VALUE IN PRIVATE EQUITY

WHERE SOCIAL MEETS SHAREHOLDER

By Mark Hepworth
Big Issue Invest
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MOVING TOWARDS AN ERA OF OPPORTUNITY FOR ALL...

The imbalance of opportunity in society is as striking today as it ever was.

In my opinion though, this lack of opportunity is caused, not so much by opportunity not being there, but because of the lack of educational qualifications, or other criteria, such as direction and focus being absent in poorer sections of society.

Clearly someone who attended private school, comes from a wealthy and educated family, and who completed their education to degree level is more likely to achieve than someone who was brought up as part of a one parent family, located in an inner city borough, didn't attend much school and left at the earliest opportunity without any exam passes.

Opportunity is always there for those naturally gifted, or lucky enough to spot it, or perhaps those educated enough to recognise it.

I recently had lunch with a leading politician and mentioned my belief that we simply must find a way of linking the powerful stallions of free enterprise to the carriage of humanity that follows behind. It is essential in a modern democratic society that we work toward inclusion for all. Forget making the rich poorer, let's make the poor richer.

To most, the goal of private equity investment is typically seen as working in direct conflict to this goal of social inclusion. The media tends to distort and exaggerate the sector like a pantomime villain - asset stripping, job losses, financial engineering...the list goes on.

Whilst the sector has, by its own admission, been guilty of nefarious practices that are far from socially useful and is deserving the scrutiny it receives, this one sided perspective often hides another aspect of the sector's impact - the positive effect it can have in creating social value.

I believe this report is a genuinely ground-breaking contribution to this debate around the role of private equity: is it possible to align the seemingly contradictory goals of shareholder value with that of social value and inclusion, and if so how can it be measured?

To me, the injection of capital into a business is a critical piece of the jigsaw if we are ever to create a society that offers more and better opportunities to more people, more of the time. How can we assess whether that investment is truly creating lasting, positive impact? How can we understand whether equity finance is flowing into the type of business where it can have the biggest 'halo', by size, sector and by location.

In this respect I welcome this study as a means of informing a sometimes imbalanced debate and, more importantly, providing a framework for the sector to better understand the impacts of its activities, good and bad.

Dr Stephen Fear
Entrepreneur in Residence & Ambassador
British Library

OPPORTUNITIES ALIGNED

Finding business solutions to the crisis of opportunity affecting today's Britain remains an agenda-topping concern across much of the public, private and third sectors.

The country's return to growth is good news. But, not so positive is that many people and many communities – especially outside London - are not sharing the benefits of the recovery.

In an age of austerity society is likely to become more, rather than less reliant on business to provide greater social inclusion over the decades to follow.

This has always been core to the role and purpose of Big Issue Invest – backing and scaling-up of social enterprises and charities that can help tackle poverty and inequality.

It has not, however, been seen as a typical concern of private equity investing.

Beyond direct investment, Big Issue Invest also seeks to understand and influence how mainstream business and investment can increase its social value. This pioneering study puts the spotlight on mainstream private equity investing.

The research provides an interesting starting point for a new debate – a debate that has yet to find its way into the headlines of mainstream media.

Throughout much of the last 150 years, social value and shareholder value have typically been seen as opposing forces – right from the birth of the labour movement in the industrial revolution to the anti-capitalist occupation of St Paul's in London in 2012 and public outcry over the tax affairs of Starbucks, Google, Vodafone and Boots.

Against such a backdrop, this study offers private equity – one of the purest forms of shareholder value creation – a powerful and transparent framework for better assessing, understanding and reporting its social value to Britain, its regions and local communities by helping to create a more balanced economy and equal geography of opportunity for all.

Surely a company that has access to the kind of growth capital, strategic input and operational support that the sector can offer has a better chance of growing, and therefore a greater likelihood of providing sustainable employment?

We hope the study provides the industry with a means by which it can shine a light on the positive social value of its activity – whether direct and intentional, or indirect and accidental – and understand where and how it might do better.

Our thanks to Mark Hepworth, Big Issue Invest's Head of Research and Policy, the author of this report, who led the conceptual thinking and development of the Social Value Scorecard approach, as well as Sam Waples who carried out the data analysis.

We developed this assessment with Big Issue Invest as a prototype. We hope this sets a standard to measuring the social value creation of the private equity and broader financial sector. Maybe the time has come for private equity – for many the least likely of social benefactors – to prove itself to be a valuable contributor.

Nigel Kershaw OBE
Chief Executive, Big Issue Invest
Group Chairman, The Big Issue Company

Darryl Eales
Chief Executive
LDC

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EXECUTIVE SUMMARY

LDC, a subsidiary of Lloyds Banking Group, is the UK's leading mid-market private equity investor, providing finance to "high growth businesses" – that is, well-established firms with at least £5 million turnover, a successful three-year track record, and profits typically in excess of £1 million. Since its establishment in 1981, LDC has invested in more than 450 "high growth businesses" spread across different sectors and regions of the UK economy.

LDC wanted to understand the "social value" to the UK of its private equity investments. Therefore, in April 2013, it commissioned Big Issue Invest (BII) – the social investment arm of The Big Issue Group – to produce an innovative methodology for assessing social value using LDC itself as a research partner and test case. This report presents the results of this collaboration.

The BII methodology defines "social value" as the value society places on a business in addressing its common challenges and needs. Today, there is a social consensus, shared by the country's economists that **the UK's big challenge is to develop a "balanced economy" that will deliver sustainable and equitable economic growth. Does LDC's investment activities help the UK meet this challenge?**

The research assesses LDC's social value added at the aggregate portfolio level. About 90% of the LDC portfolio analysed was comprised of small and medium-sized enterprises (SMEs) and larger 'mid-sized' businesses employing up to 500 people, around half of which had been active LDC investees for at least three years.

The results of BII's extensive analysis are brought together as a Social Value Scorecard showing five broad areas in which LDC's investment activity during the period 2003-2013 helped the UK meet its main national challenges:

i. **LDC invested through the UK's worst recession.** During the period 2003-2013, LDC invested over £1.5 billion and built up a portfolio of 80 UK-based companies which generate an aggregate turnover of £3 billion and 30,000 jobs. During the height of the recession, from 2008 to 2010, LDC invested in 33 UK businesses. During this time, bank lending to SMEs fell dramatically, as did overall levels of business investment.

ii. **LDC invested successfully in the overlapping SME (1 - 249 employees) and 'mid-sized' business (50 – 499 employees) sectors** – the latter, which make up 40% of LDC's portfolio, account for 2% of UK companies but 20% of private sector turnover and around 4 million jobs.[1] Across the whole portfolio, employment increased by 10% and turnover by 27%. About 45% of LDC investees out-performed their local economies and 'home' sectors by employment and productivity growth.

1 Department for Business Innovation and Skills (BIS), 2011.

iii. **LDC invested in sectors favourable to building a 'balanced economy'.** LDC's portfolio had a high representation of innovative manufacturing businesses – 23% of the portfolio versus 6% of the UK business stock. 73% of LDC's manufacturing investees have UK production operations. 46% of LDC investees are in export-intensive sectors versus 17% of all UK businesses. Finally, favouring a shift towards private sector-led investment, 50% of LDC investees are located in public sector-dependent local communities.

iv. **LDC invested in regions favourable to building a 'balanced economy'**. Two-thirds of LDC's portfolio businesses are based mainly outside the Greater South East, including London. This share is significantly greater than the rest of UK SMEs and mid-sized businesses. Whilst London continued to grow rapidly throughout the recession, it is notable that LDC continued to invest in the North West and West Midlands regions and the strategically important Manchester and Birmingham "city regions" which the CBI sees as 'engines of growth'.

v. **LDC invested in the most disadvantaged communities of the UK**. 60% of all LDC's investees are located in high unemployment areas. 31% are located in England's top 20% most deprived areas. This compares favourably with the whole SME population at 12% and social enterprises (BII's client base), 38% of which are located in the 20% most deprived communities.

This unique collaboration between BII and LDC has produced an innovative Social Value Scorecard 'tool' which indexes, assesses and summarises all of the above five areas of LDC's contribution to a more balanced and equitable economy. 'At a glance', it shows that effective private equity investment in mid-market businesses – as illustrated by the LDC case – can create social value for the UK.

The Scorecard needs regular up-dating as investment and economic conditions change. It can be used as an intra-portfolio benchmarking tool and for comparing social value performance between portfolios. It can also be adapted for large, multi-site corporations in different sectors that are looking to refresh their CSR strategies by shifting to a social value framework.

1 INTRODUCTION

LDC, a subsidiary of Lloyds Banking Group, is the UK's leading mid-market private equity investor. Since it was established in 1981, LDC has provided equity finance to over 450 unquoted 'high growth businesses' which are spread across the UK economy, by region and sector.

LDC believes that private equity is 'a force for good', and that its investment activity is beneficial to the UK economy and its regions and local communities. It has made a public commitment to creating jobs and wealth throughout the UK, throughout the economic and business cycle.

LDC commissioned Big Issue Invest (BII) – the social investment arm of The Big Issue Group – to develop an appropriate methodology for assessing whether it creates social value for the UK and to apply the methodology to LDC's portfolio of businesses for the period 2003 to 2013.

This report presents the results of this research. By publishing this report, LDC and BII hope that other private equity investors and indeed other UK-based corporations will consider adopting the methodology to refresh their own approaches to assessing their social impact.

The report is organised as follows:

- Section 2 provides an overview of LDC as a market player. It also explains BII's approach to assessing social value.
- Section 3 presents the results of a descriptive analysis of LDC's private equity investment activity within the UK, focusing on growth, geography and sector balance.
- Section 4 gives LDC's social value assessment report.

2 LDC AND SOCIAL VALUE

2.1 An Overview of LDC

LDC is a well-established, leading player in the UK private equity market. Its current leadership position is shown in Chart 2.1.

