



**Chartered Accountants Ulster Society  
Response to Consultation on the report of the  
Independent Review of Economic Policy (IREP)**

**16<sup>th</sup> November 2009**



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### **Executive Summary**

We welcome the IREP report and find it to be a comprehensive and valuable document, as well as a timely piece of work considering current economic conditions. We also fully appreciate the amount of work that has been done by the Review panel.

While we do fundamentally agree with most of what the report has to say, there are some areas which we, as Chartered Accountants, feel very strongly about and would like to highlight in our response.

These areas are:

#### **1. Venture Capital, Equity Funding and the Emerging Funding Gap**

- We strongly disagree with the recommendation that Invest NI should disengage in direct involvement with VC Funds.
- We have concerns about the usefulness of the data used to come to this recommendation (BVCA data).
- We are concerned that a funding gap is emerging in Northern Ireland and that reducing Invest NI's role in VC Funding will augment the problem.

#### **2. Funding for Business Expansion**

- We agree that the indigenous sector does need to move away from grant dependency where innovation/R&D is not present, given the reductions in grant availability in the future.
- There will be a need though for INI to develop the internal skills necessary to play a role as a co-funder alongside banks and other sources of commercial funding.
- In relation to international mobile investment, we feel that changes to the support mechanisms available to Invest NI could reduce its ability to compete to attract and retain international companies in Northern Ireland.
- We support the thinking behind an increased focus on R&D and Innovation, but would also acknowledge that Invest NI already has R&D and Innovation support as a key priority.

#### **3. Governance Arrangements**

- We welcome the report's recommendations to speed up the decision making process for major industrial cases.
- We welcome the recommendation that for projects involving financial assistance to industry, ex-post assessments of value for money should be taken on a portfolio basis.

- It is important that we encourage a culture which supports the taking of considered risk.

#### **4. Support for Company Training**

- We believe that the recommendation to reduce support for company training is a negative step. Training, especially for senior managers, is essential to develop the highest quality of leadership within industry.

#### **5. Co-ordination of Economic Policy**

- We support the call for DETI, DEL and Invest NI to work together more effectively.
- We agree that the formation of a ‘Department of the Economy’ could help to create a greater ‘joined up’ approach.
- We support a closer alignment of skills development with economic development.

#### **6. Policies and Programmes for Innovation**

- We broadly support the vision to establish an Innovation and R&D system, and its emphasis at Executive level
- We would consider it essential that the existing strengths, expertise and capacity of the existing universities be taken into consideration in exploring if the Finland VTT model should be adopted
- We would be concerned if the adoption of the VTT model resulted in any reductions in funding towards the existing research capabilities, especially in respect of areas where NI has a leading reputation

#### **7. Executive Economy sub-Committee**

- We support the establishment of a permanent sub-Committee to prioritise action on the economy, but we would stress that the new sub-committee must be focused on leadership and strategy rather than governance.

#### **8. Data Issues/Policy Performance**

- The monitoring of performance is a key role of Invest NI. More effort should be put into tracking of data in order to better judge the agency’s effectiveness.
- There is a need to address the variability of performance at client executive level. There are some exemplary Client Executives within Invest NI and their responsiveness and work ethic should be replicated across the board.

#### **9. Retention of State Aids**

- We fully support the call for DETI and other relevant departments to commence work on preparing a case for retaining state aid limits.

We believe that these areas are critical in affecting the performance of Invest Northern Ireland/ DETI, and on some we disagree with the recommendations outlined in the IREP report. The findings of our members on these areas are outlined in the following report. We hope that these findings will be construed as constructive input into the debate on the development of local economic policy.

## **Introduction**

Chartered Accountants Ulster Society represents some 3,000 Chartered Accountants in industry, practice and in the voluntary and public sectors and is a district Society of Chartered Accountants Ireland, the oldest and largest professional body of Accountants in Ireland.

With the global economy enduring such difficult times, and our local economy facing the fallout from this, it is very timely that the IREP Report should come out now. This presents an opportunity to assess the role of Invest Northern Ireland/ DETI and to instil greater vision into the role of the agency.

The full impact of budgetary pressures locally, with savings to be made and cuts in real terms to the Block Grant, will mean significant alteration to a wide range of programmes. Northern Ireland will have to become more forward-thinking and more dynamic if it is to counter the adverse effects of a second downturn or localised recession, and that must entail change in the way Invest NI/ DETI operates.

