STATES OF JERSEY

JERSEY INNOVATION FUND (S.R.4/2013) – RESPONSE OF THE MINISTER FOR ECONOMIC DEVELOPMENT

Presented to the States on 30th April 2013
by the Minister for Economic Development

STATES GREFFE

JERSEY INNOVATION FUND (S.R.4/2013) – RESPONSE OF THE MINISTER FOR ECONOMIC DEVELOPMENT

Ministerial Response to: S.R.4/2013

Ministerial Response required by: 8th May 2013

Review title: Jersey Innovation Fund

Scrutiny Panel: Economic Affairs

INTRODUCTION

The review undertaken by the Economic Affairs Scrutiny Panel encouraged the Department to reconsider the Jersey Innovation Fund its policies and eligibility criteria. Most of the recommendations contained within the Economic Affairs Scrutiny Report have been accepted and policy, operating terms of reference and application documentation has been amended.

The recommendations not accepted are either not possible under current Law or more relevant to a future Report and Proposition, which subject to States approval, will allow the Jersey Innovation Fund to make equity investments and move towards a Partnership Fund – Phase 2. This further development of the Jersey Innovation Fund (JIF) will be presented the States of Jersey within 6 months of the launch of Phase 1 of the JIF.

FINDINGS

	Findings	Comments
1	The official definition of innovation for the purpose of the JIF is understandably wide ranging in scope. However, with no clear case studies identified and more restrictive eligibility criteria, a degree of uncertainty has been introduced about the type of projects the JIF aims to support.	The definition for innovation is defined in the Report and Proposition and referenced in the EA Scrutiny Report as '*products, services and other solutions that can be new to the business or the international market'*. Appropriate case studies will be developed based on experience elsewhere to be brought forward prior to the debate.
2	It is proposed that the JIF will launch and initially operate in the model of a Government Fund, making financial support available in the form of repayable loans or non-repayable grants.	In Phase 1 of the project the JIF will operate as a Government Fund and in accordance with the Public Finances (Jersey) Law 2005 offer loans and grants.
3	Although the JIF is proposed to launch as a Government Fund, matched	The Public Finances (Jersey) Law 2005 limits the JIF to offer only loans and

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	funding with private venture capital (i.e. a Partnership Fund) was identified as the preferred model by stakeholder organisations, and recognised as a leverage opportunity by the Minister for Economic Development.	grants – Phase 1 The Government Fund. Within 6 months of launch Treasury and Resources will lodge a new R&P that will allow the JIF to make equity investments in privately owned businesses and move towards a Partnership Fund. This will require ED and T&R working closely with stakeholders to develop the R&P.
4	It is proposed that the JIF is to be a fund of last resort and, in order to qualify for a loan, evidence must be produced by an applicant to show that all alternative funding has been exhausted. There is general consensus that 'last resort' terminology is unhelpful.	To clarify. Public funds will only be invested where there is clear evidence that the project will not go ahead without support from the JIF – where a 'market failure' exists. Following the publication of the Scrutiny Review, greater care will be taken to explain the rationale of the Fund and avoid external perceptions that it has the status as a Fund of 'last resort'.
5	Stakeholder organisations agreed that basing the JIF on the principle of 'lender of last resort' was unsuitable, given its implied negativity about the quality of potential applications.	To clarify. Public funds will only be invested where there is clear evidence that the project will not go ahead without support from the JIF – where a 'market failure' exists. Following the findings of the Scrutiny Review, greater care will be taken to explain the rationale of the Fund and avoid negative external perceptions.
6	It is accepted that due to the nature of the new and innovative businesses that might be supported by the JIF, not all investments will be successful. Consequent failures could result in loans not being repaid and/or objectives not being met. A level of 'failure' would need to be accepted by the States, balanced against the positive benefits that the JIF is seeking to achieve.	A review of a similar scheme in the UK- the Small Firms Loan Guarantee Scheme-reported a write-off rate equal to 10% per annum of the value of the loans outstanding. The review also reported that a number of projects failed to reach their original growth forecasts. It is estimated that about 20% of projects supported by the JIF will fail to reach their original forecasts of growth (jobs and revenues) – of which 10% ,in outstanding loan value, will fail completely. The actual 'write off cost' to the JIF will depend on what can be recovered from the failed project and or any security taken.
7	The Minister for Economic	The 70% quoted was not the percentage

