BRITISH BUSINESS BANK

Small Business Equity Tracker

2020

Beauhurst

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CONTENTS

FOREWORD

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A vibrant and healthy equity finance market is important to enable smaller ambitious businesses to reach their growth potential and help the UK economy to recover from the impact of Covid-19

Our sixth annual Small Business Equity Tracker report provides a comprehensive picture of UK equity finance for smaller businesses, and an important benchmark of the market immediately prior to the Covid-19 pandemic. As the government's centre of expertise on smaller business finance, this research helps us to track changes in equity finance and identify areas of the market that are not working as effectively as they might.

This year's report finds that UK equity finance finished 2019 in a strong position, with a record £8.5bn invested, up 24% from 2018. The amount invested in UK SMEs has increased each year since 2016, showing the strength of the UK ecosystem in helping companies to scale up. Higher investment in 2019 coincided with a higher number of announced deals, which grew 4% to 1,832 – again a new record high – showing more companies than ever before are getting finance.

Although market activity had been strong overall in 2019, even before the emergence of Covid-19 there were indications that conditions were beginning to change.

The amount of investment into seed stage companies declined by 1% in 2019. While the scale of this decline is small, it needs to be set against seed stage investment increasing every year since 2011. Seed stage companies provide the future pipeline of scale-ups, and so the Bank is monitoring this trend very carefully. Our Enterprise Capital Funds, Angel CoFund and Regional Angels programmes have an important role in providing finance to such early stage businesses.

British Patient Capital increased its activity in 2019. Growth stage deals for the funds that we have supported are larger than the wider market, enabling later stage companies to be better capitalised.

Almost half (48%) of all UK equity deals in 2019 were in London, consistent with previous years. Our dedicated regional funds continue to make an impact, with the Midlands Engine and Northern Powerhouse Investment Funds contributing to 19% and 16% of equity deals in their respective regions. It's also encouraging to see Beauhurst identifying deals made by our Cornwall and Isle of Scilly Investment Fund in 2019.

The emergence of Covid-19 in late 2019 and its spread in early 2020 has led to governments across the world taking unprecedented steps to contain the disease. Covid-19 began to affect UK SME equity finance markets in March, but it will only be possible to provide a full assessment of the impact later in 2020. Based on the impact of the previous 2008 financial crisis, global uncertainty is likely to have a major impact on equity finance in the coming months.

In response to this, the British Business Bank has worked closely with the UK Government to deliver the Future Fund, as part of a multi billion pound support package for businesses affected by Covid-19. The Future Fund provides convertible loan notes (CLNs) for innovative UK businesses between £125,000 to £5 million. These CLNs will support these companies through the current period of economic disruption so they are able to continue their growth trajectory and reach their full economic potential once the economy recovers. This will help mitigate against the pandemic causing long-term damage to the vibrant equity finance ecosystem we have built over the last decade to support companies throughout all stages of their development.

The crisis has revealed the importance of the British Business Bank's existing equity programmes. It's reassuring to know that funds we support are more likely to invest in technology/IP-based businesses than the overall equity market. These technology companies with innovative delivery models will have an important role in ensuring the UK economy emerges strongly from the global pandemic.

As the largest UK based Limited Partner investing in UK VC, the British Business Bank remains open to investing in funds which provide equity for businesses seeking to grow rapidly. We look forward to playing our part in helping those businesses to adapt to current challenges and reach their full potential over the longer term.

EXECUTIVE SUMMARY

This is the sixth annual British Business Bank Equity Tracker Report examining trends in equity investment into UK SMEs.[1] A record £8.5bn of equity finance was invested in 2019, showing the strength of the UK equity ecosystem in supporting scale-up companies. Strong investment was combined with an increase in the number of announced equity deals which grew 4% in 2019 to 1,832, the highest annual number since the series began in 2011.

Although market activity has been strong overall in 2019, there were indications that the UK equity market was changing even before the emergence of Covid-19. The amount of annual investment going to seed stage companies declined by 1% in 2019. Although the rate of decline is small, this ends continuous year on year increases since 2011. This reversal coincides with 2019 being the first year where the number of companies receiving follow on rounds exceeded the number of companies raising equity finance for the first time.

The current health and economic crisis resulting from Covid-19 began to impact on UK SME equity finance markets in the last month of Q1 2020 (March), so the full impact is underreported in the quarterly figures. Q1 2020 investment was 36% higher than the previous quarter, but there was a 15% decline in the number of deals in Q1 2020 compared to the previous quarter and 8% compared to the same quarter a year ago. The full impact on equity fundraising is likely to be seen in the number of equity deals and investment in Q2 2020 onwards.

Evidence from the previous 2008 Financial Crisis suggests equity finance is likely to be particularly affected by the current crisis with significantly lower numbers of equity deals and investment, especially at earlier company stages. The British Business Bank is monitoring market conditions carefully and has recently delivered the Future Fund to provide finance to equity backed companies with good potential that are currently affected by Covid-19.[2]

TABLE 1
NUMBER AND VALUE OF EQUITY DEALS OVER TIME

	2017	2018	2019
Number of deals	1,784	1,758	1,832
Seed	785	738	746
Venture	700	708	739
Growth	299	312	347
Investment value (bn)	£6.5	£6.9	£8.5
Seed	£0.60	£0.83	£0.82
Venture	£2.3	£2.2	£2.4
Growth	£3.7	£3.8	£5.3

Source: British Business Bank analysis of Beauhurst

KEY FINDINGS

1. EQUITY INVESTMENT INTO UK SMEs REACHED RECORD HIGHS IN 2019 WITH £8.5bn INVESTED IN 1,832 DEALS

Equity investment into UK SMEs increased by 24% in 2019 to £8.5bn, the highest amount recorded. Equity investment was above £6bn for the third year running, and more than double the £4.0bn of investment reported in 2016. Over half of the annual increase in equity investment was due to one very large equity deal in Oneweb, a communications company, which received £940m in Q1 2019. Even without this outlier deal, equity investment was 11% higher in 2019 than in 2018.

In addition to the increase in investment in 2019, the number of announced equity deals also increased by 4% to 1,832 deals. This is the highest recorded annual number of announced equity deals and reverses the decline reported in 2018. This trend differs to the one reported by Beauhurst which showed a decrease in deal numbers in 2019 compared to 2018.[3] The difference can be explained by when the analysis was undertaken due to time lags in deals being publicly announced.

Beauhurst classifies businesses into distinct stages: seed, venture and growth, based on company development.[4] All three business stages have seen increases in the number of deals compared to 2018. The number of growth stage deals in later stage companies increased the most, by 11%, whilst the number of seed and venture stage deals increased by 1% and 4% respectively.

Equity deal sizes have been increasing for several years now and this continues to be the case in 2019, but the 2019 figures require careful consideration. The mean average deal size has increased by 21% in 2019 compared to 2018 and now stands at £5m, whilst the average growth stage deal size has increased by 27% and now stands at £17.7m. The increase in overall deal sizes and growth deal sizes is largely down to the £940m investment in Oneweb. Removing the equity deal involving Oneweb from the data shows growth stage deals are 5% larger than 2018 and the average equity deal size is 7% larger than 2018. The average venture stage deal has also increased by 3% and the average seed stage deal is 1% larger compared to 2018.

Technology companies continue to remain the key investment focus for equity investors, with 47% of investment by value going to companies in this sector, compared to 46% in 2018. Equity investment in technology increased by 27% in 2019 with £4.0bn invested, the highest amount to date, mirroring wider equity market trends. Software companies received £2.5bn of funding, while fintech companies secured £1.8bn and those working with artificial intelligence raised £880m in 2019.

2. EVEN BEFORE COVID-19, THERE WERE SIGNS OF UK SME EQUITY MARKETS BEGINNING TO SOFTEN

2019 was a positive year for UK SME equity finance overall, but there were signs emerging that the market was beginning to change. There was a slight movement away from the seed stage towards the growth stage in terms of amount invested.

The amount of finance going to venture and growth stage companies increased by 9% and 39% respectively, showing that these companies are now better capitalised than ever before. However, in 2019 the annual amount of investment going to seed stage companies declined for the first time, ending continuous year on year growth since 2011. Seed stage investment fell 1% in 2019 to £823m, down from £833m, but this remains well above 2017 levels when seed stage companies received £597m of funding.

The small decline in seed stage investment coincides with 2019 being the first year where the number of companies receiving follow on rounds exceeded the number of companies raising equity finance for the first time. This trend was identified in last year's Equity Tracker report, but additional deals announced in the subsequent 12 months following publication means that this is no longer true for 2018. There is often a delay in the announcement of deals in companies that have not received equity finance before as these deals are smaller and the companies at an earlier stage. The number of first-time companies being funded has trended down every year since 2015, suggesting this is likely to continue. This shows the maturity of the UK funding ecosystem, but also underlines the importance of the Bank's Enterprise Capital Fund (ECF) programme in supporting early stage companies seeking smaller equity deals.

Average company valuations for growth stage companies fell 36% in 2019, reversing their long run trend upwards since 2011. Whilst the median growth stage company valuation continued to increase, this signifies investors becoming more careful about valuing investments in some outlier later stage companies in 2019, but confidence in the prospects of later stage companies in the wider market remained strong.

3. THE FUTURE AVAILABILITY OF EQUITY FINANCE TO GROWING BUSINESSES IS LIKELY TO BE HIGHLY AFFECTED BY THE CURRENT CRISIS

It is currently too early to assess the full effect of Covid-19 and resulting lockdowns on the availability of equity finance for growing businesses, but the effects are likely to be significant. The latest Q1 2020 numbers provide an early indication of declining activity but are likely to underestimate the full impact as the Government initiated lockdown largely occurred at the end of the quarter, when many deals were still progressing through. In Q1 2020, there were 420 announced equity deals. This is a 15% decrease from Q4 2019, and an 8% decrease from Q1 2019. Analysis of monthly figures suggests the impact is beginning to be felt in the market as March had the least number of deals in the whole quarter and lowest amount invested.

