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COMPTROLLER AND
AUDITOR GENERAL

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The Department for Business, Innovation and Skills

Venture capital support to small businesses

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National Audit Office

The Department for Business, Innovation and Skills

Venture capital support to small businesses

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Amyas Morse
Comptroller and
Auditor General

National Audit Office

7 December 2009

Since 2000, the Department for Business, Innovation and Skills, and its predecessors, have provided venture capital funding to support young, often highly innovative companies that find it hard to raise finance through conventional means. This report examines the Department's oversight of these funds, and their performance to date.

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Summary

1 Since 2000 the Department for Business, Innovation and Skills (the Department), and its predecessors, have provided venture capital funding to support young, often highly innovative companies that find it difficult to raise finance through conventional means. The Department believes such companies have significant potential to stimulate economic growth and productivity through developing new ideas and technologies.

2 Start-up companies are often perceived by potential investors as risky, because of the initially negative cash flows and high chances of failure. Limited collateral and trading income mean that conventional loans are not usually available to such companies. Equity support, whereby the investor accepts a share in the ownership of the company, is the most usual type of financing for start-up companies but external provision is limited. Departmental consultations show this equity gap is most acute for businesses seeking between £250,000 and £2 million because of the inherent riskiness and disproportionately high cost of managing these investments and as a result potentially viable business ideas do not receive support.

3 Since 2000, the Department has placed around £337.9 million in a series of venture capital funds aimed at supporting small businesses seeking equity investment (**Figure 1**). Other investors have contributed a further £438.2 million, making a total of £776.1 million potentially available. The funds are administered by private sector fund managers who are responsible for making investment decisions, offering businesses in receipt of funding the technical and managerial expertise needed to help them grow and for managing the portfolio of investments over the cycle of the fund's life.

4 Until April 2008, the work of the fund managers was overseen by officials in the Department. In April 2008 the Department established Capital for Enterprise Limited as a wholly-owned company to deliver finance measures in support of small businesses, including oversight of the venture capital funds programme. The Department remains responsible for advising ministers on policy in this area.

5 This report examines the venture capital funds established by the Department since 2000, in particular:

- the role and development of venture capital in providing equity finance and why businesses may be unable to obtain equity finance (Part 1);
- the performance of the equity funds against the Department's objectives (Part 2); and
- the management of the programme and individual funds by the Department and Capital for Enterprise Limited (Part 3).

Figure 1
The Department's venture capital funds

Scheme name	Objectives	Year commenced	Fund sizes[1]	Government commitment	Maximum investment
UK High Technology Fund[2]	• Demonstrate to investors and the venture capital industry that commercial returns can be made on early stage, high technology investments. • Attract new institutional investors into the technology sector and encourage their longer term interest.	2000 – fund-of-funds 2000 – five underlying funds 2001 – three underlying funds 2002 – one underlying fund	£126.1m	£20m	No limit
Regional Venture Capital Funds (RVCFs)	• Establish a programme of regionally based venture capital funds where the majority of investment is provided by the private sector. • Demonstrate to potential investors that commercial returns can be made by funds investing in the equity gap such that future funds could have less Government subordination. • Increase risk capital to growing small businesses without displacing other activity in this part of the market.	2002 – seven funds 2003 – two funds	Individual funds range from £12m-46m Total raised £226.5m	£74.4m	£500,000
Community Development Venture (Bridges) Funds	• Provide venture capital to commercially viable businesses that operate within or have links to the 25 per cent most under-invested (disadvantaged) areas of England.	2002 – two funds, A and B	A) £28m B) £12m	A) £14m B) £6m	A) £500,000 B) no limit
Early Growth Funds (EGFs)[3]	• Demonstrate to private investors that commercial returns can be achieved by investing in early growth businesses. • Encourage risk funding for start-ups or early growth businesses.	2002 – one fund 2003 – two funds 2004 – three funds	Individual funds range from £3m-£5m Total raised £91m	£26.5m	£100,000
Enterprise Capital Funds (ECFs)	• Increase flow of new fund managers entering the early stage market. • Attract more entrepreneurial investors to the market. • Be a self-financing programme over the medium term.	2006 – five funds 2007 – one fund 2008 – two funds	Individual funds range from £10m-30m Total raised – £205m	£134.5m	£2m
The Aspire Fund	• Increase the number of successful women led businesses within the UK. • Act as beacon to women entrepreneurs, where they can demonstrate high growth potential. • Improve linkages between sources of funds and providers of investment readiness support.	2008 – one fund	£12.5m May raise up to £25m in co-investment	£12.5m	£1m

Figure 1
The Department's venture capital funds *continued*

Scheme name	Objectives	Year commenced	Fund sizes[1]	Government commitment	Maximum investment
Capital For Enterprise Fund[2]	• Support viable businesses, enable them to raise new long-term finance and take advantage of business opportunities even in difficult trading conditions. • Support businesses that find it difficult to finance their current business plans, where the business is over-leveraged.	2009 – fund-of-funds, two underlying funds	Individual funds £30m plus a co-investment provision of £15m Total raised – £75m	£50m	£2m

Source: National Audit Office

NOTES
1 Fund size relates to amounts committed by the Department and other investors or raised through co-investment, and not to current valuation. Co-investment is explained in paragraph 1.10.
2 The primary role of a fund-of-funds manager is to invest in other funds offering support to businesses meeting the Department's criteria.
3 This Figure and the amounts shown in paragraph 3 exclude a hybrid Early Growth Fund which incorporates debt and equity options to which the Government has committed £5 million.

Findings

6 The Department failed to establish a robust framework of objectives, and associated baselines, to enable it to judge whether the taxpayers' investment offered value for money. The Department has set multiple aims for each fund but these have not been translated into clear measurable objectives or prioritised. With the exception of the Enterprise Capital Funds no clear financial objective was set for the impact of the funds to the taxpayer, such as whether they were expected to break-even and over what timescale, and the Department did not specify objectives for wider economic benefits apart from the Bridges Funds. There is evidence of informal learning between fund launches but the Department has not put in place a structured process to measure performance against its objectives. In late 2008 the Department commenced an interim evaluation of the economic benefits of the Regional Venture Capital Funds and Early Growth Funds. The evaluation focuses on the net economic impact of the funds but will not provide robust evidence to measure achievement of all of the stated objectives.

7 Business groups, businesses and fund managers report that start-up companies face an equity gap and that public funds have an important part to play in addressing that gap. Eighty four per cent of businesses surveyed by us for three of the funds reported that the initial funding had made it easier for them to obtain additional finance from other sources. Without support, most of those who would have proceeded anyway would have delayed their plans or reduced the scale of their activity. Publicly supported venture capital was not the only source of funding available to these start-up companies. Thirty two per cent of businesses reported they would have been unable to obtain any finance without support from the funds. Around 23 per cent reported that they would not have gone ahead with their planned activity in the absence of finance from the Department's funds.

8 **The financial performance of the Department's early funds is likely to be poor, although not untypical when compared to private venture capital returns over the same period.** Venture capital funds are a long-term investment with negative cash flows until typically the eighth year of the cycle. We looked only at the interim financial performance of funds more than five years old, as the venture capital industry considers it is reasonable to begin to evaluate the financial performance of funds from this point. As the Department's funds still hold a significant number of investments the final performance of the funds at the end of their lives is uncertain. Similar cohorts of private venture capital funds have performed poorly in Europe over the last decade compared to previous periods. We found:

- *UK High Technology Funds.* The pooled interim rate of return across the nine underlying funds in June 2008 was minus 9.7 per cent (net of fund management costs), with only one of the nine funds showing a positive rate of return. Comparable private technology funds show a pooled average return of minus 5.2 per cent at that date.
- *Regional Venture Capital Funds.* The pooled interim rate of return across the nine funds at December 2008 was minus 15.7 per cent with all nine funds showing negative returns. Private funds of a similar size and vintage (time of establishment) show a return of minus 0.4 per cent but are subject to fewer investment restrictions.
- *Bridges Funds.* The pooled interim rate of return at September 2008 was plus 7.7 per cent. The fund has fewer constraints on its investment activities than the Department's other funds, notably its ability to invest in property. The interim rate of return has fallen from a peak of 17.4 per cent reflecting the economic downturn and the decline in the value of its property-backed assets.

9 **The performance of the Regional Venture Capital Funds was impeded by their design.** Recent academic research identifies a number of factors which tend to improve the chances of a successful venture capital fund, including a flow of good quality deals; the timing of investments; broad geographic coverage; larger fund sizes; and the ability to make follow-on investments and to exit individual investments on a timely basis. In the light of this research the Regional Venture Capital Funds suffered limitations against all of these criteria to varying degrees. The pool of viable business propositions targeted by the funds was restricted in some cases by investment criteria, for example their regional focus and the total allowable investment limit for a business was £500,000, which restricted the size of initial and follow-on investments.

10 The taxpayer is unlikely to receive returns on investment in the early funds, but should be better protected in future through recent improvements in fund design. Earlier funds were designed to protect other investors in the event of poor financial performance, to encourage them to invest alongside the Government. Based on valuations at 31 March 2009 the Department's Accounts currently value the £74 million invested in Regional Venture Capital Funds at £5.9 million, and the Department will only get a return if the individual funds outperform the preferential 10 per cent return to other investors. The Enterprise Capital Funds, launched in 2006, strike a better balance between protecting the taxpayer and encouraging other investors to participate because the public sector is the preferential investor, while private investors have greater opportunity to benefit from success.

11 The fee rates paid by the Department to fund managers have been comparable to the wider venture capital industry but over the lifecycle of the funds, depending on the eventual returns achieved, this is potentially an expensive form of business support. The remuneration structure reflects private sector fund management practices in percentage terms and basic salaries paid to fund managers are at the lower end of the industry scale. Businesses in receipt of support reported that they had, in most instances, benefited from the expertise of their fund manager. Over time the cost of administering the funds can, however, represent a sizeable percentage of the amount invested. By 2008 the cumulative costs paid by the investors in the UK High Technology Fund and underlying funds totalled £19.5 million (17 per cent of the amount invested); Regional Venture Capital Funds £46.1 million (36 per cent of the amount invested); and Bridges Funds £7.7 million (29 per cent of the amount invested). The funds were initially expected to last 10 to 12 years but the life can be extended with the agreement of investors. The severity of the current economic downturn suggests the funds are likely to run for some years yet before the investments can be successfully realised. The cumulative cost figures will therefore increase further.

