Closing the finance gap: VCT funding for SMEs

VCT investment activity 2000-2010

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1 Executive summary

The Association of Investment Companies (AIC) has surveyed Venture Capital Trust (VCT) managers on the nature of VCT investment over the last decade. 13 VCT managers responded, representing 65% of the sector by assets.

The AIC urges the British Government to engage with the European Commission in order to renegotiate the State Aid rules and increase the investment flexibility of the VCT scheme. This will allow VCTs to better address the finance gap and support growth among Britain’s small and medium-sized enterprises (SMEs).

The current £7 million ‘gross assets test’ for eligible investee companies restricts potential VCT investment. A significant number of companies larger than the current threshold face a finance gap. The AIC found that 38% of companies previously funded by VCTs would have been denied support under the current assets test. The AIC therefore recommends increasing the £7 million ‘gross assets test’ to a £15 million ‘balance sheet total test’.

The current limits prohibit an investee company receiving more than £2 million of assisted funding in a single year. This rule would have prevented at least 24% of companies helped in the last 11 years from receiving the investment they needed. The AIC recommends increasing the current limit from £2 million to £5 million.

The current 50 employee ‘headcount test’ would have prevented 37% of companies in the sample receiving VCT funding. This test prevents investment in SMEs able to sustain high levels of employment and acts as a disincentive to hire new workers. The AIC recommends increasing the ‘headcount test’ from 50 to 250.

The survey indicates that the pending change to the split between equity and debt included in investments will disrupt VCT activity. The AIC recommends reverting to an equity/debt split of 30:70. Any equity requirement higher than 50% has the potential to hinder the ability of VCTs to reach mutually agreeable funding arrangements with potential investee companies.

Since the scheme began in 1995, there has been no change to the limit of £1 million which a VCT can invest in a single company in a single year. The AIC recommends that this limit be increased to £1.5 million.

Demand for VCT investment has remained consistently high since 2000. A finance gap has existed throughout the period and continued demand for VCT funding indicates that it remains an important issue for SMEs in current market conditions. Making the AIC’s recommended changes will maintain the ability of VCTs to support companies with unrealised potential to deliver growth for the UK.

Selected case studies illustrating the experience of VCT investment for SMEs, and the potential impact of recent restrictions on VCT investment flexibility, can be found in Annex A.
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2 Introduction

The Association of Investment Companies (AIC) is the trade association for the closed-ended investment company sector. The Association counts 91 Venture Capital Trusts (VCTs) among its members which have approximately £2.2 billion of assets under management. This represents over 90% of the VCT sector by assets.

The AIC is seeking various changes to the VCT investment rules to allow the sector to better meet the funding needs of smaller UK businesses. In particular, it recommends:

- Replacing the £7 million ‘gross assets test’ with a £15 million ‘balance sheet total test’;
- Increasing the ‘headcount test’ from 50 to 250;
- Increasing the amount portfolio companies can receive from VCTs in a single year from £2 million to £5 million;
- Changing the required split between equity and debt on a VCT’s portfolio (for funds raised from April 2011) from 70% equity and 30% debt to 30% equity and 70% debt;
- Increasing the amount which a single VCT can invest in a portfolio company in each year from £1 million to £1.5 million.

The investment record of VCTs over the last 10 years shows that a significant number of businesses which would breach current conditions (i.e. have gross assets over £7 million, more than 50 employees and seek more than £2 million investment per year etc.) have sought support from the sector. This is despite the fact that business finance (including bank lending) was more easily accessible prior to 2008 than it is currently. These findings support the case for the European Commission to allow the AIC’s recommended changes to the VCT rules.

The AIC collected data from 13 VCT managers. Between them they manage 65% of the sector’s assets. These managers provided details of £1.3 billion of qualifying investments made in 753 smaller UK companies since 2000.1 This represents a significant injection of capital into businesses facing a funding gap. A breakdown of VCT investments by region of the UK and sector of the economy can be found in Annex B and Annex C respectively. This data demonstrates the reach of the VCT scheme and the type of company which it has supported.

Selected case studies illustrating the experience of VCT investment for SMEs, and the impact which the investments had, were also collected as part of this exercise. These can be found in Annex A.

