National Audit Office

The Department for Business, Innovation and Skills

Venture capital support to small businesses

Supplementary Appendices One to Three

Contents

Appendix One

Study methods

1 This section outlines the research methods used in the course of our examination.

Study Scope

2 This report looks at the Department's programme of venture capital funds which support small businesses seeking equity based finance. The scope of the report does not include Government provision of debt finance or tax incentives for small businesses, nor does it attempt to look in detail at "investment readiness" programmes within Government which assist small businesses in preparing their business plans so that they can pitch their propositions to investors more effectively.

3 The objective of this report is to establish whether the Department's intervention in the equity funds market in support of small businesses has been delivered effectively through answering three key questions:

- Were the equity funds well designed and consistent with the Department's objectives?
- Has the management of the equity funds programme been well executed by the Department?
- Has the performance of the equity funds to date demonstrated that the Department's objectives have been met?

Methodology

4 The following research methods were used in the course of this study:

- Semi-structured interviews.
- Literature review.
- File and document review.
- Survey of businesses.
- Case study interviews with businesses.
- Analysis of fund performance and other quantitative analysis.
- Analysis of international comparisons.

Semi-structured interviews

5 To obtain a complete view of how the Department manages the programme we interviewed officials at the Department and Capital for Enterprise Limited and had meetings with the Department's Access to Finance Expert Group and the non-executive directors on the Capital for Enterprise Limited Board. We also interviewed representatives with access to finance responsibilities at each of the nine Regional Development Agencies and twelve fund managers working across the Department's programme of funds. We interviewed a number of third parties within Government to understand their interest in and understanding of access to equity finance issues, including HM Treasury, the former Department for Innovation, Universities and Skills and the Office of the Third Sector. We also interviewed a number of independent third parties with a role in the industry including the British Venture Capital Association, the National Endowment for Science, Technology and the Arts, the British Business Angels Association, the Confederation of British Industry and the British Bankers' Association.

Literature Review

6 The study team examined academic literature and reports by organisations with an interest in venture capital and the equity gap. Documents reviewed included:

- *Assessing the scale of the equity gap in the UK economy: report to HM Treasury and SBS* (Rebecca Harding, Marc Cowling and Gordon Murray: November 2003).
- *Factors Determining the Performance of Early Stage High-Technology Venture Capital Funds*: *A Review of the Academic Literature* (Anna Söderblom: 2006).
- *Profit distribution and compensation structures in publicly and privately funded hybrid venture capital funds* (Mikko Jääskeläinen, Markku Maula, Gordon Murray: 2007).
- *Recent Developments in the European Private Equity Markets* (DG Economic and Financial Affairs, European Commission Economic Papers 319, Kristiina Raade and Catarina Dantas Machado: April 2008).
- *Shifting Sands: The changing nature of the early stage venture capital market in the UK* (NESTA; Yannis Pierrakis and Colin Mason: September 2008).
- *Twelve Meditations on Venture Capital: Some observations on dissonance between theory and practice when applied to public/private collaborations on entrepreneurial finance policy* (Gordon Murray, David Lingelbach, John Hopkins: September 2008).
- *Policy Options and Instruments for Financing Innovation: A practical guide for early stage financing* (United Nations Economic Commission for Europe: 2009).

File and document review

7 We have reviewed a range of external documentary evidence, including:

- The Department's documentation in relation to establishing and operating the funds including White Papers and Strategy documents, Rationale, Objectives, Appraisal, Monitoring and Evaluation (ROAME) statements, State Aid documents and Departmental file records.
- Key governance documents setting out the relationships, roles and responsibilities of the parties involved in the programme including the Framework Document and Investment Management Agreement which governs the relationship between Capital for Enterprise Limited and the Department, and Limited Partnership Agreements and Grant Offer Letters governing the relationships between fund managers and Capital for Enterprise Limited.
- Documents commissioned by the Department to evaluate the impact and performance of the funds to date including an unpublished early review of Regional Venture Capital Funds undertaken by KPMG in 2003, an assessment of the equity gap undertaken by SQW in 2008-09 and papers relating to the evaluation of Regional Venture Capital Funds and Early Growth Funds undertaken by the Department's Analytical Unit during 2009.
- Bids put forward by a range of individual fund managers to apply to manage funds.
- Financial documentation including Capital for Enterprise Limited's equity portfolio reports and individual performance reports from each of the funds (excluding Enterprise Capital Funds, the Aspire Fund and the Capital for Enterprise Fund).

