Facilitating access to finance

Discussion Paper on Investment Readiness Programmes

INVESTMENT READINESS PROGRAMMES AND ACCESS TO FINANCE: A CRITICAL REVIEW OF DESIGN ISSUES[1]

1.1 Abstract.

Access by SMEs to finance is constrained by demand-side weaknesses. Most businesses are not investment ready. Their owners are unwilling to seek external equity finance and those who are willing do not understand what equity investors are looking for or how to 'sell' themselves and their businesses to potential investors. These weaknesses, in turn, compromise the effectiveness of supply-side interventions, such as initiatives to stimulate business angels or which create public sector venture capital funds. This has led to the emergence of investment readiness programmes which seek to increase the pool of investable businesses. This paper reviews the design and delivery of investment readiness programmes in the UK and draws out lessons for best practice.

1.2 Introduction

High growth firms – so called gazelles – are recognised as having a disproportionate impact on economic development and job creation (Shane, 2009). It is further recognised that many firms with growth potential need to access appropriate forms of finance, notably venture capital, for growth to occur. Intervention by governments to improve the access of growing SMEs to finance is almost entirely focused on supply side measures, typically by seeking to stimulate business angel investment activity and through the creation of new investment vehicles. The implicit assumption of this approach is that constraints on access to finance arise because of deficiencies in the supply of capital. However, there is now belated recognition that access to finance can also be hindered by the existence of weaknesses on the demand side. Clearly, if there are demand-side deficiencies then this will compromise the effectiveness of supply-side interventions. Either it will prevent the fund from becoming fully invested, or it will make bad investments on account of the poor quality of deal flow with implication for its financial performance. There is considerable evidence, particularly amongst the business angel community, that investors are frustrated by the low quality of the investment opportunities that they see and so are unable to invest as frequently or as much as they would like (e.g. Mason and Harrison, 1999; 2002; Paul et al, 2003). Moreover, the existence of business angel networks, whose objective is to improve the efficiency of the market by 'introducing' investors to entrepreneurs seeking finance, and vice versa, has not improved the ability of investors to invest because many of the businesses that they have put in front of investors are not been investment ready (Blatt and Riding, 1996; Mason and Harrison, 1996a; 1999; 2002; Zu Knyphausen-Aufseβ and Westphal, 2008). This has led to the recognition that a supply side approach to address access to finance issues must be accompanied by demand-side initiatives which enhance the quality of deal flow. These considerations have led to the development of investment ready programmes.

Investment readiness is a relatively new form of intervention, and remains unfamiliar in some regions. Best practice is therefore still evolving. Our aim in this paper is to critically review the experience of some early investment ready programmes in the UK and to highlight emerging issues in their design. The next section examines in more detail what is meant by 'investment readiness'. Section 3 discusses the design of investment readiness programmes. Section 4 provides an overview of the way in which many investment

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ready schemes have been implemented. Section 5 reviews the lessons to be drawn from evaluation studies and proposes some elements of emerging best practice.

1.3 Defining 'investment readiness'

Investment readiness is generally used in the context of raising external equity finance. There are three dimensions of investment readiness: equity aversion; investability and presentational failings. We look at each in turn.

The first concerns the entrepreneur's attitude towards equity finance. Consistent with the 'pecking order' hypothesis (Myers, 1984), there is a high level of equity aversion amongst SMEs (Hutchinson, 1995; Howorth, 2001; Oakey, 2007), with most business owners with aspirations to grow their businesses reluctant to surrender ownership and control. This attitude is reflected in the vocabulary of business owners who often refer to the process of raising equity finance as requiring them to 'give away' part of their business. Equity aversion, in turn, may be related to the entrepreneur's lack of information about the characteristics and availability of alternative sources of finance (Van Auken, 2001).The consequence is that many potentially investable projects do not come forward as potential recipients for venture capital. It is argued that with a better understanding of the role of different sources of finance in business development more entrepreneurs would consider seeking equity finance.

The second, and core, dimension of investment readiness concerns the investability of those businesses that do seek external finance. The high rejection rates of business angels and venture capital funds (Riding et al, 1993; Mason and Harrison, 1994; Lumme et al 1998; Stedler and Peters, 2003) clearly indicates that most businesses that seek external finance do not meet the requirements of external investors. The investment decision-making process involves two stages. At the first stage the opportunity is assessed against the investor's investment parameters - for example, sector, stage of business, size of investment, location. The first concern of business angels when appraising an investment opportunity is the 'goodness of fit' between the opportunity and their own personal investment criteria. Key considerations include whether the investor is interested or knows anything about the industry or market, the amount of finance required and its location. Investors reject investment opportunities which do not meet their investment parameters. Lack of information – or failure to seek out the information that does exist – explains why entrepreneurs make approaches to inappropriate investors. Admittedly, given the anonymity of most business angels it is much harder to identify their interests in advance of approaching them.

At the second stage the investor screens those businesses which meet their investment parameters. Several studies have examined why investors reject investment opportunities.

A study of deals rejected by a UK business angel investment group highlighted three dominant reasons: weaknesses in the entrepreneur/management team; marketing and market-related factors, notably flawed or incomplete marketing strategies; and financial considerations, notably flawed financial projections. Most opportunities were rejected for just one or two reasons. Opportunities which failed to get past the initial screening stage tended to be rejected because of the accumulation of deficiencies whereas those rejected after detailed investigation tended to be rejected because of the discovery of a single fundamental flaw (Mason and Harrison, 1996b).

A study of investment decision making by UK business angels based on business plan summaries indicated that they were turned off by businesses that lack focus; where comprehensive and credible market information is lacking; that operate in highly competitive markets; and lack a unique selling point (USP) (i.e. 'me too' products and services). Investors wanted to understand the way that the product or service is distinctive or superior to that of the competition and how any competitive advantage will be sustained. They also placed considerable emphasis on the experience and track-record of the entrepreneur, his/her commitment, the upside potential of the business, and the use to which the finance that is sought will be put (Mason and Rogers, 1997).

Another study of UK business angels reported that the main deficiencies in the proposals that they see were, first, business plans which contain unrealistic assumptions or information that is not credible and, second, entrepreneur/ management teams which lack credibility (Mason and Harrison, 2002). Significant, although less frequently cited weaknesses included insufficient information provided, business concept requires further development and limited growth prospects of the business.

