Early Assessment of the Impact of BIS Equity Fund Initiatives

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EXECUTIVE SUMMARY

Introduction

This research study, commissioned by the Department for Business Innovation and Skills (BIS) and carried out by the Centre for Enterprise and Economic Development Research (CEEDR), provides an early assessment of the economic effectiveness of four equity funds that the Government has introduced in recent years to address market failures in the provision of finance to SMEs. This early assessment forms part of a wider economic evaluation of BIS equity funds. The funds being assessed in this report are:

- **Enterprise Capital Funds (ECF)** providing equity finance to early stage and established businesses including high-technology businesses;

- the **Capital for Enterprise Fund (CfEF)** providing equity and mezzanine finance to existing businesses;

- the **Aspire Fund** assisting women-led innovative businesses by providing matched funding;

- The **Finance South East Accelerator Fund (FSEAF)** which is part of the Early Growth Fund (EGF) programme and provides debt and mezzanine finance to smaller-scale early stage and established businesses.

These are commercially orientated venture capital funds, investing a combination of both public and private money in SMEs seeking modest amounts of equity and mezzanine finance within the SME equity gap, up to £2m.

Methodology

The research involved three key elements:

- five in-depth face-to-face interviews with a sample of fund managers for the BIS equity programmes: 4 ECFs and 1 CfEF;

- 51 face-to-face and extended telephone interviews with entrepreneurs/senior managers of businesses who had applied for funding under one of the four BIS programmes being assessed, including 36 recipients, six current applicants and nine ‘dead deals’ which did not complete. It is important to note that this is a qualitative assessment giving an early indication of how the funds are working. BIS will commission separately a quantitative assessment with a larger sample size in the future that will provide a more comprehensive assessment of the effectiveness of the funds.

- the identification of five case studies to illustrate in more detail the experiences of individual businesses and the impact BIS funds have had on their business.

Key Findings

BIS Funds are generally targeted at young innovative businesses:

- Most of the businesses surveyed that were recipients of ECF, Aspire and FSEAF funding were young, early stage businesses established since 2000, with several applicants for ECF being pre-trading businesses. However, in line with the objectives of the CfEF, several of the recipients of CfEF were longer established businesses.

- The majority of businesses were innovative, with a high proportion involved in developing and delivering market leading products and services and using or developing cutting edge technology. A high proportion were involved in IT/software related activities.

- A high proportion of the businesses were already exporting, or planning to export, the majority of their sales, especially those with global market leading products and services.

- The majority of businesses were small, employing less than fifty people. FSEAF recipients were mostly micro businesses, employing fewer than 10 employees, whilst CfEF recipients included several medium sized businesses.

Equity finance is often the most appropriate type of finance for these firms and many have had difficulty raising finance from other sources:

- The majority of applicants for the ECFs, Aspire and FSEAF were seeking early stage capital that would fund R&D and product development as well as providing working capital. The applicants for CfEF were typically seeking development capital to help with their expansion plans and in some instances this was linked to carrying out financial restructuring.

- For the majority of new/early stage businesses applying for ECFs and Aspire, equity finance was perceived as the only viable option for raising finance due to: lack of financial assets; insufficient trading record; inability to secure/guarantee debt finance; or concerns about over-gearing which made them unsuitable for debt finance. The applicants for CfEF were turning to equity or mezzanine finance because they had reached the limit of their bank lending facility or had unsuccessfully applied for bank loan finance. Similarly, most FSEAF applicants had been unable to obtain conventional bank loans.

- Equity finance requirements ranged from £250,000 to £3m, whereas the FSEAF typically acted as lender of last resort for term loans of between £50,000 and £100,000.

- The selection of equity funding source usually came down to timing and availability, with the BIS equity funds being selected because of the amount of funding offered, the fund manager’s approach and the business fit with the fund’s objectives.

- Apart from applicants to the FSEAF and CfEF, mezzanine finance was rarely sought. It was generally taken up by businesses that were already trading and who were seeking loan finance for business growth but were unable to obtain this through banks or did not want to cede ownership through an equity stake.

The application process is generally seen to work well, although some SMEs find the level of due diligence to be high:

- For the ECF, CfEF and Aspire, fund promotion relies heavily on private sector advisory networks and intermediaries, with very few applications originating from public sector advisory networks. It typically took businesses two months to find the BIS funds, although less for FSEAF.

- The application process was generally judged to have worked well, with just under three quarters of recipients rating it as ‘good’ or ‘very good’. Some respondents complained that the approach to due diligence was disproportionate to the deal size and not the ‘light touch’ that they had been led to expect from some fund managers. However, it is important to note that these funds are commercially orientated and due diligence is necessary to assess the viability of the business proposition and unlikely to vary by deal size.

- For Aspire, which required a lead investor in order for the Fund to provide matched funding, recipients complained of duplication in the due diligence process, leading to increased time and costs incurred.

- The majority of businesses used some form of external assistance, mainly relating to solicitors, accountants and consultants. More than four out of five recipients rated advice received as ‘good’ or ‘very good’.

- The application process took two to three months on average, being quicker for FSEAF term loan deals, but longer for more complex equity and mezzanine deals. Where delays occurred this was sometimes as a result of businesses being underprepared e.g. due diligence information being unavailable.

BIS funds provide finance to SMEs looking for modest amounts of equity finance:

- For the interviewed ECFs, the average deal size was between £840,000 and £1.1m for three funds and £350,000 for the fourth. In the case of CfEF, the average deal size was larger at around £1.5m.

- For the interviewed recipient businesses of the ECFs, CfEF, and Aspire, the equity finance offered from the BIS supported fund ranged between £250,000 to the £2m ceiling, whilst FSEAF finance ranged from £50,000 to the £100,000 ceiling. In a few cases funding was split into tranches, delivered according to business performance.

- Deals were typically structured over three to five years with regards to the planned exit of the fund. For equity finance the typical level of equity share of ownership sold to the fund was around 25-30 per cent. In a small number of mezzanine cases, term loans over a three to five year period also carried equity warrants[1] of between 5 and 15 per cent.

- The majority of respondents were pleased with their funding deal. Where some dissatisfaction was expressed it included discomfort with the amount of equity ownership due to a lower valuation of the business than expected and concerns about the amount of control that the fund has over business management decisions.

BIS funds generally have high finance and project additionality:

- Almost a third of recipients thought that they would not have raised the finance that they needed from other sources. Although almost two thirds thought that they would have raised the finance from elsewhere, many thought this would have been more difficult to put together and would have ceded too much equity share. Entrepreneurs may be overconfident in their ability to raise alternative sources of finance and so additionality figures may be higher than reported.

- Recipients reported a high level of project additionality. Just 17 per cent indicated that without BIS funding their project would still have gone ahead at the same time and on the same scale whereas 28 per cent indicated that they would not have been able to go ahead at all, in any format. The remainder (55 per cent) would have gone ahead, but on a smaller scale and/or later.

[1] This gives the fund manager the option to buy shares at a specified price.

BIS funds help leverage in additional funding from other sources:

- The BIS funds differed with regard to leveraging additional finance at the time of funding. Although Aspire is set up with the intention that other lead funders would refer their clients to it, in practice all four Aspire cases had to find a lead investor to provide the matching funding. Seven of the 12 ECF cases raised additional finance from other funding sources. Only one CfEF case raised additional funds, with a further two restructuring their existing bank loans as a direct result of the CfEF deal. Three FSEAF cases raised additional finance as a direct result of receiving the funding.

Although it is too early to quantify the impacts, there are indications that the businesses receiving funding have high growth potential which will lead to economic benefits:

- The interviewed ECF fund managers considered that it generally takes at least 18 months to 3 years for the benefits of investments to become evident e.g. in terms of the business winning major sales contracts. Their estimates for the time taken for investments to begin to reach profitability varied between at least two to five years.

- The majority of recipient businesses referred to experiencing positive impacts directly attributable to the BIS funding, typically resulting in moving pre-trading businesses forward with R&D and marketing and to raising sales turnover and profitability amongst trading businesses. Improved performance in sales and profitability was typically judged to be at least 50 per cent attributable to the funding.

- Although entrepreneurs may be over confident in their abilities, the growth potential of the recipient businesses is considerable, with the majority indicating that they expected to grow from a sales turnover of under £1 million to £5 million or more within three to five years, with profit margins and employment set to increase and exporting activities expected to grow considerably in many cases.

- Most respondents indicated that they were at least on-track with their forecast business development. However, more than half of FSEAF cases were currently performing below expected sales/profit levels, due to poorer than forecast market conditions as a direct result of the economic downturn. This is because, compared to the recipients of other BIS funds who were often in the pre-trading stages of business development, FSEAF recipients were more likely to be trading.

BIS funds not only provide finance but also contribute additional non-financial benefits:

- Many respondents commented on additional benefits that they had received from the BIS funding, including: fund representation as a non-executive director (NED) or board member improving corporate management; management advice; being part of a large business support network; sector expertise; improved networking access; and access to further investors including business angels.

Recipients have an overall positive experience of using the BIS funds:

- Four fifths of respondents rated the value of the BIS funds to their business as 'very good', with many stating that they would not have been able to grow and develop their business without this finance.

- The majority indicated that they would recommend other similarly placed businesses to seek and use BIS funds, with several mentioning that they had already done so.

There is evidence to indicate that the early stage equity gap is widening and that the ceiling on deal sizes needs to be raised:

- A key recommendation from both surveyed businesses and fund managers is the need for the ceiling on BIS equity deals to be raised to at least £3m and possibly higher. This fits in with other research[2] which suggests that the equity gap has increased. Some of the interviewed fund managers thought that the gap relating to early stage equity capital had widened in recent years because many VC funds 'had moved up market' whilst High Net Worth (HNW) individuals had moved out of the market completely due to the credit crunch.

[2] SQW Consulting (2009) *The Supply of Equity Finance to SMEs: Revisiting the Equity Gap*, (BIS)

1. INTRODUCTION

This study, commissioned by the Department for Business, Innovation and Skills (BIS) and carried out by Centre for Enterprise and Economic Development Research (CEEDR), provides an early assessment of the economic effectiveness of a number of Government funded equity funds introduced in recent years. These are commercially focused venture capital funds, investing a combination of both public and private money in SMEs seeking modest amounts of equity finance within the recognised equity gap.

The research, which is intended to be the first stage of a wider economic impact evaluation of these BIS VC programmes, is concerned with collecting evidence of any early indicators that the funds are addressing market failures, are contributing to business growth, and will have wider economic benefits. It is recognised that these benefits may take a number of years before they fully materialise and so this study provides an early assessment. The focus of the research has been on the experiences of businesses that have made applications to the BIS equity funds. In addition, the research has also involved obtaining information and views from a selection of the fund managers of the BIS programmes to assess the role of the funds in the wider SME financing environment. The BIS programmes under consideration are:

- **Enterprise Capital Funds (ECFs)** providing equity finance to early stage and established businesses including high-technology businesses;

- **Capital for Enterprise Fund (CfEF)** providing equity and mezzanine finance to established businesses;

- **Aspire Fund** assisting women-led innovative businesses by providing matched funding;

- **Early Growth Fund (EGF).** The focus of this research is on the Finance South East Accelerator Fund (FSEAF) which provides smaller-scale debt and mezzanine finance to early stage and established businesses.[3]

[3] Having been established earlier than the other programmes included in this study, the EGF programme has already been subject to an interim evaluation (Ci Research (2009) RVCF and EGF Interim Evaluation: Recipient Business and Stakeholder Surveys (BIS)). However, BIS is interested in exploring the FSEAF in more detail as, unlike the other funds in the EGF programme, it provides debt and mezzanine finance to early stage and established businesses, rather than equity finance.

2. BACKGROUND

2.1 Context

Only a very small proportion of SMEs seek equity finance (with most large scale SME surveys estimating this to be less than three per cent of those seeking finance[4]), however this form of finance is vital for many innovative and growth orientated enterprises who play a key role in leading the emergence of new industries, economic growth and job creation. Equity finance is suitable for businesses that have high growth potential, but also higher level of risk, lack physical assets to provide collateral on debt finance and may also lack or have uneven revenue streams that make servicing loan repayments difficult.

It has long been recognised by policy makers, practitioners and academics that there exists an equity gap in the UK, particularly relating to the early stage venture capital market[5], which means many potentially viable businesses struggle to raise the finance they need. The boundaries of the equity gap appear to have changed over time. In 1999 the upper boundaries of the equity gap were estimated to have affected businesses seeking investments of up to £500,000. However, NESTA's evidence suggests that private venture capital has been moving away from early stage investments as the size of individual funds has increased, with the private equity market shifting towards larger deal sizes, with a diminishing volume of funds being available for early stage venture capital investment (sometimes referred to as 'style drift'[6]). This is despite a 20% increase between 2001 and 2007 in the number of companies requiring investments below £2 million[7].

This shift reflects the fact that investing in early-stage technology based small firms is currently not an attractive option for private finance. This is due to several factors, including information asymmetries between investors and new and young SMEs, many of whom are not investment ready, and also the view of venture capitalists that they can make greater returns elsewhere (such as MBO and MBI activities). Recent evidence from Scottish Enterprise also indicates that venture capitalists are shifting towards 'follow-on' rather than new investments, creating a larger gap for new and early stage risk capital[8]. Therefore an equity gap exists for projects that are too large for business angels to fund

[4] The Annual Small Business Survey 2007 (BIS); Centre for Business Research (CBR) (2008) Financing UK Small and Medium sized Enterprises: the 2007 Survey, University of Cambridge.

[5] NESTA (2008) *Shifting Sands: the changing nature of the early stage venture capital market in the UK,* Report by Yannis Pierrakis & Colin Mason, NESTA Research Report September 2008.

[6] NESTA (2009) *From Funding Gaps to Thin Markets: UK Government Support for Early-Stage Venture Capital*, Research Report September 2009

[7] NESTA (2008) op. cit.

[8] Glancey, J. (2009) *The Risk Capital Market in Scotland*, (Scottish Enterprise).

but below the level for most venture capital funds to start investing, which is estimated to be in the £250,000 to £2m range[9]. Recent evidence suggests the gap may now extend up to £5m and be even higher in certain sectors such as the life sciences[10].

It is against this context that there has been a growth in public sector initiatives concerned with creating joint public/private financed venture capital funds[11]. For example, the Government launched Regional Venture Capital Funds (RVCFs) from 2002 in the nine English regions in order to address the equity gap facing SMEs in each region. The RVCFs closed to new investments at the end of 2008 and have now been superseded by the BIS equity programmes which are the subject of this study.

The Government backed equity funds (often referred to as hybrid funds) aim to balance generating commercial returns for the investors in the funds whilst at the same time achieving wider economic objectives. Since one of the ambitions of the funds is to demonstrate to potential investors that good returns can be made by investing in early stage businesses with growth potential, the responsibility for making the commercial investment decisions is devolved to private venture capital fund managers. This ensures that the investment decisions are made according to rigorous commercial criteria. At the same time, by providing equity funding to innovative early stage businesses with high growth potential that are unable to raise sufficient funds from other sources, the BIS equity funds aim to contribute to economic growth and job creation within the UK economy.

2.2 Overview of the BIS Equity Funds

Enterprise Capital Funds

Enterprise Capital Funds (ECFs) are a rolling programme of funds, with the first funds established in 2006-2007, that are intended to address the equity gap faced by SMEs with high growth potential seeking modest amounts of equity finance. Under the programme, Government funding is used alongside private sector funds, targeting investments of up to £2m that have the potential to provide a good commercial return.

[9] HM Treasury and Small Business Service (2003), *Bridging the Finance Gap: Next Steps in Improving Access to Growth Capital for Small Businesses*, London, HMSO; NESTA (2008)op cit.

[10]SQW Consulting (2009) The supply of equity finance to SMEs: Revisiting the Equity Gap, Report to BIS; CEEDR & Sanders Thomas Ltd (2009) *SME Access to Finance in London: A Scoping Study*, Report for the London Development Agency.

[11] The growth in government involvement in the venture capital market has occurred in a number of advanced economies and taken various forms, including the creation of hybrid funds – see Murray, G.C. (2007) ‘Venture capital and government policy’, in Landstrom, H. (ed) *Handbook of Research on Venture Capital*, Edward Elgar, Cheltenham

The policy objective of the programme is to increase the availability of risk finance to SMEs affected by the equity gap, thus helping to alleviate what would otherwise remain a significant barrier to enterprise, productivity and growth. This is achieved by:

- encouraging an increased flow of private capital into the equity gap, by adjusting the risk-reward profile for investors making such investments; and

- lowering the barriers to entry for risk capital managers by reducing the amount of private capital needed to establish a viable venture fund.

By providing finance to potentially viable SMEs that would not otherwise obtain equity finance due to the equity gap, ECFs aim to facilitate additional economic growth and improvements in productivity.

ECFs are a programme of national funds managed by Capital for Enterprise Ltd (CfEL)[12] on behalf of BIS. They are not restricted to particular sectors or geographical areas provided there is a demonstrable existence of commercial opportunity and an equity gap. There are ten funds, eight of which are currently operational and managed by existing private sector VC funds. The ECF fund size ranges from £10m to £30m with an average of about £26m. The eight active ECFs focus on different stages of business development such as seed, early stage and expansion stage, and on different sectors.

The existing eight ECFs comprise the following funds:

i) *IQ Capital Fund*

The Fund focuses on seed, early stage and developing high-tech businesses, as well as fast growing companies in non-tech sectors. This funding is often in partnership with expert angel investors who commit their experience, time and money to the investee companies alongside the Fund.

ii) *21st Century Sustainable Technology Growth Fund*

This Fund is also referred to as E-Synergy and focuses on early stage investments in technology companies.

iii) *The Seraphim Capital Fund*

The Seraphim Capital Fund is an early stage venture capital fund that invests between £0.5m and £2m into high growth early stage UK businesses. The Fund is a co-investment fund with links to a network comprising more than one thousand business angels.

[12] Capital for Enterprise Ltd was established by BIS in April 2008 as a wholly-owned company to deliver finance measures in support of small businesses including managing the venture capital funds programme.

iv) *The Amadeus Enterprise Fund*

The Amadeus Enterprise Fund focuses on seed stage technology companies in the UK seeking companies that offer a novel technology, although they may not have fully investigated how best to exploit its advantages. The Fund is jointly funded by Amadeus, BIS, business angels and other private investors.

v) *The Catapult Growth Fund*

The Catapult Growth Fund specialises in providing equity capital for businesses requiring between £200,000 and £2m, including early stage, development capital, and MBO/MBIs.

vi) *Dawn Capital ECF*

This fund was established for businesses within the technology, media and telecommunications sectors and also technology enabled services companies, with an emphasis on finance and healthcare. It provides funding to companies at all stages of development.

vii) *Oxford Technology Management ECF*

The Oxford Technology ECF is a specialist fund designed for technology companies in the early stage of development and invests between £100,000 and £2 million in suitable companies, plus appropriate follow-on investments.

viii) *MMC Venture Managers*

MMC Ventures is a generalist fund that invests in fast-growing UK companies.