The performance of venture capital markets during the previous 2008 financial crisis could provide some useful insights into how the availability of UK SME equity finance could be affected. However, it is important to acknowledge that current market factors are different to the 2008 financial crisis.

In times of increased economic uncertainty, VC investors concentrate on their existing portfolios rather than making new investments and focus on relatively safer investments in later stage companies.

During the 2008 financial crisis, PitchBook data shows UK VC deals declined 38% by number between H1 2008 and H2 2008 and 44% by value between H1 2008 and H1 2009. The impact was greatest on the earlier VC stages due to their higher levels of risk. The number of UK seed stage deals declined by 68%, compared to 37% for early stage VC and 24% for later VC stages between H1 2008 to H2 2008.

The decline in investment value was even greater with seed stage investment declining by 78%, early stage VC declining by 33% and later stage VC declining by 51% between H1 2008 and H1 2009. On a yearly basis, the decline in deal numbers was much lower at 2% in 2009 from their 2008 peak, but equity investment declined by 33%. The year on year decline is much smaller than the half yearly decline from peak to trough reflecting venture capitalists reacting very quickly to the economic downturn, but also recovering very quickly.

VC fundraising will also be affected by the current crisis, but the UK VC based funds currently have record amounts of dry powder ready to deploy. Preqin data shows UK VC funds collectively have £9.5bn of dry powder, which potentially equates to 13 to 17 months of investment based on 2018 and 2019 VC investment levels. This may serve to mitigate any impact caused by a decline in new VC fundraising from Limited Partners (LPs).

The British Business Bank has delivered the Future Fund to help equity backed companies raise additional finance to withstand current conditions. The Future Fund provides convertible loans to UK-based companies ranging from £125,000 to £5 million, subject to at least equal matched funding from third party investors. The Government has made an initial £250 million available for the Future Fund and will keep this amount under review.

4. BRITISH BUSINESS BANK'S EQUITY PROGRAMMES HAD AN INCREASED MARKET SHARE IN 2019 DUE TO INCREASED NUMBER OF DEALS FROM BRITISH PATIENT CAPITAL (BPC)

Beauhurst captures equity deals made by British Business Bank supported funds within its dataset. British Business Bank programmes are estimated to have supported 11% of UK equity deals between 2017 and 2019, with these deals forming 14% of the overall invested equity amount. Last year's Equity Tracker report found the Bank had supported 9% of UK equity deals between 2016 and 2018, with these deals forming 13% of the overall invested equity amount. This increase in market coverage in 2019 is due to increased activity by funds supported by BPC.

The venture stage received the highest proportion of deals completed by British Business Bank supported funds in the period 2017 to 2019. 44% of deals made by British Business Bank supported funds went to the venture stage compared to 40% for the wider equity market. British Business Bank supported funds completed slightly fewer deals than the overall equity market at the seed stage (40% of deals compared to 42%), but slightly more at the growth stage (21% of deals compared to 18%). This shows the contribution BPC is having, as the programme focuses on later stage VC.

Funds supported by the British Business Bank are more likely to invest in technology/IP-based businesses than the overall equity market, with 50% of British Business Bank supported deals between 2017 to 2019 in this sector compared to 39% of the wider market. The same holds for investment value, with 52% of investment by the Bank's supported funds going to technology/IP-based companies, compared to 43% of overall equity market investment.

The concentration of deals in London completed by British Business Bank supported funds has reduced sharply since 2016, from 73% in 2016 to 47% in 2018. The proportion in 2019 is slightly higher at 48%, but this is in line with wider equity markets, reflecting increased BPC fund activity. The Bank's Northern Powerhouse Investment Fund (NPIF), Midlands Engine Investment Fund (MEIF) and the Cornwall and Isles of Scilly (CIoSIF) are helping to address regional imbalances. NPIF began investing in 2017, with MEIF following in 2018. Beauhurst identified 57 deals completed by these two regionally focussed programmes in 2019, with MEIF and NPIF contributing 19% and 16% of equity deals in the Midlands and North in 2019 respectively. CIoSIF also started investing in 2019, with 3 of its 4 deals identified in the Beauhurst data.

Deals undertaken by British Business Bank supported funds at the seed and venture stage are generally smaller than the wider PE/ VC market showing the Bank's programmes are tackling market failures for businesses seeking smaller amounts of equity finance. Additionally, growth stage deals for British Business Bank supported funds are slightly larger than the wider PE/ VC market which shows the Bank's programmes, especially BPC, are beginning to address the funding gap affecting scale-up businesses, enabling larger deals so that scale-up companies are better capitalised.

BRITISH BUSINESS BANK RESPONSE

The British Business Bank will use the evidence presented in this report to inform our ongoing discussions with Government, business, and the finance industry, and to refine our programmes, so they remain focused on parts of the market where smaller businesses can benefit most from the Bank's support. This report highlights several important findings:

1. There continues to be a significant lack of diversity in the founders receiving equity investment. In 2019, 20% of equity deals went to a company with a female founder, and these equity deals formed 11% of total equity investment. For all-female teams, the figures were just 6% of deals and 2% of total equity investment. This shows that female founders are still underrepresented in equity fundraising.

   The proportion of deals going to companies with a female founder is higher at the seed stage (24%) than later stages, which may indicate gender diversity will improve going forward, but it is likely to take a long time. The British Business Bank is committed to increasing diversity in the UK VC industry. The Future Fund is collecting data on ethnicity and gender of applications to the fund and will be publishing this as aggregated statistics. It is also a signatory to the Investing in Women Code. The Bank is planning on publishing later this year the results from its survey of entrepreneurs, which will include a breakdown of results by ethnicity and gender.

2. London continues to receive the majority of equity investment in the UK in 2019, well beyond its share of the number of high growth businesses that are located in the capital. This shows there is still the need for programmes like NPIF, MEIF, CIoSF and the Regional Angel Programme to target regional variations in equity finance. These programmes will have an important role in contributing to 'levelling up' the availability of equity finance for businesses located in all parts of the UK. The new Local Enterprise Partnership (LEP) level analysis contained in this report shows equity deals are clearly clustered in specific areas, often centred around universities, many of which are located outside of London. The British Business Bank wishes to develop and expand upon these innovation clusters further by bringing universities, businesses, and equity investors together.

3. The recent decline in seed stage investment in 2019, shows the importance of the Bank's Enterprise Capital Fund Programme and Regional Angel Programmes, which provide funding to early stage businesses. Early investment stages are important to the overall health of the equity ecosystem by providing a pipeline of deals for later stage investors. The Bank's programmes continue to invite new proposals and make commitments to fund managers.

4. The Bank has responded to Covid-19 by introducing the Future Fund to support businesses at this difficult time. Although it is too early to assess the full impact of Covid-19 on the availability of equity finance to high growth potential businesses, the Bank will monitor market conditions very carefully and will respond as necessary to avoid damage to the long term health of the UK equity ecosystem.

INTRODUCTION

This is the sixth annual Equity Tracker report exploring trends in equity finance for unlisted UK smaller companies.[5] The British Business Bank first collaborated with Beauhurst in 2015 to produce an Equity Tracker report, in response to the then lack of reliable and comprehensive data on the number and value of equity deals into UK companies. Beauhurst identifies and records equity deals made by the full range of equity investors from large multi-million growth deals in established businesses by Private Equity funds, to smaller deals in early stage companies by angel investors and equity crowdfunding platforms.

This year's report continues to provide an overview of recent trends in SME equity finance in chapter 1 using deal level data from Beauhurst. Most of the analysis in chapter 1 covers data up to the end of December 2019, but a summary of headline performance for Q1 2020 is also provided. Additionally, the report includes new analysis on university spinouts and corporate venture capital. Chapter 2 of the report provides an overview of deals made by British Business Bank supported equity funds in 2017 to 2019 and makes comparisons to the wider UK equity market. Chapter 3 of the report identifies trends in VC during the 2008 financial crisis, using data from PitchBook to offer insights into how the VC market could be affected by current factors.

BEAUHURST DATA

A full description of the data collection and methodology is given in the appendix. Beauhurst's dataset is built from the bottom-up, identifying each individual business receiving equity investment. This focus enables the data to be analysed by company stage, sector and location, or according to the type of investor and equity deal size.

In this report 'equity investment' includes any form of external equity finance, excluding transactions on public equity markets, buyouts and family and friends rounds which do not involve outside investors. The definition therefore captures the activity of business angels, equity crowdfunding platforms, venture capital funds, corporate venture and private equity funds.

The investments reported in the Equity Tracker are all publicly announced equity deals, which includes deals that are announced via government regulatory organisations, confirmed with the investee or investor or via a press release or news source. Beauhurst also identifies unannounced deals using share allotment filings. When a company allocates its shares, an SH01 form is submitted to Companies House, but details of who the new shareholders are is not included in the SH01 form.

Whilst it is desirable to include as many deals as possible in the analysis, less information is available on these unannounced deals. In many cases it is difficult to identify the type of investor and in some cases, these deals will include investment from friends and family or issuing shares to employees of the business. This report therefore focuses on announced equity deal activity only as these are verified.[6]

Figure 1.1 shows the contribution of announced deals by number of deals and investment value as a proportion of all SME equity deals. Only a small proportion of equity deals are announced, showing UK equity finance is much larger in practice than the announced deal and investment figures contained in this report. For instance, there were 1,832 announced equity deals compared to 3,914 unannounced equity deals in 2019, giving a total estimated market size of 5,746 equity deals. By number these announced deals made up a minority of all equity deals in 2019 (32%).

However, by investment value the picture is reversed with announced equity deals contributing 74% of the total value invested (£11.6bn). This further provides support for focusing on announced deals only, as many of the unannounced deals are very small. Figure 1.1 shows the proportion of announced deals to total deals by number and value is constant over time, so trends seen in announced deals are also likely to apply to the unannounced deals as well.

