Capital for Enterprise Ltd: 2013 Survey of Fund Managers

May 2013

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Acknowledgements

CfEL would like to thank all those fund managers who took the time to respond to the survey.

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Introduction

Through its oversight role, CfEL has regular contact with fund managers operating Venture Capital (VC) funds involving public sector funding, and hears plenty of anecdotal evidence about the state of the UK VC market. This survey is designed to systematically measure and record the views of these fund managers on a variety of topics including the quality of investment opportunities available, the appetite of private investors to invest in VC funds, experiences in raising follow-on rounds, and the opportunities available for successfully exiting of portfolio companies.

This survey builds on the previous CfEL survey of fund managers undertaken in November 2011, both to allow a comparison over time, and also to cover additional topics of interest.

Methodology

The research was undertaken in February 2013 using an online survey tool.[1] Out of 59 fund managers invited to take part, 37 responded leading to a 63 per cent response rate.

It is important to acknowledge that the findings are **not representative of publicly funded VC funds**, but of the fund managers that responded to the survey. At the very least, the results provide an indication of how widely held certain views are amongst a relatively large sample of fund managers delivering Government funded VC funds.

Key Findings

- The majority of fund managers (89 per cent) **believe an equity gap exists,** although there are some uncertainties on the exact boundaries of the gap. However, the majority (59 per cent) of fund managers estimate the upper boundary of the equity gap is now £3m or above.
- **The current environment for new investment opportunities is good** with 84 per cent of fund managers judging the market as good or very good in terms of the quality of investments available. Investment opportunities are perceived to have improved over the last year and are expected to improve further in the next 12 months. Over half of fund managers (56%) expect to **make more investments in the next 12 months** than they did in 2012.
- However, other areas of the market are not so positive. The majority of fund managers (83 per cent) perceive it is difficult or very **difficult to find co-investors to syndicate with**.
- The **environment for exits is also perceived to be very difficult** with 72 per cent of fund managers thinking the opportunities for successful exits of portfolio companies is poor or very poor. However, nearly half of fund managers expect the exit environment to improve over the next 12 months. 92 per cent of fund managers report trade sales as their preferred exit route for generating financial returns.
- The majority of fund managers (92 per cent) also report **it is difficult to raise new funds**. 86 per cent of fund managers intend to raise new funds in the next two years, **with many fund managers expecting government funding may contribute to this**. Only 13 per cent of fund managers expect government funding will definitely not form part of this funding.

[1] Survey Monkey

- Fund managers continue to report "**The economy" and "obtaining finance**" as the main barriers to the success of their portfolio companies.
- **Fund managers do not believe 10 years is sufficient time** for a Limited Partnership fund to invest, develop and exit companies, with many suggesting 15 years may better suit the financing needs of early stage businesses due to the increased length of time before exits can occur.
- Fund managers undertake a variety of activities to market and promote their funds to SMEs and other investors.
- The majority (75 per cent) of **fund managers are satisfied with their experience of engaging with CfEL** over the past 12 months.

1- Introduction

Through its oversight role, CfEL has regular contact with fund managers operating Venture Capital (VC) funds involving Government funding, and hears anecdotal evidence about the state of the UK VC market. This survey is designed to systematically measure, quantify and record fund managers views on a variety of topics including the quality of new investment opportunities, the perceived appetite of investors to invest in VC funds, experiences in raising follow-on rounds, and opportunities to successfully exit portfolio companies.

This survey builds on the previous CfEL survey of fund managers undertaken in November 2011[2], to allow a comparison of trends over time, but also contains additional questions to explore other topics. For instance this survey examines the activities fund managers use to raise awareness and promote their funds to SMEs.

The next section (section 2) briefly summarises the methodology and survey response rates. Section 3 looks at the survey results and is structured along the following headings:

- The equity gap
- Venture Capital market conditions:
  - Quality of investment opportunities
  - Syndication
  - Follow on funding
  - Exits
  - Fund raising
- Obstacles faced by portfolio companies
- Fund managers' views on Government policy
- Views on optimal fund design
- Promotion of funds
- Views on engagement with CfEL
- Other comments

Conclusions are presented in section 4, whilst a copy of the survey questionnaire is contained in Appendix 1.

[2] Capital for Enterprise Ltd: Survey of fund managers 2011: James Halse, CfEL. http://www.capitalforenterprise.gov.uk/files/CfELper cent 20fundper cent 20managerper cent 20surveyper cent 20finalper cent 20reportper cent 20v2a.pdf

2- Survey Methodology

A total of 59 fund managers were invited to take part in the survey. The sampling frame comprised of fund managers of VC funds that CfEL has an oversight of including ECFs, RDA funds, and legacy funds like RVCF and EGF. Other public funds were also included such as Carbon Trust and the Coalfields Enterprise Fund. The sampling frame was identical to the previous CfEL fund manager survey, other than when fund managers had left the investment organisation. In these cases, the replacement manager was added to the sample frame. For funds established since the last survey, e.g. new ECFs, the names of the fund managers were added to the sample.

Ideally, the sampling frame should have only contained the name of one investment manager for each fund overseen by CfEL. However, in practice some funds have more than one fund manager, and so following the approach taken in the previous survey, it was decided not to exclude them from the sample. This allows the views of a greater number of fund managers to be examined, and also avoids the potential for selection bias from removing fund managers from the sample.

With this in mind, it is important to acknowledge that findings **are not representative of Government funded venture capital** funds, but rather of the fund managers that responded to the survey. At the very least, the results provide an indication of how widely held certain views are amongst a relatively large sample of fund managers managing Government funded VC funds.

The survey was administered using an online survey tool (Survey Monkey). Insofar as was possible, the survey was administered using survey methodological best practice to ensure the findings are reliable and are as robust as possible.

Fund managers were invited to take part via a personalised email issued by the CfEL project manager on 14 February 2013 containing a unique link to the survey. The email explained the reasons for carrying out the survey, assured anonymity, advised that the survey should take 10-15 minutes to complete. The unique link in the email enabled CfEL to track responses, but did not allow CfEL to identify respondents from their responses. Participants were given two and half weeks to complete the survey with two personalised reminder emails being issued to non-respondents half way during the survey period and 2 days before the survey closed.

A total of 37 managers responded – a response rate of 63 per cent. Whilst this represents a high response rate compared to internet based surveys in general[3], it is lower than the previous 2011 survey response rate of 83 per cent. Further examination revealed that response rates were lower for legacy funds like RVCFs and some regional ERDF funds, but the response rate was high for "current" funds like ECFs. The lower response rate this time round could be attributed to the older age of the funds, and possibly lower day to day engagement with CfEL as fund managers manage down their existing portfolios. The previous 2011 survey response rates may have also been boosted due to advanced notice that the survey findings were going to be presented at a CfEL hosted seminar all the fund managers were attending. This may have given fund managers a greater incentive to complete the 2011 survey, whilst this time round there was no event to increase

[3] Cook et al (2000) estimates an average sample response rate of 40 per cent based on 68 surveys.

engagement. The interpretation of the results and comparisons to the previous survey must take this into account.

The design of this survey was based on the design of the previous 2011 survey to maintain consistency and allow an examination of trends over time. However, there are a number of differences to be aware of:

- The 2013 survey is slightly longer[4] than the previous 2011 survey due to additional questions on the current state of the market to complement questions on how the VC market has changed in the previous 12 months and how it will change in the next 12 months. Additional questions were also added on optimal fund structure and optimal fund size, as well as preferred portfolio company exit route and how funds market themselves to SMEs.
- Questions were removed on perceptions of performance and government involvement in the VC market.

A copy of the survey questionnaire is contained in Appendix 1.

Types of funds managed

Respondents to the survey managed a wide range of publicly backed funds, with many managing more than one type of public sector fund. Whilst this makes it difficult to infer findings to one specific fund, it allows a wider assessment of the market covering funds at all stages of their investment cycle.

Table 1: What type(s) of publicly backed venture capital fund does your investment organisation manage? (Tick all that apply)

Fund under management	Number of respondents
Enterprise Capital Fund (ECF)	17
Early Growth Fund (EGF)	6
ERDF supported fund	17
Fund established by Regional Development Agency without ERDF	5
Regional Venture Capital Fund (RVCF)	12
Enterprise Investment Scheme (EIS)	4
Venture Capital Trust (VCT)	4
Also manage Private sector Fund	7
Other publicly backed fund	3
All funds	37

68 per cent of the fund managers reported their investment organisation managed funds that were open to making new investments.