	Findings	Comments
	Development raised the potential for high percentage levels of 'failure' amongst those projects given funding through the JIF, initially suggesting this could be as high as 70%. There is consensus, including from the Minister, that in terms of JIF recipients going out of business, such high rates would be unacceptable.	of loans written-off. The 70% cited by the Minister for Economic Development is the percentage of projects, supported by a similar fund in Israel, which did not exit on high value multiples of the original investment.
8	There is a lack of clarity about what defines 'failure' both in relation to the JIF overall and the individual projects receiving funding.	Overall failure for the JIF would be if high quality innovative projects could not proceed because of lack of appropriate funding. Failure for a project would be that it failed to achieve its original anticipated potential. This would be measured, for example, in revenues, jobs created, market share, or economic spillovers. Accepting the point made by the Panel in its review, more careful use of terminology suggesting 'failure' will be used so as to minimise negative external perceptions.
9	More clarity and detail is required regarding the monitoring mechanisms that would enable, amongst other things, the possible identification of the need to discontinue the JIF before it is depleted, should it not be performing successfully.	The Panel's views are accepted and a series of revised reporting/monitoring mechanisms are recorded in the Revised Operational Terms of Reference Framework Section 14 (as summarised below) – • JIF Board to provide Minister for Economic Development and SoJ Treasurer with a written report every 6 months. To include: A financial statement on all income and expenditure of the Fund; full details on every approved loan; report on all defaults, non or late repayments; loan restructuring and write-offs; progress reports on every project and details of any other changes to the project. • Every organisation must provide quarterly reports to include: progress report against the original plan; financial analysis of spend and income; progress report on all innovation development; changes in

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		key staff; changes in Directors. • Provide an annual Grant/Loan Assurance Statement. • At such frequency and such time as the States of Jersey Audit Committee may from time to time determine may conduct an audit of the JIF. • The SoJ at its absolute discretion may conduct an audit of all approved grants/loans. • The Comptroller and Auditor General may, at his absolute discretion, audit the fund.
10	There is a lack of clarity about what defines 'success' in relation to the JIF and the individual projects receiving funding.	As defined in the Report and Proposition; *Success for the Jersey Innovation Fund will, by encouraging investment into areas of innovation, deliver a competitive advantage for Jersey, attract additional private sector investment, attract high value inward investment businesses and raise the productivity of local organisations resulting in more job opportunities for locals.'* Given the comments of the Panel in the Review this definition will be given increased profile in the final Revised version of the R&P going to States Members.
11	The Economic Development Department only estimates between 5-10 full applications would be fully progressed each year, of which it is estimated 4-5 applicants would be successful in gaining funding.	It is anticipated that 4-5 investment will be made per annum. This estimate is based on previous experiences of promoting and managing a range of funding schemes such as the Jersey Innovation Initiate, Jersey Export Development Initiative, The Small Firms Loans Guarantee Scheme, The Rural Initiative Scheme and the Tourism Development Fund. Plus the market intelligence obtained from the Jersey Enterprise operation. Organisations that do not meet the JIF criteria or fail to secure funding will be signposted to the other support schemes, for example but not limited to, The Rural Initiative Scheme, the

	Findings	Comments
		Tourism Development Fund, or the Jersey Business Angels Network.
12	With regard to the overall Fund, there were common success criteria identified, such as the creation of locally qualified jobs, financial return to the JIF and general taxation contributions. However, these were prioritised differently amongst the stakeholders, including the 2 Ministers responsible for the JIF.	As defined in the Revised Report and Proposition; Success for the Jersey Innovation Fund will, by encouraging investment into areas of innovation, deliver a competitive advantage for Jersey, attract additional private sector investment, attract high value inward investment businesses and raise the productivity of local organisations resulting in more job opportunities for locals. Given the comments of the Panel in its Review, the Department has already begun more in-depth engagement with various organisations viewed by Scrutiny as key stakeholders and will continue to work with them to ensure that views of success can be more closely aligned.
13	To avoid becoming a sinking fund, the JIF must have a clear financial objective, and key performance indicators (KPI's) should be defined from the outset.	The aim is for the JIF is to be self-replenishing. In Phase 1 it is not anticipated that the income from royalties and loan interest payments will be sufficient to fully replenish during its early years of operation owing to the nature of loan repayments and the early stage of product lifecycles of the companies involved. As loans mature and royalty income from sales build, there is an increased likelihood that returns to the Fund would replace or exceed the amounts borrowed at the outset and reduce the early stage deficit effects. Phase 2 (equity investments) allows for greater and earlier potential returns to the JIF (through dividends and potential sale of shares at multiples of the original investment value), that will greatly improve the JIF's ability to become self-replenishing at a much earlier stage and possibly compensate from the more staged returns of Phase 1 investments. The Department will continue to work with Stakeholders and Treasury to

	Findings	Comments
		agree a mutually acceptable list of measures and performance indicators that accurately reflect the performance of the Fund, keeping Scrutiny updated on progress made.
14	Although intended to constitute a £10 million fund, it is proposed that the JIF will launch initially with £5 million, with an additional £5 million to be allocated at a later, undefined stage. The source of the additional £5 million has yet to be confirmed by the Minister for Treasury and Resources.	In accordance with paragraph f. of the MTFP Proposition, the States agreed – "to approve, in accordance with Article 32(5)(a) of the Telecommunications (Jersey) Law 2002, the disposal by way of redemption of the States 9% Preference Shares in the JT Group Ltd with the redemption value of £20 million being applied, £15 million to the Capital Programme for 2013 to 2015 and the balance of £5 million for Economic Development Department to provide funding for the proposed Innovation Fund." This was reiterated in Appendix Ten of the MTFP – 1380. "the establishment of a new Separately Constituted Special Fund to be known as "The Innovation Fund", under Article 3 of the Public Finances (Jersey) Law 2005." 1381. "Further, to approve the allocation of £5 million in 2012 to this fund. This will be managed by the Economic Development Department and an independent board." The Minister for Economic Development confirmed this when signing MD-E-2012-0137 'Jersey Innovation Fund: Operational Terms of Reference'. Likewise, the Minister for Treasury and Resources confirmed this funding with MD-TR-2012-0094 'Jersey Innovation Fund: Establishment, Funding and Operation', both of which were signed in November 2012. This funding was consistently communicated throughout the MTFP process when a target of £10 million was set for the JIF but the States could only provide £5 million within the