We welcome this opportunity to comment on the IREP report and to contribute to the development of an improved approach to economic development in Northern Ireland.

While we have considered the report in full and fundamentally agree with much of what the report has to say, in this response we would like to focus on the key recommendations that we consider to have the greatest impact, either positively or negatively in achieving our shared goal of a sustainable, growing economy.

Our headline view is that while Invest NI's performance since its inception in 2002 should perhaps have been better given the original concept of the agency, we believe that the agency should be given greater freedom to operate.

This includes greater autonomy in relation to delegated authority, a more flexible budgetary regime including End Year Flexibility, and a central role in economic development policy. We believe that this greater support and augmented role for Invest NI would help the agency to deliver better results and a speedier decision making process for major industrial assistance cases.

We would also note that the report does refer to Northern Ireland's GVA performance in relation to other UK regions and with an emphasis that our performance needs to catch up with these regions.

We would like to suggest that while we recognise the reality that Northern Ireland is perceived by many around the world as an emerging economy, our ambition should be to leap frog those other UK regions, and indeed to measure ourselves not only against these UK regions but, considering the larger global picture, to measure ourselves against the Republic of Ireland and other emerging European regions.

## **1. Venture Capital, Equity Funding and the Emerging Funding Gap**

The report calls for Invest NI to disengage its direct involvement with VC Funds. This recommendation is one with which we would strongly disagree. We feel that there is (or more accurately will soon be) both a supply and demand shortfall in terms of VC Funding in Northern Ireland at all levels of the funding lifecycle, and comment further below.

We consider future access to equity funding to knowledge led/technology businesses which are based in Northern Ireland to be crucial, and we believe Northern Ireland is at an early stage in developing the indigenous VC sector here. Therefore, we are very concerned at the recommendations contained in the report and would call for further study and detailed consultation on this matter prior to policy formulation in this regard. VC Funding, particularly at early stage, is very important to idea generation in Northern Ireland and should be increased rather than decreased to enable economic growth.

### **Venture Capital and Private Equity**

The report entitles the discussion “Venture Capital”, but goes on to mix the terms “Venture Capital” and “Private Equity”. These are in fact very different, and great care should be taken in interpreting data which combines the two.

“Venture Capital” is a source of equity finance required when a business venture is at a relatively early stage of its growth and development, likely characterised by high levels of product development and sales/marketing funding requirements relative to existing revenue levels. Indeed a venture may not have started to generate revenue. Venture Capital can range from Seed investments to stages A through C/D, and a venture capital investment is most commonly the only source of funding for the company at this point in its development, as it is unsuitable for bank debt.

“Private Equity” is a source of finance required to grow and develop an existing profitable (or near profitable) business or finance a management buyout/buyin, and the private equity investment is alongside debt finance. Often indeed the debt finance is the larger amount, with the private equity funding the equity gap.

We would be of the opinion that in relation to the core issue of productivity improvement for Northern Ireland in the longer term, venture capital is the more important of the two, and would highlight that the BVCA statistics do not differentiate between venture capital investments and private equity investments made by its members in the data presented, which has been used as a basis for the conclusions drawn. Northern Ireland has indeed had a comparatively low level of MBO/MBI activity (many would argue that given the global credit crunch and economic downturn this is indeed a positive as many MBO/MBI companies have huge unserviceable debt levels today which have led to the destruction of shareholder value with negative economic development consequences) and therefore, the data is too high level to make a meaningful comparison of venture capital activity in Northern Ireland.

## **BVCA data**

The report states that gathering data in respect of VC activity in Northern Ireland is difficult, and we would concur that there is no published study or data that allows a complete picture to be formed.

However, we are concerned that the only data which seems to have been reviewed was that generated from the BVCA. While we have no concerns over the integrity of the BVCA data, clearly it would exclude;

- Investments made by Republic of Ireland based venture capital funds; and
- Investments made by USA based venture capital funds. We are aware of at least \$20m of venture capital investment which has been made in Northern Ireland technology companies in the 2005-2008 period.
- We note also that one major local provider, Crescent Capital, is not a BVCA member and as such all investments made by Crescent are not picked up by BVCA.

Consequently we would highlight our concern that the report is based on an assumed level of venture capital investment which is potentially very understated.