The Capital for Enterprise Fund

Although originally established to address structural issues in the provision of mezzanine finance, the Capital for Enterprise Fund (CfEF) was launched in January 2009 as one of the Government's 'Real Help Now' initiatives to combat the effects of the credit crunch and recession on SMEs. It provides equity or mezzanine investment aimed at releasing or sustaining growth potential for SMEs that are over-geared and have exhausted traditional forms of bank finance.

It is a £75m fund of funds made up of £50m from the public sector which is invested 'pari-passu' with £25m from four banks (Lloyds, Barclays, HSBC and RBS). Investments range from £250,000 to £2m and had to be made between April 2009 and March 2010. The fund of funds has been divided by investing £67m in two funds managed by existing venture capital fund managers and £8m in a co-investment fund managed by CfEL[13]. Given the objectives of the Fund at meeting an immediate financing need, the investment period for the CfEF is much shorter than the other funds and has now stopped accepting new applications.

The fund managed by Octopus Investment Partners focuses on making investments in companies in southern regions, whilst the fund managed by Maven Capital Partners focuses on making investments in companies located in northern regions and Scotland.

The Aspire Fund

The Aspire Fund was established in 2008 as a beacon for women's access to finance and aims to increase the number of successful women-led businesses in the UK by ensuring that the potential to succeed is not held back through a lack of risk capital. It is intended to provide support for women-led businesses with high growth potential. The Fund operates on a co-investment model being made up of £12.5m from government which is matched equally to private sector funding making a total of at least £25m. It is able to make equity investments of between £200,000 and £2m in total, including the matched private investment. The Fund is managed by CfEL, but as a co-investment fund all investments are led by the experienced co-investor whose investment is matched.

The Early Growth Funds

The Early Growth Funds (EGFs) were set up between 2002 and 2004 in order to encourage risk funding for start-ups and growth firms. Although no sectors are excluded in principle, there is a focus on innovative and knowledge intensive businesses, university spin outs, and early growth enterprises. The funds are managed on a purely commercial basis with each fund manager responsible for their own application processes. Fund managers make all investment decisions and look to make a commercial return on investments.

Although most of the funds provide equity finance, one fund, the *Finance South East Accelerator Fund* (FSEAF), provides mezzanine finance that takes the form of debt finance but with certain equity finance characteristics.[14] This £10m fund can provide up to £100,000 of finance initially and up to £100,000 in subsequent financing rounds to businesses demonstrating significant growth potential.

[13] The co-investment fund was originally intended to be £15m but was reduced to increase investment in the two funds following better than expected demand.

[14] FSEAF finance mostly takes the form of loans to businesses that have been unable to obtain finance from other sources. It is considered to be mezzanine finance as it does have certain equity characteristics. In particular, unlike normal bank loans, with one or two exceptions FSEAF loans have a levy on turnover.

3. AIMS AND OBJECTIVES

The aim of this research is to provide an early, qualitative assessment of the impact of BIS's equity programmes in addressing market failures in SME equity finance markets, their initial contribution to business performance and also their longer term potential to contribute to UK productivity and growth.

Where quantitative data is presented, care should be taken in its interpretation as it is based on relatively small sample numbers. It is envisaged that a more comprehensive quantitative evaluation on the newer BIS VC funds will occur in the future, which will sample a greater number of fund participants.

The specific objectives of the research are to:

i) provide further details of the characteristics of recipient businesses (and unsuccessful applicants), including stage of development, product range, innovation and export record;

ii) review the reasons for using equity/ mezzanine finance over other forms of finance;

iii) provide findings that will contribute to assessments of 'financial additionality';

iv) provide details of the 'customer journey' in obtaining funding i.e. identify and document the information sources and referral routes experienced;

v) collect details of any additional finance that receipt of the BIS VC fund has enabled firms to raise;

vi) gather any emerging views of the actual and expected impact of the funding, for example in terms of facilitating innovation, turnover, or employment growth, including perceptions of the extent to which this is different from what would have happened in the absence of the funding;

vii) provide evidence of businesses' satisfaction with the fund used and satisfaction with any support received e.g. through mentors or networks associated with the funding;

viii) for businesses whose applications for BIS funding were unsuccessful, explore immediate outcomes after rejection and assess if they subsequently managed to obtain finance elsewhere.

4. METHODOLOGY

The research involved three key elements:

- interviews with a selection of fund managers;
- interviews with senior managers of businesses which had applied for funding under one of the four funds;
- identification of a number of case studies to illustrate in more detail the experiences of individual businesses.

Each of these will be described in turn.

Fund manager interviews

Five face-to-face interviews were held with the fund managers of four of the ECFs and with one of the CfEF managers. It was felt important to capture this supply-side perspective in order to give a balanced view of the effectiveness of the operation of the funds. These interviews provided valuable insights into the structure and operation of the funds, the type and range of applications, decision-making criteria, their views of the 'customer journey' and the effectiveness of the investments made to date, and their assessment of whether the BIS funds were addressing an equity gap. The funds were selected in order to give a good spread in terms of location, type of private sector contribution, and the types of investment and sectors targeted.

The five chosen funds were:

i) The Catapult Growth Fund (ECF) (based in Leicester)
ii) IQ Capital Fund (ECF) (based in Cambridge)
iii) Oxford Technology (ECF) (based in Oxford)
iv) Seraphim Capital Fund (ECF) (based in London)
v) Maven Capital Partners (CfEF) (based in Glasgow, but with regional networks)

The fund manager interviews were conducted by Adrian Lewis, a venture capital consultant (Sanders Thomas Ltd) between 26th January and 4th February 2010.

Business manager interviews

The senior managers (mostly CEOs and finance directors) of 51 businesses that had applied for one of the four BIS equity funds were interviewed, 13 in face-to-face meetings and the rest by means of extended telephone interviews. The sample was drawn from across the four equity programmes and selected to include recipients of funding, current applicants, and businesses from the 'dead deal logs' of the various funds. The researchers were dependent on the willingness and ability of the various fund managers to provide this information - some fund managers were unable or not prepared to provide details of unsuccessful applicants on the grounds of commerciality.

Table 1 shows the status of the businesses participating in the research and by equity fund. Out of the 51 interviewed businesses, 36 were recipients, six were still going through the application process, and nine were from the 'dead deal log' (i.e. comprising some businesses that withdrew their applications and others that were rejected for funding). All the business interviews were undertaken by the CEEDR research team between 25th January and 8th March 2010.

Table 1: Business Interviews by Equity Fund

Scheme	Recipients	Current Applicants	Rejections / withdrawals	Total
ECF	12	2	5	19
CfEF	11	4	4	19
Aspire	4	-	-	4
EGF (FSEAF)	9	-	-	9
Total	36	6	9	51

The interviews obtained information about:

- business characteristics (including the main areas of business activity, the extent of innovation, and the ownership structure);
- the reasons for accessing mezzanine/ equity finance (including the purpose of the funding, how much funding was sought and the alternative sources of funding considered);
- the customer journey (including their assessment of any referral process, the time taken to find the BIS equity fund, their expectations and experiences of the application process, the type and level of assistance received, and the costs in making the application);
- the funding leverage (including other sources of funding accessed at the time and subsequently);
- the actual and expected future impacts of receiving funding (including that on profitability, sales turnover, exports, and employment over the period covered by the business plan);

- additionality (including the extent to which the project would have gone ahead in the absence of BIS funding and the extent to which it would have been possible to raise the funding from elsewhere, and assessments of possible non-financial benefits of receiving the BIS funding);
- overall assessments of the value of BIS equity funding to the business and recommendations about how the fund could be improved.

In the case of the interviews with businesses from the ‘dead deal log’, additional questions were asked about:

- the reasons for not obtaining finance from the BIS fund (including the reasons for not proceeding further in the case of withdrawals);
- in the case of rejection, what the immediate impact of this was upon the business and whether or not they were able to obtain funding from other sources;
- what feedback was obtained in the case of unsuccessful applications;
- whether there were any aspects of the process of applying that they found helpful or beneficial, despite being unsuccessful/not going ahead.

Case studies

Five of the interviewed businesses feature as case studies in this report (Appendix I) in order to illustrate how businesses have benefited from the various equity programmes. The case studies were selected in consultation with BIS in order to ensure good coverage of key funds and applicant types. Two of the chosen case studies relate to ECF, two to Aspire, and one to CfEF. The consent of the CEO of each company was obtained and the details checked with them.

5. FINDINGS FROM FUND MANAGERS

This section presents the findings from the interviews held with five fund managers, these being: four out of the eight active Enterprise Capital Funds (ECFs), namely the Catapult Growth Fund, IQ Capital Fund, Oxford Technology Fund, and Seraphim Capital Fund; and one of the two funds managing the Capital for Enterprise Fund (CfEF), namely Maven Capital Partners. Face-to-face interviews were conducted by Adrian Lewis (Sanders Thomas Ltd) between 26th January and 4th February 2010.

5.1 Overview of the Funds

Table 2 shows details of when the funds were set up and their size.

Table 2: Fund Size and Structure

Fund Name	Date set up	Total size of fund
Catapult (ECF)	December 2006	£30m
IQ Capital (ECF)	October 2006	£25m
Oxford Technology (ECF)	March 2008	£30m
Seraphim (ECF)	September 2006	£30m
Maven (CfEF)	April 2009	£30m

The funds obtain private sector funding from a variety of different funding sources. For instance, High Net Worth (HNW) individuals dominate private sector funding sources in the case of some of the funds interviewed providing amounts between £25,000 to £1.1 million. One of the funds also has a number of other institutional investors and in another of the ECF funds private sector funding comes from county council pension funds. In the case of CfEF, the private sector contribution comes from the 'big four' banks.

Although ECF is a generalist programme, there are differences between the individual funds in terms of the types of businesses that they target for investment.[15] Most of the ECFs have a strong emphasis on early-stage technology businesses. For instance, Seraphim[16] invests in technology businesses that have a fully developed product based on a disruptive technology, a large applicable market and a high quality management team. The IQ Capital ECF[17] operates earlier than many other ECFs, making pre-revenue seed/early stage investments mainly in ICT and new media. The Oxford Technology Fund[18] targets early stage technology businesses, ranging from start-ups to businesses that are several years old who are located in or near Oxford. Businesses are considered for investment where Oxford Technology Management has particular expertise such as

[15] This is communicated on each of the fund's websites.
[16] http://www.seraphimcapital.co.uk/approach.php
[17] http://www.iqcapital.co.uk
[18] http://www.oxfordtechnology.com

health care, engineering and software. The Catapult Growth Fund[19] is a more generalist fund sectorally and while it still provides early stage capital, the Fund provides more development capital than other ECFs and also provides MBO-MBI investments.

The CfEF provides equity or mezzanine funding up to £2 million for more mature businesses that have viable business models with growth potential but are constrained by over-gearing or the need to repay bank debt[20]. It is a generalist fund with no sectoral biases but it excludes the same sectors as those excluded for state aid reasons by the ECFs.[21]

Table 3: Investment Pattern of the Funds

Fund	Average size of investment per company	Range of investments to date
ECF	£350k	£40k - 1m
ECF	£840k	£250k - £1.45m
ECF	£887k	£250k - £1.5m
ECF	£1.1m	£1m - £1.5m
CfEF	£1.5m	£650k - £2m

As can be seen from Table 3, the range of investment sizes is very broad but the average is between £840,000 and £1.1m for three out of the five funds. The exception is one of the ECFs, which has a low average of £350,000 and the CfEF which has a high £1.5 million average deal size reflecting its focus on established companies.

In terms of how the deals are structured, the early-stage focused ECFs tend to invest predominantly in equity. For example, in the case of one ECF, two-thirds of each investment is normally in equity in the form of preferred ordinary shares (the preference here refers to preference for repayment of capital on exit) with no specified dividends. If an IRR of 25 per cent or more on the investment is achieved on exit then the preference status of the shares lapses. The balance of the investment is in the form of plain ordinary shares with no preference status. Several investments have also initially involved bridging loans which have converted to equity once the full investment was in place.

However, one of the ECFs typically structures its deals as two thirds debt and one third equity in the form of ordinary shares. The objective is for the yield on the debt to generate sufficient income to the Fund to pay the management fee with the intention that the management fee payments do not then erode the Fund, enabling it to perform better.

In the case of Maven (CfEF), around three quarters of deals are mezzanine finance, typically comprising a five year mezzanine secured term loan with a target annual interest payment of around 10 per cent (this may vary from deal to deal) plus a rising scale

[19] http://www.catapult-vm.co.uk
[20] http://www.mavencp.com/capital-for-enterprise-fund
[21] These sectors include synthetic fibres, motor vehicles, ship building, steel, coal, transport and some agricultural and fisheries.

redemption premium that incentivises early redemption. For all mezzanine loans the Fund takes a small nil cost equity warrant (between two and 10 per cent) in straight ordinary shares, which is only exercisable on change of control. The other quarter of deals are straight equity deals with Maven typically providing 15-30 per cent of the company's equity in the form of ordinary shares.

The promotion of the funds relies heavily on private sector advisory networks, with early-stage ECFs emphasising the role of HNWs and business angel networks and later stage funds emphasising intermediaries more. Direct enquiries (including via websites) are the second most important source for most funds whereas very few referrals appear to originate from public sector advisory networks (e.g. Connect, Business Link, G2i, CfE Helpline).

As an example, data provided by one ECF shows that:

- 22 per cent of dealflow comes from partners (primarily business angels);
- 35 per cent of deals come from intermediaries – i.e. Corporate Finance Boutiques (most of this category), lawyers and accountants;
- 43 per cent come direct – this category includes emails and website approaches.

The trend is for the number of applications coming through intermediaries to increase. The Fund Manager also observed that referrals from intermediaries are more targeted to the Fund's criteria, whereas direct enquiries are not so targeted.

Similarly, in the case of CfEF, the most important marketing activity is the face-to-face meetings with the private sector intermediaries and these have proved to be the most responsive. The CfEF has a helpline run by PKF that has provided quite a few initial introductions. Maven also produces flyers for the Fund and issues deal flyers in the relevant networks/media as well as advertising in regional publications. Over 200 face-to-face meetings have been held with UK advisors/accountants/lawyers/corporate financiers and RDAs. Other enquiries come direct which may include some public sector redirections.

5.2 Characteristics of Applicant Businesses

With regard to the types of businesses applying to ECFs, the business characteristics in terms of stage, size and sector largely reflect the areas of fund management expertise.
As described above, the funds vary in terms of the sectoral range that they cover with some covering a broad range whilst others tend to specialise (e.g. in new media, medical, or healthcare investments). Whereas most of the ECFs focus on early stage and seed investments, the majority of the CfEF investments have been in established businesses (in

some cases employing more than 200 employees) and across a wide range of sectors. Specifically in the case of Maven (CfEF), the most common sector is IT/software, with the remaining sectors well distributed, although the proportion of service related businesses is judged by the interviewed fund manager to be slightly higher than normal for venture capital funds. There have been no start-up applications and only 3-4 completed deals have been early-stage. The rest are mature development capital or working capital investments.

Most of the ECF fund managers thought that they were not attracting applications from businesses that would not have normally sought venture capital since equity is the preferred way of financing technology businesses. However, in the case of the CfEF, the majority of applicants were not seeking equity from the Fund as they were originally looking for term loans which they would have probably obtained from the debt market prior to the credit crunch.

Geographic coverage of applications

The fund managers were asked about the geographical pattern of applications. Although there are no restrictions, the ECFs generally attract most applications from the region that they are based in, although some have wider geographic catchment areas than others. For instance, one ECF fund will only consider applications if they are within 1-2 hours drive of where it is based. Another fund draws 40 per cent of its applications from London and the South East and a further 30 per cent from the East of England. Similarly, one fund estimates that 40 per cent of its applications are drawn from London, Cambridge, Oxford and Bath since this reflects where innovative businesses tend to be located. However, another ECF has traditionally drawn at least 70 per cent of its applications for all its funds from the Midlands, but, following a significant marketing effort in 2009 has increased the proportion of introductions from both the south and north of England.

In the case of the CfEF, the applications have come from a much wider geographical spread of companies, with Octopus tending to focus on applications from companies located in southern regions and Maven Capital Partners on applications from northern regions as per the design of the programme. However, the Maven Fund Manager comments that the response from the North East region has been poor and hardly any applications have come from Northern Ireland, despite Maven's marketing efforts there. This shows to some extent the supply of quality investments determines the deal flow to VC funds.

5.3 Experience of Applicants with other Funding Sources

The interviewed fund managers were asked about the experiences of businesses in trying to access other sources of finance before applying to the fund. Most applicant businesses had tried and failed to get bank funding and also equity funding from other sources.

Failure was attributed to the stage of the business, lack of cashflow, sectoral concerns, overdependence on a few customers, lack of security and weak management.

One fund manager commented that the SME finance market had changed as a result of the credit crunch. Whereas it was possible for their fund to do joint deals with the banks back in 2007, this was no longer possible. In addition, the gap relating to early stage equity capital had widened as a result of many VC funds moving ‘up market’ whilst many HNW individuals have moved out of the market completely. An additional point was that some of the applicants would have previously applied for various R&D and innovation grants but that there were now fewer of these available.

In the case of the applicants to CfEF, most had sought other forms of finance (e.g. bank loans/asset finance/factoring/overdrafts) prior to applying to the Fund. The majority had not been successful although a few did eventually receive some bank funding but needed to fill a short term funding gap.

5.4 The Application Process

Application referral routes

Fund managers were asked about the effectiveness of national referral networks (e.g. some private sector networks or public sector networks such as Business Link), two of the ECFs said that they did not use them, preferring to concentrate on their regional/local networks. The other two ECFs relied on their national private networks and these worked well. Similarly, Maven worked hard at keeping in contact with intermediaries via visits and sending out newsletters.

Stages of the application process

When asked to talk through the stages of the application process and how decisions to reject or proceed to the next stage are taken, it would appear that most funds generally select heavily at the first stage of receiving applications, with few applicants making it even to a first meeting. This is common practice in venture capital funds, and shows the funds are operating commercially. Term sheets[22] are usually issued pre-due diligence in order to try and avoid unnecessary work and all funds use investment committees to approve deals with non-executives on their committees. Initial rejections can be made by individual executives but marginal cases are normally discussed at a meeting of executives/investment partners. In the case of one ECF all investment committee decisions to reject or proceed are taken by all four investment partners and decisions to invest must be unanimous.

[22] A Term Sheet (sometimes referred to as a Letter of Intent) is normally produced at the start of the negotiation of a venture capital investment, summarising the terms the proposer/investor is prepared to accept. The aim is for the parties to agree general terms of the deal before starting the due diligence process.

In the case of CfEF (Maven), initial rejections are by the investment manager handling the proposal in the early stages. If the investment manager wishes to take the proposal forward then they have to prepare a discussion paper for the investment committee, who decide whether to issue a term sheet or decline the proposal. They also decide what due diligence is required. The investment committee (consisting of any three of the five partners) also approve the final deal before completion and the decision must be unanimous amongst the partners attending the committee (although the partner putting the deal proposal forward cannot be involved in approving the deal).

