

**The National Endowment for Science, Technology and the Arts (NESTA)  
and British Venture Capital Association (BVCA)**

**Invitation to Tender**

**Government Interventions – are they changing investor behaviour?**

**1. Background to NESTA**

Created in 1998, NESTA, the National Endowment for Science, Technology and the Arts, is working to transform the UK's capacity for innovation. We have endowed funds over £300 million and use them to work across all stages of the innovation process, learning about how innovation works, funding new ventures, building and delivering innovation programmes and disseminating what we've learned nationally and internationally.

Underpinning our work is the fundamental belief that successful innovation is critical to the UK's ability to meet the social and economic challenges of the 21<sup>st</sup> century; an essential ingredient of our competitive edge in the global market place.

Led by CEO, Jonathan Kestenbaum, who took over in November 2005, NESTA is delivering a new five-year strategy focused on transforming the UK's capacity for innovation along three dimensions:

- **Innovation Programmes:** a series of imaginative, experimental programmes, exploring how best to stimulate and support innovative capacities across society.
- **Policy & Research Unit:** conducting and commissioning research in order to inform policy and improve the climate for innovation in the UK.
- **NESTA Investments:** creating innovative models of seed investment as a leading institutional investor in the early-stage market.

NESTA's Policy & Research Unit (NPRU) conducts and commissions research into the innovation policy that the UK needs to meet the national challenges of the 21st century. We seek to make a unique contribution to the debate based on NESTA's position as a national organisation that connects our investment fund, innovation programmes and the policy and research communities.

NESTA's Policy & Research Unit is launching a new research strand on 'innovation that matters' that is, innovation in response to major social challenges. NESTA is inviting applications from researchers interested in pursuing work in this area.

The aim of this strand of research is to better understand the 'innovation systems' that exist in areas of major social challenge, such as climate change. 'Innovation' is defined here very broadly – from the research and development of new-to-the-world technology products or processes, to the diffusion of novel services, business models or organisational forms, whether in the private, public or third sectors. By 'innovation system', we mean the networks of institutions and actors in the public, private and third sectors whose activities and interactions serve to invent, develop, adapt, adopt and diffuse innovations.

## **2. Background to this research**

Venture Capital is essential to the financing of innovation and early stage innovative SMEs. The role of the government is to support Venture Capital by creating a favorable environment with regulatory frameworks which effectively stimulate private investments and channel high risk resources to innovative SMEs.

The UK government has increasingly recognised the importance of early-stage equity investment for economic growth and innovative activity and as result has sought to support more directly the VC market. Several high-profile interventions have been designed to facilitate early-stage investment focusing on the 'supply-side' of the investment market (Regional Venture Capital Funds, Enterprise Capital Funds, Venture Capital Trusts, Enterprise Investment Schemes, Venture Capital and Loan Funds (ERDF 2000-2006), UK High Tech Fund of Funds, DTI's Early Growth Fund etc). In particular, these have addressed the so-called 'equity gap', in which there is a perceived lack of sufficient venture capital available at the early-stage, particularly relative to the far greater quantity of capital available for later-stage (e.g. MBO/MBI) investment.

Beyond the direct provision of public money into early-stage funds, implied in many of these schemes is a goal of attracting further private investment into this area. NESTA together with the BVCA wishes to commission research on the effectiveness of such measures in changing the investors' behavior.

## **3. The research project**

We are inviting proposals from organisations with in-depth knowledge of the early-stage venture capital market and a track record of producing high profile reports. The final output will be a report on the effectiveness of the government initiatives in early stage funding and a benchmark of performance. We anticipate this effort to be up to £100,000 in value and that the project would take up to 8 months.

The research should answer the following questions::

- Have government interventions, as listed above, been effective in attracting private resources?
- Have these actions had broader influence on the sector by:
  - Enticing existing institutional investors to shift some of the investing activity to the seed/early-stage?
  - Increasing incremental new investment in this space?
  - Altering the risk appetite of investors or crowding out investors?
- Which of the models tried so far is the most effective and efficient in meeting public sector targets? Can better models be developed based on the research findings?
- Has the intervention created sustainable funds? - i.e. funds are recirculated into the SME sector and gradually reduce the dependence of the enterprise sector on Government initiatives

## **Methodology**

The successful researcher may consider:

- Using existing databases available from UK government departments. BERR will be able to provide the successful researchers with aggregate investment activity data for each of their VC interventions. The use of HMRC or DIUS databases may also be considered by the researcher.
- Exploiting complementary information from financial private databases
- Collecting new data where necessary (e.g. non existing data, poor quality of existing data, out of date data etc)

Applicants are invited to suggest quantitative or qualitative methodologies or a mixture of the two in order to analyse the effectiveness of these measurements over the last 10 years.

The analysis could be based on:

- the financial outputs of funds in terms of amounts invested, return to investor, cash multiples and IRRs
- regional bias – for example the initial ECFs seem to favour London and S East VCs
- the views of the current fund managers
- the perceptions of private sector investors, such as banks and local authority pension funds, of the funds in which they have invested
- the achievement of soft objectives, such as increasing growth in employment, improving start up rates, supporting deprived areas and declining sectors, changing the overall investment climate and creating a breed of new and specialised fund managers

The best proposal will demonstrate:

- A deep understanding and clear methodology of how to capture and measure the effectiveness of the government initiatives
- Ability to gather the data and deliver the analysis in a cost-effective manner
- Collaborative engagement with NESTA and BVCA

#### **4. How to apply**

The closing date for all proposals under is 5.00pm BST on 17 September 2008.

Your entire proposal including all supporting documentation should be emailed to [research@nesta.org.uk](mailto:research@nesta.org.uk)

NESTA will evaluate the proposals received and notify its final decision (please see relevant dates). NESTA may invite a selection of applicants for an interview before the final decision is taken (please see relevant dates).

**This document should be read together with the accompanying guidance notes which form part of this Invitation to Tender.**

If you have a specific question not answered either above or in the guidance notes, please email [research@nesta.org.uk](mailto:research@nesta.org.uk).

