

Directors' report

Principal activity 3i Group plc is Europe's leading venture capital company. The principal activity of the Company and its subsidiaries ("the Group") is investment. It invests in a wide range of growing independent businesses. Its objective is to maximise shareholder value through growth in total return.

Tax and investment company status The Company is an investment company as defined by section 266 of the Companies Act 1985 and carries on business as an investment trust.

The Inland Revenue has approved the Company as an investment trust under section 842 of the Income and Corporation Taxes Act 1988 for the financial period ended 31 March 2002. Since that date the Company has directed its affairs so as to enable it to continue to be so approved.

Regulation The Company is an authorised deposit taker regulated by the Financial Services Authority.

3i Investments plc and 3i Japan GP Limited, both wholly owned subsidiaries of the Company, are authorised persons under the Financial Services and Markets Act 2000 and regulated by the Financial Services Authority.

Where applicable, certain Group subsidiaries' businesses outside the United Kingdom are regulated by relevant authorities.

Results and dividends The accounts of the Company and the Group for the year to 31 March 2003 appear on pages 39 to 66.

Consolidated total return for the period was a negative sum of £935 million (2002: negative sum of £960 million).

An interim dividend of 4.9p per share was paid on 8 January 2003. The Directors recommend a final dividend of 8.6p per share be paid in respect of the year to 31 March 2003 to shareholders on the register at the close of business on 20 June 2003.

By a deed of waiver dated 9 June 1994, Mourant & Co. Trustees Limited as trustee of The 3i Group Employee Trust waived (subject to certain minor exceptions) all dividends declared by the Company after 26 May 1994 in respect of shares from time to time held by it (currently 8,173,810 shares) as trustee of that trust.

Operations The Company owns substantially all the Group's investments. The Group operates through a network of 31 offices across Europe, Asia Pacific and the US.

The Group manages a number of funds established with major institutions and pension funds to make equity and equity related investments in unquoted businesses in Europe and Asia Pacific.

3i Investments plc acts as investment manager to the Company and certain of its subsidiaries. 3i Investments plc also acts as investment manager to 3i Smaller Quoted Companies Trust plc, 3i Bioscience Investment Trust plc and 3i European Technology Trust plc, investment trusts listed on the London Stock Exchange. 3i Investments plc also manages the 3i Group Pension Plan.

Business review The Chairman's statement on pages 2 and 3, the Chief Executive's statement on pages 4 and 5, the Operating review on pages 6 to 13 and the Financial review on pages 14 to 19 report on the Group's development during the year to 31 March 2003, its position at that date and the Group's likely future development.

Share capital In the year to 31 March 2003, the issued share capital of the Company increased by 1,314,425 shares to 610,918,253 shares as a result of the issue of shares to the trustee of The 3i Group Share Incentive Plan, the exercise of options under The 3i Executive Share Option Plan, The 3i Group 1994 Executive Share Option Plan and The 3i Group Sharesave Scheme and the issue of shares to the nine vendors of SFK Finance Oy. Details of these share issues are provided in note 39 to the accounts on page 62.

Major interests in shares As at 2 May 2003, the Company had been notified of the following interests in the Company's shares in accordance with sections 198 to 208 of the Companies Act 1985:

	%	Number of shares
FMR Corporation and Fidelity International Limited and their subsidiary companies	9.79	59,828,417
Prudential plc and subsidiary companies	5.17	31,613,446
Legal & General Investments Management Limited	3.42	20,914,010
Scottish Widows Investment Partnership Limited	2.98	18,215,747

Directors and their interests The names of the present Directors are set out on pages 20 and 21. Save for Lord Camoys who ceased to be a Director on 10 July 2002, Mme C J M Morin-Postel who was appointed as a Director on 12 September 2002 and Dr R D M J Summers and Mr P B G Williams who ceased to be Directors on 31 December 2002, all the Directors served throughout the period under review.

Having been appointed as a Director since the Annual General Meeting held in 2002, Mme C J M Morin-Postel retires in accordance with the Articles of Association and, being eligible, offers herself for reappointment. In accordance with the Articles of Association Mr M M Gagen, Mr M J Queen and Mr F D Rosenkranz retire by rotation and, being eligible, offer themselves for reappointment.

Details of the Directors' interests in the Company's shares are shown in note 39 to the accounts on page 62.

