

Improving the coherence, co-ordination and consistency of publicly-backed national and regional venture capital provision

Report to the Department for Business, Innovation and Skills

August, 2010

URN 10/1300



SQW

Executive summary

1. This is a report from SQW Limited on a study conducted for the Department for Business, Innovation & Skills (BIS) on 'Improving the Coherence, Co-ordination and Consistency of National and Regional Venture Capital Provision'¹. The research was undertaken during February to March, 2010.
2. The purpose of the study is to inform BIS and the Regional Development Agencies (RDAs) on how the publicly-backed equity funds (PBFs) they support can work more effectively and efficiently together. There is already a set of five National Framework Principles (NFP 1-5, described within the main report) in place to help achieve this. These are intended to enable a mutually beneficial, co-operative platform for engagement which will help ensure an appropriate supply of early stage risk capital throughout the English regions: a prime requirement for the present study has been to identify practical ways in which to 'operationalise' these Principles more fully in the short term.
3. The study also explored a range of issues that have significance for policy which have been raised by a number of recent reports on the status of publicly-backed equity funds. These issues include: the clarity of objective setting and, linked to this, the implementation of a 'fit-for-purpose' approach to fund evaluation; the balance between 'value for money' and 'economic impact' factors in assessing performance; co-investment² and the development of public/private sector 'hybrid'³ funds; significance of fund size and geographic coverage on operating costs and performance of funds; and the importance or otherwise of regional (multi-local) fund management presence.

Methods

4. The research was conducted using the following research methods:
 - *a literature review* – this included key findings from recently published evaluation and research reviews of the PBF landscape; plus a review of documentation and data provided by BIS
 - *primary research* – we received input via a mixture of face-to-face and telephone consultations from 45 informants⁴

¹ SQW acknowledges the helpful contributions from colleagues at Oxford Innovation and from Duncan Gray (Independent Consultant).

² According to BVCA, 'co-investment' (or syndication) is defined as "an arrangement whereby a group of investors come together to invest in an investment proposition which they would not be prepared to consider individually whether because of risk or amount of funding required".

³ The NESTA & BVCA research report by Nightingale *et al* (2009) on 'thin markets' defines 'hybrid' funds as "arrangements where the state invests in a venture capital fund managed by a commercial venture capitalist". To be clear, we use the term 'hybrid' funds to mean public money being invested alongside private money.

⁴ It is important to state that although informative and insightful, the primary research involved only a limited programme of consultations and no statistical robustness is claimed for the evidence provided.

- *interim reporting* – providing initial recommendations for short term action for BIS (and Capital for Enterprise Ltd. - CfEL) and RDAs: presentation of recommendations to a joint meeting of representatives from BIS, the Department for Communities and Local Government (CLG), RDAs, CfEL and other stakeholders.

Summary of conclusions

5. Based on data collated by BIS, data provided by informants, plus our own desk and primary research, the report summarises the nature of current publicly-backed equity funding in England. The mapping of the PBF landscape reveals:
 - *at national level* (i.e. PBFs designed at national level and delivered at national or regional level) – there are a total of 17 ‘live’ funds with an aggregate fund size of c. £684.5m
 - *at regional level* (i.e. PBFs designed and delivered regionally) – there are a total of 33 ‘live’ regional funds, with an aggregate fund size of nearly £634m.
6. This study found divergent views among informants on whether the numerous funds associated with current publicly-backed venture capital provision represent valuable diversity or inefficient ‘clutter’. The plethora of funds is not necessarily viewed by all informants as a negative characteristic of the publicly-backed venture capital landscape but can be a positive force by providing choice and introducing rivalry in terms of good practice and performance. Notwithstanding any merits in these different arguments, there is scope for improvement in making the current publicly-backed venture capital landscape a more coherent market place (e.g. to ensure no unproductive competition): this kind of coherence is arguably a pre-requisite for Government (in all its forms) in any investigation of what additional provision is required as well as to assess the performance of funds.
7. If a decision is taken to simplify PBF provision then it needs to encompass more than the funds provided by BIS and RDAs: the role of PBFs supported by other parts of the public sector should be included in any assessment of the national picture.
8. The following conclusions are drawn from consideration of the findings from primary research undertaken for this study linked to the conclusions and recommendations from recent key evaluation and research reports:
 - it is important to establish ‘SMART-er’ objectives for the suite of PBFs and to re-assess what can be done to introduce a more consistent, ‘fit-for-purpose’ approach to fund evaluation, one which acknowledges both financial performance of funds and the contribution of their investments to economic development goals
 - there is widespread support for the further development of public/private sector ‘hybrid’ funds, linked to a long term commitment to building angel market capacity/capability. There is a need however to establish an improved evidence base on both the efficacy of different hybrid models and on the pattern of angel investment more generally

- there are mixed views on the significance of fund size and geographic coverage on the performance of PBFs: economies of scale and flexibility of benefits are viewed as the benefits of larger scale funds on the one hand whilst others argue for the value of smaller, geographically targeted funds as part of economic development ‘tool-kits’
- there are polarised views on the importance or otherwise of regional (multi-local) fund management presence that in our view needs to be resolved through the development of a robust empirical evidence base
- recent research has suggested that there is a potential tension between regional and innovation policies in the design and assessment of PBFs. Informants in the present study gave more emphasis to the perceived ‘tension’ between the role of PBFs as economic development tools in the regions and as interventions assessed in terms of *financial* return on investments
 - in terms of understanding potential ‘market size’ for PBFs in future, there is merit in assessing the relationship between those businesses with potential that are in receipt of support from R&D and innovation-related public sector interventions and the need/demand from these businesses for early stage venture capital support
- there exists a broad consensus that the development of a well functioning early stage venture capital market in the UK is a long term ‘project’. Monitoring of progress in the ‘project’ also needs to take account of the typical ‘J-curve’ pattern of expected returns from early stage equity investment, with positive returns to funds unlikely to be achieved until around year eight after first investments
- a large number of proposals have emerged on the roles CfEL could play that would be of value to regional funders, building on the contribution that market informants consider it has already made in bringing ‘structure’ to national provision. Many of the proposals can be captured under the banner of a ‘centre of excellence’
- one of the challenges in this study has been to collate information on PBFs and their investment activity. A regularly updated, comprehensive picture of fund provision and associated investment activity in the public domain would be beneficial. There are initiatives elsewhere (notably in Scotland) to gather and publish information on all early stage investment activity that could be adapted
- cross-referral protocols for PBF managers should be piloted as part of the development of a national ‘programme’ in order to improve the ‘customer journey’, notwithstanding the practical difficulties that may be encountered. In the words of one informant: “difficult to achieve but worthwhile trying”.

Summary of recommendations

9. The recommendations brought together below have been developed through wide consultation with national and regional stakeholders plus private sector actors. They are for practical, short term actions to ‘operationalise’ further the National Framework Principles.

NFP 1: Positioning of regional and national publicly-backed VC funds

- put in place procedures which ensure early, formal involvement of regional and national partners in the design, appraisal and commissioning of new PBFs and by this means to ensure full but stream-lined consideration of issues such as additionality, complementarity and competition, and to take advantage of market intelligence at national and regional levels.

NFP 2: RDAs and BIS activities and protocols

- design and implement a co-ordinated marketing and communications plan for all PBFs customised for the following audiences: 1) business advisors, lawyers and accountants; 2) potential co-investors; and 3) SMEs (especially in new and emerging industries)
- develop cross-referral protocols between national and regional providers of PBFs and their fund managers. A key focus here is to develop and give confidence in the ability of PBFs to address needs and opportunities throughout the country, especially in new and emerging sectors.

NFP 3: RDAs and BIS reviewing fund structures

- establish an agreement between BIS and all RDAs on the two-way exchange of data/information and experience relevant to the practices of set-up, governance and management of funds, including but not limited to the role of ‘holding funds’.

NFP 4: Ongoing dialogue

- convene a regular forum (e.g. bi-annually) for national and regional PBF managers to review/exchange views on market issues, best practices and skills/training needs. It is proposed that CfEL assumes the role of assessing and taking forward key actions of national significance arising from this forum.

NFP 5: Information sharing

- design and implement a single consistent and formal reporting and evaluation framework for all PBFs which will enable robust assessment of performance and impact, and the tracking over time of the development of their role in the national and regional VC market
- establish an agreement to cover the provision of strategic market intelligence on a regular and pro-active basis from the regions to CfEL and vice versa
- CfEL to work in pro-active mode as a national ‘centre of excellence’ to support other providers of PBFs.

Other practical proposals

10. Further practical proposals for action include:

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional
venture capital provision
Report to the Department for Business, Innovation and Skills*

- publish annually a report on: ‘Publicly-backed Risk Capital Provision in the English Regions – investment activity’
- publish annually a ‘Directory of Publicly-backed Risk Capital Funds in the English Regions’.

1: Introduction

- 1.1 This is a report from SQW Limited on research conducted on behalf of the Department for Business, Innovation & Skills (BIS) on ‘Improving the Coherence, Co-ordination and Consistency of National and Regional Venture Capital Provision’⁵. The work was undertaken during February to March, 2010.
- 1.2 The purpose of the research is to inform BIS and the Regional Development Agencies (RDAs) on how the publicly-backed equity funds (PBFs) they support can work more effectively and efficiently together. There is already a set of National Framework Principles (NFPs) in place to help achieve this (shown below): the prime requirement for this study has been to identify practical ways in which to ‘operationalise’ these more fully in the short term.
- 1.3 Five Principles have been formulated and agreed between BIS and the RDAs. They are intended to enable a mutually beneficial, co-operative two-way platform for engagement which will help to ensure an appropriate supply of early stage risk capital throughout the English regions. The Principles are outlined below.

National Framework Principles

- 1) Regional JEREMIE⁶ and other Risk Capital initiatives will be positioned with a clear target market to be complementary to, consistent with and additional to the primary target investment areas of national instruments, specifically arising out of the Rowlands Growth Capital Review, the UK Innovation Fund and the Enterprise Capital Funds.
- 2) RDAs and BIS will put in place activities and protocols to ensure effective contact and communication between regional and national fund management teams to demonstrate that where appropriate investments can find follow on funding through national public instruments and vice versa, i.e. that referral mechanisms work both ways.
- 3) RDAs will commit to working together and collectively with BIS on a review of holding fund structures, taking account of economy, efficiency and effectiveness and to use their influence where they can to respond to that review (Any discussions that happen in the future under this point will take account of the practical considerations and constraints relating to ERDF programmes).
- 4) RDAs will commit to an ongoing dialogue with BIS and its advisers on future delivery arrangements, including procurement, contracting, monitoring, reporting, evaluation and benchmarking. This will be a mutual commitment

⁵ SQW acknowledges the helpful contributions from colleagues at Oxford Innovation and from Duncan Gray (Independent Consultant).

⁶ Joint European Resources for Micro to Medium Enterprises initiative. See: <http://www.eif.europa.eu/jeremie>.

with BIS similarly sharing plans and information with the RDAs.

- 5) RDAs will commit to sharing information on regional fund activity and, using any rights they hold as funders, will facilitate BIS or their advisors being invited to regional JEREMIE Investment Advisory Boards as observers. BIS will similarly commit to sharing information on national fund activity with the regions.

1.4 Based on evidence of the nature and inter-relationships in the ‘landscape’ between the regional and national provision and the associated strengths and weaknesses of the current provision, this report recommends options for joint action involving BIS, the RDAs and Capital for Enterprise Limited (CfEL)⁷.

1.5 Although the prime purpose of this study has been to offer practical options for short term action, BIS was also interested in capturing any longer term and more strategic issues to emerge during the research and having these highlighted for future consideration.

Methods

1.6 The research was conducted using the following research methods:

- *an inception meeting* with representatives from BIS and the Department for Communities and Local Government (CLG)⁸ in February 2010
- *a review of documentation* – this primarily included reports of recent evaluation and research studies on the PBF landscape plus documentation and data provided by BIS. The main reports reviewed included:
 - the National Audit Office (NAO) report on ‘Venture capital support to small businesses’⁹; the Rowlands Review of the provision of growth capital¹⁰; the NESTA¹¹ ‘Shifting Sands’ report¹²; the NESTA & British Venture Capital Association (BVCA) ‘Thin Markets’ report¹³
- *designed research tools for consultations* – interview guides were designed for each of the three main categories of informant: Government department officials, market actors and staff in RDAs

⁷ CfEL is a company limited by guarantee set-up by the Government and functions at ‘arms length’ as an autonomous entity to design, deliver and manage BIS’s financial interventions (debt, equity and hybrids) in the SME sector. It is managed by an independent Board of Directors drawn from industry and finance. See: <http://www.capitalforenterprise.gov.uk>.

⁸ CLG is the Government department responsible for the oversight of ERDF funding deployed in the English regions. See: www.communities.gov.uk/citiesandregions/european/europeanregionaldevelopment/

⁹ National Audit Office (2009) Venture Capital Support for Small Businesses.

¹⁰ BIS, Rowlands Review (2009) The Provision of Growth Capital to UK Small and Medium Sized Enterprises.

¹¹ National Endowment for Science, Technology and the Arts. See: <http://www.nesta.org.uk>.

¹² Pierrakis and Mason (2008) Shifting Sands – The changing nature of early stage venture capital market in the UK. NESTA Research Report.

¹³ Nightingale *et al* (2009) From funding gaps to thin markets: UK Government support for early-stage venture capital. NESTA & BVCA Research Report.

- *primary research* – we received input via a mixture of face-to-face and telephone consultations from the informants listed in Table 1.1 (see also Annex B)
 - we also distributed a questionnaire to another 11 market stakeholders
 - in total we received input from 45 informants over the short period of approximately two weeks.

Table 1-1: Informants (see also Annex B)

Organisation	Number of informants
HM Treasury	1
Communities and Local Government	3
BIS officials	5
BIS Finance Expert Group ¹⁴	4
British Private Equity & Venture Capital Association	2
British Business Angel Association	1
Capital for Enterprise Limited	2
Regional Development Agencies (9)	13
'Outside' representatives on RDA Investment Boards	2
Northern Way ¹⁵	1
Fund Managers	6
Legal firm	1
Carbon Trust Investment Partners	2
Other market stakeholders (by response to questionnaire)	2
Total	45

- *interim reporting* - initial recommendations were presented to a joint meeting of government officials, RDA representatives and other stakeholders, and through the submission to BIS of interim reports.

Structure of the report

1.7 The remainder of this report is structured as follows:

- *Section 2:* paints the background formed by recent policy-relevant reports
- *Section 3:* characterises the current PBF landscape in England

¹⁴ This is an advisory group which includes academics, bankers and venture capitalists.

¹⁵ The Northern Way is an initiative which brings together the cities and regions of the North of England to improve the sustainable economic development of the North towards the level of more prosperous regions. See: <http://www.thenorthernway.co.uk>.

- *Section 4:* reports primary research findings on the issues of coherence, co-ordination and consistency obtained from public sector informants with regional and national perspectives, and from the market
- *Section 5:* provides conclusions and recommended options for action by BIS and the RDAs
- *Annex A:* contains data on current PBFs
- *Annex B:* provides a list of informants
- *Annex C:* contains copies of the interview guides used during the study.

2: Background

- 2.1 There have been a number of significant reports on the status of publicly-backed equity funds over the past c. 6 months which have raised issues of significance for policy. There have also been a number of research publications during the same period which provide additional and useful insight into the early stage equity market in the UK. The issues raised in these key documents are summarised below.
- 2.2 This discussion of the background to the present study introduces a number of themes of importance for policy on the provision of publicly-backed equity finance which were the drivers that led to the current review being commissioned. In summary, these include:
- clarity of objective setting and, linked to this, the implementation of a ‘fit-for-purpose’ approach to fund evaluation
 - with issues around the balance between ‘value for money’ and ‘economic impact’ factors in assessing performance
 - co-investment¹⁶ and the development of public/private sector ‘hybrid’¹⁷ funds
 - significance of fund size and geographic coverage on operating costs and performance of funds
 - importance or otherwise of regional (multi-local) fund management presence.
- 2.3 Other more overarching themes to surface include the inter-relationship (or tension) between regional policy and innovation policy; the importance of addressing so-called ‘thin markets’ characterised by limited numbers of and limited interactions between investors and entrepreneurial firms; and the long term nature of commitment required to build capacity.

Venture capital support to small businesses

- 2.4 The National Audit Office (NAO) published its report on ‘Venture capital support to small businesses’ in December 2009. The focus of the NAO report was the venture capital funds established by BIS and its predecessors since 2000, amounting to an investment of c. £337.9m. The report examines the role and development of these funds; the performance of the funds against the Department’s objectives; and the management of the programme and individual funds by the Department and by CfEL.
- 2.5 The NAO report makes a number of recommendations to BIS, summarised below:

¹⁶ According to BVCA, ‘co-investment’ (or syndication) is defined as “an arrangement whereby a group of investors come together to invest in an investment proposition which they would not be prepared to consider individually whether because of risk or amount of funding required”.

¹⁷ The NESTA & BVCA ‘Thin Markets’ research report (Nightingale *et al*, 2009) defines ‘hybrid’ funds as “arrangements where the state invests in a venture capital fund managed by a commercial venture capitalist”. To be clear, we use the term ‘hybrid’ funds to mean public money being invested alongside private money.