Chart 2.1: The 'Top 5' Mid-Market Private Equity Investors in the UK, 2012

United Kingdom £5-150 million	Volume (No. of Investments)	Value (£m)
LDC	18	520
Phoenix Equity Partners	4	185
Graphite Capital	4	185
ECI Partners	4	182.5
Index Ventures	7	109

Source: Unquote, Regional Mid-Market Barometer 2012

LDC provides equity finance to 'high growth businesses' with ambitious management teams, a very important prerequisite for private equity investment. These are well-established firms with at least £5 million turnover, a successful three-year track record, and profits typically in excess of £1 million. Funds, ranging from £2 million to £100 million, are used for:

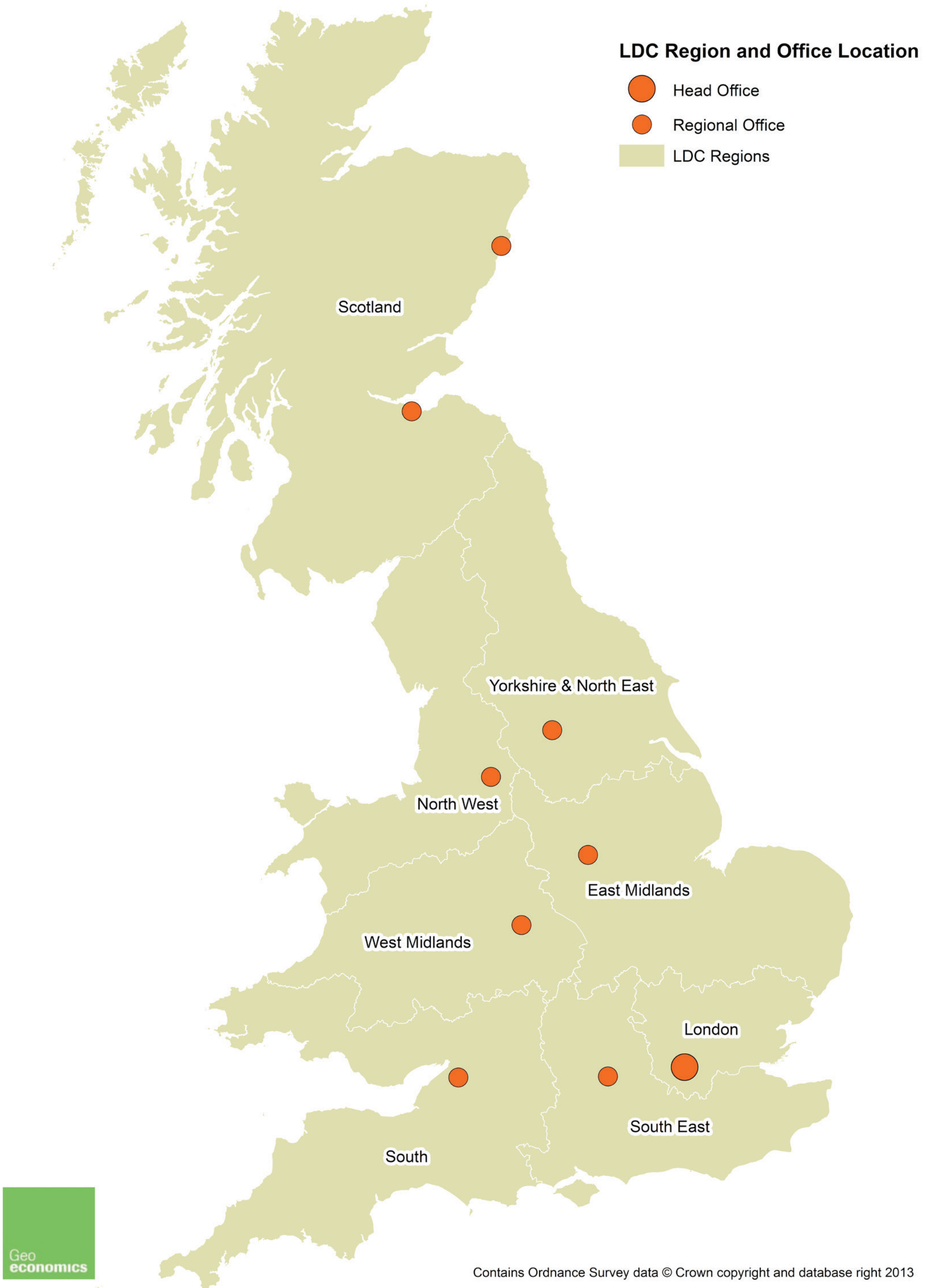
- Management buy-outs: LDC provides the management team with the necessary resources to buy the business from the current owner.
- Institutional buy-outs: LDC buys the company and then provides the incumbent and/or incoming management with a stake in the business.
- Development capital: LDC provides finance for growth through replacement, expansion and acquisition.

High-growth businesses, as investible opportunities, are known to be dispersed across regions and sectors of the UK economy. LDC's investment portfolio, expertise and organisational strategy address this 'spread':

- By sector: Construction and Property, Financial Services, Healthcare, Industrials, Technology Media Telecommunications, Retail and Consumer Services, Travel and Leisure, and Support Services.

- By geography: LDC's network of nine regional offices is shown below. LDC actively 'embeds' itself in the local economy, networking across the business, advisory and banking arenas.

Chart 2.2: LDC's Corporate Geography 2013



There are certain parallels LDC shares with the Industrial and Commercial Finance Corporation set up by the Bank of England in 1945 to help fill a 'funding gap' in the small business sector:

> *(ICFC) operated through a regional branch network and with staff who acquired expertise in particular firms and sectors. The regionalisation of the ICFC which eventually floated as 3i was partly the result of a desire to recreate the 19th century conditions of local investment that had been lost in the centralisation of investment through the stock exchange" (p.148).*

Source: Michael Heseltine's independent report No Stone Unturned: In Pursuit of Growth, 2012.

2.2 Creating Social Value

The BII methodology takes its definition of social value from two leading economic thinkers:

- Joseph Schumpeter: "social value refers to the value society itself sets on things" – such as the firm's activities as an individual business - Quarterly Journal of Economics, 1908
- Michael Porter: "businesses create economic value as market actors whilst simultaneously creating shared value for society by addressing its needs and challenges" - Harvard Business Review, 2011

Based on these definitions, does LDC 'simultaneously' create social value for the UK and its regions whilst creating economic value as an individual player in the private equity market? Does LDC's pattern of investment activity positively help the UK to address "its needs and challenges"?

In the BII methodology, we concentrate on the UK's economic needs and challenges and take the consensus view of the economics profession as being socially representative. Undoubtedly, the prevailing consensus view is that the UK needs a more 'balanced economy' for growth to be more sustainable and inclusive.[2]

The Centre for Industry and Government at the Institute for Manufacturing at Cambridge University surveyed public attitudes to 'rebalancing the UK economy'. The research found that 72% of UK citizens believe that the country needs a stronger manufacturing base, and 59% want to see a geographic rebalancing between the London and the Greater South East and the rest of the country.

A major focus of the 'rebalancing' debate has centred on Britain's unequal geography of economic and employment opportunity. The earnings, productivity and house price gap between London and the rest of Britain widened considerably during the recession. For example, in a blog article entitled "Should Britain let go of London?" Former BBC Economics Editor Stephanie Flanders comments:

> *The rest of the UK might be living through the toughest squeeze in a century, but it doesn't feel like it walking around many parts of the capital. London had a recession but it didn't last long. Its economy grew by nearly 12.5 per cent between 2007 and 2011 – twice as fast as the rest of the UK. Without London the UK would look like a different economy – one less focused on financial services, more reliant on manufacturing. That could make a difference to macro-economic policy.*

[2] See, for example, Institute for the Study of Civil Society (CIVITAS) essays on "Rebalancing the British Economy", edited by Tristram Hunt, 2013.

The BII methodology addresses a straightforward question: is LDC's *pattern* of equity investment compatible with the *pattern* of balanced economic growth the UK needs as a society? The closer the fit, potentially the more 'socially-intensive' is LDC's economic contribution, and the bigger the investment volume, the greater the social value.

The BII framework is influenced by Schumpeter's conceptualisation of business and economic growth as social processes. It starts from the social context – the challenges and needs of the UK – and then places the individual business and its contribution in that context. Welfare economics, the traditional basis for assessing the economic contribution of large firms, starts from a given business context, and then adds on the 'externalities' that spill-over to other businesses particularly via supply chains and a separate amount of 'business in the community' (CSR) benefits. This technical framework is shown in Chart 2.3 – "private" benefits, including tax contributions, make up the left column and "social" benefits are in the other two columns.

Chart 2.3: Technical Framework for Social Value Assessment

Business-level Benefits	Wider Economic Benefits	Community Benefits
Business X creates social value through its own employment, investment and procurement activities. **Direct**: scale and growth of X's workforce and turnover **Indirect:** impacts on other businesses through X's supply chains (procurement effects) **Induced:** impacts of X's workforce spending on other local firms' goods and services (multiplier effects)	Business X creates social value through its job and business impacts on the rest of the national/regional/local economy. **Localisation economies:** sector-specific, shared business benefits arising from spatial proximity – 'cluster' growth **Urbanisation economies:** shared business benefits for all sectors arising from higher critical mass of demand for infrastructure	Business X creates shared social value through partnership working with the local community, developing solutions to its challenges and needs. **Projects such as:** Education, learning & skills Employment and training Health and healthy lifestyle Personal and social well-being Arts, culture and recreation Climate change and environmental conservation

For the purpose of this analysis, we are not directly applying the above framework to LDC itself, nor are we assessing LDC's individual businesses at the level of detail the above framework calls for. The latter would certainly be desirable and more accurate than the employment and turnover measures used here - the 'direct' component in the Business-level Benefits column - but would require a case study analysis for individual LDC investees. The focus of attention is on the LDC portfolio businesses and their social value as a whole – with LDC in essence being modelled more as an 'enabler' of private equity investment, a source of finance and management packaged together.

In crude terms we are asking:

- Does the same £1 LDC invests in an individual business also produce a wider social benefit to the UK and its regions? BII's methodology requires social value creation to be integral to the mainstream activities of LDC's business.

To emphasise again, this particular study assesses LDC's social value added at the level of its overall private equity investment portfolio. The social value added at the level of the individual LDC investee business is not assessed – nor are these individual values aggregated to the portfolio level. However, the methodology used here could be adapted for the purposes of individual business case studies – so the social value of each firm in the portfolio can be assessed and then benchmarked against the portfolio average.