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		resources available in the period of the MTFP. The inability to identify the source of the additional funds at the outset should not materially affect the ability of the JIF to serve its purpose, given the predicted number of loans and the current limit on loan size (£500,000 as a result of the Public Finance (Jersey) Law 2005) – see 18 below.
15	It is widely agreed that, although a fund of £10 million is small compared to many other such schemes, it nevertheless represents a suitable scale for Jersey and was seen by stakeholders as a positive step.	The States has agreed to capitalise the JIF with £5 million in the MTFP. The potential to further develop JIF at Phase 2 into a Partnership Fund may well attract further private sector investment extending the scope and value of the Fund, with no impact on States revenues.
16	The potential level of demand for the JIF has not been assessed through formal research by the Economic Development Department, and is effectively unknown. However, stakeholder organisations and the sponsoring Ministers are hopeful of introducing or attracting sufficient levels of applicants with good ideas to the Fund.	EDD, through both current and previous support programmes, has a good understanding of the likely number of applications. The experience gained from the work done by Jersey Enterprise 2007-2011, and grants schemes such as the Jersey Innovation Initiative, Jersey Export Development Initiative, The Rural Initiative Scheme and the Tourism Development Fund has been used to anticipate the level of demand for the JIF.
17	Although the lodged Proposition report clearly sets out that the JIF would be available to support a wide range of activity, it is not clear to the Panel how the third or public sector would be able to access the fund based on the demanding criteria of the JIF Policy Framework and the Eligibility Guidelines found on the application form.	The concerns raised by the Panel about accessibility for third and public sector organisations have been addressed in the Revised Operational Terms of Reference and Application Form which have been amended to ensure that organisations from any sector, at any stage of development, value or size can make applications to the Fund.
18	Although the lodged Proposition, report and Operational Terms of Reference contain no indication of a minimum or maximum funding level per applicant, this is contradicted by the inclusion of minimum £20,000 and maximum £500,000 funding amounts on the draft	The recommended maximum funding level (£500,000) is consistent with the Minister for Treasury and Resources' maximum lending limit under the Public Finances (Jersey) Law 2005. This upper limit will be reviewed during the work required to allow for

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	application form and policy framework documents.	private equity investments (Phase 2) where the Department will obtain a clearer indication of the types and scale of investment sought coming forward from the Jersey market via the initial Phase 1 applications. Following the publication of the Panel's Review, the minimum level of £20,000 has been removed from the Revised Operational Terms of Reference and Application Form appended to the R&P. This will be monitored over the initial operational period and reviewed, along will other policies along with input from the JIF Board on a regular basis.
19	Stakeholders, and initially both sponsoring Ministers, agreed that there was little or no merit in setting minimum or maximum funding levels. However, the Minister for Economic Development later suggested that a minimum level may even be set higher than £20,000.	See 18 above The Minister and Department have accepted the views of the Panel and amended the Revised Operational Terms of Reference and Application Form appended to the R&P to reflect this.
20	The JIF Policy Framework and the Eligibility Guidelines on the application form establish the need for an applicant to be a Business incorporated under the Companies (Jersey) Law 1991. This appears to be inconsistent with the Operational Terms of Reference, which don't indicate such a narrow scope or criteria. It raises concerns that a number of potential applicants to the JIF might be inadvertently excluded, in that Partnerships, LLP's and sole traders might be ineligible to apply.	The concerns raised by the Panel about eligibility guidelines have been considered and as a consequence in order to maximise the scope and benefits of the JIF, Revised Operational Terms of Reference and Application Form have been developed that will allow applications from individuals, thirds sector organisations and any type of trading entity, such as sole traders, Limited Liability Companies, partnerships, LLPs etc. Applications from individuals or sole traders successful in securing a loan may be asked, by the JIF Board, to put in place a specific corporate governance structure which could result in establishing a company registered in Jersey.
21	The requirement for an application to demonstrate £65,000 GVA per employee effectively rules out potential applications from the third and public sectors, and many non-finance industry	The Minister and Department have accepted the views of the Panel and amended the Revised Operational Terms of Reference and Application Form appended to the R&P to reflect