Census of businesses

8 To understand more about the perspective of businesses in receipt of venture capital funding in terms of their rationale for applying for funding, the process of applying and the impact of the funding on their business, the National Audit Office commissioned GfK NOP to undertake a telephone census of businesses funded through the UK High Technology Fund, the Bridges Funds and the Enterprise Capital Funds. In parallel with this work the Department's Analytical Unit commissioned Ci Research to undertake a telephone census of businesses in receipt of Regional Venture Capital Fund and Early Growth Fund support. We agreed that our census would therefore not cover Regional Venture Capital Funds and Early Growth Funds to avoid duplication of effort. In order that we could use the Department's results alongside our own results we liaised closely to ensure consistency in terms of the contents of our respective questionnaires.

9 We provided GfK NOP with a total population of 132 businesses and a total of 66 interviews were achieved. The breakdown for individual funds is UK High Technology Fund: 35 interviews from 82 contacts, Enterprise Capital Funds: 25 interviews from 34 contacts and Bridges Funds: six interviews from 16 contacts.

10 The Department provided Ci Research with a total population of 344 businesses and a total of 132 interviews were achieved, consisting of 90 interviews from 220 Regional Venture Capital Funds contacts, and 42 interviews from 124 Early Growth Funds contacts.

Case study interviews with businesses

11 The National Audit Office commissioned Gfk NOP to undertake a follow-up set of 12 telephone interviews based on qualitative topic guides. Fund managers were approached to help us identify a sample of 13 businesses drawn from all of the Department's funds and covering a range of scenarios which we wanted to explore in more detail. These scenarios were:

- Businesses that had received funding and been successful (six interviews).
- Businesses that had received funding but subsequently failed (two interviews).
- Businesses that had received funding and had performed poorly but had managed to turn this around (two interviews).
- Businesses that had applied unsuccessfully for funding but had gone on to be successful without it (three interviews).

Analysis of fund performance

12 Enterprise Capital Funds, the Aspire Fund and the Capital for Enterprise Fund were excluded from our financial analysis since having only been established in 2006, 2008 and 2009 respectively there is limited data available and an assessment of financial performance would not be meaningful. Similarly the Early Growth Funds were excluded since the final three of the seven individual funds were launched in 2004, and with only four years of data it was too early to make a meaningful assessment of their financial performance.

13 The historical financial performance of each of the UK High Technology Fund, Regional Venture Capital Funds and Bridges Funds was analysed for each individual fund and on a pooled average basis for the fund as a whole, in terms of two key measures widely used in the venture capital industry; the investment ("cash") multiple and the internal rate of return (IRR). The investment multiple (for active funds) expresses total distributions from funds to investors plus net asset value (NAV) as a multiple of the value originally invested or drawn down from investors. The internal rate of return is the value of the discount rate at which the net present value of all cash flows equal zero. An IRR in excess of the Government's cost of capital (currently 3.5 per cent) indicates a profitable investment. Our report makes use of the IRR which (unlike the cash multiple) takes account of the time value of money.

14 We also analysed funds against a number of other performance measures including investment rates, number of funded businesses, exits for profit, write-offs and total returns on realised investments.

15 Our analysis of the performance of European venture capital funds over the same period was based on data from the Thomson Reuters database which is a single source of information covering venture capital and private equity buy-outs performance since 1969. For the UK High Technology Fund and the Regional Venture Capital Funds we identified a cohort of similar private funds launched around the same time and, in the case of the UK High Technology Fund, from the same sector. There were too few private funds with characteristics similar to the Bridges Funds to establish a cohort for comparison.

Other quantitative analysis

16 Using Capital for Enterprise Limited data and GIS mapping we analysed the geographic distribution of businesses in receipt of support from each of the Department's funds, and compared the resulting proportions with the geographic distribution of fund managers. We also analysed the sectoral breakdown of businesses in receipt of support from each of the Department's funds. We drew together from Capital for Enterprise Limited's data the numbers of surviving businesses, exits, write-offs and average investment for each of the Department's funds.