[4] At the outset the survey was promoted as taking around 10-15 minutes to complete, compared to the previous survey suggesting it should only take 10 minutes. It is widely acknowledged that the length of the survey has a direct impact on survey response rates and quality of answers, and care was taken in designing this survey to avoid making the questionnaire too long.

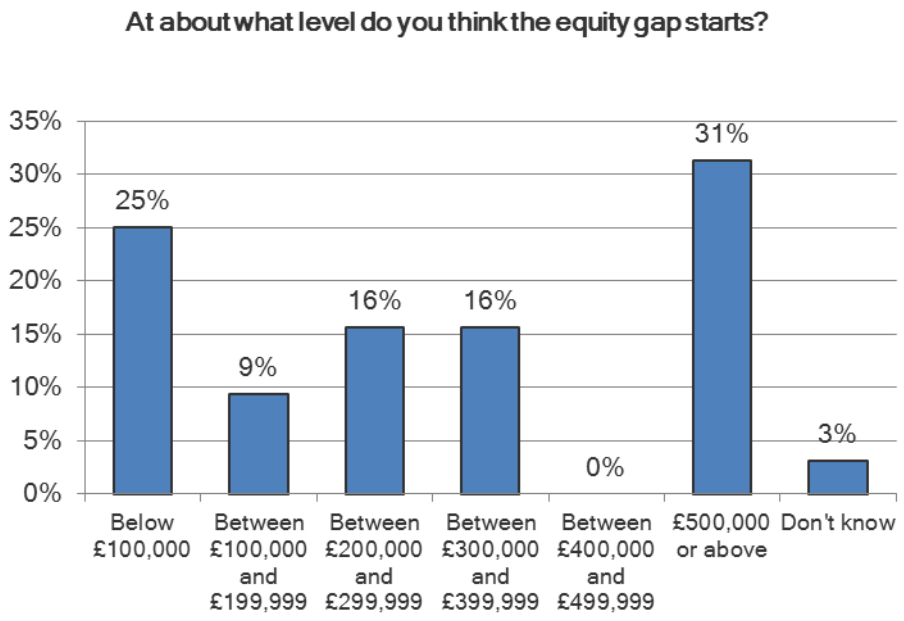
3-Survey results

3.1 The Equity Gap

The concept of an equity gap is well established and provides the rationale for Government funding of VC funds targeted at smaller investment sizes.[5] The survey asked fund managers whether they thought an equity gap exists where by viable risk capital investments could be made but few private sector venture capitalists invested. 89 per cent of funds managers thought an equity gap existed, but 11 per cent did not (equivalent to 4 respondents). Previously 100 per cent of fund managers thought an equity gap exists, but it is not clear why there has been a slight change in views.[6]

Of those managers who thought the equity gap existed, the survey then asked managers to estimate what they thought the lower and upper boundaries of the equity gap were. The results are presented in figures 1 and 2.

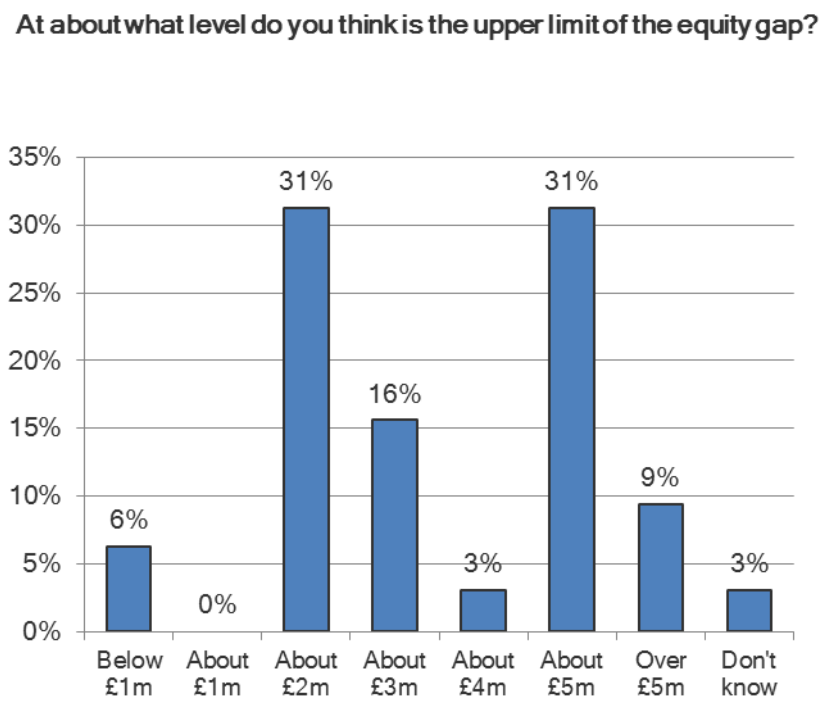
Figure 1



[5] See for instance, BIS (2012) "BIS economics paper No 16: SME access to external finance"

[6] The descriptive definition of the term "equity gap" changed slightly between the two surveys from "where debt finance is inappropriate or unavailable and the amount of risk capital required is below what many venture capitalists will invest" to "where viable risk capital investments could be made but few private sector venture capitalists invest".

Figure 2



The responses to the questions on the upper and lower limits of the equity gap show the views on the boundaries of the gap are more complex than a single set of parameters. There was little agreement in where the equity gap started with 25 per cent suggesting it was below £100,000, but 31 per cent reported it above £500,000.

The upper boundaries of the equity gap were also unclear. 37 per cent of fund managers report the equity gap is up to about £2m, however the majority (59 per cent) report the equity gap is now £3m or above. In particular, 31 per cent of fund managers report the upper boundary of the gap to be around £5m. There appears to be some upward movement in the upper boundaries of the equity gap over time as the previous 2011 survey found 47 per cent of fund managers reported the upper boundary of the equity gap to be about £3m or above (compared to 59 per cent in this survey).[7]

Several fund managers made the point that assessing the gap between two points was too simplistic and that the gap differed between different sectors. A couple of fund managers also reported the upper boundary of the gap to be above £10m.

The diverse views expressed in regards to the boundaries of the equity gap appeared to be due to type of fund managed. Managers of Enterprise Capital Funds (ECFs) were more likely to suggest higher starting and end points. Conversely, managers of other funds were more likely to suggest lower boundaries, which may reflect the differing investment size limits between the funds.

[7] This could reflect changes in the sample composition between surveys, especially the inclusion of newer ECF fund managers.

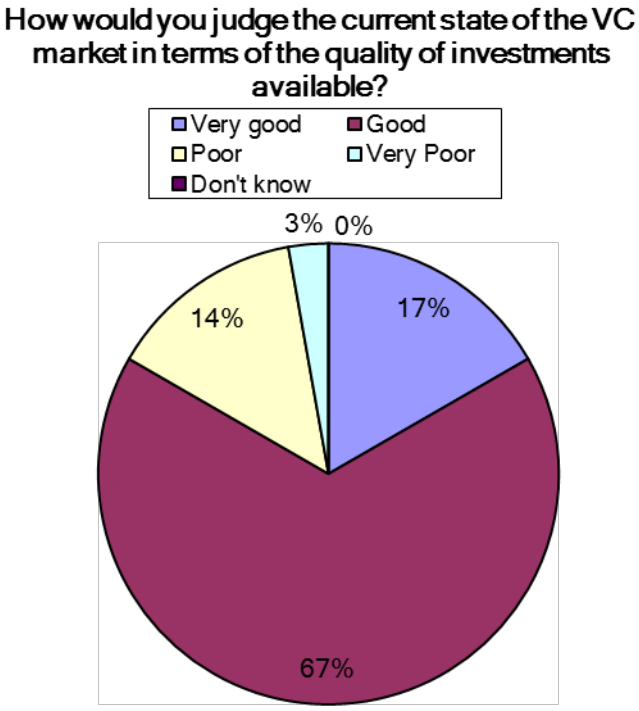
3.2 Venture Capital market conditions

The next section of the survey asked fund managers for their views on the current state of the VC market, recent changes over the past 12 months and outlook for the near future in terms of quality of new investments, syndication with co-investors, ability to raise follow-on funding, and the opportunities for successfully exiting from portfolio companies. Unfortunately, the previous 2011 survey did not ask respondents about the current state of the VC market, and so it is not possible to accurately assess whether conditions in the VC market has actually changed over time.

3.2.1 Quality of investment opportunities

There appears to be good investment opportunities available. 84 per cent of fund managers reported there are good or very good opportunities available in terms of the quality of new investments, with just 17 per cent thinking the market is poor or very poor.