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	related projects.	this. To maximise the scope of the scheme the required £65,000 GVA per employee has been removed from the eligibility criteria. Applications will now be welcomed for any project that can demonstrate that the investment in innovation will deliver productivity gains/growth (jobs and revenues).
22	The GVA levels per employee and high growth requirements could effectively rule out many potential applications, particularly in the third and public sectors, and traditional industries such as tourism and agriculture.	See 21 above.
23	The 'high growth' requirement states that an applicant must demonstrate the potential to double revenues or employment within 4 years and to employ at least 10 full-time equivalent staff by the end of the 4 year period. This appears highly restrictive.	The recommendation by the Panel to remove the reference to high growth in the eligibility criteria has been agreed and all policy documents and the application form updated. The aim of the EGDS, for which the JIF is an enabler, is to deliver growth-resulting in new jobs and increased revenues for organisations.
24	There is clear inconsistency between the stated aim of the Fund being available to all sectors of the economy on the one hand, and the emphasis placed on targeting high value, high growth opportunities on the other.	Following the publication of the Panel's Review, the Department has accepted the Panel's comments and as a consequence the JIF will be accessible to any company from all sectors which can demonstrate an investment in innovation has the potential to deliver growth resulting in new job opportunities.
25	The application process places considerable demands on an applicant, beginning with the initial 15 point request for a written report and supporting documentation contained on the application form. As the application process progresses, there are additional demands for information through the due diligence process, Funding Agreement development and post loan monitoring and reporting.	The JIF must have the appropriate levels of due diligence and risk assessment for a fund capitalised with public money. It is also important that the JIF applies the appropriate levels of post approval aftercare. The information requested is both appropriate and necessary for a Government Fund, although it will be reviewed again – based upon actual experience – as part of the R&P for the Phase 2 of JIF, which may move towards the Partnership model and

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		provide access to non-States funding, where such criteria may be seen as more onerous.
26	A balance is required between the required quality due diligence, and the need to make the application process as free of ‘red tape’ as possible, in order to ensure that it is timely and not off-putting to potential applicants.	The JIF will be capitalised with tax payer’s money so it is important that the JIF applies the appropriate levels of pre-approval due diligence and post approval aftercare. This will be balanced with the overall aims of the JIF.
27	Stakeholder organisations were united in their expectation of a timely and efficient, yet robust, due diligence process. The Panel has concerns about the ability of the due diligence process as currently proposed to meet those sound expectations.	The Minister and Department have accepted the views of the Panel, recognising the need to apply appropriate levels of due diligence at all stages, leading to the delivery of a timely, effective and commercial process. The target is applications should be considered, assessed and approved/rejected within 6 weeks – some may take longer and some may be quicker. The 6 week target gives the applicant an indication of the timescales and a performance measure for the application process. The due diligence process will regularly be reviewed with amendments made at the recommendation of the Board, if it proves to be unrealistic.
28	It is clearly proposed that grants will only be made in exceptional circumstances.	The Minister and Department agree the views of the Panel and this is consistent with the Revised Operational Terms of Reference and Application Form.
29	Any grant or repayable loan would be the subject of a detailed Funding Agreement. Each Funding Agreement would be unique and include details of any specific clauses, including repayment terms and timing arrangements for repayment.	The Minister and Department agree the views of the Panel and this is consistent with the Revised Operational Terms of Reference and Application Form.
30	Although the JIF Operational Terms of Reference broadly propose consultation between the Board, the Treasurer of the States and the Minister for Economic Development, the process by which	Each application will be unique. During the application, due diligence and the JIF Boards assessment each project will be assessed for its ability to repay the loan, over what period and at

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	loan repayment terms and interest rates are to be established is not clear, with no formal details or guidelines available.	what interest rates. It is anticipated that the Treasury and Resources Department will provide regular advice on current commercial rates of interest, against which any recommendations of the JIF Board to set different rates of interest on loans can be judged by the Minister for Economic Development.
31	The Panel is concerned by the number of outstanding questions relating to Royalty Agreements, and the limited progress that has been made by the Economic Development Department at this stage in progressing the template document, which is currently only in early draft form.	The Department recognises the concerns expressed by the Panel in its Review and will produce draft Templates for the Panel's review prior to the States Debate. Draft Template Agreements will be provided that will allow the Panel to assess the likely contents and reach a view on their progress. Whilst Templates are being developed it is worth emphasising that given the varied nature of applications, products and terms, each successful Fund applicant will require an Agreement with a high degree of bespoke content, therefore the Templates will effectively only be illustrative in nature.
32	Should the States approve the first phase of the JIF, there are proposals for a second stage to be introduced within 6 months to enable the States to make equity investments in funded projects. This is a significant step and a departure from common States practice regarding loans, and requires additional expertise and also new legislation.	The Minister and Department agree the views of the Panel and the Revised Report and Proposition confirms the commitment for EDD and T&R to work together and develop proposals that will allow the JIF to make equity investments. A new R&P will be lodged within 6 months of the launch of the JIF.
33	Although the proposed JIF is intended to be self replenishing, with stakeholders agreeing that this was a sensible aspiration, it is difficult within the context of high suggested 'failure' rates, grants, costs, lender of last resort principle, differing 'success' priorities and in particular the initial absence of the equity element amongst others, to envisage that the JIF will meet this aim. There is therefore the distinct possibility of the JIF becoming a	Whilst every effort will be made for the JIF to become self-replenishing some projects will fail to achieve their original anticipated growth and revenue forecasts, others may even fail completely resulting in a loan write-off. Making the Fund self-replenishing in the early years of Phase 1 will be represent a significant challenge for the reasons highlighted by Scrutiny, however as both companies and loans mature, any diminution in this