There are likely to be differences in the willingness of investors to make their deals publicly known. For instance, Angel and private investors are less likely to formally announce their investments than Private Equity/ Venture Capital investors. The larger the equity deal, the more likely it is to be announced.

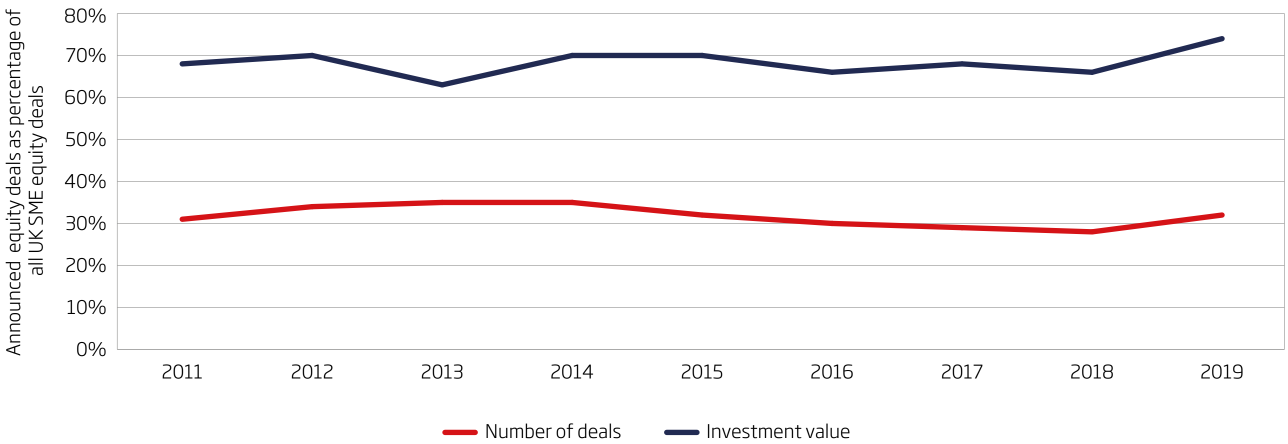
An 'SME filter' is applied to the Beauhurst data so that only companies that were SMEs at the time of receiving funding are included. Companies classed as 'large' under the European Commission definition[7] are excluded from the analysis. The SME filter is applied to the accounts filed closest to the date of the equity investment.[8] The data published by Beauhurst in 'The Deal' publication[9] do not have an SME filter applied, which explains some of the differences in the figures presented between these two publications.

This year's report builds on the previous 2019 Equity Tracker Report and figures published in the 2019/20 Small Business Finance Markets Report. There have been some refinements to the underlying dataset to ensure that this year's report is the most accurate assessment of the UK SME finance market. The figures in this latest report supersede those previously quoted due to the inclusion of new equity deals announced since the previous reports were undertaken. Comparisons between figures in this year's Equity Tracker report and last year's report are not recommended due to revisions in the number of historical deals.

FIG 1.1

ANNOUNCED EQUITY DEALS AS A PERCENTAGE OF ALL UK SME EQUITY DEALS

Source: British Business Bank analysis of Beauhurst



It is important to acknowledge that other data sources exist which also cover equity deals, including the British Venture Capital Association (BVCA) and Invest Europe. These predominantly measure the investment activities of their members, which are mainly comprised of Private Equity and Venture Capital funds. There are also other commercial data providers which gather data through a combination of technology (e.g. web-scrapers), analyst research and self-disclosure by fund managers.

These data sources will therefore have coverage of different types of investors and are not always consistent with one another. Whilst the Beauhurst dataset has good coverage of equity deals involving institutional investors, business angels are less likely to seek publicity on completed investments and are therefore less likely to be captured in the investment numbers. The UK Business Angel Association (UKBAA), which covers 18,000 investors investing through 60 groups, confirms that no robust statistics exist on the annual number of equity deals undertaken by angel investors in the UK.

The British Business Bank, in collaboration with the UK Business Angel Association, first undertook a survey of angel investors in 2018 to provide an insight into angel investment in the UK.[10] The Bank is again working with the UK Business Angel Association in 2020 undertaking a new survey that will provide useful insights into this specific segment of the UK equity market.

CHAPTER 1: RECENT TRENDS IN SME EQUITY FINANCE

1.1 TOTAL INVESTMENT

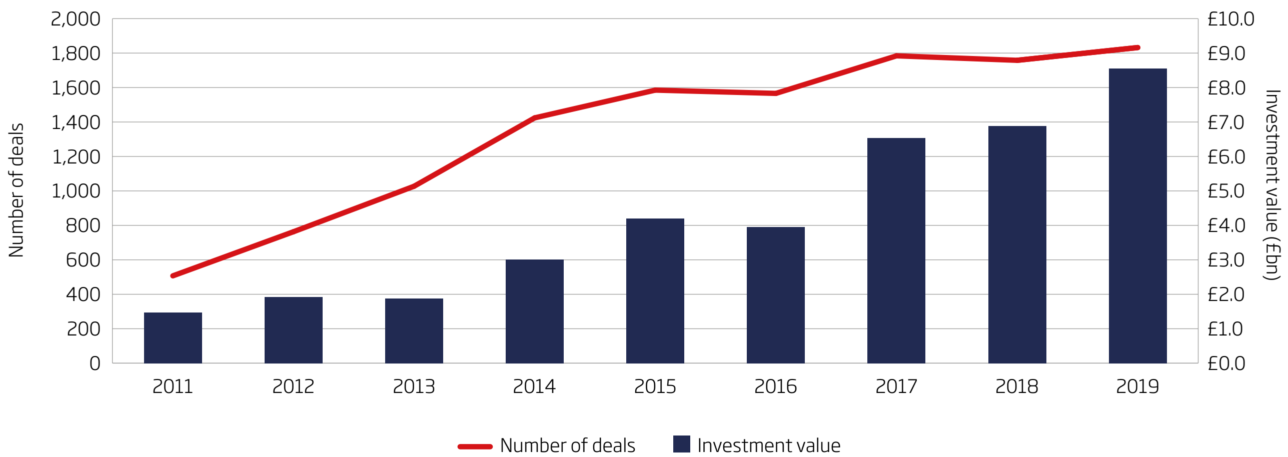
Equity deal numbers and investment into UK SMEs consistently increased year on year between 2011 to 2015, but between 2016 to 2018 yearly performance was more varied. In 2016 both the number of equity deals and value of investment declined due to a global slowdown in equity activity. 2017 saw UK SME equity finance make a full recovery with both an increase in numbers of deals and investment amounts. 2018 then presented a mixed picture – with a record amount of equity investment recorded alongside a decline in equity deal numbers.

Figure 1.2 shows 2019 was a very strong year for UK SME equity finance overall with both the number of deals and investment amounts reaching new record levels. Equity investment in UK SMEs saw particularly strong growth, increasing by 24% to £8.5bn. This is further evidence of the of the UK ecosystem's maturity and ability to successfully support scale-up companies. Equity deal numbers also saw growth in 2019, increasing by 4% to 1,832.

FIG 1.2

NUMBER AND VALUE OF EQUITY DEALS BY YEAR

Source: British Business Bank analysis of Beauhurst



The increase in investment seen in 2019 over 2018 levels can be segmented into changes in deal numbers and changes in deal sizes. The main driver of the increase in investment value is the growth stage which is responsible for 89% of the increase. Of the £1.7bn increase in investment between 2018 to 2019, the increase in the size of growth stage deals contributed £1.1bn, whilst the higher number of growth stage deals contributed £430m to the total increase. This was slightly offset by decreasing deal sizes at the seed stage which contributed negatively to the change in total investment value, although the effect was very small.

Increases at the growth stage explain the majority of the total £1.7bn increase in funding, but over half this increase was due to one very large equity deal in Oneweb, a communications company, which received £940m of investment in Q1 2019. Even without this single deal, equity investment in 2019 is at record levels, showing an 11% increase from 2018.

The increase in deal numbers observed in our data in 2019 contradicts the trends reported publicly by Beauhurst in their published deal report which show a 2% decline in deal numbers over the same period.[11] This difference can be explained by timing differences when the analysis was undertaken, with the Beauhurst numbers derived at a slightly earlier time period (31/01/2020), before subsequent deals were announced and included in the dataset. The Beauhurst published numbers include companies larger than SMEs, and so the 58% increase in investment to £12bn is more volatile due to a small number of very large deals. Our trends are consistent with PitchBook's, which show a slight increase in deal numbers in 2019, but a much larger increase in investment value.

Table 2 shows UK SME equity markets exhibiting a similar trend to European VC markets in 2019 with larger deals being undertaken on average. VC markets are interconnected, and the UK market is being shaped by wider global trends.