We would consider it realistic, that a more complete picture of the level of Venture Capital investments could be constructed, which would be very useful to the discussion and policy determinations on this source of finance. We would be very much prepared to participate in such an exercise.

## **Deal Flow**

The report draws an important conclusion in respect of the “competition” which exists between funding accessible by private sector businesses from the public sector, through Invest Northern Ireland and others, and that accessible from venture capital sources. We are firmly of the opinion that significantly greater numbers of companies in Northern Ireland would have required to raise funding through venture capital and other private equity sources in the past 10 years, if public sector support (either by way of grant or Preference Shares) had been lower. In our view this has been a very significant factor in the development of the sector here.

Looking at the specific example of Invest NI’s partnership with Crescent Capital, it is important to note that Invest NI’s participation in both Crescent’s funds has been a vital ingredient to encourage the private sector (both locally and from further afield) to invest in Crescent’s funds. Having been through fund raisings for both of these funds, we understand Crescent Capital are firmly of the opinion that the two funds (with combined private sector participation of some £22m) would not have happened without Invest NI’s participation.

There are no VC funds based locally that are backed wholly by the private sector. Previous efforts by fund management groups to raise funds wholly from the private sector have not been successful.

Given the other recommendations and conclusions drawn out in the report, for example the likely reductions in public sector expenditure and the reductions (indeed possibly to zero) in EU approval limits for grants by 2013, it seems inconsistent to us that the report should also recommend Invest NI withdraw from participation in venture capital funds, other than seed funds, at the very point where demand for venture capital will likely increase, to replace the public sources of funds.

We hold a contrary view that it is crucial that Invest NI/ DETI continue with the policy of co-investing in venture capital funds (hence creating a supply of venture capital that is not present otherwise) so as to stimulate the development of the sector here, particularly so in the current economic cycle. In the longer term, we would be very concerned that a venture capital sector will not develop here, and hence a large “gap” in the sources of possible funding for ventures will appear.

We welcome Invest NI’s role in seed funding and see the agency’s role extending up to levels of funding of around £3million to £4million. It is our belief that VC Funds operating outside of Northern Ireland are, at the moment, reluctant to get involved with our smaller market at these lower levels of investment. We believe that there are examples of good local companies which have benefited from Invest NI’s support at this level, and that those companies would have struggled to find funding elsewhere.

The provision of equity is an absolutely crucial requirement in ensuring that Northern Ireland has the building blocks to support the development of a knowledge economy. We feel that there is a need for greater competition in funding for start-up companies, and that a wider range of Northern Ireland companies should be able to access both government and VC Funding. To remove this early stage funding would be a negative step.

## **2. Funding of Business Expansion**

Under the ‘Policy Delivery’ recommendations, the report calls for grants for business expansions not involving innovation and R&D to be phased out and funding be provided by way of subordinate debt or equity. The report does not differentiate in this regard between the indigenous sector and inward investment.

We would accept that there are concerns about repeat assistance, grant culture and indeed ‘deadweight’, particularly in relation to support for indigenous businesses, a sector which will increasingly need to learn to live without grant dependency.

It is our view that the indigenous sector does need to move away from grants where appropriate, and where innovation and R&D is not present. We do need to find ways to make our resources work harder. A more commercial, less bureaucratic approach would be welcome when assessing the expansion opportunities of businesses. The move from grant funding will facilitate the opportunity for Invest NI to move further towards co-partnering with other funding partners, leaving grant funding where innovation and R&D are present. We would however sound a note of caution that Invest NI still has some way to go to fully develop the skills that would complement this approach of becoming a genuine co-funding partner, and the skills necessary, and

the framework within which to make commercially led decisions does not exist as far as we can see today.

We would be concerned in relation to international mobile investment, FDI. We believe that this area is one which needs to be handled very carefully, as changes to the support mechanisms available to Invest NI would likely reduce the agency's ability to compete to attract and retain international companies in Northern Ireland. It is vital that Invest NI has at least the same tools as other economic development agencies around the world, against which it competes, and we would be very concerned that the inability to provide grant funding for business expansion to this group of companies would be a very negative step.