	Findings	Comments
	sinking Fund.	aspiration should be minimised. Phase 2 (equity investments) allows for greater and earlier potential returns to the JIF (through dividends and potential sale of shares at multiples of the original investment value), that will greatly improve the JIF's ability to become self-replenishing at a much earlier stage and possibly compensate from the more staged returns of Phase 1 investments. The Department believes that the Revised Operational Terms of Reference reflect the concerns expressed by the Panel and encompass sufficient monitoring and governance safeguards that will prevent the JIF from becoming a sinking fund.
34	The emphasis on the requirement for the JIF Executive to have considerable and specific business expertise, as outlined in the Operational Terms of Reference and identified as being crucial by stakeholders, has been reduced by the Economic Development Department to that of a basic administrative role.	The role of the JIF Executive Officer is to provide support to the Board and manage the various stages of due diligence. This will require some basic administrative function but also require good knowledge of local business regulatory requirements. The JIF Executive Officer will also be responsible for managing/coordinating reports and after care arrangements for all approved loans. This may include outsourcing the aftercare/monitoring requirements to support organisations such as Jersey Business Ltd, Digital Jersey, Genuine Jersey, Rural Economy Advisory Team. The Department recognises the Panel's concerns and will work with Stakeholders to ensure that sufficient resource of the appropriate calibre is put in place to deliver both the administrative and functions of the role.
35	Some Innovation Funds in other jurisdictions are managed by external agencies who undertake all due diligence in reference to the management of the fund with no apparent conflict. In view of this and stakeholder consensus on the need for expertise and	The proposed operating model in Phase 1 (loans and grants) is a Government Fund, where the Fund remains within Government and complies with Public Finance Laws, Codes of Directions etc. It would not be very effective or efficient in Phase 1 for the JIF Executive Officer function to be

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	efficiency in the support provided to the JIF Board, it is conceivable that Jersey Business is well positioned to undertake the role and responsibilities of the JIF Executive.	provided by an arms-length organisation. There are also concerns about potential conflicts if a support agency bringing forward applications was also managing the due diligence processes. There is however a role for Jersey Business, Digital Jersey, and others, to provide aftercare on projects. Jersey Business, Digital Jersey and others will be fully consulted at Board level regarding any proposed role that they may take in bringing forward applications as part of the development of the Phase 2 (private equity) R&P.
36	There is a discrepancy between the limited role Treasury and Resources expects to undertake in the JIF, and the level of involvement that Economic Development has envisaged for Treasury and Resources.	The role for Treasury and Resources includes; being represented on the JIF Board, and managing the collection of loan repayments and the associated accounting/reporting processes.
37	In addition to the Economic Development and Treasury and Resources Departments, the JIF proposals establish the requirement for formal roles to be undertaken by the Economic Advisor’s Unit and the Law Officers’ Department.	The demands and nature of these roles will be bespoke to each application. The Department will work with other States and private sector stakeholders to ensure that there is a clear understanding of the role of each in the overall process.
38	The Panel is disappointed by the level of consultation undertaken by the Economic Development Department with other relevant Departments, most notably the Law Officers. This has led to a situation where there is lack of detail and progress on key areas, such as the Royalty Agreement, despite the close proximity to the proposed debate.	ED and Treasury officers have had three meetings with the Law Officers to discuss the development of the Loan and Licence agreements. Progress is being made but can’t be completed until the R&P and Revised Operational Terms of Reference, Policy Framework and Application Forms have been agreed. Draft Template Agreements will be provided to Scrutiny prior to the States debate that will allow the Panel to assess the likely contents and reach a view on their progress. Whilst Templates are being developed it is however worth emphasising that given the varied nature of applications, products and terms, each successful Fund applicant will require an Agreement with a high degree of