Figure 3



Respondents felt that the quality of investment opportunities was either better (22 per cent) or about the same (67 per cent) as it was a year ago, with no fund managers reporting deterioration. 11 per cent answered not applicable or don't know to this question.

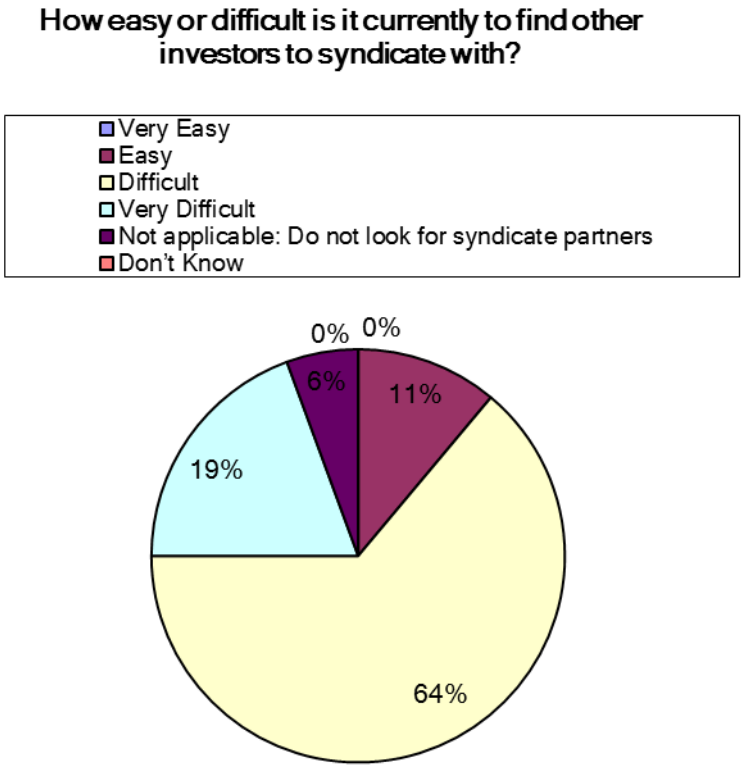
Expectations for the future quality of investment opportunities were fairly conservative with 67 per cent of respondents expecting the quality of investment opportunities to be about the same in a year's time. 25 per cent of fund managers expected an improvement, but just 3 per cent (one respondent) thought the market would be worse in a year's time in terms of the quality of new investments.

However, around half (56%) of fund managers expect to make more investments in the next 12 months than they did in 2012, whilst 11% think they will make fewer investments in 2013. 17% expect they will do a similar number of investments in the next 12 months compared to 2012. 17% of fund managers reported their fund or funds were closed to making new investments.

3.2.2 Syndication

Whilst the market for new investment opportunities appears to be relatively positive, most fund managers (84 per cent) reported that it is currently difficult to find co-investors to syndicate with (of which 19 per cent report it to be very difficult to find investors to syndicate with). Only 11 per cent of fund managers report it is easy to find co-investors to syndicate with.

Figure 4



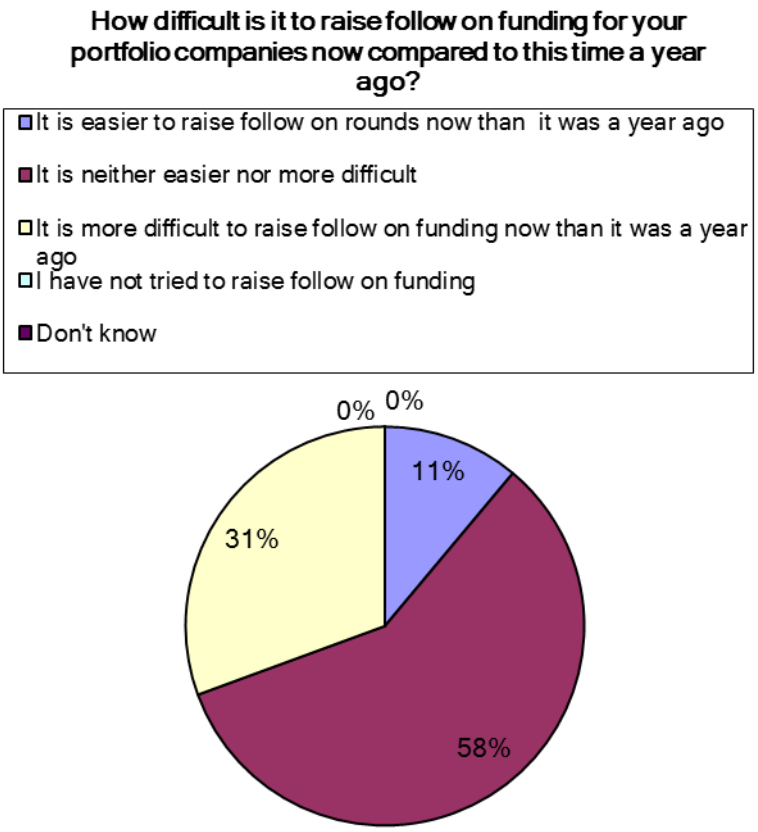
A slightly higher proportion of fund managers report it is more difficult to find syndicate partners than a year ago compared to those saying it is easier (19 per cent compared to 11 per cent). For 53 per cent of fund managers there has been no change compared to a year ago.

Likewise, most respondents (69 per cent) reported that they did not expect there to be any change in the ability to syndicate with co-investors in a year's time. An equal proportion (11 per cent) expected it to become easier compared to those saying more difficult, suggesting no real change in market conditions in the next 12 months.

3.2.3 Follow on funding[8]

Whilst the majority of fund managers (58 per cent) report there to be no change in conditions affecting follow on funding, a higher proportion (31 per cent) report it was more difficult to raise follow on funding compared to a year ago than those reporting it was easier (11 per cent).

Figure 5



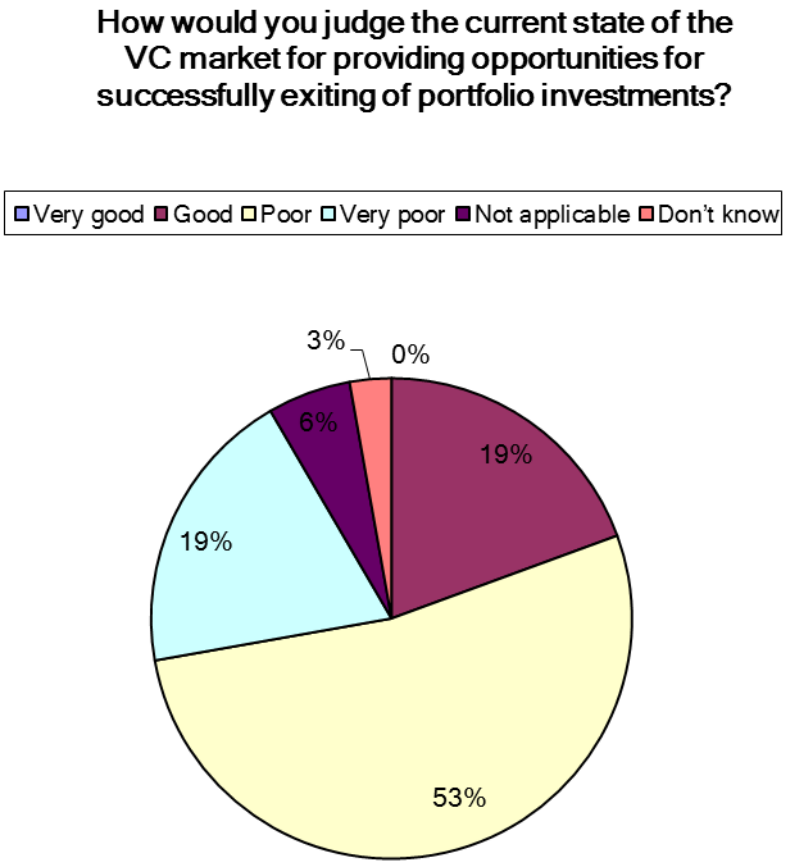
Market conditions are not expected to change in the future as the majority of fund managers (67 per cent) expect there to be no change in conditions affecting follow on funding in a year's time. A higher proportion (22 per cent) expect it will be more difficult to raise follow on funding in a year's time compared to 11 per cent saying it will be easier.