12 The creation of Capital for Enterprise Limited has the potential to strengthen oversight of the funds. The new Board at Capital for Enterprise Limited brings with it a significant range and depth of relevant experience. Our work suggests there is a clear division of responsibilities within the programme between the Department, Capital for Enterprise Limited and fund managers.

13 To date the Department has published virtually no information on the performance of the funds. The National Audit Office's analysis published in this report is the first time that information about fund performance has been made public. This partly reflects concerns over maintaining commercial confidentiality and is in keeping with practices adopted for Government venture capital interventions overseas. It is unclear, however, how keeping this information confidential helps the Department demonstrate to private investors that commercial returns can be made from investing in the equity gap – one of the original aims for the early funds. There is a case, therefore, for greater transparency balancing the legitimate needs of private investors against those of taxpayers.

Conclusion on value for money

14 Businesses in receipt of publicly-supported early stage investment have reported positive outcomes, for example that the funds have offered them much needed finance not easily obtainable from other sources and that this has allowed them to raise other finance and to grow. But the Department did not set clearly specified, prioritised objectives for its funds, nor did it establish baselines against which it could judge what it was getting for taxpayers' money.

15 The performance of the earliest funds suggests the Department is unlikely to make a positive financial return or recover all of its investment. The Regional Venture Capital Funds have particularly poor financial performance to date in comparison to other types of funds, with a pooled interim internal rate of return of minus 15.7 per cent and cumulative management fee costs of £46.1 million representing 36 per cent of the total value of investment. Improvements have been made to the design of the Enterprise Capital Funds to strike a better balance between protecting taxpayers' interests and attracting other investors.

16 In the absence of a robust measurement framework, and given the poor performance of the early funds to date, the Department agrees with our conclusion that the programme cannot currently demonstrate value for money. The Department is, however, putting in place steps so that it is better able to demonstrate value for money through strengthening its programme management and evaluation, in particular setting clear and measurable objectives and baselines for those more recent funds which are still open to investment. The following recommendations are designed to reinforce the Department's work.

Recommendations

17 We make the following recommendations:

a **The Department's objectives for its funds are not precisely defined.** The Department should define more clearly the objectives for each of its funds and the criteria against which it will evaluate whether these objectives are being achieved. These objectives should include a financial objective for each fund specifying the extent to which taxpayers' money is expected to be recovered and the timescale over which this will happen.

b **The cumulative cost of managing a total of 28 different funds all with broadly similar objectives will over time add up to a significant proportion of the money invested.** Capital for Enterprise Limited reports the cost of establishing and managing some but not all funds to the Department, and should extend this to all funds to ensure that the Department's decisions are fully informed. Although to date no extension to the life of a fund has been requested, Capital for Enterprise Limited should take this cost into account when considering any future requests to extend the life of existing funds and negotiating the terms of any extensions. The Department should also 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.

c **The validity of the Department's current investment approach is not yet demonstrated through successful exits of businesses from funds.** Fund success is crucially dependent on spotting and supporting a small number of high growth businesses. The Department should evaluate whether the current approach is likely to optimise performance. Factors influencing success which could be analysed in any future exercise to design new funds include the 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 and the merits of each of the fund models tried to date.

d **Over time a range of fund types have been established with a number of similar aims, but the Department has not viewed the funds as a programme.** The Department should begin to manage those funds that are currently investing in businesses as a programme and outline how the various elements fit together. Capital for Enterprise Limited should draw together existing information covering all individual fund types so that the Department has a more complete overview of how they fit together. The Department should then put in place a framework for evaluating the programme of funds building on the work it started in evaluating the early funds. Such an evaluation would allow the Department to undertake more informed policy making in terms of understanding the cost effectiveness of the interventions in the context of other measures to support small businesses.

e **There is little information about the funds in the public domain.** To increase transparency, the Department could make more information about the funds publicly available. While this need not include confidential or sensitive financial data, it could include breakdowns of public and private sector investment to date, geographical and sectoral analyses of where investments are being made and details of successful exits and write-offs. The Department should also consider how best to raise awareness amongst potential beneficiary companies, for example, by promoting successful businesses in receipt of its funding.

Part One

Background

Difficulties for small businesses in obtaining equity finance

1.1 In 2000, the former Department of Trade and Industry established the first of what was to become a series of taxpayer-supported venture capital funds. The funds were introduced to help bridge a perceived gap in equity finance available for start-up businesses.

1.2 In March 2008 the Government published *Enterprise: Unlocking the UK's talent,* which outlined its strategy to support business including further expansion of its support for equity finance. The Department considers that some small businesses can be the source of ideas that generate commercial success for entrepreneurs and create benefits for the wider economy through increased employment, and through increased innovation and productivity.

1.3 At various points of a business' development, and particularly in the early stages, small businesses may need to seek external finance to be able, for example, to develop new products and processes and grow the business (**Figure 2** overleaf). Small businesses seek to obtain external finance from a variety of sources – for example in the form of debt such as bank loans, or equity provided through external investors in return for a stake in the ownership of the business.

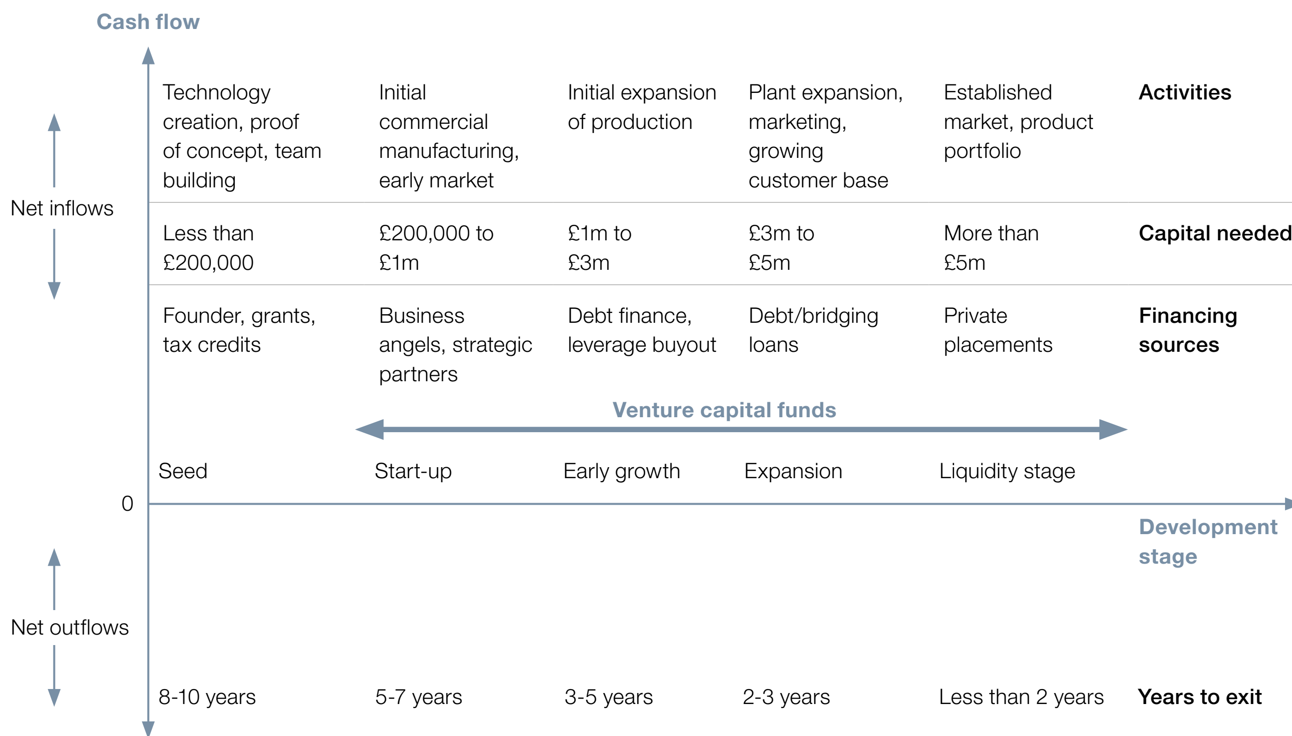
1.4 In addition to concerns about the perceived high costs of making investments in the equity gap, private investors also tend to consider early stage investment to be risky relative to the likely return on investment. The failure rate for early stage investments is high, with on average only 34 per cent of companies achieving a successful exit.[1] Even where a company is successful there is typically a long lead time to develop a product or service to the point where a business is profitable.

1 Research by S. Das, M. Jagannathan and A. Sarin, reported in *Factors determining the performance of early stage high-tech venture capital funds – a review of the academic literature,* Anna Söderblom, 2006, page 21.

The venture capital industry

1.5 Many entrepreneurs rely on support from friends and family at the seed stage of business development, but this is often insufficient in the longer term and external equity is required. Venture capital is a source of this funding for businesses and in the UK specifically focuses on early stage investments rather than on management buy-ins and buy-outs. In 2008, UK venture capital funds invested an estimated £359 million in early stage businesses. There are a growing number of business angels operating in the UK – either wealthy individuals or syndicates, who are prepared to invest directly in and mentor early stage companies or who invest indirectly through venture capital funds.

Figure 2
Stages of business development and finance requirements



Source: National Audit Office analysis based on Policy Options and Instruments for Financing Innovation, United Nations Economic Commission for Europe, 2009 and the Low carbon vehicle partnership website: http://www.lowcvp.org.uk/ewi/stages-of-business-development

1.6 Venture capital funds in the UK are typically structured as limited partnerships run by fund managers who raise money from investors, both individuals and institutions, and seek out businesses in which to invest. The investing cycle for a fund is usually around five years after which the focus is on managing and making follow-on investments in a portfolio. A key reason why private investors may find venture capital an attractive prospect is the expectation that a few successful investments will cover the costs of investing in the whole portfolio and generate an attractive return to investors, even though the majority of investments may be unsuccessful. The funds are illiquid and it can take several years for successful businesses to mature.