The interviewed fund managers were asked how long it normally takes to go through the application process. In the case of the ECFs, three months seemed to be the 'average' length of time, although one fund aimed to complete the process in just eight weeks. There were examples of successful investments being completed in three to four weeks, but these were exceptional. In cases that took six months or more, fund managers said this was normally because of delays arising from due diligence information being unavailable or external factors such as getting other investors in as part of the deal, or licensing issues.

In the case of CfEF, from initial contact to completion for a mezzanine deal generally took 10-12 weeks and for a VC deal it could take 14-18 weeks.

Interviewed fund managers attributed difficulties encountered in the application process to a number of factors including: (i) applicants having poor systems for financial control and forecasting; (ii) a lack of preparation and investment readiness before starting on the process; (iii) a lack of or poor quality of advice (one fund manager commenting that good proposals attract good advisors who do a good pre-investment job); (iv) syndication difficulties (i.e. bringing other investors on board); (v) the applicant's underestimation of the time that will need to be devoted to due diligence (this being particularly the case with younger businesses that lack the managerial capacity needed); and (vi) in the case of CfEF, problems with other senior lenders (e.g. banks) and the reluctance of other parties to engage in the process.

When companies withdraw from the process, it is usually because they have found funding from elsewhere or because they are not prepared to give up equity. Most fund managers were able to cite instances of applicants being rejected, but then returning at a later stage with an improved proposal. For example, at the time they were interviewed, one fund manager specifically mentioned they had just completed a deal which first came up one year ago, having originally rejected the proposal but given advice which the company took and then came back with a better proposal. Another fund manager also commented that some entrepreneurs approach them too early, but then learn, adapt and strengthen their proposal and return a year later.

The applications funnel

The interviewed fund managers were asked to give an indication of the proportion of applications that reach each stage of the process. However, it should be noted that definitions of what constitutes an ‘application’ appeared to vary widely between funds as did the accuracy of recording of enquiries and applications. Whereas some fund managers were able to provide detailed figures relating to a particular year, others gave a typical per annum indication of the numbers reaching each stage. In the case of the ECFs, the numbers of applications received per annum varied from just over 500 to 2000, with typically between six and 15 per cent receiving a first meeting. Many of the applications received however do not meet basic criteria and therefore are rejected immediately. Of those applications which are offered a first meeting, investments are agreed in between one and 16 per cent of cases, depending on the fund. The conversion rates between applications received and investments made are very low for the ECFs, the highest being 1.6 per cent. This is typical of other early stage VC funds and demonstrates the commercial nature of the funds.

In the case of the CfEF, Maven received over 300 applications since the Fund opened in April 2009[23], just under a third of which progressed to a first meeting. Eighteen investments had been made by March 2010, giving a conversion rate of around 6 per cent. This is a higher conversion rate than the ECFs, reflecting the fact that the CfEF is focused on established businesses.

It is interesting to note that one of the ECF funds has tracked all of the good quality applications that it had rejected during 2008-09 and found that around 20 per cent of them had managed to obtain funding from other sources.

Asked about the reasons why so many applicants are rejected early on in the process, one of the fund managers said that the majority of applicants present a weak investment case with the market being too small and the product too marginal, giving a weak competitive advantage compared to the competition.[24] Another fund manager complained that the business models that were presented were often poor and that companies invariably underestimated their financial needs.

[23] The figure for Maven does not include the 1300 enquiries that were made to the helpline, the majority of which did not meet the criteria sufficiently to be passed onto the CfEF Fund Managers.

[24] There is some support for this view in recent research by NESTA which indicates the problems that investors face in finding a sufficiently attractive portfolio firms is because “the UK does not possess an untapped resource of high potential firms whose (greater) performance will be unleashed by simply making available more equity finance within the ‘equity gap’ – NESTA (2009) *From Funding Gaps to Thin Markets: UK Government Support for Early-Stage Venture Capita*l, p.21

Role of fund manager

All ECF fund managers tend to take board observer rights and nominate non-executive directors (NEDs) to the Board of recipient companies. For example, two fund managers appoint a business angel to the board of an investee company whereas some fund managers appoint NEDs from their own management team.

All the funds managers claim to put significant time into portfolio support. Fund managers believe they add the most significant value by improving corporate governance and professionalization of the board and of the businesses systems and controls. For example, the NED provides mentoring and discipline. One fund manager claimed that when the advisory committee visited an investee company the MD paid specific tribute to the benefits brought by the Fund in this regard. Some funds have also acted as intermediaries for future company fund raising. Contact introductions and strategic advice are also commonplace.

Exit strategies

Although it is too early for the funds to have had significant numbers of exits, exits are important for generating the financial return on the investment.

All the ECFs have exit plans that revolve around trade sales. Most funds look for exit within five to seven years, although in one case they have been looking over the last eighteen months for investments with three year exit potential. In those businesses involving several years R&D prior to trading, it may be up to ten years before the fund is able to exit.

In the case of CfEF, mezzanine loans will be paid off as per the mezzanine terms. For VC deals Maven agree an exit strategy with the company over three to five years. This is analysed in the due diligence phase and discussed with management in advance and may take the form of a trade sale or IPO, or even possibly a secondary private equity sale/MBO.

5.5 Fund Managers’ Views on the ECF/CfEF meeting the Equity Gap

When asked to what extent the ECF is addressing the equity gap for early stage and growth orientated/innovative small businesses, all the fund managers praise the funds for going some way to addressing the market gap in early stage and growth funding. One interviewed fund manager commented that purely private commercial funds tend to have a very narrow focus and to invest in known management teams.

The advantages of the CfEF compared to pure VC funds as seen by the interviewed CfEF Fund Manager is its flexibility, transparency, speed (i.e. mezzanine being quicker than VC deals to arrange), management support and avoidance of equity dilution (in the case of mezzanine finance).

However, all but one of the interviewed ECF fund managers felt that there is a need for more ECF funds in the future and also larger funds with higher investment limits. They maintained that the equity gap now extended into the £3-5m investment band and that the investment level should increase accordingly. For example, one fund manager said that the structural equity gap now extends beyond investments of £2m to certainly £3m and possibly to £4m. In addition, since 2007 MBOs have also been unable to find funding as funding has become constrained. High Net Worth individuals are supporting their existing portfolios, but not doing new deals and a lot of VCTs have not been active. Another fund manager takes the view that the fund size needs to be larger for technology investments. He argued that because most technology companies need £10 million investment over their life and a fund needs to invest at least 40 per cent of this to be a significant player, an effective fund needs around £50m in order to be capable of investing in a portfolio of 20 companies which have a good spread[25].

The views of other fund managers are as follows:

"The ECF programme is in the right place and there needs to be more of them. Without ECFs it would be difficult for many businesses to get off the ground. Maybe half of the businesses invested in would not have raised the money because they are too early-stage."

"ECFs are a great instrument – a sensible mix of incentives and trade-offs for both the private investor and the government. They are very effective in addressing the equity gap and there are no cases of abuse of funds. Advisors are aware of ECFs and consequently the fund managers are the first port of call."

"The ECF is addressing the equity gap – very much so. It is doing a tremendous job and has a good name in the market. Businesses would probably not have found investments elsewhere."

ECF fund managers did not see themselves as competing against the private sector but as facilitating it, believing that most private investment would not have occurred without their presence and lead role. In the case of one ECF fund for example, 25 per cent or more of additional private sector funding is leveraged in on individual deals and HNW investors invest in companies because there is a professional fund involved in the deal. Another fund offer 50 per cent of the term sheet to other investors on more than half of their

[25] It is worth noting that NESTA considers that early stage VC funds below £25-30m are too small in that they generate poorer returns for investors than larger funds and that a portfolio size of 20-30 investments is needed to adequately spread the risks and to make follow-on investments: NESTA (2009) *From Funding Gaps to Thin Markets: UK Government Support for Early-Stage Venture Capital*, Research Report September 2009.

investments. Whilst some investors might have still invested in VC without ECF, it was generally thought that they would have invested in fewer first round deals and committed less money to them.

When asked about leveraging in other funding to recipient businesses, the ECFs generally claimed their funding leveraged in other equity finance, particularly from High Net Worth individuals (HNWs) with the fund managers playing an active role in securing this investment. For example, one fund only invests up to 75 per cent of an individual deal, the rest of the equity coming from HNWs and small institutions. Later stage deals done by another ECF also leveraged in bank support as their due diligence gives the bank greater confidence and the equity a buffer for bank finance, although there have been fewer instances of this since 2008. A few businesses had been successful in obtaining public sector R&D and innovation grants.

There are also signs that the ECFs are encouraging more investors into the lower end of the market and lowering the barriers to entry for new fund managers. As one fund manager commented: *"there is a chance for new fund management teams to prove themselves. ECFs can be the first step on the ladder. It is the same for HNW Investors who learn to invest through the process alongside the fund. They then get comfortable with the concept of the fund investment and the fund manager."*

All the interviewed fund managers claimed that the credit crunch has had a big negative effect on fund raising for new fully-raised hybrid funds. For example, one fund manager observed that the private investor funding environment is very difficult due to business confidence, fear of a further recession, poor portfolio performance and money lost on existing investments.

Whereas the ECF fund managers are somewhat equivocal as to whether the programme has increased awareness of equity financing amongst businesses, the Maven Fund Manager believes that CfEF may have encouraged business owners to consider private equity who would not previously have considered it because their experience has removed previous fears that proved not to be substantiated.

5.6 Economic Impacts

Business impact

The interviewed fund managers were asked to provide examples of where equity funding accessed via ECF had clearly contributed to positive outcomes for the business. They were all able to cite a wide range of positive outcomes including achievement of major contracts with blue-chip firms, securing export sales/contracts (very common), significant employment gain and retention, innovation (very common) and turnover growth. The fund managers generally felt that it took between 18 months and three years for the benefits of investment to start to become evident, but longer before the firm reached profitability.

Fund managers acknowledged the existence of the ‘J Curve’.[26] Estimates of the length of time before the individual ECF investments became profitable tended to be between two and four years with it sometimes taking up to five years to reach profitability. The credit crunch was seen as an extending negative factor, sometimes adding up to a year to the timescale. It was also observed that the bad investments tend to show up quicker before the good ones come through.[27]

Examples of funding impacts to date provided by the fund managers are shown below.

Catapult Growth Fund

- Oxford Biotherapeutics – provides biomarkers for cancer cells that aid development of cancer related drugs – has achieved major contracts with blue-chip pharmaceutical companies.
- 4Energy – provides telecoms base station cooling technology. It has secured major blue-chip contracts and is conducting trials to secure contracts in Germany and the Netherlands. Its products bring considerable environmental benefits.
- Accutronics – an MBO from receivership that has resulted in work and jobs being brought back from China to the UK and significant European contracts being retained by the UK business as a base for further development.
- Zinwave Holdings – a provider of wireless active wideband systems. A recent development capital investment to support manufacturing expansion and sales growth in the US and Asia.

IQ Capital Fund

- IM-sense – has developed an Image Analysis Algorithm sold to a US hardware manufacturer.
- OnRelay – since investment the company has built products which integrate fixed and mobile phones, achieving £1m sales this year with all contracts abroad (Australia, Switzerland, USA) and is now negotiating for a potential £50m contract.

[26] The J Curve describes the typical pattern for the returns on early stage venture capital investments, with negative returns being incurred following the initial investment (typically because of the costs of R&D during the pre-trading period) leading to a break even position once trading commences, followed by a steep rise in profitability once the market for the product takes off.

[27] This gives justification that this report is an early assessment of the likely benefits and the future comprehensive evaluation planned will be better at identifying the actual benefits that have occurred.

Seraphim Capital Fund

- Aria networks – a company with artificial intelligence technology for use in telecoms (planning). Following investment it has now been OEM'd internationally by a leading global fixed line and mobile player and the largest Asian fixed line and mobile player.
- Hand Made Mobile – a social network on mobile phones. On investment it only had 3 UK networks as customers. Now it has all the networks as customers and 3 per cent of their user base are company customers. It is now expanding into the USA doing the same and has already signed up 3-4 carriers (of 20).

Performance of businesses to date

When asked about how ECF investments had been performing compared to expectations and business plan forecasts when the deals were made, it was generally considered that investments had mainly met the fund managers' performance expectations but not that of the businesses themselves. The terms of the investment are usually adjusted to give the fund a reasonable target return based on the fund's own expectations. The credit crunch has had a significant negative impact on the performance of established ECF fund investments. One fund manager said that the sales turnover of businesses was sometimes half of what had been forecast, whilst another said that the performance of most businesses was 30-40 per cent down on forecast. However, according to another fund manager, those investee businesses that are pre-revenue and working toward achieving research and prototype targets have been less affected by the credit crunch.

In the case of CfEF, eight of the 12 deals completed by the time of the interview with the Maven Fund Manager had only been finalised since December 2009 so it was too early to comment on their performance except to say that all but one deal was performing as expected.

Wider Benefits

Examples of wider economic and social benefits from recipient businesses

Catapult

- 4-energy. It has saved a major communications provider 25 per cent of its energy bill, improving its carbon footprint.
- Intellitect Water. It has developed a water supply monitor for chlorine which enables real-time monitoring of water quality without generating any waste. This means water utilities and industrial users can identify water quality issues quickly and don't need to overload the water supply with chlorine in order to achieve

purification.

Oxford Technology

- Akunu – has developed an approach to software data storage that reduces the energy requirements and hence costs of data storage
- Cleansteel – will reduce steel going into landfill.
- Historical futures – will increase the visibility of ethical sourcing in retail.
- Base 4 innovation – will achieve medical benefits by allowing the human genome to be sequenced in 4 minutes.
- Organox – developing a device for sustaining organs outside of the body prior to transplantation (potential NHS benefit).
- Personal Lifting Limited – developing a machine to lift heavy patients from hospital beds to a sitting position (potential NHS benefit).

Asked about what they considered to be the wider benefits to the economy and society attributable to invested businesses, the interviewed ECF fund managers saw innovation spillovers as an almost universal benefit from early-stage technology investments. The innovations also bring environmental and healthcare benefits (including NHS cost savings). These wider benefits can be illustrated by some of the investments made by two of the ECF funds as shown above.

The CfEF fund benefits relate more to the protection of employment through stabilising the companies themselves and enabling growth through freeing up companies from short term cash flow pressures arising from servicing of bank debt. Also, by resolving creditor issues (e.g. with HMRC and trade creditors) the CfEF has put money into the system which enables other businesses in turn to pay off creditors.

Overall views of fund managers on effectiveness of funds

Fund managers were asked how successful they thought ECFs have been and will be in the future. The four ECF fund managers responded positively, saying that the ECF was a successful model which was addressing the failure of the market to provide smaller amounts of venture capital and encouraging private investors to enter this market. It was also felt that the ECF scheme is necessary in the wider scheme of things to ensure that the UK maintains its position as a high-tech knowledge-based economy. Two of the fund managers also commented that ECFs have a better chance of success than the RVCFs which they regarded as being limited to making investments that were too small and geographically constrained. As for the CfEF, the Maven Fund Manager considered that it was also proving successful with many good mezzanine investments being made which would yield a modest but safe return.

Interviewed fund managers were asked what improvements, if any, they would like to see to BIS equity programmes in general. Their replies are summarised below:

ECFs

- Raise the £2m round restriction.
- Don't count management equity in the £2m limit.
- Increase all ECF equity-gap limits to £3-4m.
- Bigger syndicate sizes.
- Ability for ECF to invest £3m on its own (the equity gap has increased).
- With a £50m fund investing up to 10 per cent of the fund in any one company the fund needs to be able to invest at least 50 per cent of this on its own.
- Need to shorten the length and difficulty of the application process.
- There is a need for continuity of government policy over a long period.
- Fund size should be a minimum of £50m (of which CfEL should fund two thirds).

CfEF

- A longer investment period (e.g.5 years).[28]
- Fund size allowed up to £100m with investors split 50: 50 between public and private sector or better matching (i.e. more public sector).
- An evergreen self-financing fund.

[28] This is how ECFs are operated, however, the CfEF was designed to address an immediate financing need resulting from the credit crunch and so had a much shorter investment period.

6. ENTERPRISE CAPITAL FUND– BUSINESS INTERVIEW FINDINGS

Interviews with twelve recipient businesses from the Enterprise Capital Fund were undertaken which at the time of fieldwork formed approximately one fifth of the total number of ECF recipient businesses. They comprised two recipients from IQ Capital; two from Seraphim Capital; two from Amadeus; two from Catapult; two from Oxford Technology; one from Dawn Capital; and one from E-Synergy.

Additionally, two interviews were conducted with applicants undertaking the due diligence process and five were conducted with ‘dead deals’ where applicants were either unsuccessful or withdrew from the process before completion of the deal.

6.1 Business Profile

Taking the sample of nineteen ECF applicants as a whole, they covered a wide range of business activities, although the main groupings relate to various IT software applications (including gaming phonetic software; photo-imaging; educational software; business data search) (six businesses) and medical micro-electronics and bio-medical engineering (four businesses). The rest of the interviewed applicants covered a diverse range of activities, including the manufacture of batteries; the development of air conditioning and refrigeration equipment; the development of infrared sensors; the distribution of health products; and financial services.

A distinctive feature of all nineteen ECF applicants was that they were highly innovative businesses at the leading edge of technological developments in their fields, several of them being entirely focused on research and product development whilst others had patented products which they were in the process of taking to market. This shows ECFs are meeting their objectives at providing finance targeted at innovative businesses.

Most were young businesses, with 11 of the 19 ECF applicants starting trading after 2006. Just two pre-dated 2000 (one of which had a recent change of ownership). Six of the businesses were spin outs, three of them from universities, two from other companies, and one from a government scientific organisation. Another company was formed as an MBO when the previous company went into administration.

At the time that they made their application, the mean employment size of the ECF applicants was 10 employees (median 5.5), with the largest having 32 employees and the smallest just one employee (i.e. the business founder). In fact, seven of the applicants had less than five employees at the time of making the ECF application.

In the case of the twelve recipient businesses, the share holding of senior managers after completion of the ECF deal ranged from none to 70 per cent and exceeded 50 per cent in half of the cases.

6.2 Reasons for seeking Equity Finance

Since most of the applicants were young businesses, the majority were seeking finance for early stage capital, although three applicants wanted to finance the start-up itself, whilst another needed to finance a MBO and another to acquire an existing business. In the case of the 12 successful applicants, the funding was mainly going to be used for R&D and working capital, including the recruitment of key staff. For example, one business had used some of the funding to appoint a marketing director in order to take the business forward, whilst the funding enabled another to build up its sales team. In another case a substantial proportion of the funding enabled the outsourcing of the development of the product technology to a specialist company.

Equity was seen as the only option for most of these businesses, as they did not have the financial and physical assets and security/guarantees required for debt finance. Several interviewed CEOs thought that the banks were unlikely to fund pre-trading ventures which would not be in profit for some time. Others that already had bank finance did not want to become overcommitted to debt finance. Two of the applicants commented that they turned to equity once they had found out that there were no grants to fund applied development leading to commercialisation.

The amount of equity sought by the 12 ECF recipients ranged from £300,000 to £3m (mean £912,000; median £750,000). Interestingly, the five 'dead deal' cases were generally seeking larger amounts (mean £2.8m), with one applicant looking for £7m and another £4m, these being outside the upper investment size of the funds.

