AC4526: Finance Dissertation

A critical review of the recent developments in Scotland's early stage funding market, with practical suggestions for the minimization of funding gaps.

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Abstract

This paper analyzes and critically discusses Scotland's current early stage venture funding market. Through nearly five hours of semi-structured interviews with nine industry experts, this paper found that angel investment lifecycles are extending through constrained long-term exits and decreased VC activity. This in turn is drawing capital away from start-ups, creating a funding gap. If Scotland is to successfully operate in an increasingly globally competitive environment then it is essential that funding provisions are not restricting the growth of promising ventures. Interestingly, the paper suggests that a funding gap only exist for less promising ventures, and that improving business models may be key in developing Scotland's economy. The final section presents the survey findings in a practical framework in an attempt to improve entrepreneur's investor readiness. Furthermore, government intervention initiatives were reviewed and have been found to have a positively significant impact on the provision of funding in Scotland.

1. Introduction

The early stage company funding market plays an essential role in supporting Scotland’s economy. Ensuring the efficient and effective operation of this market is vital if Scotland is to minimize barriers for the development of promising ventures. These ventures are essential as they provide: employment, encourage the circulation of wealth and most importantly, present export opportunities. Unfortunately, this highly undisclosed, and largely under-researched market, may be perceived to be in crisis. Double dip recessions and growing global economic competition, makes Scotland's economic future unknown (BBC, 2012).

Out with family and friends, few are willing to invest in start-up ventures as they usually have little to no tangible assets and are expected to have extensive negative returns before making a return (Mason & Pierrakis, 2009). Early stage investors, including angel and venture capital investors, provide vital but differing types of funding. Angels invest personal wealth, or invest on the behalf of a high net-worth individual, typically in very early stage ventures. They help bridge the gap between an entrepreneur’s intellectual assets and an entrepreneur’s commercially viable business. VC’s invest from an investment fund, typically in later stage ventures, enabling ventures to ‘cross the chasm’ either through expansion or costly innovation (Mason & Pierrakis, 2009).

The purpose of this paper is to examine and critically discuss the developments within, and access to, Scotland’s early stage funding provisions. The aim is to carry out, primarily, empirically based research in an attempt to generate a unique insider’s outlook to the industry, further developing upon current literature.

The primary research is a literature review. There are unfortunately only a limited number of papers and publications on the chosen subject, however those that do exist relate directly to this relatively small niche market. Therefore, the literature review does produce a very good insight into the status, changes and trends in the market. For example, the monthly industry newsletter Young Company Finance publishes virtually all angel funded deals in Scotland. In addition, the public body Scottish Enterprise, which is directly involved in funding start-up companies, researches the market for trends to support their start-up strategy.

The Scottish private equity market is small by international standards which gives reviewers and commentators the advantage of knowing and having access to the key players. The researcher will take advantage of this in the second research element of this paper, where he will conduct a series of semi-structured interviews with nine industry experts. These industry experts manage and support Scotland’s most prominent angel syndicates networks, VC funds and publication bodies. Their comments are based on many years of experience, processing a large number of deals. With reference to a lack of supply of high quality investment proposals, the final section presents the results in practical user friendly framework. This is to help entrepreneurs develop their investor readiness in the hope of improving Scotland’s stock of promising high growth businesses.

The dissertation has been broken down into literature review, research design, results and conclusion. Each section will introduce the topics it will cover.

2. Literature Review

2.1 Introduction

The aim of this section is to compile and critically review literature on Scotland's private equity market, and more specifically, the early stage funding market. This will form a baseline to which the results of an industry survey will be added.

The work of Block *et al* (2010) and Block & Sandner (2009) suggests that the recent economic developments, especially the financial crisis that started in 2008 and continues to the present day, may pose a threat to the early stage funding market in Scotland. Firstly, the economic developments experienced over the past ten to fifteen years will be defined and discussed. Following that, a positivist approach will be adopted to examine industry data taken from UK and Scottish studies. It will discuss developments (if any) in total investment, average deal size, investor structures and sectors. The findings from these quantitative studies will provide baseline performance indicators for the Scottish early stage investment market, both before and after the financial crisis of 2008. Thereafter the researcher will use carefully selected explanatory literature to provide possible explanations as to why the industry is experiencing such developments and will draw from investment lifecycles, availability of exits and access to debt. The relationship between industry trends and start-up investment levels will also be analyzed. Finally, it will address the government's current role in the early stage investment market.

2.2 Economic Developments

The world has experienced dramatic changes in the state of its economies over the past ten to fifteen years. Some of these changes have had an impact on early stage company funding in Scotland. In the late 1990's the world experienced the 'tech bubble'. Investment outlooks were positive and expectations high. The Venture Capital (VC) industry experienced a huge influx of money, helping the tech sector industry reach new peaks of activity (Mason & Pierrakis, 2009). Company valuations were high and investor competition was tough. Some even thought that the 'tech bubble' impaired investor's cognitive behaviour (Mason & Pierrakis, 2009 citing Valliere and Paterson, 2004). As you can imagine this unrealistically optimistic outlook would lead to serious problems for the investment industry.

The 10 year VC fund lifespan meant exits were sought when public markets were at their weakest. Investment returns were seriously impaired as original valuations were optimistic. As a result the 'tech bust' was experienced in early 2000's. The VC asset class lost its desirability and the supply of funds for investment plummeted (Mason & Pierrakis, 2009 citing Buckman, 2009). Start-up funding virtually stopped as VC managers conserved cash to meet the demands of their current investments (Mason & Pierrakis, 2009). Around 2003 the private equity investment sector started to stabilize and was on the road to recovery. During this period, figures show that the value of investments trebled between 2003 and 2007, from £4bn to nearly £12bn (Mason & Pierrakis, 2009, p 11).

The bankruptcy of the Lehman Brothers, immediately followed by the liquidity crisis of the American International Group in September 2008 marked the start of the global financial crisis (Block & Sandner, 2009). The crisis put serious financial strain on consumers, companies and governments. Financial institutions, across the western world, lost vast proportions of their value (Block *et al*, 2010). This collectively put most of the world's largest economies into recession.

A combination of factors caused the financial crisis, a few of which will be briefly discussed (Block *et al*, 2010). During the early 2000's feudal fund rates in the US were low and financial incentives for banks to sell mortgages were high. House prices sky-rocketed and the US experienced the 'housing bubble'. Problems occurred when banks started getting involved in high risk, sub-prime lending. Many low credit variable rate mortgage holders defaulted as the federal funds rate started to rise in 2004. The hedge funds holding these sub-prime mortgage derivatives soon crashed in 2007. Bank cross-lending insecurity increased further exacerbating liquidity problems. Furthermore, in 2004 the government altered their net capital rule enabling banks to increase their debt holding ratio. In response, CDO's (collateralized debt obligations) and MBS (mortgage backed securities) were designed. They largely contained high-risk subprime borrowing, however, because they were pooled with safer types of borrowing they were regarded as a relatively safe investment. Of course this was not the case and as soon as subprime borrowers defaulted on their over-valued homes the banks and associated investors lost out.

2.3 Industry Trends

2.3.1 Introduction

Most Scots are aware of the effect the financial crisis has had on Scotland's economy and the subsequent 'austerity' measures. However, what is not so clear is the effect on Scotland's early stage investment market.

This section will analyze developments experienced by Scotland's early stage investment market over the past five or so years. The majority of the data was taken from "The risk capital market in Scotland 2008", published by a government source, Scottish Enterprise (2009). Data is also taken from LINC Scotland, extracted through Mason & Harrison (2011). It will address the key areas of deal size, investor composition, total investment and industry sectors. It will also draw on explanatory literature to help understand these changes.

2.3.2 Total Investment

Figure 2.1 shows the total value of investments made within Scotland's risk capital market between 2000 and 2008. It shows remarkable stability between 2005 and 2008, suggesting as expected, that financial crisis hadn't impacted as of yet. Furthermore, the follow on from the 'tech boom' in 2001 not only resulted in the increased supply of funds but also investment levels. The subsequent slump of the 'tech bust' is also tracked in 2002. To gauge performance post financial crisis, Figure 2.2 shows the total investment made in Scotland between 2008 and 2010 by angel investors and shows that overall investment levels did not decrease. In 2009/10, LINC Scotland recorded an increase in investment numbers of 5.4% and yet a decrease in total investment value of -0.4%.

2.3.3 Deal Size

Reduced average deal size explains why recorded angel investment numbers have increased by 5.4% yet the total investment value has decreased by -0.4%. Figure 2.3 displays the mean and median deals sizes in Scotland. It clearly shows that since the recovery of the 'tech bust', average investment value steadily increased to £792,000. 2008 saw a noticeable decrease in the average deal size, possibly attributable to the weakening economy. Mason & Harrison (2011) found similar results. In Scotland, 2008/09, 36% of investments were under £200,000 whereas in 2009/10 this proportion had increased to 49%. It is highly likely that the recent economic developments played an important part in the reduction of deal size, yet the extent of the impact is unknown.