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1Constraints on the evidence gathering process meant that companies which were in VCT portfolios before 2000 have not been included in this research. The overall level of investment by the sector will therefore have been higher than indicated by the responses. Also, some managers were unable to provide a full data series; this also will have reduced the total amount shown.
3 Amount of investment

The average investment per company was approximately £1.8 million. This sits squarely within the funding gap identified by the Financing a private sector recovery green paper of £250,000 to £5 million. 531 companies received between £250,000 and £5 million, representing around 71% of all companies in the sample. In total, over £990 million was invested in this range, representing around 76% of all funds invested.

The spread of amounts invested in individual companies is illustrated in Figure 1.

Where investments were made at the lower end of the range, recipient companies will have had difficulties in raising finance or else they would not have approached a VCT. VCT funding is not an easy option because of the demands they put on portfolio companies. Alternatively, the planned total funding may have been greater but further funding was not provided because the portfolio company did not perform as required following an initial investment.

Where an investment was made which totalled £5 million or more we anticipate that this will primarily have represented VCTs providing follow-on funding and reinvesting in a successful opportunity. This flexibility is essential to balance the risk/reward ratio of the portfolio.
Where VCTs have provided funds it has traditionally been easier for VCT backed businesses to access other sources of finance, including bank lending. VCTs often help provide a degree of stability to portfolio companies and help the management team hone their business plan in order to secure further finance.

An AIC survey conducted prior to the financial crisis found that, between April 2004 and April 2008, 82 VCT deals (involving £250 million of VCT capital) used bank finance (totalling some £333 million) to complete the deal. This implied that, where VCTs co-invested in this way, each £1 of VCT cash was matched, on average, by bank finance of £1.33p. While this ratio may well have changed as banks have withdrawn from the market and tightened their lending practices since 2008, it is clear that, once invested, VCT finance has the ability to attract additional money to the SME sector.

4 Size of investee company

VCTs included in the survey have been able to invest in smaller businesses with gross assets of up to £15 million. The current rules, changed in 2006, limit VCT capital raised since that date to investment in companies with gross assets of just £7 million.

The AIC’s survey found that 252 companies – or approximately 37% of the sample – had gross assets of more than £7 million at the time of investment. They therefore would not have been eligible for investment under the current rules. This is a significant proportion of the total companies receiving VCT investment and suggests that companies larger than the current £7 million threshold are still facing a funding gap and therefore should be candidates for investment from newly raised VCT capital (particularly given the current tight financial conditions).

The AIC recommends increasing the £7 million ‘gross assets test’ to a £15 million ‘balance sheet total test’. This will allow VCTs to properly respond to the prevailing finance gap.

5 Follow-on investment

Follow-on investment could be required for a variety of reasons including: to reinforce growth; to exploit newly identified business opportunities; to sustain the business through a difficult trading period; or to replace withdrawn bank financing. Follow-on investment is also integral to a VCT’s business model as it allows the fund to ensure that its stake in successful portfolio businesses is not diluted by the introduction of new equity investors. This makes it easier for the risk/reward ratio to be balanced in a way which makes VCTs sufficiently attractive to their target investors.

Over the period, 279 companies (37% of the sample) received total follow-on investment of approximately £260 million. The average size of this follow-on investment was just under £1m per company. Follow-on investment made up one fifth (20%) of all the funds invested in the period.

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2 Some managers were unable to provide data on gross assets, particularly on investments made earlier in the period. Gross asset data has been provided for 685 companies. The analysis in this section is based on this total.
Of the companies which received follow-on investment, 162 received just one further injection of capital. 73 received a second contribution, 20 a third and 24 received four or more rounds of follow-on funding. This distribution is shown in Figure 2.

The greatest number of rounds of investment to any one company during the period was 6 – only 5 companies received funding on this basis.

A VCT can provide follow-on investment for a company in its portfolio, provided the company continues to meet the criteria for an eligible investment. Follow-on funding could be a number of years after initial investment. For example, one portfolio company received an initial investment of £1 million in 2001. It did not receive any further funding from the VCT until a follow-on investment of £200,000 in 2005.

The current restrictions on investment of newly raised VCT capital threaten the process of follow-on investment. Of the 252 companies which exceeded the £7 million gross assets test, 43 of these exceeded the limit while still receiving funding from a VCT. That means that 43 companies (or approximately 15% of companies receiving follow-on investment) were smaller than £7 million on initial investment, but breached the current limit when they received follow-on investment in later years. Other instances of follow-on funding would have been prevented by growing employee numbers in the portfolio company (see "Employee numbers" below).
6 Intensity of investment

As a result of State Aid approval from the European Commission, new VCT funds cannot be invested into a business receiving more than £2 million of assisted funding in a 12 month period.