We fully support the thinking behind an increased focus on Innovation and R&D; not enough business plans have a genuine focus on this area. We do, however, recognise that Invest NI has very much improved its schemes in this area, making them more flexible and available to local companies. Indeed Invest NI's own figures show a planned 34% increase in expenditure in support of Research, Development and Innovation schemes over the coming years (*Invest NI Corporate Plan 2008-11*) while Invest NI management has informed the Ulster Society that its R&D support budget has doubled since 2007/08. We would acknowledge that Invest NI already has R&D and Innovation support as a key priority and we believe this should be fully encouraged as it fosters a knowledge based and forward looking economy.

### **3. Governance Arrangements**

The report correctly identifies that Invest NI requires greater freedom to operate, with DETI having less involvement in operational matters, to enable the agency to be more entrepreneurial and responsive to business needs. Indeed, this vision of Invest NI as a nimble and responsive organisation was much heralded at its inception in 2002.

Speed of response and timeliness will become more critical in an international arena that will inevitably become more competitive as regions and national agencies chase ever fewer mobile investments. Likewise, decision-making for existing client companies should be as streamlined as possible. If deficiencies are identified, and the case for funding doesn't stack up, then inform the client company without unnecessary delay, as can sometimes be perceived. Invest NI/ DETI, in being able to act more freely, and hopefully more quickly, has to accept the associated risks.

We welcome the report's recommendations to speed up the decision making process for major industrial assistance cases as we believe that this will help to create a culture which is more accepting of taking calculated risks which have the potential to deliver better results for the local economy.

In particular, we welcome the recommendation that for projects involving financial assistance to industry, ex-post assessments of value for money should be taken on a portfolio basis, thus moving these assessments towards how they might be undertaken in the private sector.

It is important that we encourage a culture which supports the taking of considered risk. Invest NI must be free to take risks where the agency feels that it is commercially justified without being fearful of being severely reprimanded for an isolated wrong decision after the fact.

#### **4. Support for Company Training**

The report calls for a reduction in support for company training, and again we feel that this could be a negative step for the local economy. We believe that training, especially for senior managers is vital to develop the capability of management across Northern Ireland companies. The quality of leadership within industry must be at the highest possible level. As an example we would look to the success that the Republic of Ireland has had with a very well resourced programme of senior management training.

#### **5. Policies and Programmes for Innovation**

IREP calls for the Executive to work to support the development of an Innovation system, with the aim of increasing levels of Innovation and R&D to those of Scandanavia.

We welcome firstly the vision to create such a system, benchmarked against an internationally recognised leading innovation region and not just other regions of the UK, and secondly the emphasis on such initiatives and thinking at Executive level.

In particular IREP recommends that a new institution for commercially-orientated research should be explored in NI, along the lines pioneered by the successful VTT Institute in Finland. We would consider this a very worthwhile analysis, but would highlight that the existing universities have many strengths.

It is our strong belief that the two locally based universities have world recognised expertise (in key areas such as green chemistry and medicine) and also infrastructure to fulfil the role envisaged for commercially-orientated research. It should be acknowledged that Queens University is a member of the prestigious Russell Group of the 20 leading research-intensive universities in the UK and has recently been awarded the **Entrepreneurial University of the Year 2009** (sponsored by the National Council for Graduate Entrepreneurship).

Queens University is one of the leading universities in the UK for the establishment of spin-off companies in terms of both revenue generated and jobs created. We should be building upon the growing reputation and specialist capabilities of our home based Universities for research, and encouraging greater co-operation with the business sector, to fully exploit the commercial applications of the research capabilities already established. An internationally recognised and respected University is a key requirement for attracting and retaining talent and rather than

diluting this we should be seeking to enhance the reputation and commercial contributions of our existing Universities.

Given this starting point, we would anticipate that the recommended exploration of the VTT model would appropriately take into consideration the existing strengths, expertise and capacity of the existing universities, and how they may be efficiently augmented, as well as the cost/benefits of establishing an entirely new body. While supporting the vision, we would be concerned if such a development resulted in a dilution of effort, funding and expertise across more bodies rather than a concentration and focus.

We would also highlight the “C Sets” approach taken in The Republic of Ireland, aimed at encouraging overseas companies to locate more of the R&D activities in Ireland. C Sets (Centres for Science, Engineering and Technology) are joint ventures between industry and third-level institutions, funded by government.

## **6. Co-ordination of Economic Policy**

IREP calls for DETI, DEL and Invest NI to work together more effectively which we would support. It also suggests that existing areas of DETI and DEL be brought together to form a ‘Department of the Economy’.