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		bespoke content, therefore the Templates will effectively only be illustrative in nature.
39	The JIF Board would be responsible for the management of the Fund, assessing all applications and making recommendations to the Minister for Economic Development. It would be comprised of a minimum of 2 members and a Chair from the private sector, plus ex-officio, non-voting representatives from the Economic Development, Treasury and Resources and Chief Minister's (Economic Advisor's Unit) Departments. This could set the Board structure as three private sector members and three public sector members.	The number of private sector JIF Board Members has been increased to 4 Board Members including an independent Chair. The public sector will be represented by representatives from The Economics Advisory Unit, Treasury and Resources plus The Chief Executive from Economic Development. The Chief Officer from Economic Development will be there in a non-voting capacity, to avoid any possible conflicts of interest and to allow the Chief Officer to provide independent advice to the Minister for Economic Development. The representatives from Treasury and Resources and Chief Minister's Department will have voting rights.
40	The Panel recognises the need and value of the public sector members of the JIF Board, but it is ultimately the private sector expertise recruited to the JIF Board that would be crucial to the potential success of the Fund.	The Minister and Department agree the views of the Panel and the number of private sector Board Members will be increased to 4, consistent with the Revised Operational Terms of Reference.
41	Although the Economic Development Department has outlined significant roles and input for both Digital Jersey and Jersey Business in the JIF, disappointingly it has not undertaken formal consultation with either organisation despite the imminent date of the States debate on the Proposition.	The Departments Chief Executive is on the Digital Jersey Board and the Deputy Chief Officer is on the Jersey Business Ltd Board. These appointments allow for on-going and regular communication about their current and future respective roles in the JIF. Recognising the Panel's concerns, more detailed discussions have now begun at Board level with both organisations and these will be extended as the development work for Phase 2 gets underway in earnest.
42	The financial and manpower implications statement in the Proposition estimates 'the operational and management costs' of the JIF to be £100,000. However, it was soon apparent that the	ED's normal accounting treatment of cost is not to include internal manpower or other expenses on similar projects-there are reported as corporate costs. (for example the Tourism Development Fund and Rural Initiative Scheme)

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	£100,000 did not apply to anything other than the external expert advice that would be required, and took no account of internal costs such as the resourcing of the JIF Executive by the Economic Development Department.	As a consequence of the Panel's concerns, the Department has revised its estimation of the likely levels of costs incurred. The estimated total annual cost of the JIF in Phase 1 is now believed to be £150,000. (£100,000 for external costs- due diligence, specialist advice, legal, credit and other background checks, plus a 'best estimate' for internal costs – man hours for the JIF Executive, EDD Chief Officer, Law Officers, T&R and the Economic Advisors Unit of £50,000 based upon 800 man hours input per annum). This is a best estimate and will vary depending on the complexity of the applications which are currently unknown, however the experience gained during Phase 1 will be utilised to more clearly scope the overall cost implications for Phase 2 and beyond.
43	It is quite possible that total estimated charges to the Fund could equate to within a range of £250,000 to £400,000 per year, undermining the ability of the JIF to be self replenishing.	The Minister recognises the Panel's concerns, however cannot share this estimate of costings. In Phase 1 (grants and loans) 10 applications are anticipated resulting in approximately 5 grants/loans being approved. The annual cost of £100,000 or £20–£25,000 per supported project should be sufficient to meet even the most complicated projects.
44	It is proposed that the operational and administration functions of the JIF would be covered by existing Departmental resources, which the Panel was told would therefore be of no cost to the Fund. This approach does not transparently account for the internal 'invisible' costs of the Fund and the man hours it requires.	The Minister recognises the Panel's concerns and internal costs to the Department will be closely monitored during Phase 1 to allow such transparency, with any subsequent amendments being reflected in cost structure coming forward for the Phase 2 R&P.
45	No full and transparent assessment of the 'invisible' costs that will be incurred by States Departments to fulfil the administration and monitoring functions of the fund has been made. Without defining the cost of the internal resource requirements, it is difficult to	See 44 above. The Department will make a commitment to closely monitor the costs of internal resource requirements in managing the Fund throughout Phase 1 and will use this early experience as a means of evaluating how best to operate

	Findings	Comments
	determine how the Fund is performing and to measure its overall success relative to cost.	and manage the Fund in Phase 2 R&P proposals.
46	Whilst in principle the JIF is very much welcomed by the Panel, there is an unacceptable level of inconsistency within the proposals, which also lack clarity and key details that should reasonably be in place and available to Members and stakeholders at this stage of the process. Until these issues are resolved, the Panel cannot support the establishment of the JIF.	

RECOMMENDATIONS

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
1	It is recommended that a Partnership Fund would be a more suitable model to move to, in order to harness the considerable benefits of leverage, shared risk and private sector expertise. This should be given serious consideration at the earliest opportunity.	ED	Reject for Phase 1 (loans and grants) Agreed for Phase 2 (equity investments)	The Public Finances (Jersey) Law 2005 allows the JIF to provide grants or loans (Phase 1). The Government Fund model is the most appropriate structure for this initial phase. Within 6 months of launch a new R&P will bring forward recommendations that will allow the JIF to make equity investments. Subject to States approval the R&P will move the model towards a Partnership Fund in order to harness the benefits of leverage, shared risk private sector expertise and make investments in return for equity in the business	6 months from launch

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
2	Greater clarity is required on defining both 'failure' and 'success' as they relate to the JIF, both in an overall sense and as applied to individual, funded projects. This should include: • a precise framework for the monitoring of the performance of individual projects and the financial performance of the overall Fund; • a formal mechanism to establish the circumstances under which the possible temporary or permanent closure of the JIF might be considered.	ED	Agreed	Overall success is clearly defined in the Revised Report and Proposition – *'Success for the Jersey Innovation Fund will, by encouraging investment into areas of innovation, deliver a competitive advantage for Jersey, attract additional private sector investment, attract high value inward investment businesses and raise the productivity of local organisations resulting in more job opportunities for locals'.* Overall failure would be less innovation resulting in fewer job opportunities for locals The Revised Operating Terms Of Reference clarifies the minimum reporting requirements for all supported projects. These reports will allow for all projects to be performance monitored on a regular basis. The JIF Executive will also manage a Risk Register which will record and escalate a project that is not meeting the agreed project objectives The Reports prepared by the Board on a regular basis, along with the Minister being represented at Board	