An ERDF-supported seed capital fund in Scotland reported that "The majority [of investment opportunities] were declined on the basis of a suspect business plan or business model … The most common characteristic was the inability of the applicant to demonstrate a credible revenue model. They could not show that the company could attract sufficient paying customers to cover the costs of the business. Behind this generalisation are a range of problems. The inability to demonstrate any unique selling point - why would anyone purchase your product? The inability to demonstrate a route to market - how are you going to get your product to a customer? The inability to demonstrate that there were sufficient potential customers to warrant the new business. Very often the plans concentrated on the product or technology developed by the applicant, but little or no consideration had been given to the costs of marketing, distribution or customer servicing" (cited in Mason and Harrison, 2004). A study of Canadian business angels distinguished between businesses that were rejected because of shortcomings of the entrepreneur and those rejected because of shortcomings of the business (Feeney et al, 1999). Shortcomings in the attributes of entrepreneurs include: lack of knowledge and expertise to turn the idea into a viable business; unrealistic expectations (e.g. overly optimistic, unsubstantiated); and personal qualities (lack of integrity, vision or commitment, high need for control of the business). Shortcomings of the business include: poor management team (e.g. balance, experience, discipline, teamwork); poor profit potential for the level of risk; undercapitalised; and insufficient information provided.

So, here again information failure is critical. Relatively few business owners understand what is needed to attract external equity capital and how to meet the requirements of external investors. This leads to many avoidable 'own-goals' (Table 1).

Table 1. 'Own goals' in Business Plans

Inappropriate statement in business plan	Explanation
"It is our intention to hire a CEO within three months of initial funding."	Investors need to see who they are investing in and who is going to give leadership and direction to the company before investing. As a minimum, the plan must be able to say who has been targeted and agreed to lead the business once finance has been raised.
"The three founders each hold an equal share of the business and decision-making is on a consensual basis."	Investors don't invest in committees, they invest in leaders. Someone has to be the boss.
"Our existing company has developed a new technology and we would like you to invest in this subsidiary company we have set up to develop the idea."	Investors don't invest in subsidiaries. Management must be totally committed to the project they have invested in, not spending their time running another company in which the investors have no interest.
"We have been running at a loss for three years and have run out of cash. During the period the owner has continued to draw a salary of €150,000."	Investors don't invest in companies just so that the management can maintain their lifestyle. They invest in growing businesses and expect management to take a reasonable share of the risk as well as the reward.

Source : N Gray: The Angel's Share, The Herald, 4th September 2002, page 25. Nelson Gray was EBAN's European Business Angel

The third dimension of investment readiness is presentational failings. Even if the underlying proposition is sound a business may still fail to raise finance if the business plan is poorly constructed and presented. This includes shortcomings in business plans and other written documents that are aimed at investors and also deficiencies in 'pitches' at investment forums. As noted above, investors are frustrated by missing information in business plans, particularly when it relates to any of the generic questions that investors ask of any investment proposal (Mason and Rogers, 1997; Mason and Harrison, 2002). In the case of verbal pitches Mason and Harrison (2003) demonstrate that a poor oral presentation is likely to generate a negative reaction amongst potential investors. In their case study the presentation that was reviewed by investors had two fundamental failings. First, it was preoccupied with the product/technology, which was confusing to those investors who did not have the appropriate background. Second, it failed to make the business case. The need for the product was not demonstrated, the benefits to the customers were not explained and the potential customers were not identified. Interestingly, poor presentation was interpreted by some investors as a warning signal for the entrepreneur's wider lack of competence, with one investor posing the rhetorical question: "if he can't sell to investors, how can he sell to customers?" Building on this study, Clark (2008) also found a clear and statistically significant relationship between business angels' perception of the quality and content of the entrepreneurial presentation and their decisions whether or not to pursue the investment opportunity. In other words, business angels' judgments about what constituted a pursuable investment opportunity were based not just on the investment-related content of the presentation and their perception of the entrepreneurs who had made the presentation but also for the way in which this content had been delivered. The clear implication is that entrepreneurs who do not sell themselves and the substance of their investment opportunity are less likely to succeed in convincing investors to seriously consider, let alone pursue, their investment opportunity. In contrast, entrepreneurs who can tell a convincing and compelling story to potential investors are more likely to be successful in raising finance (Shepherd and Douglas, 1999).

In summary, the failure of businesses to be investment ready is primarily due to information failure (Marsden Jacobs, 1995). Entrepreneurs do not know about the advantages of equity finance, are unaware of what is involved in raising finance, what is required to attract equity investors, nor how to convincingly articulate their investment proposal to investors. Entrepreneurs need information and advice on the advantages of raising equity finance, what it means to be 'investment ready' and how to become investment ready.

1.4 Investment readiness programmes

This evidence makes a compelling case that investment readiness has to be addressed in any joined-up policies on access to finance by SMEs. The effectiveness of supply-side and other forms of intervention (e.g. business angel networks) will be compromised unless efforts are also made to address the investment readiness of the businesses that are the intended targets of these interventions. The central objective of investment readiness programmes is to raise the quality of investment opportunities. So how should they be designed? An intervention that is designed to enhance investment readiness amongst the SME population must address all of the components that influence the quantity and, in particular, the quality of demand for equity finance, namely equity aversion, investability and presentational issues. Influenced by some early Australian programmes (Marsden Jacobs, 1995; Ernst and Young/Centre for Innovation and Enterprise, 1997) Mason and Harrison (2001) proposed that a programme to enhance 'investment readiness' amongst the SME population should involve two elements. The first is information provision. Entrepreneurs do not know about the advantages of equity finance, what is required to attract equity investors, the criteria that investors use to assess investment opportunities nor how to sell their investment proposal to investors. The second is support - helping entrepreneurs to meet these standards. The programme itself would take the form of a series of seminars, workshops and one-to-one consultancy sessions encompassing the following five elements (Figure 1):

- information seminar
- investment ready review
- investment ready development programme
- investment ready presentation review
- investment networking

They further suggested that the programme would require to be customised to reflect the requirements of firms at different stages of growth and development and different classes of investor (e.g. business angel vs. venture capital fund). However, this requirement has subsequently been questioned (SQW, 2004: 17).

The first element is a broadly targeted Information Seminar designed to fill the knowledge gap about equity as an alternative source of finance for SMEs at all stages of development. This would address the following issues (following Ernst and Young/Centre for Innovation and Enterprise, 1997):

- what equity is and the benefits it may bring
- the limitations of debt funding
- the circumstances in which it should be considered
- the different types of equity providers in the market place and their specific focus
- how to access the right investor and who are the intermediaries who may provide assistance in finding appropriate investors
- equity investors' evaluation process and decision-making criteria
- how to present information which focuses on the investor perspective of the opportunity
- determining realistic funding needs for the future
- what to expect in relation to the equity parties control and legal safeguards for the future
- risk and return aspects of equity investment and the determination of 'value'

These seminars would be targeted at businesses that are seeking to grow or are already growing, and those that are seeking to commercialise an innovative process or technology. There is a need to reach entrepreneurs at an early stage to enable them to incorporate equity funding in their planning process: identifying and planning for the most appropriate financial and ownership structure for the business is critical to the potential future success of the business

This lack of understanding of how to be investment ready also exists within the SME small business support network, both private and public, particularly local, small scale advisers and service providers. Their knowledge tends to be confined to debt funding options and therefore reinforces the aversion to equity amongst their clients (Ernst and Young/Centre for Innovation and Enterprise, 1995). These seminars should therefore also be open to small business service providers (accountants, lawyers, consultants) to bring them up to the standard needed to be capable of supporting high growth ventures.