Analysis of international comparisons

17 The National Audit Office commissioned Professor Gordon Murray supported by Dr Louis Liu of Exeter University to undertake a data collection exercise to allow the National Audit Office to understand the extent of publicly sponsored venture capital programmes in other countries. Where there was information available Professor Murray was able to provide us with a breakdown of the key features of the programmes and some details of how they have been delivered by different Governments. Professor Murray was able to identify 31 programmes in 16 countries. Professor Murray also provided us with a short synopsis of his findings. Our summary of this work is available at Supplementary Appendix 2.

Appendix Two

UK Government backed venture capital schemes in the context of overseas state supported venture capital schemes

1 This paper summarises analysis undertaken by the National Audit Office based on a sample of ten overseas funds (**Figure 1**) which have a significant public participation by the state in the total of funds raised and invested and are therefore broadly similar in nature to the UK Government's programme of funds. The funds summarised are characterised by their use of risk capital funding at early stage investment in support of small businesses. The sample was selected from data collected and analysed by Professor Gordon Murray supported by Dr Louis Liu of Exeter University and is based on publicly available information about the funds. Policy officials and academics with specific knowledge of the schemes were invited to comment on and augment the information gathered.

Fund objectives and focus

2 **Figure 2** on pages 8 and 9 sets out the key objectives and focus for each of the funds in the sample. The core objective of funds is to provide public support for the creation and early growth of new, high potential firms. There is also frequently a wider aim to promote increased innovation and, ultimately, revenue and employment growth. This differs from the UK where wider economic objectives were not explicitly defined. The funds have all been specifically created to address a perceived failing in the provision of venture capital available to start-up and early stage businesses. Some schemes have specific additional objectives, for example the Governments of Finland, Denmark and Israel intended their funds to promote the internationalisation of their domestic venture capital industry by stimulating both national and international investment.

3 Most funds are structured on a national rather than a regional basis with the exception of the LSVCC Fund in Canada and the Swedish Industrial Development Fund. There are, however, some Governments such as Finland and the Netherlands which attach importance to regional development and explicitly use national funds to address marked geographical disparities in venture capital investment within the country. The FPCR Fund in France goes further than being a national fund and provides investment to European companies more widely.

Figure 1

National Audit Office sample of Government venture capital funds overseas providing support to small businesses

Country	Fund	Year established	Administering ministry/organisation
United States of America	Small Business Investment Company (SBIC)	1958	US Small Business Administration
Australia	Innovation Investment Fund (IIF)	1997	Innovation Australia
Finland	Finnish Industry Investment Ltd (FII)	1995	Ministry of Trade and Industry
Israel	Yozma	1993	Government of Israel
Canada	Labour Sponsored Venture Capital Corporation (LSVCC)	1983	Canadian state and provincial government
Netherlands	Technostarter fund	2005	Ministry of Economic Affairs, Ministry of Education, Culture and Science
Denmark	The National Danish Investment Fund (Vækstfonden)	1992	Government of Denmark
Sweden	Swedish Industrial Development Fund	1979	Government of Sweden
France	Fund for the Promotion of Venture Capital (FPCR)	2000	Caisse des Dépots et Consignations – a Government owned investment management organisation and the European Investment Bank
Germany	High-Tech Start-Up Fund	2005	The Federal German Government

Source: National Audit Office analysis of data collected by Professor Gordon Murray

Figure 2
Objectives and focus of the sample of overseas schemes

Country	Objectives	Focus: Geography	Focus: Sector
United States	To supplement the flow of private equity capital and long term loan funds for the sound financing, growth, expansion and modernisation of small businesses while ensuring maximum participation from private finance sources.	National	No preference
Australia	**1** To encourage development of new companies which commercialise research and development activity. **2** To develop a national self-sustaining, early stage, technology based venture capital industry. **3** Programme to be self-funding in the medium term. **4** To develop fund managers with experience in the early stage venture capital industry.	National	Broadly technology based
Finland	**1** To expand the supply of capital for innovative and internationalising enterprises in the growth stage and to promote the channelling to them of equity investments by private parties. **2** To promote the operations and internationalisation of the equity investment market. **3** To accelerate the commercialisation and internationalisation of the results of research and development. **4** To promote structural change in trade and industry in line with the aims of the trade and industry policy. **5** To boost enterprises' opportunities for growth and internationalisation. **6** To stimulate international investment and the networking of managerial activity.	National but activities have a regional focus	No preference
Israel	**1** To promote promising technological initiatives in Israel. **2** To encourage the involvement of major international investment houses in the Israeli technological sector. **3** To develop private sector management companies that would serve the Israeli venture capital industry. **4** To act as a flexible partner to international firms who wish to invest in the Israeli high-tech sector.	National	Emphasis on infrastructure and enabling technologies
Canada	**1** To empower local residents and workers in the ownership and decision-making of companies in their jurisdiction. **2** To foster economic growth and employment in a community, including regional development, enhancing financing for small firms, creating jobs, furthering worker education, and in some cases advancing the cause of unionised enterprise. **3** Many of the funds have stated that their principal objective is to achieve a profitable return.	Regional	No preference
Netherlands	**1** To stimulate and mobilise the bottom end of the Dutch venture capital market in such a way that the equity gap for high-tech start-ups is resolved. **2** To increase turnover for technology based start-up businesses.	National but some funds have regional focus	Technology