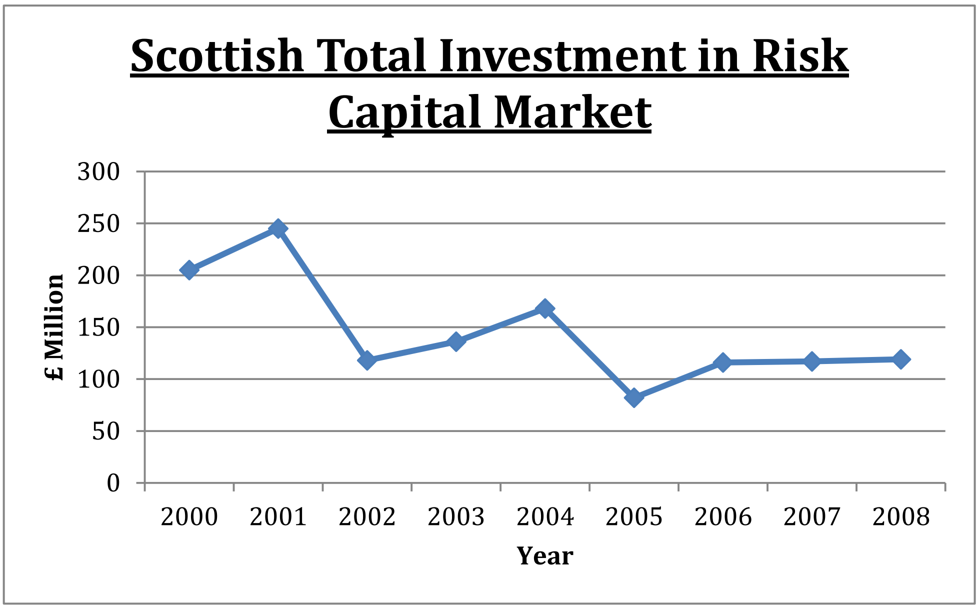

Figure 2.1: Scottish total investment in risk capital market, data: Scottish Enterprise (2009)

Scottish Angel Investment Activity

	2008/09	2009/10	Change	
Number of Investments	74	78	+4	+5.4%
Total Amount Raised	£27.6m	£27.5m	-£0.1m	-0.4%
Total Angel Investment	£17.9m	£18.2m	+£0.3m	+1.7%

Figure 2.2: Total investment in Scotland, data: Mason & Harrison (2011)

Literature suggests that lower investment valuations may be at the root of this trend. "(The 2008) financial crisis was regarded as one of the worst since the Great Depression of the 1930's" Block *et al* (2010 citing Almunia *et al*, 2009, p.1). Block *et al* (2010) states that start-ups are struggling as are consumers and have less discretionary money and are required to delay purchases. This in turn lowers prospective company valuations and therefore associated deal sizes. However, surely ventures that rely less on discretionary consumer spending, for example companies founded on highly innovative discoveries such as the medical sector would be less affected by the crisis.

Interestingly, one piece of literature suggests that the nature of the risk capital market is actually counter-cyclical (Scottish Enterprise, 2009). They suggest that "cash-rich dynamic, sophisticated and risk-taking investors will want to take advantage of any downturn because of more favourable valuations". This should drive the supply of funds into the market.

2.3.4 Investors

Figures suggest that the types of investors now supporting the early stage investment market are changing. Figure 2.4 shows the proportion of deals being completed by the various funding sources. The Figure 2.4 illustrates the increasing activity of angel and public funding (represented by Scottish Enterprise). Again, Mason & Pierrakis (2009) found a similar result stating that the composition of private sector investors has changed and that business angel investors are becoming more important. They also stated that, "The angel market is evolving from one that was dominated by individuals and ad hoc groups making small investments, typically under £100,000, and with little capability for follow-on investing, to one in which angels increasingly are investing through organised groups comprising anywhere from 20 to over 100 members".

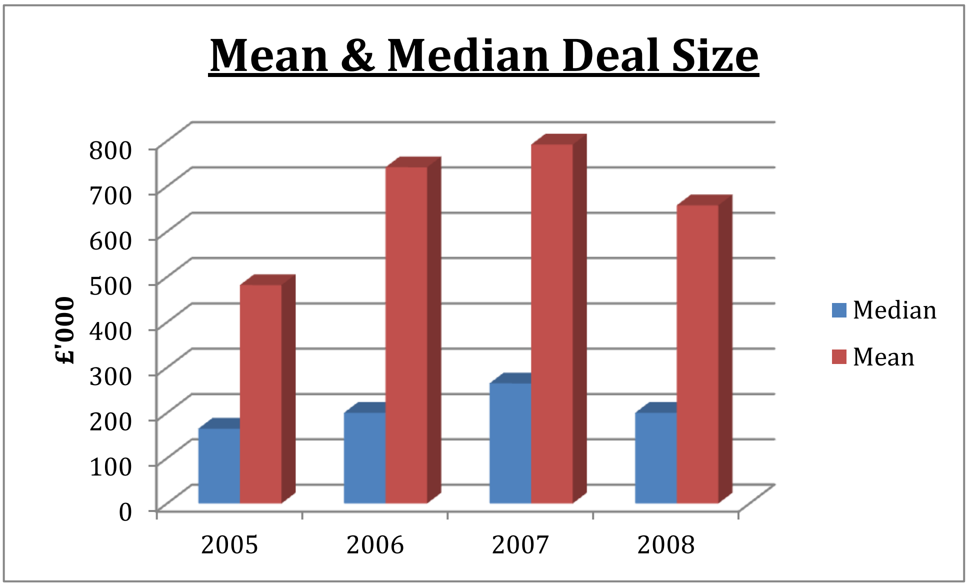

Figure 2.3: Mean & median deal size within Scotland, data: Scottish Enterprise (2009)

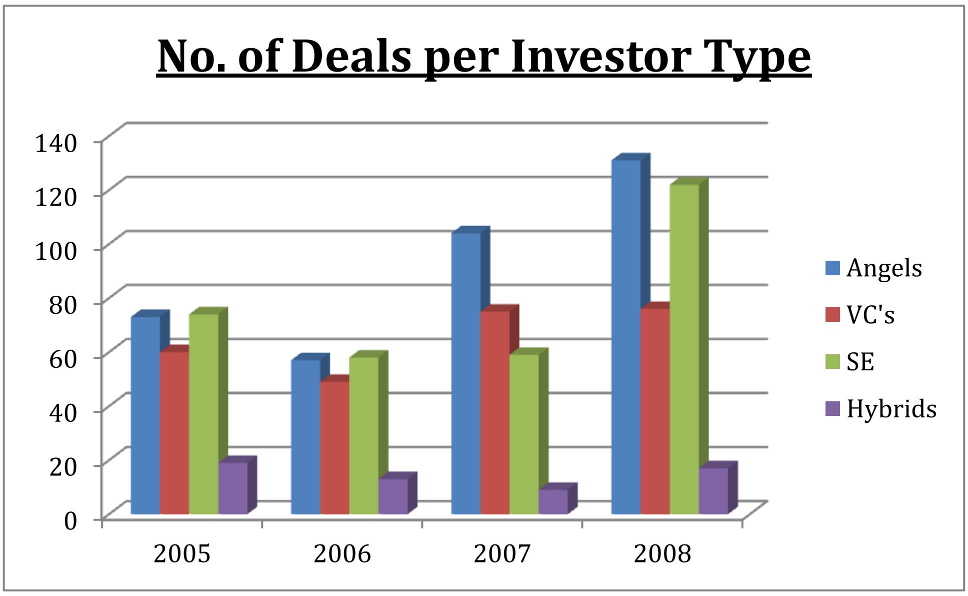

Figure 2.4: No. of deals per investor type, data: Scottish Enterprise (2009)

2.3.5 Sectors

Figure 2.5 shows the quantity of deals completed by sectors in 2009/10. Strong sectors in Scotland include: biotech/medical/healthcare, manufacturing, ICT and energy/water/recycling. Scottish Enterprise (2009, p57) reported that despite the recession "[there is still] a big appetite for innovative research solutions from big pharmaceutical and medical device companies". Furthermore, they claim the recession may actually present opportunities in the form of under-valued assets. The immediate growth of the ICT sector also looks promising as Young Company Finance (152, p.4) reports an investment increase of 81% from Q1 2009 to Q2 2011 in the UK. From these figures we can conclude that the certain sectors are developing very well despite the recession.