1.7 Governments in many developed economies have established publicly-backed venture capital funds to address the observed market failings in the provision of early stage venture capital. The core objectives of the schemes typically include support for the creation and growth of new businesses for the purposes of increased innovation, research and development, entrepreneurship, economic growth and job creation. A review of these schemes undertaken for the National Audit Office by Professor Gordon Murray is available on our website at supplementary Appendix 2 (at www.nao.org.uk).

The UK Government's programme of equity funds

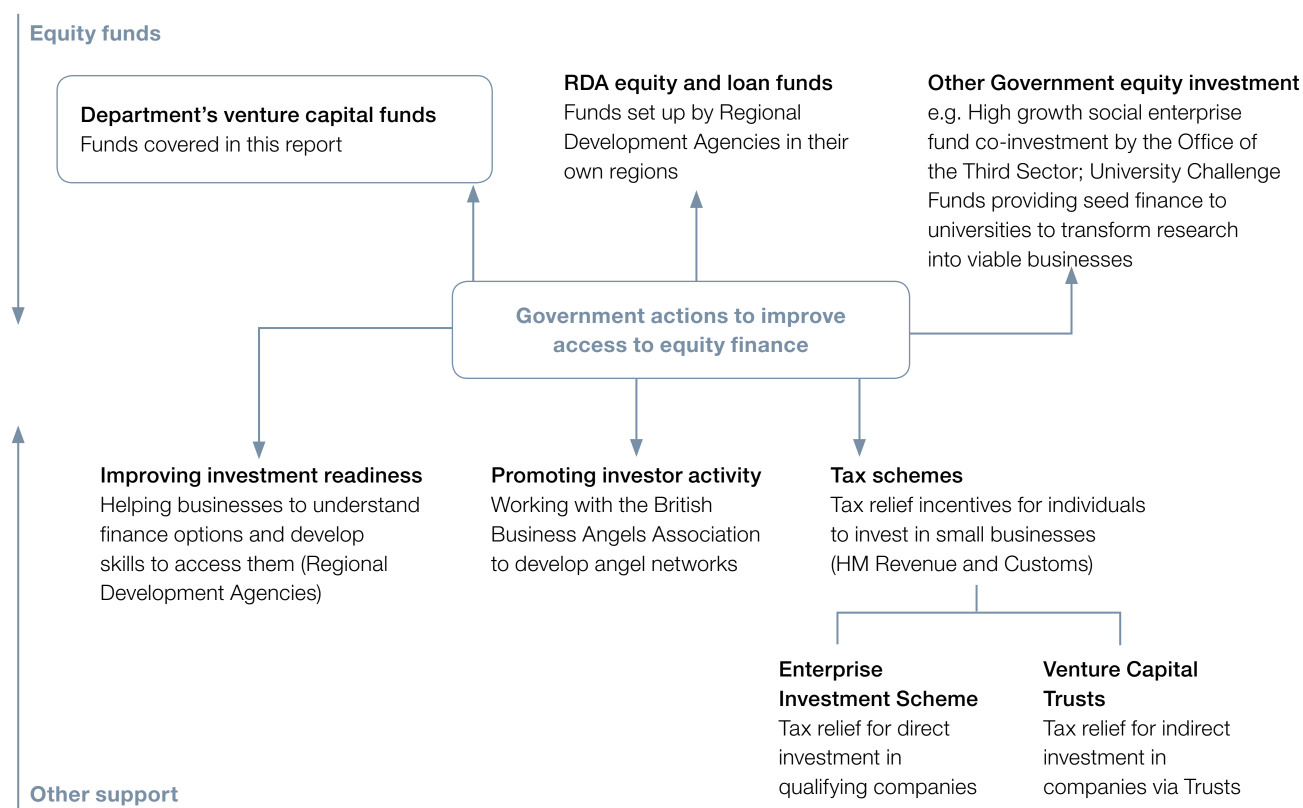
1.8 In 1999 the Government put forward proposals for a UK High Technology Fund (launched 2000) and for Regional Venture Capital Funds covering each of the English regions (2002-03). A series of further equity-based funds followed, including the Community Development Venture Capital ("Bridges") Funds (2002), Early Growth Funds (2002-04), Enterprise Capital Funds (2006 onwards), the Aspire Fund (2008) and the Capital for Enterprise Fund (2009). Recent academic research[2] in this area argues that this series of funds is one of the most advanced equity finance programmes in Europe. **Figure 3** overleaf shows these funds in the wider context of the Government's efforts to encourage equity investment in small businesses.

1.9 Capital for Enterprise Limited, a company wholly owned by the Department, has responsibilities for managing guarantee programmes to support bank lending and providing advisory and investment management services to public sector customers as well as overseeing the venture capital funds. **Figure 4** on page 15 sets out the role of Capital for Enterprise Limited, and of the independent fund managers who are recruited to manage the individual funds.

2 *From Funding Gaps to Thin Markets: UK Government support for early stage venture capital,* BVCA/NESTA, September 2009.

1.10 The Department has experimented with a variety of fund models commonly used in the venture capital industry. The Regional Venture Capital Funds, Enterprise Capital Funds and the Bridges Funds are based on a model of direct investment by the fund in the underlying businesses. Early Growth Funds, an element of the new Capital for Enterprise Fund and the Aspire Fund, are based on a co-investment model. The co-investment model relies on investors finding potential businesses in which to invest and presenting these to the fund manager. The fund manager takes a decision on whether to invest alongside the private investor based on an evaluation of the latter's investment track record and the strength of their due diligence work, rather than on a direct evaluation of the underlying business. The UK High Technology Fund and the other element of the Capital for Enterprise Fund are based on a fund-of-funds model which allows the Government to invest in a number of underlying venture capital funds thereby increasing the diversification of investments.

Figure 3
Government actions to improve access to equity finance



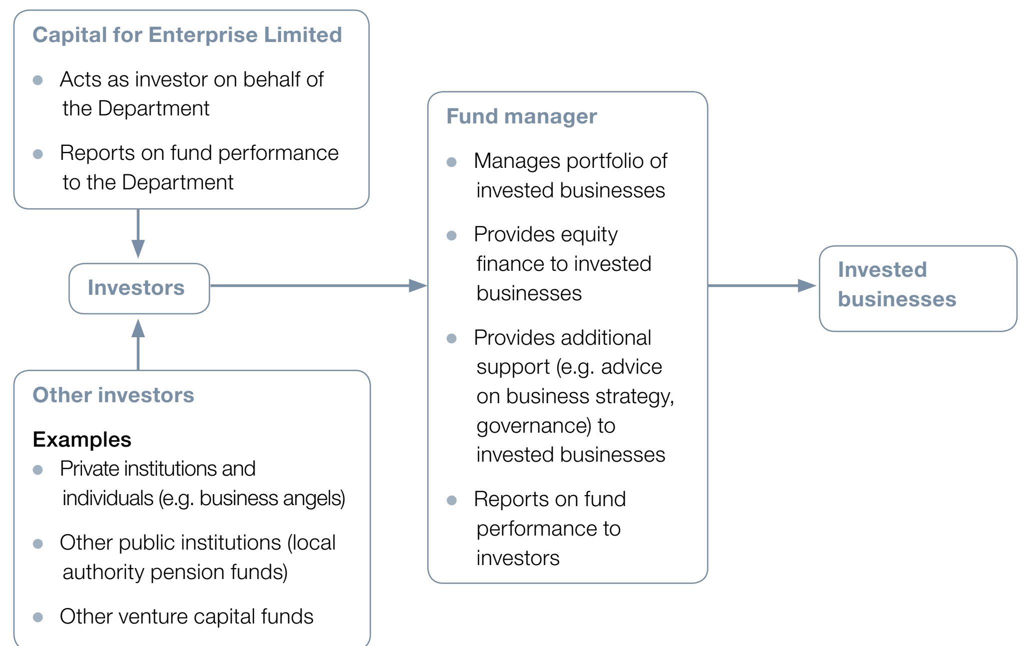
Source: National Audit Office analysis, Department's Enterprise Strategy

NOTE

1 The National Endowment for Science, Technology and the Arts (NESTA) also invests in early stage businesses both directly and through funds. NESTA is an independent organisation with endowed funds of over £300 million. It does not receive general government funds to support its work, although some Departments provide funding or contract with NESTA for specific projects.

1.11 This report examines the equity funds launched by the Department and the oversight of those funds by Capital for Enterprise Limited to establish whether the Department's intervention in the equity funds market in support of small businesses has been delivered effectively.

Figure 4
Government venture capital intervention roles and responsibilities



Source: National Audit Office analysis, Department's Enterprise Strategy

Part Two

Performance against objectives

2.1 This Part examines the Department's objectives for the equity funds and assesses their performance in terms of the benefits to small businesses and the financial returns, including the potential returns to the taxpayer. It does not consider the performance of the Aspire and Capital for Enterprise Funds which were launched only recently.

Objectives for the programme

2.2 The Department's broad aim for publicly-supported venture capital is to address the equity gap by increasing the amount of risk capital available to affected businesses, both through direct investment and by attracting private investors. The early fund types also sought to demonstrate to private investors who would not otherwise invest in this part of the market that commercial returns could be made, and were designed to encourage their involvement by providing them with a preferential return such that the taxpayer would bear losses if funds performed poorly. This reflected the Department's belief that private investors could also be deterred from investing because they underestimated the returns to be made in this part of the market.

2.3 The Department has not, however, translated these aims into clear, prioritised objectives and it has not articulated criteria for success against which achievement can be judged. For example:

- some terms employed in the fund objectives (for example "investment activity" and "commercial returns") are not precisely defined, leaving them open to interpretation;
- none of the early funds had an explicit financial performance objective and while it is not unusual for funds to have no explicit targets for internal rates of return, some form of objective (such as breaking even) should be expected. The Enterprise Capital Funds aim to be cost neutral to the taxpayer over the medium term, although which costs should be included in this assessment are not specified; and
- only the Bridges Funds have an explicit objective to generate wider economic benefits.