TABLE 2

PERCENTAGE CHANGE IN NUMBER OF EQUITY DEALS AND INVESTMENT BETWEEN 2018 TO 2019

	Number of Deals	Investment value
UK (British Business Bank analysis of Beauhurst)	4%	24%
UK (Beauhurst)	-2%	58%
UK (PitchBook)	2%	30%
Europe overall	-15%	33%
US	9%	-3%

Source: British Business Bank analysis of Beauhurst and PitchBook

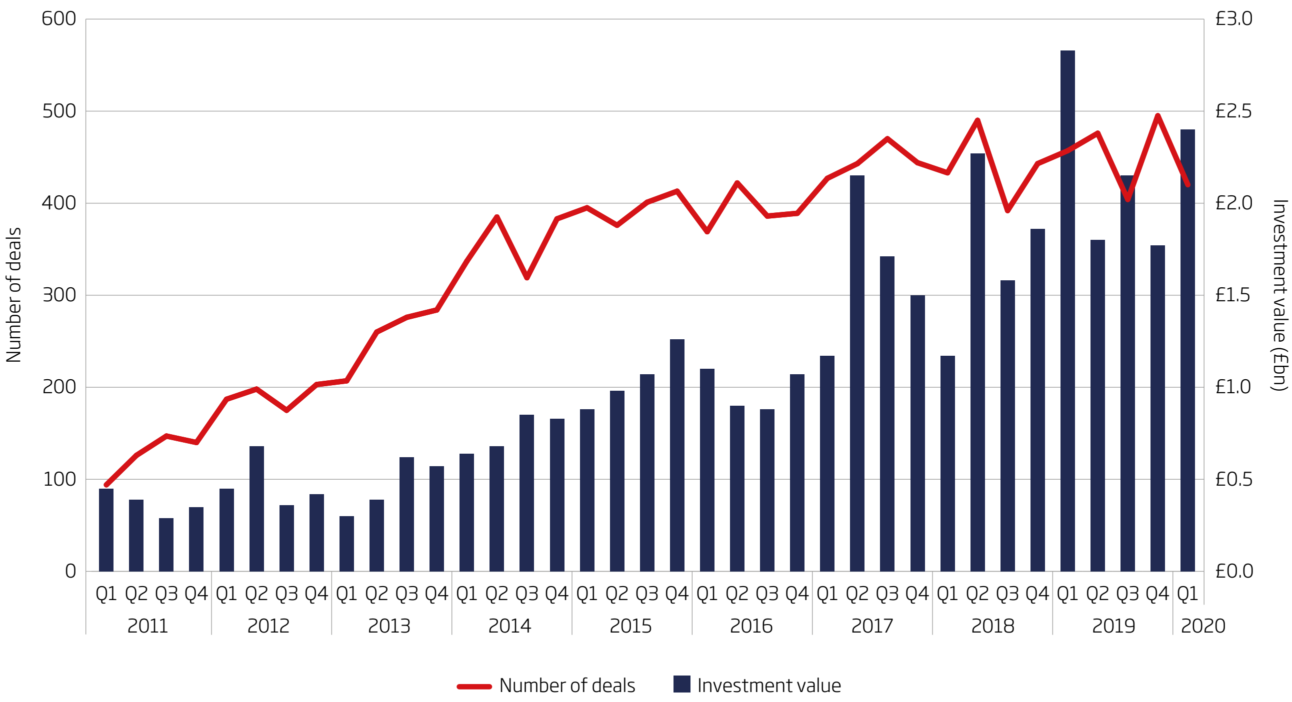
Quarterly figures are more volatile than yearly figures so care is needed in identifying trends, especially for investment values where a small number of very large deals can have a substantial impact. For instance, the Q1 2019 investment value of £2.8bn, is partly due to the £940m investment in OneWeb. Whilst deal numbers ended strongly in Q4 2019 following a weaker Q3, the decline in number of deals in Q1 2020 shows UK SMEs were beginning to become impacted by the current economic and health crisis caused by Covid-19.

Whilst there are some small seasonal trends in the quarterly number of equity deals, it is not observable every year and there are much larger movements relating to wider market factors. For instance, since 2011 the number of equity deals in Q1 is 7% lower on average than the quarterly average for the year. This is not surprising as the long run trend in the number of deals from 2011 is upwards so that Q4 deals are 5% higher than the quarterly average for the whole year. The number of deals in Q2 is 3% higher on average, but Q3 deals are 1% lower than their yearly average. The direction of the variation from the quarterly average for the year is similar if the data is narrowed down to just the last three years (2017-2019), but seasonality is less strong with the number of deals in Q1 only 1% lower compared to the yearly average. The number of equity deals in Q1 2020 is 8% down compared to Q1 2019, 3% down compared to Q1 2018 and 2% down compared to Q1 2017.

FIG 1.3

NUMBER AND VALUE OF EQUITY DEALS BY QUARTER

Source: British Business Bank analysis of Beauhurst



In Q1 2020, there were 420 announced equity deals, a 15% decrease from Q4 2019 (495). However, in terms of investment the quarter finished 36% higher than the previous quarter with £2.4bn invested due to several large deals. It is apparent several large equity deals occurred in the first quarter of 2020, including those by two unicorn businesses (OneTrust and Graphcore), perhaps trying to raise funding before market conditions tightened. For instance, there were four deals larger than £100m in the first quarter of 2020 alone, whereas there were seven in the whole of 2019.

The decline in deal numbers seen in Q1 2020 compared to the previous quarter (and the same quarter in 2019) underestimates the full market impact of Covid-19, which largely occurred towards the end of the quarter, whilst many of the equity deals were still progressing through. Assessing the number of deals month by month throughout the quarter suggests that the impact of Covid-19 mainly began to be felt in late February and March. The Prime Minister urged on 16th March for everyone 'to stop non-essential contact with others and to stop all unnecessary travel' and announced formal lock down measures on the 23rd March. The number of equity deals in January 2020 was relatively strong at 143 deals before declining to 133 in February and 126 in March. March also witnessed a markedly lower investment value of £592m. In comparison, in March 2019 there were 164 deals worth £1.44bn.

Movement restrictions make equity deals more difficult to undertake by limiting physical meetings and on-site due diligence, but economic uncertainty also increases the market risk to business projections. This uncertainty in business projections affects companies' ability to raise capital. Chapter 3 explores in more detail how equity finance markets are likely to be affected, by looking at trends during the previous financial crisis in 2008 using PitchBook data.

The British Business Bank is monitoring equity market conditions and will report market changes alongside insights from our interaction with the market, in the quarterly updates published on the British Business Bank website.[12]

1.2 BUSINESS STAGE

Beauhurst have historically classified deals into three stages; seed, venture and growth, reflecting the company's underlying position in terms of product development, commercialisation, sales and profitability. In 2019 Beauhurst introduced the 'established' company category, a subset of the original growth stage which reflects more mature companies. Beauhurst define the established category as 'companies that may well be experiencing significant growth but are doing so from a position of greater commercial security than a company at the seed, venture or growth stages'. For consistency with previous Equity Tracker reports, we are not currently using the established category in our analysis, therefore our deal stage analysis will differ to Beauhurst's own reporting in the Deal publication.[13]

The seed stage generally encompasses young companies being set up or that have been in business for a short time but have not yet made any commercial sales. The venture stage covers companies that have been in existence for a few years and are in the process of gaining market traction with sales growing rapidly. The venture stage does not solely correspond to funding by venture capitalists, as other investor types also provide funding to venture stage companies. Growth stage businesses are more developed with multiple offices or branches and substantial revenue streams (some of which may be profitable). The growth stage includes later stage VC-backed companies seeking to grow their core market, expand into new markets or create new products/services.

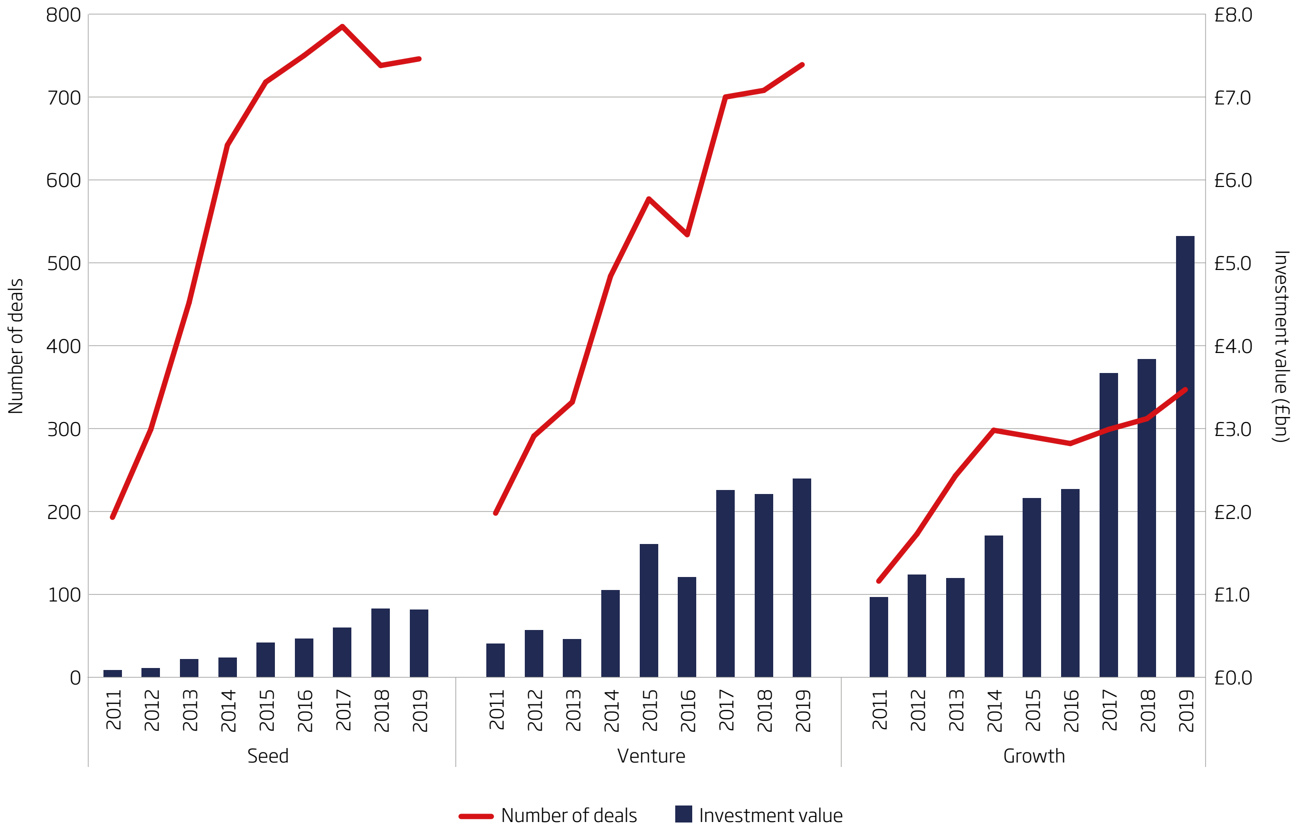
All three business stages saw increases in deal numbers in 2019 compared to 2018, but the seed stage saw a slight decline in its investment value, the first time the annual amount has been lower than the preceding year.