The second element involves focusing on those attendees at the basic seminars/ workshops who put themselves forward as candidates for equity finance. These businesses would undergo an Investment Ready Review at which they would be benchmarked on a one-to-one basis for their suitability to raise equity finance. This would cover such issues as (following Ernst and Young/Centre for Innovation and Enterprise, 1997):

- what are the entrepreneur's aspirations?
- what is the entrepreneur's attitude to ownership and control?
- are their books in order?
- are the owner's personal affairs separate from the business?
- does the business have an integrated software package?
- how experienced is the entrepreneur and management team?
- does the entrepreneur know the market?
- has the product been developed to the point of functioning prototype?
- is the product/service proprietary or can it be protected?
- has the product/service been tested in the market place?
- how competitive is the product/service?
- can the entrepreneur provide a reasonable and realistic business plan?
- can the entrepreneur articulate how the finance will be utilised?
- what is the likely rate of return on an investment?
- is there the likelihood of an exit strategy?

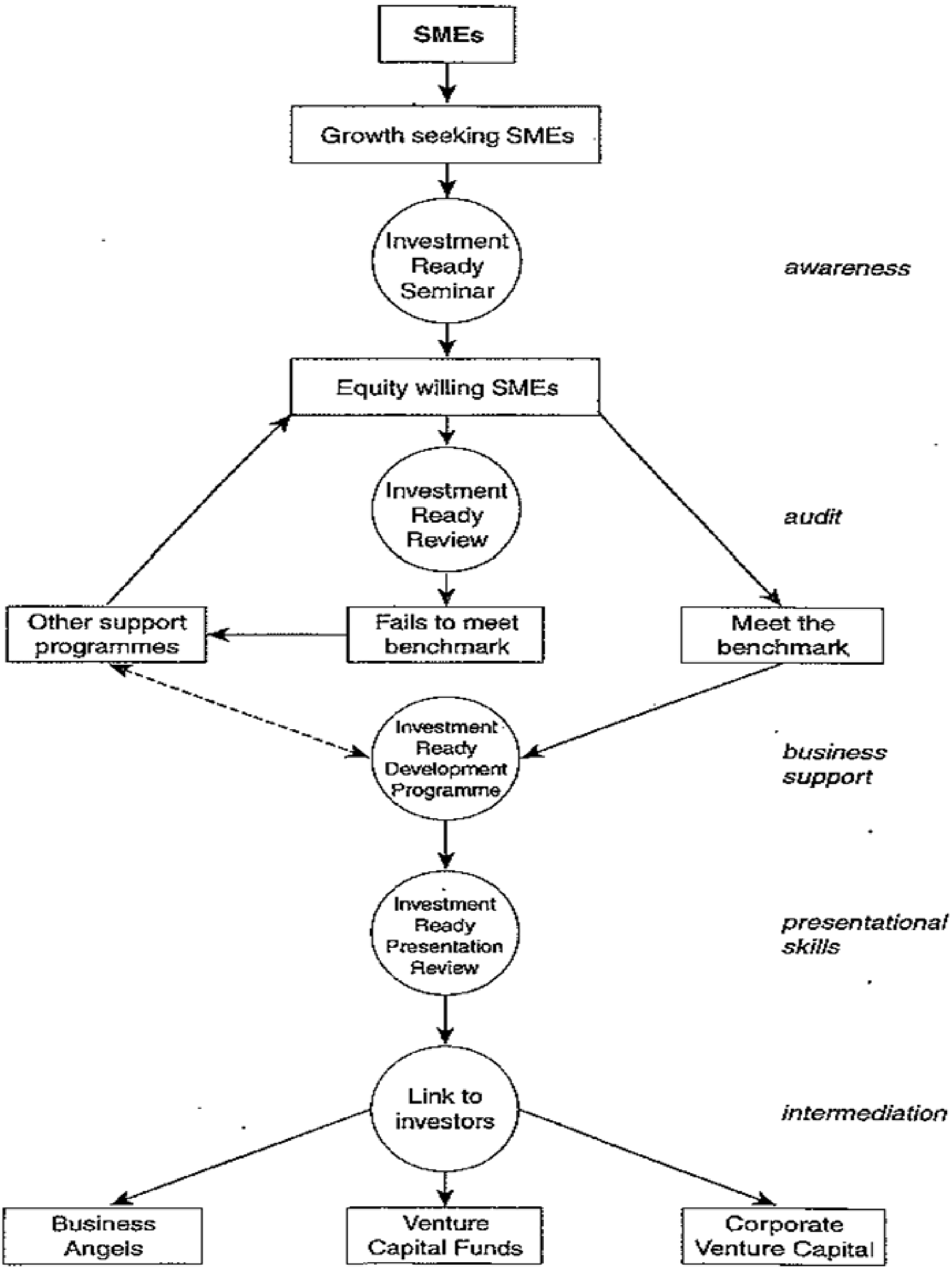
Businesses which do not receive a positive assessment will be directed to appropriate forms of support; they will have the opportunity to re-join the programme once the specific deficiencies have been addressed.

Those businesses that receive a positive assessment will proceed to the third element which is an Investment Ready Development Programme which is intended to address issues raised by the review. The objective is to accelerate companies to the stage of positive cash flow as soon as possible on the grounds that such companies are easier to 'sell' to investors than those that are still at the ideas stage. This stage, which is likely to take several months, will cover issues such as the management team, boards, intellectual property, market analysis, market positioning and market validation, business models, competition, differentiation and barriers to entry, future products/services, and financial planning. It could involve accessing other forms of business support such as innovation grants, proof-of-concept funds and CEO-designate schemes. Such schemes – which most countries offer in one form or another – are, in effect, addressing aspects of investment readiness although are not labelled as such. It can be argued that the effectiveness of these schemes are likely to be enhanced when incorporated as part of a holistic investment readiness programme.

The fourth element is an Investment Presentation Review to assist companies to prepare a 'winning' investment presentation. Knowing how to present an opportunity effectively to potential investors can be regarded as one specific aspect of being 'investor ready' as it requires an understanding of what (different types of) investors look for in an opportunity and an ability to anticipate and address the concerns of investors. Central to this presentation is the use of information which demonstrates and signals personal and organisational competence and the entrepreneur's abilities and motivations. This includes an awareness of deal structures and valuation. As noted above, presentational failings – notably not providing sufficient information - are an important reason why opportunities are rejected by investors. Providing coaching in this area is therefore critical to effective equity finance raising.