Save as shown in note 39 on page 62, no Director had any disclosable interest in the shares, debentures or loan stock of the Company or in the shares, debentures or loan stock of its subsidiaries during the period. Save as shown in note 39 on page 62 there have been no changes in the above interests between 31 March 2003 and 2 May 2003. No Director was materially interested in any contract or arrangement subsisting during or at the end of the financial period that was significant in relation to the business of the Company.

Directors' service contracts Details of Directors' employment contracts are set out in the Remuneration report on page 35.

Management arrangements 3i plc provides the Group with certain corporate and administrative services, for which no regulatory authorisation is required, under contracts which provide for fees based on the work done and costs incurred in providing such services. The contract between 3i plc and 3i Investments plc may be terminated by either party on three months' notice. The contracts between 3i plc and other Group companies may be terminated by either party on reasonable notice.

3i Investments plc provides the Group with investment management and other services, for which regulatory authorisation is required, under contracts which provide for fees based on the work done and costs incurred in providing such services. These contracts may be terminated by either party on reasonable notice.

Corporate governance Throughout the year to 31 March 2003, the Company complied with all the provisions set out in section 1 of the Combined Code on corporate governance ("the Combined Code").

The Company's approach to corporate governance The Company has a policy of seeking to comply with established best practice in the field of corporate governance. In addition, one of the core values communicated within the Group is a belief that the highest standard of integrity is essential in business.

The Board's responsibilities and processes The Board is responsible to shareholders for the overall management of the Group. It determines matters including financial strategy and planning and takes major business decisions. It is assisted by various specialised committees of the Board, all of which have written terms of reference which are reviewed from time to time. Details of the principal Board Committees are set out below. The organisational structure put in place by the Board is further described below under the heading "internal control".

The regular reports and papers received by the Directors before Board and Committee meetings are supplemented by information specifically requested by the Directors from time to time.

Roles of the Chairman and the Chief Executive The division of responsibilities between the Chairman of the Board and the Chief Executive is clearly defined and was reviewed at the appointment of the current Chairman.

The Chairman leads the Board in the determination of its strategy and in the achievement of its objectives. The Chairman is responsible for organising the business of the Board but has no involvement in the day-to-day business of the Group. The Chairman facilitates the effective contribution of non-executive Directors and constructive relations between executive and non-executive Directors.

The Chief Executive has direct charge of the Group on a day-to-day basis and is accountable to the Board for the financial and operational performance of the Group. The Chief Executive has formed a management committee called Executive Committee to enable him to carry out the responsibilities delegated to him by the Board. The Committee comprises the executive Directors, the Company Secretary, Mr C P Rowlands, Mr J B C Russell and Mr P Waller. The Committee meets on a regular basis to consider operational matters and the implementation of the Group's strategy.

Senior Independent Director On Lord Camoys ceasing to be a Director on 10 July 2002, Mr O H J Stocken was appointed Senior Independent Director, to whom, in accordance with the Combined Code, concerns can be conveyed.

Directors All the non-executive Directors including the Chairman are considered by the Board to be independent for the purposes of the Combined Code. The Board assesses and reviews the independence of each of the non-executive Directors at least annually. The Board has regard to the potential relevance and materiality of a Director's interests and relationships when assessing independence rather than applying rigid criteria in a mechanistic manner.

The varied backgrounds of the non-executive Directors (details of which are set out in the biographies on pages 20 and 21) enable them to bring an independent judgement to bear on the Board's deliberations and help to ensure the continuing effectiveness of the executive Directors and the Group's management.

The Company's Articles of Association provide for:

- a) Directors to retire at the first AGM after their appointment and for the number nearest to, but not exceeding, one third of the remaining Directors to retire by rotation at each AGM;
- b) all Directors to retire at least every three years as required by the Combined Code; and
- c) any Director aged 70 or over at the date of the AGM to retire.

Subject to the Articles of Association, retiring Directors are eligible for reappointment.

The Company has procedures for Directors to take independent professional advice, if necessary. All the Directors have access to the advice and services of the Company Secretary, the appointment or removal of whom is a matter for the full Board.

The Board's Committees The Board has established a number of Committees to assist it in fulfilling its responsibilities.

Details of the work and composition of the Audit and Compliance Committee are set out below under the heading "internal control".

The Valuations Committee consists of Baroness Hogg (Chairman), Dr J R Forrest, Mr B P Larcombe, Mr M J Queen and Mr O H J Stocken. The Committee considers and recommends to the Board the valuations of the Group's investments to be included in the interim and final accounts of the Group. The Committee met twice during the year.