- **Seed stage:** The amount invested in seed stage companies was £823m in 2019, a 1% decrease compared to 2018. 2019 saw the first decrease year on year in equity investment since 2011 but the annual total remains well above 2017 levels when the seed stage received £597m of funding. The number of seed stage deals was 746, a 1% increase compared to 2018, but consistent with the finding that the performance of early stage deals has been the weakest. Macro-economic uncertainty in 2019 is likely to have contributed to these trends, as early stage deals have the greatest level of risk.
- **Venture stage:** The venture stage has historically been the most volatile of the three business stages in terms of deals. In 2019 there were 739 venture stage deals completed, which is 4% higher than in 2018. £2.4bn was invested in venture stage companies in 2019, 9% higher than a year ago. This stage has therefore improved on 2018, reflecting the companies coming through the equity pipeline.
- **Growth stage:** The number of growth stage deals had been relatively flat over the last few years, but 2019 saw the number of growth stage deals increase by 11% to 347 deals. Investment into growth stage companies has been strong in recent years and sharply increased in 2019. £5.3bn was invested into growth stage companies in 2019, a 39% increase on the previous year.

FIG 1.4

NUMBER AND VALUE OF EQUITY DEALS BY STAGE

Source: British Business Bank analysis of Beauhurst



Figures 1.5 and 1.6 show the proportion of equity deals and investment value going to each business stage over time. Despite making up the largest proportion of deal numbers, the seed stage has seen its proportion of all deals decline in recent times and 2019 continues this trend. In 2016, seed stage deals formed 48% of all equity deals, falling to 41% in 2019. The proportion of deals going to venture stage companies stayed flat in 2019 at 40%. There has been a slight increase to 19% in the proportion of deals going to growth stage companies.

Conversely growth stage investment makes up the largest share of UK SME equity investment, with 62% of all investment in 2019 going to growth stage companies. This is due to growth stage deals being much larger than seed or venture stage deals. Historically, the proportion of growth stage investment had slowly decreased over time as deal sizes at the earlier funding stages have increased – this is the largest share of total investment since 2013. In 2019, seed and venture stages both saw their proportion of investment value fall, by 2% and 4%, respectively.

FIG 1.5

PROPORTION OF EQUITY DEALS BY BUSINESS STAGE

Source: British Business Bank analysis of Beauhurst

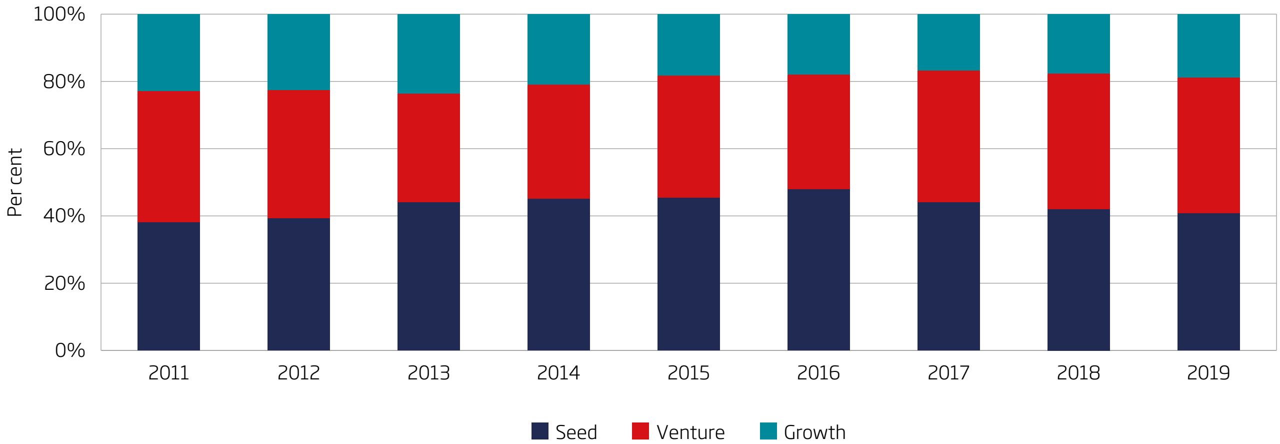
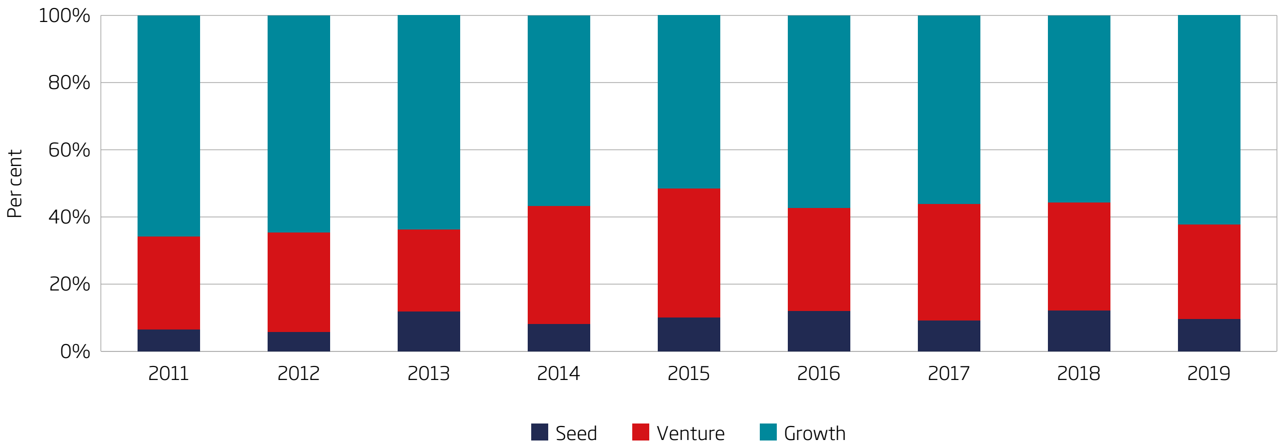


FIG 1.6

PROPORTION OF EQUITY INVESTMENT BY BUSINESS STAGE

Source: British Business Bank analysis of Beauhurst



1.3 DEAL SIZES

Average deal sizes have been trending upwards since 2013 and continued to do so in 2019 with the overall mean average deal size increasing by 21% to £5.0m. This was driven by a large increase in investment in the growth stage with the average deal size increasing by 27% to £17.7m.

This increase in the average is due to increased deal sizes in the largest deal sizes, known as 'megadeals' in the growth stage compared to the previous year. The median deal size at the growth stage decreased confirming the increase in the mean average being driven by an increase in the size of the largest deals. The venture stage saw an increase of 3% in mean average deal size and the seed stage saw an increase of 1%.[14]

Median deal sizes overall in 2019 were similar to their 2018 levels at £1m, but the trend varies by stage. At the seed stage, the median deal size increased by 6%, at the venture stage it was flat, but the growth stage decreased by 7%.

FIG 1.7

AVERAGE DEAL SIZE OVER TIME BY BUSINESS STAGE

Source: British Business Bank analysis of Beauhurst

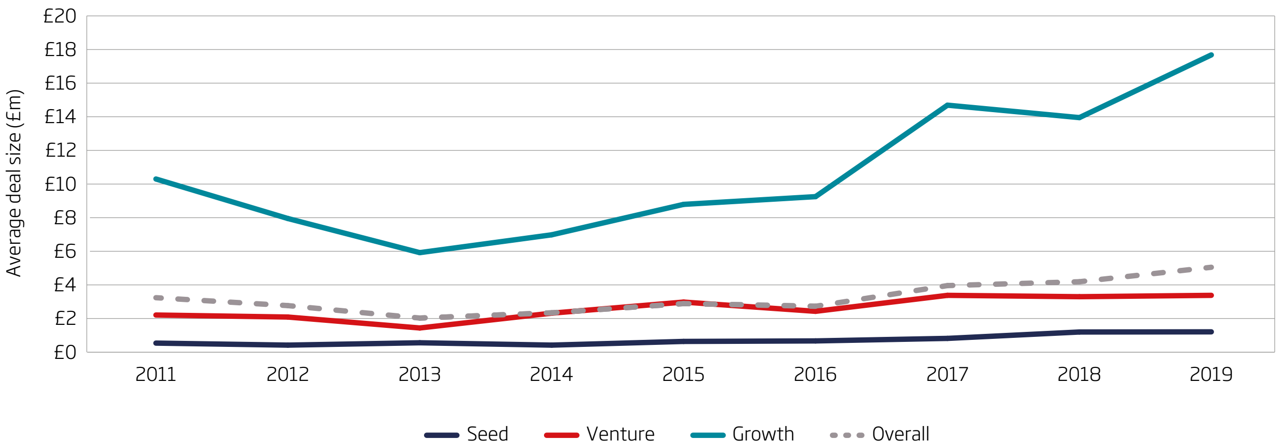
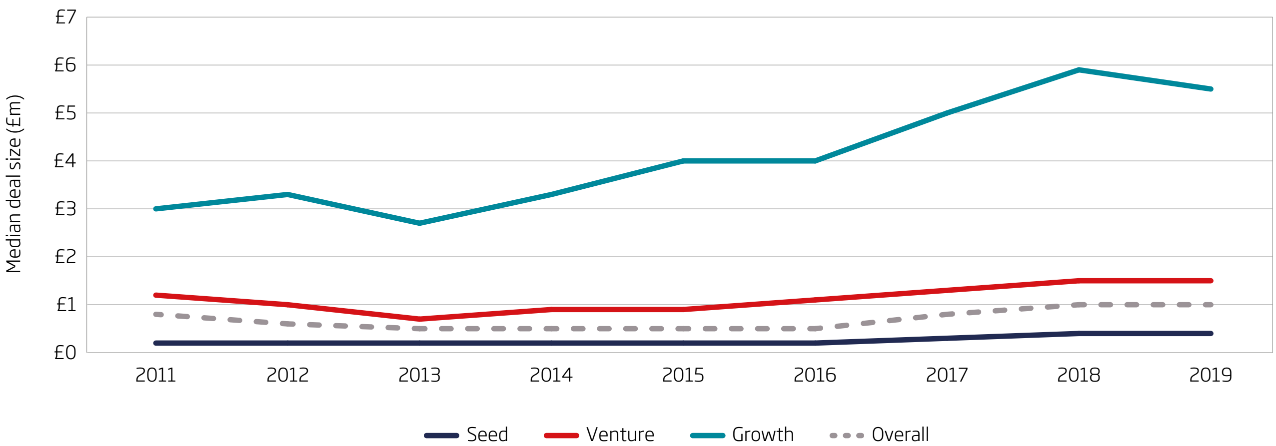