We support the thrust of this recommendation and would hope that this could provide a greater ‘joined up’ approach to economic development and help to place the economy right at the centre of the Executive’s efforts and achievements.

In terms of what Northern Ireland has to offer a potential investor, skilled people are our key product, especially in the development of a knowledge economy. This being the case, more closely aligning skills development with economic development is a worthwhile aim.

In terms of operational benefits, we would hope that Co-ordinating aspects of DETI and DEL would create greater responsiveness and reduce situations where strain of co-ordination between Departments is succeeding only in delaying action. We are aware of the situation with the Higher Education Innovation Fund, where HM Treasury money for Northern Ireland projects was held up due to a seeming inability to find agreement between those administering the funding. We would hope that a clear delineation of roles and responsibilities might reduce the chance of this recurring.

## **7. Executive Economy sub-Committee**

IREP has suggested that The Office of the First Minister and Deputy First Minister should establish a permanent sub-Committee to prioritise action on the economy. We believe that this is a worthwhile initiative, however we would stress that the new sub-committee must be focused on leadership and strategy rather than governance.

We would hope that this sub-committee would be able to co-ordinate economic development across the various Northern Ireland Departments, and would help to fulfil the stated aim of the Executive to have the local economy as the number one priority.

## **8. Data Issues/ Policy Performance**

The Review has identified a need for the Invest NI data collection system to be developed as a single database. Again, we find this to be a worthwhile initiative.

We would acknowledge that the fact that IREP has needed to construct its own database for the purpose of the review signals a deficiency in Invest NI's existing provision.

The monitoring of performance is a key role of Invest NI and is dependent on the ability of Client Executives to capture, analyse and record data within Invest NI systems. A lot more effort should be put into the tracking of data, an effort which is currently ad hoc. A more regimented way of identifying the key performance data of the Invest NI is required in order to better judge the agency's effectiveness.

We believe it would be useful if data were kept which might answer questions such as 'how many times Invest NI has lost out on inward investment projects?' or 'how often has the decision not to support a company resulted in jobs going elsewhere?'

There is a need to address the issue of variability or level of consistency of performance at Client Executive level. We believe that the agency does have some exemplary Client Executives providing timely decision making and advice for local companies, however there is variation in performance at Client Executive level. The level of expertise within Invest NI must reflect the changing global economic situation and requires a different culture and work ethic. Traditional civil service working patterns are outdated. Responsiveness is about being able to respond on a 24 hour basis, and the ability prioritise critical opportunities on behalf of client companies.

## **9. Policy Delivery – Retention of State Aids**

The Report calls for DETI and other relevant departments to commence work on preparing a case for retaining state aid limits. We fully support this recommendation.

Having emerged from a protracted and costly conflict, Northern Ireland, as a periphery of the European Union, is about to be hit by a series of testing and severe economic conditions every bit as challenging as what it had to face during the worst days of the civil upheaval.

A strong, united case must be made to Europe to extend Northern Ireland's Special Status beyond 2013 which is when the worst effects of Governmental cutbacks and retrenchment will be evident.

We appeal to political leaders to focus their energies in this regard and to devise a coordinated and united campaign to reverse this retrograde development.

## **Conclusion**

As previously stated, Chartered Accountants Ulster Society fundamentally agrees with much of the IREP report, but believes that there are several areas which require further consideration.

We strongly agree that Invest NI should be given freedom to operate and that steps should be taken to ensure that layers of bureaucracy that hamper the agency's efforts are removed.

We believe that providing greater autonomy in relation to delegated authority, a more flexible budgetary regime including End Year Flexibility, a central role in economic development policy and a portfolio approach to ex-post assessment would help Invest NI to be more entrepreneurial and provide a more responsive service to local businesses and start-ups. We hope that this would be a major step in combating a risk-averse culture which exists where the local public sector interfaces with the private sector.

We also have very strong concerns over the emerging funding gap for small business in Northern Ireland. We see an important role for Invest NI in boosting VC provision in Northern Ireland through partnership, and encouraging greater competition in this area.

The Ulster Society hopes that this feedback is viewed as constructive, and is willing to offer further clarification on any points within this response. We are a committed partner to the economic development of Northern Ireland and are very willing to contribute the combined expertise and experience of our membership to any further action in this vital area.

*Chartered Accountants Ulster Society*  
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