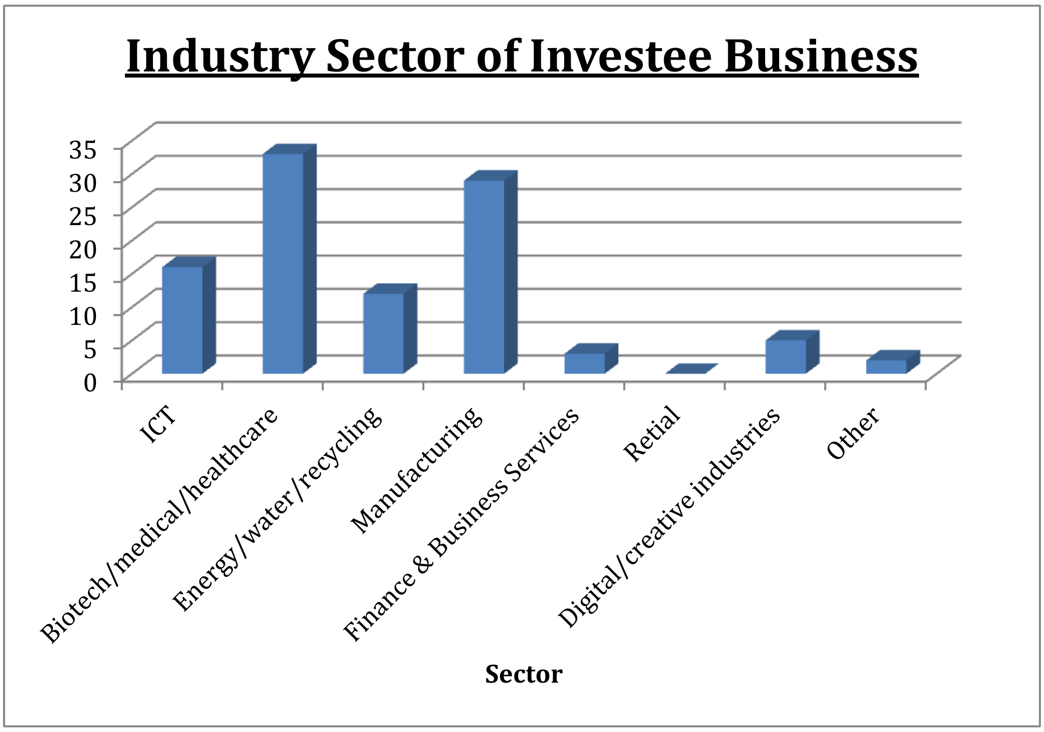

Figure 2.5: Sectors 2009/10, data: Mason & Harrison (2011)

2.4 Investment Lifecycle

Evidence suggests that angels and venture capitalists alike are now investing more, in later stage ventures and in follow-on. Mason & Harrison (2011) found Scottish angels increased their follow-on investment from 67% of investment to 76% between 08/09 and 09/10. Figure 2.6 shows that over time more deals are being done with companies which have already received previous investment.

Scottish Enterprise (2011) reported that the business angel market is adopting more of a 'cradle to grave' strategy. This implies that angels are finding that their investment lifecycles, the duration between their initial investment and exit, are getting longer. One possible explanation for this may be that angels simply have a greater investment capacity than they used to (Mason & Harrison, 2011). Scottish Enterprise (2010) reported that venture capitalists prefer to invest later, i.e. closer to the public market. As a result early-stage investors are required to support their investment for longer, ensuring that their investments are more market ready and revenue generating (Scottish Enterprise, 2010). For years VCs have provided angel investors with investment liquidity though exits, enabling them to complete their investment cycle relatively quickly. However more recently, “The lack of exits in the investment community is causing a reduction in the recycling of capital and a general drought of resources in an already under capitalised industry” (Scottish Enterprise, 2010, p.2).

As entrepreneurs are relying on investors to support them for longer, the number of funding rounds and therefore overall investment required from angels is increasing. If an investment angel is presented with a follow-on investment opportunity then they are face with a dilemma. Should they risk writing off all or part of their past investment, through dilution, or further plough more money into the venture?

Another explanation for the growing length of investment lifecycles might be related to the decreasing role in which debt is playing in funding emerging companies. “The need for banks to rebuild balance sheets to meet statutory capitalization requirements and the general ongoing problem of liquidity within the international banking system is likely to reduce the availability of debt finance, even to established business, for some considerable time” (Scottish Enterprise, 2009, p.4). Furthermore, “There is no doubt that companies which are unable to secure or extend bank loans and overdrafts are looking at equity as a substitute” (Scottish Enterprise, 2009, p.42.) Despite equity being perceived as more expensive, further diluting shareholders, SE found that it was a “welcome opportunity to balance the risk profile of their portfolios” (Scottish Enterprise, 2009, p.42).

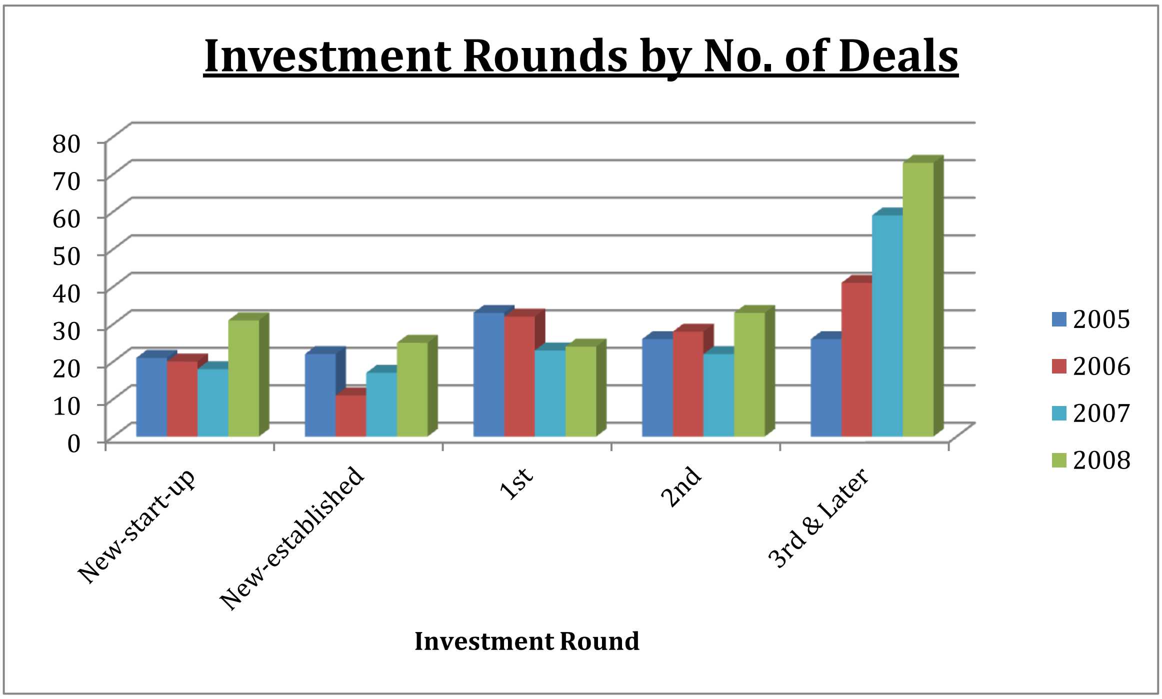

Figure 2.6: Stage of investment, data: Scottish enterprise (2008)

2.5 New/early-stage Investment

Data shows that later stage firms are successfully completing more funding deals than they used to and that funds are being drawn away from start-ups. Although Figure 2.6 shows the steady increase in deals completed in the 3rd round and later it actually shows relative stability regarding earlier stages of investment.

The Scottish Investment Bank's annual review, 2010/11, confirmed that angel investors have been focusing on follow on investments (Scottish Enterprise, 2011). They also added, "As a result, investment in start ups and new companies is even more challenging and reliant on new angel syndicates and other investors entering the market for the first time with new funds to invest" (Scottish Enterprise, 2011, p.5). This is founded on the assumption that not only do angels have finite resources but also that they are near capacity. Considering current investment lifecycles are getting longer, angels may simply not have enough resources to invest in new opportunities. Furthermore, if an angel was presented with the opportunity to follow-on invest or invest in a new opportunity they may simply prefer a firm that they have experience with.

As previously stated access to debt finance has become more difficult but it is important to remember that debt is not merely another source of finance. Angels, VC's and banks play crucially different roles and fund ventures with differing characteristics. As banks predominately lend to businesses with revenues and assets, the impact of bank debt provisions is not significant to in early stage businesses.

2.6 Governmental Intervention

2.6.1 Introduction

In Scotland the Government plays a very active role, via Scottish Enterprise, in funding entrepreneurial growth companies. Gerard Kelly, head of Scottish Investment Bank, partner of Scottish Enterprise, said, "improving access to finance is critical if we are to emerge from the recession in a strong position" (Young Company Finance, 155, p.9). Other areas of Scottish Enterprise focus on providing expertise and advice. This section discusses the role, functions, impact and availability of public funding in Scotland. It will start by discussing the development of the Scottish Investment Bank and will then move onto the equity, tax and grant initiatives.