- *objective setting:* BIS should define more clearly the objectives for each of its funds
 - this should include a financial objective for each fund, specifying the extent to which taxpayers' money is expected to be recovered and over what timescale
- *evaluation criteria:* BIS should define more clearly the criteria against which it will evaluate whether the objectives are being achieved (see also the recommendation on 'programme' evaluation below)
- *operating costs:* the cost of establishing and managing all funds should be reported to ensure that the Department's decisions are fully informed
 - this should be taken into account when considering future requests to extend the life of an existing fund and when negotiating the terms of any extensions to the life of a fund
 - BIS should evaluate the costs and benefits of each of the fund models it has used to date so that it can be sure that the most efficient model, at a fund size which takes advantage of economies of scale, is used in future
- *new fund design:* BIS should evaluate whether the current approach is likely to optimise performance, including through successful exits of businesses from funds
 - factors to be analysed here should include: size of individual funds; the pattern and scale of investment; the criteria used to decide the size of pool of ideas from which investments will be chosen; the merits of each of the fund models tried to date
- *a programme approach:* BIS should manage as a programme those funds that are currently investing in businesses and should outline how the various elements fit together
 - CfEL should draw together existing information covering all individual fund types to provide a more complete overview of how they fit together
 - BIS should put in place a framework for evaluating the programme of funds to inform policy making in terms of understanding the cost effectiveness of the interventions in the context of other measures to support small businesses
- *public reporting:* BIS could make more information about the funds publicly available, including a breakdown of public and private sector investments to date; geographical and sectoral analyses of investments; details of successful exits and write-offs
- *awareness raising:* BIS should consider how best to raise awareness amongst potential beneficiary companies, for example, by promoting successful businesses in receipt of its support.

Provision of growth capital to UK SMEs

2.6 The Rowlands Review of the provision of growth capital, commissioned by BIS, was published in 2009. It considered whether and in what form intervention might help increase the supply of long term growth capital to SMEs. In particular, the review examined the evidence of market failure and the case for intervention, developing proposals for Government to consider on the focus, size and scale of any new intervention, and the level of public support required.

2.7 The Rowlands Review makes a number of recommendations, summarised below:

- *fund design:* Government should ensure that interventions are sufficiently flexible to meet the needs of business at many different stages of development
 - it should consider carefully: the optimal size of funds; their ability to provide follow-on funding; the size of individual investments; and their sector and/or geographical focus
- *a programme approach:* Government needs to intervene to ensure that businesses can access finance to start, expand and grow - to build an effective escalator of finance within the finance gap
 - it must also ensure sufficient sector/geographical focus and overcome the current restrictions of scale
 - also, the current landscape would benefit from simplification, with any new intervention to increase the supply of growth capital part of an integrated solution to the financing problems of businesses in addition to providing a credible source of follow-on funding.

2.8 In addition to these general recommendations, the Review made specific recommendations on the introduction of a new mezzanine product. It proposed a design that addressed the following matters:

- *co-investment:* draw in private funding to the maximum extent possible
- *scale:* to have a large total fund size in order to capture economies of scale; allow the intervention to make a significant impact on the funding gap; provide money for follow on investment; and provide regional coverage
- *objectives:* operate with entirely commercial objectives and strategies aimed at maximising returns
 - but whilst avoiding the pressure for early exit from investments and whilst providing long term support to SMEs.

2.9 The Review's conclusions include that:

- *equity aversion:* a mezzanine product would help address demand side aversion to pure equity

- *management*: any intervention would need a centralised asset allocation and risk management function which would also set the overall strategic direction of the investment strategy and avoid "mandate creep"
 - however, in addition there is a need for the ability to find, assess and manage investment opportunities in the regions.

Putting the case for localised fund management presence

2.10 The Northern Way report¹⁸ on private investment in the regions argues that given the concentration of funds and fund management around London and the South East, the number of investment executives based in the North is approximately one third of expectations given the size of the population. The report states: "This matters because investors are likely to attach a higher risk premium on potential investments outside their patch, not only because of cost, time and distance, but because they lack the supporting inherent local knowledge and understanding that comes from experience and integration with the local business network".

2.11 In looking forward, the report makes the following recommendations for the achievement of "success" from a regional perspective:

- establishment of a national network of locally-based fund managers in each of the major cities outside the Greater South East able to work within business networks; to monitor and nurture opportunities; deliver deals and secure co-investment; and start to influence business culture
 - the authors draw an analogy between this model and that operated by 3i in the early 2000s
- critical mass of funding from an appropriate mix of public and private sources, (individual and institutional investors)
 - with local fund managers able to access national or pan-regional funds, and thus motivating the best fund managers to build a career in the regions
- larger funds would also pool risk more effectively, reduce administrative costs and prove more attractive to institutions
- sustainable and long term commitment, including to build long term capacity
- strong national support, on the basis of a clear national objective to promote the development of venture capital capacity and equity investment outside the Greater South East
 - in the view of this report, regional initiatives have often failed to secure sufficient commitment from government, while national programmes have not addressed the need to build capacity in under-served markets

¹⁸ The Northern Way Private Investment Commission (2009) Preparing the ground: private investment in the regions - in the recovery phase and beyond.

- flexibility to structure deals according to business need, with freedom for fund managers to act on a commercial basis, tailoring bespoke funding packages as required, with fewer restrictions on type, stage, size and sector. The need to set strict boundaries for regional funds could be lessened, as the delivery model itself encourages access by local businesses.

Recent research

2.12 The NESTA report ‘Shifting Sands’¹⁹ investigated the nature of the supply of venture capital in the UK, the sources of the supply of early stage funding and the significance of government interventions to increase the early stage supply. It concluded:

- that public sector investment in the early stage market has shifted from standalone public sector funds to co-investing with private investors
 - this includes both *ad hoc* co-investing by free-standing public sector funds with private investors as well as co-investment funds which are required to invest alongside private investors
- as to whether or not this increased public sector involvement has ‘crowded out’ private sector investors, the authors offer no conclusive answer but can point to no evidence of this occurring.

2.13 The report’s authors point to the following issues requiring further investigation:

- the capacity of the organised angel groups to maintain or increase investment
- does the limit on the amount that can be invested in a single company by public sector funds constrain follow-on investing in a co-investment situation?
- what have been the returns achieved by co-investments and how do they compare with the returns achieved by other types of investments?
- will such returns be sufficient to recycle into further investments without the need for further government financial commitment?
- are co-investments sufficiently attractive to encourage more private sector investors and thereby reduce the need for further government intervention?
 - the authors note the favourable assessment of the Scottish Co-Investment Scheme and ask if other co-investment schemes with different models are equally successful: is the experience of their investment partners equally positive?

¹⁹ Pierrakis and Mason (2008) Shifting sands: the changing nature of the early stage venture capital market in the UK. NESTA Research Report.

- 2.14 The report also makes the telling general point that despite the importance now of public-private co-investing little is known about its process, operation and outcomes. (Notwithstanding this, it has until recently probably been too early to assemble an evidence base to assess outcomes and impacts specifically of co-investment mechanisms.)
- 2.15 The recent NESTA & BVCA report on ‘Thin Markets’²⁰ also focused on so-called ‘hybrid’ venture capital funds, i.e. ones backed by both private and public sector funding and managed by a commercial venture capitalist, which as indicated above are regarded as playing an increasingly important role in early-stage funding of firms with growth potential.
- 2.16 From an analysis of six funds operating in England and the devolved areas of Wales and Scotland, the report concluded that although there had been a positive impact on firm performance relative to a control group, the scale of impact of the funds so far has been small. However, the analysis finds “repeated encouraging evidence of firms that have received funding engaging in growth-oriented ‘equity investment’ behaviour”.
- 2.17 The authors explore the reasons for the modest impact. They argue that:
- a demand-side perspective would suggest that the UK does not have a large cadre of high potential firms being held back by a lack of early-stage VC funding
 - a supply-side interpretation would suggest shortcomings in the investment decisions of some funds or the support they provide to investee firm (“expertise matters as well as cash”).
- 2.18 However, the authors prefer to consider the deficiencies in impact – the compromising of fund performance - as attributable, at least in part, to the investment restrictions imposed on the funds by government sponsors. They point to the following constraining factors:
- the requirement to invest in specific regions
 - limit on the amount invested in any given business.
- 2.19 The report concludes that the underlying cause of the modest impact of funds to date is better understood in terms of what they call a “thin market”, with limited numbers of investors and limited numbers of entrepreneurial firms - each has difficulty in finding and contracting with the other at reasonable costs.
- 2.20 The authors of the NESTA & BVCA report recommend that hybrid venture capital funds should be larger than at present. They justify this on the basis that small funds have insufficient financial resources to cover their high fixed costs (especially expert management), to diversify portfolios or to provide the follow-on funding (with consequent vulnerability to dilution effects). They advise a minimum size for a fund to be c. £50m, but with early stage funds specialising in life sciences and clean tech preferably larger still. They also advise that funds should have sufficient scale to manage a fully diversified portfolio with at least 20 enterprises and to be capable of taking high-performing firms through the several rounds of financing necessary for a successful IPO or trade sale exit.

²⁰ Nightingale *et al* (2009) From funding gaps to thin markets UK Government support for early-stage venture capital. NESTA & BVCA Research Report.

- 2.21 They recommend that funds with a commercial focus should be free to select their investments from a large pool of high quality firms. They argue that geographic constraints are likely to have a negative impact on the size of the pool of candidate investees. They argue against any constraints associated with a sub-national focus or where the target geography lies outside international centres of excellence, especially where the investment is in support of new technologies.
- 2.22 Whilst acknowledging that constraints in investment size are imposed to ensure that early stage and small tranches of finance remain available through public intervention, this not only prevents funds operating in a commercially effective way but it also has a negative effect on the investee businesses – “as a ‘drip feed’ of finance means that the entrepreneur’s time is spent searching for the next round of funding (that may not be available) rather than growing the business”. It is argued that policy should focus on improving the flow of funding to high potential, growth-oriented firms (through a ‘funding escalator’) spanning all stages from formation to successful exit.
- 2.23 The report also points to the increasing effectiveness of angel networks and syndicates. Being often locally focused and ‘hands on’, they are seen to have the potential to support regional development ambitions without compromising their own economic viability.
- 2.24 The authors of the NESTA & BVCA report take a positive view of the future potential for hybrid funds in the UK, but with certain conditions: that the initiatives operate in an economic and commercial manner; they focus on exceptional and internationally competitive technology, intellectual property, entrepreneurs and businesses; and they operate without regional constraints.

Important themes for policy development

- 2.25 The following table provides our comments against the main themes arising from the above reports on publicly-backed equity finance.

Table 2-1: Themes of importance for policy on the provision of publicly-backed equity finance

Theme	Comment
Objective setting and implementation of ‘fit-for-purpose’ approach to fund evaluation Value for money and economic impact factors in assessing performance	<i>From primary research conducted for the present study there may be tensions to resolve between the approach adopted by the NAO in assessing fund performance and the emphasis placed on assessing the economic impact on the regions of those businesses in receipt of publicly-backed equity finance. This is discussed more fully in Section 4.</i> <i>Other recommendations in the NAO report which have found support in our primary research include enhanced clarity over approaches to monitoring and evaluation, the importance of benchmarking good practices in fund design and operations, and the provision of more information on fund management made available in the public domain.</i>
Co-investment and the development of public/private sector ‘hybrid’ funds	<i>The importance of encouraging co-investment provide a strong theme in the primary research for the present study, with some informants arguing it should be used much more but with many uncertain as to the efficacy of different models. The ‘Shifting Sands’ report re-inforces the need for better empirical evidence.</i>
Significance of fund size and geographic coverage on operating costs and performance of funds	<i>The Rowlands Review raises important issues concerning deficits in the evidence base: similar concerns over deficiencies in evidence are raised by Perriakis and Mason. The Review proposes the adoption of a programmatic approach and refers to the establishment of a funding “escalator”, a concept which met with polarised views on its applicability during our primary research. However, we found broad agreement on</i>

Theme	Comment
	<p><i>the need for flexibility within publicly-backed provision, including the ability to use mezzanine-type support at all investment levels and the ability to provide follow-on funding.</i></p> <p><i>The 'Thin Markets' report recommendation for the development of hybrid venture capital funds to be larger than at present (as small funds have insufficient financial resources to cover their high fixed costs, to diversify portfolios or to provide the follow-on funding) as well as the Rowlands Review's emphasis on giving due consideration to the optimal size of funds is broadly in line with the findings from the primary research.</i></p>
<p>Importance or otherwise of regional (multi-local) fund management presence</p>	<p><i>The Rowlands Review draws out distinctions between fund management functions requiring regional (or multi-local) presence and effectiveness, and those that may be performed centrally. The issue of where fund management functions should be located has been a contentious one during our primary research.</i></p> <p><i>The proposition in the Northern Way report of the city-based presence of fund managers with delegated responsibility within an overall national framework (the 3i analogy) is an interesting way of potentially reconciling views expressed to us for example about unhelpful 'fragmentation' on the one hand and 'disadvantage' because of greater South East bias on the other. The extent to which one type of fund management presence in a city or region for publicly-backed funds (as seems to be the implication of the 3i analogy) would satisfy those regional stakeholder interested in building indigenous regional VC capability and investment for the longer term is open to question. For some informants, within-region choice is regarded as a benefit.</i></p>
<p>Inter-relationship (or tension) between regional policy and innovation policy</p> <p>Importance of addressing so-called 'thin markets' characterised by limited numbers of and limited interactions between investors and entrepreneurial firms</p>	<p><i>The authors of the 'Thin Markets' report make a number of policy recommendations especially on commercial focus and removal of geographic constraints which, as will be seen later in the present report, introduce some clear tensions with current regional patterns of provision (the report's authors describe this as "a potential tension between regional policy and innovation policy"). Stakeholders in some regions emphasise the importance of providing finance to 'good' and not just 'high growth' or 'stellar' companies.</i></p> <p><i>The difficulty associated with connecting investors and entrepreneurial firms has been raised during our primary research.</i></p>
<p>Long term nature and commitment required to build capacity</p>	<p><i>It is recognised that any successful policy formulation needs to have national and regional backing over the long-term, with the commitment to build capacity. This links in with the importance of the long-term nature of venture capital provision with respect to the expected returns of PBFs. This is discussed more fully in Section 4.</i></p>

3: Description of current provision

- 3.1 Based on data collated by BIS, data provided by informants, plus our own desk and primary research, we summarise below the nature of current publicly-backed equity funding in England. More details on the characteristics of each fund are provided in the spreadsheets in Annex A to this report.
- 3.2 Assembling this information has been non-trivial. There was no single source of information on publicly-backed equity provision and in some cases data availability was ‘patchy’.
- 3.3 For completeness, we have included in the assessment of national and regional PBFs not only funds that are actively investing i.e. ‘live’ funds, but also those that are now closed to new investments i.e. ‘legacy’ funds (the latter are highlighted in *italics* below and in Annex A).

National provision

- 3.4 National PBFs are defined as those that are designed at a national level and delivered at a national or regional level. Table 3-1 presents the results for the national PBFs in England.

Table 3-1: National publicly-backed equity funds

Scheme	Fund structure	Number of funds	Fund size (£m)	HM Government commitment (£m)
‘Live’ funds:				
Enterprise Capital Funds	Direct investment	9	239	156.2
Aspire Fund	Co-investment	1	12.5	12.5
UK Innovation Investment Fund	Fund of funds	1	325	150
Social Entrepreneurs Fund	Direct & Co-investment	1	10	10
Carbon Trust Venture Capital Fund	Direct investment	1	25	Not applicable
Carbon Trust Seed Fund	Direct investment	1	3	Not applicable
NESTA Fund	Direct & Co-investment	1	50	Not applicable
Coalfields Enterprise Fund	Direct & Co-investment	1	10	10
Coalfields Growth Fund	Direct & Co-investment	1	10	5
Sub-total		17	684.5	343.7
‘Legacy’ funds:				
Early Growth Funds	Co-investment	7	31.5	31.5
Capital for Enterprise Fund	Direct	3	75	50
UK High Technology Fund	Fund of funds	1	126.1	20
Regional Venture Capital Funds	Direct investment	9	224.0	74.4
Bridges Community Development Venture Fund	Direct investment	2	40	20
University Challenge Seed Fund	Direct investment	19	60	Not applicable
Total ‘legacy’ funds		41	556.6	195.9
Total ‘live’ and ‘legacy’ funds		58	1,241	539.6

Source: BIS; CfEL; SQW primary and desk research. Note: in the case of fund of funds that have a number of underlying funds, we have counted this as one fund. See also Annex A, Table A-1.

- 3.5 The results in Table 3-1 and Annex A indicate the following:
- there are a total of 17 ‘live’ funds with an aggregate fund size of £684.5m, of which the aggregate HM Government commitment is nearly £344m
 - there are 6 main funds (with 41 sub-funds associated with them) that are currently closed for investment i.e. ‘legacy’ funds
 - in terms of both ‘live’ and ‘legacy’ funds, there are a total of 58 with an aggregate fund size of over £1.2bn, of which the aggregate HM Government commitment is nearly £540m
 - based on the available data, the national variability in the size range of investments that is possible across the current portfolio of ‘live’ PBFs is from no minimum limit to £3m
 - there are 16 national funds that have a specific regional focus i.e. the funds are designed at a national level but delivered regionally²¹.

Regional provision

- 3.6 Regional PBFs are defined as those that are designed and delivered at a regional level. Table 3-2 presents the results for regional PBFs in England. It is worth noting that these results exclude those funds that were designed at a national level but delivered regionally (i.e. Regional Venture Capital Fund and the Early Growth Fund).
- 3.7 It is important to re-state that our assessment of publicly-backed funds covers those funds that are closed to new investments (‘legacy’ funds) and ones actively investing (‘live’ funds).
- 3.8 However, the regional landscape may continue to change. It is at least possible that in some regions there remains the possibility of introducing additional PBFs supported by still uncommitted ERDF resources.

²¹ This refers to the nine Regional Venture Capital Funds and the seven Early Growth Funds.