The final element is Investment Networking to provide a link between the businesses that have completed the programme and potential investors. This function is undertaken in many countries by business angel networks. However, it could also be undertaken by networks based on university and business school alumni associations, or other investor-entrepreneur networking events such as investment breakfasts, CONNECT-type meetings and First Tuesday-type events.

Figure 1. A model of an Investment Ready programme (Mason and Harrison, 2001)



Source :

In view of the importance of competent delivery, Mason and Harrison (2001) recommended that the programme is delivered by consultants and experienced practitioners who have close familiarity with the requirements and expectations of business angels and other early stage investors rather than by bureaucrats (or those perceived as such).

Mason and Harrison (2001) also emphasised the time scale and costs involved. Because of the need to change both culture and practice, investment readiness needs to be long term; developing investment ready businesses is not a short term process either for the businesses themselves or for the programme as a whole. Investment readiness programmes will also be expensive. Government cannot expect the businesses that are the target audience for the programme to be able to afford the full costs of participating in the programme.

1.5 Investment readiness programmes in practice: an overview

Despite the compelling argument for investment readiness programmes to complement supply-side initiatives they are still relatively uncommon. Certainly there are many types of initiatives that address aspects of investment readiness, but rarely labelled as such. Interventions that seek to address investment readiness in a holistic way remain limited. A recent mapping exercise of training provision for investors and entrepreneurs across Europe identified just 18 investment-ready programmes spread across six European countries (Ready for Equity, 2008).

A review of investment ready programmes reveals considerable heterogeneity in practice. First, there are differences in their starting point and orientation, with many focusing primarily on either the business plan or the pitch, or both. Second, programmes differ in terms of whether they are generic, and delivered through workshops, or company specific and delivered by mentoring, or both. As the model suggests, both are required, with individual company support becoming critical in the later stages. Third, there are differences in the emphasis given to the investment process itself (e.g. legals, transaction process, investment instruments, shareholder agreement, etc), with most programmes giving such issues only cursory attention. This requires much greater attention in investment readiness programmes. Fourth, there are variations in the length of such programmes, ranging from a couple of hours to four days. Fifth, there are signs of emerging diversity of focus, with examples of investment ready programmes targeted at women and at third sector (i.e. social) businesses and at deliverers of such programmes. One common element is that such programmes are generally linked to a funding mechanism.

A number of observations can be made. First, many so-called investment ready programmes, often run by commercial businesses, focus primarily or exclusively on either the business plan or the pitch, or both. This is problematic. As stressed throughout this paper, investment readiness is much more than preparing a business plan or developing a slick presentation. Moreover, the value of investing 100 to 200 hours in writing a business plan is increasingly being questioned (Gumpert, 2003; Kawasaki, 2004). Investors are placing less emphasis on the business plan. They are unlikely to read a business plan at the outset. However, they will listen and react to a pitch. It is therefore more important to develop a short, punchy power point presentation that provides answers to the key questions that an investor will want to know about the business. In addition these programmes often give too much emphasis to financials – business angels take a fairly cynical view of finances, believing that, in the words of one investor, “accountants … can tweak the assumptions and come up with any figure. So it's the last thing I look at." Investors will not look at the financials if the narrative does not stack up (Mason and Rogers, 1996). Accordingly, programmes which focus just on these elements are unlikely to be successful.

Table 2. The main assessed sections in the Ask-BIRT Business Investment Readiness Tool

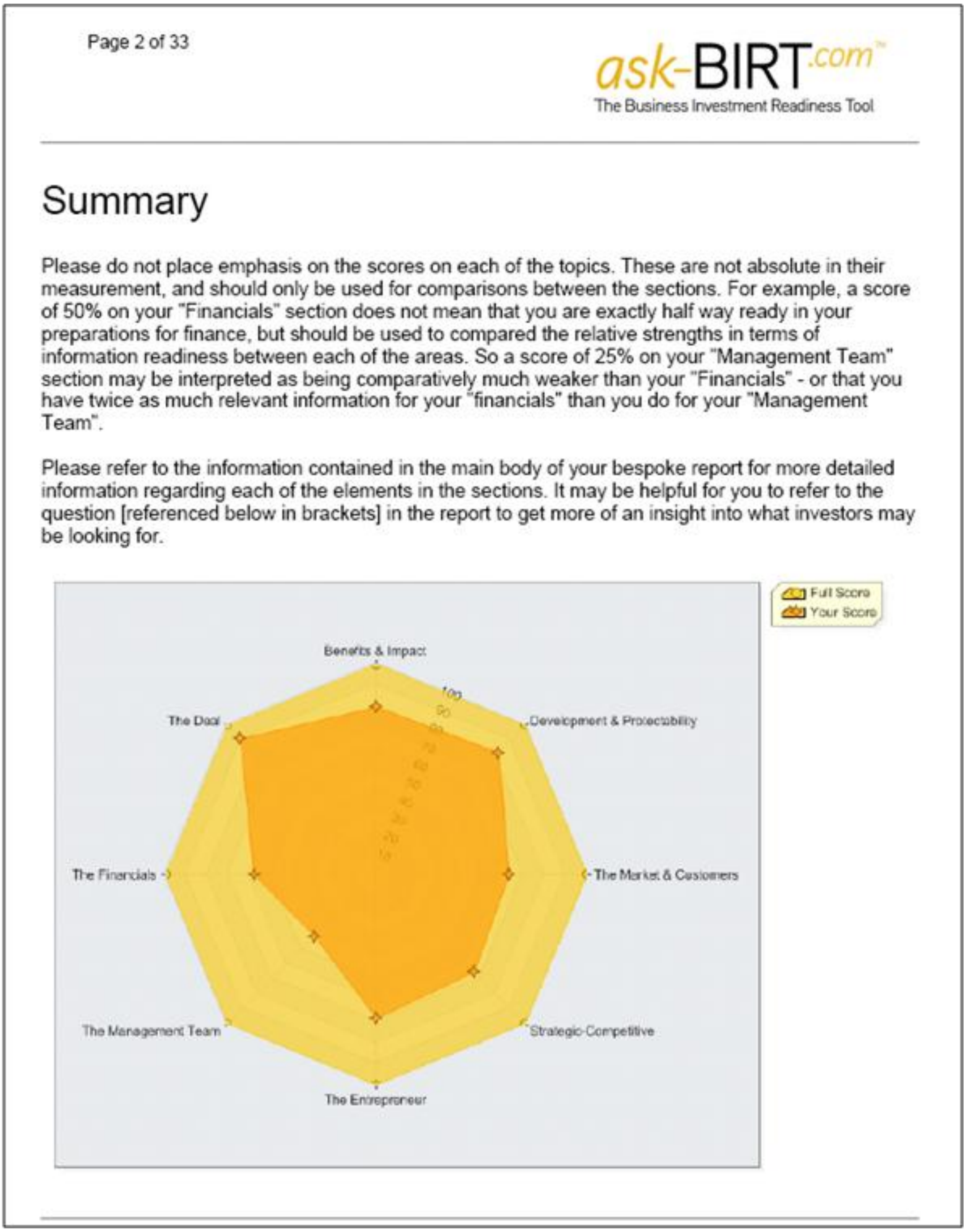
Sample question (form 60) for each section