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
				Meetings, will provide the level of input and monitoring required for the Minister to be assured of overall satisfactory performance. Future Terms of Reference for the Board are likely to include the type of KPI's and other measures that Scrutiny are seeking in terms of the Minister being in a position to independently evaluate the longer term progress of the Fund	
3	To provide clarity about the very purpose of the JIF, there must be a common position established by the Ministers for Economic Development and Treasury and Resources regarding the prioritisation of the various success criteria.	ED	Agreed	The purpose is to encourage investment into areas of innovation. Success measures are to – 1. deliver a competitive advantage for Jersey; 2. attract additional private sector investment; 3. attract high value inward investment businesses; 4. raise the productivity of local organisations. The outputs from the above should lead to more job opportunities for locals 1-4 above are in no order of priority, and a project does not have to deliver against them all. The priority outcome is	

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
				job creation which is consistent with the SoJ Strategic Priorities	
4	The source of the second £5 million due to the Fund should be clearly identified by the Minster for Treasury and Resources.	ED	Accept	The Minister shares the Panel's concerns regarding the source and timing of the second stage £5 million States investment (see above). The inability to identify the source of the additional £5 million at the outset should not materially affect the ability of the JIF to serve its purpose however, given the predicted number of loans and the current upper limit on loan size (£500,000 as a result of the Public Finance (Jersey) Law 2005). See above.	6 months from launch
5	The JIF should not adopt the principle of minimum or maximum funding levels per applicant.	ED	Accept	The Minister and Department have accepted the views of the Panel and amended the Revised Operational Terms of Reference and Application Form appended to the R&P to reflect this The £500,000 maximum amount is consistent with the Treasury Ministries lending limit under the Public Finances (Jersey) Law 2005. This may change in the R&P for Phase 2 The proposed £20,000 minimum grant or loan	Immediate

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
				limit has been removed and the Revised Operational Terms of Reference and the Application Form have been updated.	
6	Partnerships, LLP's and sole traders must not be excluded from applying for funding. Therefore, there should be clarification of the consequences of the requirement for an applicant to be a business incorporated under the Companies (Jersey) Law 1991.	ED	Accept	The concerns raised by the Panel about eligibility guidelines have been considered and as a consequence, in order to maximise the scope and benefits of the JIF, Revised Operational Terms of Reference and Application Form have been developed that will allow applications from individuals, thirds sector organisations and any type of trading entity, such as sole traders, Limited Liability Companies, partnerships, LLPs etc. Applications from individuals or sole traders successful in securing a loan may be asked, by the JIF Board, to put in place a specific corporate governance structure which could result in establishing a company registered in Jersey.	Immediate
7	If the JIF is realistically to be made available to the third and private sectors, and non-finance industries, the proposed eligibility criteria relating to GVA per employee and high growth business should be amended to a less demanding level.	ED	Accept	The Minister and Department have accepted the views of the Panel and amended the Revised Operational Terms of Reference and Application Form appended to the R&P to reflect this	Immediate

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
				To maximise the scope of the scheme the required £65,000 GVA per employee has been removed from the eligibility criteria. Applications will now be welcomed for any project that can demonstrate that the investment in innovation will deliver productivity gains/growth (jobs and revenues)	
8	Whilst ensuring effective and robust processes are established where required, such as due diligence, continued attention should be paid to ensuring that the JIF is not overburdened by red tape	ED	Accept	The management of the JIF will not be overburdened with red tape. But it will have the appropriate levels of due diligence and risk assessment for a fund capitalised with public money.	Immediate
9	Outstanding issues relating to the work required of the Law Officers Department must be resolved, not least the development of the Royalty Agreement template, prior to the States debate.	ED	Accept	The Department recognises the concerns expressed by the Panel in its Review and will produce draft Templates for the Panel's review prior to the States Debate Draft Template Agreements will be provided that will allow the Panel to assess the likely contents and reach a view on their progress. Whilst Templates are being developed it is worth emphasising that given the varied nature of applications, products and terms, each successful Fund applicant will require	April 2013

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
				an Agreement with a high degree of bespoke content, therefore the Templates will effectively only be illustrative in nature.	
10	• The JIF should retain the objective of being self-replenishing. It is vital therefore to ensure that in addition to implementation of the Panel's monitoring and cost related recommendations: a clear financial objective and Key Performance Indicators are established; • formal guidelines are established between the relevant Departments regarding interest rate levels, and the process for establishing loan repayment terms is clearly set out; • the equity element is developed, as proposed, within 6 months; grants are awarded <u>only</u> 'in extremis'	ED	Accept	The aim is for the JIF is to be self-replenishing although it is worth stressing that this is unlikely in the early stages owing to the nature of staged repayments and the product development lifecycles of the companies involved. In Phase 1 it is unlikely - owing to the nature of interest payments on loans and scale of early stage income from royalties – that income will be sufficient to replenish the fund within the early years. As loans mature and royalty income from sales build, there is an increased likelihood that returns to the Fund would replace or exceed the amounts borrowed at the outset and reduce the early stage deficit effects. Phase 2 (equity investments) allows for greater and earlier potential returns to the JIF (through dividends and potential sale of shares at multiples of the original investment value), that will greatly improve the JIF's ability to become self-replenishing at a much	