Table 3-2: Regional publicly-backed equity funds

Region	Number of all funds	Number of active funds ('live' funds)	Number of funds closed to new investments ('legacy' funds)	Total 'live' fund size (£m)	Total 'legacy' fund size (£m)	Total 'live' and 'legacy' fund size (£m)
North East	13	8	5	132.4	51.3	183.7
North West	11	8	3	312.0	36.8	348.8
Yorkshire & Humber	5	3	2	90.0	87.0	177.0
West Midlands	7	6	1	57.2	5.4	62.6
East Midlands	2	2	0	15.0	Not applicable	15.0
London	4	4	0	20.0	Not applicable	20.0
South East	1	1	0	5.0	Not applicable	5.0
South West	3	1	2	2.5	38.4	40.9
East of England	0	0	0	Not applicable	Not applicable	0.0
Total	46	33	13	634.1	218.9	853.0

Source: BIS; CfEL; SQW primary and desk research. Note: 1) Regions that have JEREMIE Venture Capital Loan Fund (VCLF) i.e. North East, North West and Yorkshire & Humber, the 'holding fund' has several sub-funds. The sub-funds are counted in the number of active funds ('live' funds) above. For example: North East VCLF with its one holding and six sub-funds is counted as six funds not one fund; 2) In the West Midlands, one of the funds (Advantage Mezzanine Fund) is not 'live' yet, therefore not counted in the figures for West Midlands above; 3) results exclude those funds that were designed at a national level but delivered regionally (i.e. Regional Venture Capital Fund and the Early Growth Fund).

3.9 The results above and in Annex A indicate the following:

- there are a total of 33 'live' regional funds, with an aggregate fund size of £634m
- there are a total of 46 'live' and 'legacy' regional funds with an aggregate fund size of c.853m
- North West, North East, Yorkshire & Humber followed by West Midlands have the highest aggregate 'live' fund size
 - with the exception of West Midlands, the other three regions have the JEREMIE - Venture Capital Loan Fund (VCLF)
- North East, North West and West Midlands have the greatest number of 'live' funds
- the following illustrates the regional variability in the size range of investments that are possible across the current portfolio of 'live' PBFs²²:
 - North East - £20k to £1.25m

²² This excludes nationally designed but regionally delivered funds (i.e. Regional Venture Capital Fund and Early Growth Fund).

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional
venture capital provision
Report to the Department for Business, Innovation and Skills*

- North West - £3k to £3m
- Yorkshire & Humber - £15k to £2m
- West Midlands - £50k to £1m
- East Midlands - £250k to £0.5m
- London - £63k to £1.5m
- South East - £100k to £0.5m.

4: Coherence, co-ordination and consistency

- 4.1 In this section we report on the results of primary research with a wide range of informants offering regional and national public sector perspectives and others offering a market/private sector perspective. We have drawn on these findings in making recommendations for short term practical actions in Section 5. However, we also offer comment on findings of potential longer term significance throughout the text (*in italics*). It is important to note that whilst our recommendations for action seek to build on consensual views, on these issues we do not pretend any statistical rigour to the evidence gathered and interpreted.
- 4.2 At the end of this section we distil views on strengths and weaknesses in the present PBF landscape and on how the landscape might be enhanced.

Relationship between regional and national funds

- 4.3 What by some is seen as a ‘confused’ regional landscape is by others regarded as carefully designed and formally (and robustly) appraised provision to suit the needs of regional economic development and regionally-based businesses. The view put in support of the latter position is that diversity should not be regarded necessarily as a negative. Also, a degree of overlap between regionally-based funds and a degree of competition between their fund managers is considered by some as a “good thing” as it offers prospective investees some choice rather than only one publicly-backed source.
- 4.4 For areas with no or limited regional public sector provision currently the concern is with access to funds within the equity gap, not where the funding comes from. However, even here the design of publicly-backed provision would need to take account of within-region differences if, as some regional stakeholders argue, firms with ‘good’ potential but located outside national investment ‘hot spots’ are to have an opportunity to access seed or early stage funding within the sub-£2m level.
- 4.5 The issue of a gap in current provision is most often raised in regions which do not have a ‘sufficient’ ERDF funding pot. This, it is argued, leads to a shortage of seed and early stage finance in a funding gap which angels alone cannot fill. Two approaches have been suggested: (1) a national seed and early stage fund allocated out to the regions, or (2) collaboration between certain RDAs to pool their limited ERDF funds in order to participate in a JEREMIE or a similar initiative. In addition, these funds should have some built-in flexibility of structure to permit mezzanine deals, a flexibility that the existing JEREMIE initiatives appear to have and which may help overcome the still widely prevailing aversion to equity.
- 4.6 The issue of fragmentation of provision is one of particular relevance to those informants that have a national perspective on public policy implementation. Interestingly, no clear consensus emerges. Views received include the following:

- it is reasonable to expect that different regions should have different forms of provision to meet their region's specific needs and opportunities – “clutter is not necessarily a bad thing... clutter should be accepted”
 - the argument that a fragmented or “cluttered” landscape confuses SMEs should not go unchallenged: the ‘best’ SMEs will know where to go to get advice and information, including to corporate finance advisors
 - as a counter view, the landscape is “cluttered” and this is perceived negatively by businesses and other investors. The landscape would be enhanced by simplification/rationalisation
 - the diversity is a concern due to perceived inefficiency or at least no realisation of economies of scale
 - diversity is acceptable so long as it delivers value for money.
- 4.7 The view from the market is also mixed over whether the current publicly-backed landscape is adversely affected by fragmentation. Again, some consider that fragmentation is not necessarily a negative factor partly because national provision leaves gaps and the regions try to fill these gaps. Achieving full geographic coverage may result in greater fragmentation but that is a necessary cost for the advantages of provision which can cater for regional and sub-regional requirements. These advantages include for example close proximity to SMEs (the ‘market place’) and a choice of funds for the SMEs.
- 4.8 However, with fragmentation the negatives are loss of efficiency of operations by not sharing best practice; lack of scale, thereby limiting the service/support offer; creation of too many small “pots of money” which can only ‘drip feed’ investees; and increased search costs for SMEs.
- 4.9 Others with a market perspective view the current landscape in the following ways:
- not coherent partly because of funds being used as a “social policy” tool to create employment and address economic inequality
 - lack of co-ordination between funds and other sources of early stage finance such as business angel networks
 - although still fragmented, the involvement of CfEL has brought a degree of “rationalism” and expertise from the private sector. As a result, the landscape is becoming more “structured”
 - “cluttered” in some areas, as is evident from businesses finding it difficult to know where to access support: also perceived overlap and competition between funds
 - too many small regional funds including in specialist sectors which in practice require funds of scale.
- 4.10 **Comment:** *On the whole, the feedback suggests that there is no clear consensus on the issue of fragmentation. This appears to be an unintended consequence of addressing regional needs*

and offering greater choice for the prospective investee, but it may also be creating many funds of insufficient scale, especially for specialist sectors of the business-base. The divergent views re-inforce the need for re-visiting the framework for PBF provision in the context of regional economic and innovation policies.

Competition between funds

- 4.11 One RDA informant put the case succinctly: there should be no competition because there should be no unproductive overlap between regional and national (i.e. CfEL) funds. It is noted that all proposals for new funds have to be approved by a Review Group for which BIS provides the secretariat and so is well placed to “influence the parties towards joined-up thinking”. It is also important to note that the central government appraisal of regional funds takes place within the context of RDAs having the autonomy to develop PBFs to serve a region’s economic needs as long as they are within the eligibility criteria established by the cross-government Business Support Simplification Programme.
- 4.12 Perhaps unsurprisingly, no regional informants acknowledge ‘unhealthy competition’ in their region. However, some do acknowledge a degree of competition between managers of in-region funds for the best deals, but differentiation of fund investment strategies limits this. Furthermore, one comment (made with a sense of irony) expressed the desire for more competition between regional and CfEL’s provision as it would indicate that “ECF had an interest in looking for investees in our region”.
- 4.13 It has been argued that central government departments contribute to what some with a national perspective view as ‘clutter’, with the perception in places that national bodies establish new funds “on a whim”. We received some negative views for example on BIS’ ASPIRE Fund: “it is hard to justify a separate fund for women entrepreneurs”. However, we were referred, interestingly, to a study in London to assess the funding landscape in the context of consideration being given to a JEREMIE application. This discovered that the sub-£2m equity gap existed and that raising funding was even harder for women-owned businesses. However, there were no plans locally to establish a specialist fund targeting this disadvantaged group.
- 4.14 Notwithstanding some of the comments above, it is generally acknowledged that competition between publicly-backed funds is inappropriate, not least because it can drive down valuations. We sense that the available evidence on the degree of competition is anecdotal only. A minority of informants chose to point to follow-on funding being provided by other publicly-backed regional funds as evidence of valuable onward referral rather than competition i.e. giving a sense of an ‘escalator’ operating.
- 4.15 **Comment:** *those that take the negative view, either explicitly or implicitly draw analogies with the wider ‘business simplification’ agenda to rationalise business support products delivered by the public sector in the English regions. The funds predominantly in scope for this study (those supported by RDAs and those operated by CfEL) form only a part of the PBF funding portfolio in England. So, if there is ‘clutter’ and this is a negative factor in the landscape, the situation may be much worse than is visible in RDA and CfEL provision.*

Significance of national instruments

- 4.16 CfEL's investments to date are viewed by public sector consultees in many regions as being very concentrated in London and the South East. This links to concerns in some regions that the ECF delivery model is not working equally effectively for all places (see later). This is a pattern that is justified by CfEL on the basis of the distribution of GVA across the regions.
- 4.17 However, this is a controversial issue. An informant with a national perspective commented that while investments do mirror the pattern of GVA they are *less* concentrated in London and South East than private VC funding has been. The argument is also made that the presence of publicly-backed regional funds outside the Greater South East may be viewed as a compensating factor. Perhaps even more controversially, one informant posed the possibility that large regional funds in parts of the Midlands and in the North of England may be crowding out national publicly-backed funds to an extent. We are not aware of an evidence base which could confirm this or otherwise.
- 4.18 More generally, it is argued that CfEL (or its fund managers) is not close enough to know what the opportunities are in many regions²³. Also, there is little expectation of change under current operating arrangements as "fund managers don't travel". A fairly common view is that ECF managers have not looked very hard for attractive deals in the regions – "we have no evidence that they have looked". The same informants point to a dearth of good evidence of engagement with the regional investment readiness support programme.
- 4.19 There is also the view expressed that the fund management market is wary of CfEL due to its multiple roles of: being close to policy making; holder of funds (funder of funds); and also a fund manager making its own investments. There is need for greater clarity over plans for the future development of CfEL and future strategy of BIS: "what are RDAs aligning themselves with now?"
- 4.20 A number of views were expressed specifically on ECFs. For some RDAs, the ECF is seen as an attractive instrument: "attractive enough to draw commercial fund managers into running the EFC funds". It is seen as having a clear focus on supporting companies with high growth potential on "properly commercial terms rather than simply doling out money to help companies in 'difficult' regions."
- 4.21 However, the majority of RDA informants express "disappointment" at the level of ECF investment activity in many parts of the country. The view is expressed that the ECF delivery model is not working in many regions: indeed there is a highly sceptical view as to whether deals are even looked for in some regions. There is limited contact between ECF and regional providers, and no consistent approach to cross-referral (this is characteristic of other types of PBFs).
- 4.22 This disappointment among RDAs regarding ECFs is in direct contrast to the view from the market where the general consensus is that that ECFs are working well. One market informant

²³ CfEL only makes direct investments from the Aspire Fund and Capital for Enterprise Fund. It is based in Sheffield. For other funds, CfEL appoints fund managers who are drawn from elsewhere in the UK.

highlighted the fact that the design of the ECFs reflected Government's learning from previous funds²⁴.

- 4.23 However, at the sub-£1m level where much of the in-region demand is positioned, ECF is often perceived as having no interest, with informants drawing the implication, therefore, that current national provision cannot be used to meet regional need. It is possible to counter this perception with empirical data that demonstrate that four out of the nine ECFs launched to date have mean investment sizes of between £200k and £900k.
- 4.24 According to a number of regional stakeholders, having a national fund such as ECF with a regional focus would be welcomed especially in regions with little or no current publicly-backed provision: one model proposed is for a regional allocation plus a 'central pot' to go to if demand is especially high.
- 4.25 *Comment: any shift towards greater centralisation of publicly-backed provision over the longer term will have a credibility gap to overcome with many regional stakeholders in terms of the geographic distribution of investments.*

Communication and referrals

- 4.26 Most informants see no conflict between CfEL and the RDAs. There is an RDA/BIS working group on 'access to finance' whose last meeting was attended by CfEL. Perceptions of communication levels with CfEL vary from "limited" to "reasonable". There is limited if any joint working or cross-referral with CfEL.
- 4.27 There is a general view that more sharing of information between CfEL with RDAs would help in gaining a fuller picture of market demand and dynamics.
- 4.28 Informants point out that there is limited contact between fund managers where they are in competition with each other. There are examples of fund managers working closely together where they are not in competition. However, this is something which is put in place by the managers themselves rather than through some externally imposed requirement to do so.
- 4.29 In some cases the structure of the PBFs forces co-investment due to investment limits (e.g. Regional Venture Capital Funds). This requires contact with other fund managers but in practice this is on an *ad hoc* basis and driven by deal activity.
- 4.30 However, the general perception is that whilst there is an awareness of opportunities and recommendations may be made to other fund managers, there is no formal process to ensure this occurs. Referrals tend to be driven by the need for co-investment.
- 4.31 Some informants are highly sceptical about the feasibility of introducing cross-referral processes to the PBF landscape – "fund managers won't share their professional secrets". However, where fund managers of different funds (including mezzanine and equity funds) work for the same organisation (e.g. for Finance South East), communication is established more formally through regular (weekly) "escalator" meetings. Referrals also get made to other RDAs where a firm has made an ineligible approach and to other sources of assistance such as UKTI and MAS.

²⁴ It is relevant to note that the ECF model is relatively new and has been responsible for c.50 investments to date.

- 4.32 **Comment:** *although many informants would like to see a cross-referral process working between regional fund managers and CfEL's funds, in the words of one informant, effective cross-referral processes will be "difficult to achieve but worthwhile trying".*

Role of Capital for Enterprise

- 4.33 A number of suggestions have been made as to the role CfEL could with benefit play in the PBF landscape. These are summarised in the bulleted list below.

- 4.34 An underpinning issue is for CfEL (or its successor) to become more aware (and seen to be more aware) of the regional players in the early stage equity market, their contributions and performance. Also, in discussing its role, many look to CfEL to be more proactive in approach to relationship building and collaboration.

- 4.35 Suggestions for CfEL's role by regional and market stakeholders include:

- CfEL, as BIS representative, present on regional investment advisory panels – bringing knowledge of the wider investment market and bringing benchmarking insights. The European Investment Fund (EIF) will play a similar role when representing the EIB on JEREMIE advisory panels
- merit in facilitating role in sharing best practices, including on process efficiencies
- merit in offering a tool to facilitate benchmarking on like-for-like basis across regional and national PBFs
 - providing access to expert assessment of fund management performance
- collating reports on all PBF investments (including number of deals and investment size) being made in what sectors, and especially those viewed as offering best prospects for growing new industries and new jobs. This it is argued would provide a better evidence base to track the nature of the equity gap(s), of demand and supply, and of the balance between public and private provision – all by geography and by sector
- benefit from having a national 'wholesaler' of finance who could assist in gaining access to private and institutional funds – "a national body to bat for you" in the investment market
- role in providing access to expertise in setting up PBFs:
 - CfEL on panels appointing fund managers
 - advice on structuring funds – including operating costs and assessment of expected financial returns
 - contractual/legal matters
 - fee structures
 - performance management

- development of exit strategies etc.
 - CfEL's overall market knowledge to inform commercial evaluation with information on extant market conditions e.g. changing IPO market.
- 4.36 The degree to which CfEL's business model requires it to charge public sector clients for this advice and support may inhibit take-up.
- 4.37 *Comment: there is no shortage of proposals for the roles that CfEL could play of value to regional funders. Many can be captured under the banner of a 'centre of excellence' on the characteristics of effective and efficient publicly-backed equity provision and its positioning in the wider investment market.*

Monitoring and evaluation of performance

- 4.38 It is important here to recall that RDAs are bound by their sustainable development mission for their region and now also by the protocols of the Impact Evaluation Framework (IEF)²⁵.
- 4.39 There is a widely held view amongst regional stakeholders that the approach to PBF evaluation deployed by the NAO was too narrow (some say flawed). It appeared to assess only commercial returns from the funds. Although some informants in the regions argue that regional funds will achieve acceptable positive returns in time and would not face some of the adverse criticisms levelled by the NAO, they still argue that the benefits which accrue to regional economies extend beyond this financial return and that wider contributions, e.g. to regional GVA, should be included in any evaluation.
- 4.40 There is also a perception amongst regional stakeholders that CfEL is primarily concerned with a financial return on the investment of tax payers' money. By contrast, it is noted that RDAs' funds are intended to do other/different things: they have a focus on achieving economic development impact and then add on a consideration of commercial return as a secondary issue. Both RDA and ERDF strategies are aligned in meeting these economic development objectives as distinct from financial performance of funds.
- 4.41 It is important to balance perceptions with stated roles and intent. BIS has its own goals for economic development, with the ultimate objective of its various business support schemes being to boost economic growth through additional economic output or increases in productivity. Its own approach to evaluation has been developed to reflect this. However, it is also concerned with achieving objectives in a cost effective way: it is in this context that assessing financial returns from funds is relevant as part of an assessment of value for money.
- 4.42 We are also informed that CfEL as the delivery body for BIS has the objective of cost neutrality over the medium term for the ECF programme: its gives its fund managers the objective of maximising returns but within the economic objectives and parameters of each scheme. It is not clear how well the latter point is known amongst regional stakeholders.
- 4.43 A number of public sector informants in the regions argue that there are evaluation issues beyond the provision of finance which need to be clearly articulated whilst emphasising the

²⁵ As best as we can ascertain, no IEF-compliant evaluation of a regional publicly-backed equity fund has been published to date.

differentiation between PBF and grant support. One implication is that the ‘quality’ of fund management throughout the cycle of the fund is important to monitor/assess. However, we were cautioned that the success of a fund is strongly dependent on when it is launched (presumed to be relative to conditions in the wider economic environment).