6.3 Alternative Funding Considered

The businesses differed in terms of how many alternative VC funds they considered previously. At one extreme, some entrepreneurs devoted up to one year searching for sources of equity finance. For example, one respondent said that he spent the whole of 2008 searching and contacting around 100 VC funds, with 15 of them expressing an interest in investing in the company. Another respondent considered about 30 VC funds, before narrowing down to five. However, it was more typical for entrepreneurs to approach five to six alternative funds. A common conclusion that entrepreneurs arrived at was that most VC funds were not interested in investing in anything below £3m whereas individual business angels were only interested in relatively small investments, generally below £50,000. This confirms the existence of an equity gap for SMEs seeking modest amounts of finance.

Where a choice of funding existed, the ECF source was generally favoured because it provided the size of funds required, offered favourable terms, and the entrepreneurs felt comfortable with the approach of the fund managers. One company narrowed the choice down to two alternative ECF fund managers and played one off against the other in order to get the best terms, whilst another company was attracted to a particular ECF fund manager because it gave them access to a business angel network that could prove useful for future follow on funding. In another instance the entrepreneur chose the ECF fund because of the expertise and knowledge that the fund manager had of the sector.

6.4 Additionality

Ability to raise finance from elsewhere

definitely would not have raised finance from other sources	2
probably would not have raised finance from other sources	0
no strong opinion	0
probably would have raised finance from other sources	5
definitely would have raised finance from other sources	5

Five of the interviewed CEOs were confident that they could have raised the funding they needed from other sources in the event of not being successful with their ECF application and another five said they probably would have been able to do so. Some already had other VC funds taking an interest, including alternative offers, although they doubted whether this would have been on such good terms. Others said that there would have been a limit to how much time they could have devoted to looking at other sources.

Extent to which would have gone ahead with business plans

would not have gone ahead at all, in any format	5
would have gone ahead at the same time, but on a smaller scale	0
would have taken longer to go ahead, but at the original planned scale	2
would have taken longer to go ahead and on a smaller scale	2
would have gone ahead at the same time and at the same scale	3

Five of the 12 recipient businesses considered that they would not have been able to go ahead at all with their business plans had they not obtained the equity funding as a result of the ECF scheme. These included a start-up as well as an MBO where the deal had to be completed within a month to avoid the company being wound up. Two respondents considered that they would have been able to still go ahead at the planned scale, but that things would have been delayed. For example, the CEO of a new business venture who planned to obtain the technology that he needed by means of the acquisition of a US company said that they would have lost the opportunity in the event of not obtaining the ECF funding. This would have resulted in them having to start the process of finding a suitable acquisition candidate all over again. Another two cases thought that they would have to reduce the scale of the project as well as taking longer to implement it. The other three cases assessed that they would have been able to go ahead at the same time and on the same scale if they had not obtained the ECF finance, although for one of them a condition of the alternative funding would have required the business to relocate to the US.

This suggests that although the number of businesses reporting to be entirely finance additional is relatively small, ECFs appear to be working through partial finance additionality by enabling businesses to raise finance more easily/speedily to enable businesses plans to go ahead quicker or on a larger scale.

6.5 The Customer Journey

Two thirds of the recipients (8 out of 12) knew at the time of applying that the ECF was a government supported fund, whereas the others only became aware through discussions with the fund managers.

The recipients experienced various routes to finding out about the fund: four already knew about it either directly or via an existing NED; two found out about it through their VC network; five were directed to it by their corporate finance advisors; and one found reference to it in information provided by Business Link.

Ratings of ECF recipients for referral process

Very poor	Poor	Neutral	Good	Very good	DK/NA
2*	0	0	2	6	2

*one commented that it would have been difficult to find out about the scheme without paid assistance and the other was critical of the lack of specific help from Business Link

Ratings of ECF recipients for time taken to find the Fund

Very poor	Poor	Neutral	Good	Very good	DK/NA
2	0	0	2	8	0

For the ECF recipients, it typically took one to two months to find the fund, although in a couple of cases it took six months to one year. Where delays occurred, it was sometimes because other matters were taking place at the same time, such as searching for a suitable company to acquire in one case, and entering negotiations with a larger VC investor in another.

When asked about what they believed was required for the application process and how the reality compared to their expectations, several commented that it took longer than expected to carryout the due diligence process and to complete the deal (in several cases over six months rather than the expected three to four months). However, these respondents said that the delays were sometimes caused by the difficulties of negotiating with other investors or because another investor pulled out of the deal. Most found the process straightforward and professional, although one respondent criticised the process for being "*very complicated, messy, and time consuming,*" involving eight changes to the business plan.

Ratings of ECF recipients of the application process

Very poor	Poor	Neutral	Good	Very good	DK/NA
1	0	0	3	8	0

Most of the recipients were pleased with the way the application process went, describing it as *"straightforward"; "relatively painless compared with previous experiences"; "the fund manager was brilliant at sorting problems out arising from another VC fund awarding less money than expected"*. The reason why one respondent rated the process as 'very poor' was because the ceiling cap on the size of the fund meant that the company had to spend time finding other funding sources which then proved more demanding on due diligence, adding considerably to the costs involved.

The two businesses that were still going through the application process at the time of interview both rated the process as 'good' and, despite not obtaining the funding, all but one of the five 'dead deal' cases rated the process as 'good' or 'very good', commenting on the professionalism and helpfulness of the fund manager.

Just over half of the ECF recipients (7 out of the 12) employed a corporate finance advisor/VC broker and a solicitor, whilst others relied on their own resources (including the expertise of NEDs). In fact, only two of the interviewed entrepreneurs admitted that no one on their management team had any previous experience of raising equity finance. Most of the respondents rated the advice they received as 'very good', although two rated it as 'very poor'. From hindsight, one entrepreneur regrets that he did not use independent advice and another entrepreneur was critical of the fund manager for requiring him to use their preferred consultants *"at extortionate rates"*.

Ratings of ECF recipients for advice

Very poor	Poor	Neutral	Good	Very good	DK/NA
2	0	0	0	7	3

The ECF recipients were asked to estimate the cost to the business of going through the application process. Their estimates of the key costs involved i.e. legal costs, due diligence, advisory fees, arrangement and other VC fees range from £25,000 to £150,000. The main cost however was considered to be the management time involved (typically half of the CEO's time for several months).

Turning to the five examples of 'dead deals', two of them were unsuccessful as they required more funding than the ECF fund manager was able to give them because of the £2m cap on individual investments. In both cases the entrepreneurs were happy with the application process, but they did not advance beyond the first meeting stage once they realised that the ECF fund would be unable to meet their requirements with regards to the size of funding. The third case, whilst optimistic of its chances following discussions with one of the fund's investment managers, was rejected by the investment committee on the grounds that they did not understand what the business was trying to do and found the presentation poor. Similarly, the fourth case, requiring funding to start-up, was also rejected because the fund managers were not convinced by the business case presented, having initially promised funding according to the respondent. As for the fifth case, the interviewed CEO says that they were in the end turned down by the ECF fund manager because the fund did not want to co-invest with another VC fund that was already on board.

6.6 The Deal Structure

The sample of 12 recipients received the ECF funding between October 2006 and January 2010: there were two cases in 2006; one in 2007; five in 2008; three in 2009; and one in 2010.

The amount of initial ECF funding received ranged from £250,000 to £1.7m (mean £673,000; median £500,000). One company received £1 million initially and then took up the option of a further £500,000 four months later and another received £500,000 initially and then took another £250,000 from the same ECF fund a year later.

The ECF equity stake involved ranged from 9.6 per cent (in the case of a £500,000 investment) to 83 per cent (in the case of a £1.5m investment). The average (mean) level of ECF equity was 33 per cent. For some entrepreneurs, their unwillingness to give up too much equity was clearly an issue limiting the amount of funds that they were able to access. For example, one entrepreneur set a top limit of 30 per cent for the amount of equity they were prepared to surrender in the negotiations. In contrast, other entrepreneurs, and notably serial entrepreneurs, were quite prepared for the VC funds to take a majority holding in the business. For example, one entrepreneur did not have a problem with the ECF taking an 83 per cent stake in the business, commenting that in his experience VC funds rarely want to change or interfere in the management of the investee businesses. What was more important for this entrepreneur was the increase in the valuation of the business resulting from commercialisation of the products.

6.7 Funding Leverage

Not only are ECFs a combination of public and private money but it was frequently found that ECF recipients were drawing additional funding that they required from several other sources. In seven cases other funding followed (or was conditional upon) the ECF funding, including cases where business angel and bank loan finance was unlocked on completion of the deal. Table 4 shows the type and amounts of funding that were leveraged in for these seven cases. It shows that the ECF funding was able to leverage in up to three times as much funding from other sources.

Other entrepreneurs commented that once the ECF deal was in place, they found that other VC funds started to take a more active interest in the business: "*they now wanted to keep the company on their radar*"; "*the VC industry is a small community and they tend to behave like vultures once someone makes the first move.*"

Table 4: Sources of Leveraged Funds

ECF FUNDING	£	OTHER FUNDING	£
Case 1:	£500k £250k	Business Angels Business Angels	£200k £250k
Case 2:	£250k	VC Fund Business Angel Network Individual investors	£250k £250k £300k
Case 3:	£600k	Different fund from same fund manager	£600k
Case 4:	£500k	Other VC funds	£1.5m
Case 5:	£600k	Corporate Equity Investor Seed Fund Business Angel Network Individual investors	£500k £250k £100k £100k
Case 6:	£300k	Individual investors Bank invoice financing	£200k £750k
Case 7:	£1.7m	Bank debt finance: Business Angels	£1.8m loan + £500k overdraft £300k

At the time of interview, three quarters of ECF recipients were beginning the process of seeking further funding, which generally would involve going back to the same sources, with sums ranging from £300,000 to £4m being sought.

6.8 Actual and Likely Impact of Funding on Business Performance

It is too soon to assess the actual impact of the funds on business performance as in the case of most of the ECF recipients the deals were completed less than one year ago. At the time they were interviewed, two thirds of the recipients were still essentially at the pre-trading stage, including two that received the first tranche of ECF funding two to three years ago. These were all cases where the bulk of the funding has been used for research and development, developing the intellectual property and prototypes, and patenting products.

Having said this, however, the majority of recipients assessed the impact to have been very positive, enabling developments that would not have taken place without ECF funding. Two entrepreneurs said that their businesses would not have existed had it not been for the ECF whilst another (the MBO case) thought that they would have gone out of business without the ECF. In the case of those recipient businesses that were doing at least some trading at the time of the interview, they all attributed between 40 and 100 per cent of their current turnover and profitability to the impact of obtaining ECF finance.

In terms of more quantifiable changes, the median annual sales turnover of the 12 recipient companies at the time of funding was zero, rising to a median of £50,000 in 2009, and then a forecast median of £600,000 in one year’s time and £5m in three year’s time. Two businesses had a forecast sales turnover of £20m in three year’s time. For three quarters of the recipient companies, the sales growth will be predominantly in international markets, with 80-90 per cent of predicted sales being exports. In line with the objectives of the ECF, this suggests recipient businesses have high growth potential.

With regards to profitability, only three of the recipient businesses were making a profit at the time of receiving the ECF funding and these were the only businesses to be in profit at the time of the interviews. Half the businesses forecast that they will be in profit in one year’s time and all but one forecast a profit for three years time, several forecasting a gross profit of between £1m and £4m.

At the time of receiving the funding, the 12 recipients employed 120 people (median of 5.5) which had increased to 194 people at time of being interviewed (median of 11) (i.e. an increase of over 60 per cent). Forecast employment for three years time totals 362 (median of 25), indicating a threefold increase in employment since receiving the ECF funding.

There were two cases where business performance proved to be significantly worse than what was forecast at the time of receiving the ECF funding. In a case where ECF funding was used to purchase a business, performance had been well behind the sales and profit forecasts in the business plan. The CEO attributed this to the recession and the failure of the market to grow as expected, resulting in a fall in the market value of the business. In the second case, the deterioration in the performance of the business was attributed to the failure to agree terms for the second tranche of funding, with the result that the business had been unable to finance the commercialisation of its products. The CEO blamed this on the poor management of the particular ECF that invested in the company.

Turning to the five ECF ‘dead deals’, the interviewed CEOs were asked about the impact on the business of not receiving the funding. In the case of an intended new business venture, the applicant was unable to launch the business because of the inability to raise money from any source. Similarly, an early stage business was unable to move ahead with the patenting and commercialisation of its products because of the failure to obtain funding from any source. In another two cases, much of the funding required was raised from other sources (including existing investors and another VC fund) so that the project was able to go ahead, although the sales turnover was thought to be below what it would have been had the ECF application been successful. And in the fifth case, the failure to obtain ECF funding resulted in the business diverting its focus of operations from the UK to the USA and China instead where there turned out to be significant market opportunities, leading the CEO to comment that the company was now performing better than it would have done if it had gone ahead with its original business plan.

6.9 Non-Financial Benefits

The interviewed recipients were asked whether they had received any non-financial benefits of the ECF. With one exception, all the recipients thought that there had been non-financial benefits, including being introduced to a network of partner investors, introduced to potential customers or suppliers, and benefiting from the knowledge and expertise of the board nominee from the Fund. For example, one CEO particularly welcomed the fact that the fund management nominee on the board was a scientist and that he made it possible for the company to tap into various networks, including introducing them to complementary businesses. And the chairman of another company commented that the particular ECF fund has 'institutionalised help', with "*a network of partner investors who are locally based, understand how high tech sector businesses operate, and can offer real sector specific assistance with built-in mentor support.*"

However, the experience of another recipient company illustrates the conflicts of interest that can arise in certain circumstances. In this case it was the managing director of the ECF fund who sat on the company's board. In the early stages, the CEO found the nominee's input to be very helpful: "*he brought professionalism to the board, understood the technology, and was able to help structure the business.*" The CEO's view changed however when it came to negotiating the second phase of the deal, such that according to the CEO "*the fund manager was more concerned with getting the best deal for the investors in the fund than taking the interests of the business to heart.*"

6.10 Summary

Rating of value of ECF to the business

Very poor	Poor	Neutral	Good	Very good	DK/NA
1	0	0	0	11	0

The ECF finance is rated very highly in terms of its value to the business by all but one of the sample of twelve recipients. Several respondents said that it would have been difficult (although not necessarily impossible) to go ahead without it, a typical quote being: "*it was the only funding available at a very difficult time that really offered what we wanted.*" Another respondent remarked that it was "*speedy, timely, efficient, and professional – a good deal for us at the time.*" The 'very poor' rating was given by the company which had failed to negotiate the second tranche of funding and now felt that the business was weaker than before receiving the original ECF funding.

Ways in which experience could be improved:

Most recipients appeared happy with the way things were and had no suggestions to make. Those that did mainly focused on the time and cost of undertaking the due diligence, in one case commenting that it seemed disproportionate to the size of funding involved. One respondent was critical of the £2m ceiling on funding, saying that this was not a lot of funding in today's market and arguing that more flexibility and discretion would have helped optimise the investment. Another respondent complained about the fact that obtaining ECF had prevented the company from accessing other government funds, saying that the level of state aid allowed was too low. Another respondent said that he had felt uncomfortable with the contractual arrangements and the share of the ownership of the business taken by the fund, with the implication that the management of the company could be removed at any time. In the light of his experiences, the owner of the company that was most critical about the ECF felt that as a government fund, the management of the ECF needed to be more in tune with the needs of SMEs rather than, as he saw it, optimising the returns for investors. However, business owners should recognise that ECFs are commercial funds investing a combination of government and private sector funds in viable growth orientated businesses within the boundaries of the equity gap.

7. CAPITAL FOR ENTERPRISE FUND - BUSINESS INTERVIEW FINDINGS

Eleven interviews with Capital for Enterprise Fund (CfEF) recipient businesses were completed, which at the time of fieldwork formed around a third of the total number of businesses currently funded. Seven of the recipients were from the Maven Capital Partners Fund operating in the north of the UK and four were from the Octopus Fund operating in the south. Additionally, four interviews were conducted with applicants currently undertaking the due diligence process and four interviews were undertaken with 'dead deals' where applicants were either unsuccessful or turned down for the CfEF.

7.1 Business Profile

The business activities of the portfolio companies were very diverse. Recipient businesses comprised: three IT related businesses involved in communications, gaming software and educational software; a chemical company; a business and financial support service; a tea blending company; a restaurant chain; a sport retailer; a children's entertainment chain; and two industrial support services offering maintenance and cleaning. Additionally, the dead deals and applicants in progress comprised: a pharmaceutical company; an exhibition and event organiser; a language translation and interpretation business; a construction company; three support services to the oil and gas industry; and a media and broker business.

The majority of businesses considered themselves to be innovative. Fifteen of the nineteen respondent business managers, including eight recipients, considered their businesses to be innovative, mainly in terms of the way they were applying technology or being focused on a niche market. Only nine of these businesses (four recipients) were using cutting edge technology (e.g. digital and nano technology) in their operations.

In line with the objectives of the fund, the majority of businesses are established and larger than the recipients of other BIS VC funds. Ten businesses (including six recipients) were established prior to 2000, with five of these undergoing ownership changes since 2000 and four (three recipients) being established in the last five years.

The surveyed businesses applying for CfEF (including applicants and dead deals) were predominately medium sized, with between 60 and 250 employees at the time of making their CfEF application. There was only one smaller business which employed seven staff.

The share of ownership held by senior managers ranged from 20 to 100 per cent (up to 90 per cent for recipients) and in eleven cases was under 50 per cent.

7.2 Reasons for Seeking Finance

As these were predominately established businesses, they were typically seeking capital to help with their expansion plans and this was linked to carrying out financial re-structuring in some instances. For example, four recipient businesses wanted equity finance to obtain better gearing with their existing bank debt.

Funding was mostly sought for one or more of the following purposes: new product development (6 cases including 3 recipients), working capital (12 cases including 6 recipients) and asset purchases (7 cases including 5 recipients).

All of these businesses turned to equity funding because: (i) they knew already that they had reached the limit of their bank lending facility; (ii) they applied unsuccessfully for bank loan finance, with three respondents specifically mentioning the failure of obtaining an EFG bank loan; and (iii) in one case they were offered debt finance but on unfavourable terms.

The amount of finance sought ranged from £500,000 to £2.8m with a median of £1.5m.

7.3 Alternative Funding Considered

Five cases looked at alternative VC funds, with two cases contacting 20-30 VC funds, but alternative offers were only tabled in a couple of cases and judged to be on unacceptable terms in terms of the amount of equity that the VC fund required. In another case, discussions with a VC firm were well underway when the CfEF manager was contacted but as the fund manager required exclusivity, it effectively ended contact with the other VC fund.

Six cases only approached CfEF as the respondents believed that anything less than £3m was too small for most VC funds, or that other funds would require more equity than they were prepared to give.

Mezzanine finance was considered in five recipient cases and taken forward in four of them where retaining ownership was a key factor. Whilst some did not consider this type of finance, others considered that the repayment terms were too expensive, particularly on top of the cost of existing debt finance.