The data collected by the AIC shows that 182 companies received more than £2 million of VCT funding in any particular calendar year. The review was not able to identify precisely how many investments would have been prevented if the calculation was made on a rolling basis, but it is likely to be even higher than the proportion identified. Even on the current analysis, some 24% of the companies received over £2 million in a calendar year and therefore under the new rules would not have been able to secure all the capital they were seeking.

There is no justification for restricting the pace at which companies are able to secure investment from State Aid sources when there is a strict limit already imposed on the gross assets of any recipient company. The AIC recommends that the £2 million annual investment limit be increased to £5 million.

7 Demand for VCT investment

Companies would not normally apply for VCT funding unless there was no alternative. The process of securing capital from a VCT is challenging. It invariably involves the company’s owners diluting their equity, which is often not their preferred option. This will only be done at a price amenable to the VCT, whose managers are not prepared to overpay. The process will involve significant due diligence and can involve real changes to the business, including the recruitment of individuals to undertake senior management roles. Despite the demanding nature of the process, the appetite for VCT capital has been consistently high over the period.

The AIC has collated data on the number of investment inquiries which nine VCT managers received between 2005 to 2010. The data confirms constant demand for VCT support. The table below shows the numbers of inquiries logged in each year.

<table>
<thead>
<tr>
<th>Year</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
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<tbody>
<tr>
<td>Inquiries logged</td>
<td>3084</td>
<td>2919</td>
<td>3475</td>
<td>2554</td>
<td>2999</td>
<td>3009</td>
</tr>
</tbody>
</table>

This shows that interest in VCT finance continues to be strong as small businesses seek development capital to exploit opportunities created by the current return to more stable trading conditions.

The AIC also collected data on how many inquiries were converted to an actual VCT investment. This showed that the conversion rate over the period was small – around 1.5% in each year. The conversion figures were 1.22% in 2008, 1.78% in 2009, and 1.72% in 2010. This contrasts to 1.59% in

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3 There were variations in how each company recorded this information. For instance, some managers logged all phone inquiries, while others only included potential opportunities once due diligence passed a certain stage.
both 2005 and 2006. Our sample showed a spike in 2007 where the level rose to just over 6%, although it is not certain what factors influenced this variation. However, the overall picture is clear. Even in exceptional years, conversion of inquiries into investment is low. There may be any number of reasons why this is the case. The owners of the potential investee company may not be prepared to accept the price of securing a VCT investor, for example, it may value the company’s equity at a higher price than the VCT manager. Alternatively, the investee company may not meet the investment strategy of the VCT, it may not meet the criteria for VCT investment, or the manager may decide that the proposition is not financially viable.

8 Employee numbers

Since April 2007, VCTs have been unable to invest newly raised funds in companies with more than 50 employees. Since 2000, some 37% of investee companies (or 186 by number) had more than 50 employees at the time of investment. In total, they received approximately £300 million of VCT funding, or approximately 23% of the total invested over the period.4

Had the 50 employee rule applied to the funds invested since 2000 many companies facing a finance gap would have been denied capital. The 50 employee headcount test has no bearing on the nature of companies facing the finance gap.

The AIC recommends that the 50 employee headcount test be raised to 250 – the upper limit of the European Union’s definition of an SME.

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4 A number of VCT managers did not collect data on employees throughout the survey period. Data on employee numbers was secured for 504 companies, the analysis in this section is based on this total.
9 Equity vs. debt

As a result of the State Aid rules of the European Union, VCTs will have to ensure that the overall qualifying portfolio is made up of at least 70% equity investments where funds are raised after April 2011. This is a reversal of the previous position which only requires 30% of a VCT portfolio to be held in equity.

VCT debt investments are risk capital. They are not the same as debt finance from a bank. Interest payments received by VCTs depend upon the investee company’s performance. If portfolio companies do not meet their targets then interest is not paid. VCT debt stands behind bank finance. Bank finance takes precedent when creditors are paid out.