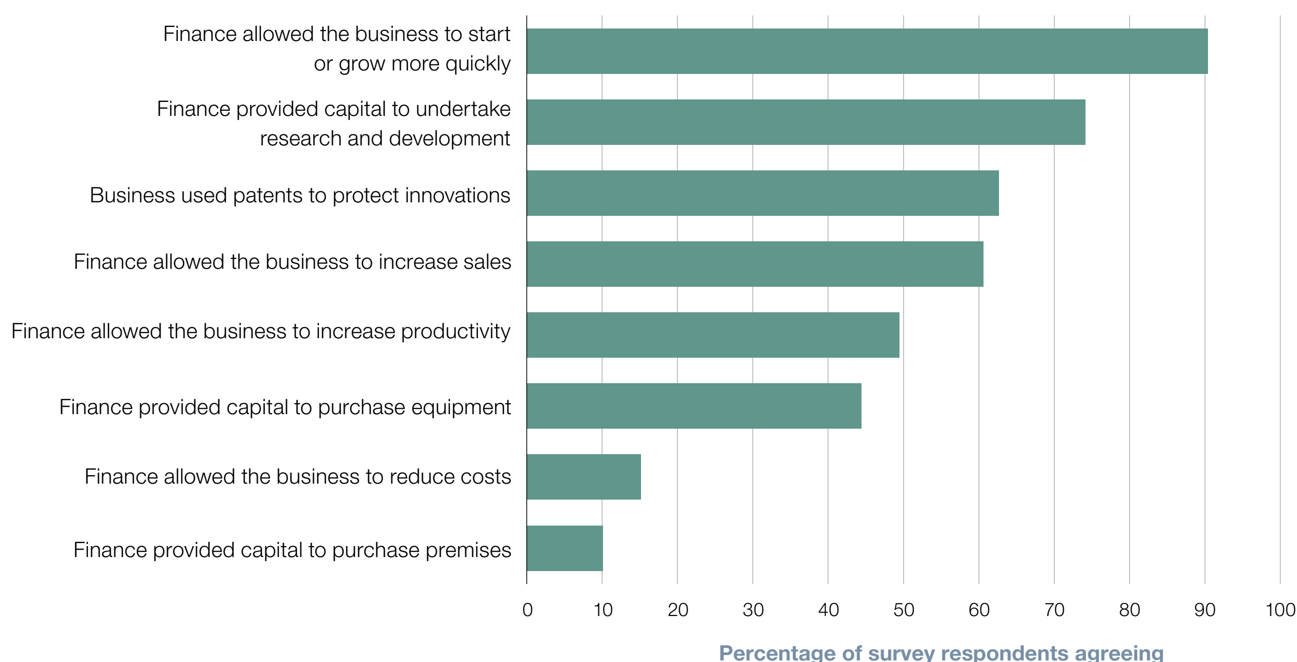
In the absence of baselines against which to track progress and the lack of clear, measurable objectives, the National Audit Office has developed proxies against which we assess the performance of the funds. These include the extent that Departmental funding is additional and not displacing other investment; evidence of focused targeting of the equity gap; evidence of overall increases in the availability of risk capital; and the rate of return of funds, the level of successful exits to date and the cost of managing funds relative to the investment.

Benefits of the programme to small businesses

The impact of investment for recipient businesses

2.4 Businesses in receipt of funding have been positive about the support received and the impact of funding on their business' development. We surveyed businesses in receipt of support from the UK High Technology Fund, the Bridges Funds and the Enterprise Capital Funds. In parallel, the Department as part of its evaluation of the Regional Venture Capital Funds and Early Growth Funds surveyed businesses in receipt of support from those funds. The surveys revealed high levels of satisfaction, with more than 90 per cent of respondents saying they would recommend the funds to others. **Figure 5** shows examples of how surveyed businesses have benefited from the finance, while case study 1 at supplementary Appendix 3 at (www.nao.org.uk) provides an example of a business which has high growth potential after receiving finance.

Figure 5
Benefits of receiving funding cited by supported businesses



Source: Surveys by GfK NOP for the National Audit Office and Ci Research for the Department

2.5 There is evidence to suggest that the Department's funds have complemented other sources of finance, although a degree of displacement cannot be ruled out. The initial investment from the funds comprised a mix of Department and private funding. Of those businesses that had subsequently sought and obtained additional finance from other sources, 84 per cent said the initial public funding had made it easier. On the other hand just less than a third of businesses (32 per cent) said they would have been unable to obtain any finance without support from the funds, and 27 per cent said they had not tried to obtain finance from other sources. In interviews, representatives of investors, fund managers and Regional Development Agencies considered that the Department's funds had not displaced other investment activity.

2.6 There is also some evidence that finance from the Department's funds has resulted in additions to the overall level of business activity, though it is difficult without baselines to measure the size of any increase. Around 23 per cent of respondents said they would not have gone ahead with their planned activity in the absence of finance from the Department's funds. Of those who said they were likely to have gone ahead, 71 per cent said they would have had to delay their plans without funding, and 66 per cent said their activities would have been slightly or significantly smaller than planned.

Evidence on targeting the scale of the equity gap

2.7 In 1999 a consultation supported the Department's view that the equity gap affected investment up to £500,000. A further assessment in 2003 based on wider research indicated a gap between £250,000 and £2 million. The Department's latest analysis conducted in 2009 suggests that it remains at least as wide. The businesses, fund managers and academics consulted during our study agreed on the existence of a gap in the availability of equity funding for start-up businesses in the UK. Most of those consulted thought the gap in available equity support particularly affected early stage businesses seeking investments between £100,000 and £2 million. A significant number of interviewees reported, however, that the problem may also affect businesses seeking amounts up to £5 million.

2.8 There is evidence that targeting of the early funds in addressing the extent of the equity gap was not as effective as it could have been. Initially the Regional Venture Capital Funds could only invest up to a maximum of £500,000 of public and private money (including follow-on investment) which fund managers said restricted the ability of invested businesses to obtain finance from the funds at crucial stages of their development. This limit was driven partly by the European Commission's conditions for compliance with state aid rules, which restricted the total amount of finance for individual companies but also reflected the Department's own assessment of the gap in 1999. The more recent Enterprise Capital Funds are better positioned to cover the range of the equity gap (now estimated to be up to £2 million) and provide greater flexibility for fund managers to make follow-on investments.

The regional nature of the equity gap

2.9 Interviews with Regional Development Agencies, fund managers and business groups suggested that the equity gap affects some regions more than others, but opinions differed on the effects. The Regional Venture Capital Funds had a deliberate regional focus with a view to establishing a fund in each English region. While this was achieved, compared to other fund types they delivered low investment totals over their investment periods relative to the amounts committed and to initial expectations. Five[3] of the nine funds invested low amounts relative to the other four. Of these five, four funds cancelled bank debt facilities totalling £14 million and two had their private investor commitments reduced by a total of £10 million. Factors potentially contributing to relatively low investment are the limits on the amounts that could be invested in individual businesses, including where follow-on finance is needed, and the limited pool of good business propositions identified in some regions. The Department has subsequently created funds on a national basis in recognition of these difficulties.

2.10 It is important under a national model that the Department can be sure that the best businesses have a chance of receiving support irrespective of where they are located. The distribution of investments under the national programmes has been concentrated in London and the South East, although this may reflect that some areas produce more investment opportunities than others. About 50 per cent of the fund managers, for example, are based in these two regions as are 43 per cent of the businesses they have invested in to date (**Figure 6** overleaf). Stakeholders' perceptions of the equity gap reflected the region they represented. Interviewees from outside London and the South East tended to view the equity gap as a more significant problem in their region. This was because the high degree of co-location between fund managers and invested companies in London and the South East, coupled with the Department's shift to national funds, was thought to put businesses in their region at a disadvantage. In contrast interviewees in London and the South East considered there was insufficient finance available to meet all the demand from businesses with good prospects.

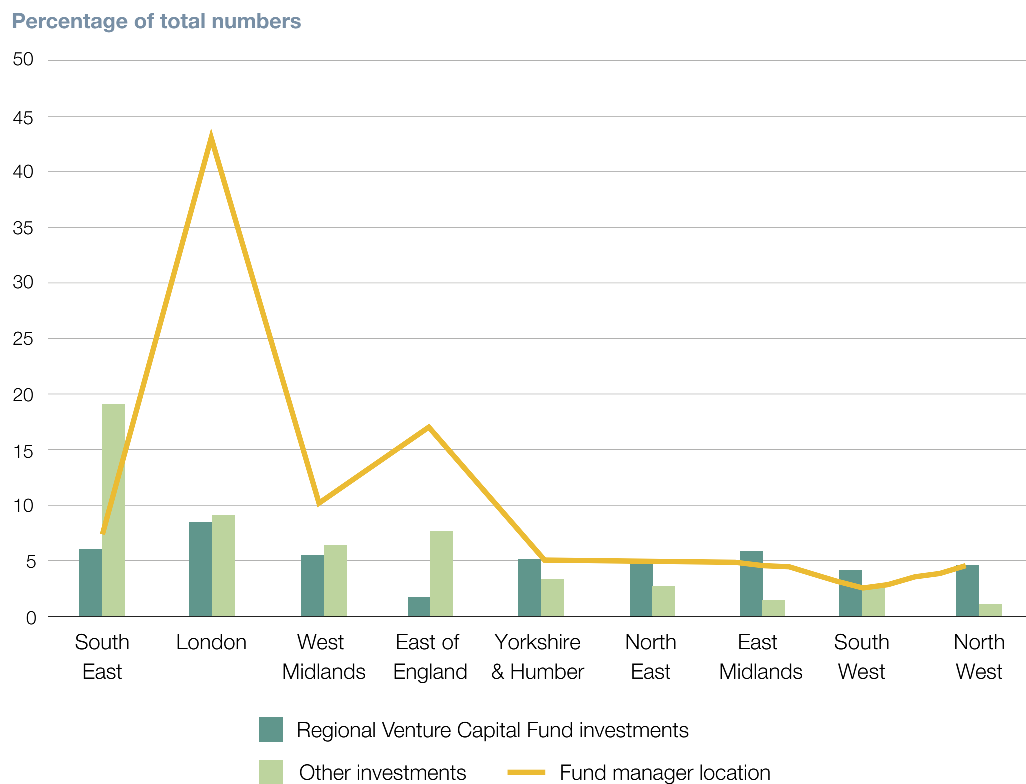
Evidence on the sectors most affected by the equity gap

2.11 With the exception of the UK High Technology Fund, the Department did not target particular sectors, believing that the equity gap affects a range of sectors. Academic research has suggested that the equity gap particularly affects technology sector businesses, partly because investors may perceive that these investments involve longer lead times for the development of products and generating returns, greater uncertainty about the scale of any returns and therefore greater risk.[4] Our analysis (**Figure 7** page 21) showed that computer related sectors (27.6 per cent) accounted for the largest proportion of investments by fund managers, with investments in other services and manufacturing (23.9 per cent) exceeding other sectors.