FIG 1.8

MEDIAN DEAL SIZE OVER TIME BY BUSINESS STAGE

Source: British Business Bank analysis of Beauhurst



The number of deals below £499k had been falling every year since 2015, but the decline stopped in 2019. It now stands at 572 deals in 2019, 1% higher than in 2018. The number of deals between £500k-£999k and £1m-£1.99m increased slightly in 2019, by 3% and 2% respectively. This suggests that very early stage companies trying to raise equity finance are still being supported by the funding ecosystem in 2019. A strong funding ecosystem at the earliest stages is important for the health of the overall equity finance ecosystem as it creates the pipeline of companies that will go on to raise larger rounds at later stages. If the pre-seed/seed stage financing market is not functioning correctly it inhibits equity markets in the future as investment opportunities for venture and growth stage investors will become more limited.

The upper three deal size brackets (£2m-£4.99m, £5m-£9.99m and £10m+) were also strong, increasing by 3%, staying flat and increasing by 17% respectively. Whilst some of the movement through deal size categories will be due to inflation, larger VC funds have been raised in recent years. These larger funds are better able to participate in larger deals.

FIG 1.9

NUMBER OF DEALS BY DEAL SIZE CATEGORY

Source: British Business Bank analysis of Beauhurst

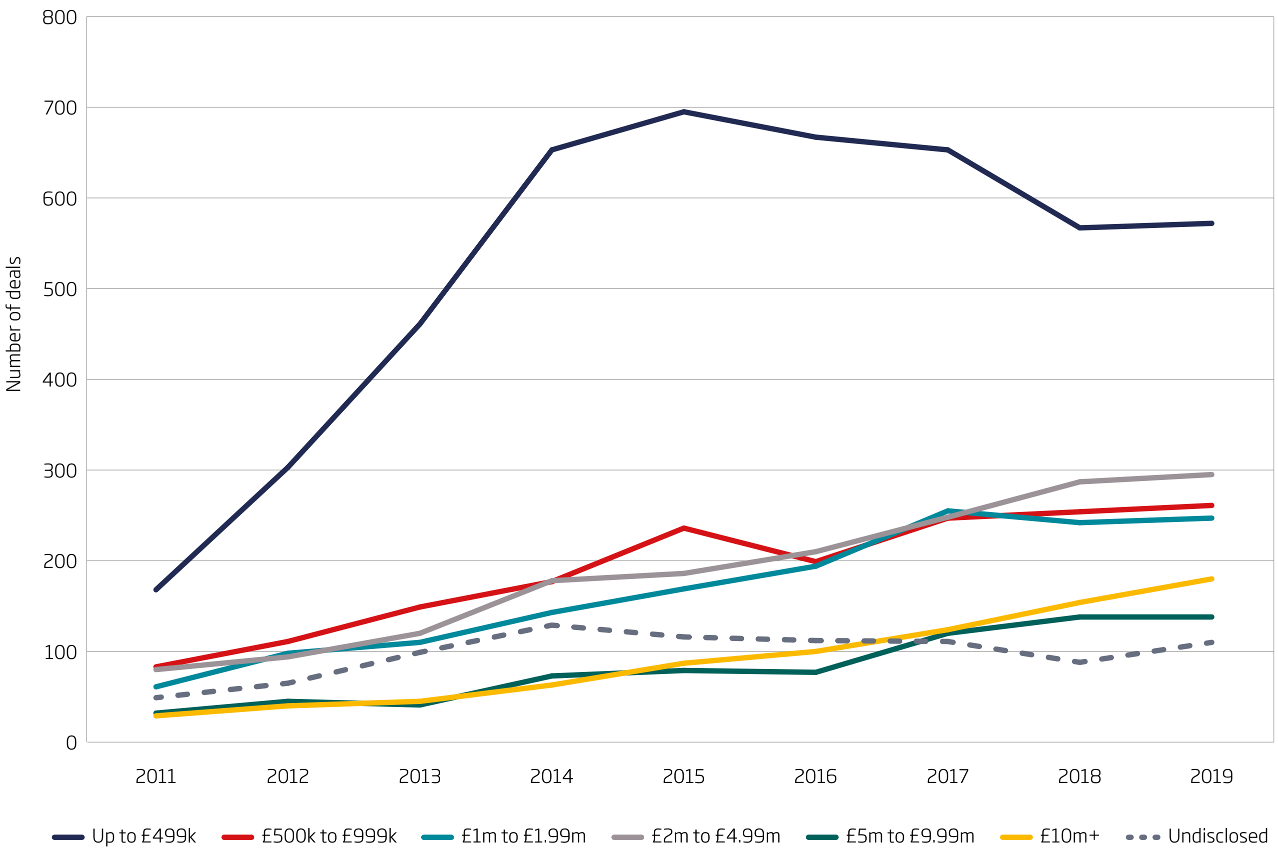


FIG 1.10

PROPORTION OF SEED STAGE EQUITY DEALS BY DEAL SIZE CATEGORY

Source: British Business Bank analysis of Beauhurst

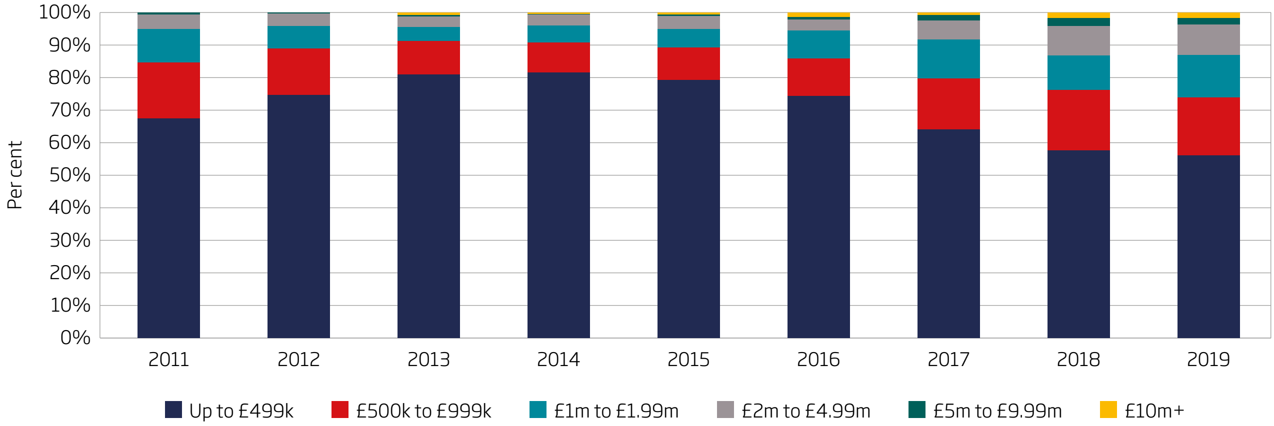


FIG 1.11

PROPORTION OF VENTURE STAGE EQUITY DEALS BY DEAL SIZE CATEGORY

Source: British Business Bank analysis of Beauhurst

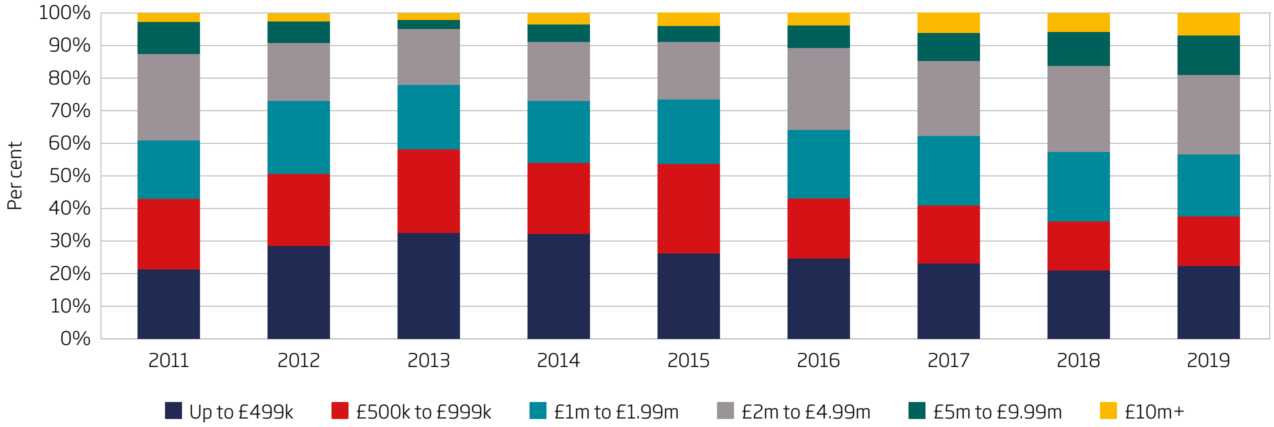
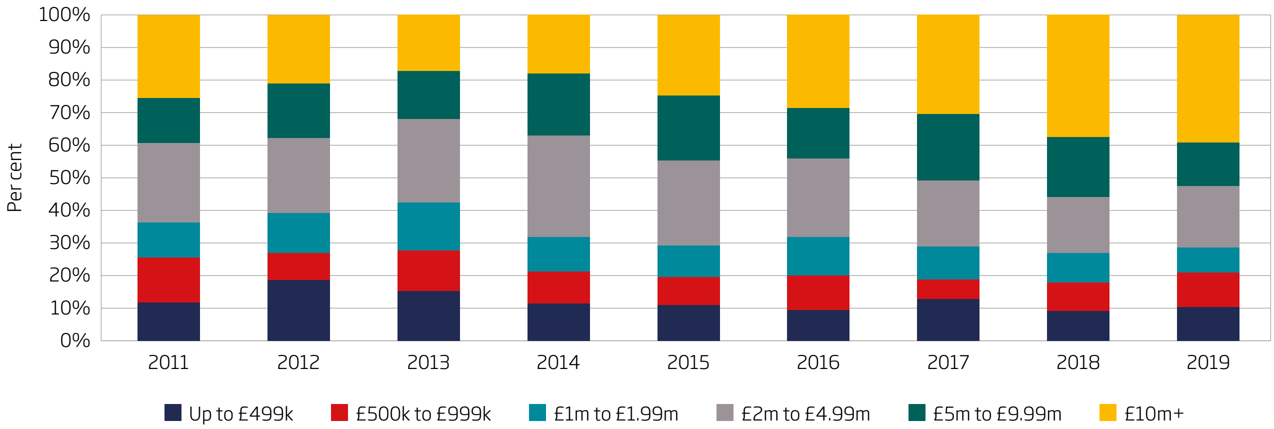