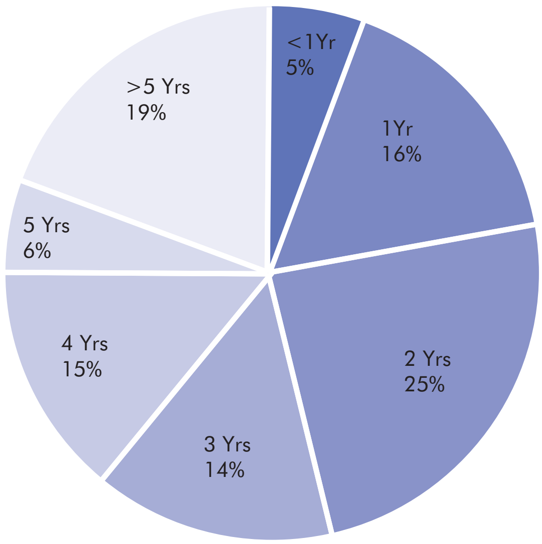
Notwithstanding the above remarks, the BII methodology does provide a new and different perspective on private equity investment as a potentially 'socially valuable' part of the UK's economic landscape. This report is of course a case study of one private equity investor, however the size and breadth of LDC's portfolio does enable us to develop 'a bigger picture' view – one that could start a lively and more informed public debate.

GROWTH SOCIETY VALUE
LDC SOCIAL
RESPONSIBILITY BIG ISSUE
INVESTMENT CHALLENGES
COLLABORATION BALANCED ECONOMY

3 THE ANALYSIS

This analysis focuses on LDC's portfolio of private equity investments between 2003 and 2013. The portfolio was made up of 129 businesses more than half of which were involved with LDC for at least 3 years. We distinguish between 'past investments' – i.e. where LDC has entered and exited – and 'current investments', where it remains as an active investor and management partner.

Share of the LDC Portfolio by Length of Involvement Time (%)



LDC's investment portfolio is comprised of larger SMEs and 'mid-sized' businesses: firms with 50-250 employees make up 50% of the portfolio and firms with more than 250 employees account for a further 40%; 10% of the portfolio consists of businesses with less than 50 staff.

The analysis examined five aspects of LDC's actual behaviour as it relates to the need for a more balanced UK economy:

1. **Investing through the recession**
2. **Investing in high growth businesses**
3. **Investing across sectors**
4. **Investing in the regions**
5. **Investing in disadvantaged areas**

Investing through the Recession

See Charts 3.1 and 3.2.

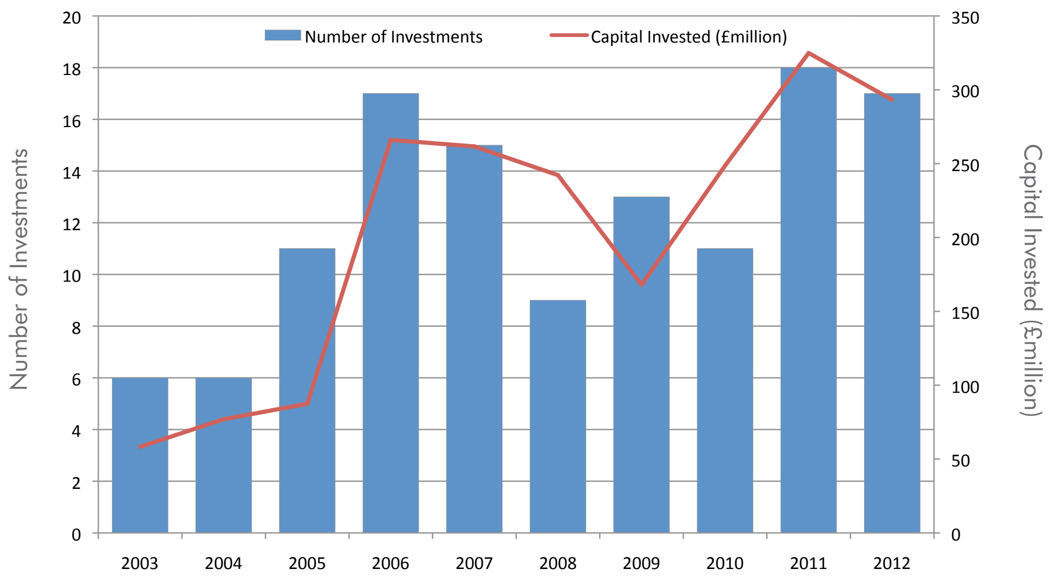
The time frame of this study corresponds with the UK's worst recession since the 1930s. The "Blue Book 2013" confirmed that UK growth in Q2 of 2013 was 0.7%, and that GDP remains 3.2% below its pre-recession peak. The Breedon Review 2012 estimated that the finance gap for SMEs could be between £84 billion and £191 billion over the next five years – a brake on the recovery?

- LDC continued to invest through the UK's worst recession. It invested over £1.5 billion and built up a portfolio of 80 UK-based companies which generate an aggregate turnover of £3 billion and 30,000 jobs during the period 2003 – 2013 (see Chart 3.1). At the height of the recession (2008 – 2010) LDC invested in 33 businesses.

- UK SMEs are currently heavily reliant on bank lending (loans/overdrafts) – about 20% use bank lending whilst 1-2% look for private equity finance. Bank lending to SMEs fell through the recession[3]; and, the decline in business investment continued into the second quarter of 2013 (Chart 3.2). A Grant Thornton report on the importance of "mid-sized" businesses for the UK economy concluded that "there are strong arguments for promoting alternative finance such as equity and bond issuance, which currently tend to be the preserve of larger businesses". [4]

- According to the Bank of England, there has been "a growing use of non-bank finance by SMEs, albeit from low levels, including from peer-to-peer lending, crowd funding, venture capital funds, and insurance companies and pension funds." Private equity is part of this new alternative for SMEs with growth potential.

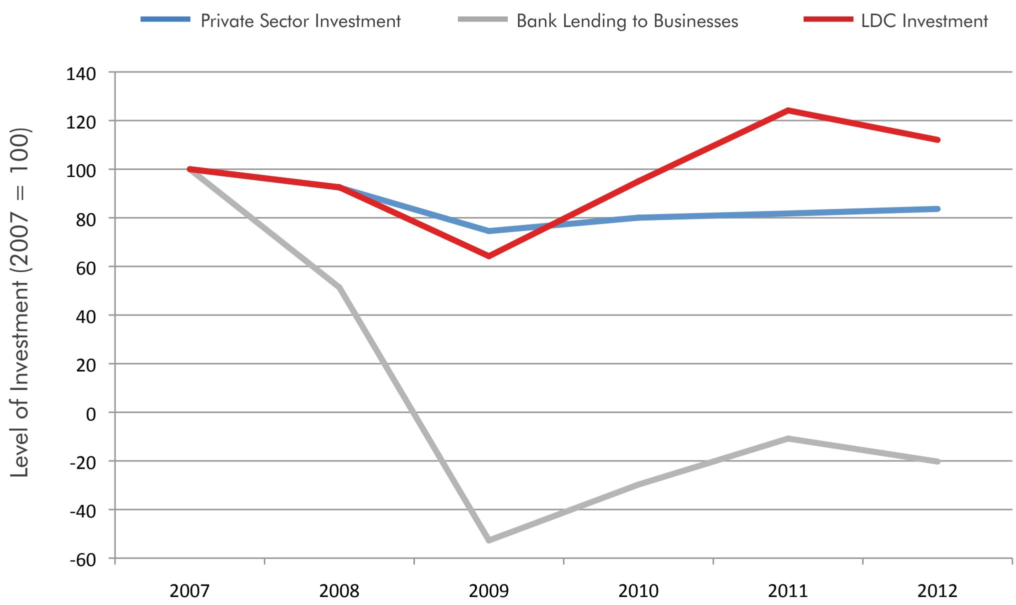
Chart 3.1: Number and Value of LDC Equity Investments



Source: LDC

[3] Bank of England, Trends in Lending, October 2013
[4] Grant Thornton, Agents of Growth: How UK mid-sized businesses are beating the market, 2012

3.2: LDC versus UK Investment Trends, 2007-2012



Source: Private Sector Employment - The Blue Book, Chapter 9, Table 9.2, Gross fixed capital formation, ONS 2013. Bank Lending – Trends in Lending, Table 1-A, Average net monthly flow, Bank of England July 2013; Source: The Blue Book, Chapter 9, Table 9.2, Gross fixed capital formation, ONS 2013

Investing in High Growth Businesses

See Charts 3.3 and 3.4.

Britain's 'high growth businesses' have been persistently 'targeted' by government support agencies, as much as by LDC and other private investors. Between 2008 and 2011, less than 10% of firms generated more than 50% of UK job creation.[5] *The economic contribution of these types of businesses is disproportionate. Warwick University's Stephen Roper found that mid-market businesses represent just 1.37% of UK companies, but contribute 32% of private sector GDP and employ 11 million people.*[6]

- As Chart 3.3 shows, the majority of LDC investee businesses grew by employment and turnover during their period of partnership/financial involvement with LDC. Across the whole portfolio, aggregate employment increased by 10% and turnover by 27%. Turnover growth is significant and positive for both past (17%) and current investments (37%).
- Most LDC investees out-performed their 'home' local economies – see Chart 3.4. 57% of investees out-performed their local economies by employment growth and turnover/GVA growth, compared to around 18% who under-performed. 44% of past investments out-performed both benchmarks whilst 24% under-performed – the stronger figures for current investments were 65% and 14% respectively.

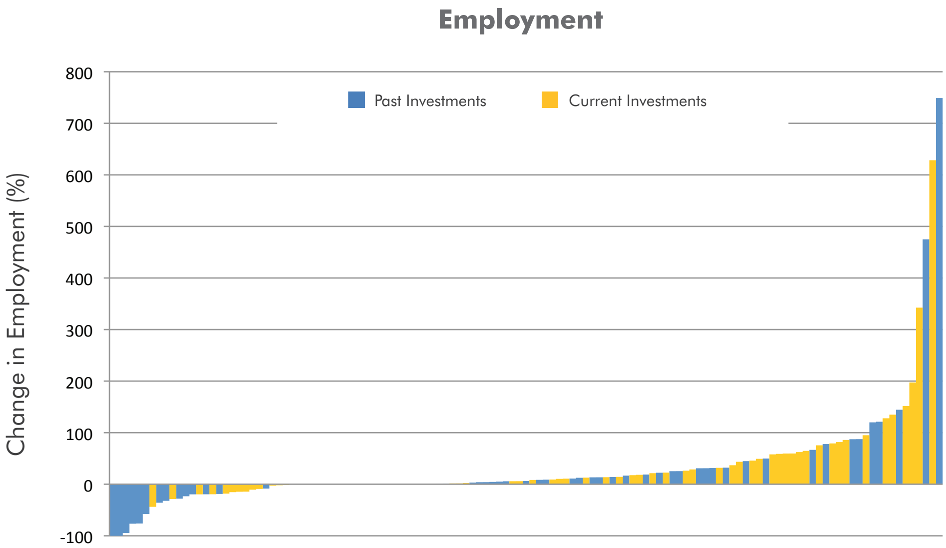
[5] NESTA, The Importance of High-Growth Businesses to the Recovery, 2011
[6] GE Capital, Leading from the Middle: The Untold Story of British Business, 2012.