With respect to the CfEF ‘dead deals’, mezzanine finance was considered in three cases and applied for mainly because “*that was what was available*”, although it proved to be more expensive than conventional bank loans due to higher interest rates, reflecting the lack of tangible security available[29]. In one case where mezzanine finance was not considered, the respondent indicated that it would not solve their problem as the business was already highly geared. In this situation, the interviewee stated that equity was the most appropriate form of finance.

7.4 Additionality

Ability to raise finance from elsewhere

definitely would not have raised finance from other sources	1
probably would not have raised finance from other sources	2
no strong opinion	1
probably would have raised finance from other sources	4
definitely would have raised finance from other sources	3

Three recipients indicated that they could have definitely raised alternative finance, but in these cases this related to VC finance, either on a scale that was beyond the requirement of the business at the time, or with equity share demands that were unacceptable to the existing shareholders. It was also notable that three of the four CfEF dead deals claimed they were able to raise sufficient alternative finance elsewhere.

Where recipients suggested that they would probably have raised the finance from other sources, this was likely to be VC finance, but it was thought that it would have taken a long time to find and that this would probably have cost the business in terms of lost growth opportunity in the interim.

Extent to which would have gone ahead with business plans

would not have gone ahead at all, in any format	2
would have gone ahead at the same time, but on a smaller scale	0
would have taken longer to go ahead, but at the original planned scale	2
would have taken longer to go ahead and on a smaller scale	4
would have gone ahead at the same time and at the same scale	3

If their application for CfEF had been unsuccessful, almost three quarters of the recipients thought that they would not have been able to go ahead with their planned business development at that time. In two cases the growth project would have been halted altogether because no alternative funds were likely to be found and the businesses had exhausted their bank debt finance options. One respondent stated that: "*without this finance the business might have collapsed with the loss of 250 jobs.*" Several respondents mentioned that it could have taken several years to find the required level of funding and that they doubted whether sufficient finance would be found to support the scale of growth they had planned for. The three businesses that would have gone ahead with their growth projects unchanged indicated that the alternative sources of finance were likely to have

[29] The mezzanine loans are secured on the business assets, although they typically rank behind existing bank debt and therefore in the event of a default, there is unlikely to be sufficient assets to repay the mezzanine loan.

been on less favourable terms and that the business would have been more ‘stretched’ to achieve their objectives. Another two applicants indicated that they would not be able to go ahead with their proposed project without CfEF finance.

With regard to the dead deals, three of the four businesses were able to go ahead with their business plans at the same time and at the same scale because they were able to raise similar levels of funding. In these cases the CfEF deal did not progress because alternative funding sources were available which included a mix of private equity, venture capital and bank debt. Only in one case was the project put on hold and this business was continuing to look for finance, six months after unsuccessfully applying for CfEF.

7.5 The Customer Journey

Most recipients and current applicants (11 out of 15) knew at the time of applying that the CfEF was a government supported programme, whilst the remainder only became aware through subsequent discussions with the fund managers.

Examining all cases (i.e. including current applicants and dead deals as well as recipients) revealed various routes to finding out about the CfEF: nine already knew about it either directly or via an existing NED; three saw it advertised; one found out about it through their VC network; four were directed to it by their corporate finance advisors/brokers; one was referred by Scottish Enterprise; and one was referred through the other CfEF manager, with whom they had previous equity funding contact.

Recipient ratings for referral process

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	1	0	2	6	2

The majority of recipients indicated that the process of information and referral to CfEF was very good, although one respondent was critical, stating that: *“…if we had not been in contact with Scottish Enterprise I don’t see how we would have found out about it*.”

Recipient ratings for time taken to find the CfEF

Very poor	Poor	Neutral	Good	Very good	DK/NA
1	1	1	6	2	0

For most recipients the time taken to find the CfEF scheme was assessed as ‘good’ or ‘very good’. Typically it took a couple of months to find out about the fund, although in two cases that already knew about the existence of the CfEF it was immediate. In the two cases where the time taken to find the fund was deemed ‘poor’ or ‘very poor’, it took 12-18 months and this was assessed to have held back business development.

Respondents were asked whether the application process had matched up to their expectations. All of the recipients commented that it took longer than expected to undertake this process. Most expected that it should take no more than a couple of months, but in several cases it took a lot longer. The four CfEL applicants currently going through the due diligence process indicated that the reality either matched or was very similar to what was expected.

With respect to 'dead deals' the four respondents indicated that the reality matched their expectations in the sense that they knew from the start that it was likely to be difficult and time consuming. One respondent indicated that once it became known that it was a government scheme they knew it would take longer because they perceived that it would involve a lot of 'red tape'. However, in another case the respondent stated that the reality was slightly better than expected, because the level and quality of communication was impressive and a strict timetable was adhered to.

The process of application included detailed business plans, financial forecasts, various elements of due diligence (e.g. financial checks, market reports, management references and in one case market branding research), extensive negotiations and legal issues, in order to complete the deal. Comments included that it was "*a demanding and rigorous process*", although "*professional and necessary*." Several cases commented that "*there was an excessive amount of due diligence*" and one case criticised fund managers for being "*ultra conservative and unwilling to take risks.*"

One recipient, a CEO with considerable experience of accessing international and UK VC finance commented: *"Initial negotiations were quick and moved from initial contact to the point of accepted application within four to six weeks. Thereafter, I feel badly misled. The due diligence process was described as 'light touch, quick, easy and low cost'. It was anything but! It took from mid-August through to the beginning of December, fully three and a half months to complete the deal*." In this case the management team's previous experience of VC deals led to an expectation that mezzanine finance would require less due diligence compared to pure equity investment. There was a far greater degree of research (e.g. management references and market research in a sensitive sector – the defence industry), compliance with legal matters and negotiation over the lending terms than had been initially envisaged.

Another experienced executive chairman recipient made an observation which was commented upon by several other recipients: "*This was the most thorough due diligence process that I have ever experienced! This was more akin to VC fund deals than debt finance and in my opinion was totally over the top."* This reflects that due to the lower secured ranking of mezzanine finance, it is riskier than traditional bank or senior debt finance which is secured on the assets of the business and hence a greater degree of due diligence is required.

Recipient ratings for application process

Very poor	Poor	Neutral	Good	Very good	DK/NA
1	2	3	2	2	1

The main reason for the six recipients giving a negative rating ranging from 'neutral' to 'very poor' was in their opinion the due diligence was "*excessive*" and "*over the top*", one comment being that it was "*more appropriate to a deal ten times the size*". However, this reflects the funds commercial nature, and the fixed due diligence costs that give rise to the equity gap. There is no suggestion that the level of due diligence undertaken by the CfEF is different from other commercial mezzanine finance funds. On the other hand, one interviewee commented that "*everyone did a magnificent job*" and the professionalism and quality of the fund managers was frequently praised.

Five recipients and one current applicant employed a corporate finance advisor/VC broker, whilst three recipients mentioned that they were required to engage corporate consultants (e.g. for market research and management referencing) and most cases engaged a solicitor for contractual aspects. Overall, the quality of external professional advice received was deemed to be very high and highly satisfactory. There were a few concerns raised about the high cost of consultancy and legal assistance received and in some cases the amount of consultancy required by the business.

Recipient ratings of external advice

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	3	2	5	1

In line with other mezzanine finance applications, the cost of obtaining the funding was considerable. Legal fees and due diligence costs were estimated to come to over £150,000 in six recipient cases (and also five applicant/dead deals) and attending to the paperwork (i.e. business and financial planning, application forms, legal documents and agreements) and negotiations typically took up a quarter to a half of the CEO's time for two to three months. This varied depending on the extent the business already had the business and financial planning reports compiled.

7.6 The CfEF Deal Structure

For the 11 recipients interviewed, CfEF funding was received between September 2009 and January 2010: three cases in September to October 2009; four cases in November to December 2009; and four cases in January 2010. Applicants currently undertaking the due diligence process expected to receive funding between the second or last week of February 2010.

The amount of CfEF funding received ranged from £500,000 to £2m, with a median of £1.5m. One case received an initial tranche of £1m with a second tranche of £500,000 available from six months later if the business performed sufficiently well.

The CfEF equity stake involved ranged from none, in four cases of a mezzanine finance deal, to 50 per cent in a case involving £500,000 of equity finance and £1.5m in debt finance. In those cases receiving equity finance, the average (mean) level of equity share taken by the fund was 26 per cent. In two mezzanine cases respondents mentioned that CfEF holds an equity warrant that gives the fund manager the option of purchasing shares to the value of between 5 and 15 per cent until the term loan repayment is made. The debt finance term is typically between three and five years duration.

The CfEF 'Dead Deals'*:*

Four interviews were undertaken with CfEL 'dead deals', where applicants were either unsuccessful or did not want to proceed further. Three dead deals were due to voluntary withdrawal from the application process, with two cases withdrawing because they found a better deal elsewhere and the third because the deal proved to be very expensive, in terms of the cost of refinancing the company's debt, which was unlikely to be accepted by their shareholders. The remaining dead deal was turned down because it was ineligible for the Fund, although unfortunately this was only discovered well into the application process.

When asked about the immediate impact on the business of not being able to raise finance, the respondent for the unsuccessful business indicated that the immediate impact was that it delayed the intended growth of the business, including taking on 40 additional staff. There was no immediate impact on the businesses which withdrew as they were able to raise alternative finance from other sources.

7.7 Funding Leverage

The majority of recipients did not seek additional funding at the time of the CfEF deal, although in one case the CfEF deal led to its existing institutional investors contributing a further £500,000 in funding. Two cases were able to re-structure their bank debt on the strength of the CfEF investment.

With respect to the applicants currently undertaking the due diligence process, three out of the four were seeking to raise between £0.5m and £3m in additional funding which in two cases depended on the CfEF application. With regard to the dead deals, two businesses were seeking £1m of additional funding (in one case in the form of a bank loan and the other from further equity funding) which depended on their success in raising finance from the CfEF.

7.8 Actual and Likely Impact of Funding

For most recipients it was too soon at the time of the interviews to assess what the impacts of the funding have been, since the deals were only completed during the last six months. However, it was clear that for most of these businesses the key benefit of receiving finance has been to unblock the intended expansion path of the business which will lead to improved sales and profitability in the future. The average (median) forecast sales growth over the next 12 months was £1m and forecast pre tax profit increase was £300,000.

For one company the funding came at a particularly good time and had already made a major contribution to improving business performance: "*This has had very positive impacts as the funding came a week prior to getting a new contract which required considerable working capital and asset funding of £500,000 from the Capital for Enterprise Fund. This was immediately put to work on plant modifications with a further £500,000 earmarked for operating costs prior to receiving income from the project in 5-6 months time. This will enable profits to rise by £1.7 million in the next 12 months, with exports increasing from 75 to 80 per cent of our trade and creating 5 extra full-time jobs in the next year."*

However, one isolated case considered that, although the CfEF funding had enabled continued expansion at a time when SME access to finance was constrained, the cost of mezzanine finance had reduced the company's growth potential by £100,000 this year. The respondent indicated that the business would be looking to clear this finance as quickly as possible, with the aim of pursuing less expensive finance options in the near future. It is reasonable to consider that if business could have obtained cheaper finance at the time of investment, such as through conventional bank debt, it would have done so, and that the provision of CfEF funding at least enabled the business to achieve stability and steady growth.

For the four applicants currently undertaking the due diligence process the expected impacts included major growth in export revenue and considerable cost savings as a result of the new products and technology to be developed. It was also expected to allow management to put more strategic plans into practice.

Nine recipients gave clear indications of employment growth during the next twelve months which ranged from an extra five to 150 FTE jobs (median 45 jobs, mean 55 jobs). Six recipients already exported, with exports representing between 5 to 97 per cent of their current sales turnover. All of these businesses indicated that they will increase the value of their sales exports during the next twelve months with four businesses increasing the export share of their sales turnover during this period.

Whilst it was difficult for recipients to give an accurate indication of the value of the CfEF finance with regard to their current and future business performance, the majority indicated that it was making a significant difference (8 of 11), representing more than half the value of new sales generation during the next twelve months. Several recipients indicated that their current business growth performance was directly related to the impact of the finance, with one respondent stating "*growth would not have been possible without this finance.*"

Similarly, the businesses undertaking the due diligence process indicated that they expected to double their sales turnover within 12 months of receiving the CfEF funding.

All of the recipients of CfEF finance indicated that they were currently on-track with their growth forecasts at the time of funding.

7.9 Non-Financial Benefits

Recipients were asked whether they had received any non-financial benefits from the CfEF. Seven of the cases thought that there had been such benefits, including: being introduced to potential customers or suppliers; being provided with information about potential acquisition targets; and moving towards a more rigorous approach to corporate reporting. One recipient mentioned that the firm's improved liquidity would definitely increase their credit rating with their clients. It is also worth noting that two current applicants perceived that CfEF would assist with business management and networking.

One recipient raised a concern over CfEF publicity, indicating that: "…*being associated with the Fund's press releases has had some negative repercussions with some of our customers who have raised concerns as to why our business would need to be receiving government assistance.*" The respondent was keen to stress that the finance was to assist growth rather than to save the company from any imminent collapse and that it should be seen as a positive achievement to receive this finance in the current economic climate.

7.10 Summary

Recipients rating of value of CfEF to the business

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	1	2	8	0

Overall, the contribution of the CfEF is highly regarded by the recipient businesses. The majority of them rated the CfEF finance as very good, in terms of its value to their business, with none of them giving a negative rating. One respondent described the finance as "*a perfect fit with our requirements*", and several mentioned that it was "*the only finance available at the time*".

Ways in which experience could be improved:

When asked what improvements could be made to the CfEF programme, four recipient cases focused on the need to reduce the costs involved, referring to *"the outrageous cost of repayment*", whilst there was a general acceptance from other respondents that although the finance was expensive, it was the only suitable funding available at the time. It is important to acknowledge that the higher costs of mezzanine finance reflect the higher risks of financing business considered too risky for normal bank debt.

Six recipient cases suggested streamlining the application process in order to "*make it more appropriate for the size of the lending, reduce the application costs and reduce the amount of haggling involved*". Additionally, four applicants/dead deals complained about the application process. It was suggested that the time-scale for the due diligence process should be reduced and that there should be no cap on the amount invested.

Suggestions for improving the application process included: using a standardised template in order to reduce the contractual costs involved; provision of guidelines on what is involved in applying; using a list of preferred lawyers and consultants if this proved to be a way of keeping the costs down; and the sharing of good practice amongst SME owners in receipt of CfEF, the point being made that: "…*smaller, less commercial, businesses might need more assistance to get through the process."*

There was some consensus of opinion amongst recipient businesses that the amount of due diligence involved was more commensurate to larger scale equity funding and that they would prefer if this was scaled back to achieve the 'lighter touch' approach that some had been led to believe would be the case. However, the CfEF is a commercially focused fund and there is no evidence that the level of due diligence is different to other comparable funds. A small minority of businesses also felt that there was a need for greater clarity from the outset on what the terms and conditions of mezzanine finance will be.

Most helpful aspects of the CfEF finance scheme:

All of the recipients mentioned that the CfEF finance had been helpful and would make a positive impact on their business. In terms of what was most helpful, the majority referred to the timeliness of the finance and the fact that it was available when they required it and in three cases was relatively 'speedy' to access. One respondent referred to CfEF as "…*giving a much stronger financial focus to the business*", whilst one mentioned that the VC funder presence on their board had improved their corporate reporting and another said that it had improved their business planning. Two further recipients and one applicant highlighted the value of the networking and PR assistance that they had received.

One of the dead deal respondents commented that although they were unsuccessful in obtaining the CfEF funding, the application experience had been helpful and beneficial and that they should be "*more investor ready in the future*" as a result.

Plans for repayment:

The CfEF recipients were asked how they planned to repay the finance. In six cases where equity finance was obtained this was likely to occur through either a trade sale or perhaps a company flotation. The remaining five cases were fairly evenly split between repayment through increased business profits and obtaining further external finance via future equity investment or less expensive debt finance. Equity finance was more likely to lead to a trade sale or further growth plans involving additional equity investment, whilst mezzanine finance was more likely to lead to loan repayment via retained profits or debt consolidation when cheaper loan finance could be secured.

8. ASPIRE FUND – BUSINESS INTERVIEW FINDINGS

Four interviews were undertaken with the managers of businesses funded by the Aspire Fund. At the time the fieldwork was undertaken there were only five firms funded by this fund. No ‘applicants in progress’ or ‘dead deal’ interviews were undertaken as no information was available on such contacts.

8.1 Business Profile

Two of the businesses were involved with healthcare activities and two were involved in web-based on-line activities. Three of the businesses considered themselves to be innovative and at the cutting edge of technological applications in their field, one in terms of producing a novel, bespoke software solution for charity giving, and two in terms of developing, licensing and selling new technology and products in the healthcare field (one operating in ophthalmic products and the other in women’s urinary products). The fourth ran an on-line recruitment website aimed at HR recruiters and agencies.

All four businesses were established in the last six years but none were spin-outs from other businesses or institutions. One healthcare business had yet to start trading and only two of the businesses had at least one year of trading experience.

The share of ownership by the senior managers of the business was just 10 per cent in one case, 20 per cent in two cases and over 50 per cent in the fourth case.

8.2 Reasons for Seeking Equity Capital

The on-line recruitment business was seeking capital for start-up, whilst the other three were seeking early stage finance for working capital to assist with R&D, clinical trials and licensing. Funding was used for a combination of software development (1 case), clinical trials and licensing (1 case), working capital (all cases), and asset purchase (1 case).

All of these businesses turned to equity funding because of the difficulties in obtaining bank finance (although one business already had a bank loan and another had a SFLG Scheme loan offer which was drawn down under the EFG Scheme once the equity funding was in place). The amount of equity sought ranged from £500,000 to £2m.

In three cases the Aspire Fund was perceived as the only source of funding available at the time which was sufficient to meet the needs of the business, whilst in another case Aspire was favoured because it allowed for greater retention of ownership.

8.3 Additionality

Ability to raise finance from elsewhere

definitely would not have raised finance from other sources	1
probably would not have raised finance from other sources	1
no strong opinion	0
probably would have raised finance from other sources	0
definitely would have raised finance from other sources	2

Two respondents indicated that at the time of the Aspire funding, it would have been very difficult to raise any finance from other sources, since a wide range of VC, banking and angel funds had been explored during a nine month period, without success in raising sufficient funds.

The two cases which indicated that they would definitely have raised finance from other sources suggested that it would have taken longer to organise and structure the alternative funding. In one case this was because of the fragmented nature of using individual business angel finance and in the other case this was because of the extended negotiations relating to equity shareholdings that would have taken place with other potential equity investors. This respondent was particularly pleased with the company valuation and shareholding taken by Aspire.

Extent to which would have gone ahead with business plans

would not have gone ahead at all, in any format	0
would have gone ahead at the same time, but on a smaller scale	1
would have taken longer to go ahead, but at the original planned scale	2
would have taken longer to go ahead and on a smaller scale	1
would have gone ahead at the same time and at the same scale	0

In all four cases, it is clear that Aspire funding offered some project additionality. In two cases this was because it would have taken considerably longer to raise sufficient finance to go ahead with the project. For example, one respondent referred to the time and complexity involved in raising alternative business angel finance, which would have involved individual deals with perhaps more than 10 business angels. In another case the timing of the Aspire deal was critical to the scale of the project, since other sources of funding available were not sufficient to finance the scale of R&D required and lack of funding would have held back business development until further funding could be found. In the remaining case the CEO indicated that it was unlikely that they would have found the level of funding required at the time, resulting in a probable scaling back of activities.