Flexibility in the split between debt and equity is very important for VCT managers as it increases the likelihood that a mutually agreeable deal can be reached with the owners of the company seeking finance. Owners of growing companies can be reluctant to dilute their equity. Often, they prefer a combination of debt and equity to balance their desire to raise capital with their ambition to retain their ownership stake in the company.

The AIC’s research found that, over the period, approximately £670 million was invested as equity and £664 million was invested as debt. This represents a split of 50.2% equity and 49.8% debt. If AIM companies and companies traded on other junior markets are excluded from this calculation, then approximately £406 million was invested as equity and £658 million as debt, representing a split of 38% to 62%. Considering these figures, the AIC recommends that the equity-to-debt ratio requirements be returned to their original level of 30% equity. An equity requirement any higher than 50% has the potential to seriously hinder the ability of VCTs to reach mutually acceptable funding arrangements with potential investee companies.
10 Limit on a single VCT investment

The Government should also reconsider the current rule which restricts a VCT from providing a single company with more than £1 million of finance in any one year. This provision was introduced when the scheme was first launched in 1995. 15 years on, taking into account inflation, an equivalent limit would be around £1.3 million per year. The rules have not been adjusted to take account of this. With this in mind, the AIC recommends that this limit be updated to allow an individual VCT to invest £1.5 million in a particular company in any one year.

Since 2000, VCTs invested more than £1 million but less than £1.5 million in an individual company on 143 occasions. Figure 3 shows that the average investment per company has been in between this range since 2005.

*Figure 3 – average investment per company per year*

Under the current rules, companies seeking more than £1 million in the space of a year from VCTs need to seek funding from more than one VCT. If the limit of £1 million was moved to the higher level of £1.5 million, those 143 investments could have been achieved by just one VCT. This could contribute to lower due diligence costs and, possibly, larger VCTs which will be able to operate on a more cost effective basis. A deal with just one VCT may also be a more natural business arrangement and might further enhance the relationship between the investor and investee.
Acknowledgements

The AIC is grateful to the following managers for their help in preparing this research: Albion Ventures LLP, Beringea LLP, Bluehoney Investors LLP, Climate Change Capital Ltd, Edge Group, Elderstreet Investments Ltd, Foresight Group, ISIS Equity Partners, Matrix Private Equity Partners, Maven Capital Partners, NVM Private Equity, Octopus Investments Ltd, Rensburg Shepherd Investment Managers Ltd.
Annex A: Selected case studies

Prime Care Holdings and Albion Ventures LLP

Prime Care Holdings Ltd (PCH) provides domiciliary care services to some 500 elderly or disabled clients. The services include administering medication as well as help with daily activities such as washing and bathing, meal preparation and help with morning and evening routines. The company also provides palliative care in patients’ own homes. The services are provided from six regional offices focused on the South Coast of England spanning from Hastings in the east to Bournemouth in the west. Approximately 80% of clients are funded by local authorities and PCH is an approved or preferred provider in all the areas it operates. The company employs approximately 250 full and part-time care and administrative staff. PCH differentiates itself by providing a very high quality service, for which it has been awarded the highest level 3 star (“Excellent”) rating from the Care Quality Commission, the industry regulator.

The investment

Albion Ventures LLP (AVL) first invested in PCH in September 2008 when PCH operated from 2 offices in East Sussex, had approximately 240 clients, approximately 120 employees and generated annual revenues of £1.5 million. The initial investment was £1.4 million, which was required to allow the company to reduce existing gearing and to provide working capital for further expansion. The company was unable to source further banking finance at the time and was under pressure from its lenders to reduce its outstanding borrowings. At the time of investment the company was under threat of administration, which would have had a profound impact on its clients and employees. The Albion VCTs invested £0.9 million in secured loan stock and £0.5 million in ordinary equity, taking a 33.9% share in the equity of the company. **Without the loan stock component the Albion VCTs would not have been able to invest as their shareholding would have exceeded 50% and the dilution to the founders would have seriously diminished their motivation to grow the business.**

At the time of the investment Steve Allen, founder and CEO of Prime Care said: “We were looking for the right finance partner to support us in our ambitious growth strategy. [AVL’s] integrated debt and equity package provides the flexibility we need together with the ability to draw further funds in line with the expansion of the business. Coupled with their knowledge and experience in the care sector, we felt that [AVL] offered a very attractive proposition and we are very excited about having them on board.”