2.6.2 Scottish Investment Bank

The Scottish Enterprise (SE) investment team is responsible for the promotion of 'high growth early stage companies' (Scottish Enterprise, 2011). In addition to UK public funds, SE has secured access to the European Regional Development Funding (ERDF) enabling them to invest in SME's through a variety of schemes. The Scottish Investment Bank (SIB) was started in December 2010 to combat the challenges of the economic downturn (Scottish Enterprise, 2011). The SIB provides a wide range of support initiatives intended to boost capital growth for Scotland's economy. SE has a successful history of funding support for Scottish SMEs with an earlier initiative resulting in the successful spin-out Scottish Equity Partners (SEP).

2.6.3 Equity Initiatives

The Scottish Seed Fund is one of a number of Government initiatives and is responsible for supporting the earliest stage ventures. It will match private investment like-for-like between £20,000 and £250,000 providing the start-up meets the criteria for size and commercial viability (Scottish Enterprise, 2011). Irrespective of the ongoing trends in investor portfolio consolidation

SE state that this scheme helps efforts in building new investor relationships. Young Company Finance (155, p.9), November 2011, reported, “since inception, the fund has invested £8.4m in Scotland’s most promising seed stage companies and levered an additional £15.5m from private investors”. At a ratio of nearly 1:2 this would appear to be an efficient use of public support funds.

The Scottish Co-investment Fund (SCF) will invest between £100,000 and £1m from a £72m equity investment pot (Scottish Enterprise, n.d.). The concept behind this fund is an interesting one and is what is known as a hybrid fund (Mason & Pierrakis, 2009). Like the Scottish Seed Fund it too invests alongside a private investor, however, here the SCF partner is responsible for all aspects of the venture valuation and deal negotiation. This is founded on the premise that the private investor would only invest in a viable concept and at an appropriate price. The fund is intended for ventures which find a willing private investor yet the investor does not have sufficient funds to meet the ventures requirements. Prior to this initiative entrepreneurs may not have received any investment from willing investors as it may have been perceived that the investment wouldn’t be sufficient to get the venture to where it needs to be.

The final form of equity support is intended for more developed ventures seeking between £500,000 & £2,000,000 alongside a private investor (Scottish Enterprise, 2011). The Scottish Venture Capital fund will match any private investment with a total deal value up to £10m, providing of course the firm meets the criteria.

Following this the Scottish Investment Bank also offers other types of support including the Scottish Loan fund. The fund enables qualifying SME’s to take out a range of mezzanine loans between £250,000 and £5m. Certain eligibility criteria include sustained operating profits, being based in Scotland, management with a track record and ideally operating in an expanding or export market (Scottish Enterprise, n.d.). A mezzanine loan is a hybrid product between bank loans and equity which provides the lender the flexibility of conversion.

2.6.4 Tax Initiatives

UK tax incentives for angel investors are provided in the form of tax reliefs. The Enterprise Investment Scheme (EIS) allows individual investors to claim back 20% on shares issued before the 20th of April 2011 and 30% on shares after that date (HM Revenues and Customs, n.d.). Furthermore, tax incentives offer full capital gains tax relief, which can also be offset against previous losses.

Despite the already extensive tax relief options, it was enounced that the EIS would be lifted from 30% to 50%, irrespective of your personal tax rate (Young Company Finance, 156). The initiative, known as the Seed Enterprise Investment Scheme (SEIS), was described by some as ‘astonishing’ (Young Company Finance, 156, p.9). For the tax year 2012-13 only, investors could receive a total of 78% tax relief in the form of 50% income and 28% capital gains tax. Unbelievably, losses can also be claimed further reducing investment risk.

2.6.5 Grant Initiatives

SE and SIB also offer a variety of grants to support earlier stage ventures. Rather than investments, these grants are essentially ‘gifts’ of support. In return for these ‘gifts’, SE and SIB seek to develop a range of growth businesses that will provide capital growth for Scotland.

2.6.7 Summary

The influence of public funding available through and administered by SE is undeniably significant. Figure 2.7 shows the increasing role that public funding has had over the last decade in the UK but fails to show the influence of the SIB. Hybrid funds in particular appear to be a very popular investment resource. Irrespective of the continuing economic concerns, SIB reports for 2010/11 a total SIB investment of £23.2m in 41 new companies (Scottish Enterprise, 2011, p.7). Furthermore, they made seven exits generating £10.8m and currently have 241 active companies within their portfolio. The figures are a strong improvement on 2009/10 where Scottish Enterprise invested in 32 new companies (Scottish Enterprise, 2010, p.2). Whilst the initiatives do appear to have boosted public investment and therefore economic growth, what is not clear is the tangible impact on overall investment levels.

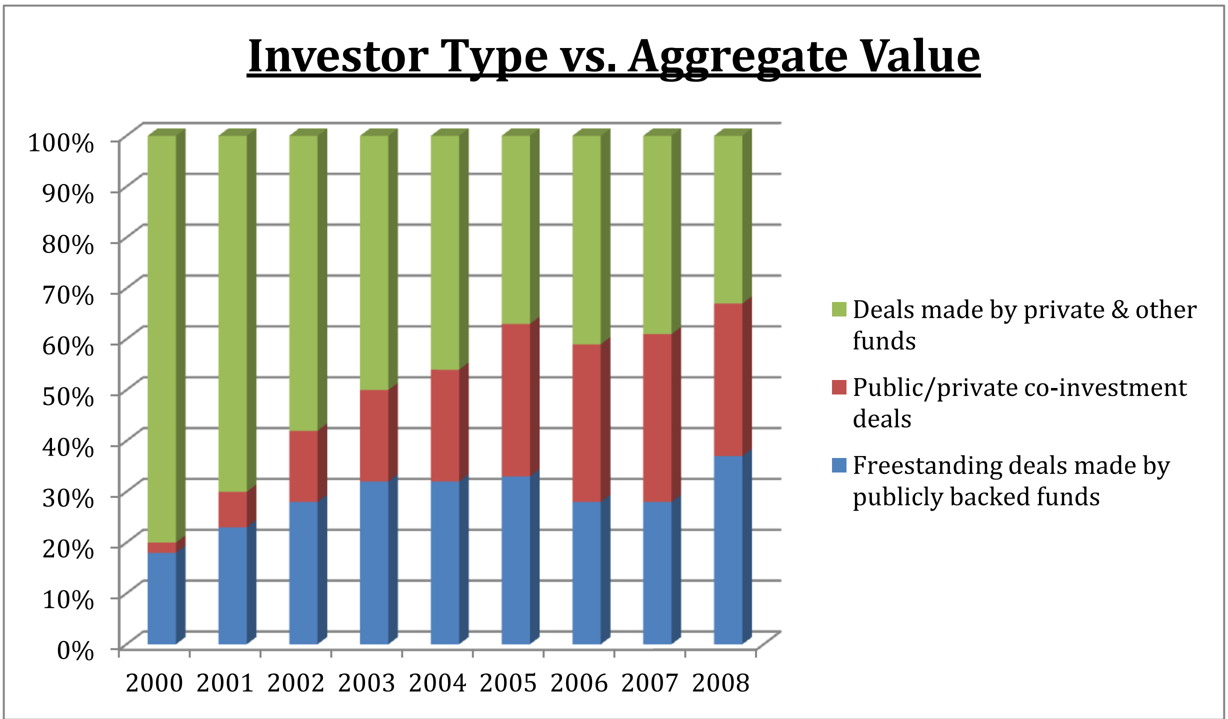

Figure 2.7: Proportion of public vs. private investment, data: Mason & Pierrakis (2009)

2.7 Conclusion

To conclude, this review has comprehensively examined the key literature and discussed several key findings. It started by addressing the economic developments which have taken place over the past 10 years or so. It is clear that the 2008 financial crisis put serious financial strain on consumers, corporations and governments. What is not clear is what impact these economic developments had on the emerging company market within Scotland.

It was found is that since the 'tech bust' in the early 2000's investment levels have seriously tailed off. However, more recent statistics showed that in 2009/10 deal numbers actually increased by 5.4% and investment value was steady over the previous year. Reports suggest that deal sizes are getting smaller and that later stage venture funding are seeing lowering valuations whilst early stage ventures are not.

Furthermore, it has been found that investment angels and public initiatives are supporting an ever increasing proportion of the market.

Analysis concluded that a number of key developments were at the root of these industry trends. Increased volatility levels meant that VCs are investing less and in safer, later stage ventures. Furthermore, debt has become less readily available for both earlier and later stage ventures. Therefore, investment angels are finding themselves funding a growing proportion of the emerging company market and that the Government is stepping in to assist them. Angel investment lifecycles are being extended, through constrained exits and they are being required to develop their investments further into revenue generating, market ready propositions. Literature further suggests that angel resources are being focused on their current investments and that new angel investors and syndicates provide a significant part of the solution to the drought in start-up funding within Scotland.