3 East of England, East Midlands, London, West Midlands, Yorkshire and Humber.
4 Research by Mason and Harrison, quoted in *Factors determining the performance of early stage high-tech venture capital funds – a review of the academic literature*, Anna Söderblom, 2006, page 20.

Figure 6

Distribution of investments by the Department's funds across the English regions

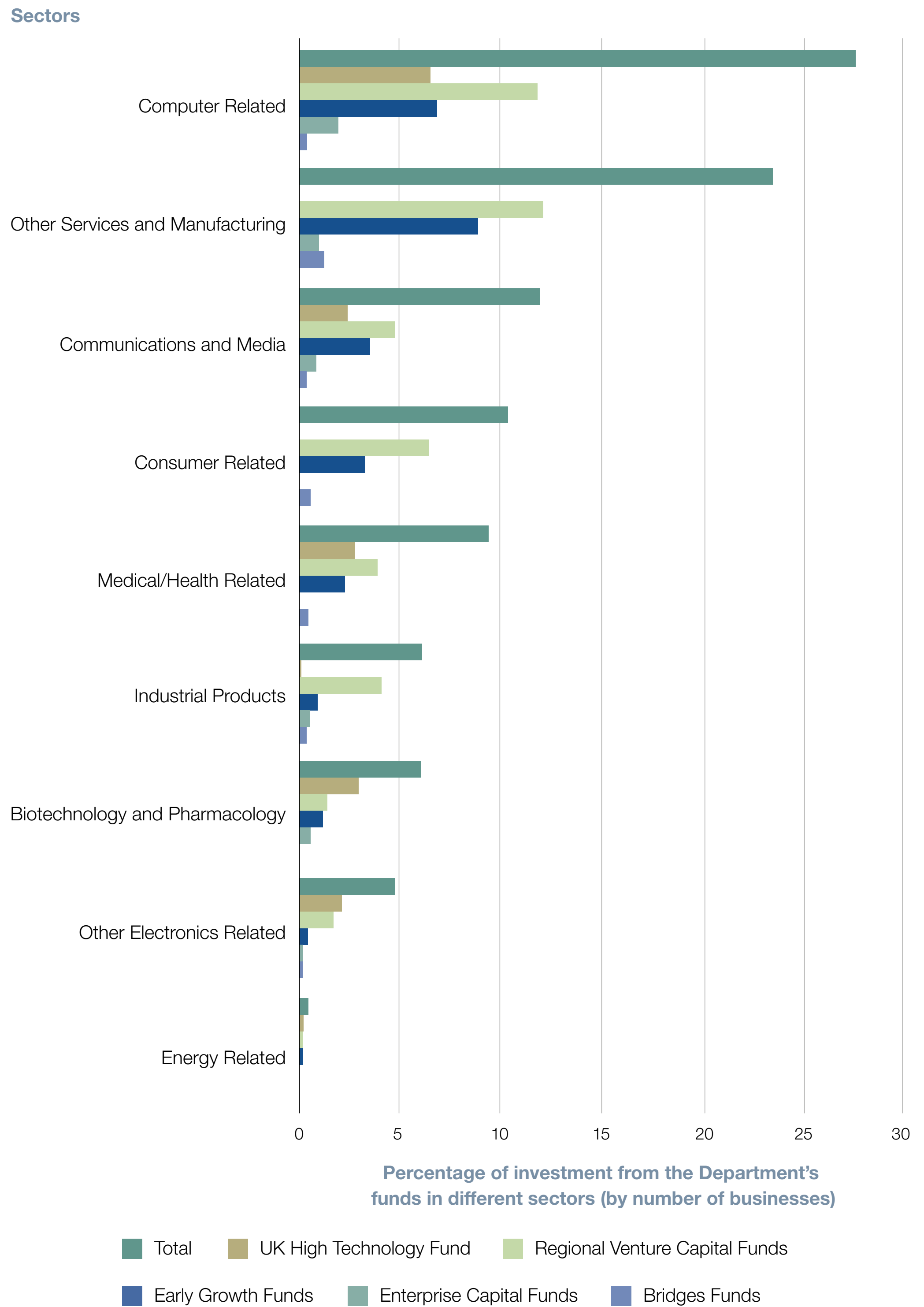


Source: Capital for Enterprise Limited, Thomson Reuters database and National Audit Office

Availability of risk capital

2.12 The Department's funds have attracted varying amounts of private sector investment into this part of the market, although the extent to which this closes the equity gap cannot be measured. Funds launched up to and including the Enterprise Capital Funds have attracted £413.2 million from other investors, or 60 per cent of the total raised by these funds (**Figure 8** on page 22). The percentages raised from other investors vary considerably by fund type, reflecting fund design and market appetite depending on the timing of fund raising. Targets were set for each fund type and all of these have been met or exceeded to date. The UK High Technology Fund has been particularly successful at attracting other investment, raising around £5 for every £1 committed by the Department.

Figure 7
Distribution of investments by the Department's funds by sector



Source: National Audit Office

Figure 8

Amounts raised for investment through the Department's funds

Fund	Number of funds	From the Department (£m)[1]	From other investors (£m)[1]	Percentage raised from other investors	Target from other investors (if any)	Total raised (£m)[1]
UK High Technology Fund[2]	1	20.0	106.1	84.1	£105m	126.1
Regional Venture Capital Funds	9	74.4	152.1	67.2	At least 50 per cent	226.5
Bridges Funds	2	20.0	20.0	50.0	50 per cent	40.0
Early Growth Funds[3]	6	26.5	64.5	70.9	Match funding	91.0
Enterprise Capital Funds	8	134.5	70.5	34.3	At least one-third	205.0
Total	**26**	**275.4**	**413.2**	**60.0**		**688.6**

Source: National Audit Office analysis of Capital for Enterprise Limited data

NOTES

1 The Figure includes amounts committed to the funds by the Department and other investors or through co-investment, and excludes investments made in recipient businesses from other sources.

2 The number of funds shown excludes the nine underlying funds.

3 Early Growth Funds require that the Department's funding is at least matched by business angels. This Figure excludes the debt-only Early Growth Fund.

4 The Figure excludes amounts raised through the Aspire and Capital for Enterprise Funds.

2.13 There is some evidence to suggest that the Department's funds may have encouraged further investment in this segment of the market. We found that:

- The UK High Technology Fund and the Bridges Funds (Bridges Community Development Venture Fund I) launched follow-on funds financed wholly by private investors which, though different in nature, would not have been possible without their experiences of the funds supported by the Department. Capital Dynamics European Venture 2005 raised €69 million, while Bridges Community Development Venture Fund II has raised £75 million compared to a target of £50 million.

- Analysis by the National Endowment for Science, Technology and the Arts (NESTA)[5] based on data collected by the British Venture Capital Association indicates that the number of companies receiving investments of less than £2 million rose annually by an average of 2.2 per cent between 2000 and 2007[6], and that there was an increasing trend between 2001 and 2007 of both deals with public sector involvement and private-only deals.

5 *Shifting sands: The changing nature of the early stage venture capital market in the UK*, NESTA, September 2008, Tables 3 and 4.

6 The data does not distinguish between initial and follow-on investments.

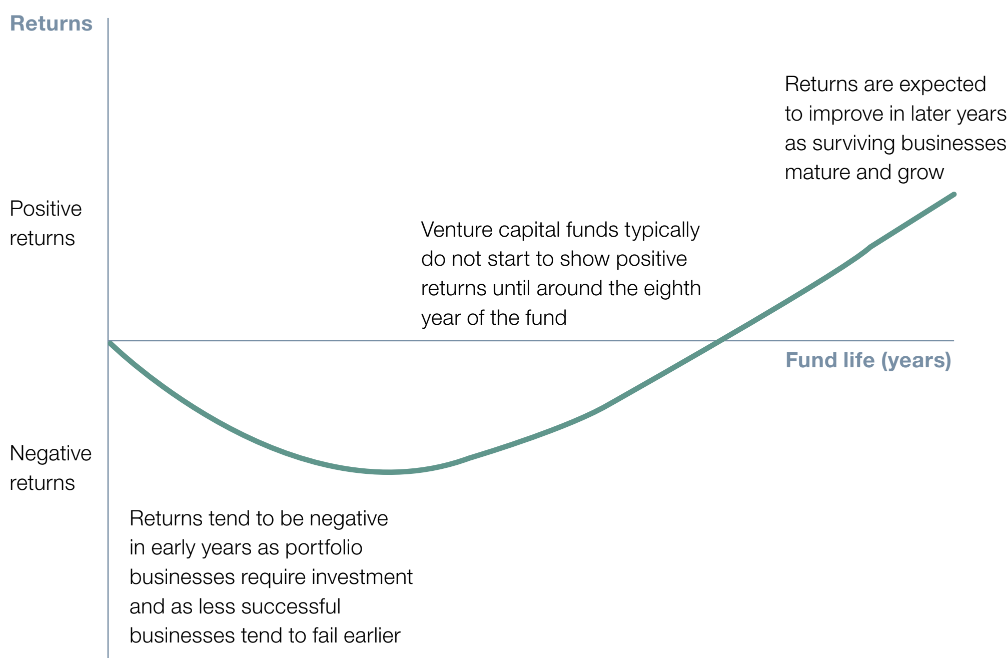
Financial performance

Financial performance in context

2.14 None of the Department's funds have reached the end of their life when it becomes possible to judge performance fully. In this report their financial performance is estimated using interim internal rates of return. The internal rate of return is one of the usual measures of performance used in the venture capital industry and represents the percentage discount rate at which the net present value of all cash flows between investors and the fund equals zero and where an internal rate of return in excess of the Government's cost of capital (currently 3.5 per cent) indicates a profitable investment. **Figure 9** illustrates the "J-curve" profile of expected returns over the life of a venture capital fund where, on average, positive returns only occur around year eight. Experts in the sector suggested that it is reasonable to start to form an opinion on a fund's potential performance from its fifth year. Therefore in this section we only consider the financial performance of the UK High Technology Fund, the Regional Venture Capital Funds and the Bridges Funds.[7]