Figure 2
Objectives and focus of the sample of overseas schemes *continued*

Country	Objectives	Focus: Geography	Focus: Sector
Denmark	**1** To strengthen development and renewal in the Danish economy by procuring financing for promising projects in small and medium-size businesses by financing projects that others hesitate to, and work actively to strengthen business networks. **2** To create the best performing market for innovation finance in Europe by 2010. **3** Further improve the functioning of the Danish market to rank among top five in the world by 2015.	National	Technology
Sweden	To offer growth capital, competence and network to Swedish companies providing development capital for innovative technology start-ups and expansion capital for established companies that want to grow.	Regional	Broad technology based
France	To encourage private investment in French and European innovative companies less than seven years old in sectors where it is difficult to mobilise private funding.	National and European	Broadly technology and life sciences
Germany	To provide technology focused companies with start-up capital and ensure necessary support and supervision for their management and to achieve profitable exits.	National	Early stage technology and Research and development

Source: National Audit Office analysis of data collected by Professor Gordon Murray

4 Many funds are focused primarily on technology and knowledge-related sectors, although there are several generalist funds operating. This focus is perhaps unsurprising given that these sectors may allow for significant growth potential and may be where the equity gap is particularly acute.

Key features of the funds

5 **Figure 3** sets out some of the key features of the funds in the sample including the model, the size of investment, the level of public commitment, the deal size and the life of the funds. The usual model for funds is that of direct co-investment by the state in one or a small number of funds. Several funds in the sample, however, use a fund-of-funds model, allowing state investment in a range of different underlying venture capital funds. Analysis of the development of funds in advanced economies has shown that the fund-of-funds model is becoming increasingly prevalent, partly because the state is clearly removed from commercial decisions made by the funds. The limited partnership model as used in the UK, where the investors hire a commercial fund manager to manage the funds, is standard in private sector fund management and has been used extensively in publicly-supported venture capital programmes with the exception of Canada where funds are established as corporations and in Sweden where the state can on occasion be the sole investor.

6 The aggregate size of funds varies but inevitably the largest fund is the SBIC in the United States which was established in 1958. The percentage of public investment in a fund varies significantly between countries and individual programmes and ranges from 15 per cent in Sweden to 88 per cent in Germany. Most schemes set out an explicit maximum commitment of public funds, for example a public/private sector match of 1:1 or 2:3.

7 In terms of deal size, the smallest size of portfolio firm investment is in the Netherlands at £88,000 and some schemes do not set a lower limit for investments. Academic analysis of the success factors determining performance of funds suggests that making several small investments in an early stage fund is not a strategy for optimising returns. Following commercial venture capital practices, funds frequently have a cap on the maximum deal size either as an absolute figure or as a percentage of the total committed capital in the fund. Where this is on a percentage basis, as in Sweden, the maximum deal size can be comparatively large – currently around £14 million – which is above even the most generous estimates of where the equity gap lies. In the case of Sweden, however, this may also reflect that the scheme can provide development capital for mature firms.

8 Most funds have a limited life with the exception of the LSVCC fund in Canada which is an “evergreen” fund with an indefinite life. A typical fund has a closed life of around ten years which is consistent with private sector practices.