Rapid growth, highly innovative start-ups provide a crucial link in the recovery of Scotland's economy. The SIB's role is to support Scotland's funding infrastructure ensuring financial constraints are not restricting the growth of promising ventures. The strength of the emerging company market, an integral link in Scotland's economic recovery, may well lie in the success of initiatives such as hybrid investment schemes.

3. Research Design

3.1 Introduction

This section describes and justifies the approach taken towards the research. This includes discussing the research aims and problems, philosophical approach, data collection and sampling, the interview process and finally, ethical issues.

3.2 Research Overview

The main objective of the research is to gain a unique insight into Scotland's early stage investment market and to discuss any developments from insiders. The research will be heavily empirically based and will seek to explore and explain the market. For the researcher, it was essential that the research path was not artificially constrained and was able to follow a course which enabled it to best meet the research aims. It was therefore decided an inductive approach was most appropriate.

3.3 Research Problems

Trying to capture, decipher, analyse and provide insight into any financial market is difficult, and the private equity market is no different. One of the biggest problems was gaining access into this private market. This is a market where published public information is scarce and where most deals go on behind closed doors. This is especially true of friends and family funding and there is hardly ever any information available on these deals. Furthermore, using the relatively recent 2008 financial crisis as a motivation for the study means that qualitative and even basic quantitative research within this market is very scarce. This means that there was no proven research template which could be replicated or the possibility of cross-reference with regards to discrepancies in research design, structure or results. One element in favour of research in Scotland is the relatively compact and well networked nature of the market where the participants are very willing to give time to help achieve a better understanding.

Achieving a sufficient absolute sample size is difficult given the limited size of the market, presenting a problem of external validity. Internal validity is also an issue worth considering. Ensuring the findings are presented in a manner which isn't biased or influenced by the researcher's preconceptions is always a difficulty. Furthermore, there is the problem of data analysis. With the researcher having no prior experience or extensive knowledge of the early stage investment market there is the difficultly of ensuring that the participant's views are understood and expressed accurately and fairly.

3.4 Methodology

This methodology section addresses the theoretical framework upon which this research project is founded. As literature describes an organization as social entity (Bedeian & Zamnuto, 1991), only accepting knowledge which can only be proven through natural science techniques would be illogical. Therefore, interpretivism will form the approach, allowing the research to accept less traditional forms of knowledge. This will help to dig deeper into the complex social workings of investors and organizations.

Regarding ontology, constructivism would appear to be the most appropriate outlook as it suggests that "social phenomena and their meanings are continually accomplished by social actors" (Bryman &

Bell, 2007, p.22). It also states that meaning is given by the beholder suggesting that investors will assess and interpret ventures differently. This approach will hopefully help the researcher take account of each of the participant's varying views.

Finally, a value-laden approach will be adopted. This enables the researcher to present the findings through the value framework that has been constructed as a result of the research. If a value-free approach was adopted then it would not give the researcher the opportunity to share the collective of informal findings. For example, common trends in participant's body language.

3.5 Data Collection & Sampling

It was decided that the best way to gain an insight into this complex and highly opinionated industry would be through a qualitative study. Data collection would consist of semi-structured interviews with primarily open-ended questions. This approach provides a structure that encourages participants to develop their views in further depth and enables them to follow a direction that they believed would be most insightful. The interview schedule is provided in the appendix (6.4).

The emerging company investment market is in essence a private one. This obviously left concerns as to how to gain access into this tightly woven industry. It was decided that the research should be approached from the supply side of funds i.e. the investors. It was perceived that interviewing entrepreneurs would seriously hamper both the internal and external validity of the study.
If a potential funder disagrees with an entrepreneur's valuation, then entrepreneurs usually perceive this to be a result of the funder's short sightedness rather than a weakness in their opportunity. This is not to say that the sample chosen is totally unbiased, as this would be misleading, however, the sample consists of industry experts. These industry experts operate at the forefront of Scotland's most influential angel syndicate networks, venture capitalist funds and public investment organizations. This should suggest that the responses are well balanced, founded on years of experience of analyzing, investing and exiting.

Due to the relatively small and private nature of the market, it was decided that no specific sampling technique would be adopted. The plan was to approach as many different organizations as feasibly possible, understanding that some participants wouldn't be available for interview. Following the first few interviews a limited snowballing sampling approach formed as satisfied participants suggested long-term colleagues and friends within the industry. The approach typically consisted of a formal letter requesting their participation followed by a polite email reminding them of the request.

Fifteen senior executives were approached, twelve initially then another three through snowballing. Through the cooperation of the industry experts and the persistence of the researcher, nine interviews took place. A total interview recording time of 4h50m was gathered, generating an average interview length time of 32mins. Four of the participants were from a private angel/angel syndicate backgrounds, two from VCs and, the final, three from publication and legal backgrounds.

3.6 Interview Process

The interviews took place between the 6th and 22nd of March 2012. The interviews were recorded through the use of a dictaphone or mobile phone app in the case of the telephone interviews. This made it easier for interviewer to concentrate on the participant's responses, improving the depth of the results and interview structure. Interview notes and recordings were transcribed soon after the interviews to help accurately capture both the verbal and non-verbal responses.

3.7 Ethical Issues

Ethics is a key concern with any form of research. Since all of the participants had responsibilities towards their industry, they were made aware that they would not be held accountable for their responses. Participant anonymity was a priority. To achieve this, a participant number coding system was used. Participants were made fully aware that they were being recorded and that the recordings would be securely stored and destroyed after transcription. Furthermore, a University of Aberdeen ethics form was completed and submitted before the research started. All participants were made aware that they were participating out of their own choice and could withdraw at any stage.

3.8 Conclusion

The research design section addressed the philosophical and physical approach to the research. It was found that a qualitative study in the form of semi-structured interviews would best gain an in-depth insight into this market. A key issue was gaining access to these high profile industry experts and ensure internal and external validity. Finally key ethical issues were addressed to ensure complete satisfaction.

4. Results

4.1 Introduction

This section will critically discuss the findings from nearly 5 hours of interviews with nine industry experts. The objective is to expand on current literature by diving deeper into the emerging company finance industry to reveal what is actually changing at an investor level. There are two primary aims. The first is to academically and critically present the findings in the hope of gaining further insight into this private market. The second, to provide an interesting and practical framework which entrepreneurs can use to improve their invest-ability. To ensure the findings are presented comprehensively and accurately, this section will be written from an interpretive and subjectivist viewpoint.

In the first section results, developments within the investment process, has been broken down into four parts. It will address changes in the investment selection process, management requirements, venture valuation and investment tools. Following that, the funding market itself will be critiqued discussing follow-on investment, start-ups and the funding ladder. The final section, intervention, will discuss attempts by the government to boost the early stage investment market and provide a practical framework for entrepreneurs to improve their invest-ability.

4.2 Investment Process

4.2.1 Venture Selection Process

One clear change that has emerged from the interviews is the perception that the funding bar has been raised. Three participant's suggested that a form of natural selection is taking place where ventures are being required to present evermore impressive propositions, where only the strongest proposals will succeed. This may well be a defence mechanism that investors have adopted in response to the increased volatility levels. Furthermore, investors are said to question things more, 'not believing the hype' with reference to the 'me-too' ventures which sprouted in the mid 2000's. There is also a common perception that investors can now afford to be more selective with their investments safe in the knowledge there will always be more promising ventures around the corner.

Participant 2: "*[Investor are] not believing the hype in business plans*"

One particular area that has certainly grown in importance is the need for exits or what one participant described as, the need to 'churn the finance'. Investors now want to know how will this venture achieve exit, when, where and for how much. Participant's viewed exits not as a side thought but rather a key integral part of the investment proposition. There were suggestions that previously it was assumed that exits would always be available for viable businesses. One participant reported that, 60-70% of their investments are made in pre-revenue ventures. It is therefore no surprise that early stage investors are concerned about the exits as they present their primary, often only, source of return. This development may stem from the early stages of the financial crisis where 'big corporates' (prospect buyers) cut investment levels, with the knock on effect on the trade sale market.

4.2.2 Management Team

Whilst the developments in desired management team are less clear cut, participants emphasized the correlation between the founders/management team of a venture and its success. Some participant's reported the need for roundedness or completeness of skill sets. Others suggested that completeness is not essential nor expected of these early stage ventures. However, the team must be approachable and understand their gaps. After all, angel investors typically provide what is known as 'smart money'. The term 'chemistry' was also frequently used to describe the importance of shared vision and an ability to work effectively as a group, both management and investor.

Smart money: 'Smart money' suggests that angels not only provide funding but also knowledge, experience and contacts.