[8] A question on the current state of the VC market for follow on funding was not asked due to limitations on questionnaire length.

3.2.4 Exits

The market for successfully exiting portfolio companies remains challenging. Most respondents (72 per cent) reported they would judge the exit opportunities for their portfolio companies as being poor or very poor. Just 19 per cent of fund managers report the current state of the VC market for providing opportunities for successful exits is good.

Figure 6



Most respondents (61 per cent) reported they would judge the exit opportunities for their portfolio companies as being about the same as a year ago, with 31 per cent thinking exit opportunities were better now and 6 per cent thinking they were worse.

In terms of future expectations, respondents were more positive with 47 per cent expecting exit opportunities to have improved in a year's time and 53 per cent expecting them to remain about the same. No fund managers expected it to get worse.

Fund managers were asked about their preferred exit route for generating the highest financial return from their portfolio companies. 92 per cent thought a trade sale offered the potential for the greatest financial return, but 3 per cent thought an IPO, and 3 per cent a sale to another PE firm.

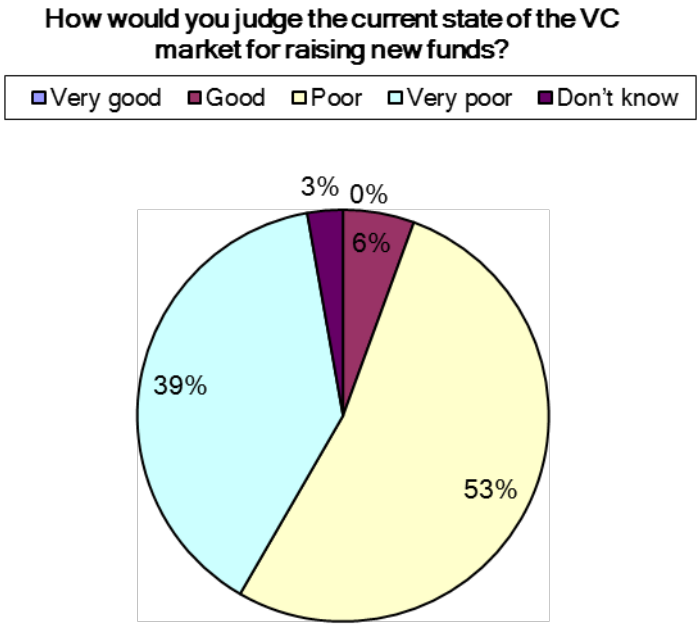
The low preference for IPOs may reflect difficult fund raising conditions in SME public equity markets like AIM.

3.2.5 Fund raising

Fund managers were asked how easy it is for VC funds to currently raise new funding. The majority of fund managers (92 per cent) reported they would judge the current state of the market for raising new funds as poor or very poor (39 per cent rated the market as very poor). Only 6 per cent of fund managers report the current market is good for raising new funds, suggesting market conditions are very difficult for managers trying to raise new VC funds.

Respondents who had rated the market for raising new funds as poor were asked an open response question about why they considered the market was poor. The majority of respondent's views covered "Low risk appetite from institutional investors", "VC funds are too small for institutional investors to invest" and "Poor track record of VC as an asset class". The range of responses was very similar to the previous 2011 survey results which asked the question as a closed question with prompted answers. The answers only differed in a number of areas. For instance, no one in the current survey mentioned any concerns about government funds being overly restrictive as a reason for difficulties in fund raising. However, a few respondents in this survey mentioned "EIS distorting the market" and a "lack of government investment to cornerstone new funds" as possible reasons for the difficult conditions.

Figure 7



Fund managers do not expect these difficult fund raising conditions to change any time soon, as 81 per cent expect the market to be the same in the next 12 months. Whilst 8 per cent of fund managers expect it to be easier to raise funding in 12 months' time, this is offset by 11 per cent of fund managers who expect it to be more difficult.

Fund managers were asked whether they had actually tried to raise new funding recently. 64 per cent of respondents had either raised or tried to raise new funds in the last two years, which is similar to the previous 2011 survey's figure of 68 per cent. A higher percentage (86 per cent) intended to raise funding in the next two years, which is also similar to the previous survey's figure of 85 per cent.

Of those who expected to raise new funds in the next two years, only 13 per cent expected they would not require any Government funding. 42 per cent expected Government will provide funding and another 42 per cent expected this may be the case. This shows the importance of Government funding at this end of the VC market.

3.3 Obstacles faced by portfolio companies

Fund managers were asked about the obstacles faced by their portfolio companies from a pre-determined list. This question was repeated from the previous 2011 survey to allow an assessment of changes over time, and is itself based on a question used in the BIS Small Business Survey.

As table 2 shows, "obtaining finance", "the economy" and "shortage of managerial skills/ expertise" were each given as a barrier affecting their portfolio companies by over 50 per cent of fund managers.

Table 2

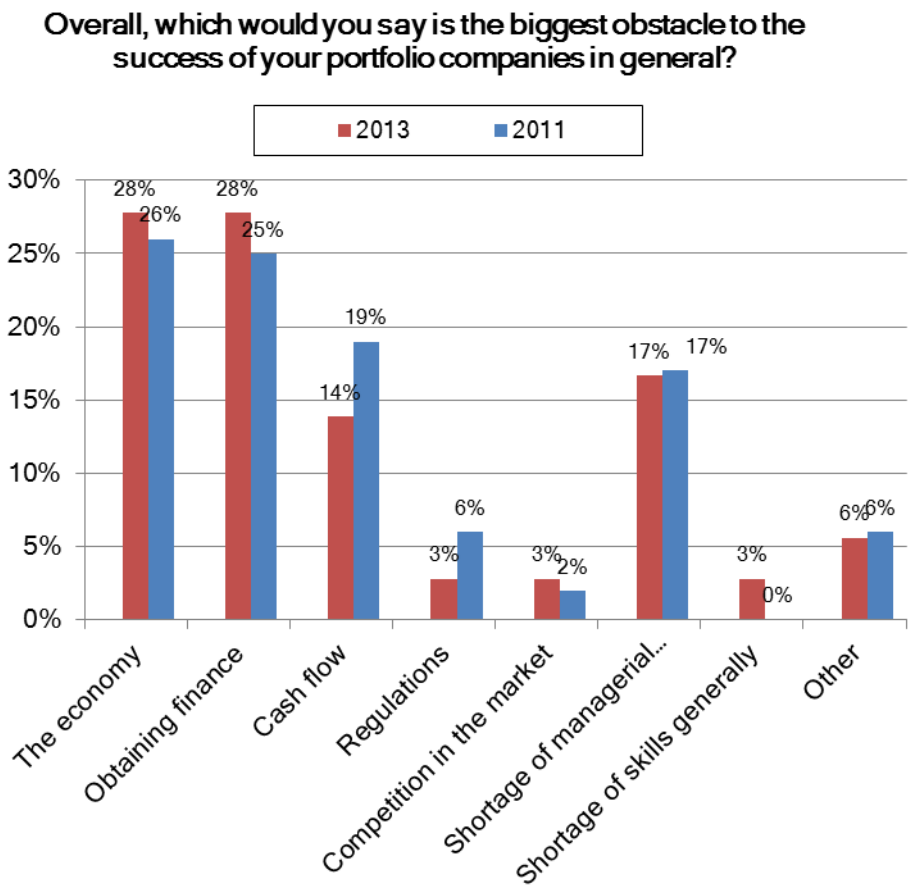
What are the main obstacles to the success of your portfolio companies?	**Per cent**
Obtaining finance	67%
The economy	53%
Shortage of managerial skills/expertise	50%
Cash flow	44%
Competition in the market	31%
Recruiting staff	22%
Retaining staff	14%
Regulations	14%
Shortage of skills generally	11%
Taxation, VAT, PAYE, National Insurance, business rates	3%
Other	17%

Fund managers were then asked to identify the biggest obstacle to the success of their portfolio companies. It is useful to compare the latest results with those from the previous survey. Figure 8 shows that in both surveys fund managers cited "The economy" as the biggest obstacle to the success of their portfolio companies, although there was a slight increase from 26 per cent in 2011 to 28 per cent in 2013. There was also an increase in "obtaining finance" as a barrier from 25 per cent to 28 per cent in the latest survey, so that is now equal in prevalence to "the economy" as the main barrier affecting portfolio companies.

There has been a decline in the prevalence of "cash flow" as the main reported barrier to 14 per cent, down from 19 per cent in the previous 2011 survey. This may reflect respondents' being more likely to report "the economy" and "obtaining finance" as barriers. All these three factors are inter-related, and so it is unlikely to signify a real improvement in the challenges portfolio companies face.