Figure 9

The profile of returns expected over the life of a venture capital fund



Source: National Audit Office

7 The Early Growth Funds launched in 2004 were less than five years old when the most recent data were collected.

Trends in the European venture capital industry

2.15 European venture capital returns are considerably less than those in the United States. For example the 10-year average internal rate of return for US venture funds (1997-2006) was 20.5 per cent compared to 6.8 per cent in Europe.[8] There is wide acknowledgement that European performance has been poor over the last decade. The persistently negative returns have been attributed partly to the end of the "dot.com" era when the valuations for technology companies collapsed. This legacy will affect the performance of funds launched around this time whether private or Government led. **Figure 10** shows the performance of (a) the UK High Technology Fund and (b) Regional Venture Capital Funds[9] compared to a cohort of funds similar in size and vintage. Private venture capital funds, however, would inherently be expected to outperform the Regional Venture Capital Funds because they have fewer investment restrictions.

Performance of the Department's funds

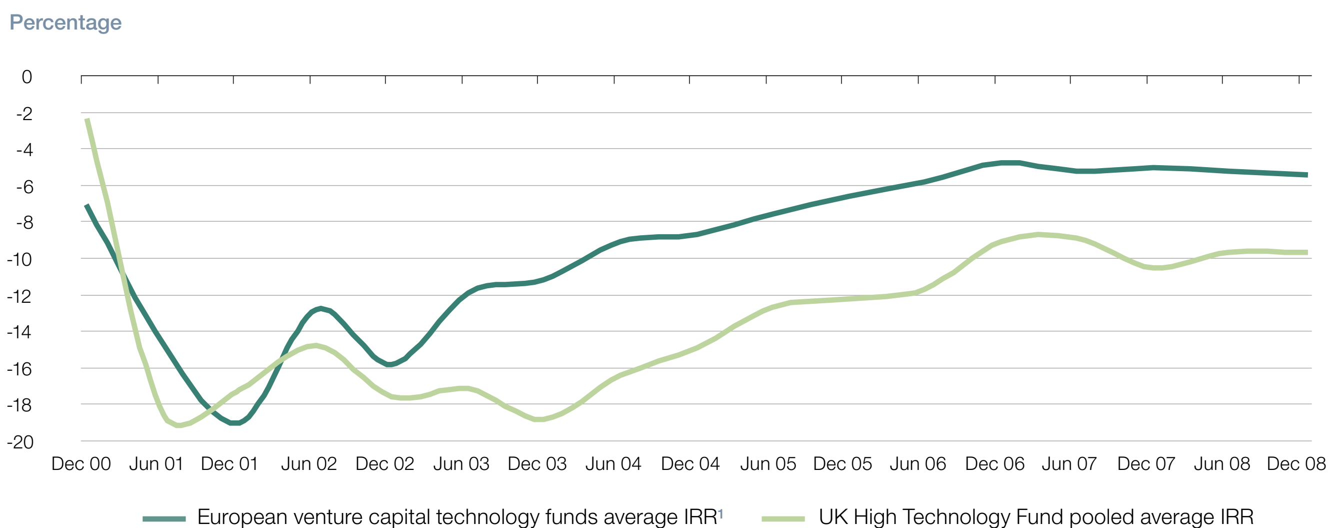
2.16 For each of the three earlier funds we analysed their interim pooled average internal rate of return and the extent to which funds had been able to make successful exits using their most recent data. We also looked at cumulative fund management costs relative to total investment. While cumulative costs will continue to rise, final proportionate costs are not yet known.

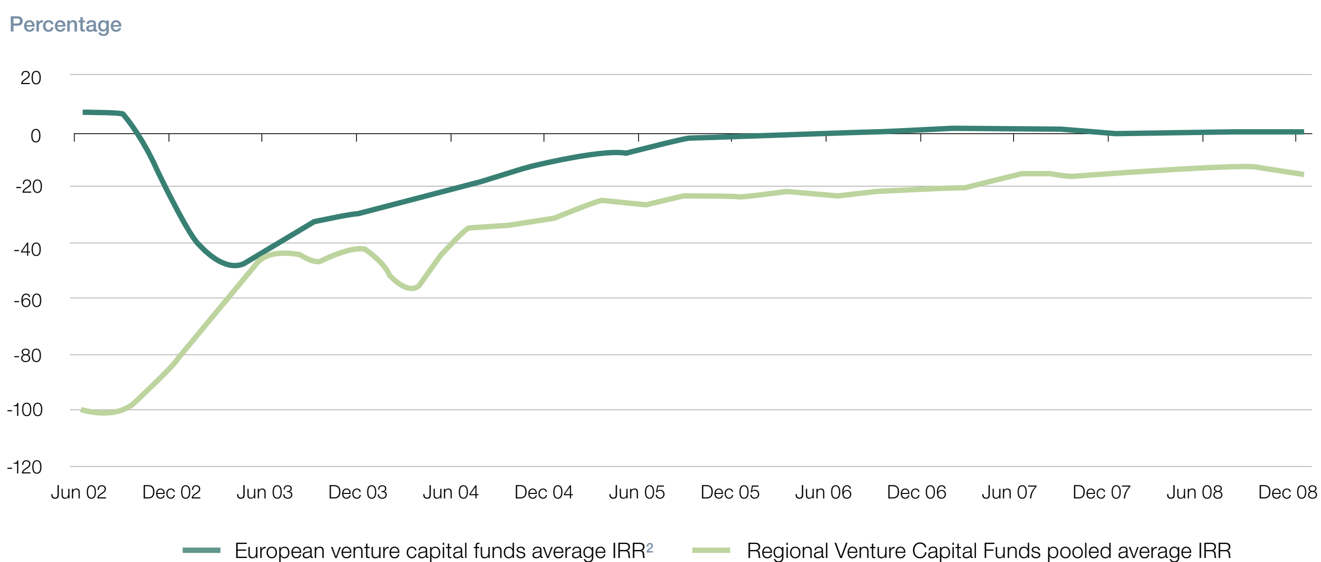
- **UK High Technology Fund:** The interim pooled average internal rate of return at December 2008 was minus 9.7 per cent. Our analysis showed this was below the pooled average of comparable European venture capital technology funds of minus 5.4 per cent. Only one of the nine underlying funds invested from the UK High Technology Fund showed a positive internal rate of return. Of 245 investments the fund had made 29 successful exits. The design of the fund is such that private investors receive a preferred return on their capital plus 10 per cent, provided funds perform sufficiently well to deliver this. The Government takes the first losses and only receives a return after the private investors have received their preferred return. The cumulative fund (including underlying funds) management costs to December 2008 were £19.5 million, 17 per cent of the total invested.

8 *Recent Developments in the European Private Equity Markets*, Kristiina Raade and Catarina Dantas Machado, European Commission Economic Paper 319, April 2008.
9 It was not possible to identify a cohort of private funds similar to the Bridges Funds because of their specialised nature.

Figure 10

Performance of (a) UK High Technology Fund and (b) Regional Venture Capital Funds relative to European venture capital funds





Source: Thomson Reuters database, National Audit Office

NOTES

1 Internal rate of return for European venture capital technology funds of sizes £32.7 – 163.4 ($50-250) million and launched in 2000, the same vintage as the first UK High Technology Fund underlying funds.

2 Internal rate of return for European venture capital funds up to £53 ($80) million in size and launched in 2002, the same vintage as the first Regional Venture Capital Funds.

3 Fund size values have been converted using average exchange rates during the year the funds were launched.

- **Regional Venture Capital Funds:** As at December 2008 all nine funds showed negative returns and the interim pooled average internal rate of return was the lowest across all the fund types at minus 15.7 per cent. European venture capital funds of a similar size but with fewer investment restrictions have an interim pooled average return of minus 0.4 per cent. Returns to the Government and to other investors are allocated in the same way as for the UK High Technology Fund. In its most recent Accounts (based on valuations at 31 March 2009) the Department values the £74 million invested in the funds at £5.9 million, after paying the other investors' preferred return out of its own capital commitment. Of the 356 investments only 18 successful exits have been made across the funds – one fund has yet to make an exit. The cumulative fund management costs to December 2008 were £46.1 million, 36 per cent of the total invested. This is relatively high largely because several funds invested below expectations.

- **Bridges Funds:** The funds showed a positive interim pooled average internal rate of return of 7.7 per cent at September 2008. The funds have fewer constraints on its investment activities than other funds – notably its ability to invest in property. The rate of return, however, has fallen from a peak of 17.4 per cent reflecting the economic downturn and the decline in the value of its property-backed investments. The funds have a good exit record – three of 28 investments have generated sufficient returns to pay for about half the cost of one of the two funds. The cumulative fund management costs to September 2008 are £7.7 million, 29 per cent of the total invested, again relatively high but due to one of the two funds under-investing with investors' agreement to retain a contingency for follow-on investments. The same fund carries similar subordination in favour of private investors to the other early funds, such that the taxpayer could bear the costs if fund performance deteriorates further.