As well as technical domain knowledge it is essential that the management has a comprehensive understanding of their market. With the increasing number of university spin-outs, participant's showed their frustration with founders which failed to demonstrate 'commercial savvy'. In these highly volatile and commercially competitive times, investors need to trust that the management understands how to generate sales and develop their product/service to be commercially 'disruptive' in their market. Disruptive implies entering an established market by changing one or more of the existing accepted commercial realities of that market.

4.2.3 Venture Valuation

Participants reported that the techniques for venture valuation have not changed but that the economic conditions that are taken into consideration have. Three participants emphasized their concerns with the growing divide between founder's expectations and the performance realities of their venture.

Participant 3: *"Founders think they might be on a gold mine when actually there is bankruptcy around the corner"*

The increased volatility and risk of the economic downturn has resulted in investors making more conservative valuations. Although it was not explicitly stated, the researcher got the impression that increased funding demand competition levels and therefore the entrepreneur's weakened bargaining position may also have a part to play. Interestingly, one participant clearly stated that skilled managers, with a promising idea, in a growing sector can actually claim a premium price as a result of high levels of investor competition. A number of participants alluded to the fact that few prospective ventures are in fact promising or have skilled managers.

Putting a value on a pre-revenue venture is clearly a difficult task, one which has been exacerbated by the increased volatility levels. It was reported that many investors use a 'backwards from exit' valuation model as none of the conventional valuation models apply to pre-revenue propositions. Investors start with an exit value and work backwards, through the dilution process and additional funding rounds to come to a price that they are willing to pay. The divide between investor and founder valuations may be explained by founders underestimating the scale of the funding required to get the venture revenue generating/acquirer ready and overestimating investor exit value. They also fail to acknowledge the risk element of investment because of their own absolute faith in their venture. Worryingly, participant's reported that many entrepreneurs come to a valuation not through a logical process but rather with a general notion of value with the attitude 'it's bound to be worth this'. To further help the intersection of founder and investor valuation, one participant said:

Participant 5: "*We fight hope with evidence*"

Participant 3 went on to explain that the general notion that putting funds into a venture will increase a venture's value is not true. It's fair to say, a venture is only worth what it can be sold for.

4.2.4 Investment Tools

There appears to be relatively little change in the types of investment tools used by early stage funders. Investment angels can receive strong tax breaks through the government backed tax incentive schemes. Unfortunately, angels are only eligible for the SEIS scheme if they invest in ordinary shares. One participant described how the SEIS scheme artificially distorts the market, indirectly inhibiting the use of other investment tools, such as debt loans and convertible debt. Furthermore, the participant explained that term debt or convertible loan debt would provide angels with an appropriate alternative to ordinary shares. Investors may prefer to use convertible debt for very early stage ventures as a safer alternative and then convert to equity at a later stage. If the SEIS scheme was to incorporate convertible debt as simply a method to equity investment then it may be possible to further remove barriers between investors and founders. The use of convertible debt would reduce ownership squabbles, eliminating founder dilution at the start. Angels could then simply convert upon the VC's entering, at the VC price plus a little discount.

4.3 The Funding Market

4.3.1 Follow-on Investment

When an angel is presented with the opportunity and more usually necessity to follow-on invest they are forced to make a rational judgement call. Some participants reported that they were more ruthless with their follow-on decision making and were quicker to drop nonviable companies. From the findings, two primary causes have been attributed to the increasing levels of follow-on investment. The first suggests that it is a natural development, whilst the other, more concerning, suggests that it is merely a symptom of larger fundamental issues within the industry, the funding ladder, addressed later.

Participant 5: "*it's not bad, it's not a crisis thing, it's just a perfectly natural state*"

One participant explained that follow-on investment levels are a natural course of development. With an average venture receiving 4 funding rounds, imagine, in year 1 a high profile angel makes six new investments. In year 2 they make six new investments plus the six follow-on rounds of the previous year, and so on. The natural state for a mature angel investor is to invest more in follow-on.

4.3.2 The Economic Importance of Start-Ups

Increasing follow-on investment levels are not a concern on their own; however, their impact on start-up investment levels and therefore the impact on the wider economy is a concern. Despite the fact that this dissertation is specifically attempting to characterize the Scottish marketplace it is important to remember that Scotland competes on a wider international level. Many perceive Scotland and the UK as a whole to be in a pivotal decade where unless it wishes to follow in the footsteps of its Greek counterparts it needs to act. One participant emphasised the importance of developing and supporting rapid growth ventures with, crucially, international sale appeal. Start-ups are a vital component in ensuring wealth is brought into the country rather than merely circulated.

Fortunately, angel syndicates have reported that start-up investment levels have been steady, although proportionally down because there are now more angels in the market, despite the tough economic conditions. Unfortunately, the findings suggest that angel's investment lifecycles are getting longer and that angels are withholding finance for their current investments. To help ensure the investment balance is maintained angel syndicates are continually trying to encourage new angels to become active

4.3.3 The Funding Ladder

The findings suggest that the changes above may not simply be as a consequence of the economic conditions but are rather the symptoms of one fundamental long-term development within the industry. So far these changes have been explained by many individually operating factors. Throughout the interview process it became apparent that these factors aren't operating in isolation, just as the literature suggests, but are rather a part of one underlying network problem, known as the funding ladder.

A venture's progression through the early stage funding sources is metaphorically represented by the funding ladder where each step represents a funding source. Figure 4.1 proposes the stages of private funding a venture would go through if it adhered to funding ladder in Scotland. Findings suggest however that this funding progression is not as clear cut as it once was. The development in the funding ladder has been attributed to three primary shifts, including; VC inactivity, debt inactivity and lack of exits.

Participant 5: "*The conveyer belt has broken*"

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Figure 4.1: Funding Ladder

VC Activity

It has been found that VC's are becoming ever more risk adverse and that their investment levels are on the decline in Scotland. Furthermore, angels are also typically less willing to work alongside VC's due to dilution issues. This is effectively limiting VC's role in funding early stage ventures as they are entering the funding market later.

Debt

Participants were in no doubt that debt access for all stages of ventures has decreased and has become more risk adverse. The impact on very early stage ventures is less pronounced as pre-revenue funding has never been a particular area of interest for banks although the old Small Loans Guarantee Scheme did provide significant debt finance to start-up SME's prior to the banking crisis. One participant thought that banks were correct to move away from pre-revenue investments, whilst another disagreed. The second participant stated that banks shouldn't stop servicing this market but rather should adapt their mechanism for investment selection. The participant went on to explain that, there are many high potential ventures with strong investor support that the current classification system discriminates against simply because of a lack of revenues. He suggested that a more sophisticated classification criteria or even a dedicated department could result in high quality investments for the bank and benefit the economy.

Exits

Exits, or more correctly the lack of them, also have their part to play in the breakdown of the funding ladder. 2003/04/05 saw large numbers of angels investing as a result of the strengthening economy. This drove the demand for exits during the late 2000's. Worryingly, one participant stated that from 2008 onwards:

Participant 5: *"[the] exit landscape has been a drought"*

The participant added: "Every time there is a sprout of uncertainty or serious international shock.... ['big corporates'] sit on their wallets and our exit horizon extends another year". The need for exit has clearly been intensified as angels have seen their exits go from 3-5years to 5-7 years, and now angels can realistically expect exits in 7-9 years upwards. This is creating a funding gap where angels are being required to support their investments for longer, drawing funds away from start-ups. Fortunately, despite the tough economic conditions, participants reported that the general consensus is that 'big corporates' are looking to invest and exits are now being achieved.

Funding Gaps

These developments within the funding ladder have result in two main funding gaps. Figure 4.2 illustrates the shifts in investor activity and their area of support. The first gap refers to very early stage ventures that seek finance to support the development of their product into one which commercially viable. As just discussed, decreased angel investment activity, because they have concentrated on follow-on funding, in this part of the market appears to be at the root of this gap. Findings suggest that new angel investors and angel syndicates are the key to plugging this gap. Interestingly, as previously mentioned, one participant stated that he does not believe that this funding gap exists for promising ventures alluding to the fact that many propositions show limited promise. It may be suggested that the requirements for a venture to now be considered promising may have risen meaning prospects are being rejected based on the poor proposition rather that a lack of available funding. In addition, SIB's earlier stage funding and the number of ventures receiving SIB funds must to some extent be alleviating the angel's problem.

The second major funding gap sits closer to the trade sale side of the market and is a result of constrained investment levels by 'big corporates'. The general malaise in trade sale exits means investors cannot recycle their money for re-investment in new ventures. VCs and exits historically provide SMEs the opportunity to 'cross-the-chasm' with regards to international expansion and major innovation projects. This more advanced funding is crucial for Scotland's economic growth. It is suggested that the lack of long-term exits is inhibiting the completion of angel investor lifecycles. In addition, if there are very few trade sales then there are few opportunities for start-up entrepreneurs to make capital to enable them to join the ranks of the angels.