Additional funding of £0.6 million was provided in March 2009 and a further £1 million in March 2010 to provide working capital and enable PCH to expand its presence to 6 branches. The total investment of £3 million now comprises £0.9 million of equity (30%) and £2.1 million of loan stock (70%). Since the initial investment the company has doubled in size, as measured by revenues, number of clients and number of employees. Without the additional investment PCH would have run out of cash and not been able to achieve its business objectives.
Had the VCTs been restricted to invest in companies with less than 50 employees only, neither the initial nor the follow-on investment would have happened.

Value added by the VCT

Prior to the initial investment AVL worked closely with the founder to formulate a credible growth strategy for the business and develop the business plan into a fundable proposition. During that process AVL recognised that PCH needed a stronger finance function and that the founders could benefit from mentoring by an individual with experience of growing a business. As part of the transaction process AVL identified and recruited a high calibre full-time finance director and an experienced non-executive chairman. The chairman has been instrumental in defining the roles of the executive team and guiding the team through the expansion of the business. In addition, one of AVL’s partners acts as a non-executive director of the company. AVL introduced proper financial and management reporting to the company, proper budgeting disciplines and a staff performance incentive scheme covering the entire organisation. Through its board seat AVL works with the executive management to shape the strategy of the business and to improve its operational and financial performance. In addition, AVL is helping the company to identify potential acquisition targets in order to accelerate its growth.

Impact of the investment

The immediate impact of the investment has been to initially stabilise the business, which was under threat from its lenders, and then allow it to double in size over a two year period. This has safeguarded the jobs of 120 employees and created a further 130 part-time and full-time jobs. Many of these jobs have flexible working hours allowing those with heavy family obligations to return to work and enter the job market for the first time. PCH works closely with Job Centre Plus, Working Links, Maximus, Skills Training, Shaw Trust and other providers of “back to work” programmes to offer jobs and training to the unemployed. Of the current employees approximately 40 were long term unemployed prior to joining PCH. In addition, Prime Care has embraced the new apprenticeship initiatives promoted by the Government and has already 7 apprentices through Skills Training UK.

The company’s performance incentive scheme encourages its employees to complete NVQ qualifications, which are funded by the company. Since the investment 47 employees have been trained to NVQ Level 2 or higher. PCH has won a number of accolades for its on-the-job training programmes and continuing investment in skills development, including a National Training Award, the South East Business Award for ‘Excellence in Skills and Development’ and the Job Centre Plus Award 2010. PCH was the first social care organisation in the UK to achieve Investors in People Profile status and the Investors in People Silver Award.

Aside from providing job opportunities and the continued investment in staff training through the recession, PCH has expanded its high quality service to now reach some 500 vulnerable people and allow them to maintain their independence in their own homes. Therefore, the investment has also had a significant social impact.
Chess Dynamics Ltd and Beringea LLP

Chess was established as a special purpose machine design engineering business by Graham Beall in 1993. In 2001, Chess was commissioned to design and manufacture a turntable for a portable radar system. Realising that Chess could become a significant subsystem supplier to the defence industry, Mr Beall decided to invest in the design and development of a number of key technology products to fill a gap in the market for sophisticated electro-optical positioners. The company has subsequently become a supplier to many prime defence contractors in the UK and Europe.

The investment

By the end of 2007 turnover had grown to £1.8 million, of which around 50% was exports, with an operating profit of £80,000. However, the growth in turnover had required a significant investment in both fixed assets and working capital. Chess had reached the limit of its overdraft facility of £400,000. It was clear that the business could not continue to grow without the injection of substantial additional capital, which its bank was not prepared to provide.

The bank did, however, introduce the company to an independent consultant, who in turn introduced it to Beringea, the manager of ProVen VCT and ProVen Growth and Income VCT, seeking an investment of £2 million.

The financial projections presented to Beringea by the consultant were poorly prepared and certainly not robust enough to form the basis of a £2 million investment. However, Beringea recognised that Chess had the potential to grow significantly and decided to invest time in helping the company to become “investment ready”. Beringea introduced Chess to an independent interim financial director, with a brief to work with the company’s management to prepare a robust set of financial projections.