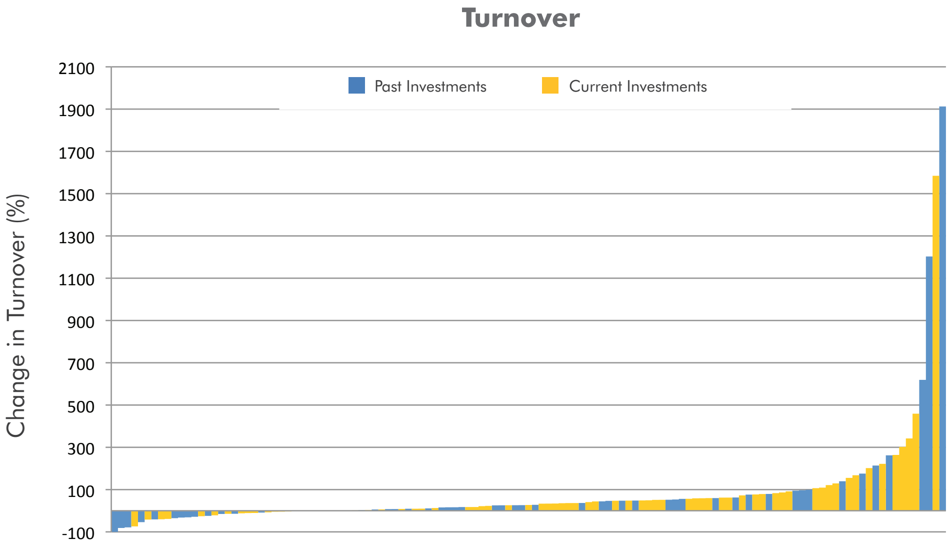
- LDC links its private equity finance to management development (the majority of its investments are management buy outs). The strategic need to improve management in UK SMEs and mid-sized businesses has been consistently underlined by researchers. [7]

- The 'piano' charts show that on balance LDC investee employment and turnover growth performance is positive. There are negative business outcomes amongst the success stories, like the rest of the private equity sector. LDC's net contribution to business growth performance requires further, in-depth analysis.

Chart 3.3: Business Growth during LDC Involvement

From Investment Date to Exit Date, or 2012 if still a Current Investment





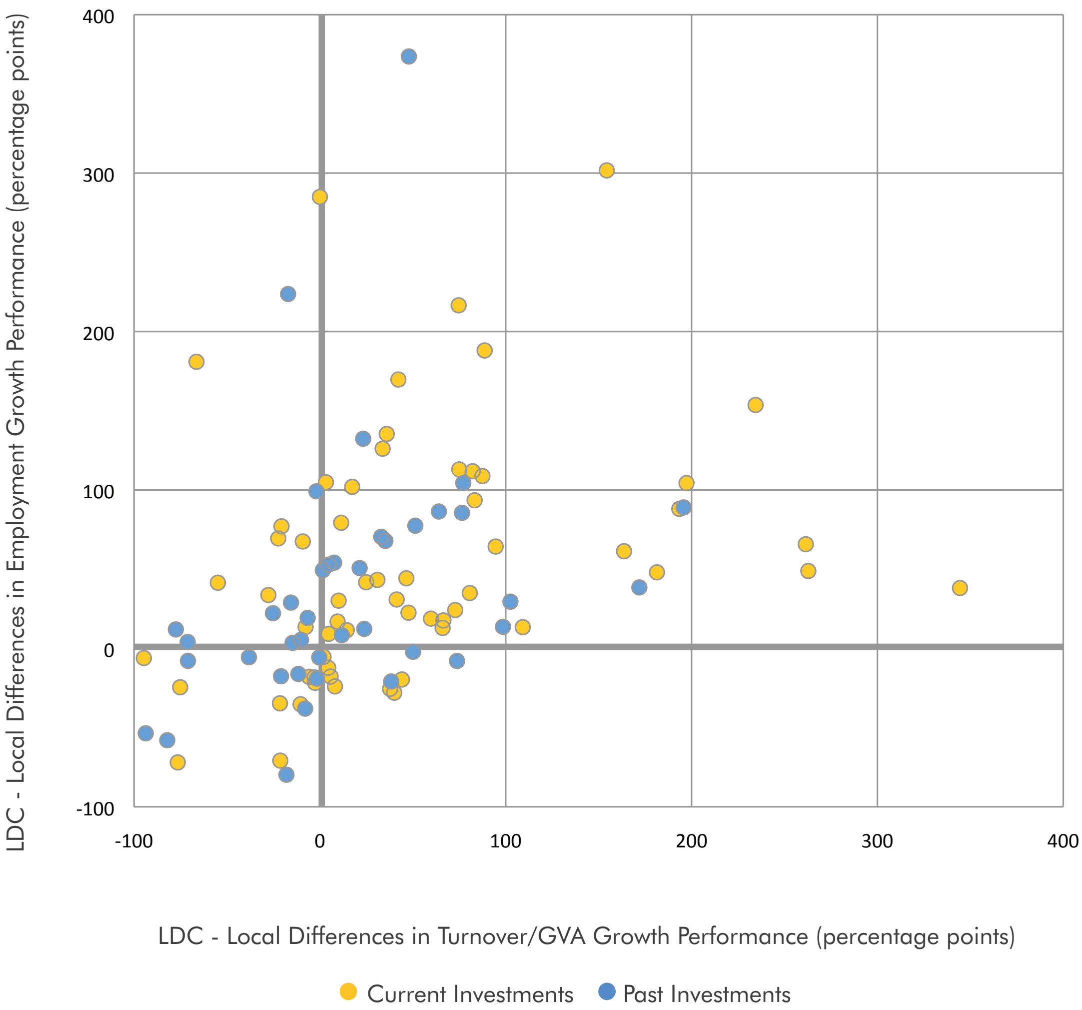
Source: LDC

[7] Centre for Economic Performance (CEP), Constraints on Developing UK Management Practices, BIS Research Paper 58, 2011

Chart 3.4: LDC Investee Growth Performance versus Local Economic Growth Performance, 2008-12

The vertical axis measures the difference (by percentage point) in employment growth rates between individual LDC investees and their local economies by sector. The horizontal axis measures the difference in turnover/GVA growth rates between individual LDC investees and their local economies for all sectors.

Local earnings growth is used as a proxy for local GVA growth. 'Local' here refers to the local authority area where the LDC investee has its head offices.



Source: LDC, Annual Population Survey, and Annual Survey of Hours and Earnings

Investing across Sectors

See Charts 3.5, 3.6 and 3.7.

Business employers see 'rebalancing' the UK economy in terms of structural change – specifically, shifts from consumption to production sectors, from domestic to export markets and from the public to the private sector. Please see CBI and EEF perspectives in the Annex. Professional economists such as Professor David Bailey emphasise the importance of manufacturing exporters:

> *We may have got rid of that millstone statistic, the comparison between exports to Ireland and the BRIC countries, but we do still export more to Belgium and Luxembourg than we do to China – a pretty telling statistic. To grow the sector (manufacturing), it is imperative that we look to export to different markets, not just the BRICs, but to other expanding economies, such as Indonesia and Turkey. Part of the problem overlaps with the wider problem of access to finance, with companies often having the capability to win export orders, yet unable to access the necessary short-term finance to deliver on them.*

Source: CIVITAS, Rebalancing the British Economy, 2013.

- As Chart 3.5 shows, the striking feature of LDC's investment portfolio is its high representation of manufacturing businesses – 23% of the portfolio versus 6% of the UK business stock. Over 30% of LDC's manufacturing investments are in 'high-technology manufacturing' as opposed to the national figure of under 6%.

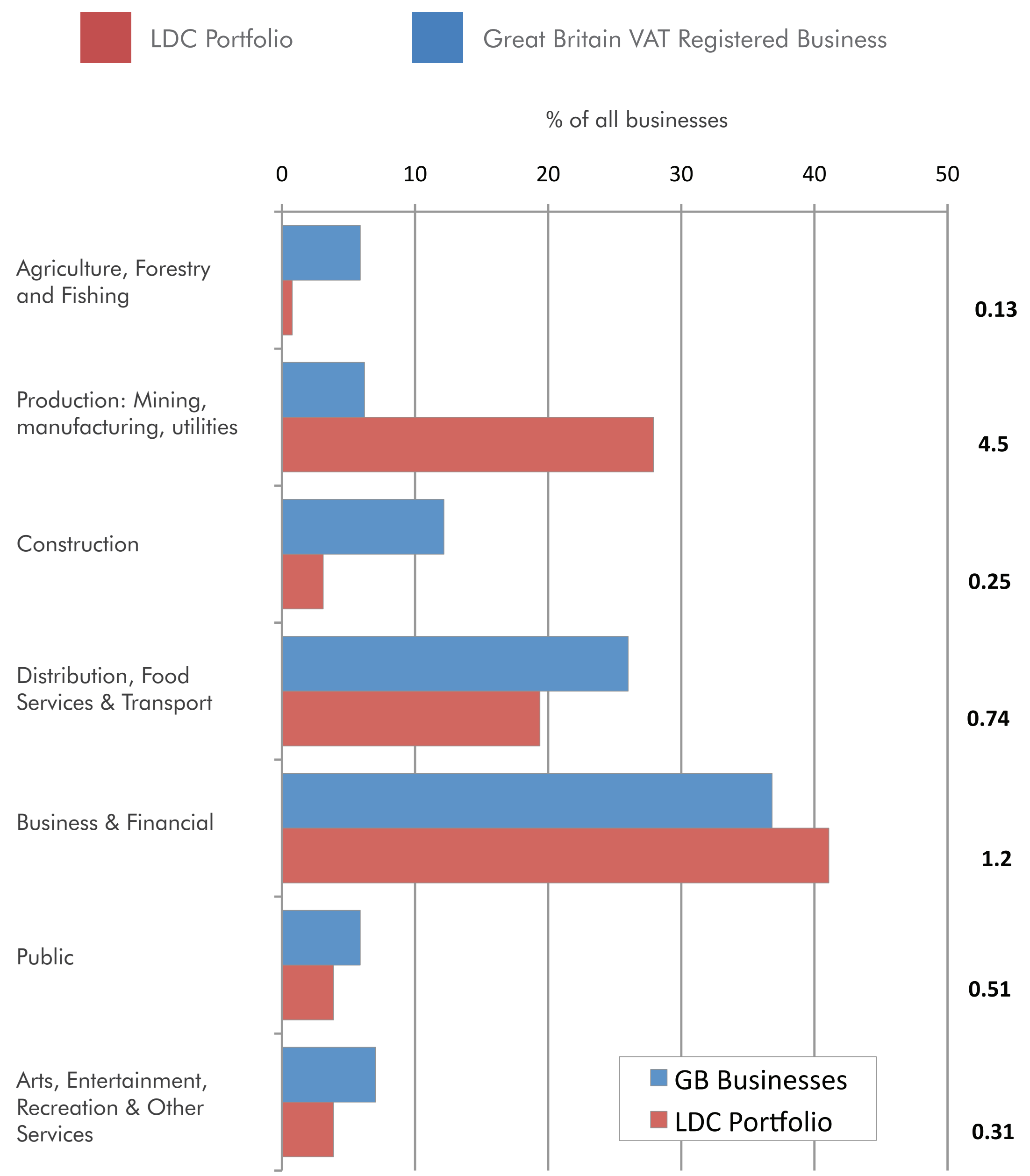
- Respectively 73% and 91% of LDC's manufacturing and high-tech manufacturing investments have production operations in the UK (see Chart 3.6). These operations have local, regional and national supply chains – partly if not wholly within the UK. Hence the social value created by LDC investments is significantly greater than estimated here. Case studies of individual manufacturers would illuminate these wider social value 'externalities' (see Chart 2.3).