17 per cent of fund managers continued to identify a shortage of managerial skills/expertise as the biggest obstacle to the success of their portfolio businesses. This compared to just 1 per cent of SME employers overall from 2010 BIS Small Business Survey, and reflects the unique characteristics of VC funded companies compared to the overall SME population.[9]

Figure 8



[9] It may also reflect a difference in opinion as fund managers are answering on behalf of their portfolio companies, whilst the BIS Small Business Survey asks business owners directly and business owners may not be able to accurately judge the quality of their own skills and expertise.

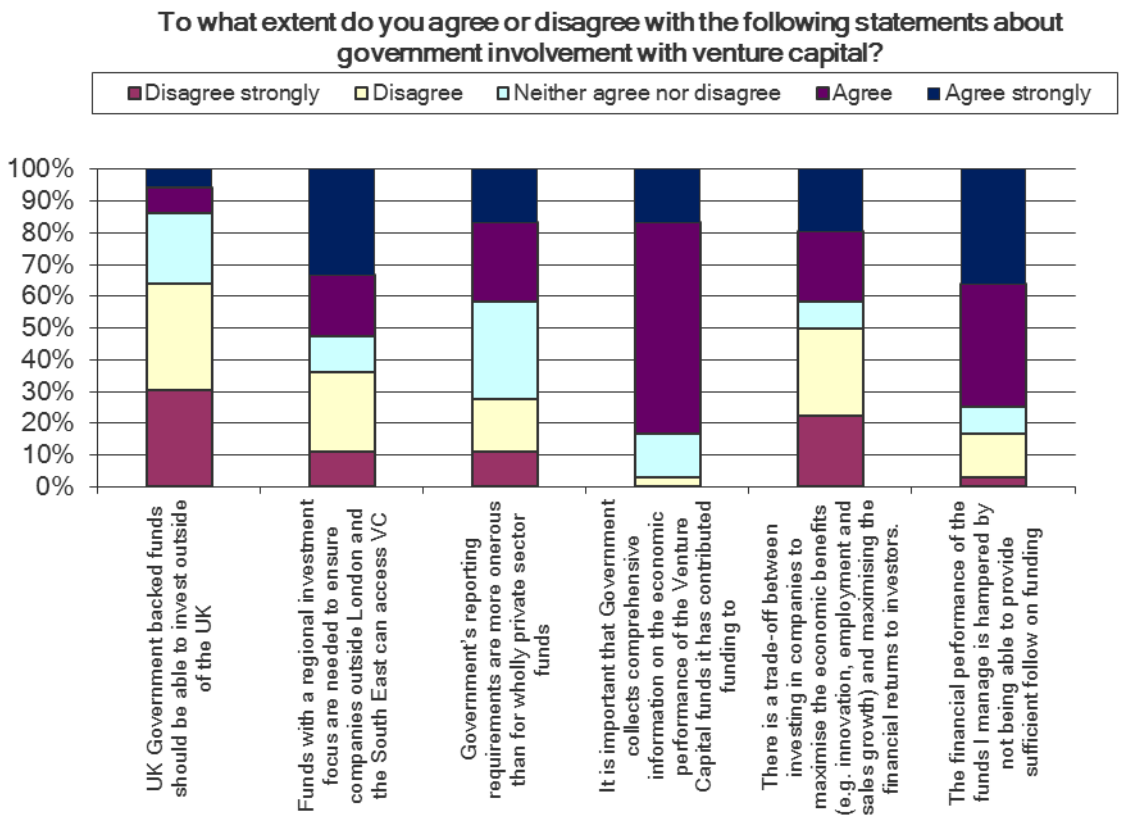
3.4 Fund managers' views on Government policy

In this section of the survey, respondents were presented with six statements about the design of Government VC funds and were asked to what extent they agreed or disagreed with each of the statements. A summary of the results is shown in the table below, but the detailed results are shown in figure 9.

Table 3

Statement	Per cent agreeing with statement	Per cent disagreeing with statement
UK Government backed funds should be able to invest outside of the UK	14%	64%
Funds with a regional investment focus are needed to ensure companies outside London and the South East can access VC	53%	36%
Government's reporting requirements are more onerous than for wholly private sector funds	42%	28%
It is important that Government collects comprehensive information on the economic performance of the Venture Capital funds it has contributed funding to	83%	3%
There is a trade-off between investing in companies to maximise the economic benefits (e.g. innovation, employment and sales growth) and maximising the financial returns to investors.	42%	50%
The financial performance of the funds I manage is hampered by not being able to provide sufficient follow on funding	75%	17%

Figure 9



UK Government backed funds should be able to invest outside of the UK

Whilst making investments outside the UK can help fund managers to diversify their portfolio which may help increase overall fund returns, the underlying objective of UK Government funded VC schemes is to fund UK SMEs. The majority (64 per cent) of fund managers thought Government backed funds should not be able to invest outside the UK. Only 14 per cent thought they should be able to invest outside the UK.

Funds with a regional investment focus are needed to ensure companies outside London and the South East can access VC

Just over half (53 per cent) thought there was a need for regional funds to ensure companies outside of London and the South East can access VC. However, 36 per cent disagreed with this statement. There are some differences between different types of fund as only 24 per cent of ECF fund managers agreed there was a need for regional funds. Although it is widely recognised that VC deals are more concentrated in London and South East regions, addressing regional imbalances by having a narrow geographic focus can restrict the ability of fund managers to invest in high quality businesses leading to lower financial returns.[10]

[10] For instance, see NAO (2009 "Venture Capital Support to Small Businesses"

Government's reporting requirements are more onerous than for wholly private sector funds

42 per cent of fund managers agreed that Government reporting requirements are more onerous compared to 28 per cent who disagreed with this statement. 31 per cent neither agreed nor disagreed. It is important that the use of all public sector funding is monitored to assess its effectiveness. Whilst the Government does ask funds involving public funding to provide additional information on investment characteristics and subsequent performance of the funded business, the reporting requirements are generally designed not be a burden on fund managers.

It is important that Government collects comprehensive information on the economic performance of the Venture Capital funds it has contributed funding to

The ultimate objective of Government funded VC funds is to provide economic benefits, which may require additional data collection from fund managers and primary research with portfolio companies to measure this.[11] 83 per cent of fund managers agreed that it is important for Government to collect comprehensive economic performance information about the funds it has contributed funding to. Just 3 per cent (one respondent) disagreed with this statement. 14 per cent neither agreed nor disagreed.

There is a trade-off between investing in companies to maximise the economic benefits (e.g. innovation, employment and sales growth) and maximising the financial returns to investors.

Whilst 42 per cent of fund managers agreed that that there was a trade-off between economic benefits and financial returns, a higher proportion (50 per cent) thought no trade-off existed. Whilst the survey findings are mixed, investing in later stage businesses is often seen to be more profitable than investing in early stage businesses. However, investing in early stage businesses is seen to offer the most potential for wider economic benefits through innovation and development of new technology rather than investing in later and more established businesses.

The financial performance of the funds I manage is hampered by not being able to provide sufficient follow on funding

Government funded VC funds have limits on the size of investments they can do in order to ensure they are targeted at the equity gap, but this may restrict the ability of fund managers to provide follow on funding. 75 per cent of fund managers agreed that the financial performance of the funds they managed was hampered by not being able to provide sufficient follow on funding. Only 17 per cent disagreed with this statement. Although ECF fund managers can invest larger amounts than some legacy funds e.g. RVCFs, 76 per cent of ECF fund managers agreed that financial returns was hampered by not being able to provide sufficient follow on funding.

