

Response to the Independent Review of Economic Policy

First let me say that I welcome the IREP report as being both a timely and thought provoking addition to the debate on the issues facing the Northern Ireland economy today. I realise that this response is late but I would beg your forbearance as I was hospitalised for the past few weeks however, I am very keen to comment on one aspect of the report ie Private equity.

I note that the Panel sets out to make recommendations to “to improve productivity, both for indigenous businesses and also to attract new investors to the region. I would like to address my comments to the first element of this i.e. improving productivity in indigenous businesses.

As a backdrop to this I think it is important to note the observation within the report that the NI economy is dominated by small firms; much more so than the rest of the UK. This has a fundamental effect on productivity both in terms of missing out on the efficiencies that go with scale but also on the quality and depth of management that it is possible to afford within small firms.

The quickest way to address this issue is to encourage more Merger and Acquisition activity within the existing base of companies. Private equity, as opposed to Venture Capital, has a major role to play in facilitating this

The report does not distinguish between “venture capital” and “private equity”. In fact I would go so far as to say it confuses the roles that these two instruments play in the economy.

The BVCA explain the difference on their website as follows:

What is the difference between private equity and venture capital?

Often the source of confusion, in Europe venture capital is a specific component of the private equity industry and refers to when funds used to invest in companies in the seed (concept), start-up (within three years of the company's establishment) and early stages of development. In turn, private equity denotes management buy-outs and buy-ins, whether it is classified as small (less than £10m invested), mid (greater than £10m and less than £100m invested) and large (greater than £100m invested).

In general venture capital funds invest in companies at an early stage in their development when they often have little or no track record and are cash-hungry. In contrast, private equity funds invest in more mature companies with the aim to eliminate inefficiencies and drive growth.

The report notes that “*there is a significant body of evidence that access to private equity can have considerable benefits for individual companies and an economy in general*”.

The report goes on to argue that the low level of VC activity in Northern Ireland is due to a limited demand for venture capital. It concurs with the Varney Review that the sector is well served by funds such as NI Tech, Viridian and Crescent Capital II. This may or may not be the case but none of these funds address the private equity market as distinguished from VC above.

Para 3.67 specifically compares the very low level of MBO/MBI activity in NI compared with other UK regions. It refers to a BVCA study which highlights the economic activity of private equity across the UK and points out that NI has missed out on this. It is also pointed out that *“with the exception of Enterprise Equity, all VC funds in NI, past and present, have, at their core, public sector funding.”* This automatically skews the focus of these funds towards venture investing and away from the private equity end of the market.

Therefore the argument that the low level of activity is due to demand may be levelled at the venture market but it cannot be made of the private equity market in Northern Ireland.

The need for more private equity in Northern Ireland stems from

- Need to encourage and facilitate more M&A activity;
- Preponderance of small family owned businesses with succession issues;
- Need to encourage and facilitate entrepreneurial managers;
- Reluctance of banks to lend at previous gearing levels;
- Reduction of Selective Financial Assistance.

I would contend that the reason behind the low level of private equity activity is the lack of investment by Northern Ireland based financial institutions in private equity funds. Elsewhere in the UK there is considerable activity by, for instance, local authority pension funds in regional private equity firms. This does not happen in Northern Ireland where all non-civil service public sector pensions come under the auspices of NILGOSC. Although NILGOSC have participated in two local venture capital funds – managed by Crescent Capital and Clarendon – they say that this is because these funds are to a large extent under-written by Invest NI. NILGOSC do not invest in private equity funds locally. The London based investment advisors to NILGOSC maintain that they have no remit to invest in Northern Ireland but are singularly there to maximise returns to the pension fund.

I believe that this primary objective would not be impaired by devoting some funds to the Northern Ireland economy. It is interesting to note that our political leaders have spent considerable time talking to pension funds in the US in an attempt to get them to ring fence some money for Northern Ireland but, as far as I can tell, they have not talked to the local pension fund which has roughly £3 billion of assets under management.

The report proposes that, except for seed stage funds, Invest should not get directly involved with VC funds – but facilitate between funds and companies. I would go further and argue that Invest should actively encourage financial institutions to invest in private equity in Northern Ireland. The financial institutions to be targeted should primarily be local pension funds, local endowment funds and local banks. However, the inclusion of international institutions which are predisposed to the success of the Northern Ireland economy is, of course, to be welcomed.

I would of course be more than happy to discuss this and provide more detail if you think this would be helpful.

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