8.4 Customer Journey

All four interviewed recipients were clear at the time of applying that Aspire was a government supported programme. There were various routes to finding out about Aspire:

two saw it advertised (e.g. through press announcements); one found out via a business friend; and one from a NED (company chairman) who had good knowledge of government programmes.

Ratings for referral process

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	0	2	2	0

There was a high level of satisfaction with the referral process to the Aspire Fund and the visibility of the Fund, with two respondents specifically mentioning seeing press releases about it.

It is evident from these cases that it was typically the business entrepreneurs who found Aspire rather than other lead investors who referred them to the Fund. This may be partly a reflection of the businesses approaching the Aspire Fund before it had become properly established and known within investment networks and therefore the lead investors did not know about Aspire. However, it is also indicative of the fact that some businesses found Aspire before their lead investors and were then tasked with finding other lead investors. An observation from one respondent was that their lead investor was a private equity investor who had never heard of Aspire and that: "…*it is a mistake to think that the lead investor will necessarily lead to Aspire, as in our experience the onus was on our business to seek out Aspire."*

Ratings for time taken to find the Aspire Fund

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	1	2	1	0

It typically took between five and six months to find out about Aspire (in one case because Aspire did not exist when the search began). This length of time was generally viewed as acceptable because the entrepreneurs indicated that finding and accessing external venture capital is a long-haul process which can quite often take a year or more.

Two respondents indicated that the application process matched their expectations, whilst two were critical of the excessive due diligence which increased costs and proved very time consuming. The length of time to complete the application process was typically six to nine months (partly because Aspire was not yet set up). One case complained about having to repeat the due diligence process that they had already gone through with the lead investor and having to pay three separate legal fees (i.e. their own, the lead investor's and finally Aspire's legal fees). Whilst this is a common feature of co-investment models, perhaps more could be done to bring the due diligence requirements of different investors into closer alignment and reduce unnecessary overlap and cost from the process.

Another respondent was very critical of the extensive legal requirements and the due diligence process which took six months to complete and duplicated much of the work that had previously been done for the lead investor: *"This was, without doubt, by far the worst experience of due diligence procedures that the firm and its highly experienced management team have ever undertaken!"*

Ratings for application process

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	1	1	0	2	0

One case employed a corporate finance advisor and all engaged a legal team for the contractual aspects. In all cases there was a high level of satisfaction with the quality of professional assistance received, although several respondents mentioned that these expenses and particularly the cost of legal fees for each party were high. One respondent mentioned receiving a cap of £20,000 for legal fees, but mentioned that their solicitor had regretted this offer as complexity of the work undertaken had run well past this limit.

The overall self reported cost of negotiating the deal, including legal fees and due diligence costs, was between £20,000 and £90,000. Internal time costs for business planning, meeting and negotiations typically took at least half of the CEO's time for six months, which included pulling together and successfully obtaining the lead investor and the Aspire investment finance.

Ratings of advice

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	0	2	2	0

Respondents were positive on the value of the advice they received as part of the application process.

8.5 The Aspire Deal and Funding Leverage

Two cases received Aspire funding in July and August of 2008, whilst the two other cases received their funding in August and September 2009.

The amount of Aspire funding received ranged from £250,000 to £400,000 with equity stakes ranging from five to 20 per cent for Aspire.

As a co-investment fund, much of the funding was provided by the lead investors. It is notable that in two cases, the lead investors were found after initial contact with the Aspire Fund. In one case, whilst the Aspire Fund was still being established, it was able to direct the enquiry towards a seed fund, whilst in another case a private investor dropped out and Aspire was able to suggest some venture capital funds to provide matched funding. Overall, the aggregate Aspire investment for the four cases was £1.4m which was matched by £2.8m of other investment.

Lead funders provided between £100,000 and £750,000 and involved a venture capital fund (£750,000 in one case), various private equity investors and business angels (up to £200,000), and seed funds (£400,000 in one case and £250,000 in another). Additionally, £250,000 of private equity was raised in one case, £200,000 of business angel finance was raised in one case and £850,000 was raised from existing shareholders in the other case.

Additionally, one case also secured a £150,000 EFG Scheme loan once the Aspire deal was completed and another recipient has now received the offer of a second round of funding from Aspire of £109,000.

8.6 Impact of Funding

Two businesses attributed most of their recent growth and improved profitability to obtaining the Aspire funding, although for one of these the market had been flat in the last couple of years due to the recession, resulting in poorer than expected performance. The other two businesses had yet to start trading, but attributed at least 20 per cent of current business development to the Aspire funding. Both reported that, due to receiving funding from the Aspire Fund, they were on-track to start trading within the projected timeframe. Indeed, one healthcare business stated that they could not have proceeded to the clinical trials stage without this funding and that these have proceeded well and expects to be trading by early 2011.

The growth potential of the Aspire funded firms is considerable. Whilst two of these businesses were not trading at the time of being interviewed, the other two were in early stage trading with sales turnover of between £500,000 and £1m resulting in breakeven or low level profitability. However, within three years all of these businesses are forecast to generate sales turnover of between £5m and £10m, with balance sheet profitability in excess of 20 per cent of sales. This shows that the Aspire Fund is targeted at high growth potential businesses.

All four businesses have potential to export, with two either currently exporting or expecting to export from start of trading at a level of five to 10 per cent of their overall sales turnover and with the expectation that this will increase to above 50 per cent of annual sales turnover within the next three years. The other two businesses have a primarily UK trade focus, but have potential to trade globally, perhaps at the level of five to 10 per cent of sales turnover within the next three years.

The four businesses are currently operating with between three and twenty employees. Employment growth since receipt of the Aspire funding has been quite small, leading to about ten net additional FTE jobs. Two of the firms are likely to only increase staffing levels to a total of 10 to 15 FTE employees during the next three years, with growth focused on sales and marketing. There appears to be relatively small employment growth compared with the forecast increase in sales turnover during the next three years, but it should be noted that there will also be additional job creation through subcontracted manufacturing activities. This may reflect the industry sectors these businesses are in and their outsourcing business model. The two other businesses may increase to around 50 FTE staff, with increased administrative and product/service development activities which will be undertaken in-house.

Three of the cases will require further external funding in the future, ranging from £1m to £2m, in order to complete the development of the business during the next three years. These businesses are all considering additional equity funding as the most suitable type of finance, although in one case it is expected that this finance will be raised entirely from existing investors. The remaining case expects to be able to fund further growth organically through re-investing profits.

8.7 Non-Financial Benefits

Respondents were asked if they had experienced any non financial benefits from the Aspire Fund. Two respondents commented on the excellent PR that they have received *"…which has opened lots of doors*" and also in one case the helpful management advice and networking they have received which will help take their service to market. One respondent mentioned that the presence of Aspire at board meetings had "…*provided very useful management know-how and a good sounding board.*"

8.8 Summary

Rating of value of Aspire to the business

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	0	1	3	0

The women entrepreneurs were happy with the overall value of the Aspire Fund to their business. All of the respondents indicated that they were pleased with the Aspire funding with most rating it as 'very good' and reporting that it was valuable to their business development. It was evident that whilst some recipients were unhappy with the level of due diligence required, they were all certain that the benefits of the Aspire finance far outweighed this initial inconvenience and cost. All would recommend the Fund to other similarly placed businesses. Key comments from the women entrepreneurs were:

"*Aspire appeared to be particularly suitable for us as it is in-tune with women-led businesses."*

"*This is an excellent fund, easy to access, highly professional, and just what we needed.*"

"It was good to find funding that was targeted at women's businesses and so highly professionally run."

Ways in which experience could be improved:

One entrepreneur would welcome the opportunity to share experiences and knowledge with other businesses that have received funding through the government's equity programmes. It was also suggested that assisted CEOs should be encouraged to give something back by offering their services as NEDs to other government assisted businesses.

Two entrepreneurs commented that they had not experienced a "*light touch*" application process and that it needs to be quicker and streamlined, removing duplication of due diligence work. It was evident from both respondents that the duplication of due diligence to cover both the lead investor and Aspire's matching contribution had led to spiralling costs (including triple legal fees) and considerable replication of due diligence, which was felt to be more in-line with the role of a lead investor, rather than a secondary investor. One respondent queried whether Aspire's position was contradictory, since they are required not to be the lead investor, but in effect act as a lead investor in requiring such rigorous due diligence.

Plans for fund exit from the business:

All four cases will seek trade sales in order to exit the Aspire Fund within the next three to five years. The respondent CEOs indicated that they were already in the process of positioning their businesses for these trade sales, liaising with potential buyers who are likely to be global manufacturers (e.g. pharmaceutical manufacturers) or service providers (e.g. IT/Internet Service/Web Provider businesses). In all cases the entrepreneurs are predicting the potential sale value of the businesses to be in the region of tens of millions pounds. In common with other venture capital investments, only a small proportion of investments will generate this level of return in reality. The entrepreneurs expect trade sales will result in more secure conditions for the majority of the workforce, although the senior management and sales teams will probably not stay on.

9. FSEAF EARLY GROWTH FUND: BUSINESS INTERVIEW FINDINGS

Nine interviews were undertaken with managers of businesses receiving funding from the Finance South East Accelerator Fund (FSEAF) operating as part of the Early Growth Fund (EGF) in the South East region. The FSEAF has been established since 2004 and has invested in around 150 SMEs. Therefore, the sample size of nine businesses as a proportion of the total number of SMEs funded is relatively small compared to the other BIS funds. In general, the recipient businesses of the FSEAF also received their funding less recently than the other BIS funds.

Finance South East undertook its own evaluation of the Fund in 2010 which was based on a much larger sample.[30]

9.1 Business Profile

Six of the businesses were IT related, with their activities involving: advanced communications systems (two cases); IT security, on-line software rental; I-Pod docking systems and digital film post production. The remaining businesses included air traffic controller training, gourmet food manufacturing and precision engineering.

All of the businesses considered their services and products to be innovative, ranging from the production of gourmet pies with unique recipes to laser precision engineering and the delivery of a unique degree course in airline management. Five businesses used cutting edge technology involving high end laser, nano and IT software technology and three businesses specifically mentioned holding patents.

The surveyed businesses were typically less than ten years old, with the two older businesses established during the 1990s both having undergone radical change within the last five years through an MBO in 2006 and change in business activity in 2009 respectively. Six of the businesses started trading between 2001 and 2004 and one more recently in 2008.

At the time of receiving the FSEAF finance, these were predominately micro sized businesses, employing between three and ten staff. There was one larger business which employed 30 people.

It is important to acknowledge that the FSEAF provides mezzanine finance structured as loan finance. In only a minority of cases does FSEAF take an equity share in the business. Of the businesses surveyed just one case reported the FSEAF holding an equity stake equivalent to five per cent. In all other cases, the deal was structured as debt finance. Five of the businesses had non- executive directors (NEDs), but none had NEDs

[30] *Finance South East Accelerator Fund (2010) Meeting the Funding Gap: A regional response, Research Report*

from the FSEAF, although FSEAF had board observation rights in the case where it held an equity stake. This is to be expected given that FSEAF is a debt rather than an equity fund.

9.2 Reasons for Seeking FSEAF

In all cases, funding from the FSEAF was required in order to assist business development, mostly for early stage activities such as new product and service development (6 cases), including product testing and asset purchase, but also for sales and marketing (3 cases), including export missions and establishing distribution networks overseas. Four businesses specifically mentioned needing working capital to ease early business stage cash-flow, with one business seeking to expand to a second retail outlet requiring asset finance and working capital.

All of the businesses were seeking debt finance and were unable to obtain conventional bank loans. This was mainly due to being early stage business propositions which were deemed to be too risky by the banks. Whilst the surveyed managers generally accepted that they were presenting risky propositions, they were typically averse to considering equity funding and ceding a share of ownership. In some cases, the entrepreneurs could not understand why their businesses were too risky for the banks to offer them a loan under the Small Firms Loan Guarantee (SFLG) or Enterprise Finance Guarantee (EFG) schemes.

Several respondents mentioned that the banks appeared to be unwilling to lend to young growth oriented businesses because this was considered to be too speculative, the businesses did not have sufficient track records, or in a few cases the senior managers were unwilling or unable to secure loans against their personal property. Several respondents mentioned that they were unable to obtain bank finance under the SFLG Scheme or more recently through the EFG, Whilst a couple of businesses acknowledged that they were over geared and that their banks had suggested that they should be seeking equity investment, there was a general consensus amongst respondents that they were unwilling to seek equity finance as they were seeking relatively small sums of finance (typically £50,000 to £100,000) which was below the level that private sector VC investors would be interested in. Several managers suggested that business angel investors were not suitable because they would want too much equity share for such comparatively small-scale investments. Overall, therefore, it appears that a combination of failure to obtain bank finance together with the managers' reluctance to consider options that would involve equity dilution led to them applying to the FSEAF.

The total stage finance/project cost ranged from £50,000 to £1m (median £180,000), with all businesses seeking between £50,000 and £100,000 from the FSEAF. Only in two cases did the Accelerator Fund cover all of the project cost. In all cases respondents considered that this funding was being used towards developing an innovative product or service in terms of either UK or export markets.

9.3 Alternative Funding Considered

Other sources of funding explored included: bank finance in most cases; business angel and private equity investment/venture capital in a few cases. There were a number of instances where additional private sector funding was leveraged in at the time of receiving the FSEAF investment. These sources included bank finance (I case); private investors (2 cases); business angels (1 case); venture capital funds (2 cases); and a business partner (1 case).

None of the respondents specifically mentioned seeking or requiring mezzanine finance, reflecting the nature of the FSEAF as a debt fund. The majority of the cases (8) received term loans over a three to five year loan duration. In only one of the recipient businesses interviewed did the loan have an equity warrant attached. This was against the wishes of the business, but was implemented by the fund due to the high level of risk. The business could not obtain finance from other sources and so had to agree to the terms : "*We were seeking a term loan, but at the last minute in negotiations the Accelerator Fund introduced a five per cent equity requirement, with a £25,000 buy-out clause. We were extremely unhappy about this, but had no choice in the matter*".

9.4 Additionality

Ability to raise finance from elsewhere

definitely would not have raised finance from other sources	3
probably would not have raised finance from other sources	1
no strong opinion	1
probably would have raised finance from other sources	1
definitely would have raised finance from other sources	3

When asked whether, in the absence of FSEAF, finance could have been sourced elsewhere, there was an even split, with three respondents stating that they definitely would not have raised finance from any other source. However, three respondents stated that they would definitely have raised the finance and three cases were less certain. Where finance would definitely have been raised, the indication was that this would have taken longer to raise and would have been on unsatisfactory terms, such as equity finance which ceded a high proportion of ownership and bank debt finance secured by the directors' personal property.

Extent to which would have gone ahead with business plans

would not have gone ahead at all, in any format	3
would have gone ahead at the same time, but on a smaller scale	1
would have taken longer to go ahead, but at the original planned scale	3
would have taken longer to go ahead and on a smaller scale	2
would have gone ahead at the same time and at the same scale	0

All of the respondents indicated that the FSEAF was in their view effectively "*lender of last resort finance*" and that it had a high level of finance additionality. This is highlighted by three cases who reported that they would not have gone ahead with business development in any format without FSEAF finance. Three cases may have been able to proceed on a smaller scale and five cases would have taken longer to go ahead, albeit with three aiming for a similar scale of project. Where the project would still have gone ahead on a similar scale, this would mainly have involved seeking private equity or business angel type investment, although the latter was perceived as complicated, fragmented and therefore time consuming to find and put together and also overly demanding with regard to ownership share requirements. One respondent suggested that: "*80 per cent share of ownership for £100,000 was far too excessive for me to contemplate*."

9.5 The Customer Journey

Only one respondent was not aware that the FSEAF was a government supported fund, although they were aware that Finance South East was associated with other government programmes. The FSEAF appears to have been well promoted through business support agency networks, with the majority of respondents mentioning this route to finding the Fund through organisations such as; Business Link, Surrey Technology Centre, Thames Valley Innovation, Oxford Innovation, UKTI, a local business networking group and a Chamber of Commerce.

Ratings for referral process

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	0	1	5	3

There was a high level of satisfaction with the referral process to the FSEAF, with those respondents who could remember how they found it mentioning that it was referred to them early on in their search process. One respondent specifically recalled seeing a presentation at their local chamber meeting and being impressed by the Funds suitability for their requirements.

Ratings for time taken to find the FSEAF

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	2	2	5	0

It typically only took between one to two months to find out about FSEAF, although in a couple of cases it took four months. None of the businesses were affected by delays in finding out about the FSEAF.

Six respondents indicated that the application process for FSEAF matched their expectations. Indeed a couple of respondents mentioned that the process was more straight forward, easier and quicker than they had envisaged. All of the respondents commented upon the help and guidance provided by the fund managers who were very supportive and 'nursed' them through all stages of the process. Typically it took between one to two months to move through the application process to receipt of funds. However, in three cases it took longer and for one business it took four months, twice as long as expected. Delays and problems usually occurred because there was a greater amount of due diligence than originally foreseen, such as for additional business plans (e.g. sales and marketing plans) and guarantees. This may reflect businesses lack of investment readiness. Whilst the respondents complained about this, they also accepted that the process was thorough and highly professional. Two respondents specifically mentioned that they were surprised not to be given the opportunity to pitch to the FSEAF panel themselves, in order to demonstrate their passion for the business. However, all applications to the credit committee are undertaken by the FSEAF fund managers on behalf of their clients as this enables an objective assessment of the information presented. Only one business encountered a problem with the application process and this was in respect of the introduction during terms negotiations of a five per cent equity stake due to the riskiness of the business. The business deemed this as highly unsatisfactory, but could not prevent the clause. It should be noted that despite this, they rated the overall application process as 'good'.

Ratings for application process

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	0	4	5	0

For the most part, the businesses found the FSEAF application process straight forward and were "*walked through the process at every stage by the fund manager*." Other external assistance received included from solicitors, particularly in respect of checking final draft terms. One respondent mentioned using an accountant, but in most cases the management team were able to provide the business planning and financial forecasting required for applications.

Overall, respondents were extremely satisfied with the external professional assistance that they received, which was deemed as 'very good' in seven out of the nine cases. One respondent summed up the general feeling with regard to the application process and assistance received:

"*FSE are a good organisation, there were no delays and the application assessment went through very quickly. At every stage we were clearly informed by the fund manager what* *was required and although due diligence was thorough, it was not overly onerous. I have nothing but praise for the Fund, which was managed in a highly professional, efficient and commendable manner*."

Ratings of advice

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	0	2	7	0

The typical cost of the application process was £2,500 comprising of a £500 legal fee and a £2,000 FSEAF arrangement fee. Additionally, respondents indicated that about 10-20 days of management time was required, which appears lower than the due diligence required for the other BIS equity funds, mainly depending upon the extent of due diligence requirements. One respondent was keen to point out that in a small business management time is precious and that his time taken working on the FSEAF application had an opportunity cost relating to potential lost sales opportunities.