Details of the work and composition of the Remuneration Committee are set out in the Remuneration report.

The Nominations Committee consists of Baroness Hogg (Chairman), Dr J R Forrest, Mr B P Larcombe, Mme C J M Morin-Postel, Mr F D Rosenkranz, Mr F G Steingraber and Mr O H J Stocken. The Committee met four times during the year. At the request of the Board, the Committee considers and makes recommendations to the Board on the appointment of Directors and proposes which non-executive Directors should be invited to retire, having regard to the changing needs of the Board as a whole from time to time.

The size and composition of the Board and the balance of its membership as between executive and non-executive Directors is regularly reviewed by the Nominations Committee and the Board. A formal and transparent process for the appointment of Directors has been established with the objective of identifying the skill and experience profile required of new Directors and identifying suitable candidates.

The Committee is supported by specialist recruitment consultants, to identify suitable candidates for appointment as non-executive Directors, where appropriate.

Directors' training and development The Company has developed a training programme, which provides a framework within which training for new Directors can be planned. Newly appointed Directors are offered relevant training on the responsibilities of directors of a listed company.

On appointment, all non-executive Directors have discussions with the Chairman and the Chief Executive following which appropriate briefings on the responsibilities of directors, the Company's business and the Company's procedures are arranged. The Company provides opportunities for non-executive Directors to obtain a thorough understanding of the Company's business by meeting members of the senior management team who in turn arrange, as required, visits to investment offices and support departments. The non-executive Directors are encouraged to let either the Chairman or the Company Secretary know if there are any particular individuals in the Company they would like to meet or if there are any areas of the Company's business in which they are particularly interested. Presentations on different aspects of the Company's business are made regularly to Directors.

Board effectiveness The Board has established a process led by the Chairman with the assistance of the Senior Independent Director for evaluating on an annual basis the performance of the Board, its Committees and individual Directors with particular attention to those who are due for re-appointment. The results of the Board evaluation process are shared with the Board as a whole.

The Company's relationship with its shareholders The Company recognises the importance of maintaining a purposeful relationship with all its shareholders. The Company uses its AGM as an opportunity to communicate with its shareholders. At the Meeting, business presentations are made by the Chief Executive and the Finance Director. The Chairmen of the Remuneration, Audit and Compliance and Nominations Committees are available to answer shareholders' questions.

The Chief Executive and the Finance Director, together with the Group Communications Director, meet with the Company's principal institutional shareholders to discuss relevant issues as they arise. The Chairman ensures that regular reports are received by the non-executive Directors from the Company's brokers with the objective of ensuring that non-executive Directors remain aware of shareholders' views. The Chairman also maintains a dialogue with shareholders as required.

In accordance with the Combined Code, the Notice of the 2002 AGM was dispatched to shareholders not less than 20 working days before the meeting. At that meeting, details of proxy votes received were made available in accordance with the recommendations of the Combined Code. In accordance with the Company's Articles of Association, on a poll, every member who is present in person or by proxy has one vote for each share held.

Portfolio management and voting policy In relation to unquoted investments, the Group's approach is to seek to add value to the businesses in which the Group invests through the Group's extensive experience, resources and contacts. In relation to quoted investments, the Group's policy is to exercise voting rights on matters affecting the interests of the Group and its managed funds.

Employment The Group's policy is one of equal opportunity in the selection, training, career development and promotion of employees, regardless of gender, ethnic origin, religion and whether disabled or otherwise.

The Group treats applicants and employees with disabilities equally and fairly and provides facilities, equipment and training to assist disabled employees to do their jobs. Should an employee become disabled during their employment, efforts are made to retain them in their current employment or to explore the opportunities for their retraining or redeployment within the Group. The Group also provides financial support, through a Company Disability Scheme, to disabled employees who are unable to work.

The Group's principal means of keeping in touch with the views of its employees are through employee appraisals, informal consultations and regular staff surveys. These processes have been maintained and are undergoing further development. Managers throughout the Group have a continuing responsibility to keep their staff fully informed of developments and to communicate financial results and other matters of interest. This is achieved by structured communication including regular meetings of employees.

3i has clear grievance and disciplinary procedures in place, which include comprehensive procedures on discrimination and 3i's equal opportunities policy. 3i also has an employee assistance programme which provides a confidential, free and independent counselling service and is available to all staff and their families in the UK.

There are clearly defined staff policies for pay and working conditions.

