback from members regarding European Structural and Investment Funds (ESIFs) in Scotland (paragraphs 3 to 5).

2. Together with this response we are submitting an informative article on the backing from the European Investment Fund (EIF) for venture capital investment in the UK. This was commissioned by and published in Corporate Financier, the magazine of ICAEW's Corporate Finance Faculty. It may be of interest to the Committee's consideration of future replacement programmes for ESIFs that our members describe the EIF as an excellent investor and cite, in particular, its stringent diligence and how it understands both the businesses and the funds deploying the money.

Current processes and spending

3. The most well-known ESIF among our members who invest in or advise businesses in Scotland is the European Regional Development Fund (ERDF). ERDF investment is considered critical to helping prepare businesses' infrastructure for investment readiness. There is a concern that there is no obvious source for such business support (apart from the UK government) when ERDF investment ceases.

4. Our members commented mostly on the Scottish Co-investment Fund, which is partly funded by ERDF. It is delivered by the Scottish Investment Bank, together with accredited investment partners, a list of which is published. However within our advisory and investment member firms we found little awareness of how such public funding is used overall and they would like to see better reporting of how the funds are used both at investment partner and individual investment level.

5. Qualifying enterprises for EU support programmes must meet the EU definition for SMEs[1], which focuses on staff headcount and either turnover or balance sheet total. We highlight challenges associated with the definition:

    - early stage businesses with high growth potential may easily breach the upper headcount (250) within a very short period;
    - the data that need to be considered and assessed against the thresholds (and in which quantities or proportions) will depend on whether the business is an autonomous enterprise, a partner enterprise or a linked enterprise. Different rules for consolidation can result in a business being 'promoted' in some instances to a larger category;
    - the details underlying the definition can be difficult to interpret.

Future programmes

6. We recently made submissions to the UK government's Green paper on industrial strategy[2] and to the proposals Financing growth in innovative firms[3], both of which

[1] What is an SME?
[2] View our response, in particular paras 1-8 and 68-69
[3] View our response

have explored whether and to what extent to replace investment in the UK made by international financial institutions such as the EIF and the European Bank for Reconstruction and Development. Much of the Scottish evidence and the Committee's conclusions on this inquiry should be helpful to the UK government's support programmes.

7. Consistent with comments in our submission on the UK's industrial strategy, we think that directing replacements for ESIFs must be informed by an investment strategy so that financing is channelled into sectors and businesses with the potential to create the biggest long-term benefit. Intelligent distribution can be achieved by reference to an investment strategy which identifies key sectors and any gaps in the effective supply of capital to these, and areas of economic development. The absence of the restrictions of ESIF conditions presents an opportunity to involve industry experts in setting criteria for qualifying businesses and the period within which funds must be invested. The type of gap analysis and measurement that will determine distribution of replacement funds or programmes should be considered as soon as possible to ensure that the data that will be needed is available in 2023 when funding ends.

8. While the Scottish government has committed to pass on the UK government's guarantees in full to Scottish stakeholders, replacement of those ESIF investment activities that meet strategic priorities is time sensitive as high-growth companies, in particular, will also be attractive to investors from outside Scotland and the rest of the UK.

9. Replacement funds or programmes may include a mix of fiscal incentives and grants, direct investment and public-private investment. What will be appropriate will depend on the sectors they are intended to support and efficiency in the supply and demand for capital in those sectors (including UK government support).

10. Transparent investment parameters and reporting are key, in addition to having clear investment priorities. For example, direct investment options must include clear parameters so that they lead to a genuine increase in the variety and supply of funding and avoid displacing existing investors and funding. Public-private options, on the other hand, must include clear conditions for exit.

11. There is an opportunity to develop the terms of a future funding agreement with investment partners that is not prescribed by the ERDF template, such that the requirements and administrative obligations on the manager are not disproportionate.