9.6 The FSEAF Deal

Four of the interviewed businesses received FSEAF finance in 2009 (between March and September), one in 2008 and four in 2007. In line with the FSEAF being a debt fund, all recipients received term loans for periods of between three and five years but in one case the mezzanine loan was structured to allow FSEAF a five per cent equity stake in the business.

Six businesses received the full £100,000 funding limit in a single tranche, one business only required £50,000 and two others received an initial tranche of £50,000 with an option after six months for a further £50,000 tranche if the business was performing sufficiently well. In neither of these latter two cases has the second tranche been used, due to poorer than expected business performance.

9.7 Funding Leverage

Six businesses raised additional funds at the time of receiving the FSEAF, although some of these funds such as a FSE product development grant and internal director investments would have been available in any case. When asked what the FSEAF had specifically leveraged in from other external funding sources, that would not otherwise have been made available, three businesses indicated that it had led to additional funds, ranging from £10,000 of private equity investment up to a £300,000 bank loan.

Subsequently, only one business had received further external funding and this was through an EU assisted bridging loan. When asked if the FSEAF had made the business more confident and able to access future external finance, six indicated that it had, due to the growth and business development that it had supported. One respondent commented that: “*it enabled a step change in the business and we are now looking for an additional £500,000 in equity finance and willing to cede a 20 per cent share in the business, as we are over geared and would benefit from some further working capital.”* Several respondents indicated that they now felt on a stronger footing to look for equity funding, without having to cede such a large share of ownership as they would have done at the time of receiving the FSEAF finance.

9.8 Actual and Likely Impact of Funding

Some of the FSEAF recipient businesses surveyed had received their funding a few years previously and so the impact of the funding could be assessed, unlike the other BIS funds in this report. Eight out of the nine surveyed businesses indicated that the FSEAF finance had made a positive impact, improving their business performance and assisting development and growth. Seven respondents suggested that current business growth was largely due to the FSEAF finance, with one case indicating that it was 100 per cent attributable, stating: “*without this finance the project would not have gone ahead.*” In the two remaining cases, one respondent attributed 40 per cent of current business performance to FSEAF, stating that although it represented 10 per cent of project finance, it had made a disproportionately important impact in unlocking other funds. One respondent indicated that their business venture had failed. This was because they had made a poor location choice for their second retail outlet and had not foreseen the level of increasing competition in their niche food retail market. This business has survived to pay back the FSEAF term loan, despite the failure of the project the FSEAF loan was being used to fund, and had now moved into the lower overheads, more flexible, events catering sector.

Seven of the FSEAF cases were currently performing below expected levels with regard to their sales turnover and profitability. This was due mainly to poorer than forecast market conditions and only one case, buoyed by the market opportunities of the forthcoming 2010 football World Cup, indicated that it was currently ahead of its growth schedule. However, apart from the one failed case, all of the respondents remained highly optimistic that their businesses will achieve their growth goals within the next three to five years.

All of the businesses, except for the failed project, demonstrated considerable growth potential resulting from the FSEAF finance. Six of the businesses exhibited major step change performance where sales turnover was forecast to rise from between £200,000 to £560,000, up to between £1.3m and £10m during the three to five year term loan period. All of the businesses forecast increased profitability during the term loan period, with four cases moving from a small loss or breakeven into sustainable profitability. Five cases were exporters at the time of receiving FSEAF finance and eight cases will be exporting by the end of the term loan period. The level of exporting, proportionate to sales turnover, is expected to increase in four cases and remain the same in four. Six cases forecast that exports will represent at least half of their sales turnover at the end of the loan period and at least 80 per cent in three cases.

Although these were predominately micro sized businesses at the time of receiving the FSEAF finance, they forecast considerable employment growth which could result in a net aggregate increase of 80 FTE jobs in the nine businesses by the end of the loan term (three to five years). Seven cases forecast employment growth with two cases forecasting approximately an extra 30 FTE jobs each. Jobs will mainly be created in sales (including export teams), administration and technical support work.

Respondents were almost equally split between whether they expected to fund future business development out of retained profits (four cases), or would seek further external investment (five cases). Where further investment will be required, four cases will seek equity investment because they believe that their businesses will be on a stronger, more established footing and that they will therefore be in a stronger position to obtain private equity investment on more advantageous terms, ceding less share of ownership. These respondents all indicated that equity investment would facilitate faster growth and provide the necessary working capital. All of these businesses would be seeking finance in the range of £100,000 to £500,000.

Respondents were also asked about the wider impacts on the UK economy FSEAF financed business had made. In seven cases where FSEAF had supported innovative activity which was assisting the business to develop global export markets, the impacts on the UK market were thought to be quite small. In these cases, where business was growing in the UK, they were unlikely to be taking market share away from other UK businesses because they were operating in niche markets and services without direct competitors. The remaining two businesses, which both had a focus on the UK domestic market, indicated that they had suffered from increasing competition. Both of these businesses had subsequently adjusted their core business activities in order to find niche, underserved UK markets.

9. 9 Non-Financial Benefits

In addition to the direct benefits of receiving funding, respondents were asked if they had received any additional benefits from FSEAF. Four respondents indicated that there had been tangible additional benefits. These predominately included assistance with financial management from the FSEAF's account managers, as highlighted by this case example: *"The main additional form of assistance has been from our account manager in terms of his financial know-how. Our business partners are mainly sales oriented, so they have benefited considerably from this financial management input."* Another respondent referred to the broader management support offered by their account manager: "*Regular review of the business with the account manager has been very cathartic, enabling us to see problems and put them right. They have provided a lot of SME business management* *expertise and know-how and industry experience."* Two of the respondents specifically mentioned that their account managers had been helpful in networking their businesses and finding consultancy and information that had assisted business development.

However, five respondents indicated that they were surprised how little contact they had received from their account manager. In none of these cases was this perceived as a problem for the business, although one respondent indicated that FSEAF might have benefited through better promotion of its services by the account managers and one respondent stated that: "*The Fund should get involved in the business more. They keep a close eye on the business, receive management figures each month, but never offer any advice."* This may reflect that FSEAF is mainly a debt rather than an equity fund. FSEAF meets with its invested businesses at least quarterly in the first year and half yearly there after, although more frequent contact is undertaken where circumstances require. In comparison, equity funds tend to have a monthly board meeting. Therefore, FSEAF fund managers are less likely to be involved in the day to day running of the business, unless the finance costs were increased to take into account their greater involvement, or there were other services that they can sell to the business.

9.10 Summary

Rating of value of FSEAF to the business

Very poor	Poor	Neutral	Good	Very good	DK/NA
0	0	2	0	7	0

The majority of the businesses rate the FSEAF as very good in terms of the value of the Fund to their business with seven out of nine respondents giving a 'very good' rating and two businesses giving a neutral rating provided by the two least successful businesses. Seven respondents indicated that the Fund, although representing a very expensive loan, was well worth pursuing as it offered the only viable and acceptable means of funding business growth at the time. One respondent specifically stated that: "*what they are doing in the current economic climate is good, acting as a lender of last resort."* Two respondents were keen to stress that this type of finance is only effective for businesses with a clear and realistic growth plan and one respondent specifically commented on this type of finance being good for those who are not comfortable with ceding a share of ownership.

One of the respondents summarised the cost of the loan as follows: "*There is a lot of money to pay back on very expensive terms. We have a five year term loan at 7 per cent above base with quarterly management fees and turnover performance levy charges (0.5 per cent per quarter, rising to 1 per cent) and an annual maintenance charge of 1 per cent of loan value. We were also required to take out key person assurance. This all adds up to a very expensive proposition. It is also incredibly expensive to pay back the loan early".* These costs reflect the FSEAF role in providing finance to businesses that are too risky to raise finance from conventional lenders, which FSEAF publicly acknowledges: "FSE accepts this, however, it should be acknowledged that interest rates are set on a case by case basis to reflect the level of risk and that limited personal security is generally taken".[31] The cost of the finance is positioned between debt and equity, with it being more expensive than bank debt but possibly less expensive than equity finance for the businesses which grow successfully in terms of the value of the equity given away.

Ways in which experience could be improved:

Four respondents put forward the case for reducing the cost of borrowing, stating that the FSEAF term loans were extremely expensive, particularly as: "*the SMEs still have to provide personal guarantees and life cover, so the lending risks are minimised*." One respondent commented that: "*The biggest problem is the cost of the finance. This is lender of last resort finance backed by the government. It is actually incredibly expensive. Repayment interest was 13 per cent, plus fund management and quarterly turnover levies. If we had failed to pay back the loan, the Fund would have had hold over our assets. Make the funding less expensive, which would encourage more businesses to use it and succeed."* Although the mezzanine finance provided is secured, it is typically subordinated behind bank debt, and so there is little tangible value in the security. If personal guarantees are taken, they typically relate to a small proportion of the loan and are not backed by personal asset pledges[32]. Therefore, the fund's security requirements are very different from those of banks, and it is likely that many recipients do not fully understand this.

It may be noted that several of these businesses were advised by their banks to consider equity finance and might have been better served by this type of finance. However, in the majority of cases the surveyed managers were averse to ceding a share of ownership for relatively small-scale levels of equity finance.

Although the majority were happy with the application process, three respondents suggested improving it by simplification and reducing the amount of paperwork. There was an isolated case of one respondent who was required to offer an equity stake in the business and was particularly concerned that the terms of business should be made clear from the outset. The indication here is that FSEAF operates under different terms from other bank debt finance which businesses need to understand at the outset in their dealing with the Fund. However, these terms are clearly outlined on the Finance South East Website.

[31] Finance South East (2010) *Meeting the Funding gap: A regional response*, Research Report

[32] They are unsupported with recovery typically dependent on future earning capacity and co-operation of the individual.

Most helpful aspects of the FSEAF:

All of the respondents indicated that the most helpful aspects of FSEAF were the relatively quick and easy access to finance offered at a critical time for the development of their business. Additionally, several respondents specifically praised the ‘helpful’ and ‘professional’ assistance of their account manager in guiding them through the application process. One CEO with considerable experience of accessing equity finance noted that accessing FSEAF *“was relatively painless and inexpensive compared with the equity investment route.”*

Plans for fund exit from the business:

The majority of cases expected to repay the FSEAF term loan through their increased profitability. However, in three cases a trade sale was likely to take place within the next three to four years and these businesses were already positioning themselves in the market and exploring opportunities with potential buyers. Two businesses mentioned that, whilst they were most likely to repay their loan through profits, they would be seeking equity finance within the next three years which might help them to restructure their debt finance to provide more working capital and to assist faster business growth.

10. SUMMARY OF KEY FINDINGS

This final section draws on the analysis of the four BIS finance initiatives in the previous four sections to present a number of key findings from the interviews with business managers who applied for funding under one of the programmes. To facilitate cross referencing to the specific programmes, it adopts the same structure as the preceding sections.

10.1 Business Profile

The profile of the businesses receiving investments is as expected given the objectives and market position of each programme. Most of the businesses surveyed were young, early stage businesses established since 2000, with several applicants for ECF being pre-trading businesses, undertaking R&D and developing prototypes and/or in the initial stages of launching their products and services. The applicants for CfEF tended to be older businesses, although several had undergone ownership changes, such as MBOs, since 2000.

The majority of businesses were innovative, with a high proportion involved in developing and delivering market leading products and services (particularly for ECF and Aspire recipients). A high proportion were involved in IT/software related activities and were using or developing cutting edge technology.

A high proportion of the businesses were already exporting, or planning on exporting, the majority of their sales, especially those with global market leading products and services.

At the time of applying to the BIS funds, the majority of businesses were small, employing less than fifty people, with most of the FSEAF recipients being micro businesses with less than 10 employees. The exception is the CfEF where businesses were typically medium sized with between 50 and 250 employees.

10.2 Reasons for Seeking Finance

For the majority of new and early stage businesses, equity investment was perceived as the only viable option for raising finance due to their lack of financial assets, insufficient trading record, the founder’s unwillingness to secure/guarantee debt finance against private property or concerns about over-gearing.

A number of respondents mentioned the unwillingness of banks to lend since the credit crunch, indicating that they were not able to obtain finance through the SFLG Scheme and subsequent EFG Scheme. Some indicated that the banks considered their business growth propositions to be too speculative for loan finance and that they were directed towards equity finance as being more suitable to their level of risk and stage of development.

The amount of finance sought ranged considerably from £50,000 up to £3m. Where businesses were seeking equity finance the lowest levels of funding sought were around £250,000, whereas in the case of the FSEAF, businesses had mainly been seeking bank debt finance and had turned to the FSEAF as a lender of last resort for term loans of between £50,000 and £100,000. Recipients of the CfEF also reported approaching the limits of their ability to obtain bank lending.

10.3 Alternative Funding Considered

Those businesses seeking equity finance typically considered a range of options such as private investors, business angels and corporate VC funds. The selection of equity funding source usually came down to timing and availability, with the BIS equity funds being the only ones that would provide the right amount of finance at the right time. In some cases corporate VC funds had been prepared to offer more substantial finance (typically in excess of £3m), but this was too much for the business's requirements at that time.

In other cases business angel funding was available, but this was small-scale, often below £50,000 and would have involved considerable negotiation to put together sufficient packages of finance. Furthermore, business angels often required higher levels of equity share in the business than was acceptable for the business owner for the level of finance provided.

In the small proportion of cases where choice of funding existed, the selection of BIS funds typically came down to the deal, the amount of funding offered, the fund manager's approach and the business fit with the fund, particularly with regard to sector and networking activities.

Other than the FSEAF and CfEF where mezzanine finance was offered and drawn down, mezzanine finance was rarely sought in other BIS VC programmes. This was because it was generally considered as more expensive than debt finance (because of the costs of servicing) but also more complex than other forms of debt finance, and not suitable for early trading businesses that lacked smooth revenue flows. Where mezzanine finance was taken, this was typically used by established businesses seeking term loan finance for business growth but who were unable to obtain this bank finance and did not want to cede ownership under equity finance.

10.4 Additionality

Across BIS programmes as a whole, there appears to be a high level of additionality recorded by the recipients. This mainly relates to the speed and scale of the finance provided. Moreover, the actual finance and project additionality may be higher than the reported figures indicate since fund managers consider that the entrepreneurs who apply to BIS funds may well over estimate their ability to obtain finance from other sources.

Just under a third of recipients (30 per cent) claimed that they would not have been able to raise the finance that they needed from other sources had they not obtained the BIS funding. Two thirds (64 per cent) thought that they would have been able to raise the finance from elsewhere. However, amongst these, many thought that the alternative sources of finance would have been more difficult to put together and would have ceded too much equity share.

In terms of facilitating outcomes, overall, just 17 per cent indicated that in the event of not receiving funding from the BIS fund it would still have been possible for them to go ahead at the same time and on the same scale. On the other hand, 28 per indicated that they would not have been able to go ahead at all, in any format[33]. Whilst the rest (55 per cent) considered that they would have gone ahead, in most cases this would either still have been at the original planned scale but have taken longer (25 per cent) or would have been on a smaller scale and taken longer to go ahead (25 per cent), with the others (5 per cent) still going ahead at the same time but on a smaller scale.

10.5 Customer Journey

The majority of respondents knew at the time of applying that the fund was government backed. Those that did not initially know this were informed by their fund managers.

Routes to finding these funds varied considerably, with some cases employing corporate VC advisors and exploring large numbers of funds through VC networks, whilst others referred to company directors seeing press releases and advertisements. Whereas many ECF applicants had found out about the fund managers from private VC networks, the FSEAF appeared to be particularly well promoted through business support networks such as Business Link, UKTI, local innovation centres and Chambers of Commerce.

The typical time taken to find the BIS fund was two months, although often shorter for the FSEAF but longer for some of the businesses applying to ECF and CfEF. Whilst the majority of respondents indicated that they had no concerns about the length of time it took

[33] It is interesting to compare this with the results of the NAO's recent survey of recipients of BIS's previous equity funds (the UK High Technology Funds; Regional Capital Funds; and Bridges Funds) which found that 23 per cent of businesses would not have gone ahead with their planned activity in the absence of finance from the funds.

to find the BIS fund, some respondents suggested the programmes could be better promoted. The application process was generally judged to have worked well, with just under three quarters of recipients (72 per cent) rating it as ‘good’ or ‘very good’. Many respondents praised the “thorough and professional approach” taken. However, some respondents found the level of due diligence was not the ‘light touch’ that they had been led to expect. Indeed, some who claimed to be highly experienced in VC deals were highly critical that the level of due diligence went well beyond that necessary for a deal of this size. It is important to acknowledge here that this may reflect that the level of due diligence required for an equity deal is fixed and does not vary by size of investment, and is a contributing factor to the existence of an equity gap in this area. Also, given that the BIS funds comprise contributions from private sector funds as well as the Government’s own contribution, it is important that a rigorous due diligence process is undertaken for the fund to make commercial investment decisions.

A particular observation from Aspire Fund recipients was that due diligence processes had to be duplicated between the required lead funder and Aspire, which appeared to be unnecessarily time consuming and expensive. Additionally, the business had to pay legal fees for the two funds as well as their own legal costs.

The majority of businesses used some form of external assistance to assist them through the application process. Typically, they used legal assistance with regard to finalising agreement terms. Additionally, accountants, corporate advisors and various consultants were used in order to provide business plans, financials, presentations and comply with due diligence (e.g. business referencing, marketing). Generally, there was a high level of satisfaction with the advice received, with 84 per cent of recipients rating it as ‘good’ or ‘very good’. Respondents praised the external professional assistance received as being highly professional, although there were some concerns about whether it was really necessary given the relative modest amounts of funding involved.

There were some concerns that the overall cost of the application process, which typically ranged between five to 10 per cent of the overall finance raised, was too high. Also, some respondents referred to “over the top due diligence”. However, these costs appear to be in line with those of private sector fund managers as other research[34] confirms that “for a small investment in a technically complex company, the costs can easily account for 10 per cent or more of the investment”. Where businesses had difficulties with due diligence, this was sometimes due to the business not being investment ready.

The application process itself typically took about two months, although being quicker for FSEAF term loan deals, but longer for more complex equity and mezzanine deals. The main reasons for delays were due diligence requirements and agreement negotiations. In some cases delays were due to problems with other funders that were going to be part of a funding package and therefore out of the control of the BIS fund managers.

[34] SQW Consulting (2009) *The Supply of Equity Finance to SMEs: Revisiting the Equity Gap.*

10.6 The Deal Structure

The amount of equity finance offered ranged between £250,000 and the £2m ceiling cap, whilst for FSEAF the finance ranged from £50,000 to the £100,000 funding ceiling. In a small minority of cases funding was split into tranches which could be delivered according to business performance. Also in a minority of cases there was an indication that further funding might be available, after the first year.

For those businesses receiving equity finance the average (mean) level of equity share given up to the fund was 29 per cent, although it did reach 83 per cent in one case. In the mezzanine cases surveyed across the CfEF and one case within the FSEAF, the term loans covered a three to five year duration, but with equity warrants, ranging from five to 15 per cent over the period of the loan.