FIG 1.12

PROPORTION OF GROWTH STAGE EQUITY DEALS BY DEAL SIZE CATEGORY

Source: British Business Bank analysis of Beauhurst



The number of deals greater than £10m in size increased in 2019, both in absolute terms and as a proportion of overall deals. The proportion of total investment value coming from these deals rose from 65% to 71%. There were seven SME deals larger than £100m in size in 2019 and 22 further deals greater than £50m in size.

Table 3 shows the ten largest equity deals in 2019. The ten largest deals in 2019 were equal to £2bn and formed 24% of the market. This is compared to the ten largest deals in 2018 equalling £1.2bn and forming 18% of the market. The largest equity deal in 2019 was £940m invested in Oneweb, but the largest equity deal of 2018 was £180m. However, even excluding Oneweb, the average size of the ten largest deals in 2019 was still 3% higher than those reported in 2018. It is important to note two of these equity deals involve an element of debt in the funding round, but it is not possible to separate this out.

FIG 1.13

PROPORTION OF INVESTMENT FROM DEAL SIZES GREATER THAN £10m

Source: British Business Bank analysis of Beauhurst

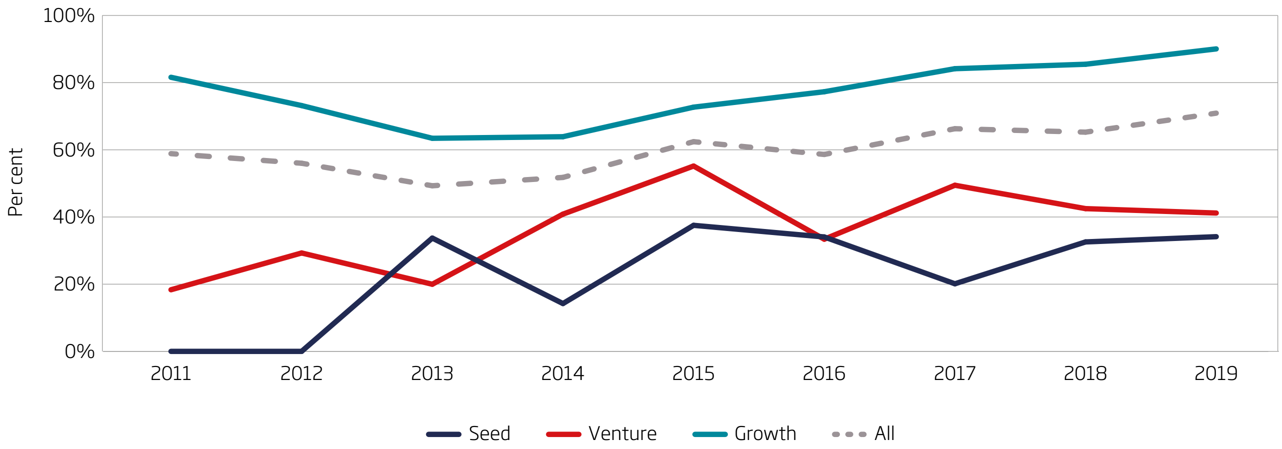


TABLE 3

THE TEN LARGEST EQUITY DEALS IN UK SMES IN 2019

Company name	Deal size	Business stage	Sector	HQ location
OneWeb	£940m	Growth	Internet and networking hardware	Hammersmith and Fulham
CMR Surgical	£195m	Growth	Robotic Surgery	South Cambridgeshire
Checkout.com	£176m	Growth	FinTech	Westminster
OneTrust	£160m	Growth	AI, Digital Security	City of London
Iwoca	£150m (Contains debt in funding round)	Growth	Fintech, Alternative Finance	Camden
Sonovate	£110m (Contains debt in funding round)	Growth	Fintech	City of London
Achilles Therapeutics	£100m	Venture	Drug discovery	Stevenage
Rapyd	£81m	Growth	FinTech	Tower Hamlets
Starling Bank	£75m	Growth	Challenger Bank, FinTech	City of London
Toob	£75m	Seed	Telecommunications services	Portsmouth

Source: British Business Bank analysis of Beauhurst

1.4 INVESTORS

Figure 1.14 shows the number of equity deals over time by equity investor type. PE/VC funds remain the most active type of equity investor in UK SME finance, involved in 784 deals in 2019, up from 712 the year before. PE/VC investors were involved in 43% of deals in 2019, a similar proportion as in 2018 (41%).

Crowdfunding platforms were the next most active type of equity investor involved in 437 deals in 2019. The number of deals involving crowdfunding platforms continues to grow, increasing by 19% compared to 2018. Crowdfunding platforms were most likely to invest in seed stage deals in 2019 – with 50% of crowdfunding deals in 2019 going to the seed stage. In 2019, crowdfunding platforms were involved in 220 seed deals, 24% higher than the previous year. Deals involving crowdfunding platforms tend to be smaller than other deals, and so this increase in seed stage deal numbers involving crowdfunding platforms was not high enough to offset the wider decline in investment at the seed stage.

Government funds were the third most prevalent type of equity investor in the UK in 2019 with involvement in 313 deals. Government deals include equity deals directly made by the devolved administrations' finance organisations (Scottish Enterprise and Finance Wales), as well as the JEREMIE (Joint European Resources for Micro to Medium Enterprises) backed funds and other local government funds.

Beauhurst includes some of the British Business Bank's programmes within its definition of government funds (Angel Co-Fund, as well as some NPIF/MEIF investments depending on whether the deal was announced by the fund manager themselves on their own website or was announced on the NPIF/ MEIF website). However, it excludes funds supported by the British Business Bank through our Enterprise Capital Fund, British Patient Capital and UKIIF programmes. Deals involving Government funds formed 17% of all equity deals in 2019. As previous Equity Tracker reports show, there are large differences between different regions and devolved administrations. See Chapter 2 for more detailed analysis of deals involving funds supported by the British Business Bank.

It is important to recognise that Beauhurst underestimates the number of deals involving business angels, as business angel deals are less likely to be formally announced than other equity investors. The proportion of deal activity involving business angels (either lone business angel or through an angel network) was flat in 2019, at 22% of all deals. The number of deals involving business angels increased from 391 in 2018 to 404 in 2019.

The likelihood that business angel deals are under-reported in the Beauhurst dataset compared to other types of equity investor is important, especially the case when comparing to the number of deals involving crowdfunding platforms where most deals are publicly announced as part of the fundraising process. It is therefore incorrect to interpret the number of deals involving crowdfunding platforms as being ahead of the number of deals involving angels. The British Business Bank is currently working with the UK Business Angel Association undertaking a new survey in 2020 that will provide useful insights into this part of the market.