Following the production of these projections, Beringea negotiated the terms of an investment from ProVen VCT and ProVen Growth & Income VCT with Mr Beall, the CEO and major shareholder. The investment comprised £750,000 in equity for approximately 30% of the equity, together with £750,000 in secured loan notes. Although Mr Beall was reluctant to cede any equity, he recognised that this was the only way that Chess was going to be able to fulfil its potential.

Value added by the VCT

It was clear to Beringea that although Mr Beall had the ability and drive to lead the business through the next phase of its life, the senior management of the business would need to be strengthened to enable Chess successfully to take advantage of the opportunity for rapid growth.

Following the investment, Beringea arranged for the interim FD who had prepared the financial projections to join the board. A part-time financial controller was also appointed. About a year after the investment Chess recruited a full-time financial director to replace both of these roles.
In addition, Beringea appointed one of its senior investment managers to the board of Chess to work with the executive directors.

Beringea also spent a considerable amount of time finding a non-executive chairman with experience as CEO of a larger defence business to mentor and support Mr Beall. The experience that Chess has been able to draw on as a result of this appointment has been invaluable.

**Impact of the investment**

Following the investment the company was able to invest in additional manufacturing capacity and fixed assets, the development of new products to extend its product range, the recruitment of key additional staff, as well as to finance the increasing working capital requirement of the business.

In the first year following the VCTs' investment, Chess’s turnover doubled, from £1.8 million to £3.6 million. The following year turnover grew by a further 45%, to £5.2 million. The company continues to export a sizeable proportion of its production.

The number of employees has increased from around 26 at the point of investment to 47 in November 2010. Unfortunately, if the number of employees increases by 3 or more people, the VCTs will not be able to provide any additional funding raised under the current VCT rules to support any further expansion of the business. *This could well constrain the growth of the business in the future.*

Despite his initial reluctance to cede equity to the VCTs, Mr Beall now believes that raising equity funding from the ProVen VCTs was “the best thing I ever did!”
CB Imports Group Ltd and Matrix Private Equity Partners

CB Imports Group (CB), trading as Country Baskets, is one of the UK’s leading importers and distributors of floral sundries. It sells a wide range of products (including artificial and dried flowers, glassware, pottery and sundries) to florists and gift shops. It trades from large cash and carry outlets. At the time that Matrix invested, the company had four sites: Leeds, Manchester, Glasgow and Birmingham. As it is a warehouse and retail operation it employs a large number of people – approximately 300 at the time of investment. Turnover is approximately £20m and it makes profits of approximately £2 million.

The investment

The business was founded by a husband and wife team. Unfortunately they were killed in a tragic helicopter accident in 2007. Their shares in the business were then held on trust for a number of beneficiaries. The implication of this was two-fold – firstly the trust was naturally risk averse and did not wish to expand the business; secondly there was no equity in the hands of the management team that took over the running of the business. In order to address these problems, Matrix and the management team invested into the company to enable equity to be released from the trust and also to provide growth capital to expand the business. The objective was to roll out the concept to further outlets across the UK – aiming to open a new site each year.

This transaction was initiated in the mid part of 2009 at a time when there was limited appetite for bank lending. The company also had existing bank debt in the form of mortgages on its premises. The trust was reluctant to take on additional bank debt as they felt that whilst it may enable some cash to be released to the beneficiaries, it would also increase the risk of their key assets. They strongly preferred to have a long-term equity investor.

The company imports most of its product from the Far East. At the time of the deal, the sterling/dollar exchange rate had shown significant volatility. Given the weakness of sterling and concerns about the ability to pass on increased costs in a challenging economic environment in the UK, the company was very concerned about exposing the business to volatile exchange rates and margins, at the same time as having to pay back a committed bank loan.

Value added by the VCT

The ability of the VCT to structure the deal with a high proportion of long term 5 year loan was perceived to be very attractive. It enabled the trust to retain 50% of the business as well as the management team to secure a reasonable 25% stake.
At the time of the investment, Matrix introduced one of its operating partners who was appointed chairman. The individual concerned, Dick Steele, has a strong background in retail. He was previously chairman of Hobbycraft – a very successful rollout of a similar business. That experience was perceived to be invaluable.