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
				earlier stage and possibly compensate from the more staged returns of Phase 1 investments. Interest rates, loan repayment periods, repayment holidays, multiple draw downs, royalty percentages will be considered on a case by case basis. The Board, which includes a Treasury representative, will make recommendations on the all the above details to the Minister for Economic Development. Within 6 months of launch a new R&P will bring forward recommendations that will allow the JIF to make equity investments. Subject to States approval the R&P will move the model towards a Partnership Fund in order to harness the benefits of leverage, shared risk private sector expertise and make investments in return for equity in the business The Department shares the Panels views that Grants will only be given in extremis from the Fund, given that such States support may be available under different support programmes	

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
11	The Minister for Economic Development should formally engage with Jersey Business, with a view to that organisation undertaking the functions of the JIF Executive.	ED	Accept	The R&P proposes a Government Fund allowing for grants and loans to be offered in Phase 1. The Fund will operate within the Public Finances (Jersey) Law 2005 and Financial Codes of Direction which it would be difficult for an outside body to administer on the Minister's behalf. During the work to prepare the R&P for Phase 2 (equity investments and move towards a Partnership Fund) the Department will engage in in-depth discussions with Jersey Business to evaluate whether there is a more intensive role that it could play in working without outside third parties, in delivering the Partnership Fund model.	May 2013
12	All States Departments involved in the JIF must have their roles and responsibilities more clearly defined, most notably the Law Officers and Treasury and Resources. This will require formal discussions and should result in clear guidelines outlining their particular responsibilities	ED	Accept	The roles of the various Departments are recorded in the Revised Operating Terms of Reference drawn up as a response to the Panel's Report.	Immediate
13	It is recommended that the number of Board members recruited from the private sector, through a full and formal recruitment process,	ED	Accept	The Minister and Department agree the views of the Panel and the number of private sector Board Members	Immediate

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
	should be set at a minimum of four (inclusive of the Chairman).			will be increased to a minimum of four, consistent with the Revised Operational Terms of Reference.	
14	The Minister for Economic Development must engage in formal discussions at the earliest opportunity with Digital Jersey and Jersey Business, regarding their roles in the JIF.	ED	Accept	The ED Chief Executive is on the Board of Digital Jersey and the Deputy Chief Executive is on the Board of Jersey Business Limited. This allows for on-going constructive discussions about their current and future roles in supporting the JIF. Jersey Business, Digital Jersey and others will be fully consulted at Board level regarding any proposed role that they may take in bringing forward applications as part of the development of the Phase 2 (private equity) R&P. Both the above, and other bodies, will be fully engaged in the development of Phase 2 which will be lodged as a R&P within 6 months of launch of the JIF.	May 2013
15	A best estimate of annual operating costs for the management of the JIF, including all overhead support (external and internal costs), should be provided. Additionally, an assessment should be undertaken of this estimated annual cost of operating the Fund against a measure of	ED	Accept	The estimated total annual cost of the JIF in Phase 1 is now believed to be £150,000. (£100,000 for external costs- due diligence, specialist advice, legal, credit and other background checks, plus a 'best estimate' for internal costs – man hours for the JIF	

	Recommendations	To	Accept/ Reject	Comments	Target date of action/ completion
	deliverables/outcomes arising from the utilisation of the Fund. Transparency on this exercise will effectively provide an indication of the true utility of the JIF			Executive, EDD Chief Executive, Law Officers, T&R and the Economic Advisors Unit of £50,000 based upon 800 man hours input per annum) This is a best estimate and will vary depending on the complexity of the applications which are currently unknown, however the experience gained during the Phase 1 will be utilised to more clearly scope the overall cost implications for Phase 2 and beyond	
16	Due to the level of inconsistency in the proposals, and the lack of key details that could reasonably be available to Members and stakeholders at this stage, the Minister for Economic Development should consider the findings and recommendations contained within this report, and address the issues it raises, before the Proposition is debated by the States.	ED	Accept	The debate has been delayed until 30th April	

CONCLUSION

The recommendations made by the Economic Affairs Scrutiny Panel have been welcomed and the changes made will, in Phase 1, improve access to the JIF and increase the amount of investment in all areas of innovation which overall should drive growth and create new job opportunities for locals.

Some of the recommendations made refer to Phase 2 of the project which, subject to States approval, will allow the JIF to make equity investments and move it towards a Partnership Model.

During the development of the Report and Proposition for Phase 2 these recommendations will be carefully considered and, as appropriate, adopted. The development of Phase 2 will involve further engagement with key stakeholders and subject to further scrutiny.