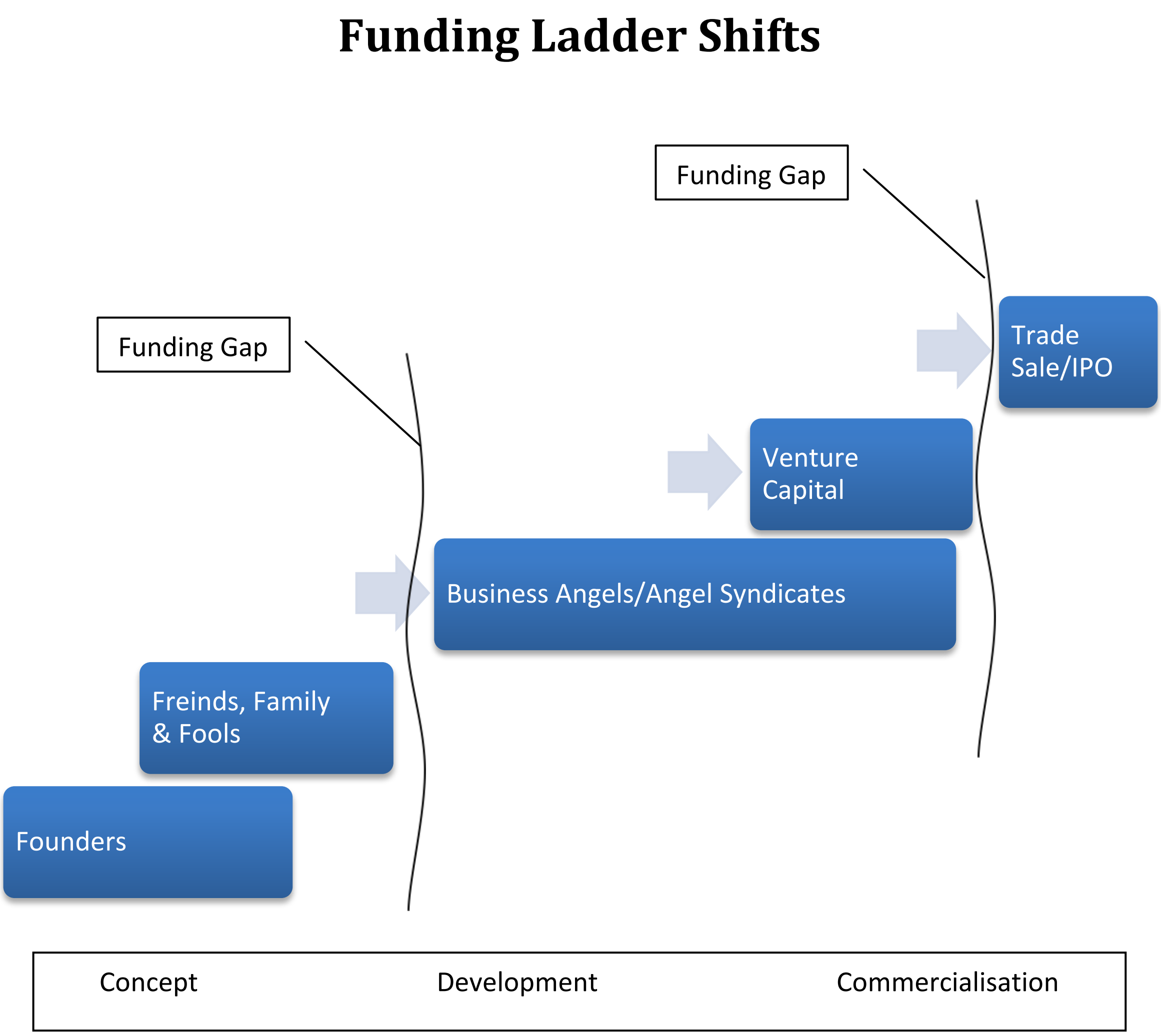

Figure 4.2: Funding ladder shifts & funding gaps

4.4 Intervention

4.4.1 Introduction

So far the findings have defined the changes within the industry and their causes. It has also expressed concern for start-ups investment levels and the impact on Scotland's economy. This final section will approach the situation with the question, so what are we doing about it? The first part of this section will approach from the supply side of funding by discussing the effectiveness of government initiatives in improving access to funding for emerging companies. The second part will approach from the demand side, presenting the finding through a practical framework in a bid to improve the quality of entrepreneurs, their teams and their proposals.

4.4.2 Government

The Scottish Investment Bank represents the single biggest investor in Scotland. Participants unanimously agreed that the SIB has a positive significant impact on the emerging company funding market.

The Scottish co-investment fund is perceived to be one of the most successful initiatives yet, not for the most obvious reasons. Participants reported that the co-investment fund doesn't actually encourage angels to invest more, in fact quite the contrary. It enables angels to invest less, across more ventures, successfully diversifying their risk.

When asked, "Since its introduction, how has the EIS scheme impacted angel investment", participant 2 responded "*the EIS scheme, really, made angel investment, in fact, there wouldn't have been any angel investment without it, or certainly not to the same level. It had a huge impact*".

This attitude, to a greater or lesser extent appears to be right across the board. The EIS appears to be a very positive step in encouraging the growth of the angel market. However, one participant expressed very serious concerns for the new 'double dosed' tax reliefs, known as SEIS, introduced in April 2012. With the combination of tax breaks including SEIS, capital gains tax and offsetting losses, for every £1 an investor puts into a venture they are risking 11p. This astonishing discovery is one which opens concerns of unwanted industry attention, from high net worth tax avoiders. If tax avoidance became prolific then the SEIS scheme may well be to the detriment of the industry as tax avoiders have no interest in becoming angel investors. Interestingly, although the SEIS scheme doesn't actually alter whether or not a deal is actually worth doing it does offer Scottish investors with unparalleled tax relief. Furthermore, it successfully protects Scotland against the attractions of foreign investment, securing its place in an international economy.

The effectiveness of the grant initiatives is more controversial. Although generally considered positive, scepticism typically originates with later stage ventures. The question has to be asked, how long should a venture receive support for. Surely, given time, ventures that are not commercially viable aren't viable enterprises and therefore a grants culture is not the answer. Potentially SIB's biggest failing is likely to result from the fact that it is a public body, investing public funds and so must be perceived to invest in a fair manner. This perception of fairness constrains SIB's potential, stopping them from only supporting the most economically beneficial ventures.

4.5 Investor Readiness

4.5.1 Introduction

Using hard to obtain, investor insider knowledge, this section will present arguments that are focussed on improving investor readiness. Participants outlined three key areas for success. They have been categorized into: management team, viable concept and the business plan.

4.5.2 Management Team

Participants stated that the management team is the most crucial part of any investment proposition, even beyond the concept. Trust is essential, this refers at both, a basic level that the investor is honest, and at a deeper level, the investor is going to take into consideration their actions on all of the stakeholders. Investors demand that the management team can display strong domain knowledge, commercial drive and crucially a good understanding of their market. This includes an understanding of the potential customers, competition and the business and financial models. Any gaps in these skills within the team should be filled or at least understood before seeking investment. Most importantly, entrepreneurs should never be under the illusion that domain knowledge is a substitute for an understanding of the commercial application. One participant suggested that the early stage investment industry is a ‘people’s business’. Entrepreneurs must display, what participant’s call ‘chemistry’. In essence, the founders must be able display team working and communication skills, with a ‘passion for success’. The investor must perceive the entrepreneur as likeable and be able to envisage themselves working harmony.

4.5.3 Concept

Participant’s expressed the view that simple fundamental business flaws are at the root of many failed ventures. A few of these fundamentals include; being able to display a clear sustainable competitive advantage, the ability to offer a value proposition to all stakeholders and offering a financially viable scalable idea. Many ventures lack these fundamentals or worse, simply fail to discuss them in suitable depth. It is essential that business plans explicitly state, using evidence and examples if possible, how the venture will become disruptive within the marketplace. Furthermore, entrepreneurs should never assume the marketplace is predictable or simplistic, especially when proposing international growth. Simply because a venture has ‘market traction’, initial spout of revenues, in one location doesn’t automatically mean that it is cheaply scalable or they will achieve strong growth in other locations.

4.5.4 Business Plan

With some participants reporting that they receive literally hundreds of unsolicited business plans a year, it is essential that the entrepreneur present them self in a productive manner. The business plan must be clear, concise and cover the required material. The pitch should clearly state how the venture is going to generate acquirer value and attract buyers. One participant suggested that a ‘hook’, an emotional attachment, can inspire investors to read on. For example, if a family member has cystic-fibrosis and you read the first page of a business plan which proposed a cure you would most likely read on. One of the biggest flaws entrepreneurs make is that they fail to prove evidence backing their claims. If you claim you will achieve exit through trade sale in ‘x’ number of years at ‘x’ price for ‘x’ amount of follow-on investment, then prove it. For example name another similar company which achieved what you are proposing. Use examples to state clearly your milestones That you will achieve and remember, investor’s value propositions backwards from exit, so should you.