[11] An example of an evaluation assessing likely economic impact is shown in BIS (2010) "Early Assessment of the Impact of BIS Equity Fund Initiatives"

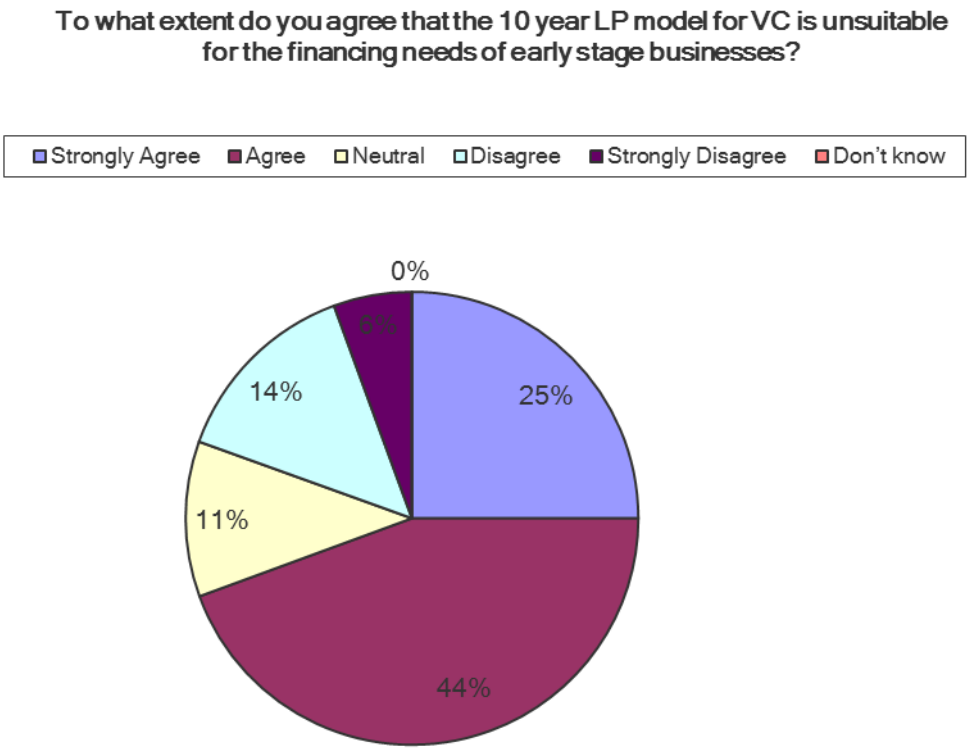
3.5 Optimal fund design

Fund managers were asked a range of questions about their preferences for structure and size of fund. These issues were identified in the previous 2011 fund manager survey, and so are now being investigated more comprehensively within this survey.

3.5.1 Fund structure

Fund managers were asked to what extent they thought the widely used 10 year Limited Partnership (LP) model for VC was unsuitable for the financing needs of early stage businesses. 69 per cent of fund managers agreed this was the case, with only 20 per cent disagreeing.

Figure 10



Of those fund managers who thought the 10 year LP model was unsuitable, they were then asked to think of a more suitable structure. The question was asked as an open question but around two thirds of fund managers thought a longer term fund structure was required (with around 15 years being mentioned in most cases). In their view, this reflects the length of time it takes to develop the technology in very early stage businesses and also the extended length of time to find suitable opportunities to exit their investments.[12]

[12] NESTA (2010) "Venture Capital: Now and After the Dotcom Crash" confirms the average time from initial investment to IPO or M&A exit was 5.7 years in 2009, an increase from 2.61 years in 2000. For early stage investments with unproven technology, the investment time period until successful exit could be even longer than the average.

A significant minority (roughly a quarter) mentioned an evergreen structure was more suitable than the current model. A couple of fund managers suggested a rolling year by year funding structure dependent on fund managers reaching specified goals.

3.5.2 Size of fund

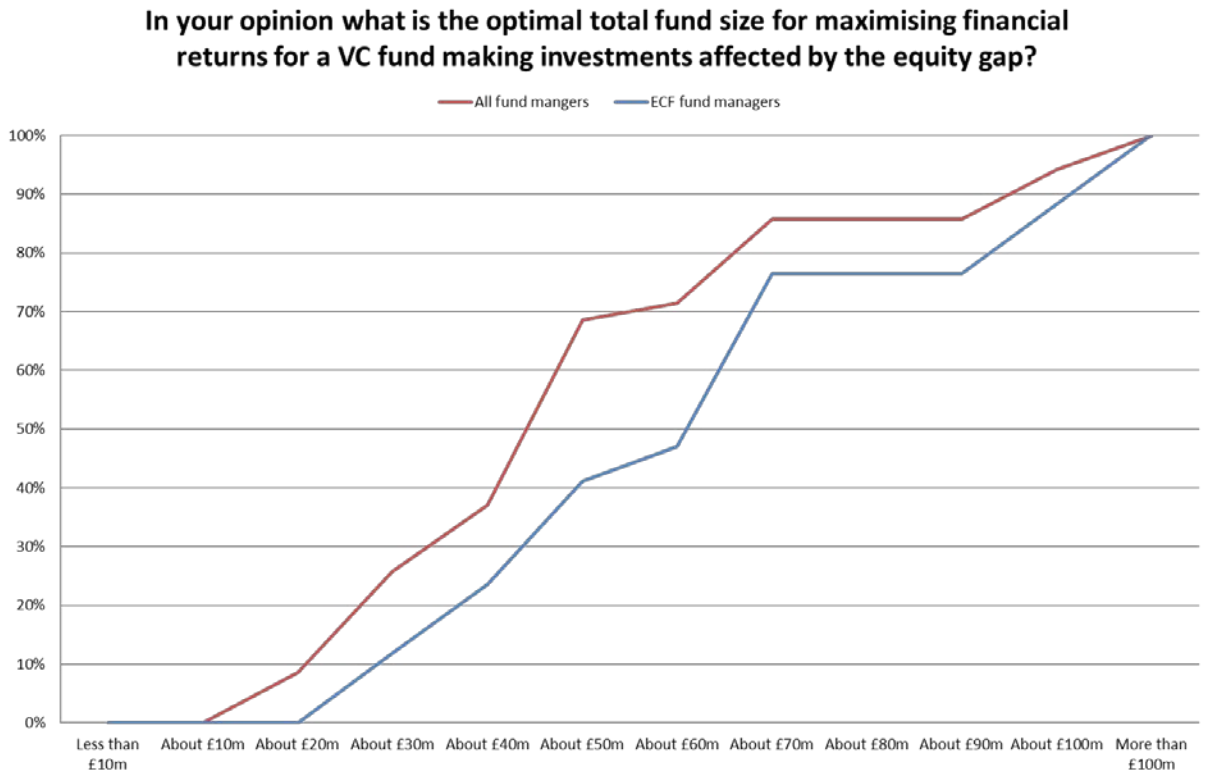
There is plenty of anecdotal evidence that Government funded VC fund sizes need to be larger to minimise fixed costs and allow opportunities for follow on investment, but if funds are too large there will be diseconomies of scales from managing too many investments. Fund managers were asked to provide an estimate of the optimal fund size for maximising financial returns for VC funds targeted at the equity gap.

Table 4

Optimal fund size	Per cent	Cumulative per cent (excluding don't know)
Less than £10m	0%	0%
About £10m	0%	0%
About £20m	8%	9%
About £30m	17%	26%
About £40m	11%	37%
About £50m	31%	69%
About £60m	3%	71%
About £70m	14%	86%
About £80m	0%	86%
About £90m	0%	86%
About £100m	8%	94%
More than £100m	6%	100%
Don't know	3%	

There was a high degree of uncertainty about the optimal size of fund with answers ranging from £20m to above £100m. The median average fund size for all fund managers was an optimal fund size of about £40-50m, but ECF fund managers thought the optimal fund size should be larger at around £60m. This may reflect the differences in opinion on the boundaries of the equity gap and the required investment sizes needed to target the funding gap.