Figure 3
Key features of the sample funds

Country	Fund model	Size of fund/s	Public commitment as percentage of fund size	Deal size	Life of fund
United States	Fund-of-funds	£11.3bn	75 per cent of total fund size	£70.1m maximum	10 years
Australia	Direct investment in fund	£222m	Rounds 1 & 2: 62 per cent of total capital. Round 3: 50 per cent on individual fund basis.	Rounds 1 & 2: lower of £2m or 10 per cent of fund's committed capital. Round 3: lower of £5m or 20 per cent of fund's committed capital	10 years (with possible three year extension)
Finland	Fund-of-funds and direct investment	£503m	Maximum 50 per cent of total fund size	£8.8m maximum	5 to 10 years
Israel	Fund-of-funds and direct investment	£147m	Maximum 40 per cent of total fund size	Individual investments between £0.6m and £3.5m	Five years
Canada	Direct investment through corporations (not limited partnerships)	£5.6m	Not known	Not known	Indefinite life but with eight year lock-in
Netherlands	Fund-of-funds	£132m	50 per cent	£88,000 to £2.2m	Maximum 12 years
Denmark	Mainly direct investment but also fund-of-funds	£264m	67 per cent of fund 1 and 50 per cent of fund 2	£89,000	Not known
Sweden	Direct investment through regional funds and directly in companies	£135m	Between 15 and 50 per cent	Single investments cannot exceed five per cent of value of assets under management (currently around £14m)	5-10 years
France	Fund-of-funds	£132m	Up to 30 per cent	Between £13 and £32m	Five years
Germany	Direct investment through equity and convertible loans	£239m	88.2 per cent of total fund	Up to a maximum of £0.9m	12 years

Source: National Audit Office analysis of data collected by Professor Gordon Murray

NOTE

1 Exchange rates as at May 2009.

vPerformance requirements and distribution models

9 As in the UK where the current Enterprise Capital Fund model seeks to protect public investment by requiring a predetermined and preferential minimum return for the public sector the state often puts in place certain protections. This can be achieved through different devices such as stipulating commercial practices for funds as in the United States where to participate in the programme, a fund must apply for a license or more explicitly, for example, by specifying a period by which the fund is expected to become profitable, as in Finland (5-10 years) and the Netherlands (by 2010).

10 **Figure 4** sets out the profit distributions for each of the funds in the sample. As in the UK, it is unusual for funds to have established target rates of return for investors. Private sector investors would usually expect to achieve an adequate level of return comparable to that achieved through investing in other asset classes to justify continued investment or subsequent fund raising. Private sector returns, therefore, usually take precedence over financial returns to the state. Distribution of returns is frequently either on a pari passu basis or the private sector gains a greater proportionate share of distributions. It is common, however, for private investors to gain a majority share of additional profits so that the greater the overall return of the fund the greater the benefit to private investors. Offering downside protection to private investors as in the case of the early funds in the UK has occasionally been used overseas, but is less common than pari passu or proportionate distributions.

Evaluation

11 Only in a few cases has the state set out performance criteria for evaluating funds – these can be quantitative, for example in the Netherlands the state established a target for the number of investments made in a given period. Criteria can also be qualitative covering for example risk management issues as in Finland. The relative immaturity of many funds also means it is difficult to draw conclusions on how well commercial performance criteria have been met. Formal evaluation of funds undertaken by the state and made available in the public domain is very unusual. The most comprehensive, robust and transparent evaluation is judged by Gordon Murray to have been undertaken in Finland. More often, Gordon Murray considers that evaluation by independent academics has been hampered by limited availability and access to quantitative data. His analysis found that internal Government evaluations are rare and usually lack rigour, technical competence and detachment. Gordon Murray has observed that “Most programmes of public funds do not appear to define the evaluative methodology or the data collection that will be needed to be put in place by the time of the launch of a new programme. Formal evaluations too often appear both superficial and an after-thought to the programme execution itself”.