2.17 Figure 11 shows that of the 810 businesses that received equity finance through the Department's programme since 2000, 576 remain in the portfolio. Exits through a sale or Initial Public Offering are taken in the industry as another measure of success. A total of 45 profitable exits to date have been made, but Capital for Enterprise Limited does not report an aggregate value for exits across all funds. Prospects for exits of remaining portfolio businesses have declined because the current economic downturn has severely limited opportunities. A further 189 investments were written off by fund managers where businesses had failed, or generated exits where proceeds were below the cost of investment. We calculated that the 45 profitable exits to date generated net proceeds of £250 million, but taking these together with exits below cost and write-offs the funds have generated net proceeds of £11 million to date. A healthy level of write-offs is expected in the venture capital industry reflecting the nature of risk involved and the need for fund managers to focus on their better investments. The level of write-offs in the programme to date is not unusual and indeed may be less than is usual given the high failure rate for early stage businesses of 66 per cent.

2.18 Analysis of the three early fund types (paragraph 2.16) shows the Department subordinated its investment in favour of private investors so they would be encouraged to invest, typically allowing its investment to be drawn down first, taking first loss and giving other investors a priority return. While this helped the funds to attract other investors, it left taxpayers exposed to losses and bearing fund management costs if the funds performed poorly. Analysis by Professor Gordon Murray for the National Audit Office of Government-backed venture capital interventions in other countries shows that subordination of Government investment returns or the provision of downside guarantees to private investors are less commonly employed than proportionate return distributions to all investors. The recent Enterprise Capital Funds are more consistent with international Government venture capital interventions and offer the Department better protection against poor performance, although other investors will receive proportionately more than taxpayers in the event that the fund is successful.

Figure 11

Businesses benefiting from the Department's funds as at 31 December 2008

Fund	Year commenced	Surviving businesses	Profitable exits[1]	Write-offs[1]	Invested businesses	Average investment £'000
UK High Technology Fund	2000-02	166	23	56	245	457
Regional Venture Capital Funds	2002-03	247	18	91	356	373
Bridges Funds	2002	18	3	7	28	946
Early Growth Funds[2]	2002-04	101	1	34	136	154
Enterprise Capital Funds	2006-08	44	0	1	45	854
Total		**576**	**45**	**189**	**810**	**408**

Source: National Audit Office analysis of Capital for Enterprise Limited data

NOTES

1 Profitable exits are those where proceeds exceeded the cost of the investment. "Write-offs" include exits where proceeds were below cost.

2 The Figure does not include 85 businesses that received finance through the Early Growth Fund with debt options.

Factors influencing the performance of the funds

2.19 Recent academic research has identified a number of factors that tend to improve the chances of a successful venture capital fund, including a flow of good quality deals; the timing of investments; broad geographic coverage; larger fund sizes; and the ability to exit individual investments on a timely basis. In the light of this evidence, the Regional Venture Capital Funds suffered limitations against all of these criteria to varying degrees. The pool of viable business ideas to choose from was restricted by investment criteria, in particular the regional focus of the funds. The funds were also small (eight of the nine funds ranged from £12-30 million) with a limit of £500,000 on the size of individual investments (see paragraph 2.8). Small fund sizes also make it more difficult to cover the high fixed costs of fund management.

Comparisons with other publicly-supported funds

2.20 There is very little information available internationally on the performance of government supported funds, particularly internal rate of return measures. Other equity funds have been established by public sector bodies in the UK, for example several Regional Development Agencies have set up funds. These funds often contain a loan component which limit their comparability with the Department's funds and tend to have different objectives, for example job creation. We were further unable to compare the financial performance of these funds with the Department's funds because in general rates of return were not calculated for regional funds, whose focus is more on collecting and reporting other performance measures such as the numbers of businesses and jobs created and safeguarded.

2.21 The only domestic comparison we have identified is the Scottish Co-investment Fund launched in 2003 by Scottish Enterprise and subject to three evaluations to date in 2006, 2008 and 2009. The internal rate of return on this fund was negative (minus 1.8 per cent) in 2008, projecting a more positive final position than the pooled average return on the Regional Venture Capital Funds. The fund is not, however, directly comparable because, while it is of a similar vintage, it has several structural differences – it is a co-investment fund and has no specified life. While it initially carried the same investment limit as Regional Venture Capital Funds this was extended to £2 million in 2007. There is also no publicly available information on the cost of the fund to allow for a full comparison.

Part Three

Management of the funds

3.1 This Part examines management of the funds by Capital for Enterprise Limited, including: oversight by the Department; the arrangements for selecting and overseeing the work of fund managers; and an assessment of the Department's development of funds as the programme has evolved.

Governance and the role of Capital for Enterprise Limited

Role and relationship with the Department and other stakeholders

3.2 Capital for Enterprise Limited was established by the Department on 1 April 2008 to strengthen the delivery and oversight of the programme of funds. The Department's rationale for establishing a separate delivery organisation was based on an identified need to professionalise Government's interventions in the small business finance market, in particular through establishing a close involvement and presence in the market.

3.3 Overall responsibility for the venture capital programme and policy in this area remains with the Department. The Department has recently established a governance structure to ensure that it is discharging its duties to monitor Capital for Enterprise Limited's activities including monthly review meetings with the Chief Executive and frequent attendance at Board meetings and Audit Committees. Procedures are being put in place to ensure that senior officials in the Department are aware of any key issues and risks arising from this oversight activity.

3.4 The governance arrangements within Capital for Enterprise Limited compare favourably with private sector practices for similar sized companies. There is oversight through an independent Board consisting of a Chairman and four other non-executive members, in addition to the Chief Executive. Past experience of non-executive Board members includes starting and operating a successful small business, and fund management experience in both public and private sectors. Board members were recruited and appointed under best practice Corporate Governance processes.

3.5 Capital for Enterprise Limited management and staff are drawn from a mix of backgrounds with an understanding of commercial investment, private sector finance and public sector policy. By July 2009 the company had 14 full-time equivalent staff, five of whom work on the venture capital programme. Two senior posts are filled by individuals involved in the planning and management of the funds in the Department, and the Chief Executive has private sector fund management experience. Capital for Enterprise Limited is moving to supplement senior management expertise through an external appointment.

3.6 Staff costs of £925,000 in 2008-09 represent nearly half the annual administrative cost of running Capital for Enterprise Limited. The highest paid director was the Chief Executive who received an annual salary in the band of £115,000–£120,000, which is not out of line with the salaries received by senior officials in similar delivery-focused organisations across Government. Remuneration of officials is overseen by a remuneration sub-committee of the Board which operates within HM Treasury's pay remit guidelines. Capital for Enterprise Limited operates a performance related pay scheme and has developed a performance appraisal framework that focuses on programme and delivery objectives rather than on the financial performance of the business or the funds.

Oversight of fund managers

Selection

3.7 The selection of fund managers is of paramount importance to the success of the funds. Until 2009 fund managers had been selected through open competition processes, which we found had been conducted thoroughly and professionally. Fund managers we interviewed, including some who had been unsuccessful in some competitions, considered the selection process in these instances had been fair.

3.8 The recent competition to appoint fund managers for the Capital for Enterprise Fund, however, was not put out to the open market. The Department believed it needed to act quickly to get the funds up and running in the midst of a deteriorating economic climate and constrained investment market. Capital for Enterprise Limited identified a range of potential fund managers with the experience and capacity to manage the fund and invited them to submit bids. In the circumstances, we consider this approach was appropriate.

Investment mandate

3.9 Individual investments made by fund managers must comply with the Limited Partnership Agreement and meet minimum conditions set by Capital for Enterprise Limited. While there are formal restrictions on what sectors can be invested in for some of the funds, managers are expected to use their discretion and judgement. Each fund has an Investment Advisory Committee which advises on, but cannot direct or veto, the fund manager's decisions.

Performance and remuneration of fund managers

3.10 There is evidence that businesses have benefited from support from fund managers beyond the provision of finance. In the surveys of businesses, 73 per cent considered their fund manager to be very or fairly helpful. Respondents cited support through the fund manager's role as a non-executive director; in seeking to raise further finance; developing and improving marketing; helping with recruitment of key staff; helping to develop business plans and strategies; and providing general business advice. Case study 4 at supplementary Appendix 3 at www.nao.org.uk provides an example of a fund manager providing practical help to a business.

3.11 Underperformance by fund managers is picked up by Capital for Enterprise Limited through identification of outliers when evaluating performance data, but there are limited formal levers available to address this other than termination of the contract. There is, however, evidence that Capital for Enterprise Limited has used its influence to take corrective action. For example, reductions in management fees amounting to £0.7 million (some 8 per cent) regarding two of the Regional Venture Capital Funds were negotiated in 2004 because of lower investment than initially expected.

3.12 Remuneration levels are determined by the bid made by the fund manager prior to selection and appointment. An annual management fee is paid to the fund management company and is intended to cover the cost of investment activities including salaries. Fund managers also receive a share in the profits when the fund is fully divested of all the investments in its portfolio equivalent to a pre-determined percentage of the capital gain of the fund. This share is typically 20 per cent which is within the acceptable range found in the private sector for small funds which have been managed by the same fund manager from launch. The managers will not receive any profit share if the early funds continue to under-perform.

3.13 The management fee for each of the Department's funds varies between two and three per cent of the total fund size for the initial investment period compared to between two and 2.5 per cent typically received in the private sector, private funds tending to be larger. The management fee has reduced over time and for the new Capital for Enterprise Fund is below two per cent. To align fees more closely to the amount of effort required, Capital for Enterprise Limited has moved away from fees based on the value of investments in the early funds to fees based on cost of extant investments in the Enterprise Capital Funds. A sample of Regional Venture Capital Fund managers told us that their basic salary lay in the range of £50,000-£90,000 per annum. While not directly comparable because it includes private equity funds and considers salaries for more senior fund managers, the May 2007 industry average for Heads of Equity Fund Management was in the range of £116,000-£130,000 per annum.[10]

10 *City Pay Guide, May 2007* quoted by KPMG in work for the National Audit Office report *Department for International Development oversight of CDC Group plc*, HC 18 2008-09.