3i's employment policies are designed to provide a competitive reward package which will attract and retain high quality staff, whilst ensuring that the cost element of these rewards remains at an appropriate level. Remuneration policy is reviewed by the Remuneration Committee of the Board.

All UK employees receive a base salary and are eligible for a performance related bonus. 3i operates an Inland Revenue approved Share Investment Plan to encourage employees' involvement in the performance of the Group and also operates share plans for senior executives and investment staff. Further details of these plans are set out in the Remuneration report.

In its international operations, 3i's remuneration policy is influenced by market conditions and practices in the countries in which it operates. The overall remuneration package of employees in 3i's non-UK operations is similar in structure to that available to UK employees, except that employees outside the UK (other than expatriate UK employees) do not participate in the 3i Group Pension Plan. Instead they participate in local state or company pension schemes as appropriate to local market conditions.

As at the most recent valuation date, 98% of UK employees were members of the 3i Group Pension Plan (details of which are set out in the Remuneration report).

Executives both in the UK and in 3i's non-UK operations may also participate in "carried interest" schemes, which link executive remuneration to the performance of investments in executives' business units.

Charitable and political donations Charitable donations made by the Group in the year to 31 March 2003 amounted to £209,972. Excluding the Company's matching of Give As You Earn contributions by staff, approximately 22% of those charitable donations were to charities which advance education, approximately 55% went to causes which aim to relieve poverty or benefit the community, or both, and approximately 23% went to medical charities. Further details of charitable donations are set out in the Corporate Social Responsibility report on pages 22 to 24.

In accordance with the Group's policy of not making donations to political parties, no donations were made to political parties during the year. Under the Companies Act 1985, as amended, the Company is required to disclose particulars of any donation to any EU political organisation and EU political expenditure incurred during the year. During the period, 3i plc, the main trading company of the Group, made payments to three organisations, detailed below, which may fall within the definition of donations to EU political organisations. These payments (annual subscriptions to the Industry Forum of £2,938 and the Enterprise Forum of £1,880 and corporate membership of the European Business Network of £1,040) amounted to £5,858.

Policy for paying creditors The Group's policy is to pay creditors in accordance with the CBI Prompt Payers Code of Good Practice copies of which can be obtained from the Confederation of British Industry at Centre Point, 103 New Oxford Street, London WC1A 1DU. The Company had no trade creditors during the year. 3i plc, the main trading company of the Group, had trade creditors outstanding at the year end representing 10 days of purchases.

Statement of Directors' responsibilities The Directors are required by UK company law to prepare accounts which give a true and fair view of the state of affairs of the Company and the Group as at the end of the period and of the profit for the period. The Directors have responsibility for ensuring that proper accounting records are kept which disclose with reasonable accuracy the financial position of the Group and enable them to ensure that the accounts comply with the Companies Act 1985. They have a general responsibility for taking such steps as are reasonably open to them to safeguard the assets of the Group and to prevent and detect fraud and other irregularities. Suitable accounting policies, which follow generally accepted accounting practice and are explained in the notes to the accounts, have been applied consistently and applicable accounting standards have been followed. In addition, reasonable and prudent judgements and estimates have been used in the preparation of the accounts.

Going concern The Directors are satisfied that the Company and the Group have adequate resources to continue to operate for the foreseeable future. For this reason, they continue to adopt the "going concern" basis for preparing the accounts.

Internal control The Board is responsible for the Group's system of internal control and reviews its effectiveness at least annually. Such a system is designed to manage rather than eliminate the risk of failure to achieve business objectives and can provide only reasonable and not absolute assurance against material misstatement or loss.

The full Board meets regularly and has formally adopted a schedule of matters which are required to be brought to it or its duly authorised Committees for decision. This is aimed at maintaining full and effective control over appropriate strategic, financial, operational and compliance issues. The Board has put in place an organisational structure with clearly defined lines of responsibility and delegation of authority. Each year the Board considers and approves a rolling strategic plan and an annual budget. In addition, there are established procedures and processes for planning and controlling expenditure and the making of investments. There are also information and reporting systems for monitoring the Group's businesses and their performance.

An Audit and Compliance Committee, comprising Mr O H J Stocken (Chairman), Dr J R Forrest, Mme C J M Morin-Postel and Mr F D Rosenkranz, all independent non-executive Directors, reviews the effectiveness of the internal control environment of the Group and the Group's compliance with its regulatory requirements. During the year the Committee met four times. The Committee receives regular reports from the internal and external auditors, the regulatory compliance function and Risk Committee and monitors their activities and effectiveness.