Product – Benefits & Impact Which attributes do you think are a substantial improvement in performance/cost/price of similar products/service currently on the market? Product – Development & Protectability How complete is your prototype development? [100%=fully functional and tested product, all parts patented; 0%=not built yet, not researched] The Market & Customers Is there an established distribution channel? [Either set up by yourself or by others] [If “yes”:] Do you have access to this channel? [If “no”] How are you going to get your product/service to market? Strategic-Competitive What is your business model? – That is, how are you going to make money out of this venture? Do you have any other products/services that are forthcoming in your portfolio?	The Entrepreneur Do you have any other experienced & successful business persons whom you can call upon for advice or contacts? How comfortable are you selling yourself or ideas to others? The Management Team Do you have at least one “star” or “heavyweight”/expert/industry veternan/guru on your management team? The Financials What have you spent your money on so far? Where did you get the money to fund these activities? The Deal What returns can you realistically expect from this venture? Over what period of time? What is the maximum proportion of this business you willing to trade for equity?

Source :

Second, a number of investment ready self-assessment products have been developed. These are software tools designed on the basis of how investors evaluate business plans to provide an automated assessment a business’s investment readiness. They are positioned at the Investment Development Review stage and offer an alternative to a personalised assessment of their attractiveness to potential investors. An example is the Business Investment Readiness Tool (BIRT) developed by Finance Tree in North East England (www.ask-birt.com). Businesses provide information on the following: the benefit and impact of their product/service; the development and protectability of the product/service; market & customers; strategic-competitive plans; the entrepreneur; the management team; business financials; the deal being sought (Table 2). The feedback which businesses receive normally comprises numerical scores which compares its relative strengths and weaknesses on a range of dimensions of the business and its management team plus an automatically-generated bespoke report which includes advice on how to improve the attractiveness of the business to investors, which together enable an entrepreneur to assess their strengths and weaknesses in seeking to raise finance (Figure 2). A variant on this approach is the Venture Ready Report™ offered by the Wayne Brown Institute in Utah, USA (http://www.venturecapital.org/submit_idea.htm). Businesses submit a structured five to eight page executive summary which is assessed by a panel of venture professionals. Feedback is in terms of a scorecard and overall score, business model classification (e.g. high potential, lifestyle, fad venture, research project, charity) and diagrammatic comparison against a high potential venture which highlights the businesses weaknesses.

Figure 2. A Sample of a bespoke report generated by Ask-BIRT



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ask-BIRT.com™
The Business Investment Readiness Tool

Summary

Please do not place emphasis on the scores on each of the topics. These are not absolute in their measurement, and should only be used for comparisons between the sections. For example, a score of 50% on your "Financials" section does not mean that you are exactly half way ready in your preparations for finance, but should be used to compared the relative strengths in terms of information readiness between each of the areas. So a score of 25% on your "Management Team" section may be interpreted as being comparatively much weaker than your "Financials" - or that you have twice as much relevant information for your "financials" than you do for your "Management Team".

Please refer to the information contained in the main body of your bespoke report for more detailed information regarding each of the elements in the sections. It may be helpful for you to refer to the question [referenced below in brackets] in the report to get more of an insight into what investors may be looking for.

Source :

It is important that these investment assessment tools should not be seen as a low cost alternative to personalised approaches which assess businesses in terms of their investment readiness. First, they require considerable investment to develop. The BIRT tool required one person-year to develop plus substantial computing resources to operationalise. Second, they are not designed to replace one-to-one interaction. Rather, they are intended as a precursor for follow-up interventions. In the case of BIRT, each entrepreneur is invited to attend a post-assessment consultation, with the output report providing a platform for further courses, workshops and tailored assistance that are offered by Finance Tree. The Venture Ready™ programme feeds into a mentoring programme.

Third, and a further area of concern, is that there is often no follow-up to the Investment Readiness Review and the Industrial Readiness Development Programme, with the entrepreneur generally left to take the initiative in addressing the issues raised. Moreover, specialist assistance is often required to remove the barriers to investment that are identified by the expert diagnosis and the costs involved are likely to be beyond what the entrepreneur can afford and what a prospective investor is willing to spend. This highlights the need for businesses to be able to access appropriate support either to become investment ready or to enable a potential investor to clarify particular issues that are critical to their investment decision. In such cases investors will be deterred by the costs (typically the time involved) of undertaking the necessary investigations in order to assess whether the business has the potential to become an attractive investment opportunity. Having identified the problems that prevent such businesses from being investment ready, there are likely to be further costs – both time inputs to provide the necessary level of support and fees to employ specialists (e.g. legal advice to resolve an IP issue) - to fix them. Potential investors are not prepared to make the necessary investment because of the risk that the business will remain uninvestable even after the outstanding issue(s) is addressed. The rational response of investors is therefore to reject these opportunities and seek out others that involve lower investigative and support costs (Douglas and Shepherd, 2002). Thus, businesses that are participants in investment readiness schemes and which are deemed (e.g. by a potential investor) to be potentially investable but require significant additional work to get to the point where they could attract funds need to be able to access to small amounts of funding to cover the time of the potential investor or to access the necessary expertise to address those impediments to funding that are fixable.

A good illustration of this type of intervention is an EU-funded programme developed by LINC Scotland which, in its current form, enables companies seeking finance to obtain funding to cover the cost of an agreed programme of deliverables that are identified by the solutions provider - typically a potential investor – or by LINC Scotland itself (Mason and Harrison, 2004). This is designed to remunerate the investor's time (usually a business angel) plus any expert inputs in the form of IP protection, legal costs or specialist external due diligence (e.g. on technology) to solve specific problems. The maximum grant is now £15,000 per company: this covers 70% of total costs (half of which is provided by the EU, with the remainder provided by the professional firms which sponsor the scheme) with companies providing the balance. Should an investment occur the grant becomes convertible to LINC Scotland equity in the company on the same terms as the main external investors. LINC Scotland will exit at the same time as the other investors.