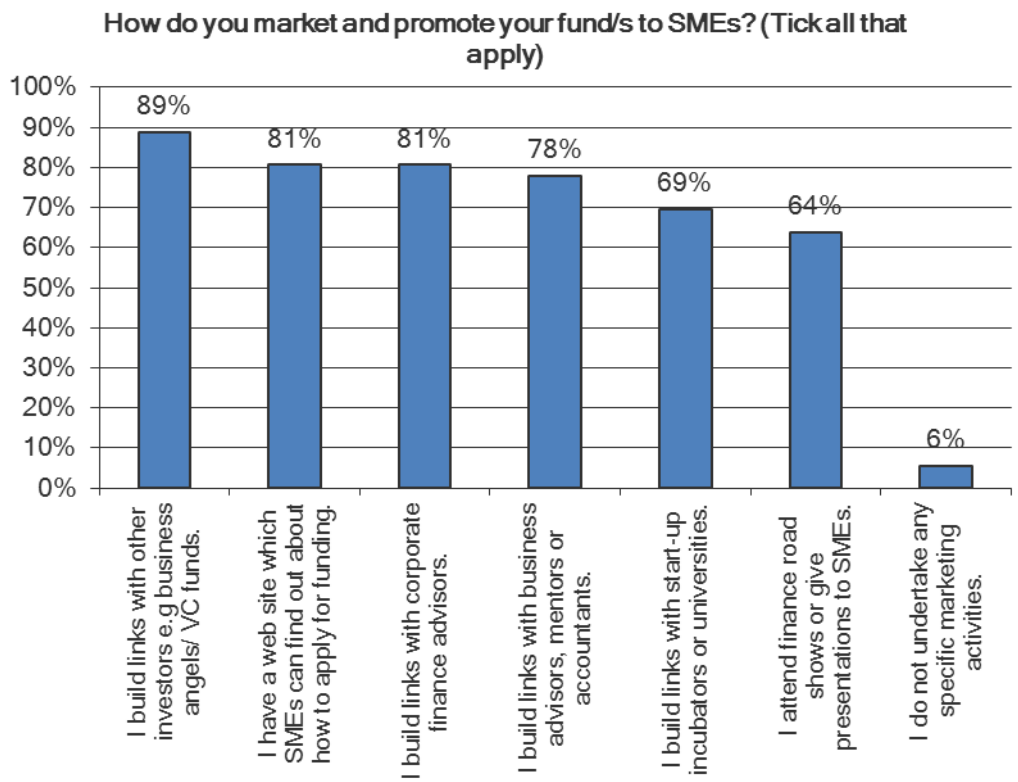
Figure 11



3.6 Promotion of funds

Fund managers were asked how they marketed and promoted their VC funds to SMEs. The most common response given by 89 per cent of fund managers was to build links with other investors such as business angels and venture capitalists. 81 per cent of fund manager's funds had a website. 6 per cent of fund managers (equivalent to 2 respondents) did not undertake any specific marketing activities.

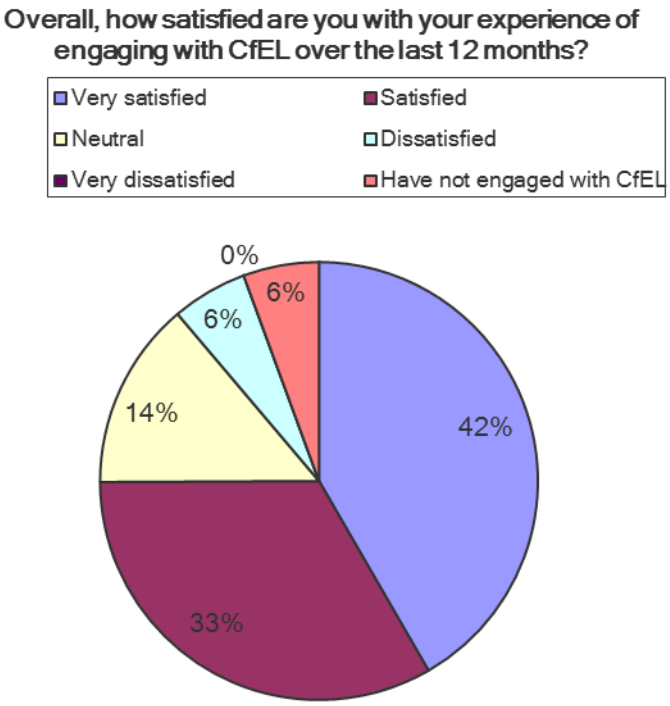
Figure 12



3.7 Engagement with CfEL

CfEL has an oversight role of many public sector funded VC funds and so fund managers were asked to what extent they were satisfied with their experience of engaging with CfEL over the previous 12 months. Overall fund managers were satisfied with 75 per cent reporting they were satisfied or very satisfied with their engagement (42 per cent were very satisfied). Only 6 per cent were dissatisfied (equivalent to two fund managers), whilst 14 per cent described their experience of engagement with CfEL as 'neutral'. It is not possible to examine whether there has been a change over time in fund manager's engagement with CfEL due to differences in the way the question was asked in the previous survey.[13]

Figure 13



Fund managers had the opportunity to expand on their experience of engaging with CfEL through an open comment question. Positive comments focused on CfEL being professional and operating as a "well-balanced fund-of-funds, with a commercial focus, but understanding /appreciation of 'early stage' issues." CfEL was also seen as not being too overly bureaucratic. However, negative comments focused on Government finance policy more widely with the length of time it takes to implement new policy announcements and the focus on England only interventions (specifically relating to the Business Angel co-fund).

[13] The previous survey asked about CfEL's level of engagement in terms of detail.

3.8 Other Comments

As with the previous survey, there was an opportunity for fund managers to provide additional comments at the end of the questionnaire. 9 respondents provided comments across a number of areas. The following provides a short summary of the views:

- The £2m funding limit on ECFs is too restrictive and there is a need for funds to cover follow on funding amounts of between £3m-£10m.
- The boundaries of the equity gap and optimal fund size to address it vary between sectors.
- The scale of public sector funding devoted to VC is too small, and there is a need for a greater number of ECFs to be established each year and for larger fund sizes to be supported.
- There should be a greater focus on financial returns rather than start-ups and jobs created.
- There is a need to go beyond just finance and address issues around the quality of management by providing more funding for HEIs and business schools and linking them to high growth SMEs.
- The issue of geography was raised by several respondents with the need to ensure funding goes towards SMEs in specific (and conflicting) areas. For instance, respondents suggested funding was required for SMEs in the regions, SMEs in London and the South East as they are perceived to offer the most potential for each pound of investment and also the Midlands, as it is perceived to lose out compared to the North and South East.

4-Conclusions

CfEL hears plenty of anecdotal evidence about the state of the UK VC market from the fund managers of the VC funds CfEL has oversight of. The survey was designed to measure and record the views of these fund managers in a systematic and robust way to help inform SME finance policy. Whilst there has been a decline in the response rate compared to the previous 2011 survey, CfEL is confident these survey findings still provide useful evidence on the views of fund managers delivering publically backed funds.

The survey confirms that whilst there appears to be good investment opportunities available, challenges remain in other parts of the VC market. In particular, the ability for fund managers to find co-investors to syndicate with, the environment for successful exits and ability to raise new funds remains difficult.

The survey also highlighted the difficulties in identifying the exact boundaries of the equity gap, which are often seen to more complex than a single set of parameters and also the gap is perceived to vary between different sectors. However, the survey findings do confirm that the upper boundaries of the equity gap are perceived to be larger than the current £2m investment limit for ECFs.

A number of additional topics relating to the design of Government funds were explored. For instance, there is strong support from fund managers for extending life of the Limited Partnership model from 10 to 15 years to better meet the financing needs of early stage businesses. In addition, fund managers thought larger funds might help with improving the financial returns publicly backed VC funds generate.

Appendix 1 – Questionnaire

- **Thank you for agreeing to complete the 2013 Capital for Enterprise Survey of Fund Managers. Your responses will help CfEL provide advice to the Government and improve the quality of Government SME finance policy initiatives.**
- **Your responses will be kept anonymous so please be as honest as possible. We will only present aggregated findings and it will not be possible to identify you or the fund you represent.**
- **Please answer the survey in relation to all VC funds under your management, not just publicly backed funds to provide us with a view on the current and future state of the venture capital market. If your own personal views differ to those of the VC organisation you represent, please give your own views.**
- **The survey should take no longer than 10-15 minutes to complete.**

- **If you have any questions, comments or concerns about the survey please contact Dan van der Schans, the CfEL project manager on...**

Section 1 – Your fund

1. What type(s) of VC funds do you manage? (tick all that apply)

a) An Enterprise Capital Fund (ECF)
b) An Early Growth Fund (EGF)
c) A European Regional Development Fund (ERDF) supported venture capital or loan fund
d) A venture capital or loan fund established by a Regional Development Agency without ERDF
e) A Regional Venture Capital Fund (RVCF)
f) Enterprise Investment Scheme
g) Venture Capital Trust
h) We also manage private sector venture capital fund (I.e. No Government or European funding or tax relief)
i) Other publicly backed fund not mentioned above (Please state…)

2. What is the status of this fund/ these funds for new investments? (Tick all that apply)

a) Fund is not yet investing in companies
b) Fund is still open to new investments
c) Fund is closed to new investments

Section 2 – The Equity Gap

3. Do you believe that some Small and Medium Sized Enterprises (SMEs) face an "equity gap" where viable risk capital investments could be made but few private sector venture capitalists invest?

a) Yes
b) No

c) Don't know

4. At what level approximately do you think the equity gap starts?
a) Below £100,000
b) Between £100,000 and £199,999
c) Between £200,000 and£299,999
d) Between £300,000 and £399,999
e) Between £400,000 and £499,999
f) £500,000 or above
g) Don't know
h) If "£500,000 or above" please specify

5. What do you think is the upper boundary of the equity gap?
a) Below £1m
b) About £1m
c) About £2m
d) About £3m
e) About £4m
f) About £5m
g) Over £5m
h) Don't know
i) If "over £5m" please specify

Section 3 – The current and future state of VC market

This section asks you about your views on the current and future state of the VC market. Please answer this section in relation to all VC funds under your management, not just publicly backed funds.