- 46% of LDC portfolio businesses are in 'export-intensive' sectors compared against 17% of all UK businesses. 35% of current LDC manufacturing investees export to the BRIC countries; almost three quarters of the manufacturing firms are exporting (see Chart 3.7).

- The CBI has highlighted the need for a shift from government-led to private sector-led investment as central to re-balancing the UK economy. Chart 3.8 shows that LDC's private equity investment is helping to bring about this shift in areas of Britain where local economies and communities are most in need of it. Around 50% of LDC investees are located in less "resilient" communities that depend more on government investment and jobs.

Chart 3.5: Sector Balance of LDC Portfolio Investment versus GB Business Stock

Note the strong concentration of Production/Manufacturing in the LDC portfolio – shown by the high 4.5 score on the right of the chart.



Source: LDC, Inter Departmental Business Register

Note: LDC 'sector concentration quotient' is shown on right of chart. A score of above 1 means the sector is over-represented in LDC's portfolio relative to the national average; a score of less than 1 means it is under-represented.

Chart 3.6: The Geography of LDC's Manufacturing Sector Investments

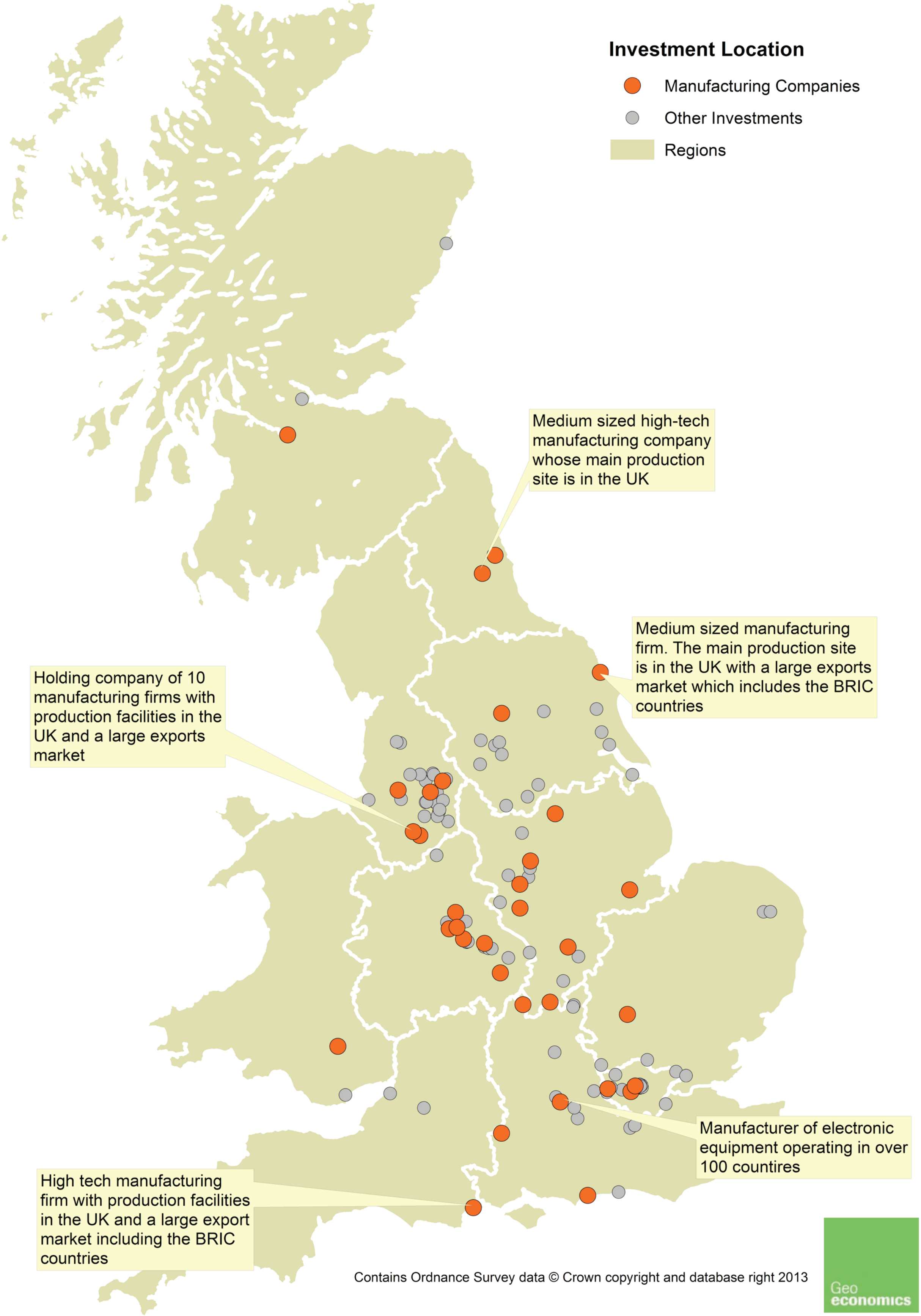
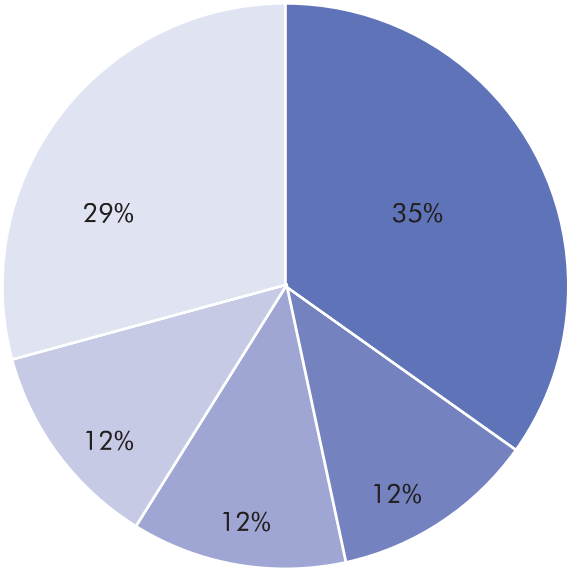
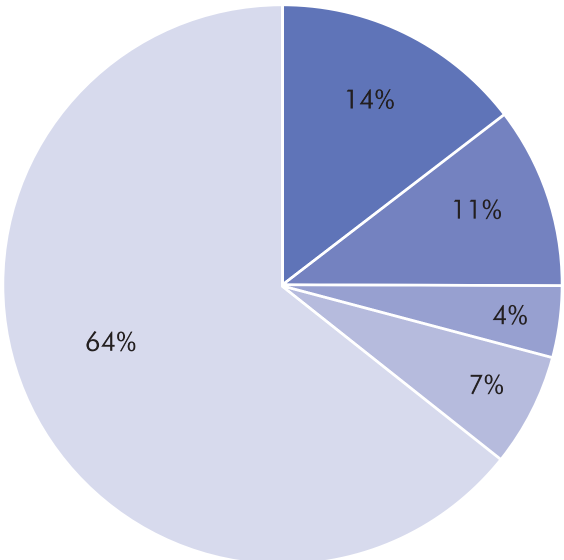