- 4.44 Another issue which enters into the debate over evaluation is the significance of the limitations on PBFs to provide follow-on finance and thus avoid over-dilution and/or low valuation, with consequent adverse effects on IRR from the fund. This kind of issue is raised by informants who go on to point to the inappropriateness of evaluating PBFs using private VC performance benchmarks.
- 4.45 It is important however to make clear that regional funds are not destined to under performance on measures of financial return. Some informants point to a number of successful exits from the legacy funds in the regions as indications that over time they will perform well in terms of return on public investment. However, even the optimists are not expecting IRRs of 20%, regarding such levels as unrealistic for seed/early stage funds.
- 4.46 In light of this situation, the solution put forward by some market informants is to combine both commercial (e.g. IRR) and public sector/economic development metrics (e.g. job creation, GVA). One informant during the round of RDA consultations raised the concept of what was referred to as a “double bottom line” for assessing PBF performance.
- 4.47 Having data on both kinds of measures would permit fund performance to be assessed using a form of ‘balanced-scorecard’: the potential for under-performance in terms of IRR to be set against GVA contribution would be acknowledged, with performance benchmarks (ratios) developed through evaluations over time of multiple funds in different regional settings.
- 4.48 *Comment: it is of course possible to propound a counter-argument in favour of the pre-eminence of the IRR measure. This argument goes as follows: successful exits and associated success of a fund as measured by IRR are linked closely to success of the investee and its consequent contribution to national GVA. For a regional fund the ambition of course is to achieve success as measured by IRR and contribution to regional GVA.*
- 4.49 *The inclusion of economic impact (net additional GVA contribution) in the ‘balanced’ assessment of the impact of a PBF would bring issues of adjustment for ‘deadweight’ into consideration²⁶.*
- 4.50 Any measurement of performance should be over the long term not least to take account of the typical “J-curve”²⁷ pattern of expected returns over time.

²⁶ It is worth noting that Josh Lerner (2009) in ‘Boulevard of Broken Dreams – Why Public Efforts to Boost Entrepreneurship and Venture Capital Have Failed and What to Do About It’ advocates an approach known as “regression discontinuity” analyses when undertaking an evaluation of a venture capital fund. He points out that it is better to assess those fund applicants that were not selected for investment – they were “just above or just below the cut-off line”. These entrepreneurs or venture funds are likely to have the closest characteristics to those that were selected and therefore possible to measure the fund’s impact without having to ‘randomly’ select a sample.

²⁷ See for example the National Audit Office Report for the J-curve principle. This recognises that a VC fund will experience negative returns early in its ‘fund life’ as portfolio businesses require investment. It will not be till around the eighth year of a fund that positive returns are experienced. These returns are then expected to increase in later years as portfolio businesses grow.

- 4.51 **Comment:** *the development of a consistent approach to monitoring investment activity and evaluating performance/impact of all PBFs whilst widely seen as desirable is acknowledged to be non-trivial. Designing one evaluation scheme that will satisfy the requirements of the RDAs, BIS, ERDF and EIB (for JEREMIE) and will enable both financial returns to a fund and the economic impact of the fund to be assessed will be ‘challenging’.*

Customer journey

- 4.52 At a regional level, the picture appears quite mixed, especially concerning the role that Business Link (BL) plays – from little or no role to a significant partner in providing onward referrals. We received quite contrasting views on the level of awareness and know-how within BL on equity finance and on whether in any event there was a role needing to be played.
- 4.53 The following list shows the diversity of issues raised:
- concern is to avoid fund managers spending time on queries that could be answered by BL – BL should be passing on qualified leads to fund managers
 - regional finance providers will maintain a Customer Relationship Management (CRM) system i.e. one separate from what BL may do – helping to track activity and progression during the customer journey
 - one informant in a region with multiple funds argues that the ideal is for the customer to ‘see’ only one fund – the diversity should be evident only in the ‘back office’, with incentives for fund managers to ‘work together’ for the good of the customers and the region’s economy.
- 4.54 As another illustration of diversity here, an access to finance lead in one RDA indicated that potential deals come from: 1) funds found via web-searches or from other public source of basic information; 2) a direct approach made to the fund – but this rarely leads to an investment straight away; 3) referrals by investment readiness support organisations; 4) BL referrals to the latter who then refer on to a fund manager. The significance of a pro-active fund manager seeking out deals in this context requires further investigation.
- 4.55 It is acknowledged that the ‘journey’ can be slow, the elapsed time in part influenced by fund managers’ capacity to assess prospective new deals. During this consultation, we were also reminded that equity aversion still exists widely.
- 4.56 Also in terms of the ‘journey’, the concept of a funding ‘escalator’ is regarded as too simplistic by some informants with regional and national roles: “SME’s financing needs cannot be shoe-horned into such a structure”. Others who do find the concept useful and promote the presence of an ‘escalator’, see it as an important contributor both to the customer journey and in the market positioning of different types of publicly-backed financing instruments, e.g. from a Proof of Concept Commercialisation Fund grant to a mezzanine/debt Accelerator Fund and to a Seed Fund.
- 4.57 However, whatever the view of this particular construct, one informant argued against giving the impression that raising equity finance was a simple, easy task – “it is not and should not

be seen as one”. Whilst of course very appropriate to assist first timers, this informant argued that “any company worth its salt would do its own homework first”.

- 4.58 In the view of market stakeholders, the challenges of the current landscape for SMEs seeking equity finance primarily relate to: 1) the size of search and information costs; 2) in some cases a lack of clarity over where to go for support (albeit acknowledging that the ‘best’ firms will find where to go); and 3) availability of only small successive amounts of investments at sub-£2m level due to many small funds.

Summary of strengths and weaknesses in provision

- 4.59 The number and diversity of publicly-backed funds in the regional funds are viewed as a strength by some and a weakness by others. Whatever the case, funds directly supported by BIS and by RDAs form only part of the picture. Although out of scope for this study, we were referred to information on a wider range of equity and related schemes with public sector support from other government departments and also from ERDF but not formally involving RDAs. So if diversity and multiple small-scale funds is truly a ‘weakness’ as some would argue, then the situation might be much ‘worse’ than they realise.
- 4.60 One RDA informant argued that there has tended to be too much emphasis in national policy and regional strategy implementation on ‘equity’. In arguing for the importance of mezzanine instruments, greater flexibility in publicly-backed funds would be valued and strengthen the ‘offer’ to SMEs. The recommendation of the Rowlands Review for a mezzanine instrument is welcomed, albeit this is for deal sizes (addressing a gap considered to extend up to £10m) that will at least in part exceed that which is typical of RDA-backed funds.
- 4.61 Based on the views of informants drawn from across the public sector and the market, we list below our interpretation of the main strengths in the PBF landscape:
- publicly-backed equity provision has a high profile on the national policy agenda
 - the agreement of the National Framework Principles has been a significant, albeit early step forward to enhance the synergy between national and regional provision – at a minimum, it is catalysing further discussion on fund design and performance evaluation
 - in some areas significant progress is being made in developing new expert capability and capacity in fund management
 - growing importance of co-investment enabled by public funds (e.g. ‘hybrid’ funds) - although the empirical evidence base on the sustainability and further capacity for this is deficient
 - the responsiveness of the ‘system’ as indicated by the likely policy action to address the current issues in the sub-£10m ‘gap’ – the mezzanine instrument proposed by the Rowlands Review
 - evidence of learning from previous PBF experience – as exemplified for some market informants by design of ECF

- flexibility within a number of funds to provide mezzanine finance
- CfEL's approach to procurement, due diligence, assessment of risk and practice of accessing the private sector
- the winning of JEREMIE support is regarded as highly significant for those regions in the north that have been successful – bringing not only additional finance to these regions but also attracting new fund management capability and capacity.

4.62 We list below our interpretation of the main weaknesses in the PBF landscape:

- there are fundamental issues to be reconciled, arguably weaknesses, reflected in contrasting views over the objectives and appropriate performance measures for publicly-backed provision
- other fundamental issues relevant to fund design to be reconciled reflected in contrasting views on extent that multi-local fund management presence is required for effective and efficient funds
- as indicated in a number of the research papers referred to in Section 2, there are weaknesses in various aspects of the empirical evidence base
- lack of consistent empirical evidence on quality of performance of the publicly-backed funds in the regions
- perceived imbalance between supply of publicly-backed finance and the volume and quality of demand in some regions
 - others argue that the lack of evidence of 'demand' is the weakness
 - no evidence on how demand links to companies benefitting from the 'Solutions for Business' products
- the restrictions placed on funds e.g. in terms of investment limits and sectors
- from the perspective of a number of regional stakeholders in the public sector, the lack of impact of ECFs in many parts of the country
- over-emphasis of some funds on small technology start-ups as opposed to medium-sized manufacturing businesses which also have the potential for growth and job creation
- a perspective in the market that the targets associated with RDA funds relate to number of new deals done and this encourages many small deals. This potentially results in under-funding ('drip-feeding') or a reluctance by the funds to provide follow-on investment
- the effectiveness of initiatives to encourage and support 'matching' with business angel funding remains 'patchy' and plagued by deficiencies in empirical evidence

- perceptions of significant under-investing by funds in some areas leading some market informants to press for a greater level of national oversight
- again from a market perspective, several informants argued that the JEREMIE funds are making provision more complicated and one informant argued that they may introduce competition between regions as companies (potential investees) are attracted to locate within a region with JEREMIE provision – inappropriate from UK perspective
- a market view is that the European Investment Bank (EIB) contribution to JEREMIE at near commercial rates/terms is not a “cheap” form of finance
- the continuing emphasis of PBF provision at the sub-£2m level is failing to acknowledge that the “real gap” is up to £5m
- from a market perspective, for specialist sectors (e.g. clean energy) there is not enough knowledge and expertise in the regions to invest in the best deals.

4.63 The main constraints in current provision highlighted by the market related to the following:

- EU State Aid restrictions on PBFs, in particular the allowable investment size
- lack of central function to control the flow of finance to the regions.

Emerging views on improving the landscape

4.64 We distil below recurring views on how the PBF landscape could be improved. As indicated at the beginning of this section, what follows should be viewed as ‘ideas’ to be considered rather than a statistically rigorous polling of opinion. Where there are differences of view, we have added a comment (*in italics*).

Policy implementation

- *national framework*: develop a strategic framework for all publicly-backed equity funding within which existing national and regional provision can be positioned and explained
 - *there would be merit in linking this framework to the innovation support system especially for newly emerging sectors*
- *differentiated PBF support*: Government policy should distinguish between “generalist” and “specialist” sector PBFs. For the specialist sector, national level support not regional is advised and these funds should be of larger scale
 - *again there would need to be confidence in pan-national accessibility*
- *scope of the NFPs*: extend the National Framework Principles to all government departments that provide equity finance.

National framework – regional presence

- *relevance of multi-local fund management presence:* obtain empirical evidence to resolve divergent views on the merits or otherwise of ‘diversity’ of funds and of the ‘presence’ of fund management functions within the regions
 - *there is an acknowledgement of the need to consider the nature and needs of different roles within the fund management function e.g. investment strategy development and monitoring oversight; deal sourcing; deal making; delivery of management support to investees; management/administration of the fund*
 - *there is also an acknowledgement that the nature of roles and needs may be different for ‘general’ versus ‘sectoral’ funds and between seed/early stage and growth/development funds*
 - *one informant argued that a regional presence (whether an office or someone who knows the region well) would enable deals to be captured that are in the “next tier of quality – still good deals but perhaps not the top high fliers” and that “it is this tier that ought to be the target for publicly-funded VCs as the very top level will be able to find funding elsewhere”.*

Financial model/structures

- *co-investment:* a national co-investment fund is proposed to help distribute early stage equity provision in ways to address any regional distortions
 - *BIS is also advised to consider establishing a national “matching” pot to permit regions with little ‘single pot funding’ to access European funds*
- *mezzanine finance:* introduce more PBF mezzanine products to the market as these will be ‘cheaper’ than equity and provide funds with a more regular flow of income as well as providing returns to investors
- *boundary conditions:* remove constraints (on size, geography, investment size) on the operation of PBFs – *however, there would need to be confidence in pan-national accessibility*
 - *in designing any future framework due consideration should be given to the scale and flexibility of funds by stage and investment size: the optimal size and centralised vs. multi-local design factors may be different for seed/very early stage investments and those above c. £1m deal size*
 - *however, other informants note the degree of autonomy practiced and prized by RDAs which would be a key factor in designing a new national framework.*
- *flexibility:* design in flexibility to PBFs, including flexibility to support businesses in the new industries/new jobs sectors where the burn rate of equity funding is too fast for the funds businesses in the regions typically access

- *expansion of ECF model*: BIS is advised to establish regional ECFs, with co-investment with funders in the regions
 - establishing regionally focused ECFs would allow ECFs to be the clear next step after seed funding
- *equity gap*: acknowledge and act on situations where the equity gap extends up to £10m
 - *one informant expanded on this: it is unhelpful to continually re-enforce the view that the gap is below £2m and to design publicly-backed funds with this upper level in mind: “if a fund is known to be capped at £2m a subsequent investor can screw down the value of the equity”.*

Human capital

- *money plus management*: fuller appreciation is needed of the skills that VC-backed management teams receive and of the degree to which this is being delivered to investees supported by PBFs
- *investment readiness*: benchmark resources and quality associated with investment readiness support across the country.

Understanding the market environment

- *level of demand*: commission further research to address the uncertainty around the nature and scale of demand for equity finance
 - we were informed that: “premier UK funds invest outside of the UK suggesting that there is not enough demand for equity within the UK”
 - *there may also be merit in investigating the relationship between need for and benefits of publicly-backed equity provision and beneficiaries of the national and regional innovation support system (see also comments made in the NESTA report on Thin Markets on “potential tension between regional policy and innovation policy”)*
- *market conditions*: the current market is closed to Initial Public Offerings (IPOs) and trade sale of companies are occurring sooner because funds want to exit their investment, resulting in lower returns – mezzanine/growth finance will enable companies to develop further
 - more generally, CfEL to be pro-active in providing national level market intelligence on activities and trends.

Information on PBFs

- *national source of information*: to supplement multi-local provision, establish a single online source of information on all forms of PBF provision

- *reporting PBF investment activity*: collate and publish data on all PBF investment activity and on fund performance on a regular basis (see Venture Economics in USA and the Scottish Enterprise reports on early stage investment activity in Scotland)
- *co-ordinated marketing*: enhance marketing of PBFs particularly to intermediaries (lawyers, accountants and other business advisors) and to potential co-investors. The intermediaries are an easier and more effective target being a key source of information and support for many SMEs.
 - development of a directory of PBFs is considered a good early step
- *best practice*: encourage sharing of best practice between CfEL and RDAs, and their fund managers
- *cross-referrals*: encourage PBF managers to share information and cross-refer potential investees - the key point made here is that if an SME is not suited to a particular fund then it should be referred on to a suitable source of further advice or support
 - development of a “referral flow chart” (a protocol) might be helpful in ensuring that regional fund managers are aware of national funds, so that appropriate referrals can be made.

Appraisal, monitoring and evaluation

- *consistent approach*: in the context of a national framework for PBF provision with national oversight, ensure a commonly agreed, consistent approach to appraisal, monitoring and evaluation of fund performance and impact
 - consistency will permit comparative analysis on a like-for-like basis
 - in evaluation there would be merit in combining both commercial (e.g. IRR) and public sector/economic development metrics (e.g. GVA)
- *streamlining*: of appraisal/approval and reporting procedures for PBFs required by central government departments.

5: Conclusions and recommendations

- 5.1 This section outlines the main conclusions based on the findings from primary and secondary research. It also provides recommendations for improving the coherence, co-ordination and consistency of the publicly-backed venture capital provision in the immediate future. The aim is to provide mechanisms for engagement between BIS and RDAs which will make the implementation of the National Framework Principles (NFPs) fully effective for all.
- 5.2 It is important to restate that although informative and insightful, the primary research involved only a limited programme of consultations²⁸ and no statistical robustness is claimed for the evidence provided.

Conclusions

- 5.3 This study found divergent views among informants on whether the numerous funds associated with the current publicly-backed venture capital provision represent valuable diversity or inefficient ‘clutter’. The plethora of funds is not necessarily viewed by all informants as a negative characteristic, but can be a positive force by providing choice and introducing rivalry in terms of good practice and performance. Notwithstanding any merits in these different arguments, there is scope for improvement in making the current publicly-backed venture capital landscape a more coherent market place (e.g. to ensure no unproductive competition): this kind of coherence is arguably highly relevant to the public sector (in all its forms) in any investigation of what additional provision is required as well as to assess the performance of these funds.
- 5.4 If a decision is taken to simplify PBF provision then it needs to encompass more than the funds provided by BIS and RDAs: the role of PBFs supported by other parts of the public sector should be included in any assessment of the national picture.

Current provision

- 5.5 The mapping of the PBF landscape reveals the following provision:
- *national level* (i.e. PBFs designed at national level and delivered at national or regional level) – there are a total of 17 ‘live’ funds with an aggregate fund size of c.£684.5m
 - *regional level* (i.e. PBFs designed and delivered regionally) – there are a total of 33 ‘live’ regional funds, with an aggregate fund size of c. £634m.

Strengths and weaknesses in provision

- 5.6 In Table 5-1 those strengths, weaknesses and constraints in the current PBF landscape which are considered to have greatest significance for future policy implementation are summarised.

²⁸ A total of 45 informants.