6. How would you judge the current state of the VC market in terms of the quality of investments available?
a) Very good
b) Good
c) Poor
d) Very poor
e) Don't know

7. How do these opportunities compare to those you were assessing this time a year ago?
a) The quality of investment opportunities has improved compared to a year ago
b) The quality of investment opportunities is about the same as a year ago
c) Investment opportunities are now worse than a year ago
d) Not applicable: I am not looking at new investment opportunities
e) Don't know

8. Thinking about your future expectations, in a year's time do you expect the quality of investment opportunities to have improved or deteriorated compared to those you see currently?

a) I expect the quality of investment opportunities to have improved
b) I expect the quality to be about the same
c) I expect the quality to be worse
d) Not applicable: I am not looking at new investment opportunities
e) Don't know

9. Do you anticipate that you will invest in more companies in the next 12 months than you did in 2012?

a) Yes will invest substantially more
b) Yes will invest slightly more
c) Will invest about the same
d) No- will invest slightly less
e) No- will invest significantly less
f) Not applicable: Fund/s closed to new investments
g) Don't know

10. How easy or difficult is it currently to find other investors to syndicate with?

a) Very Easy
b) Easy
c) Difficult
d) Very Difficult
e) Not applicable: Do not look for syndicate partners
f) Don't Know

11. When making initial investments, is it easier or more difficult to find syndicate partners now compared to a year ago?

a) It is easier to find syndicate partners now than a year ago
b) There has been no change compared to a year ago
c) It is more difficult to find syndicate partners now than a year ago
d) Not applicable: I have not tried to find syndicate partners
e) Don't Know

12. In a year's time, do you expect it to be easier or more difficult to find syndicate partners for initial investments

a) I expect it to be easier to find syndicate partners in a year's time
b) I expect there to be no change in a year's time
c) I expect it to be more difficult to find syndicate partners in a year's time
d) Not applicable
e) Don't Know

13. How difficult is it to raise follow on funding rounds for portfolio companies now compared to a year ago?

a) It is easier to raise follow on rounds now than it was a year ago
b) It is neither easier nor more difficult
c) It is more difficult to raise follow on funding now than it was a year ago
d) Not applicable: I have not tried to raise follow on funding
e) Don't know

14. In a year's time, do you expect it to be easier or more difficult to raise follow on funding for portfolio companies?

a) Easier in a year
b) Neither easier nor more difficult
c) More difficult in a year
d) Not applicable
e) Don't know

15. How would you judge the current state of the VC market for providing opportunities for successfully exiting of portfolio investments?

a) Very good
b) Good
c) Poor
d) Very poor
e) Not applicable
f) Don't know

16. How would you rate the availability of exit opportunities for portfolio companies currently compared to this time a year ago?

a) Better now
b) About the same
c) Worse now
d) Not applicable
e) Don't know

17. And thinking ahead, what are your expectations regarding the availability of exit opportunities for portfolio companies in a year's time?

a) Better in a year
b) About the same
c) Worse in a year
d) Not applicable
e) Don't know

This section asks you about the VC market in relation to new fund raising and whether your investment organisation has or will try to raise new funding in the future.

18. How would you judge the current state of the VC market for raising new funds?
a) Very good
b) Good
c) Poor
d) Very poor
e) Don't know

19. Please explain what informs your thinking of why the market is poor for raising new funds?
….

20. In a year's time, do you expect fund raising to be easier or more difficult?
a) I expect it to be easier to raise new funds in a year's time
b) I expect it to be the same as now
c) I expect it to be more difficult to raise funds in a year's time
d) Not applicable
e) Don't know

21. Have you tried to raise/ raised new funds in the last 2 years?
a) Yes
b) No
c) Don't know

22. Do you expect to fund raise in the next two years?
a) Yes
b) No
c) Don't know

23. Do you expect Government funds will form part of this funding?
a) Yes
b) Maybe
c) No
d) Don't know

Section 4 – Investment preferences

This section asks your views on preferred exit routes for maximising financial returns.

24. What exit route from portfolio investment companies do you see as offering the potential for the highest financial return? [randomise order]
a) Sale to another PE firm
b) Divestment on flotation (IPO)
c) Trade Sale
d) Sale to financial institution
e) Sale of quoted equity post flotation

f) Sale to management (buy-back)
g) Repayment of preference shares/ loans
h) Divestment by other means
i) Don't know

SECTION 5 – Problems faced by portfolio SMEs

We are interested to know about the specific factors impacting on the success of your portfolio companies.

25. What would you say are now the main obstacles to the success of your portfolio companies in general (mark all that apply) [randomise order]

a) The economy
b) Obtaining finance
c) Cash flow
d) Taxation, VAT, PAYE, National Insurance, business rates
e) Recruiting staff
f) Retaining staff
g) Regulations
h) Availability / cost of suitable premises
i) Competition in the market
j) Shortage of managerial skills/expertise
k) Shortage of skills generally
l) Pensions
m) No obstacles
n) Other [please specify]

26. Overall, which would you say is the biggest obstacle to the success of your portfolio Companies in general? (Choose one only)

Section 6 – Government involvement in venture capital

27. To what extent do you agree/disagree with the following statements about government involvement in venture capital (1 disagree strongly, 2 disagree, 3 neither agree nor disagree, 4 agree, 5 agree strongly) – [randomise statement order]
a) UK Government backed funds should be able to invest outside of the UK
b) Funds with a regional investment focus are needed to ensure companies outside London and the South East can access VC
c) Government's reporting requirements are more onerous than for wholly private sector funds
d) It is important that Government collects comprehensive information on the economic performance of the Venture Capital funds it has contributed funding to

e) There is a trade-off between investing in companies to maximise the economic benefits (e.g. innovation, employment and sales growth) and maximising the financial returns to investors.
f) The financial performance of the funds I manage is hampered by not being able to provide sufficient follow on funding

28. To what extent do you agree that the 10 year LP model for VC is unsuitable for the financing needs of early stage businesses compared to a longer term or evergreen fund structure? [randomise order]
a) Strongly Agree
b) Agree
c) neutral
d) Disagree
e) Strongly Disagree
f) Don't know

29. What would you suggest as an alternative fund structure to replace the 10 year LP model?

30. In your opinion what is the optimal total fund size for a VC fund making investments in companies affected by the equity gap?
a) Less than £10m
b) About £10m
c) About £20m
d) About £30m
e) About £40m
f) About £50m
g) About £60m
h) About £70m
i) About £80m
j) About £90m
k) About £100m
l) More than £100m
m) Don't know

Section 7 – Promotion of funds to SMEs

We are interested to know how you make SMEs aware of your fund.

31. How do you market and promote your fund/s to SMEs? (Tick all that apply) [randomise order]
a) I have a web site which SMEs can find out about how to apply for funding.
b) I attend finance road shows/ give presentations to SMEs.
c) I build links with corporate finance advisors.
d) I build links with business advisors/ mentors/ accountants.
e) I build links with start-up incubators/ universities.

f) I build links with other investors e.g. business angels/ VC funds.
g) Other please explain…
h) I do not undertake any specific marketing activities.

Section 8 – Perceptions of CfEL

32. Overall, how satisfied are you with your experience with engaging with CfEL over the last 12 months?

a) Very satisfied
b) Satisfied
c) neutral
d) Dissatisfied
e) Very dissatisfied
f) Have not engaged with CfEL

Do you have any specific comments you would like to make about your engagement with CfEL?

33. If there is anything you would like to tell us about your experience of working with SMEs, the venture capital market, government policy designed to help SMES or your experience of working with CfEL, please provide comments in the box below.

Thank you for taking the time to complete this survey. Your input is greatly appreciated and your comments will be used to help inform Government SME Finance policy.

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CfEL is not able to deal with queries direct from companies looking for funding. Investment decisions are taken by the manager or lender of each of the individual schemes or funds. Companies should therefore contact a fund manager or bank with a relevant lending/investment focus, rather than CfEL. Details of participating managers and banks can be found on the CfEL website.