Chart 3.7: Export Performance of LDC Portfolio Businesses

Manufacturing



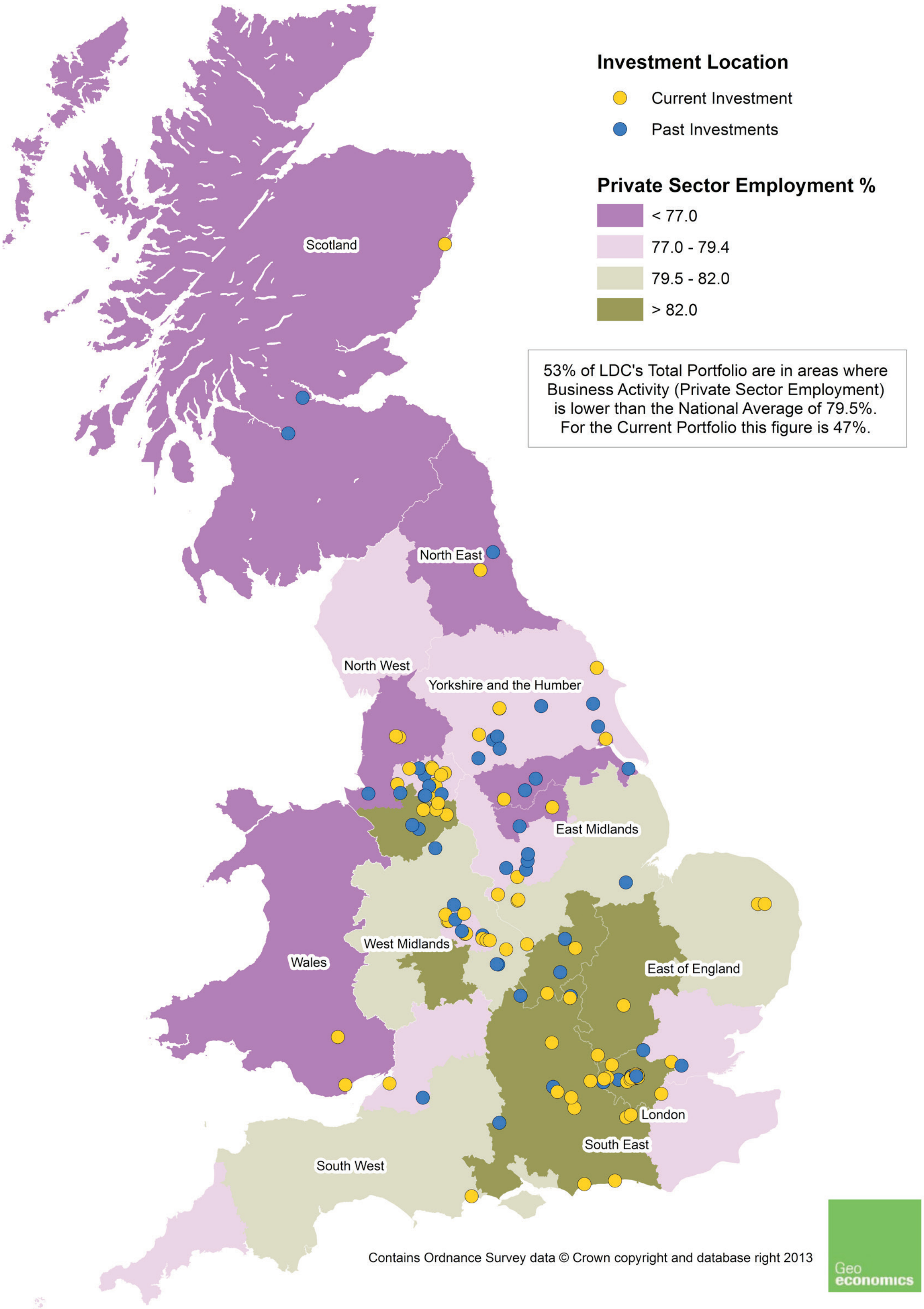
All Investments



- Exports (20% or more of Sales) to BRIC countries
- Exports (20% or more of Sales)
- Exports (less than 20% of Sales) to BRIC countries
- Exports (less than 20% of Sales)
- Does not Export

Chart 3.8: Location of LDC Investees by Private Sector-Intensive Local Economies

Re-balancing takes in shifting the UK economy from the public sector to the private sector (in terms of GVA, investment and employment).



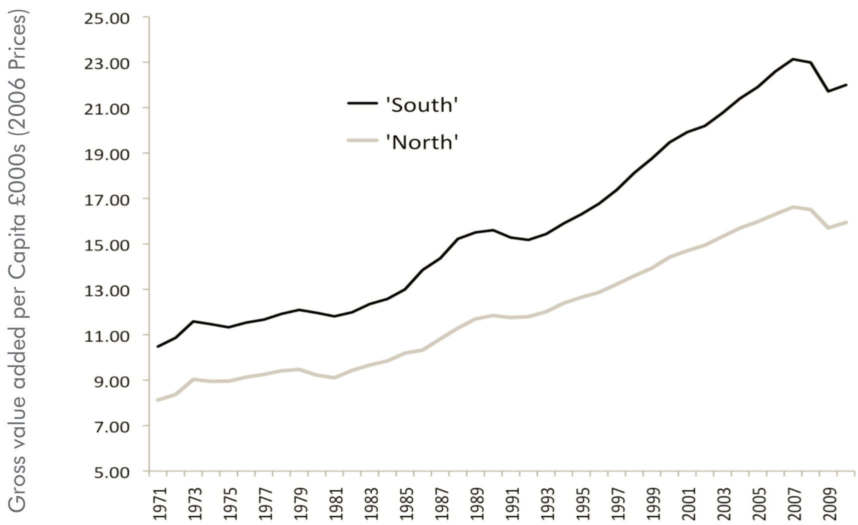
Note: This analysis uses LDC Investee Head Office locations only.
Source: LDC; Business Register and Employment Survey, 2011

Investing in the Regions

Please see Charts 3.9, 3.10, 3.11 and 3.12. Also see Chart 3.6 above.

The 'North-South Divide' has persisted despite decades of regional policy aimed at creating a more balanced pattern of economic development (Chart 3.9). The Government's current Regional Growth Fund is actually less resourced than the previous Regional Development Agency network. The Recession has deepened the 'Divide'. ONS regional GVA data shows that London's economy grew by 12% through the recession – four times the growth rate of the North and Midlands regions. Household disposable income is much higher in the Greater South East – London plus the South East and East of England regions – than in the rest of the country. Average income in London is nearly twice that of the North East.

Chart 3.9: The Persistence of the North-South Divide, 1971-2010



Source of data: Cambridge Econometrics

- As Chart 2.10 shows, about two-thirds of LDC's portfolio investments are UK businesses based outside the Greater South East. This share is significantly greater than for the total GB stock of both SMEs and mid-sized businesses.

- There are big differences between the regions outside the Greater South East, with LDC's portfolio investment more highly concentrated in the North West and West Midlands, the traditional heartlands of mid-sized businesses and manufacturing industry and 'home' to the powerful Manchester and Birmingham city regions.

Chart 3.10: Regional Distribution of LDC Investees & GB Stock of SMEs and Mid-Sized Firms

Regional Share of Businesses (%)					
	All LDC Investments	LDC Current Investments	All GB Vat-registered Businesses	All GB SMEs (1-250 employees)	All GB Mid-Sized Businesses (50-499 employees)
East Midlands	11.6	9.3	6.9	6.9	7.3
East of England	6.2	6.7	10.1	10.1	9.4
London	14.7	17.3	16.6	16.6	15.4
North East	1.6	1.3	3.0	3.0	3.8
North West	20.9	20.0	10.1	10.1	11.1
Scotland	2.3	1.3	7.8	7.8	8.4
South East	11.6	14.7	15.8	15.8	14.2
South West	2.3	2.7	9.5	9.6	8.4
Wales	1.6	2.7	4.4	4.4	4.3
West Midlands	14.7	16.0	8.3	8.3	9.2
Yorkshire and the Humber	12.4	8.0	7.4	7.4	8.5
Great Britain	100	100	100	100	100
Greater South East (GSE)	32.6	38.7	42.5	42.5	38.9
Outside GSE	67.4	61.3	57.5	57.5	61.1

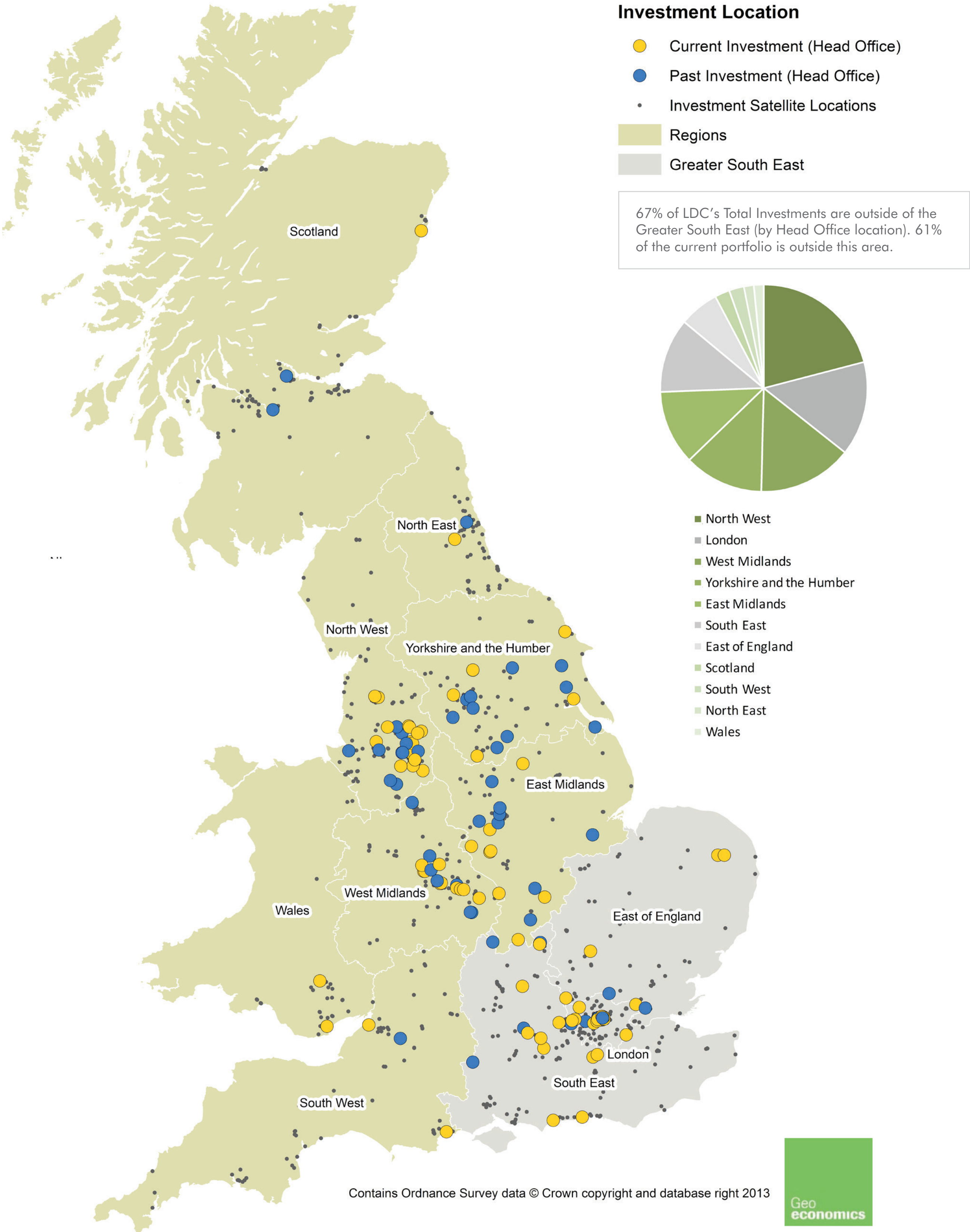
Source: Inter Departmental Business Register

- About two-thirds of aggregate employment for the past and current LDC portfolio is located outside the Greater South East, compared to nearly 60% of all private sector jobs. Again reflecting the capital's high growth rate in the midst of the recession, LDC's current portfolio is strongly oriented towards London and the West Midlands – the 'hubs' of LDC's sector-based initiatives in engineering and technology.