1.6 Investment readiness programmes: evaluations

This section probes more deeply into the functioning and impact of investment readiness programmes. It is based on three sources of evidence: (i) an evaluation of the UK Government's Investment Readiness Demonstration Projects; (ii) an overview of an investment readiness programme introduced by the University of Warwick Science Park; and (iii) an evaluation of the Finance and Business Programme delivered by Finance Tree Ltd in North East England. We draw upon this evidence for important insights into the design and delivery of investment ready programmes.

i) Evaluation of the UK Government's Investment Readiness Demonstration Projects

The Mason and Harrison (2001) paper prompted the UK's Small Business Service to conceive a pilot programme of Investment Readiness Demonstration Projects. Following a competitive tender six bids for projects were funded along with an existing programme ('Fit4Finance') to roll it out more widely. The new projects all started in 2002, with Fit4Finance established a year earlier, and were evaluated in 2004 by SQW Limited (SQW, 2004).

Table 3. An overview of the approaches adopted by the UK's Investment Demonstration Projects

Project components	Description
Information seminar	To provide information on a range of issues relating to investment, generally presented by specialists. The audience included both business owners and intermediaries providing business support and professionals (e.g. accountants, lawyers)
Investment ready review	Most projects offered a diagnostic session where a project member carried out a review of the business, as assessment of its need for finance and whether it was a candidate for equity finance. If the business was judged not to have the potential to raise equity finance it was signposted to an alternative source of support. The diagnostic review ranged between 1.5 hours/half a day meeting to a more structured and in-depth assessment covering a much longer period of time. Those businesses identified as appropriate candidates for equity finance then progressed either to one-to-one support or a group based programme, or a combination of both.
Investment ready development programme	There was less consistency in how the intensive support was delivered. Where it was through one-to-one support the emphasis was on identifying and addressing gaps and deficiencies in the business plan before being presented to a potential investor or developing a business plan where one did not exist. In some cases support would also focus on particular issues that required to be addressed (e.g. review of marketing strategy, recruitment of new team members). In other cases this support was delivered through a combination of mentor support and workshops.
Investment ready presentation review	This typically took the form of a mock panel presentation where the business could rehearse its presentation in a safe environment and receive feedback. Panellists normally comprised members of the investment community. Generally panel members were provided with a copy of the business plan before the session and interrogated the entrepreneur after the presentation.
Investment networking	Most of the projects had strong relationships with investors, investor groups or investment funds and so were able to provide introductions to potential investors.

Source : Source: compiled from information in SQW (2004)

The projects varied in their design and focus. This was deliberate because one of the aims of the Demonstration Projects was to test a number of approaches to investment readiness. Nevertheless, most covered all of the elements in the 'Mason-Harrison programme' outlined earlier, although there were variations in how these were delivered (Table 3). One variant took the form of intensive and continuous support over a sustained period whereas the other provided injections of support at various points as the business progressed on its journey to becoming investment ready. A further distinction was between delivery through group-based workshop structures and delivery on an individual basis by one or a series of advisors. Both structures offered benefits, were not mutually exclusive and a combination tended to be complementary.

The projects were judged by the consultants to have achieved additionality. However, the Consultants noted that it was problematic for the business clients to make an accurate judgement on the extent of additionality because they were being asked to reflect on their likely behaviour in the absence of the programme, but with the benefit of hindsight of experiencing a project designed to raise awareness of the benefits of equity. Certainly the businesses could not have afforded the full cost of the intensive, sophisticated support that they received nor would they have had the exposure to a range of specialists and investment candidates or the introductions to the wide range of potential investors in the absence of the scheme. Positive impacts were identified in awareness raising, personal, business development and financial benefits, and funding success, with the participating businesses reporting 96 funding deals, with others still in the process of equity negotiation at the time of the evaluation. The Consultants concluded that the demand for such an intervention appears to exist, and where the projects have been delivered effectively they have achieved positive impacts.

The evaluation also drew out a number of important lessons for the design and delivery of investment readiness programmes. First, they are not a short-term intervention. Investment readiness programmes require long-term commitment over several months to support businesses to the point where they are ready to seek equity finance. It is therefore essential that sufficient time is allowed for businesses to complete the programme. It also takes time for such programmes to become established and embedded in networks. Second, the costs of delivery of such programmes are fairly high and the client group – start-up and early stage businesses – are poorly positioned to pay. Indeed, none of the projects recovered the full cost of delivery; it therefore seems unlikely that such intensive and specialized investment readiness programmes could become self-financing. It follows that the public sector must subsidise such programmes if they are deemed to make an important contribution to the emergence of entrepreneur-led, high growth businesses and in turn to economic development. Third, continuous awareness raising is necessary to recruit businesses to the programme. Fourth, referrals should come through established and credible networks acting as a first stage filter. Fifth, both group and individual delivery models have merit but individual delivery is essential for certain elements in the programme. Sixth, the involvement of potential investors in delivering the support adds credibility and realism. Seventh, in order to prevent potential conflicts of interest a formal separation is required between the investment readiness programme and the funding process. Finally, the delivery team is the critical success factor in terms of their expertise, experience, reputation and access to appropriate specialists, networks and investors (SQW, 2004).

ii) University of Warwick Science Park

A second source of evidence comes from an unpublished paper by David Rowe, Chief Executive of the University of Warwick Science Park, which describes an investment readiness programme designed to support knowledge-based businesses on the science park to access finance from business angels and venture capital funds (Rowe, 2005). This programme was developed in the light of the SQW evaluation and designed specifically for early stage knowledge-based businesses. The key features of the programme were as follows:

- A referral network approach to attracting clients – working through intermediaries already known to the client.

- A 1:1 mentoring approach to assessing and working with the company, provided at minimal cost to the client.

- Funding to enable the programme to complement its mentoring with direct assistance in the form of interim managers, professional advisors, marketing expertise, etc as necessary, along with some seed funding.

- Direct access to and involvement with the business angel network and venture capital funds as soon as the client's mentor deemed the business to have reached a position of investability.

- Where appropriate, providing clients with coaching in presentations at investment forums and help in improving the presentation of business plans.

Funding was provided by the Regional Development Agency and the ERDF.

The various forms of support that businesses in this programme can access – which links to our earlier comments about the need to intervene to 'fix' problems identified by the investment readiness programme - is a particularly important feature of the Warwick Science Park programme. Companies can access one or more of the following:

- R&D grants (typically up to €65,000) to help companies complete their product or service development programme.

- Subsidized business advice (up to a total of €5,000) for marketing, technical assistance, business planning, intellectual property advice, etc.

- 50% of the cost of an Interim Manager with the key skills necessary to resolve a major weakness in the company. This addresses the key problems in many early stage companies of the lack of management time and specialized skills.