The vast majority of respondents were pleased with their funding deal. Amongst the small minority of complainants, the main reasons were discomfort with the amount of equity ownership offered and concerns about the amount of control that the fund had over business management decisions, including the hiring and firing of senior managers.

Amongst the dead deals, it is notable that some fell through because better offers were received from other private sector VC funds. This could be viewed as a positive finding as it shows public sector funds are not displacing private sector funds by under cutting them. A complaint from some recipients and dead deals was that the BIS funds should have a higher ceiling cap than the current £2m, which is dictated by current state aid rules.

Many businesses reported the repayment costs of the FSEAF's term loans to be very high, which also included additional management fees, turnover performance levies and high early repayment penalties. Many of the businesses specifically chose the FSEAF as an alternative to ceding ownership through equity finance and respondents recognized that this was lender of last resort finance, as their businesses were too risky to raise debt finance from mainstream lenders. Although, many felt these repayment terms to be excessively high, the majority (seven out of nine) considered the value to the business to be 'very good' (the highest option).

10.7 Funding Leverage

There were differences between the BIS funds in their ability to leverage additional finance at the time of funding. All four Aspire Fund cases were required to find a lead investor to at least match the Aspire investment and seven of the 12 ECF cases raised additional finance ranging from £450,000 to £2.6m. Several of the ECF applicants were negotiating packages of funding from various investors at the same time, although the ECF deal was usually the trigger factor for the other investors deciding to go ahead. Only one CfEF case raised additional funds, with a further two restructuring their existing bank loans as a direct result of the CfEF deal. Three FSEAF cases raised additional finance ranging from £10,000 to £300,000 as a direct result of receiving FSEAF funding.

10.8 Actual and Likely Impact on Business Performance

In many cases the finance obtained from BIS funds had only been received within the last 12 months and so it was too early to gain clear evidence of the full impact to these businesses. Several of the ECF recipients were still a few years away from obtaining significant trading income. However, the majority of respondents were able to refer to experiencing positive impacts from the funding. Impacts had typically resulted in moving pre-trading businesses forward with R&D and marketing and to raising sales turnover and profitability amongst trading businesses. In the case of the ECF and Aspire recipients particularly, the injection of equity finance was clearly facilitating leading edge innovatory developments which had the potential for exporting to a global market.

Where businesses were trading, improved performance in sales and profitability was typically judged to be at least 50 per cent attributable to the funding.

The growth potential of the recipient businesses was considerable, with the majority indicating that they expected to grow from sales turnover of under £1 million to £5 million or more within three to five years. Profit margins and employment were also set to increase and in many cases exporting activity was expected to grow considerably. For example, taken together the 12 ECF recipients predicted that their employment in three year's time would be three times what it had been at the time the ECF deal was agreed.

Most respondents indicated that they were at least on-track with their forecast business development. However, more than half of FSEAF cases considered that they were currently performing below expected levels with regard to their sales turnover and profitability, due to poorer than forecast market conditions as a result of the economic downturn. FSEAF businesses are more likely to be affected by the economic conditions as a higher proportion of funded businesses are trading businesses compared to pre-trading businesses in ECF and Aspire Fund.

The 'dead deals' exhibited varied business performance. Those that were able to obtain sufficient funding from alternative sources were able to go ahead with their projects and achieve growth, whereas those that had not been able to find alternative funding were held back from their forecast future business growth.

10.9 Additional Non-financial Benefits

Aside from the impact of receiving finance, many respondents commented on receiving non-financial benefits. Typically, these related to the presence of a fund representative as a NED or board member and the more rigorous approach to corporate management this imposed on the business. Others referred to the benefits of the management advice received, which was particularly helpful where the existing directors were better suited at R&D and sales rather than financial management. Other benefits included being part of a large business support network and sectoral expertise, improved networking access, PR and access to further investors including business angels. There were a number of instances of where recipients were introduced to potential customers and suppliers through these networks.

10.10 Overall Assessment of BIS Funds by Recipient Businesses

Overall, recipients rated the value of the BIS funds very highly with more than 80 per cent rating the value to their business as 'very good'. Many stated that they would not have been able to grow and develop their business without this finance. The vast majority indicated that they would recommend other similarly placed businesses to seek and use BIS funds and several mentioned that they had already referred other businesses.

10.11 Suggestions for Improvement

This section summarises the various suggestions made by the interviewed businesses on improvements they thought could be made to the BIS initiatives.

Fund Promotion

Whilst most respondents mentioned that they were satisfied with the referral mechanism and time frame in which they found the appropriate BIS fund, some respondents indicated that they believed these funds could be better promoted. The survey demonstrated that the funds were most effectively promoted through press releases and advertising to business support networks (particularly VC networks), rather than direct advertising to SMEs. Few businesses appear to have found out about the programmes via public support networks (with the possible exception of FSEAF) and this is confirmed by the views of fund managers themselves. It is important therefore that fund advertising promotion is effective and targeted, with mainstream business support and VC finance networks being kept updated with details of the funds available.

In the case of Aspire, more might be done to promote the Fund within venture capital networks since the few women-led businesses that had applied to the Fund appeared to have found out about it themselves, rather than through lead investors.

Application Process

As mentioned above, the majority of interviewed businesses rated the application process as either 'good' or 'very good'. However, SMEs often found the level and cost of the due diligence process for the BIS funds to be very high, especially in relation to the modest amounts of funding the business was looking for.

The key problems arising from the thoroughness of the due diligence process are the time delays caused to the process and the additional costs incurred through consultancy fees and additional management time. In some instances, this was due to a lack of business investment readiness. It is important to acknowledge that this may reflect that the level of due diligence required for an equity deal is fixed and does not vary by size of investment.

Some possible solutions suggested by respondents experienced at going through VC funding application processes include setting up a template approach which is clear and easy to follow and reducing unnecessary duplications of due diligence. This was especially the case for the Aspire Fund which is a co-investment fund, where recipients mentioned paying legal fees in triplicate (i.e. their own legal fees plus those of Aspire and the other lead investor). This could be reviewed in the design of future funds in order to reduce the cost burden on applicants. One suggestion is for Aspire to work closely with lead fund manager and where necessary take a leading role to help ensure that due diligence is undertaken in an effective and efficient manner.

There was a call from a number of the interviewed business managers for reduced legal and consultancy fees relating to due diligence and terms agreements. Some respondents suggested that the amount of consultancy work could be reduced, whilst others suggested that certain costs should be capped.

Fund Offer

A key recommendation made by both surveyed businesses and most fund managers is the raising of the upper investment levels as the perceived equity finance gap now extends up to at least £3 million. Some of the interviewed fund managers thought that the gap relating to early stage equity capital had widened in recent years because many VC funds 'had moved up market' whilst High Net Worth (HNW) individuals had moved out of the market completely due to the credit crunch. EU State Aid regulations currently restrict government backed funds from offering a substantial number of investments above the £2 million threshold in any given year. This is an area where the UK government might wish to request a change in EU State Aid policy given other evidence suggesting an increase in the upper boundaries of the equity gap.

It is clear from the responses of some of the recipient businesses that they did not fully understand the basis on which the BIS equity funds had been established, since they expected government backed funds should have significantly lower fees and costs than those of private sector sources. BIS funds are managed by commercial fund managers making commercial investment decisions within the boundaries of the equity gap. This conflict is perhaps inevitable in the case of government venture capital funds as funds have to balance the need to make an acceptable return for private investors whilst at the same time supporting the needs of businesses.

Although businesses were satisfied with the overall value of funding and the additional benefits it facilitated, several respondents found the cost of mezzanine finance loans under FSEAF and CfEF to be high. Evidence from the interviews with recipient businesses suggests that the mezzanine loans have helped the business obtain finance arising from the difficulties in obtaining bank finance during the credit crunch, and have unlocked business expansion plans. There is clearly a balance between the cost of borrowing on one hand to the SME, the costs of fund management and business failures and providing an adequate return to investors. Although the pricing of the mezzanine loans reflects the level of risk and the subordinated nature of the finance behind other lenders, this may be an area where the costs and terms and conditions can be better communicated to businesses upfront with the differences between mezzanine finance and conventional bank loans clearly distinguished. Many FSEAF recipients chose this form of finance as an alternative to ceding ownership through equity finance, which they believed to be more costly.

APPENDIX I: Case Studies

CASE 1: (ECF) PHONETIC ARTS LTD

Set up in 2006, this company is developing IT gaming phonetic software and currently produces two unique market leading pieces of software. The aim is to grow the company over the next three to four years before probably selling the business to a large US gaming company.

The company sought £500,000 of funding at the end of 2007 to finance early stage research and development and software development. Since the value of the business was in its IP and R&D capability rather than its fixed assets, debt finance was not an option for the level of funds required. The CEO first became aware of the possibility of ECF finance through the Cambridge Business Angels Network and this led to an application being made to two funds: IQ Capital and Amadeus. The CEO did not realise at the time that both these funds were backed by the Government. The original intention was to raise all the funds required from business angels, but it soon became clear that VC fund backing would be necessary in order to kick start the collective financing of the project. It was only when the funding from IQ Capital was agreed that a further £200,000 was unlocked from Business Angels.

According to the CEO, the application process went smoothly, with the due diligence being 'straightforward and minimal' and the contractual issues being 'easily sorted out' – "*the investors were backing a good idea and they could see it was.*" However, the main problem was that the valuation was just 60 per cent of what they were looking for. IQ Capital was chosen over Amadeus because they offered competitive terms and they seemed to have a better feel for the business and its market.

The deal with IQ Capital was finalised in May 2008 and involved £500,000 for a 25 per cent ownership stake. The company secured a further £500,000 ten months later, half from IQ Capital and the rest from five new private investors. In the event of not being able to access the funding from IQ capital, the CEO considers that they would still have been able to go ahead with the planned developments as they would have taken up the similar offer from Amadeus. IQ was selected because it demonstrated a good understanding of their business sector. Since financing the business IQ have had a helpful NED presence and the CEO commented that: "I*Q are well networked and we feel part of a bigger group, with plenty of people to call on for help, which is very reassuring.*"

Although progress is running about one year behind schedule, sales turnover is forecast to increase from the present level of £300,000 to £3 million in three years time, with the business breaking even in 12 months time. Employment is forecast to rise from 14 at present to 25 in three year's time. The CEO estimates that at least 50 per cent of this performance will be attributable to obtaining the ECF finance.

CASE STUDY 2: (ECF) MANIC MONKEY LTD

This business, set up in 2007 by a female entrepreneur with a background in publishing and children's literature, is concerned with applying gaming and recreational software technology to developing educational software for children. It is forecast to achieve a sales turnover of £5 million by 2013, of which 80 per cent will be exports (primarily to the huge Indian and Chinese markets). The company has recently received an 'exporter of the year' award.

The founder and CEO decided to apply for £500,000 of equity funding in 2008 as she did not want to become over-committed to debt finance. The funding was required at the time for product development and to build up the sales team. Working through a corporate finance advisor, the CEO was introduced to four possible funds, including Dawn Capital who appeared to have the kind of IT expertise and knowledge that she was looking for – "*they seemed to be the right sort of people to contribute to and motivate the business"*.

Having had no experience of attracting equity funding previously, the CEO left much of the initial negotiation to her corporate finance advisor. However, a key consideration for the founder in entering discussions with venture capital funds was to find investment partners who would add value through their expertise, as well as to retain majority control of the business. Whilst the application process took several months longer than expected, she found Dawn Capital straightforward to deal with and the offer, consisting of £500,000 for just under a 30 per cent stake, was finalised in October 2009. This then led to other VC fund managers wanting to talk to the company, but the founder did not want to dilute her equity stake any further at that stage. She also wanted to avoid ending up with several shareholders. However, in thinking ahead, the CEO recognises that the continued development of the business cannot rely solely on a combination of self-funding and debt finance and that further equity funding will be required – "*we need to fund the business in a grown up way.*"

Although it is still early days, the CEO considers that the impact of the ECF funding has been very positive, enabling the business to move up to another level. They have already expanded employment from 6 to 11 employees since receiving the funding, and expect to be employing between 15 and 20 in 12 months time. Whilst it probably would have been possible to have obtained equity funding from other sources, the Dawn Capital deal has enabled the company to take advantage of new market opportunities which may have been missed if the search for funding had continued. The CEO has welcomed the expertise and knowledge that the Dawn Capital board representative has brought to the company, commenting that: "*it has helped the business grow up*".

CASE 3: (CfEF) MONKEY BIZNESS LTD

This company, set up in 2006, specialises in children's indoor play centres, providing all round family entertainment built around the 'healthy lifestyle' concept. It had six sites at the time of the CfEF investment and currently has eight sites. The company is looking to open a further six sites across the UK in the next three years, which would more than double the size of the business from the time CfEF invested.

In 2009 the company was looking for equity finance in order to obtain better gearing with its existing bank debt and in order to grow the business. The company had expanded too quickly and taken on too much debt finance. It had tried unsuccessfully to raise more debt finance from its existing bank using the Enterprise Guarantee Fund, so equity was seen as the solution in a difficult market for raising finance. The company was originally seeking £3 million, of which £1 million would be in equity.

Using a financial broker, the company initially looked at 30 VC funds, of which three expressed interest, and two made offers including Octopus. Whilst Octopus was not the best deal, the company thought they were more professional and in-touch with the company's requirements. It is not known if the other VC offer would have survived the due diligence process which proved to be long and difficult.

The broker saw the CfEF initiative advertised in January 2009, and the company put in an application to Octopus in the following month. It then took a further six months before the deal was agreed. The managing director commented that the application process was more in-depth, demanding and time consuming than expected, but was nevertheless very professional and necessary. After discussion with Octopus, the company brought in an interim finance director to help get through due diligence. A major benefit of the process was that it made the company focus on its business plan and to work out how to get the most out of the business.

The eventual deal from Octopus comprised £500,000 in equity and £1.5 million in debt finance repayable in four years. For this Octopus took a 50 per cent stake in the business, becoming the largest shareholder, and leaving the senior managers with a 30 per cent stake. In fact one of the attractions of the deal was that it enabled the founders to retain an element of ownership. The company was then able to renegotiate its debt finance with the bank and other lenders to save £160,000 through an interest and capital payment holiday. This created a further breathing space.

The managing director considers that without CfEF funding the company would have been in serious financial difficulties even to the extent of not being able to survive. Whilst another offer of equity funding was originally received, the only other viable option for the company at the end of the process was to raise around £200,000 in Business Angel finance, but this was felt not to be worthwhile in view of the complexity of the arrangements necessary for relatively little funding.

The mezzanine finance deal has meant that the company can now continue with its expansion plans, moving from a current sales turnover of £4 million to over £10 million in three years time and increasing employment from 280 to over 500 over the same period. Octopus has a presence on the board, being actively involved with monthly board meetings and has provided useful assistance to date.

CASE 4: (ASPIRE) EVERYCLICK LTD

Formed in 2005, this company is developing bespoke software to provide a unique online charity donation service for the UK. In 2008, the company sought to raise £700,000 in order to fund its software and service development. The company already had bank loans and further debt finance was not considered appropriate for funding this development.

The company had employed a corporate VC advisor to help find suitable funds, but this did not lead to anything. The CEO then saw an advertisement/press release for the Aspire Fund and contacted them in March/April 2008 (at the time the Fund was being set up) to find out more. She realised that matching investment would be needed and already had some possibilities through her own private investor network. She observed that: "*It was refreshing to find a fund where being a woman was an advantage. The VC and Angel world is dominated by men, so there are times where you feel that you are swimming against the tide. The Aspire Fund is a breath of fresh air as they want to see women build successful high growth businesses and are there to support female enterprise. I believe it will prove a winning formula.*"

The experience of the application process matched up to expectations, with an offer being agreed just three months after first contacting Aspire. Whilst the CEO would have liked this to have been quicker, she realises that her company was the first to obtain Aspire funding. Aspire agreed to provide £350,000 for a seven per cent equity stake. Over the same period the CEO negotiated £100,000 from a lead private investor and a further £250,000 from existing private equity investors.

Without Aspire funding the project would still have gone ahead, but on a smaller scale significantly downscaling the business, because the company would have been dependent upon fragmented sources of funding which would have been complex to organise. Aspire enabled them to obtain the bulk of the funding from just two sources. The CEO comments that post funding: "*Aspire have been highly supportive and provided good access to a number of key individuals that will have a significant impact on the future growth of this business. Their PR is excellent and has opened lots of doors.*"

So far the CEO reports that the company has not managed to achieve its forecast levels of performance because the market has been flat throughout 2009. However, the completion of the first licence sale of their technology to Microsoft in December 2009 should help to get the business back on track. The company is forecast to reach £8 million sales turnover in three year's time, with its employment increasing from 12 at present to 50. Insufficient profit over the last couple of years means that further expansion (including global marketing to secure strategic partnership deals) will need to be funded through a second tranche of equity funding. The company has already been offered a further £109,000 from Aspire and is currently seeking a further £1.4 million from existing investors and new private VC funds.

CASE 5: (ASPIRE) ALTACOR LTD

Formed in 2007, this company was set up by two entrepreneurs to build an ophthalmic specialty pharmaceutical company with marketed products and a low to medium risk development pipeline. Ophthalmology is a growing market with unmet need, the market size is being driven by an aging population, higher levels of screening and refractive surgery. The company has a three to four year growth plan, with the aim of exiting through a trade sale.

The company raised £1 million in 2007 to start the business and then in 2009 sought a further £1 million to move the business forward, including new product development and marketing. Equity finance was the preferred option and it was unlikely that debt finance would have been suitable for the company's funding requirements. It was the Chairman of the company who, through his various funding networks knew of the Aspire Fund and quickly realised that the business ticked a lot of the right boxes i.e. the CEO was a female entrepreneur and the business was developing innovative products in a growth sector. The company already had another fund (specialising in the bio tech sector) on board who would be the lead investor.

The initial contact with Aspire was at the end of 2008, but it took until August 2009 to receive the funding. The process was protracted for a number of reasons including the undertaking of further due diligence, in addition to that carried out by the lead investor. The CEO had expected from both the company's chairman and the Aspire Fund manager that the application process would be 'light touch', but it proved more demanding in time and expenses than she had anticipated.

Aspire provided £400,000 for an 8.2 per cent stake in the company, matching the £400,000 from the lead investor. In addition, a further £200,000 was obtained from Business Angels.

Without the Aspire funding, the CEO considers that it would have taken even longer to complete the funding process. Whilst they would have probably obtained some equity funding, it would not have been sufficient for the R&D that they wanted to carry out. The Aspire funding was therefore the linchpin to funding the R&D and marketing support. Although the protracted funding process impeded the company's ability to grow whilst it was being implemented, several recent commercial successes are now seeing growth on the expected trajectory. From its turnover level of £360,000 in 2009, the company is forecast to reach £6 million revenues by 2012, although employment is forecast to increase from the current five to 10 employees over this period. The company is now seeking a further £2 to 3 million of equity finance to expand the R&D pipeline and augment product marketing. Since closing the funding the Aspire manager has attended one board meeting and has been provided with regular updates. She has been supportive towards the next financing round due to complete in Spring 2010.