**Impact of VCT investment**

The business is trading well and ahead of budget. A new site in Gateshead was opened in January 2010. At the time, there was poor weather in the North of England and the snow created significant trading disruption. Not having to service bank debt in that uncertain period was very useful. Gateshead has steadily shown progress and in the summer, ahead of schedule, the company opened up a sixth site in Bristol. To date, these rollouts have been funded by the original sums invested by the VCTs and cash-flow.

*However, if the VCTs wanted to invest further sums to accelerate the rollout, the investment would not qualify under the current rules for the following reasons:*

- The company would fail under the employment rules. This is unfortunate as the company has the potential to provide a significant number of jobs.

- The company would fail under the gross assets test. The warehouses that the company own have a value of approximately £5 million. It also holds significant stocks of approximately £6 million and has debtors of approximately £2 million. New VCT funds cannot invest in companies with more than £7 million in gross assets.
Inspired Thinking Group and ISIS Equity Partners

Birmingham based Inspired Thinking Group (ITG) provides services that help marketing departments operate more efficiently. This includes outsourced print management services to major retailers and branded businesses including M&S, Punch Taverns and KFC. The business was formed in 2009 by CEO Simon Ward, formerly Commercial CEO of St Ives plc, following the acquisition and integration of three independent Birmingham based marketing businesses. Mr Ward and his team have used their 15 plus years of experience to grow ITG within 12 months into a business with actual revenues for 2010 of £14 million and plans to double that into 2011.

Within its print management services ITG does more than just manage the print supply chain; it works with customers to re-specify what really needs to be printed to save cost at source. ITG also provides highly efficient artwork services and in-store marketing such as events and visual merchandising. All these services combined are already saving some major retailers considerable sums within their marketing departments - enabling them to get more effectiveness out of fixed budgets.

The investment

ISIS Equity Partners (ISIS) invested £3.2 million from the Baronsmead VCTs into ITG in May 2010 to support the acquisition of Total Marketing Services LLP (TMS).

The business had a limited range of bank facilities and had no debt, the start-up having been funded by Mr Ward and the team themselves. The initial proposition of finding funding to acquire TMS and grow was not suitable for the banks and needed to be equity funding.

The team could have funded the acquisition from their own resources. However, having had previous positive experiences of private equity they were keen to bring a partner on board.

The acquisition by ITG of TMS enables the business to enter the fast growing market of workflow management systems. Management will use the combined ITG and TMS as a platform to introduce additional innovative services to their customers with the aim of improving efficiency and effectiveness across all areas of a marketing department.

Mr Ward commented at the time of investment: "ITG is a dynamic, ambitious business that is pushing back the boundaries of traditional marketing. To do this we need an agile business culture and ISIS have supported this culture superbly. Together, we will grow ITG into a market leader".

Value added by the VCT

According to Mr Ward, ISIS has provided much more than the money. In addition to ensuring structure and discipline ISIS situation and sector understanding have been valuable in helping the board develop strategy and, critically, helping the team decide what not to do.
Through previous investments in the marketing services space and with a track record and heritage investing in the consumer retail sector, ISIS was able to demonstrate real empathy and understanding of the market challenges and opportunities ahead of ITG.

“The fact that ISIS has directly relevant experience of similar businesses in similar situations to ITG, only accelerates our progression and adds to our strategic thinking. They also know when to leave us alone to get on with the day job…Private equity ensures structure and discipline throughout the business, in particular in areas of planning and reporting which are important attributes for a growing business”, says Mr Ward.

**Impact of the investment**

The main purpose of the investment was to allow ITG to complete the acquisition of TMS. This has now been achieved. With the help and advice provided by the VCT – but above all the skill and dedication of the entrepreneurs – ITG now has real potential to sustain its strong business growth.

It should be noted, however, that at the time of investment ITG employed 80 people. Thanks to the help which the VCT provided, this is expected to more than double over the next three years. *Under the new eligible investment rules, this investment would have been prohibited as the company exceeded the 50 employee headcount test.*
Annex B: Geographical spread of VCT investment

VCT schemes operate across the UK, with managers based in cities such as Aberdeen, Birmingham, Bristol, Edinburgh, Glasgow, Leeds, Liverpool, London, Manchester and Newcastle. This geographical reach is a major advantage of the scheme.
Annex C: Sector spread of VCT investment

The VCT scheme has proved adept at supporting a wide range of business sectors – including key growth sectors such as advanced manufacturing, biotechnology and information technology.

*Sectorial spread of VCT investments by number*