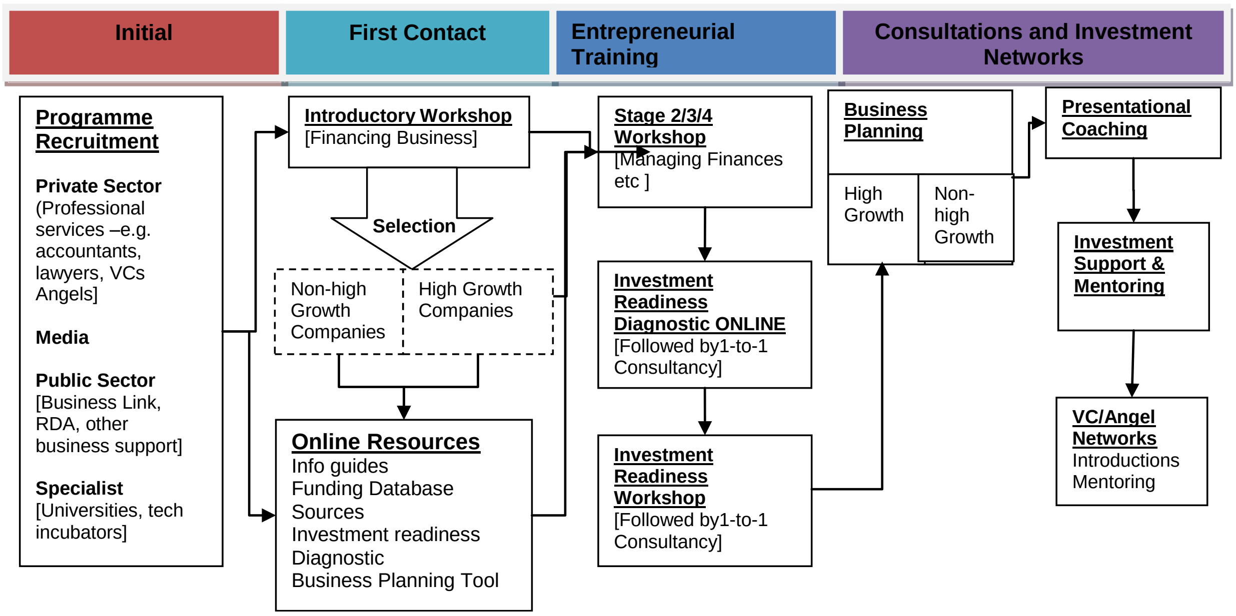
- An investment of up to €70,000 of seed capital (from the Concepts Fund) to provide working capital to enable the company to reach a higher level of development which, in turn, enhances its prospects of raising equity capital (and reduces its cost). In some cases the fund has co-invested with external investors as part of an investment package.

Businesses which successfully complete their action plans are introduced to private sector investors through their mentor. This includes the Science Park's own business angel network. Of course, some of these businesses will be unsuccessful in raising finance. Others do not reach investment ready status for whatever reason. Nevertheless, both of these groups of entrepreneurs come out of the programme enriched by the experience which they apply to their business. Approximately 35% of the businesses that enter the mentoring phase of the programme receive one or more offers of equity finance and secure the investment they are seeking. There has been a fourfold increase in the level of investment activity in science park businesses in the two years in which it has been operational compared with the period before it was launched. This performance also compares well with the Investment Readiness Demonstration projects evaluated by SWQ Limited. Here again, the experience of the programme confirms the SQW findings that investment readiness is a long-term intervention. Clients typically take a year or more to become investment ready (Rowe, 2005).

iii) Finance Tree's Finance and Business (F&B) Programme

The 'Finance & Business' (F&B) Programme in North East England was delivered by a private company, Finance Tree, on behalf of the North East Regional Development Agency at a cost of £2m of public funding. The programme was independently evaluated to show the associate benefits impact and value-added and to help better understand the impact on SMEs over the life of the programme and hence contribute to knowledge of best-practice. The evaluation was based on a longitudinal tracking of the experiences of business owners. In terms of headline statistics, 1464 SMEs registered with the programme and 884 received one day or more of assistance.

Figure 3. Finance Tree's Investment Readiness Programme



Source :

Following Mason and Harrison's (2001) paper, the elements of the F&B programme were specifically designed to meet the proposed three distinct dimensions of investment readiness requirements: (i) entrepreneurs attitudes towards equity finance; (ii) Investibility of the project; (iii) presentational failings. The F&B programme therefore presented a real opportunity to road-test the practicalities of the model, and to identify any other components that would improve the design of such investment readiness programmes. Because the F&B programme was one of the first major 'Access to Finance' initiatives, design evolved over time as best-practice considerations were incrementally adopted. The resulting investment readiness model was not quite as linear in form as the model proposed by Mason & Harrison (2001) (Figure 3).

Experience of promoting the programme clearly indicates that the marketing challenge should not be under-estimated. It takes time for the programme to develop momentum. The marketing budget therefore needs to be substantial. There was a strong emphasis on networking with the local private sector (professional services and organisations), public sector (e.g. Business Links, Regional Development Agency, other business support), and other specialist knowledge-based organisations (e.g. universities, technology incubators), and through media (newspapers, magazines, special web articles) to raise awareness of the programme. After the initial tranche of publicity, promotion was based on the offer of an introductory course , offer of further information/ advice online, and through the use of free online tools all of which were designed to stimulate confidence within the entrepreneurial community to embark on the investment readiness pathway.

This initiative highlights four major areas concerning the design of investment ready programmes.

First, it is critical to ensure that the entrepreneur has a "continuous pathway" towards meeting investors requirements. Although the framework of the Programme included the five core "elements" of the Mason and Harrison (2001) model, in practice entrepreneurs could take a "pick and mix" approach to the programme offering. This might be expected, since entrepreneurs have differing requirements. By 'picking and mixing' entrepreneurs are, in effect, customising the service according to their needs. This works with self-motivated entrepreneurs who are well-informed about all of the elements of the programme and recognised their own needs. But in practice, entrepreneurs "don't know what they don't know". This is one of the reasons why entrepreneurs disengage from the Programmes. Most entrepreneurs therefore prefer a bespoke suite of accessible scheduled activities designed by experts to cover what entrepreneurs need to know. Thus, the investment readiness journey, by necessity, needs to be both prescriptive and linear. Any mismatch between provision and requirements will create a gap, at which point the entrepreneur is in danger of being disengaged from the whole process. Each of the arrows that flow between the nodes in Figure 2 have been opportunities to create value-added information and/or networking events and clinics. One way in which this has been done is through on-line tools which have the advantage of being very accessible. Examples are FundFinder™, a bespoke searchable funding database, and Ask-BIRT™, an online self-assessment investment readiness strengths and weakness tool (see Table 2 and Figure 2). If done to a high standard and integrated into the marketing strategy, these tools can be effective in attracting participants to the programme by providing entrepreneurs with a sample of the "value-add" that investment readiness programmes can provide, especially if used in conjunction with the other core elements. The initial development and set-up costs are comparably high, but once the tools are online, the running costs are minimal. The resulting auto-generated bespoke reports from these tools provide a platform to initiate interactions between the entrepreneur and Programme advisors/consultants.