Table 5-1: Strengths, weaknesses and constraints in PBF provision

Issues	Commentary
STRENGTHS:	
Agreement on NFPs	<p>Although acknowledged as a first step there appears to be general agreement among public sector informants that achieving agreement on these Principles has the potential to enhance synergy in PBF provision and is already catalysing discussion on fund design and performance evaluation.</p> <p>It will be important to sustain the momentum gained from these early steps. The recommendations set-out later in this section are designed to assist this process.</p>
Co-investment enabled by public funds ('hybrid' funds)	<p>The evidence of the growing importance of co-investment is an indication of the following benefits:</p> <ul style="list-style-type: none"> • increased availability of early stage capital - leveraging effects • introduction of private sector expertise, 'insight' and risk-sharing along side public sector investment.
Evidence of 'learning' in the UK	<p>Widely held view among market informants is that CfEL and its delivery of PBFs has improved over time (including in procurement, due diligence, assessment of risk and practice of engaging of the private sector).</p> <p>Experience in the design and delivery of PBFs is now also embedded within most regions. The development and sharing of this emerging experience base (in addition to international learning) needs to continue and be further enhanced as a key element in the long term 'project' to build a mature and effective early stage venture capital market in the UK.</p>
Success in winning JEREMIE support	<p>For some JEREMIE is highly significant: it has provided an opportunity for substantial leveraging of finance and in addition has catalysed the attraction of new fund management capability and capacity.</p> <p>JEREMIE is bringing additional diversity to the PBF landscape, further reinforcing the need to consider nationally the attractiveness/feasibility of a consistent approach to assessing fund performance and economic impact.</p>
WEAKNESSES:	
Multiplicity of objectives and performance indicators	<p>Especially amongst market informants the perceived multiplicity of objectives and associated performance indicators is seen as unnecessarily complex and inappropriate, essentially a weakness in PBF provision.</p> <p>This introduces what are arguably fundamental issues associated with the rationale for PBFs and the demands of diverse public sector funders. Performance indicators need to be designed with due regard to strategic objectives. This issue links to comments above on attractiveness of a consistent approach to assessment which is addressed further in the recommendations made in this report.</p>
Location of fund managers	<p>The location of fund managers associated with nationally organised PBFs is regarded by public informants, especially in the north, as a weakness in the current landscape. The perception is of a bias in location and consequently in investment activity towards the South East.</p> <p>There appears to be considerable diversity of opinion both amongst public and market informants as to significance of geographic proximity between fund managers and investment propositions in determining deals that are made.</p> <p>Resolving this difference in opinion will be important when designing any new and large national funds: resolution will require better empirical evidence than is currently available.</p>

Issues	Commentary
Imbalance between supply and demand for PBFs	<p>There is a perceived disconnect between the supply of PBFs and 'demand-side' issues, these include:</p> <ul style="list-style-type: none"> • the lack of empirical evidence on the level and nature of demand for PBFs • the absence of evidence on how demand links to companies that are beneficiaries of 'Solutions for Business' products. <p>As a consequence, there is a perceived over-supply (or under-supply) of PBFs in different regions, with potential implications for the efficient allocation of resources.</p> <p>Going forward, it will be important to establish the potential 'market-size' of eligible investee companies, and the level actually seeking PBFs.</p> <p>Any future assessment of the demand-side will benefit from exploring how the provision of PBFs fits with the innovation and investment readiness support interventions by the public sector.</p>
Fund restrictions	<p>Many market informants have expressed the view that the performance of funds is limited by the restrictions placed on them e.g. in terms of stage, size, sector and geography.</p>
Targets associated with RDA funds	<p>There is a market perspective that a primary target for RDA funds is the 'number of deals done'. This is seen as encouraging an inappropriate large number of small scale deals: the consequence is under-funding ('drip-feeding') or indeed reluctance by the regional funds to provide follow-on investment.</p>
'Matching' with business angel funding	<p>Initiatives that encourage and support 'matching' with business angel finance are 'patchy'.</p> <p>However, knowledge of the scale and impact of angel investment is affected adversely by lack of consistent and robust data.</p>
JEREMIE funds make provision complicated	<p>Several market informants argue that the introduction of JEREMIE funds in the northern regions has made provision more complicated.</p> <p>Perhaps not surprisingly, there is a clear difference of opinion between those that are successful in winning JEREMIE support and those that have a stricter market perspective. While recognising the unique nature of JEREMIE funds, this further exemplifies the debate over 'useful diversity' versus 'clutter'.</p> <p>It also, as mentioned above, reinforces the need to consider nationally the attractiveness/ feasibility of a consistent approach to assessing fund performance.</p>
Lack of regional knowledge and expertise for specialist sectors	<p>The market view is that for specialist sectors (e.g. clean energy) the regional knowledge and expertise is not sufficient to source and invest in the best deals.</p> <p>It is advocated by the market that specialist sectors require scale in terms of fund size supported by specific technical expertise and this can only really be delivered at a national not regional level.</p>
CONSTRAINT:	
EU State Aid restrictions	<p>EU State Aid restricts the investment size of PBFs and this has implications for the eventual financial performance of individual funds.</p>

Themes for policy development

5.7 Here we draw conclusions on the links between the findings from primary research undertaken for this study with the conclusions and recommendations from recent key

evaluation and research reports referred to in Section 2. The main themes emerging from these sources (see Table 2-1) are considered in turn.

Objective setting and implementation of 'fit-for-purpose' approach to fund evaluation

- 5.8 We conclude there are tensions to be resolved between an approach to assessing fund performance which emphasises financial return to funds and one which emphasises economic development impact. We see merit in developing an approach which takes account of both kinds of performance assessment – a ‘double bottom-line’ approach.
- 5.9 Addressing the above issue of fit-for-purpose fund evaluation is an important pre-requisite to developing a common view on what constitutes ‘value for money’ and an ‘appropriate’ contribution to economic development.
- 5.10 However, designing one evaluation scheme that will satisfy the requirements of the RDAs, BIS, ERDF and EIB (for JEREMIE), and will enable both financial returns to a fund and the economic impact of the fund to be assessed will be ‘challenging’. Success is likely to require different parts of the public sector to work more closely together in developing a ‘programme’ approach to the provision of PBFs within a national framework that ensures optimal additionality from the public investment.

Co-investment and the development of public/private sector 'hybrid' funds

- 5.11 We conclude that there is widespread support for encouraging ‘hybrid’ venture capital funds albeit with some informants in the regions also noting the importance of long term commitment to the building of angel market capacity/ capability. As experience of ‘hybrid’ funds is gained in different parts of the country there would be merit in evaluating the efficacy of different models. This is consistent with the ‘Shifting Sands’ report²⁹ and its reference to the need for better empirical evidence.

Significance of fund size and geographic coverage on operating costs and performance of funds

- 5.12 Informants offering a national or market perspective tended to support the ‘Thin Markets’ report recommendation for the development of larger scale PBFs than at present (as small funds have insufficient financial resources to cover their high fixed costs, to diversify portfolios or to provide the follow-on funding). However, smaller scale and geographically targeted funds continue to be seen as valuable parts of economic development ‘tool-kits’ in places. We conclude that segmentation and diversity of provision is likely to remain appropriate in principle but that fund design in future must give serious consideration not only to economies of scale issues raised in the ‘Thin Markets’ report but also the likely size of the pool of high quality deals available in different geographies: the latter is especially important in the context of deal flow associated with high-tech/high-growth investable companies looking for finance within the equity gap.

²⁹ *Op.cit.*

Importance or otherwise of regional (multi-local) fund management presence

- 5.13 The study encountered polarised views on this issue. Our perception is that proponents on either side of the debate ‘assert’ but find it difficult to draw on robust empirical evidence. To the extent that future PBFs are designed with a wider geographic scope, the full implications of fund manager location need to be determined.

Inter-relationship (or tension) between regional policy and innovation policy

- 5.14 The authors of the ‘Thin Markets’ report refer to a “potential tension between regional policy and innovation policy”. Informants in the present study expressed the ‘tension’ differently – between the role of PBFs as economic development tools in the regions and as interventions to be assessed primarily in terms of financial return on the investments made.
- 5.15 Notwithstanding this, in terms of understanding potential ‘market size’ for PBFs in future, there is merit in assessing the relationship between businesses with potential that are in receipt of support from R&D and innovation-related public sector interventions and the need/demand from these businesses for early stage venture capital support.

Long term nature and commitment required to build capacity

- 5.16 We conclude that there exists a broad consensus that the development of a well functioning early stage venture capital market is a long term ‘project’. The requirement for long term commitment from the public sector to support and encourage the development of market capability and capacity, including the angel market, only re-inforces the importance of action now to enhance coherence, co-ordination and consistency of the PBF landscape.
- 5.17 The ‘project’ also needs to take account of the typical ‘J-curve’ pattern of expected returns to funds from early stage equity investment, with positive returns unlikely to be achieved until around year eight following initial investments.

Other conclusions

- 5.18 Drawing on all the evidence gathered in the study, we offer the following additional conclusions:
- there is no shortage of proposals for the roles that CfEL could play of value to regional funders, building on the contribution that market informants consider it has already made to bringing ‘structure’ to national provision. Many of the proposals can be captured under the banner of a ‘centre of excellence’ on the characteristics of effective and efficient publicly-backed equity provision and its positioning in the wider investment market
 - CfEL may also have a beneficial role to play in collating and making more widely available benchmarking information on PBF performance and on other factors relevant to enhancing PBF design in future
 - one of the challenges in this study has been to collate information on PBFs and their investment activity. A comprehensive picture of provision in the public domain is in our view required. There are initiatives elsewhere (see Scotland) to gather and publish

information on early stage investment activity that could be adapted with merit for all publicly-backed equity provision in England

- the issue of improving the ‘customer journey’ by a greater degree of cross-referral between different PBFs was raised by a number of informants (public and market). However, even when considered desirable, informants pointed to the difficulty of implementing formal cross-referral protocols: market informants noted that informal referrals are not uncommon between trusted peers in the market. We conclude that cross-referral protocols should be piloted as part of the development of a national ‘programme’ albeit fully aware of the practical difficulties that may be encountered. In the words of one informant: “difficult to achieve but worthwhile trying”.

Recommendations

- 5.19 The recommendations summarised below have been developed through wide consultation with national and regional stakeholders plus private sector actors.

NFP 1: Positioning of regional and national publicly-backed VC funds

- 5.20 This recommendation is in response to divergent views concerning the objectives of publicly-backed equity provision, how it should be evaluated and how regional and national provision should be designed and operated.
- 5.21 It is recommended that procedures are put in place which ensure early, formal involvement of regional and national partners in the design, appraisal and commissioning of new PBFs and by this means to ensure full, streamlined consideration of issues such as additionality, complementarity and competition, and to take advantage of market intelligence at national and regional levels.

NFP 2: RDAs and BIS activities and protocols

- 5.22 This recommendation is in response to those who hold the view that the landscape is ‘cluttered’ and that the introduction of better communication between regional and national fund management would improve the customer journey.
- 5.23 It is recommended that a co-ordinated marketing and communications plan for all PBFs is designed and implemented, and that the outputs are customised for the following audiences: 1) business advisors, lawyers and accountants; 2) potential co-investors; and 3) SMEs (especially in new and emerging industries).
- 5.24 It is recommended that cross-referral protocols between national and regional providers of PBFs are designed, operationalised and monitored. A key focus here is to develop and give confidence in the ability of PBFs to address needs and opportunities throughout the country, especially in new and emerging sectors.

NFP 3: RDAs and BIS reviewing fund structures

- 5.25 This recommendation is in response to the widely held view that exchange of learning and experience on a range of structural issues concerning the operation of funds would be of significant benefit to all involved.
- 5.26 It is recommended that an agreement is established between BIS and all RDAs on the two-way exchange of data/information and experience relevant to the establishment, governance and management of funds, including but not limited to the role of 'holding funds'.

NFP 4: Ongoing dialogue

- 5.27 This is linked to the reasons for the recommendation above, but is in response to views which place value on the interaction and sharing of experience between managers of publicly-backed funds.
- 5.28 It is recommended that a regular forum (e.g. bi-annually) is established for national and regional PBF managers to review/exchange views on market issues, best practices and skills/training needs. It is proposed that CfEL takes on the role of assessing and taking forward key actions of national significance arising from this forum.

NFP 5: Information sharing

- 5.29 This is in response to the evident absence of a consistent approach to monitoring, evaluating and reporting across the publicly-backed equity funding landscape. This is acknowledged as non-trivial to resolve but it is wholly in line with for example what RDAs are now charged to do over the evaluation of all other interventions.
- 5.30 It is recommended that a single consistent and formal reporting and evaluation framework for all PBFs is designed and implemented which will enable robust assessment of performance and impact, and the tracking over time of the development of the national and regional VC markets.
- 5.31 It will be important to develop a shared understanding of the objectives of PBFs and the evaluation of their performance – commercial return from the fund and economic development impact (“double-bottom line”). In our view, agreement on prime purpose(s) between the different providers of PBFs is the critical underpinning of much of what is recommended elsewhere in this section.
- 5.32 It will also be important in the context of evaluation to ensure the comparisons are being made on a like-with-like basis. The evidence base assembled will assist in assessing the merits or otherwise of regionally-based fund management.
- 5.33 It is also recommended that an agreement is developed to cover the provision of strategic market intelligence on a regular and pro-active basis from the regions to CfEL and vice versa.
- 5.34 The pro-active provision of advice and support from CfEL (as a national ‘centre of excellence’) to the regional providers in the following areas would be beneficial:
- selection and development of fund managers

- contractual/legal matters
- fee structures
- governance
- performance management, including provision of business management support
- realising exits
- source of best practice
- administrative support
- national/international market intelligence
- incentive mechanisms for fund managers
- playing a co-ordinating role in marketing co-investment opportunities in PBFs towards national players in the VC market
- value of different co-investment options.

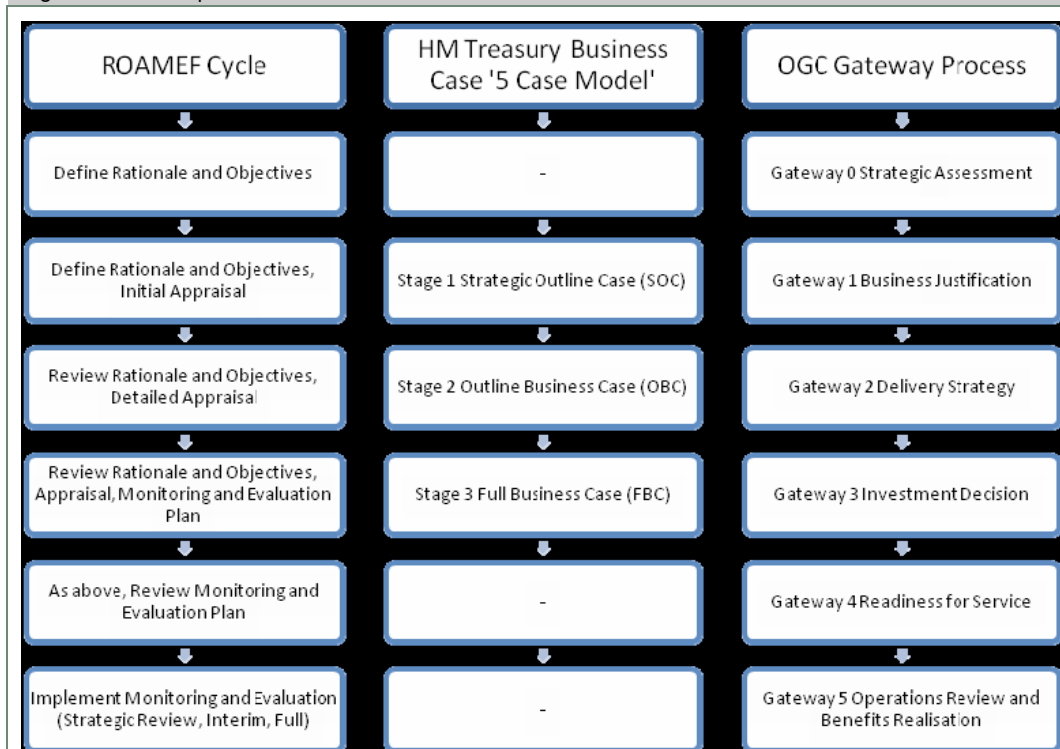
Practical proposals

- 5.35 What follows are some practical ways in which to operationalise the recommendations made above.

Streamlining decision making on introduction of new publicly-backed funds

- 5.36 This proposal contributes to NFP 1 – *Positioning of regional and national publicly-backed VC funds*.
- 5.37 The formal processes of *ex ante* appraisal and decision making relating to the approval of new PBFs can involve a number of organisations in central government as well as individual regionally-based public agencies. The processes within the UK to some degree vary depending on the immediate source of public sector finance for the PBF: central Government department(s); regionally-based organisations and/or ERDF. In the context of the present study, the key government departments are BIS and CLG and the key regional organisations the RDAs.
- 5.38 However, it is possible to conceive of a national ‘system’ for the design and appraisal of PBFs that extends to those put in place from time-to-time by other central Government departments. There is research evidence that indicates a better, more streamlined procedure would be beneficial. Although, charting the *status quo* and assessing the appropriateness of existing ‘generic’ approaches (some illustrated below) in any detail is beyond the scope of this report, what we can offer are some basic parameters that should be considered in any re-design.

Figure 5-1: Basic parameters



Source: diagram taken from http://www.scottish-enterprise.com/about-us/research-publications/-/media/publications/About%20Us/evaluations%20and%20economic%20impact%20studies/se2009_se_appraisal_guidance.ashx

Design principles

- 5.39 It will of course be essential to define *in unambiguous terms* which PBF propositions come within the ambit of the decision-making process. Linked to this must be a clear statement, and understanding, of what level of authorisation the various parties to a PBF proposal have in decision making.
- 5.40 Given that all PBFs find investees within a regional context, it is arguable that all PBFs should go through a similar process of appraisal to optimise likely additionality – to avoid unproductive competition, displacement and confusion in the market.
- 5.41 We are attracted by a ‘gated process’ that limits the amount of preparatory work only to that essential to decision making at the next decision point (or gate). For this to be effective as well as efficient, the information requirements at each stage gate need to be clearly expressed, the process of assessment needs to be aligned with these requirements (to avoid leaking into anticipation of future development of a proposition before full evidence is available) and the process needs to be transparent, with high quality feedback to proponents.
- 5.42 Where two or more organisations are involved in the assessment and the ‘go-no go’ decision making at each gate, every effort should be made to collapse their interests in a formal, structured way into one process of assessment. This is especially important where more than one government department is involved.