Chart 3.11: Regional Employment Distribution of LDC Investees & All GB Businesses (%)

	All LDC Investments	LDC Current Investments	All GB Private Sector Employment
East Midlands	8.1	7.2	7.2
East of England	4.5	4.1	9.3
London	23.1	34	16.6
North East	2.4	0.7	3.5
North West	14.5	13.7	10.9
Scotland	7.6	0.5	8.3
South East	6.7	10.1	14.7
South West	3.3	2.5	8.7
Wales	0.8	1.6	4.2
West Midlands	17.2	20.3	8.6
Yorkshire and the Humber	11.8	5.4	8.0
Great Britain	100	100	100
Greater South East (GSE)	34.2	48.2	40.6
Outside GSE	65.8	51.8	59.4

Chart 3.12: The Regional Distribution of LDC Portfolio Businesses



Note: This analysis uses LDC Investee Head Office locations only.

Investing in Disadvantaged Areas

Please see Charts 3.13 and 3.14.

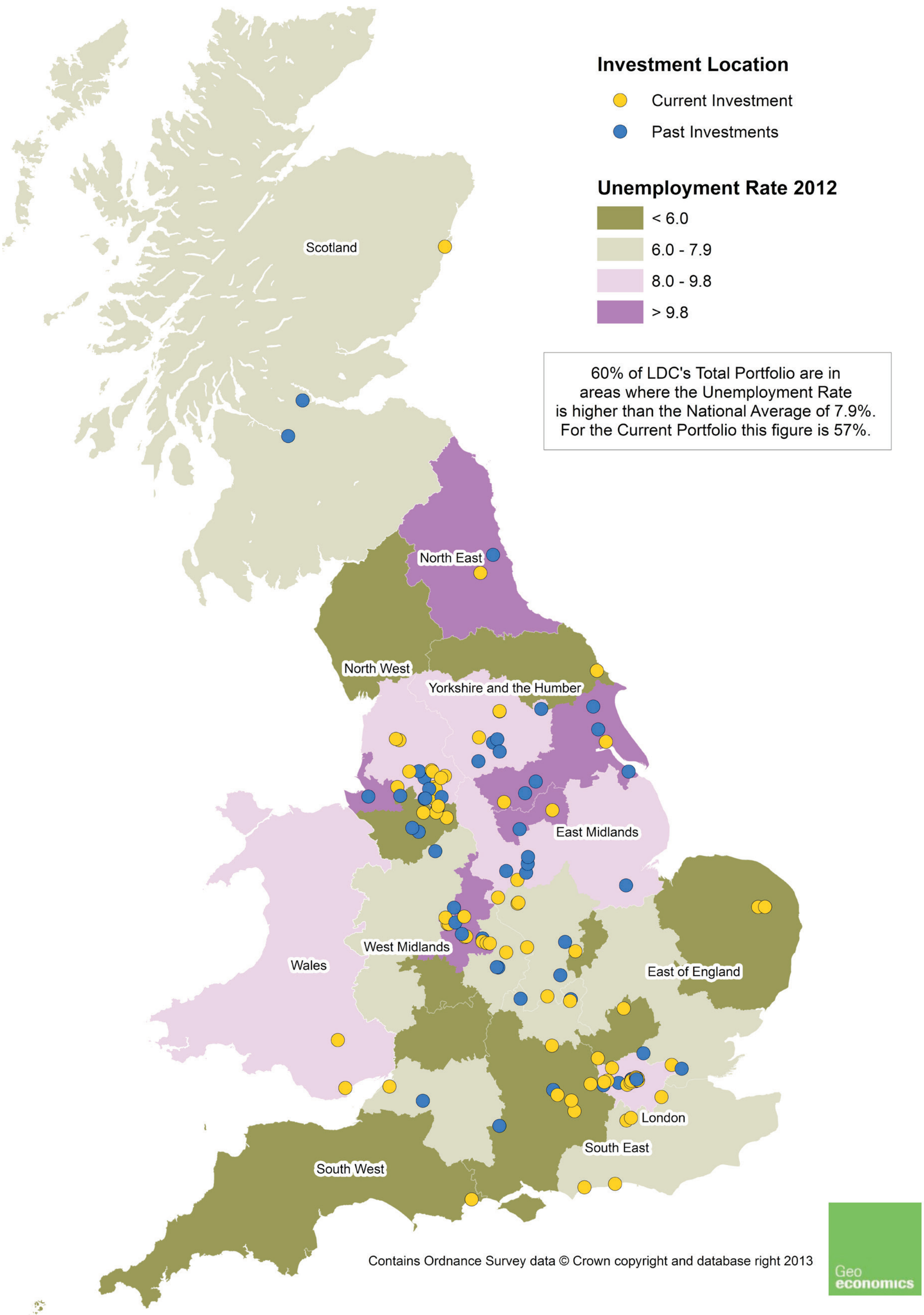
Levels of unemployment and socio-economic deprivation vary significantly across and within regions of the UK – including London, where new evidence showed a massive difference in life expectancy between prosperous outer London (e.g. Richmond) and disadvantaged inner London boroughs (e.g. Tower Hamlets). Using 2011 Census data, ONS/Cabinet Office research indicates that 60% of local variation in community well-being is explained by the incidence of long-term unemployment. Job creation in disadvantaged local communities with less resilient economies, therefore, has a much higher relative social value than in less disadvantaged areas.

- 60% of all of LDC's investees are located in areas where the local unemployment rate is higher than the national average of 7.9%. For the current portfolio this share stands at 57%. See Chart 3.11, where 'local' refers to the Local Enterprise Partnership geographical boundaries (multiple local authority areas).
- 31% of all of LDC investees are located in England's top 20% most deprived areas, the figure for the current portfolio being 38%. See Chart 3.14, where 'local' refers to local authority boundaries.
- This is far better than the whole SME population, 12% of which is located in the 20% most deprived areas of Britain AND favourably with social enterprises (BII's clients), 38% of which are located in the most deprived communities.[8]

LDC does not prioritise high unemployment/deprived communities in its search for 'high growth businesses'. However most of its investees are located in urban areas of Britain where the incidence of socio-deprivation tends to be high compared to suburban and rural areas. Further, some proportion of the investee business' workforce will not live in the surrounding disadvantaged area – higher level staff will tend to commute in (the picture in most big and medium-sized cities, including London). Again, case study research would help to refine this social valuation. ***On balance though, there are known to be tangible and intangible spill-over effects for the local economy and community – infrastructure, direct and indirect job creation (at different skill levels), local business confidence etc. Hence, social value is created in the disadvantaged areas where LDC private equity investments are made.***

[8] Social Enterprise UK, State of Social Enterprise Survey 2013

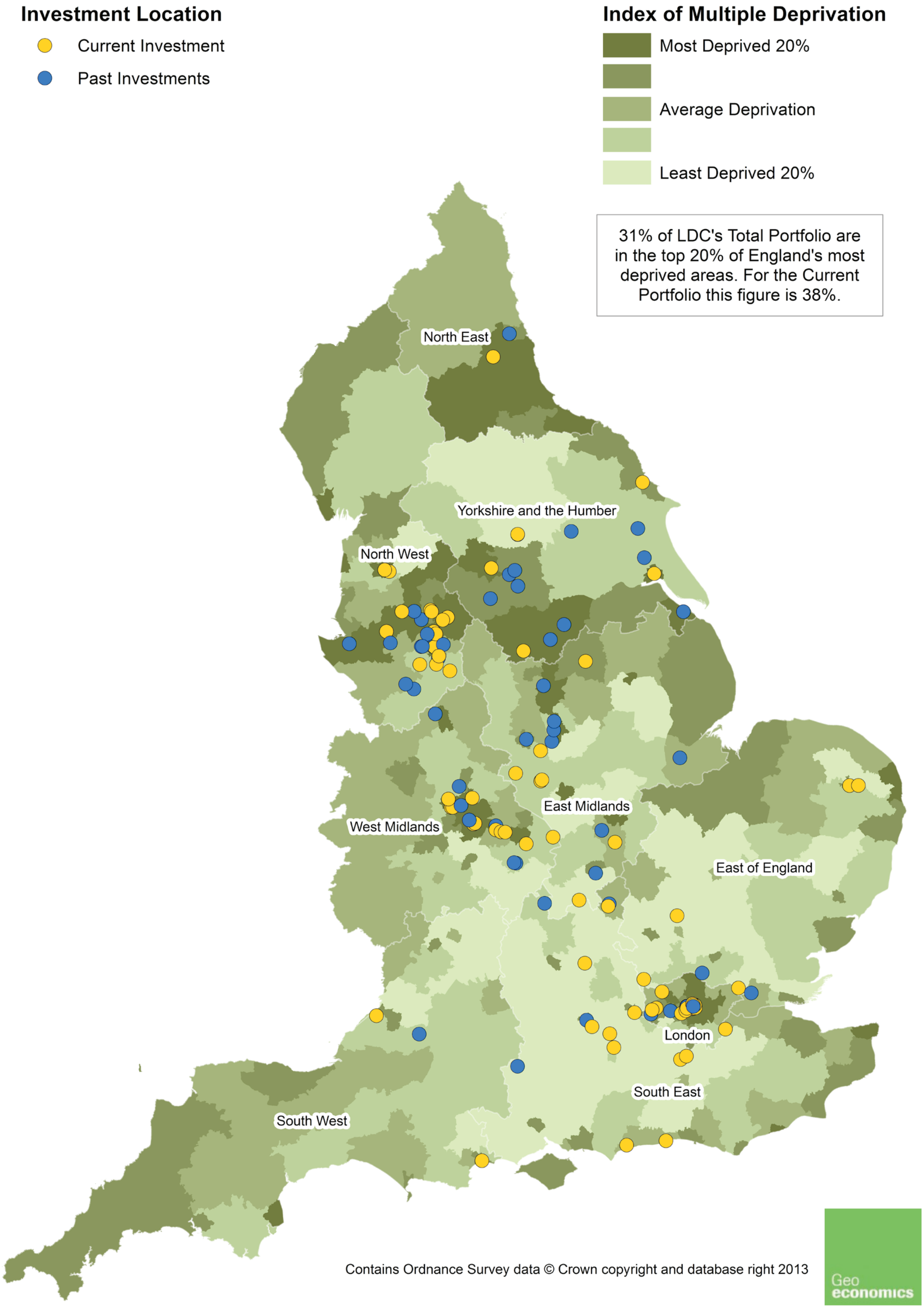
Chart 3.13: Location of LDC Investees by Local Unemployment Rate



Note: This analysis uses LDC Investee Head Office locations only.

