

# Pivot

## *How 3i Reinvented Itself*



**Ashton Olds**  
Retail  
Research

By market capitalisation, 3i is among the top twenty companies listed on the London Stock Exchange. It is larger than such notable businesses as Haleon, Tesco and Vodafone. The ascension of 3i, a mid-market private equity investment company, has been a surprise for benchmark-aware investors. Its rise has been meteoric – the shares have risen 300% in the past five years – its structure as an investment company is unique, and the engine behind its share price appreciation, a 58% stake in the Dutch discount retailer Action, is by no means a household name.

Pre-dating 3i's recent rise to prominence is a fascinating history. For many years, it carried out a function of national importance for Britain, mediating between SMEs, the City and the government.

3i's origins can be traced back to the 1931 Macmillan Committee, which highlighted a shortage of long-term capital for smaller businesses, colloquially known as the 'Macmillan Gap'. This gap reflected the absence of reasonable funding options for smaller businesses, which lacked the

scale to list on public exchanges. As ministers and the Bank of England planned for post-war reconstruction, aware the Macmillan Gap could widen further, proposals crystallised into the formation of two new bodies in 1945: the Finance Corporation for Industry (FCI) to support larger firms, and the Industrial and Commercial Finance Corporation (ICFC) to supply medium- and long-term capital to smaller ones.

The then 'big five' clearing banks (Barclays, Lloyds, Midland, National Provincial and Westminster) were seen as the logical source for the ICFC's capital given a sharp increase in assets during the war. At the time, the banks were reluctant to provide the required seed capital given divided opinions about the existence of the Macmillan Gap and reservations over replicating the continental banking system. However, they eventually conceded and supported the establishment of the ICFC, if only to prevent Whitehall from intervening in their activities further.

Led by a small, highly motivated team, the ICFC had sufficient independence to survive the conflicting interests of the government and its own sceptical shareholders. For the first twenty years, it was led by its Chairman, Lord William Piercy, who had held senior private and public roles

after beginning work in the City as a timber broker at the age of just twelve.

In its early years, the ICFC required sound judgement when allocating funds. Many companies had grown on the back of war production while others did not have an established profit record. The ICFC was ahead of its time, building in-house due-diligence capabilities with greater detail than traditional bankers, utilising technical knowledge, examinations of factories and operating accounts, and personnel audits.

By the 1950s, a regional network had been established to spread the geographic base of its investments and pave the way for its specialists to become locally informed investors. The ICFC generally provided investment via long-term, fixed-rate loans which offered certainty and were carefully priced so as not to overstretch firms. Equity investment was also provided to lessen the risks posed by leverage.

Over the latter part of the century, considerable change would occur. The ICFC's success would help to normalise professional investment in unquoted British companies, paving the way for new competition. In the 1970s it merged with the FCI to establish Finance for Industry (FFI), and by the 1980s had been renamed 'Investors in Industry', or '3i'.

As capital markets in the UK and Europe evolved, 3i's model followed, transitioning from an SME funder into a modern private equity house which targeted fewer but larger buyouts. In 1994, 3i listed on the London Stock Exchange with a £1.5bn market capitalisation. It was then that the company broadened the scope of its fundraising, raising its first external fund totalling £225m.

The venture capital industry in the UK soared in the late 1990s and early 2000s, but the fallout from the dot-com boom saw the number of firms collapse. 3i had also grown rapidly, opening offices across North America and Asia. The considerable returns it made in technology companies over 1999 and 2000 were quickly lost, but its geographic diversification, portfolio mix and strong balance sheet provided a partial buffer.

Over the following years, economic recovery underpinned recovery in the business. Impressive investment returns and fundraising propelled the group forward and fuelled chunky distributions to shareholders.

However, the upswing was fleeting, with the Global Financial Crisis causing a deterioration in conditions for private equity firms. By December 2008, 3i's shares had fallen below its 1994 listing price and were trading at a 75% discount to their net asset value. The leverage carried by the group into the crisis forced new management to raise £732m via a rights issue to recapitalise, and catalysed a strategic shift that prioritised streamlining, including exits from existing investments.

The 3i investors recognise today started to take shape in 2011. Simon Borrows, an ex-banker who had advised on the 3i IPO in 1994 while at Barings Bank, joined as CIO and became CEO in May 2012. In June 2012, he announced a bold strategy for the company, which he noted was "too decentralised and lack[ing] focus and consistency".

Under his plan, 3i would reduce staff, magnify its geographic focus and cut its number of investments.



*The gap*

His approach offered several advantages. The smaller team and narrower portfolio helped to improve sharpness in asset allocation, and its focus on exits raised enough funds to ensure the company could deploy its own balance sheet capital rather than external funds. The benefit of proprietary capital is 3i can let winners run, rather than exiting investments on the typical five-to-seven-year private equity cycle. It also no longer needs to deploy capital when market valuations become frothy or exit investments when conditions are poor.

The past decade has seen 3i develop a phenomenal track record. This is illustrated by its share price, which on a total return basis has delivered 30% growth pa since Borrows announced his strategic shift in June 2012.

While this change in fortune reflects a focused investment company which has executed admirably, a large part pertains to the incredible performance of Action, a leading European non-food discount retailer.

In 2011, 3i and third-party investors acquired Action from its founders. At the time of acquisition, Action operated 250 stores across three countries and generated €€80m in

EBITDA. Through 3i's ownership and involvement, Action today operates more than 3,000 stores across fifteen countries and generates EBITDA above €2bn pa. While 3i has lifted its stake in Action over time – mostly self-funded from the proceeds of Action's dividends – the prevailing valuation of 3i's 57.9% stake in Action is £19.2bn, a sum many leagues higher than its initial investment of £134m. Today, Action comprises 71% of 3i's portfolio and is the primary reason it trades at a c45% premium to net asset value.

While Action has undeniably been an incredible investment, it must be acknowledged that without the 2012 pivot and restoration of the balance sheet, 3i would have not been afforded the opportunity to hold its stake over the long term and generate the gains it has.

From plugging the post-war Macmillan Gap to funding Europe's fastest-growing discounter, the 3i of 2025 is a very different beast to the ICFC of 1945. However, at its core, the principles which define 3i are largely unchanged: it manages patient proprietary capital and is fortunate enough to have the freedom over when to act.