- 5.43 For RDAs and other independent bodies seeking central government approval for PBF proposition, it will be important of course for them to consider their own internal decision-making process in the light of what is put in place at the national level. Any emerging issues associated with where decision-making authority lies should be resolved in the design stage of any revised process.
- 5.44 As well as clarity over what information is required and over decision-making criteria and authority at each stage gate, those charged with assessing propositions and giving a ‘go-no go’ decision should commit to an acceptable elapse time from receipt of proposition to decision at each stage gate. This should be a one key indicator of process performance.

Importance of options appraisal

- 5.45 Typically in a stage gated process conducted by individual public sector organisations, the earliest stage involves the development of ‘options’ of how to address the perceived ‘problem’ or market failure. This can in some circumstances involve the development of a long list of options before narrowing down to a short list for which market-related and cost-benefit information can be obtained and compared.
- 5.46 Given the current debate over the appropriate way for the public sector in the UK to address the ‘equity gap’, the development of a short list of options and their subsequent assessment should form the agenda for early engagement between proponents and decision-makers – the basis of the gate one assessment.
- 5.47 It seems to us that given the polarity of views on for example the significance of demand vs. supply constraints, the appropriate scale of fund, investment size requirements, location of fund management functions, and sector/technology vs. generalist balance, the development and assessment of options needs to embrace PBF design and delivery both in-region and nationally, rather than compartmentalising options development to within a pre-defined geography.

CfEL as ‘centre of excellence’

- 5.48 This proposal contributes to NFP 1 – *Positioning of regional and national publicly-backed VC funds*.
- 5.49 In the context of CfEL acting as a centre of excellence/knowledge centre for equity finance, it is appropriate to examine what existing bodies such as for example BVCA, EVCA, BBAA and the National Venture Capital Association (NVCA)³⁰ in the USA provide in the public domain and to members: for UK bodies this will help to avoid unnecessary duplication and crowding out.
- 5.50 Examples of what some of these organisations provide in terms of knowledge transfer include:

³⁰ <http://www.nvca.org/>

- BVCA offers a range of research outputs including: an annual report on the performance of portfolio companies³¹; BVCA ‘Private Equity and Venture Capital Performance Measurement Survey Report’³²; monthly BVCA newsletters.
 - training courses are delivered on topical areas e.g. work of VCs; skills for negotiation, improving pitches; best practice in financial modelling; legal agreements etc.
- EVCA has an online ‘Knowledge Centre’ which provides access to publications on economic impact reports including papers on ‘Employment contribution of Private Equity and Venture Capital in Europe’³³ and ‘Social & Economic Impact of Venture Capital’³⁴. The Centre also provides statistics on performance, fundraising, investments. Other functions cover the following:
 - the EVCA Institute offers courses/master classes on relevant VC topics with contributions from leading professionals and academics
 - EVCA Barometer is a monthly publication on specific research and analysis of key market indicators
 - Pan-European Private Equity Performance Benchmarks Report which reports on annual performance of private equity funds in Europe.
- NVCA’s online resource contains a plethora of industry statistics, latest industry trends/studies/publications e.g. report on ‘Venture Impact – The Economic Importance of Venture Capital-Backed Companies to the US Economy’³⁵ which sets-out the contribution of VC backed companies on job/revenue creation and innovation over a 30 year period. Other notable examples are as follows:
 - NVCA Capital Venture Yearbook with industry statistics over the past 20 years
 - templates of model legal documents used in VC transactions
 - guides to governance practices
 - portfolio valuation guidelines
 - eVenturing Entrepreneur’s Resource Centre run in collaboration with the Kauffman Foundation of Entrepreneurship³⁶
 - separate public platform – ‘NVCAccess’ - that members of the VC community and its followers can access current and relevant industry information, public policy updates - <http://nvcaccess.nvca.org/>.

³¹ <http://www.bvca.co.uk/Research/features/BVCAEYAnnualReport2009>

³² <http://www.bvca.co.uk/assets/features/show/PerformanceMeasurementSurvey2008>

³³ <http://www.evca.eu/knowledgecenter/default.aspx?id=618>

³⁴ <http://www.evca.eu/knowledgecenter/default.aspx?id=618>

³⁵ Report can be found at:

http://www.nvca.org/index.php?option=com_content&view=article&id=255&Itemid=103

³⁶ <http://www.kauffman.org/> and <http://www.entrepreneurship.org/>

- 5.51 Any unhelpful overlap with the above private sector intermediaries could be obviated if the CfEL ‘centre of excellence’ focused only on issues relevant to PBFs. This, however, is a rather restricted role and in any event knowledge to inform policy and practice for equity investment to address market/system ‘failure’ needs to be set within the wider context of private sector provision and economic conditions.
- 5.52 It is relevant also to consider the role as a ‘centre of excellence’ assumed by KfW Bank in Germany, seen as an ‘exemplar’ of a state-owned investment bank. According to its web-site (http://www.kfw.de/EN_Home/KfW_Bankengruppe/index.jsp):

“KfW Bankengruppe gives impetus to economic, social and ecological development worldwide. As a promotional bank under the ownership of the Federal Republic and the Länder (federal states), it offers support to encourage sustainable improvement in economic, social, ecological living and business conditions, among others in the areas of small and medium-sized enterprise, entrepreneurialship, environmental protection, housing, infrastructure, education finance, project and export finance, and development cooperation.”

- 5.53 Within the description of its research, there is reference to the following activities and outputs associated with equity investment and support for SMEs:
- *Economics research* – series of publications focusing on SMEs financing needs, innovation, access to VC as well as finance issues relating to e.g. energy, education, infrastructure projects
 - *Corporate Finance Service* – annual enterprise survey on bank connections, borrowing and financing conditions
 - *Business Climate Index for the German private equity market* – quarterly index published in association with the German Private Equity and Venture Capital Association (BVK) on current and projected business climate, differentiating between early stage and growth finance stage
 - *Start-up Panel* – in conjunction with the Centre for Economic Research (ZEW), KfW set up a panel study of newly established firms in Germany across nearly all industries. Computer-aided telephone interviews are conducted with c. 6,000 start-up firms per annum, allowing analyses of survival and development of newly founded firms
 - *MakroScope* – macroeconomic papers focusing on financing and investment models and factors influencing the corporate landscape
 - *MittlestandsMonitor* – production of annual reports in collaboration with other research institutes on SME financing and innovation
 - *Brief overviews* – concise information in the form of a handout on business start-ups in Germany – ‘Entrepreneurship in Brief’. This draws on data from the Start-up Panel and a population-representative large-scale survey.

‘Publicly-backed Risk Capital Provision in the English Regions – investment activity report’

- 5.54 This proposal contributes to NFP 2: *RDAs and BIS activities and protocols*; and to NFP 3: *RDAs and BIS reviewing fund structure*.
- 5.55 The proposal is to collate, analyse and publish evidence on publicly-backed equity investment activity in the English regions, reported at regional (and perhaps sub-regional) level and at an aggregated, national (England) level. Established on a consistent basis and drawing on information *from all* PBFs, it is envisaged that a comprehensive report is published on an annual basis.
- 5.56 Consistent reporting, sustained over the longer term, will provide valuable longitudinal evidence of the size, structure and nature of PBF provision that will be of value to policy makers, economic development agencies, businesses and their advisors; and potential co-investors. It will provide a picture of PBF provision to compare and contrast with investment activity of a wholly private nature. It will provide a picture of PBF provision to new and emerging technologies and sectors that that can be assessed alongside complementary public sector investments in support of priority sectors/technologies, innovation and commercialisation.

Parameters

- 5.57 A list of possible parameters to be reported is provided below. There will need to be agreement reached on detailed definition of terms and scale categories. There would be merit, for PBF and private market comparisons, to adopt a scheme which dovetails with private investment reporting schemes adopted by the BVCA and potentially in future by the BBAA. In all cases, the aim would be to achieve trend data through a reporting process sustained over time.
- 5.58 The selected parameters given here are drawn from two existing equity investment reports with a longstanding history – the ‘Risk Capital Market in Scotland’ reports published by Scottish Enterprise and the ‘Private Equity and Venture Capital Report on Investment Activity’ published by the BVCA.

Table 5-2: Reporting parameters

Adopting parameters used in Scottish Enterprise reports	Adopting parameters used in BVCA reports
Investment by stage and by round	For each region: Investment by stage: number of companies; % of companies; amount invested; % of amount invested; average amount invested by stage.
Investments by size: number of deals by size category; median deal size	Investment by region compared to total number of VAT registered businesses: number of VAT businesses; number of companies backed by PBFs; companies invested in per 1,000 VAT businesses.
Investments by type of investor: in the case of PBFs this would be the scale of investment by type of co-investor	For each region: Investment by industry sector: total amount and %
Number of deals by type of investor: in the case of PBFs this would be number of deals done with type of co-	For each region: Investment by technology and technology investment by

Adopting parameters used in Scottish Enterprise reports	Adopting parameters used in BVCA reports
investor An additional parameter to include could be type of investor in terms of regional vs. national PBFs	financing stage
Investment by geographic origin/location: in the case of PBFs this would be of the co-investor	For each region: Funds raised by source (type of investor): amount; %
Investment by sector: also investment by regional priority sectors	For each region: Divestments: amount by type; %; number of divestments; number of companies
Investment in university spin-outs: number and value; % of total	
Number of deals by age of company	

- 5.59 Whilst of course there would be merit in adopting parameters which are already collated by the PBFs, this should be seen as a long term ‘project’ and extra effort should be invested now, if necessary, in order to establish a high quality reporting framework for future benefit.

‘Directory of Publicly-backed Risk Capital Funds in the English Regions’

- 5.60 This proposal contributes to NFP 2: *RDAs and BIS activities and protocols*.
- 5.61 The proposal is to collate and publish a directory of all PBFs in England. Directory entries are envisaged which summarise the nature of the funds (e.g. their geographic/ sectoral scope and investment criteria), provide profiles of their investment portfolios and provide contact information. Funds established by public bodies in the regions and by national government departments would be in the directory.
- 5.62 This directory is not intended to replace the information already provided in the public domain by individual PBFs and their managers. It is envisaged, however, that by providing a single comprehensive information source, PBF provision will be made more coherent. The directory would also be useful for marketing PBFs towards potential investees and their advisors, and towards potential co-investors.
- 5.63 It is envisaged that the directory would be available on-line and backed by a searchable database; that it would be linked to other relevant web sites offering business support (e.g. Business Link); and that links from the web sites of business associations and related networking organisations would be established.

Directory content

- 5.64 The following proposal on content of directory entries should be taken as indicative only. We have drawn heavily on the content of the directory of angel investors and VCs available on the BBAA web site and on the web sites of listed fund managers.

- name of Fund and Fund Manager

- short description of the Fund: stage/deal size; source of funds; outline investment criteria; restrictions on eligibility of investees; number of investments to date
- short description of the Fund Manager
- contact information.

5.65 The following text is extracted from the web profile of Catapult³⁷ as an example of the nature and amount of public domain information that might be provided to the directory in addition to ‘core’ searchable parameters.

“Catapult specialises in providing Equity Capital for businesses requiring between £200k and £2m.”

“Catapult provides a full range funding requirement from early stage, development capital to MBO/MBIs. Since 1999 we have invested in over 65 companies, providing initial and further follow on requirements. We look for management teams with a good track record who have a plan to rapidly develop a profitable business. Businesses must have growth potential, a sustainable unique selling point, be scalable and be capable of achieving a profitable exit for the investors within a reasonable time frame.”

“We can invest in all stages of the business lifecycle including start ups, early stage, development capital or MBO/MBIs. We invest in most sectors and are flexible on this, but have a particular interest in Healthcare, Medical Devices, Environmental or green propositions and Support Services. Businesses we back always require investment to achieve their goals.

However, mentoring from experienced Independent Non Executives can be almost as important as the investment. We can introduce companies to experienced Independent Non Executives who can add value to their business and help them.”

5.66 The BBAA directory provides the following contact information³⁸.

Contact	name
Address	postal address
Email	
Telephone	
Fax	
Website	web address
VCard	downloadable VCard

³⁷ See: <http://www.catapult-vm.co.uk/index.shtml>

³⁸ See for example: <http://www.bbaa.org.uk/memberProfile.php?id=242&profile=100>

5.67 We envisage the directory having profiles of each PBF's investment portfolio. Again drawing on Catapult as an example, the following illustrates the kind of information that could be supplied for each investee:

"XXX Limited

Website: investee's address

Location: investees location

Date of first investment:

Amount invested to date: £

Fund contact:

XXX Ltd's YYY products and systems are proven to protect thermally sensitive equipment such as radios, routers, batteries and equipment rooms from the detrimental effects of temperature. As a result they can save money and energy, while removing the need for air conditioning and cutting carbon emissions. YYY initially invested £300k. It then followed this with a further £1m alongside £1m from ZZZ."

Marketing and communication plan

5.68 This proposal contributes to NFP 2 – *RDAs and BIS activities and protocols*.

5.69 To market and communicate information on PBFs to the audiences listed below, it is important to account for their different requirements and potential usage of the information. It will also be essential to market the information through the most appropriate channels for each particular audience.

5.70 *Business advisors, lawyers and accountants* – this group can be considered the most economically efficient in terms of being able to be reached with information, partly because the group is relatively easily identifiable through representative bodies and networks. For this group the basic requirement is to make aware *what* PBFs are available at a regional and national level and *how* those PBFs can be accessed. Some examples of the main channels through which this can be achieved are via:

- representative bodies such as The Law Society, Institute of Chartered Accountants and their extensive networks and publications
- accessing incubator/incubation facilities which connect business advisors, lawyers and accountants with start-up/early stage businesses
 - UK Business Incubation (UKBI)³⁹, RDAs and Business Link can play a role in identifying and reaching these professionals
- design and delivery of professional development courses on PBFs which could cover information on the range of funds available; fund services and specialisation; fund objectives; target group for the fund; investment size; investment criteria; process involved to access the funds; track record of fund manager etc.
 - this would be similar to the three-day courses run by BPP⁴⁰ on 'Venture Capital and Private Equity' for financial advisers, lawyers, accountants,

³⁹ <http://www.ukbi.co.uk>

⁴⁰ BPP is a private sector company, see: <http://www.bppprofessionaldevelopment.com>

corporate executives and others who wish to understand the working of venture capital/private equity⁴¹.

- 5.71 *Potential co-investors* – the important consideration for this group is the provision of information that *details the nature of potential deals/prospects* so as to attract their interest that would eventually lead to successful co-investment. This links in with our proposal outlined above of a Directory and Investment Activity Report of publicly-backed risk capital funds for the English regions. It will be important to reach every business angel network by using existing communication channels.
- 5.72 *SMEs* – information on PBFs can be directed to this group through connecting the SMEs to well informed business advisors, lawyers and accountants and by making information available through existing network and initiatives the SMEs are involved in, for example:
- Knowledge Transfer Partnerships (<http://www.ktponline.org.uk>)
 - Knowledge Transfer Networks (<http://www.ktnetworks.co.uk>)
 - entrepreneurs' clubs (e.g. similar to the Edinburgh Entrepreneurship Club: <http://www.edinburgh-entrepreneur.man.ed.ac.uk>)
 - local business clubs (e.g. <http://www.bcne.org.uk/home/home.aspx> in the North East)
 - universities/research institutes
 - Chambers of Commerce
 - Trade Associations etc.
- 5.73 To assist SMEs in understanding the range of PBFs and related services, one option is to develop free interactive web-tools. (For example, to understand the impact of raising private angel or venture money, one tool that can already be accessed via the web is the 'Equity Simulator' available at: <http://www.ownyourventure.com>).

Cross-referral protocols

- 5.74 This proposal contributes to NFP 2 – *RDAs activities and protocols*; and to NFP 4 – *ongoing dialogue*.
- 5.75 Development of a more coherent approach to design and appraisal should over time lead to enhanced complementarity of PBF provision and thus less reason for any unproductive competition (or reluctance to cross-refer) between PBFs, however financed or delivered.
- 5.76 Feedback from one consultee indicated that implementing cross-referrals is going to be difficult partly because of the incentive structures for fund managers: but notwithstanding the difficulties this is something which should be tried⁴².

⁴¹ This covers a diverse range of topics (e.g. history and development of the industry; participants in the industry; fund structures; valuation issues; deal structuring; legal and technical issues etc)

⁴² In addition to this, the Regeneris Consulting (2008) West Midlands Risk Capital Study for Advantage West Midlands highlighted the limited nature of establishing a formal mechanism for referral of businesses from fund to

- 5.77 In the short term, it is of course important that for those funds delivered only within regions the RDA or the established Holding Fund organisation ensure appropriate cross-referral between the fund managers with whom they have contracted in order to ensure no unproductive competition: this is arguably a matter for the RDAs and where ERDF funding is involved, CLG. BIS may wish to ask that a protocol be established.
- 5.78 In the short term, a key task is to ensure that effective cross-referral protocols are in place between regional funds and national funds: this is a matter for CfEL/BIS and the RDAs (or their Holding Fund organisations)
- the terms of the protocols need to be ‘realistic’ in the context of current fund management contracts and incentives
 - the protocols need to include the requirement to report on cross-referrals made so that evidence at least of cross-referral ‘activity’ can be gauged
 - to encourage compliance, it would be possible to embed *a commitment to cross-referral* (or at least to *informed signposting*) in the description of every PBF – part of the national and regional PBF ‘brand’
 - one option to consider is referral/signposting to a regionally-based ‘clearing-house’, a Business Link or member of a panel of professional advisors rather than directly to another fund.
- 5.79 In addition to the formal cross-referral, it is worth considering what Mason & Pierrakis⁴³ have suggested:

“...given the emphasis that venture capitalists place on trusted networks for deal referrals, there is a need to develop funding ‘pipelines’ between the key players in the regional entrepreneurial eco-system (e.g. universities, incubators, angel groups, local venture capital funds) and non-local private sector venture capital sources.”