3.14 Over time the fees paid to fund managers can add to a sizeable proportion of the investments made. Over £40 million had been paid, for example to the managers of the Regional Venture Capital Funds to December 2008. In remunerating fund managers the Department is seeking to minimise these costs but needs to set them high enough to attract good quality fund managers. Management fees represent the largest single element of operational costs at some £15 million in 2008, compared to Capital for Enterprise Limited operational costs (including non-venture capital roles) of £2.5 million.

(iii) Learning from monitoring and evaluation

Formal evaluation of funds

3.15 The design of funds launched to date has not been informed by the results of formal lessons learned exercises or any assessment of the programme as a whole as it has evolved. A formalised process would provide the Department with more informed decision-making where funds are launched in relatively short succession, as happened with the early fund types, and where there is insufficient time to wait for a formal evaluation.

3.16 There is evidence that the Department undertook some preliminary thinking about the evaluation of the early funds, but on the basis that it considered it was too early to evaluate most funds fully, there was no formal evaluation until it began an interim evaluation of the Regional Venture Capital Funds and Early Growth Funds in November 2008. The focus of this evaluation is on capturing the wider economic benefits with a view to estimating the net additional benefits of the funds. The Department plans to publish results in late 2009, and plans subsequent interim evaluations of the other funds in due course. This evaluation approach is limited as it does not look at financial performance or evaluate achievements against all of the stated objectives for the funds. It is difficult to measure the delivery of additional benefits because of the absence of baselines. Professor Gordon Murray reported similar problems with evaluation frameworks of government venture capital programmes in other countries.

3.17 In the absence of formal lesson learning and evaluations the Department has taken some steps to gather information on potential success factors, bringing together the views of interested parties on its proposals and the experience gained by officials managing the funds to inform subsequent fund design. Examples of the changes made as a result include the revised risk and reward arrangements on the Enterprise Capital Funds, and the decision to launch these funds over a series of rounds to mitigate the effect of a poor vintage year. Steps taken include:

- drawing on the advice of its Expert Group on access to finance issues;
- commissioning analysis on the equity gap and undertaking modelling of different potential outcomes from the Enterprise Capital Funds; and
- consulting widely on proposals for funds, although Regional Development Agencies said they did not fully understand the basis on which the Department reached its decisions on the design of more recent funds.

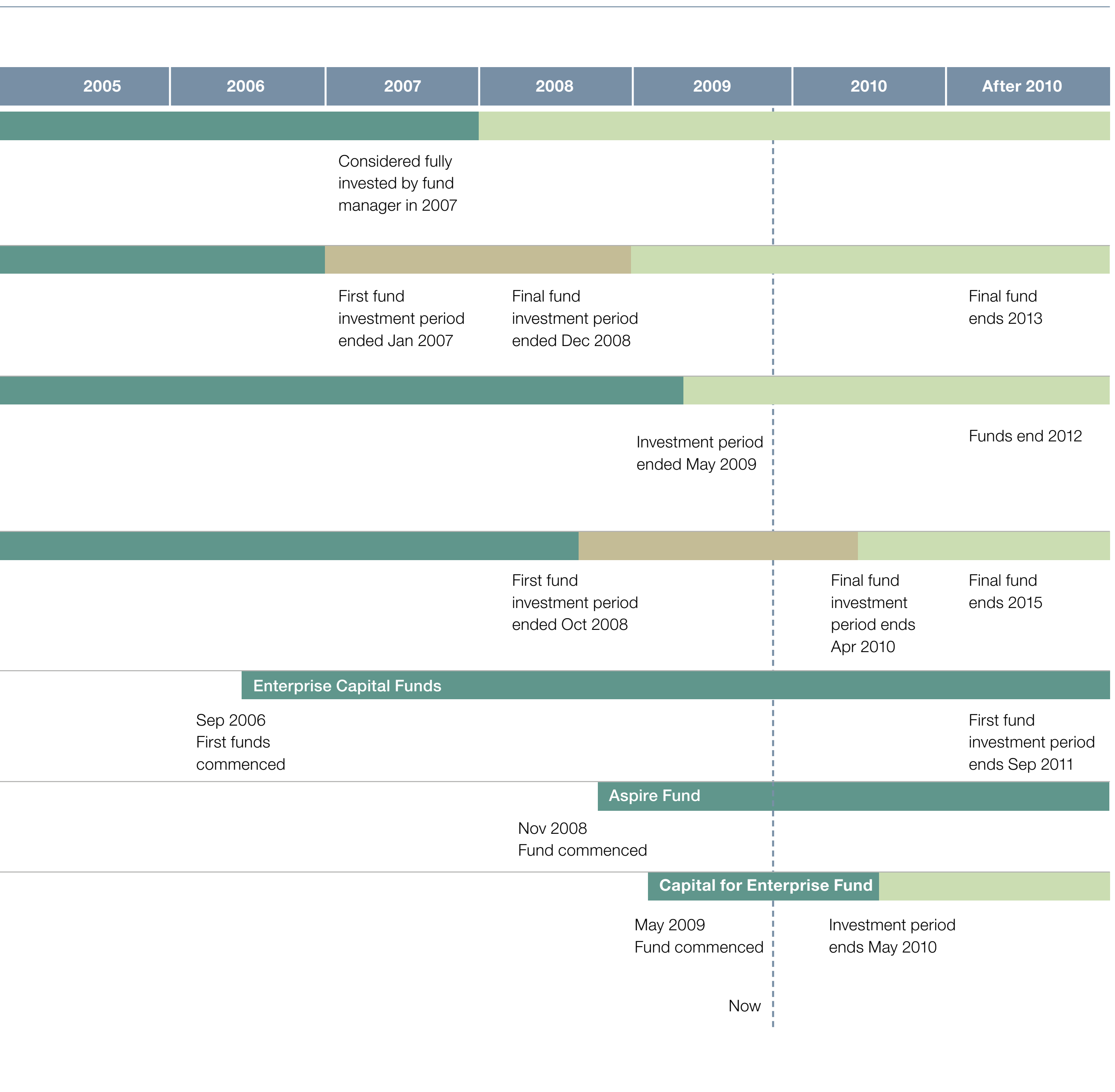
Ongoing assessment of the programme

3.18 Monitoring by Capital for Enterprise Limited focuses on financial performance, with limited review of performance by the Department against other objectives. Since April 2008 financial information is collected and analysed by Capital for Enterprise Limited and reported to the Department at quarterly intervals. Fund managers report quarterly to Capital for Enterprise Limited on portfolio performance, valuation and investment activity. Monitoring of the long term performance of businesses in receipt of funding is also important for capturing long term economic impacts. Until 2008 the Department did not collect or report information on the success of businesses once they are divested from the funds but is now putting in place plans to track businesses more effectively.

3.19 There is also almost no performance information about the funds in the public domain. The Department has sought to protect the commercial nature of some of the information. Our work suggests this lack of published information is not out of step with practices in other countries. But one of the objectives of the early funds was to demonstrate to investors that commercial returns could be made. Aside from this report, there is currently no information published on the extent to which the funds have been committed, how many investments have been made, and the number of successful exits and write-offs. There is also very little information available about successful investments and limited marketing of these and the funds generally by the Department. The Department believes marketing should rest with fund managers and target serious applicants. Case study 6 at supplementary Appendix 3 at www.nao.org.uk illustrates the views of some businesses about the visibility of the funds.

Appendix One

Timeline



2005
2006
2007
2008
2009
2010
After 2010
Considered fully invested by fund manager in 2007
First fund investment period ended Jan 2007
Final fund investment period ended Dec 2008
Final fund ends 2013
Investment period ended May 2009
Funds end 2012
First fund investment period ended Oct 2008
Final fund investment period ends Apr 2010
Final fund ends 2015
Enterprise Capital Funds
Sep 2006 First funds commenced
First fund investment period ends Sep 2011
Aspire Fund
Nov 2008 Fund commenced
Capital for Enterprise Fund
May 2009 Fund commenced
Investment period ends May 2010
Now

Appendix Two

Study methods[11]

Method	Purpose
Analysis of fund performance data	To assess the historical financial performance of the funds[12] including rates of return, exits, the potential profit share arrangements at the end of the funds' lives and to compare returns against domestic and European venture capital funds.
Analysis of cost data	To assess the level and value of investments and component costs of managing the programme.
Analysis of individual investments made by each fund	To assess how effectively investments have targeted the equity gap.
Analysis of international comparisons	To gather data on and compare the key features and management of similar funds established overseas against the UK's experience.
Semi-structured interviews: • Nine Regional Development Agency representatives • 12 fund managers • Department and CfEL officials/ non-executives • Other Government Departments • Industry stakeholder organisations	To gather evidence on how the Department has designed, implemented and managed the programme, to gather evidence on the equity gap and how the intervention is perceived to have targeted it and to gather contextual evidence on the venture capital industry.
Literature review	To provide context on the venture capital industry, to assess the available evidence on the factors which influence the performance of venture capital funds and evaluate how performance of other funds compares to the Department's funds.
File and document review	To gather evidence on how the Department has designed, implemented and managed the programme.
Telephone survey of 198 businesses in receipt of funding	To assess the perceptions of those businesses which have received investment in terms of the reasons for applying, the application process, the impact of the funding and the role of fund managers.
Case study interviews with 13 businesses	To assess examples of businesses' experiences after receiving funding covering a range of scenarios including businesses which became successful, businesses which failed and businesses which struggled but managed to survive.

11 A more detailed outline of our study methods is at supplementary Appendix 1 at www.nao.org.uk
12 Early Growth Funds, Enterprise Capital Funds, the Aspire Fund and the Capital for Enterprise Fund were not analysed as they are insufficiently mature to draw conclusions.

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