Figure 4

Profit distributions and downside protections for the sample of funds

Fund	Profit distributions	Downside protections
United States	Pari passu where state has 50 per cent of capital. Where less than 50 per cent state gets profit participation only and private investors get remainder.	None noted
Australia	Distributions are on the basis of capital share. Further profits then shared 10:90 in favour of private investors.	The governing documents must include default provisions relating to the manager, investors and the overall financial position of a licensed fund. The consequences of default may depend on who commits the default and the circumstances in which it arises. The governing documents will include provisions relating to the underperformance of the licensed fund.
Finland	Pari passu	Pari passu
Israel	Pari passu	None noted
Canada	Investors holding for a full eight years get a return in excess of 100 per cent of investment even where fund hasn't been profitable – mainly through tax credits.	None noted
Netherlands	Public participation as a loan with capped returns. The fund only has to pay back 50 per cent before the public's sector investment is returned. Additional income divided 80:20 in favour of private sector.	The loan is given with zero interest and if no income is generated from participation in the fund, the loan does not have to be paid back.
Denmark	Public participation as a loan; buy-out option for private investors. In these hybrid funds, private investors obtain one-third of the returns on the investments belonging to Vækstfonden and have the option to purchase all shares if the company becomes viable (government subsidy and buy-out protection).	Guarantees are provided covering 50 per cent of the losses of selected venture capital for "development" companies. These are being phased out.
Sweden	Not known	Not known
France	Pari passu	None noted
Germany	Pari passu	Pari passu

Source: National Audit Office analysis of data collected by Professor Gordon Murray

NOTE

1 *Pari passu means distributions to public and private limited partners and losses are shared on a pro-rata basis.*

Appendix Three

Case studies summary report

Introduction

1 The Department for Business, Innovation and Skills (the Department) seeks to encourage the creation and growth of new firms such that entrepreneurs with the potential to succeed in business have the chance to do so. Small businesses with high growth potential may experience difficulties obtaining the equity finance they need at key stages of their development, because investors may be deterred by the high due diligence costs and greater risks relative to investing in later-stage businesses and at larger amounts – a problem known as the "equity gap". Since 2000 the Department has sought to address this equity gap through the establishment of a series of venture capital funds including the UK High Technology Fund (2000), Regional Venture Capital Funds (2002-03), 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).

2 In May 2009 the National Audit Office commissioned GfK NOP to conduct qualitative research to obtain a deeper understanding of the impact of the receipt of finance from the Department's venture capital funds on individual businesses. GfK NOP interviewed a senior representative of:

- six businesses that had received funding and had subsequently performed successfully;
- two businesses which had received funding but subsequently failed;
- two businesses which had received funding and had performed poorly but had managed to turn this around; and
- three businesses which had applied unsuccessfully for funding but had gone on to be successful without it.

3 This qualitative research follows on from quantitative research (surveys of businesses in receipt of funding from the UK High Technology Fund, the Bridges Funds and Enterprise Capital Funds) conducted by GfK NOP during March and April 2009. The case study interviews also included businesses in receipt of funding from the Regional Venture Capital Funds and Early Growth Funds.

Key messages from case studies

4 Each interviewee was asked to identify key messages for the National Audit Office. The consistent key messages coming out of our case studies are:

- The provision of equity finance and support to some small businesses in this part of the market is crucial, and the Department's funds provide this finance where alternatives are unavailable.
- The importance of the timing of finance being made available, with several interviewees saying funding at the right time made the difference between the business surviving or failing.
- The involvement of fund managers is generally well regarded by businesses.
- Businesses feel more could be done to provide guidance and information to help small businesses find the most appropriate fund and fund manager for their circumstances. Interviewees appeared reliant on knowledgeable advisors to help them find the right fund manager. Promotion of the funds would help raise awareness amongst small businesses of their options.

5 Other key messages identified by a smaller number of interviewees included:

- Fund managers should have a greater mix of skills and people, and should have more experience of running businesses, not just a finance background.
- Fund managers should be able to demonstrate a strong book of contacts and connections to help businesses develop and grow.
- While most felt the application process straightforward, and one interviewee considered the process less bureaucratic than obtaining other forms of Government support, some felt it time consuming and bureaucratic relative to obtaining money from other investors, for example business angels, and compared to obtaining finance from public sector bodies in the US.
- Fund managers could do more to make businesses aware of impending closure of investment periods if there is money still available.

Case studies in more detail

6 The following case studies illustrate some of these points in more detail.

Case study 1
A business with high growth potential after receiving finance

We spoke to a spin-off company from a UK University that specialises in highly innovative polymer transistors and electronics. The principal product developed by the company will be launched in the United States in 2010. The product is intended as a replacement for paper allowing electronic documents to be transported and read just like paper documents. The company was established in 2000 and received initial and several follow-on investments from one of the underlying funds in the UK High Technology Fund. The company has raised a significant sum enabling it to build a factory in Germany and to develop from a technology company to a product company. The company started off with a workforce of five people and now employs 70 people in the UK with a worldwide workforce of around 200 people since expanding into the United States and Germany. A company executive told us "Equity finance was the only option and it's a substantial amount, so we wouldn't have got anywhere without the funding". The interviewee considered the key factor for high technology businesses was a fund's ability to finance businesses consistently over time, rather than as one-off financing.