Reflections on an appropriate, consistent process of formal evaluation

- 5.80 This proposal contributes to NFP 5 – *Information Sharing*.
- 5.81 It is clear that there are differences of view – at the very least profound differences of emphasis – over how PBFs should be evaluated. This has been flushed out by the recent National Audit Office report on PBFs which, in short, used the financial return to the taxpayer from these Funds as the key metric. This approach to evaluation was (at least by implication) endorsed by the recent report by the House of Commons Committee of Public Accounts on venture capital support from BIS: for example, this report highlighted a substantial under-performance of the Regional Venture Capital Funds relative to private VC funds in Europe.
- 5.82 The appropriateness of this approach to evaluation is questioned by organisations supporting PBFs at the regional level. Whilst some argue that regionally-based early stage PBFs may

another. One option suggested in the report was shared business support services or a “blood-bank” of non-executive directors/advisors.

⁴³ Mason & Pierrakis (2009) *Venture Capital, The Regions and Public Policy: The United Kingdom Since the Post-2000 Technology Crash*.

perform much better than those assessed by the NAO, they also argue that the return to the economy should take into account the net additional economic development/regeneration gain and not only the financial performance of a PBF⁴⁴. Those holding the latter view argue that it is inappropriate to assess PBFs designed to address the ‘equity gap’ relative to wholly private sector VC fund performance – the argument put is that such an approach does not compare like with like.

- 5.83 This latter viewpoint is not surprising: the mission of RDAs is economic development/regeneration and all their interventions come under an impact evaluation framework (IEF) protocol set and agreed with BIS. To the extent that PBFs remain part of the RDAs’ ‘toolkit’, their intervention in this way is likely, as a minimum, to require their PBFs to be evaluated under the terms of the IEF. A key element in the IEF approach is to assess the net additional value accruing to the business beneficiaries (in this case the investees) and to quantify this as a net additional impact on the regional economy in terms of Gross Value Added.
- 5.84 The adherence to an approach to evaluation other than the financial performance of PBFs is further influenced by the terms of the ERDF support which many regionally based PBFs receive. ERDF support and now JEREMIE support for PBFs require particular evaluation procedures to be put in place.

The ‘double-bottom line’

- 5.85 The recent ‘challenging’ reports from the NAO and the House of Commons Committee of Public Accounts make the resolution of these divergent views important.
- 5.86 One informant during our round of RDA consultations raised the concept of a “double bottom line” for assessing PBF performance. We interpret this as meaning an approach which seeks to value both the economic development impact of PBFs designed to address the ‘equity gap’ as well as the financial performance of the Funds.
- 5.87 We see merit in this approach. Whilst it is beyond the scope and resources of this report to design such a dual evaluation framework, we offer the following comments relevant to establishing a ‘theory of change’ for this kind of intervention by the public sector:
- the public sector’s reason for doing is to support economic competitiveness and productivity through innovation and business growth
 - equity finance and associated management support is accepted as one important input that businesses with growth potential require
 - for certain businesses and certain stages of investment, the existence of an ‘equity gap’ is accepted: the case for public sector intervention to fill this gap remains broadly accepted
 - the value to the business (the investee) therefore is central to the case for intervention

⁴⁴ It is worth noting that BIS evaluation strategies for all types of business support products focus on an assessment of economic additionality.

- the net additional benefit to the investee, and through this to GVA impact, is therefore an important element in determining if the reason for intervention is being addressed satisfactorily
- however, the effectiveness and efficiency of the PBFs in *all* their processes (i.e. including but not restricted to deal making and investment) needs to be assured and it is reasonable to benchmark with wholly private sector processes, whilst acknowledging differences in motivation
- the ‘final’ return to the tax-payer could be assessed by: *net additional GVA contribution + net financial return to a Fund*, with certain caveats:
 - a ‘balanced scorecard’ approach would be appropriate to ensure that performance of PBFs under both metrics are at least ‘reasonable’
 - the timescale to first and maximum impact (factors now regarded as important in IEF compliant evaluations) whilst fairly clear conceptually are non-trivial in relation to the acquisition of empirical data. It is impact aggregated over time that permits a full assessment of *value for money* to be made.

5.88 Given the protracted timescale over which VC *fund* performance needs to be assessed, it will be important to agree on a set of lead indicators of progress towards satisfactory PBF performance.

Approaches to performance assessment

5.89 The characteristics of IEF compliance are well known in BIS and the RDAs: they are not repeated here.

5.90 It is helpful, however, to summarise the parameters used by the BVCA⁴⁵ in its annual report on private VC fund performance. Although accepting that a PBF is not the same as a wholly private VC fund, it remains important to incentivise and assess PBF management performance in ways close to private sector practice in order to ensure effective and efficient fund management, otherwise, arguably, both the benefits to PBF investees and value for money of the public sector investment will be sub-optimal.

5.91 BVCA uses the following parameters:

- performance of fund (% return per annum) by investment stage, vintage of fund and by elapse time since inception (at 3, 5 and 10 years)
- capital raised (£) by investments stage and vintage of fund – for PBFs this could be used to capture co-investment funds raised

⁴⁵ A full account of methodology is published by BVCA – see: http://admin.bvca.co.uk/library/documents/BVCA_Performance_Measurement_Survey_2008_final_19-Aug-09.pdf.

- since inception IRR (%) – for pooled funds, with pooled average values, median values and variances provided for specified time periods
- since inception IRR (%) – by investment stage and vintage of funds, with data by year and to date
- since inception Multiples to Paid-in Capital⁴⁶ (%) - by investment stage and vintage of fund.

⁴⁶ Multiples show the total amount distributed to investors as a percentage of paid-in capital (DPI) and the total amount distributed plus the residual capital attributable to investors as a percentage of paid-in-capital (TVPI). These statistics used by BVCA for purely private sector VC funds would need to be adapted for use with PBFs with a co-investment component.

Annex A: Characteristics of current provision

- A.1 The tables below set-out the current national and regional PBFs based on data collated by BIS, data provided by informants, plus our own desk and primary research. For completeness we also present PBFs that are now closed to new investments (these are shown in *italics* in each table).
- A.2 We wish to insert a strong ‘health’ warning to the information/data provided below as at present there is no single source of information on the nature of publicly-backed equity provision and the data that are available from different sources is ‘patchy’ and in some cases conflicting.

National

Table A-1: National PBFs

Scheme	Objectives	Fund manager/ delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
Enterprise Capital Fund (Total 9 funds)	Increase flow of private capital into the equity gap by adjusting the risk-reward profile for private investors making such investment Lower the barriers to entry for entrepreneurial risk capital managers by reducing the amount of private capital needed to establish a viable venture fund	Seraphim	2006 : 5 funds	Total: £239m	£156.2m	No limit	£2m
		IQ Capital	2007: 1 fund	Individual funds range: £10m-£34m			
		Sustainable Technology Fund	2008: 2 funds				
		Amadeus & Angels Seed Fund	2009: 1 fund				
		Catapult Growth Fund	(end 2016-19)				
		Dawn Capital					
		Oxford Technology					
		MMC Ventures					
		Panoramic Growth Equity					
Aspire Fund	Increase the number of successful women-led businesses within the UK Improve linkages between sources of funds and providers of investment	CfEL	2008	£12.5m	£12.5m	£100k	£1m

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional venture capital provision
Report to the Department for Business, Innovation and Skills*

Scheme	Objectives	Fund manager/ delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
	readiness support						
UK Innovation Investment Fund (UKIIF)	<p>Drive economic growth and create jobs by investing in growing technology-based businesses including digital technologies, life sciences, clean technology and advanced manufacturing</p> <p>This is through investing in the UK Future Technologies Fund and the Environmental Innovation Fund (UKIIF is a fund of funds)</p>	Hermes Private Equity European Investment Fund	2009: fund of fund (UKIIF) 2010: 2 underlying funds	£325m	£150m	Not available	Not applicable
Social Entrepreneurs Fund	To improve access to equity funding for new and growing social enterprises that are seeking equity capital to develop their business	Bridges Ventures	2009-18	£10m	£10m	Not available	£1.5m
Carbon Trust Venture Capital Fund	Accelerate the commercialisation of clean energy technology businesses	Carbon Trust Investment Partners	2002	Up to £25m	Not applicable	£25k	£3m
Carbon Trust Seed Fund	Accelerate the commercialisation of clean energy technology businesses	Carbon Trust Investment Partners	2007	Up to £3m	Not applicable	£25k	£1.5m
NESTA Fund	To directly invest in early stage technology businesses, particularly life sciences, clean tech and ICT	NESTA	Not available	£50m	Not applicable	£25k	£1m
Coalfields Enterprise Fund	Supporting the growth of business and encouraging entrepreneurship in England's former coalfield regions	Enterprise Ventures Limited	2004-14	£10m	£10m	£40k	£0.5m
Coalfields Growth Fund	Supporting the growth of business and encouraging entrepreneurship in	Enterprise Ventures Limited	2009-14	£10m	£5m	£40k	£0.5m

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional venture capital provision
Report to the Department for Business, Innovation and Skills*

Scheme	Objectives	Fund manager/ delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
	England's former coalfield regions						
Early Growth Funds (Total 7 funds)	Increase the availability of small amounts of risk capital (average of £50,000) for innovative and knowledge intensive businesses, as well as for other growth businesses	West Midlands: Advantage Early Growth Fund North East: North East Equity Matching Yorkshire & Humber: The Viking Fund South East: Finance South East (Accelerator Fund) England wide technology focused: E Synergy England wide: GEIF Ventures England wide: London Seed Capital	2002: 1 fund 2003: 2 funds 2004: 4 funds (end 2012-16)	Total: £31.5m Individual funds range: £3.6m-£10m	£31.5m	Not available	Not available
Capital for Enterprise Fund	Invest in viable businesses with existing cash flows and growth potential but which are currently constrained through being over-leveraged	Octopus Investments Maven Capital Partners CfEL	2009-2015	£75m	£50m	No limit	£2m
UK High Technology Fund	Demonstrate to investors and the VC industry that commercial returns are possible from investment in early stage, high-technology businesses Attract new institutional investors into the technology sector	Capital Dynamics (fund of fund managers)	2000: fund of funds 2000: 6 underlying funds 2001: 2 underlying funds 2002: 1 underlying fund	£126.1m	£20m	Not available	No limit

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional venture capital provision
Report to the Department for Business, Innovation and Skills*

Scheme	Objectives	Fund manager/ delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
Regional Venture Capital Funds (Total 9 funds)	Increase the supply of risk capital to growing SMEs in each of the nine English regions Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap	Create Partners Catapult Venture Managers YFM Fund Managers NEL Fund Managers Midven	2002: 7 funds 2003: 2 funds (end 2012)	£224.0m	£74.4m	No limit	£0.80m
Bridges Community Development Venture Fund (Total 2 funds)	Provide venture capital finance to SMEs capable of growth that are located and have economic links with the 25% most disadvantaged wards in England	Bridges Ventures	2002-2012	£28m and £12m	£14m and £6m	Not available	No limit
University Challenge Seed Fund Total 19 funds including: White Rose Consortium Manchester Technology Fund Wyvern Seed Fund The Mercia Fund Cambridge Enterprise Cardiff Partnership Fund Imperial Innovations Kinetique Fund Combined London Colleges Fund Isis Innovations The Synergy Fund Bloomsbury Bio Seed Fund	Enable universities to access seed funds in order to assist the successful transformation of good research into good business	Spark Ventures Javeline Ventures WM Enterprise Other	1999	£60m	Not applicable	Not available	£0.5m

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional venture capital provision
Report to the Department for Business, Innovation and Skills*

Scheme	Objectives	Fund manager/ delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
Edinburgh Technology Fund							
Cascade Fund							
Iceni Fund							
Lachesis Fund							
Nestech							

Source: BIS; CjEL. Note: As the focus of this report was primarily on publicly-backed equity schemes, we do not present any indirect public sector interventions in the early stage equity market, through tax based measures. These include Venture Capital Trusts (VCTs), Enterprise Investment Scheme (EIS) and Corporate Venturing Scheme (CVS).

North East

Table A-2: North East PBFs

Scheme	Objectives	Fund manager/ delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
North East Venture Capital Loan Fund	Designed to increase access to finance for micro and medium enterprises (EC and European Investment Bank initiative) Set-up as 'holding fund'	North East Finance	2010-2014	£125m	£18.25m	Not available	Not available
One North East - Growth Fund	Provision of direct funding to businesses at expansion stage and across sectors but predominance in manufacturing	NEL Fund Managers	2006-2014	£5m	£0.75m	£50k	£0.35m
One North East - Creative Industries Co-investment Fund (transitional)	Aim to transition to a co-investment approach for the creative sector into JEREMIE Funds	Northern Film and Media	2010-2011	£2.4m	Not applicable	Not available	£0.25m
One North East - Proof of Concept Fund	Support early stage business creation within the technology sector	NorthStar Equity Investors	2010-2021	£15m	£2.19m	£20k	£0.1m
One North East - Technology Fund	Invest in technology companies at all stage of development - from proof of concept through to seed and development capital stages	IP Group	2010-2021	£25m	£3.65m	£50k	£0.125m
One North East - Accelerator Fund	Invest in predominantly early stage companies	NorthStar Equity Investors	2010-2021	£20m	£2.92m	£50k	£0.75m
One North East - Angel Match Fund	Actively engage with the North East's early-stage investment community, in particular with the business angel community	Rivers Capital Partners	2010-2021	£7.5m	£1.10m	£50k	£0.15m
One North East – Growth Fund (500+)	Invest in 'later stage' companies – general sectors	Finance Wales	2010-2021	£20m	£2.92m	£350k	£1.25m

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional venture capital provision
Report to the Department for Business, Innovation and Skills*

Scheme	Objectives	Fund manager/ delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
One North East – Growth Fund	Invest in ‘later stage’ companies – general sectors	NEL Fund Managers	2010-2021	£20m	£2.92m	£50k	£0.4m
Early Growth Fund – North East Equity Matching Fund <i>(part of national scheme)</i>	Increase the availability of small amounts of risk capital (average of £50,000) for innovative and knowledge intensive businesses, as well as for other growth businesses	Entrust	2004-2016	£2.9m	£2.9m	Not available	Not available
One North East - Three Pillars Fund (pilot)	Pilot investment fund, supporting businesses in the “3 Pillars”: Energy; Healthcare and Health Sciences; and Process Industries	North East Finance	2007-2009	£2.6m	£2.6m	Not available	£0.1m
One North East - Design and Creative Fund (pilot)	Pilot investment fund to support businesses in the digital, media, creative and design sectors	North East Finance	2007-2009	£3.0m	£3.0m	Not available	£0.06m
One North East - Proof of Concept Fund	To invest in technology and science based SMEs and in activities leading to SME formation and spin-out from the research base	North East Finance	2003-2009	£12.8m	£8.25m	£20k	£0.1m
One North East – NE Co-investment Fund	Address the equity gap that exists for early stage technology focused companies	North East Finance	2005-2009	£30m	£4m	Not available	Not available
One North East - Evolve Mezzanine Fund (pilot)	To pilot a mezzanine fund structure	NEL Fund Managers	2009	£2.9m	£2.9m	£50k	£0.2m
Regional Venture Capital Fund – North East <i>(part of national scheme)</i>	Increase the supply of risk capital to growing SMEs Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap	NEL Fund Managers	2002-2012	£12m	£4.5m	Not limit	£0.8m

Source: BIS; CfEL; One North East.

A.3 Further information provided by One North East on particular funds (already identified above) set-up under the new VCLF initiative is presented below.

Table A-3: North East PBFs – further information on new funds

Scheme	Sector	Stage of development of investees	Average investment per SME – including follow-on investment	Financial instrument	Main demand areas addressed
One North East - Proof of Concept Fund	Technology/ innovation	Early stage	£103k	Convertible loan; Equity	Proof of Concept Seed Capital
One North East - Technology Fund	Technology/ innovation	Any stage	£417k	Equity; Quasi-equity	Seed Capital Development Capital Mezzanine Finance
One North East - Accelerator Fund	General	Predominantly early stages	£333k	Equity; Quasi-equity	Seed Capital Development Capital
One North East - Angel Match Fund	General	Predominantly early stages	£167k	Equity; Convertible loan	Angel Match Proof of Concept
One North East - Growth Fund (500+)	General	Later stages	£570k	Equity; Quasi-equity	Development Capital Mezzanine Finance
One North East - Growth Fund	General	Later stages	£182k	Equity; Quasi-equity	Development Capital Mezzanine Finance

Source: One North East; A £5m "Micro Finance" fund has also been set-up – this is a pure debt instrument and not equity, therefore not included in the table above.

North West

Table A-4: North West PBFs

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
North West Venture Capital Loan Fund	Designed to increase access to finance for micro and medium enterprises (EC and European Investment Bank initiative) Set-up as 'holding fund' with four sub-funds: Development Capital Fund; VC Fund – early stage/technology; Priority Sector Fund; and Loan Fund <i>(Note: there is also an interim NW VCLF managed by YFM and MTI)</i>	North West Business Finance Yorkshire Fund Managers Enterprise Ventures Finance Wales Carbon Trust Investment Partners Spark Impact AXM Venture	2010-2014	£185m	Not available	£50k	£0.25m
Business Angels Programme (formerly TechInvest)	Increase the supply of finance for North West businesses operating in the equity gap	Northwest Business Angels	1993	c.£21m	Not available	£10k	£0.5m
Merseyside Special Investment Fund	Increase finance to entrepreneurs in Merseyside through the provision of mezzanine, venture capital, loan and seed finance	Alliance Fund Managers	1996	£106m	Not available	£3k	£3m
Lancashire Rosebud Fund	Provision of equity (and loan) to businesses located in or wanting to locate in Lancashire (Lancashire County Council investment)	Lancashire County Developments Limited	1986	Not available	Not available	£50k	£0.75m
The University of Manchester Premier Fund	To support commercialisation of technology spin-outs from Manchester universities	MTI Partnership	2008	Not available	Not available	£250k	£0.75m
Rising Stars Growth Fund	Increase VC finance to North West	Enterprise Ventures	2002-2008	£9m	Not available	£30k	£1m

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional venture capital provision
Report to the Department for Business, Innovation and Skills*

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
	early stage technology business with high growth potential						
North West Business Investment Scheme	Increase access to risk finance to start-up and SMEs with growth potential through provision of finance to meet the equity gap	YFM Private Equity	2003-2008	£23.3m	Not available	Not available	£0.5m
North West Seed Fund	Increase supply of small scale seed capital to emerging North West businesses in the equity gap	Enterprise Ventures	2003-2008	£4.5m	Not available	£50k	£2m
Regional Venture Capital Fund – North West Equity Fund <i>(part of national scheme)</i>	Increase the supply of risk capital to growing SMEs Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap	WM Enterprise	2002-2012	£25m	£8.9m	Not available	Not available

Source: BIS; CfEL; Northwest Regional Development Agency; NWDA Interim Evaluation NW Business Investment Funds – Final Draft Report (2008); Alliance Fund Managers; NW VCLF Appraisal (2009); www.nwbusinessangels.co.uk; www.lancaster.com.