5. Concluding Remarks

With an increase in global economic competition, from the rapid growth economies of the east, Scotland's economic future becomes ever less clear. Early stage, high growth ventures are an essential component in the recovery, and security, of Scotland's economy. As ventures develop they provide jobs, encourage the circulation of wealth and, most importantly, present export opportunities. Achieving outside funding is a major stepping stone for early stage ventures and is one that will most likely be encountered more than once. An up-to-date understanding of the emerging company finance market is crucial if Scotland is going to minimize barriers for promising young ventures.

The objective behind this project was to gain a deeper understanding of this under-researched market by analyzing and discussing recent developments that have taken place. In addition to describing and explaining the current market, this paper has reviewed current government intervention provisions and made suggestions for improvement. The final section aimed to develop a practically founded, user friendly, framework that entrepreneurs can use to develop their investor readiness.

To achieve this two forms of research were carried out. The first sourced, and reviewed, current quantitative and qualitative literature on trends and developments to the early stage investment market. The second consisted of nearly five hours of semi-structured interviews with nine industry experts. These industry experts manage Scotland's leading angel syndicate networks, VC investment funds and publication networks.

Data revealed that despite tough economic conditions, between 2008/09 and 2009/10 the quantity of investments actually rose by 5.4% within Scotland. Interestingly, whilst the quantity of investment deals rose, total investment value straight lined. Shrinking deal sizes and lower venture valuations were attributed to this trend. The financial crisis created a highly volatile and commercially competitive environment that drove down business revenues and subsequent valuations. It was found that biotech/medical/healthcare, manufacturing and ICT sectors are successfully completing the highest number of funding deals at this time. Furthermore, the literature revealed that angel and government funding is supporting a growing proportion of the market, whereas, venture capital activity is decreasing. This was explained by angel investment lifecycles extending with reports of a 'cradle to grave' strategy being adopted by angels.

Concerns were expressed that angel's lifecycles were not only getting longer but were also drawing funding away from, economically vital, start-ups. The survey results confirmed the literature findings, in that, exits and VC activity were the driving force behind this shift in angel investment lifecycles. Decreased VC activity means that VC's are no longer providing the early exits that angel's desire. Furthermore, the survey suggested that angels are less willing to work alongside VC's due to dilution issues. The general malaise in the trade sale market, as a result of the financial crisis, has further constricted angels exits, locking angels into their investments for longer. Ultimately, this later stage funding gap, through a lack of exits, is driving angel funding away from start-ups resulting in a significant early stage funding gap. Interestingly, the survey results suggest that the majority of start-up ventures fail to achieve funding not because of a lack of funds, through a proposed funding gap, but rather due the lack of promise in their proposition. The continued encouragement and development of new angel syndicates, and private investors, is essential if this funding gap is to be filled. It has been proposed that large scale, long-term exits may hold the key to the completion of the investment lifecycle and regeneration of the funding ladder. In addition, the lack of long-term exits restricts entrepreneurs from generating enough capital to join the ranks of the angels, and further driving economic growth.

Irrespective of the fact that the general perception is that ‘big corporates’ are now buying, large scale exits are unlikely to be achieved soon. Extensive government intervention initiatives have been put in place in a bid to boost Scotland’s short and long-term economic growth and security. The Scottish Investment Bank (SIB), Scottish Enterprise’s investment division, offers a range of equity, tax and grant initiatives. It can be concluded that, these initiatives do appear to be having a positive impact in significantly minimizing the very early stage funding gap thus encouraging the growth of Scotland’s economy. The survey results suggested that participants believed that the equity co-investment model, where SIB leave all stages of venture valuation and due diligence to the private partner, is a good use of public funds. Furthermore, participants reported that SEIS provides angel investors with internationally unparalleled tax relief, successfully protecting Scotland against the attractions of foreign direct investment. Despite this, it has been found that the SEIS eligibility criteria needs to incorporate convertible debt, as a means to equity, if it is going to maximise its potential. Grants have been found to be; on the whole, beneficial however, their sweeping application may need review. SIB’s largest flaw is its necessity to be perceived to invest in a fair manner, not necessarily a manner that is most economically beneficial.

The perception that the early stage funding gap primarily exists for less promising ventures provides motivation to the writing of final section, investor readiness. This section found explained that investors look at three key areas before making an investment in a venture. First and foremost is the management team. The management team must be able to display: technical domain knowledge, commercial drive and knowledge and ‘chemistry’. Secondly, there concept must: display a sustainable competitive advantage, deliver value to the stakeholders and have a financially feasible scalable idea. The final section addressed one of the biggest problems entrepreneurs face, getting potential investors to read their business plan. They need to ensure that their business plans are clear, concise and cover the required material if they are going to encourage investment.

6. Appendix

6.1 Self-Reflection

At first I wasn't sure on the area I wanted to study but I knew that I wanted my research to develop its own ideas, through primary sources. Scotland's early stage investment market has long been an interest of mine due to its hands-on, highly personalized investment approach. I believe it's important to support the growth of British business. While I have very limited knowledge of this market, I have always shown a passion to learn about financial markets. It was decided that I would attempt to characterize the early stage investment market through a preliminary literature review and further through qualitative research. The recent financial crisis and growing global competition would provide the motivation behind the research. These two factors are causing major changes in the UK economy and are driving the need for development, making the research very timely.

One of my main motivators was knowing that I was attempting to go inside the industry, representing the voices of Scotland's most influential early stage investors. Due to this responsibility I felt a lot of pressure to represent them correctly and fairly. This dissertation was written in mind of not only the assessors but also the nine participants I am representing. I am extremely grateful to all of the participants for their cooperation and good will in helping me achieve a greater understanding. Any concerns I may have had in approaching such influential individuals went straight out the window as soon as I met them, everyone was extremely welcoming and understanding. All of the participants will receive copy of this dissertation as a token of my appreciation.

While I have found this dissertation process to be extremely challenging, it has also been very rewarding. I have given it my complete focus for an entire semester and on the whole I am pleased with the results. My enthusiasm for the subject matter enabled me to, in the main, stay focussed and keep to my timetable although, I would have liked to have spend a little more time structuring, motivating and working on some final touches, including rewording a few sections. The only problem encountered was one of time. The sheer extent of the work carried out meant that interviews were not finished until late March. This essentially left April to write and structure my findings which, with a lot of other commitments, meant timescales were tight.

I am very grateful to all of the participants that have been involved in this process as they have given me a greater comprehension, insight and understanding of the investment industry. This has also enabled me to further develop my communication skills through writing letters, emails and structuring and conducting interviews, both by telephone and face-to-face. The dissertation as a whole has helped me develop my written communication, organisation and analytical skills. I have found the whole process to be a very useful stepping stone in my degree and would be delighted to further study the early stage investment market.

6.2 Limitations

Elements of bias may arise from the survey sample. Responses were only taken from the supply side of funding and therefore the views are primarily of those of investor and regulators. Unfortunately, as previously mentioned, there were a very limited number of quantitative papers with up-to-date statistics for Scotland's early stage investment market.

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6.4 Interview Schedule

Let the participants know their Rights! Recording, withdrawal and anonymity.

<u>**Selection Criteria**</u>

1. Do you think investment **selection criteria** has changed and if so how?
    a. Are some elements more important than they used to be?

2. What do you look for in a **management team** of a potential business? Have you become more particular?

3. Do you think the **control demanded** by investors has changed? Proportion of firm required/ board representation/ management.

4. Do you think investors invest a greater proportion of available funds into **follow-on** business than they did in the past?
    a. Has this had an effect on the number of new investments?
    b. To what extent do you think investors feel **compelled to invest** in follow-on opportunities?

<u>**Market Conditions:**</u>

5. Do you think there has been a **reduction in debt** access from the banks? Has this impacted on the demand for angel investment and if so how? (number of rounds)

6. What impact has the performance of the **IPO market** had on angel and venture capital investment?
    a. Have exit strategies changed for investors?

7. Has the way in which investors **value firms** changed?

8. Are there any new types of **investment tools** being introduced by investors, for example, preference shares or debt finance?

<u>**Governmental influence:**</u>

9. Has the role of Scottish Investment Bank changed?
    a. What are the most valuable elements?
    b. Do you think there is more or less government finance as part of the early stage finance package?
    c. How easy is it to obtain?

<u>**Implications:**</u>

10. What are the few winning characteristics that you look for in an investable firm?

11. What are the most common mistakes unsuccessful firms make?

12. <u>**Is there any area's which have changed over the past five years which I have missed out?**</u>