Source: Interviews by GfK NOP for the National Audit Office

Case study 2
A business which attributed its survival and growth to receiving finance

We interviewed the founder of an internet technology business founded in 2000. In 2001 it sought external finance to allow the business to develop its software and grow globally, at a time when the availability of finance was constrained by the bursting of the dot com bubble. The business received around £500,000 from a Regional Venture Capital Fund. Our interviewee said that "if the fund had not given us funding at that time the company would have collapsed … It allowed us to maintain our trading position and maintain development during a very difficult time in the market … At that time there was no money for anybody … it (the finance) did save us". The business was sold to a US company in 2007 for US$60 million.

Source: Interviews by GfK NOP for the National Audit Office

Case study 3
Two businesses which failed after receiving finance

Early stage businesses are risky and several businesses in receipt of funding from the Department have subsequently failed. Two interviewees we spoke to from failed businesses gave us contrasting examples of why their companies did not succeed. In the first example the business failed three years after receiving funding because the part of the telecoms market it was positioned in disappeared. The interviewee said failure could not be attributed to the fund "It was a global market condition which caused the market to collapse…it was all part of the telecoms bubble and much, much bigger companies also collapsed including Marconi". In contrast, another interviewee thought his business had failed because investment of £100,000 (£50,000 from the Department's fund) was inadequate to support an emerging technology business. We were told that "I think we always needed to raise other funds. Maybe we were just too optimistic about what we could achieve with such a small amount of money".

Source: Interviews by GfK NOP for the National Audit Office

Case study 4
How businesses can adapt, with help from fund managers

In 2003 a company manufacturing niche high end bicycles received £50,000 from an Early Growth Fund and additional match funding of £50,000 from a business angel. After receiving funding the company found itself in difficulties between 2005 and 2007. The Managing Director told us that there was an unexpected drop in sales and that as an export company the exchange rate also went against the business. Despite this bad spell the company continued work on product development, restructured the business and applied for additional funding. The business then gained new customers and turnover grew by 30 per cent in 2008 and is expected to grow a further 15 per cent in 2009. The Managing Director was very positive about the support he received from the fund during the difficult phase "It was a combination of support, advice and some mentoring…even though things were touch and go they hadn't given up on us".

Source: Interviews by GfK NOP for the National Audit Office

Case study 5
Businesses which tried but failed to obtain finance from the funds

Outcomes and experiences differ for those businesses which are unsuccessful in their attempts to obtain finance from the Department's funds. Two of the businesses we spoke to pulled out of the process because they considered that the fund manager in each case was seeking too large a stake in the ownership of the business in return for finance from the funds. One of these businesses obtained finance from another venture capitalist which allowed the business to grow. The other business was unable to obtain finance from other sources but received an injection of a smaller amount of equity finance from the owner and a friend, and has grown subsequently. A third business we spoke to had had its request for finance rejected by a fund manager on the grounds that it was at too early a development stage. The business received alternative funding from business angels and continues in existence.

Source: Interviews by GfK NOP for the National Audit Office

Case study 6
Views on the visibility of funds to businesses seeking finance

Several interviewees considered that more could be done to help guide businesses in finding the most appropriate fund and fund manager for their circumstances:

"Maybe something a bit more pro-active in terms of contacting such businesses and suggesting there is access to funding rather than leaving the onus on the business trying to work out where they might find it. Actually make it known to people".

"There needs to be one place you can go, someone on the other end of the phone or wherever, knows what kind of business you do when you tell them and then tells you what kind of venture capitalists have money, what their funds are and which ones are the most applicable ones to approach because it would save SMEs an awful lot of time by not wasting it on approaching non-relevant investment funds."

"Knowing what is on offer. Because I think if you're a start-up business or a small company, you don't know your way around this world very easily, I would hope that (funds) could perhaps promote themselves more effectively to SMEs so that they know what is on offer."

Source: Interviews by GfK NOP for the National Audit Office