The second important lesson learned during the evolution of the Programme concerns the customisation of programmes to the requirements of the entrepreneur. For example, additional bespoke events were targeted specifically at university science spinout companies (e.g. on evaluating the market size for unique high-growth products and services; on intellectual property and finance), However, there is a trade-off between the "streaming" of businesses based on their differing needs and the finite resources that are at the disposal of the investment readiness programmes. In short, customisation adds considerably to the costs of delivering an investment ready programme.

The third lesson was the recognition that the power of local knowledge should not be under-estimated in setting up and designing an effective programme. Investment readiness teams who have good local networks in both the public and private sectors and across all sectors are better able to efficiently connect the entrepreneurs with the appropriate sources of expertise (e.g. investors, legal, other support networks, etc) within the region. A team with good local knowledge and established contacts has the added advantage of being able to identify the types of experts from whom local entrepreneurs would want to take advice. Delivery of content by experienced consultants and practitioners and by successful high-profile entrepreneurs has been an important marketing strategy to achieve high levels of participation at events.

The fourth lesson concerns the design of the monitoring processes and targeted reviews. Most investment readiness programmes are publicly funded, and this carries with it a duty to continuous reporting of various key performance indicators (KPIs) of the Programme. Examples of reported indicators include the number of companies receiving specified days of assistance, number events hosted, number of participants, new job creation, amount of leveraged finance, and in-kind contributions. However, while these KPIs may suit bureaucrats, they are not particularly helpful to those engaged in running such programmes. Thus, there is a need to develop more meaningful measures to assess the performance and impact of such programmes. These might include the following:

- the amount of interest in, and enthusiasm for, equity finance amongst entrepreneurs;
- increased knowledge of financing options;

- programme referrals to other support and finance organisations;
- amount of business networking at information events;
- assisting businesses to access various types of funding - grants debt and equity;
- other benefits for the business? e.g. clearer strategic direction; better financial; management

Such monitoring is required to follow companies on a case-by-case basis, tracking their progress towards becoming investment ready.

It was also clear from this programme that an investment readiness programme is not a short-term process. As already noted, it is likely to take several months, and possibly much longer, to deliver the programme and for businesses to address the issues that emerge and become investment ready. This raises two important questions. First, for the purposes of evaluating an investment ready programme what is the appropriate monitoring period for the benefits to emerge? Second, how long should a programme run to have the most beneficial effect on businesses? This has important implications for both the evaluation of the programme and the length of time that the programme is funded.

The F&B programme was originally funded for two years but subsequently received funding for an additional six months. An evaluation was therefore undertaken at the end of the two-year programme. However, a number of stakeholders, quoted in the evaluation, thought that "it was too early to make a summative assessment of the impact of the programme on business and regional development". The Finance Tree evaluation, which was based on the longitudinal tracking of the initial cohort of clients found that 18 months after the start of the programme, 27% of businesses identified a positive change in their business, but this increased to 52% six months later, with businesses reporting (after 24 months) an aggregate increase in turnover of £1.68m, 31 new jobs created, over £1m in new funding (by 22 businesses) and £186,960 from in-kind contributions from the public sector. This provides clear evidence that the benefits of an investment readiness programme take time to emerge. Moreover, these figures understate the positive impact of the programme because they do not record the benefits beyond 24 months, nor the impact on those companies that had joined the programme more than 12 months after the start.

Once the funding ceased the programme had to close. It operated for just 30 months. This is surely an inefficient use of public resources. First, there are substantial sunk costs incurred in setting up such a programme. The programme needs to run over a number of years to justify such costs. Second, the programme took time to develop momentum, raise awareness and achieve a positive reputation. It also takes time for those involved in the programme to develop knowledge and learning which can be translated into good practice. Terminating a programme after such a short period of time significantly reduces the return that is generated by the investment of public funds in the programme. It is wasteful. The implication is therefore that investment ready programmes should be funded with a view to being operational for several years if they are to achieve a step change in the quality of the deal-flow reaching equity investors. Moreover, the closure of the programme creates a need which in due course is filled by other publicly funded investment ready programmes which have to start from scratch because the learning from the previous programme – mainly in the form of the tacit knowledge of the individuals involved - has dissipated.

1.7 Conclusion

There is now a growing recognition that improving the access of SMEs to finance is not exclusively a supply-side issue. The impact of an increase in the supply of early stage venture capital will be limited because many of the businesses that come forward are not investment ready. The consequences are, first, that investors are unable to make as many investments, or invest as much as they wish, and second, that investors who are under pressure to invest (such as government funds) will invest in poor quality businesses in order to 'get money out the door'. This recognition has prompted various organisations, often with government support, to develop investment ready schemes. These comprise three distinct elements: (i) finding out – seminars which provide information on the types of finance available, the role of different types of finance in growing a business and the specific role and importance of equity finance and where it can be sourced (ii) becoming investment ready – workshops and tailored support to enable business owners understand what investors look for and how to address these issues in their own business; and (iii) finding and attracting investors – training in presentational skills and connections to potential investors. It would be appropriate, in order to emphasise the connectivity between the creation of new investment funds and investment readiness, for the investors in new venture capital funds to set aside a proportion of funds under management (say 5%) to establish independently-run investment readiness programmes. Indeed, the £125m JEREMIE fund in North East England has an investment readiness programme built in to address the deal flow for its six equity funds).

There are three lessons for policy makers considering the introduction of investment ready schemes. First, they are not a quick fix. The duration of a properly designed programme is extensive, lasting a year or more. Positive results will be slow to emerge. Momentum takes time to build, the advisory team takes time to develop expertise and the reputation of the programme takes time to develop. Second, investment ready projects involve significant costs to the public purse and cannot be expected to recoup their costs from users. Third, the Mason and Harrison (2001) model appears to be fairly robust. Programmes which deliver the awareness and presentation elements but do not effectively engage in the (more costly) critical diagnostic and business support components are unlikely to be effective. What is being delivered in such programmes is necessary but is not sufficient to get businesses investment ready. This is because investment readiness is fundamentally about business development issues, is often nebulous and generally company-specific and requires the input of significant amounts of expertise to identify and address barriers to investment. As a consequence, such support is time-consuming and, therefore, expensive to deliver (and, of course, well beyond the means of most start-up and early stage companies to purchase themselves). Finally, an important modification to the original Mason-Harrison (2001) investment readiness model is connections to other business support programmes that offer assistance to address the sorts of issues identified in the investment readiness review that need to be addressed to make the business investment ready.

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