Source: Annual Population Survey

Chart 3.14: Location of LDC Investees by Level of Local Deprivation



Notes: This analysis uses LDC Investee Head Office locations only. Scotland and Wales are excluded from the above analysis because they use different and non-comparable measures of deprivation – this excludes 5 LDC businesses.
Source: Index of Multiple Deprivation 2010

4 LDC'S SOCIAL VALUE SCORECARD

The various strands of our social value assessment for LDC are brought together in the form of a 'Social Value Scorecard' (see Chart 4.1). This scorecard is for the entire portfolio, including both current and past investments.

For each of the five domains of social value, we have indexed LDC's performance against the relevant benchmark or comparator – these are national and local trends and averages based on published data (mostly ONS data).

In order to maintain consistency across all domains the Index scores apply to the period 2008-2012 – the recession's time-frame. The boundaries of the time-frame are adjustable.

There are 12 social value indices altogether. An index score of above 1 means that LDC out-performs the benchmark/comparator, whilst a score of less than 1 means that LDC under-performs.

- **LDC's scorecard is very positive: the index scores across all five domains and for 11 out of the 12 indicators are above 1. The domain average and overall scores are the median values.**

- **Given its target market, as expected, LDC's social value performance is highest in the Business Growth domain, where investee businesses are highly dynamic employers in their local economies.**

- **The scorecard shows that LDC's contribution to 'rebalancing by sector' is significant. The strong performance on exports and manufacturing is exactly what the CBI and other economic observers believe is essential to balanced economic growth (see Annex).**

- **LDC's performance on 'rebalancing by region' is also positive but less significant than its sector contribution. Importantly though, the positive scores on both aspects of 'rebalancing' show that growth is achievable simultaneously by sector and region – rather than being London-centric or London-driven.**

- **The 'social intensity' of LDC's portfolio is positive and encouraging – LDC's investee businesses are concentrated in disadvantaged areas to the same extent as UK social enterprises are – and far more so than other UK SMEs.**

Chart 4.1: The LDC Social Value Scorecard, 2013

Social Value Domain	Indicator	Portfolio Index Score	Domain Score
Investment (2008-12)	Bank lending	1.7	1.5
	Business investment	1.3	
Business Growth (2008-12)	Businesses Employment Growth	4.8	4.8
	Local Sector Employment Growth	10.5	
	Local GVA/Earnings Growth	4.8	
Re-balancing by Sector	Manufacturing Sectors	4.5	2.7
	Export-intensive Sectors	2.7	
	Businesses in low private sector-intensive areas	1.1	
Re-balancing by Region	SME Stock outside GSE	1.1	1.1
	Employment Outside GSE	1.1	
Investing in disadvantaged areas	Businesses in High Unemployment areas	1	1.3
	Businesses in Deprived Areas	1.6	
OVERALL SCORE		1.7	11.4

From the scorecard results we can conclude that LDC's social value performance – defined in terms of the UK's need to build a more 'balanced economy' – is positive and encouraging. Whilst LDC goes about its routine business as a private equity investor, it is also creating social value for the country – as a nation made up of regions and local communities.

This report on LDC is the first time we have applied the BII social value assessment framework. It can be refined and extended:

1. LDC could up-date the scorecard every year or six months to monitor and evaluate its own social value added. This could encourage LDC to use the methodology to guide its pre-investment decision process (positive screening). Building a time-series database will increase the power of the methodological framework.

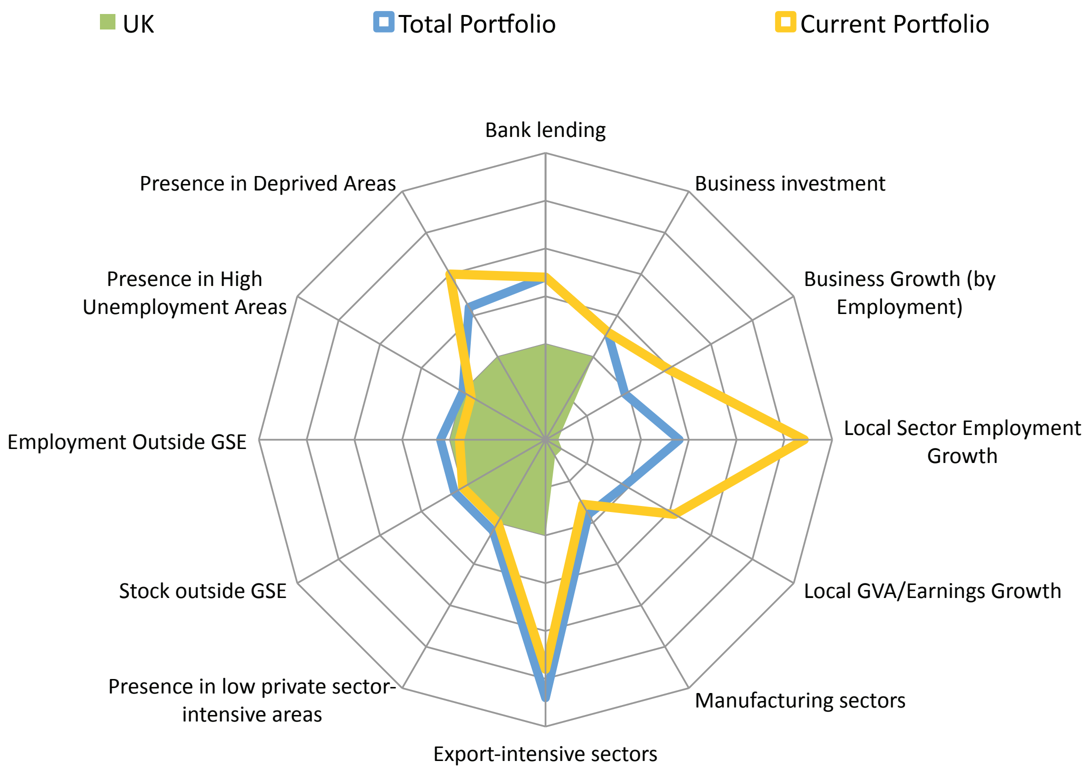
The 'spider chart' in Chart 4.2 shows, for example, how LDC's social value performance differs between its overall 'past and current' portfolio and its current portfolio taken separately. It indicates that LDC recent investment activity has been more GSE/London oriented. However, on average LDC investments have a higher 'social intensity' in terms of their concentration in deprived areas and local employment impacts.

2. The BII methodological framework could be promoted to other players in the private equity sector and related sectors. This would enable benchmarking at the sector level, and offer opportunities to compare social value performance across different portfolios.

3. Business and sector case studies could bring the portfolio-level assessment to life. They could deepen understanding of how businesses create social value in specific contexts, absolutely and relatively.

4. The 'spider web chart' shown in Chart 4.2 offers another way of looking at LDC's social value performance and how it varies across the 12 different indices/indicators. To illustrate how the methodology can be extended, we have drawn 'webs' for past and current portfolio investments separately (see Chart 4.2).

Chart 4.2: LDC Social Value 'Spider Chart'



Annex: Views on Re-balancing the UK Economy

Government Perspective

HM Treasury: Government Policy is to Rebalance the Economy (July 2013)

Rebalancing the economy is not about trading the success of one sector for another. It's about spreading our success more evenly - both geographically and by sector - and supporting the world class industries we already have, as well as the new ones that we're developing.

Academic Perspective

Ben Gardiner, Ron Martin and Peter Tyler, Centre for Geographical Economic Research Working Paper CGER No. 1, June 2012 - "Spatially Unbalanced Growth in the British Economy"

The United Kingdom continues to experience the pronounced broad North-South imbalance highlighted in this paper, it may also see a widening economic divide between the devolved and non-devolved regions of its North. There is thus an urgent need for a clearly identified industrial policy that is coordinated with a regional policy that seriously begins to address the North-South imbalance in the UK's economy that has become so deep-seated over recent decades.

Michael Kitson, Cambridge University economist & Assistant Director of the Centre for Business Research, Compass July 2013

In the UK, there are sectoral imbalances: we have seen a focus on the financial services and the relative decline of manufacturing. There are regional imbalances: London has done very well over the last thirty years while the North West and the North East have not. There are also trade imbalances: we have had a big balance of payments deficit and we are not paying our way; for the last thirty years we have been borrowing from the rest of the world to fund our consumption habit. These three imbalances – in our sectors, our regions and our balance of payments – cannot continue and we are destined to see much lower growth for ourselves and our children in the future.

Business Perspective

Confederation of British Industry, CBI: **A Vision for Rebalancing the UK Economy: A New Approach to Growth, 2011**

The UK economy is over-dependent on household and government consumption as drivers of GDP growth, which is leading to rapidly rising household and government debt – an unsustainable model of economic growth. Rebalancing the UK economy must consist of resurrecting business investment and net trade as the drivers of economic growth.

CBI: **The UK's Growth Landscape: Harnessing Private Sector Potential across the Country, 2012**

Only sustainable, private sector growth can lead the UK back to economic health, weaning the economy off its debt-fuelled dependence on government and household consumption. This private sector growth must come from all corners of the UK if the economy is to successfully rebalance towards investment and exports and establish a sustainable growth footing. The view from business is that a new approach is needed, one based on the 'geography of growth', which seeks out private sector growth at every spatial level and in every part of the UK.

Engineering Employers Federation: **The Route to Growth - An Industrial Strategy for a Stronger, Better Balanced Economy, 2012**

We want a rebalanced model of growth to deliver greater prosperity for the UK driven by more innovation, higher investment and exporting, a lower cost of doing business, and a more flexible and productive workforce – this is our strategy. The UK's world-class manufacturing sector is well placed to deliver on this and the current government has the chance now to set such a strategy. But to be successful, our strategy needs to endure beyond the latest political fad or any one political party; we need all our politicians to recognise the value of having a clear vision, gearing the whole of government to delivering that vision, and setting clear accountability arrangements. We also need a strategy that speaks to more than just our sector – no one sector can by itself deliver our vision. We need all actors in our economy bought into delivering the rebalanced growth we so badly need. So our ambitions are ambitions for growth, not just industry; and our challenge to all others is to define industrial strategy in terms of the overall economy we all want.

Value in Private Equity: Where Social Meets Shareholder

By Mark Hepworth
Big Issue Invest

March 2014