The Committee reviews the interim and annual accounts of the Company before their approval by the Board and reviews the scope of the annual audit and any audit findings. The Committee also oversees the Company's relations with its external auditors and recommends to the Board the appointment of the Company's auditors and approves the terms of their engagement.

Risk Committee is a management committee formed by the Chief Executive whose purpose is to review the business of the Group in order to ensure that business risk is considered, assessed and managed as an integral part of the business. There is an ongoing process for identifying, evaluating and managing the Group's significant risks. This process was in place for the year ended 31 March 2003 and up to the date of this report. The process is regularly reviewed by the Board and complies with the internal control guidance for Directors on the Combined Code, issued by the Turnbull Committee. The process established for the Group includes:

Policies

- Core values, Group standards and Group controls together comprising the Group's high level principles and controls, with which all staff are expected to comply.
- Manuals of policies and procedures, applicable to all business units, with procedures for reporting weaknesses and for monitoring corrective action.
- A code of business conduct, with procedures for reporting compliance therewith.

Processes

- Appointment of experienced and professional staff, both by recruitment and promotion, of the necessary calibre to fulfil their allotted responsibilities.
- A planning framework which incorporates a Board approved rolling Strategic Plan, with objectives for each business unit.
- Formal business risk reviews performed by management which evaluate the potential financial impact and likelihood of identified risks and possible new risk areas, set control, mitigation and monitoring procedures and review actual occurrences identifying lessons to be learnt.
- A comprehensive system of financial reporting to the Board, based on an annual budget with monthly reports against actual results, analysis of variances, scrutiny of key performance indicators and regular re-forecasting.
- Regular treasury reports to the Board, which analyse the funding requirements of each class of assets, track the generation and use of capital and the volume of liquidity, measure the Group's exposure to interest and exchange rate movements and record the level of compliance with the Group's funding objectives.
- A compliance department whose role is to integrate regulatory compliance procedures into the Group's systems.
- Well defined procedures governing the appraisal and approval of investments including detailed investment and divestment approval procedures incorporating appropriate levels of authority and regular post investment reviews.

Verification

- An internal audit department which undertakes periodic examination of business units and processes and recommends improvements in controls to management.
- The external auditors who are engaged to express an opinion on the annual accounts.
- An Audit and Compliance Committee which considers significant control matters and receives reports from the internal and external auditors and the regulatory compliance function on a regular basis.

The internal control system is monitored and supported by an internal audit function which operates on an international basis and reports to management and the Audit and Compliance Committee on the Group's operations. The work of the internal auditors is focused on the areas of greatest risk to the Group determined on the basis of the Group's risk management process. The external auditors independently and objectively review the approach of management to reporting operating results and financial condition. In co-ordination with the internal auditors, they also review and test the system of internal financial control and the information contained in the Report and accounts to the extent necessary for expressing their opinion.

Auditors' independence and objectivity Subject to annual appointment by shareholders, auditor performance is monitored on an ongoing basis and formally reviewed every five years, the next review being scheduled for 2003. The Audit and Compliance Committee recognises the importance of ensuring the independence and objectivity of the Company's auditors. It reviews the nature and extent of the services provided by them, the level of their fees and the element comprising non-audit fees. Safeguards have been put in place to reduce the likelihood of compromising auditor independence, including the following principles which are applied in respect of services provided by the auditors and other accounting firms and monitored by the Audit and Compliance Committee:

- Services required to be undertaken by the auditors, which include regulatory returns, formalities relating to borrowings, shareholder and other circulars. This work is normally allocated directly to the auditors.
- Services which it is most efficient for the auditors to provide. In this case, information relating to the service is largely derived from the Company's audited financial records, for example, corporate tax services. This work is normally allocated to the auditors subject to consideration of any impact on their independence.
- Services that could be provided by a number of firms including general consultancy work. All significant consultancy projects are normally put out to tender and work would be allocated to the auditors only if it did not present a potential threat to the independence of the audit team. Other services under this category include due diligence within the investment process. If this service were to be provided by the auditors, the specific team engaged would be independent of the audit team.

Details of the fees paid to the auditors are disclosed in note 13 to the accounts on page 50.

Auditors In accordance with section 384 of the Companies Act 1985, a resolution proposing the reappointment of Ernst & Young LLP as the Company's auditors will be put to members at the forthcoming Annual General Meeting.

By order of the Board

A W W Brierley
Secretary

14 May 2003

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