Yorkshire & Humber

Table A-5: Yorkshire & Humber PBFs

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
Yorkshire & Humber Regional Venture Capital Loan Fund	<p>Designed to increase access to finance for micro and medium enterprises (EC and European Investment Bank initiative)</p> <p>To provide three sub-funds:</p> <ul style="list-style-type: none"> Seedcorn fund (£15m indicative) – for technology or knowledge-based businesses Equity fund (£48m indicative) Small loans fund (£27m indicative) 	<p>Finance Yorkshire</p> <p>Enterprise Ventures</p> <p>NEL Fund Managers/Northstar</p> <p>Ex South Yorkshire Investment Fund Team</p>	2010-2014	£90m	£15m	£15k	£2m
Early Growth Fund – Viking Fund <i>(part of national scheme)</i>	Increase the availability of small amounts of risk capital (average of £50,000) for innovative and knowledge intensive businesses, as well as for other growth businesses	Viking Fund Managers	2004-2016	£5m	£5m	No limit	£0.20m
Yorkshire & Humber Regional Venture Capital Fund <i>(part of national scheme)</i>	<p>Increase the supply of risk capital to growing SMEs</p> <p>Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap</p>	YFM	2002-2012	£25m	£10m	No limit	£0.8m
Yorkshire Forward Partnership Investment Fund	<p>Increase the supply of risk capital to growing SMEs</p> <p>Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap</p>	Partnership Investment Fund Limited	2004-2014	£37m	Not available	Not available	Not available

*Improving the coherence, co-ordination and consistency of publicly-backed national and regional venture capital provision
Report to the Department for Business, Innovation and Skills*

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
South Yorkshire Investment Fund	As above	South Yorkshire Investment Fund Limited	2002-Evergreen	£50m	Not available	Not available	Not available

Source: BIS; CfEL; Finance Yorkshire Business Plan (2009) Regional Venture Capital Loan Fund for Yorkshire & Humber, 2009-2019; www.vikingfund.co.uk.

West Midlands

Table A-6: West Midlands PBFs

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
AWM – Mercia Technology Seed Fund 2	Increase investment in high technology businesses	West Midlands Enterprise	2007-2017	£5m	None	£50k	£0.5m
Advantage Enterprise and Innovation Fund (AEIF)	Encourage angel investment in developing businesses	Catapult Venture Managers	2005-2015	£15.9m	None	£250k	£1m
Advantage Technology Fund (ATF)	Provide equity gap funding for technology businesses	Innovotec	2001-2016	£8.4m	None	Not available	£0.4m
Creative Advantage Fund	Invest in early stage creative businesses	Advantage Creative West Midlands Limited	2000-Evergreen	£1.5m	None	£75k	£0.15m
Early Advantage Fund	Encourage angel investment in early stage businesses	Midven	2009-2019	£8m	None	£50k	£0.25m
Growth Advantage Fund	Increase equity gap funding for growth stage businesses	Midven	Expected 2010-2019	£18.4m	None	£250k	£0.75m
Advantage Mezzanine Fund	Provide mezzanine finance for growth stage businesses	To be appointed	To be set up	£18.4m	None	£50k	£0.5m
Advantage Early Growth Fund (AEGF) <i>(part of national scheme)</i>	Increase the availability of small amounts of risk capital (average of £50,000) for innovative and knowledge intensive businesses, as well as for other growth businesses	Advantage Early Growth Limited	2004	£9.9m	£5.0m	£20k	£0.2m
Regional Venture Capital Fund(Advantage Growth Fund) – West Midlands <i>(part of national scheme)</i>	Increase the supply of risk capital to growing SMEs Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the	Midven	2003-2013	£17.5m	£6m	£250k	£0.66m

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
	bounds of the equity gap						
Advantage Creative Fund (ACF)	Invest in early stage creative businesses	Advantage Creative West Midlands Limited	2003	£5.4m	None	£10k	£0.25m

Source: BIS; CfEL; Advantage West Midlands; www.advantagecreativefund.co.uk. Note: there is also an Advantage Transition Bridge Fund which is a debt instrument (loan).

East Midlands

Table A-7: East Midlands PBFs

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
East Midlands Lachesis Fund	Commercialise research from the Universities of De Montfort, Leicester, Loughborough, Nottingham and Nottingham Trent	SPARK Venture Management	2002-Evergreen	£10m	£6m	£250k	£0.5m
East Midlands Early Growth Fund	Increase the availability of small amounts of risk capital for innovative and knowledge intensive businesses, as well as for other growth businesses	E-Synergy	2006-2016	£5m	£5m	£30k	£0.5m
Regional Venture Capital Loan Fund – East Midlands <i>(part of national scheme)</i>	Increase the supply of risk capital to growing SMEs Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap	Catapult Venture Managers	2002-2012	£30m	£9m	No limit	£0.8m

Source: BIS; CfEL; emda; www.earlygrowthfund.com. Note: The East Midlands Early Growth Fund is not part of the national scheme.

London

Table A-8: London PBFs

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
London Technology Fund - Pan London	Target the gap in funding for technology companies at the earliest stage of their development	Company Guides Venture Partners	2005-July 2010	£12m	£6.1m	£63k	£1.5m
London Technology Fund – Objective 2	Target the gap in funding for technology companies at the earliest stage of their development	Company Guides Venture Partners	2005-July 2010	£3m	£1.2m	£99k	£1.5m
Creative Capital Fund – Pan London	Provision of seed capital investment and support for creative industries in Pan London areas	AXM Venture Capital	2005-July 2010	£2.5m	£2m	£500k	£0.75m
Creative Capital Fund – Objective 2	Provision of seed capital investment and support for creative industries in London Objective 2 areas	AXM Venture Capital	2005-July 2010	£2.5m	Not available	Not available	£0.75m
Regional Venture Capital Fund – London <i>(part of national scheme)</i>	Increase the supply of risk capital to growing SMEs Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap	YFM Fund Managers	2002-2012	£46m	£15m	No limit	£0.8m

Source: BIS; LDA; www.londontechnologyfund.com; wwwccfundco.uk.

South East

Table A-9: South East PBFs

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
South East Seed Fund	Provide equity investment to SMEs including university spin-outs/spin-ins	Finance South East	2008-2017	£5m	None	£100k	£0.5m
Early Growth Fund – Accelerator Fund (part of national scheme)	Provide mezzanine finance to fill the gap between traditional debt and equity funding in the South East	Finance South East	2004-2014	£10m	£5m	£25k	£0.1m
Regional Venture Capital Fund – South East (part of national scheme)	Increase the supply of risk capital to growing SMEs Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap	WM Enterprise	2002-2012	£30m	£7.5m	Not available	Not available

Source: BIS; CfEL; South East England Development Agency; Finance South East.

South West

A.4 There are currently no publicly-backed equity funds in the South West of England that are open to investment.

Table A-10: South West PBFs (none are currently open to investment)

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
South West Cleantech Low Carbon Mezzanine Co-investment Fund	Provide mezzanine finance alongside equity investments in early stage Cleantech businesses.	To be appointed	Start July 2010	£2.5m	£2.5m	£50k	£100k
Regional Venture Capital Fund – South West Ventures Fund <i>(part of national scheme)</i>	Increase the supply of risk capital to growing SMEs Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap (RVCF comprises of Cornwall Objective 1 Mezzanine Fund and Finance South West Objective 2)	YFM Fund Managers	2002-2012	£21m	£7.5m	No limit	£0.8m
Finance Cornwall - Objective 1	Provide equity, mezzanine and loan finance	Finance Cornwall	2002-2008	£20m	Not available	Not available	Not available
Finance South West - Objective 2	Provide equity, mezzanine and loan finance	Finance Cornwall	Until 2008	£18.4m	Not available	Not available	Not available

Source: BIS; South West Regional Development Agency. Note: For Finance Cornwall Objective 1 and Finance South West Objective 2, we have excluded the loan amount of £6m from each fund when summing up to obtain an aggregate value for South West Funds.

East of England

A.5 There are currently no publicly-backed equity funds in the East of England that are open to investment.

Table A-11: East of England PBFs

Scheme	Objectives	Fund manager/delivery body	Year start and end	Fund size	Government commitment	Minimum investment	Maximum investment
University of East Anglia – Low Carbon Venture Capital Fund	Invest in low carbon sector	To be appointed	Start June 2010	£20m	Not available	Not available	Not available
Regional Venture Capital Fund – East of England <i>(part of national scheme)</i>	Increase the supply of risk capital to growing SMEs Demonstrate to potential investors that commercial returns are possible from funds used to invest in SMEs within the bounds of the equity gap	Create Partners	2003-2012	£17.5m	£6m	No limit	£0.8m

Source: BIS; East of England Development Agency.

Annex B: List of informants

Table B-1: Informants

HM Treasury

Department for Business, Innovation & Skills

Department for Communities & Local Government

Capital for Enterprise Limited

BIS Access to Finance Expert Group

East of England Development Agency

South West Regional Development Agency

Finance South East

South East England Development Agency

London Development Agency

North West Development Agency

Advantage West Midlands

East Midlands Development Agency

Yorkshire Forward

One North East

British Private Equity & Venture Capital Association

British Business Angel Association

Northern Way

SJ Berwin

Carbon Trust Investment Partners

Enterprise Ventures

North Star Equity Investors

Octopus Ventures

Maven Capital Partners

Catapult

North East Investment Advisory Fund

North East Finance

Maven Capital Partners

Regional Finance Forum – West Midlands

Angel News

Engineering Employers Federation

Annex C: Interview guides

Regional Development Agencies

Objectives of the research

The focus of the research is on BIS and RDA delivered VC funds. The key objectives of the research are to:

- Identify the strengths and weakness of the current BIS and RDA venture capital landscape, in particular focusing on the deployment of resources across the landscape and its current management arrangements.
- Explore the ways in which BIS/Capital for Enterprise Limited (CfEL), and RDAs can work together to bring greater coherence to public sector VC provision.
- Develop and examine a range of potential models/options which could deliver an effective framework through which BIS and RDAs could work together to deliver improved coherence, co-ordination and consistency to the publicly backed venture capital provision.

The nature of the research is process focused and is concerned with what incremental steps that can be taken now or in the short term to make the VC landscape work better. It is not about any drastic restructuring of the VC landscape.

Questions

Background

Can you briefly explain your role with respect to access to finance for SMEs/ venture capital provision within your organisation?

Resources

How many publicly backed funds are deployed in your region? Can you please identify these funds?

- Do you have information/data on these funds in terms of the following key parameters: stage of investment; geography; sector; amount invested; investment size; no. of deals; no. of companies invested in; total fund size etc.

What resources are deployed to deliver regional VC funds?

Are you able to provide information/data characterising the deployment of resources? For example:

- Costs

- No. of individuals employed in the regions to establish and manage funds
- Fund raising activities
- Current procurement of venture capital services

How many different fund management boards do regional people have to participate in and how often across all funds?

- How many different reporting requirements to different investors/management authorities are there?

Where is there duplication of roles between central Government, Capital for Enterprise and RDAs and business advisors and investment managers contracted by RDAs?

What are the reasons for and against reducing this duplication?

Policy objectives and investment strategies

What are the objectives and target market for RDA and BIS funds?

What are the strengths of current public sector venture capital provision that the Government should look to maintain, scale-up or otherwise enhance?

Where is there excessive and negative duplication between RDA and BIS VC funds? Where is there complementarity?

Across the landscape of BIS and RDA delivered VC funds are there gaps in provision?

Is there a degree of 'unhealthy' competition between public sector funds for deals?

Is there any issue over improving the financial performance of your regional fund on top of achieving the social and economic objectives of the ERDF fund?

- If so, how are you currently or planning to address this?
- Can you give an indication of the expected 'returns' to your region from the investments in venture capital funds?

BIS national instruments

In your view, what do regional funds deliver that national funds do not?

Do national funds fail to deliver full regional objectives?

What is your view of BIS's ECF instrument? Does it have the potential to provide a 'ready made' solution for the provision of venture capital within a region (For example, an application could be made for an ECF fund with a specific regional focus and could be marketed as an RDA specific fund)?

- If so, please explain.
- If not, why not?

Are there local fund management advisory services that provide the services available to RDAs from CfEL? From RDAs perspectives are there any barriers to the take up of CfEL advisory services?

Communication

What contact do publicly backed Fund Managers currently have with one another?

What processes could be put in place to enhance this network and what benefits (if any) would this bring?

Do you get many SMEs referred to you both from other regions and from within the region?

- What kind of referral process is in place?

CfEL

How do you currently work with CfEL in the provision of VC in the regions?

How would you describe your working relationship? What are the positives and negatives?

- Are there any barriers to closer collaboration with CfEL?
- What kind of services can an organisation like CfEL potentially offer that would be of benefit to you e.g. finding fund managers, fund raising activities etc?

Monitoring of fund performance and evaluation

What information do (i) CfEL and (ii) RDAs gather on fund performance? Could this be done on a more consistent and cost effective national basis?

What types of information and data could be collated so that a better evidence base can be captured to measure performance/impact of the regional funds; and which is perhaps compliant with the latest Impact Evaluation Framework (IEF) guidelines?

- How could this be done and by whom?

How could CfEL or an alternative national structure usefully provide expertise and assistance to RDAs in order to improve the financial performance of their funds (both new and RDA legacy funds) e.g. using knowledge and expertise of the market to benchmark fund manager performance?

What information do BIS and RDAs gather on the economic impact of funds? Could this be done on a more consistent and cost effective basis?

Customer Journey

How easy or difficult is it for the customer – the SME – to navigate the current venture capital landscape and identify appropriate sources of finance, either for first round funding or subsequent rounds? Please explain.

If it is difficult, do you have any views on how the customer journey for SMEs needing VC can be improved?

- Can an ‘effective escalator’ of finance be applied across the landscape of provision?

National Framework Principles

What is your view of the NFPs that were agreed between the RDAs and BIS, in particular the degree to which each of the NFPs have been operationalised?

Recommendations/solutions

For a better network of VC provision, with strong regional capacity, what would you identify as the main components and key recommendations for a structure of delivery to:

- Improve overall distribution of funds, and
- Achieve coherence, co-ordination, consistency and overall impact?
- What merit and what role might a national structure of oversight have over national and regional publicly backed venture capital funds?
- Do you have any suggestions on where future synergies can be developed with BIS to enhance the provision of VC funds?

Other

Do you wish to make any other comments?

[Interviewer: might be worth capturing any thoughts on recent research – Rowlands, NESTA and NAO]

END.

Fund Managers

Can you briefly explain your role with respect to access to finance for SMEs/ venture capital provision within your organisation?

To what extent does your organisation support the view that the current publicly backed venture capital landscape is adversely affected by:

- fragmentation, and/or
- a lack of overall co-ordination and coherence?

What, if any, are the implications of the current landscape for the SME seeking equity finance?

What in particular would you highlight as the main strengths/weaknesses and any constraints in current provision, considering issues of: size; structure and costs; sector and regional focus; and customer experience, including access and referral (to a fund and from one fund to another)?

Do you consider that any of the following aspects of publicly funded venture capital provision need to be improved? And if so how?

- the efficiency of funds
- financial performance of funds
- the marketing of funds
- achieving strong deal flow
- co-ordination between different programmes and fund managers.

What are the strengths of current public sector venture capital provision that the Government should look to maintain, scale-up or otherwise enhance?

In response to Ministers' aims for a better network of provision, with strong regional capacity, what would you identify as the main components and key recommendations for a structure of delivery to:

- improve overall distribution of funds, and
- achieve coherence, co-ordination, consistency and overall impact?

In your view, is it important to have Fund Managers located in the regions to find and execute deals i.e. what is the significance of a having regional presence?

What contact do publicly backed Fund Managers currently have with one another?

What processes could be put in place to enhance this network and what benefits (if any) would this bring?

Do you get many SMEs referred to you both from other regions and from within the region?

- What kind of referral process is in place?
- What merit and what role might a national structure of oversight have over national and regional publicly backed venture capital funds?

Are there any other comments you wish to make?

END.

Stakeholders

Can you briefly explain your role with respect to access to finance for SMEs/ venture capital provision within your organisation?

To what extent does your organisation support the view that the current publicly backed venture capital landscape is adversely affected by:

- fragmentation, and/or
- a lack of overall co-ordination and coherence?

What, if any, are the implications of the current landscape for the SME seeking equity finance?

What in particular would you highlight as the main strengths/weaknesses and any constraints in current provision, considering issues of: size; structure and costs; sector and regional focus; and customer experience, including access and referral (to a fund and from one fund to another)?

Do you consider that any of the following aspects of publicly funded venture capital provision need to be improved? And if so how?

- the efficiency of funds
- financial performance of funds
- the marketing of funds
- achieving strong deal flow
- co-ordination between different programmes and fund managers.

What are the strengths of current public sector venture capital provision that the Government should look to maintain, scale-up or otherwise enhance?

In response to Ministers' aims for a better network of provision, with strong regional capacity, what would you identify as the main components and key recommendations for a structure of delivery to:

- improve overall distribution of funds, and
- achieve coherence, co-ordination, consistency and overall impact?

What merit and what role might a national structure of oversight have over national and regional publicly backed venture capital funds?

Are there any other comments you wish to make?

END