FIG 1.14

NUMBER OF EQUITY DEALS PER YEAR BY INVESTOR TYPE

Source: British Business Bank analysis of Beauhurst

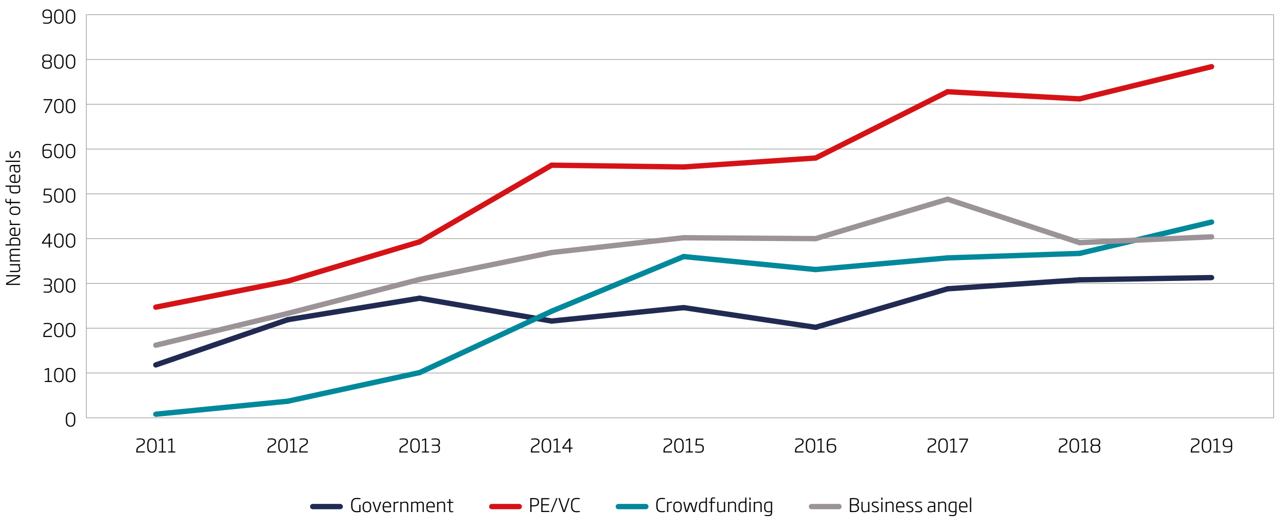
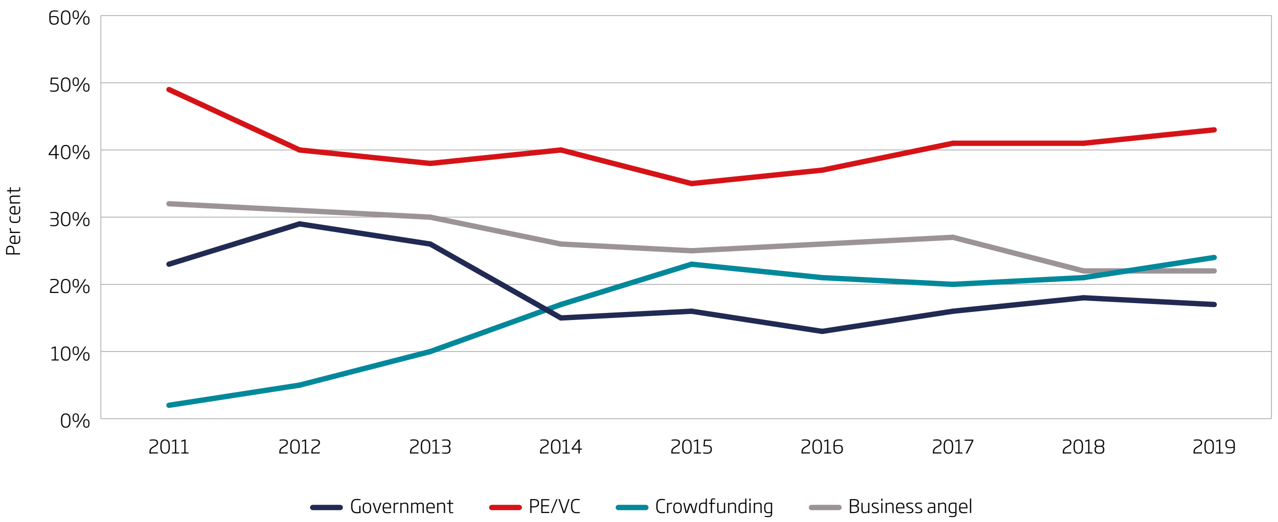


FIG 1.15

PROPORTION OF EQUITY DEALS PER YEAR BY INVESTOR TYPE

Source: British Business Bank analysis of Beauhurst



CORPORATE VENTURE CAPITAL

This year's report explores the contribution of corporate venture capital. Corporate VC (or CVC) is a subset of wider VC. CVC funding comes from large corporates, who invest in smaller start-up companies that are potentially relevant and beneficial to the parent group.[15] Corporate venture capitalists generally have two main objectives for making investments in start-up companies. Developing the strategic capabilities of the parent corporation; and providing a source of financial return for the parent corporation.

BVCA[16] acknowledges there are a broad range of delivery models. Corporate VCs can invest directly from their own balance sheet or create dedicated funds that do this, both as a Limited Partner (LP) investor into funds or as a dedicated internal fund and as a General Partner (GP) investor. Two well-known global examples of large corporate venture capital funds include GV (Google Ventures)[17] and Intel Capital[18] and both these funds invest in the UK SME market.

Table 4 provides the list of corporate investors ranked by number of deals between 2017 to 2019. The corporate investor with the largest number of deals is DMG ventures, which is part of the Daily Mail Group. DMG ventures invests in companies in consumer media and B2B information services companies spanning industries from Edtech, Property, Insurance and Events.[19] Google Ventures is the next largest investor by deal count with 11 deals followed by Salesforce Ventures.

Global Brain Corporation is unique within the list. Whilst not strictly a corporate investor in isolation, Global Brain manages other organisations' corporate venture capital funds. For instance, Global Brain Corporation manages funds on behalf of Sony, KDDI and Mitsui Fudosan who are the limited partners of the funds.[20] The Sony fund in particular looks for start-ups that have the potential to contribute to new business development for the Sony Financial Group. It therefore meets BVCA's wider definition of a corporate VC investor, although some of the deals may not be part of the corporate fund.

TABLE 4

TEN LARGEST CORPORATE VCS BY NUMBER OF DEALS 2017-2019

Rank by deal count 2017-2019	Fund Name	Parent Company	Number of deals	Value of deals contributed to
1	DMG ventures	Daily Mail Group	12	£155m
2	GV (Google Ventures)	GV Google	11	£264m
3	Salesforce Ventures	Salesforce	9	£196m
4	Global Brain Corporation	Global Brain Corporation	8	£94m
5	Tencent	Tencent	7	£81m
6	Unilever Ventures	Unilever	7	£20m
7	Santander InnoVentures	Santander	6	£142m
8	Outward VC (previously INVC)	Investec	4	£113m
9	Intel Capital	Intel	3	£57m
10	Sistema Venture Capital	Sistema	2	£13m

Source: British Business Bank analysis of Beauhurst

Corporate venture first emerged in the 1960's, but since then its popularity with corporate businesses has increased and decreased in cycles. Currently, corporate venture capital deals and funding are at record highs.[21] PitchBook data shows there were 1,182 European VC deals involving corporates in 2019, with both deals and investment value increasing over the last decade. PitchBook[22] suggests 'CVCs have sourced innovative VC investments to stay ahead of competitors and seek favourable returns' but corporate venture is likely to fall in 2020 and beyond as corporates are currently trying to preserve their capital. Beauhurst data confirms the number and value of equity deals involving corporate VC investors has increased between 2011 and 2019. Figure 1.16 shows there were 178 equity deals worth £2.7bn in 2019. The number of deals in 2019 increased by 16% and the investment value increased by 56% compared to 2018 levels.

Figure 1.17 shows equity deals involving corporate investors form roughly 10% of the market, with the percentages declining slightly in 2013 and 2014, despite the absolute number of deals per year being flat. The value of investment involving corporates increased from 14% in 2011 to 31% in 2019.

Compared to wider equity markets, a lower percentage of investments were at the seed stage in 2019, 25% compared to 41%. A higher proportion of deals were at the growth stage (31% compared to 19%). Corporate deals tend to be larger than the wider equity market, with deals at the venture (£6.7m compared to £3.4m) and growth (£36.6m compared to £17.7m) stages being much larger.

Corporate VCs therefore provide a valuable contribution and diversity to the UK SME equity ecosystem.

FIG 1.16

NUMBER AND VALUE OF EQUITY DEALS INVOLVING CORPORATE VENTURE

Source: British Business Bank analysis of Beauhurst

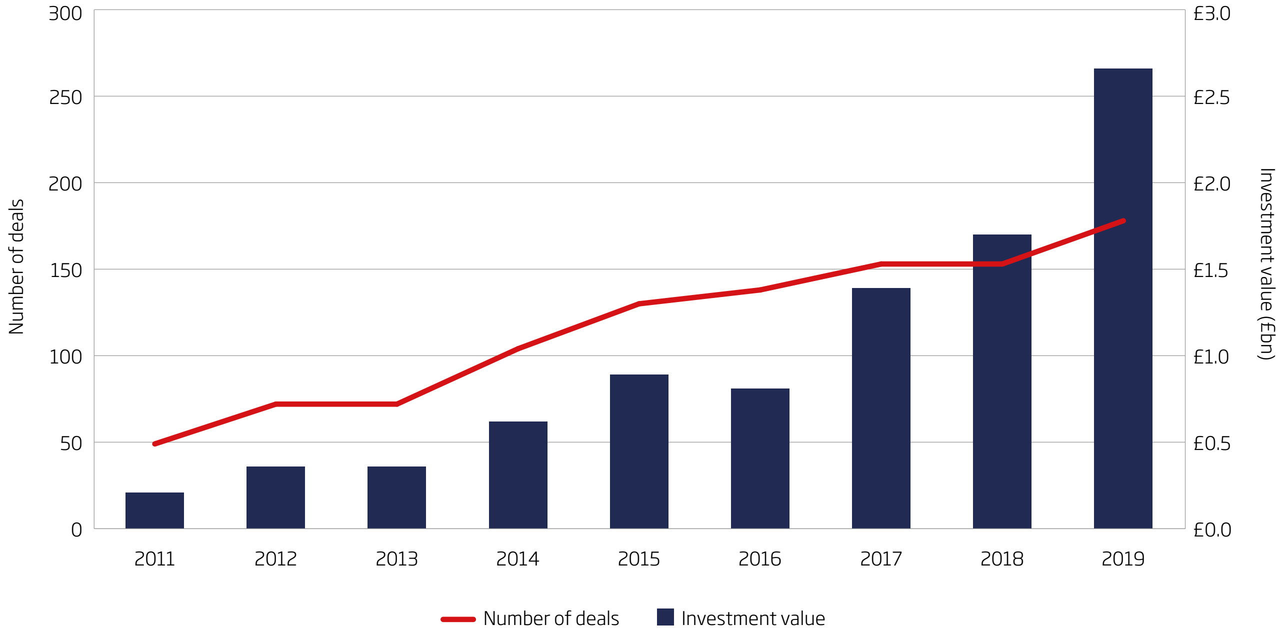
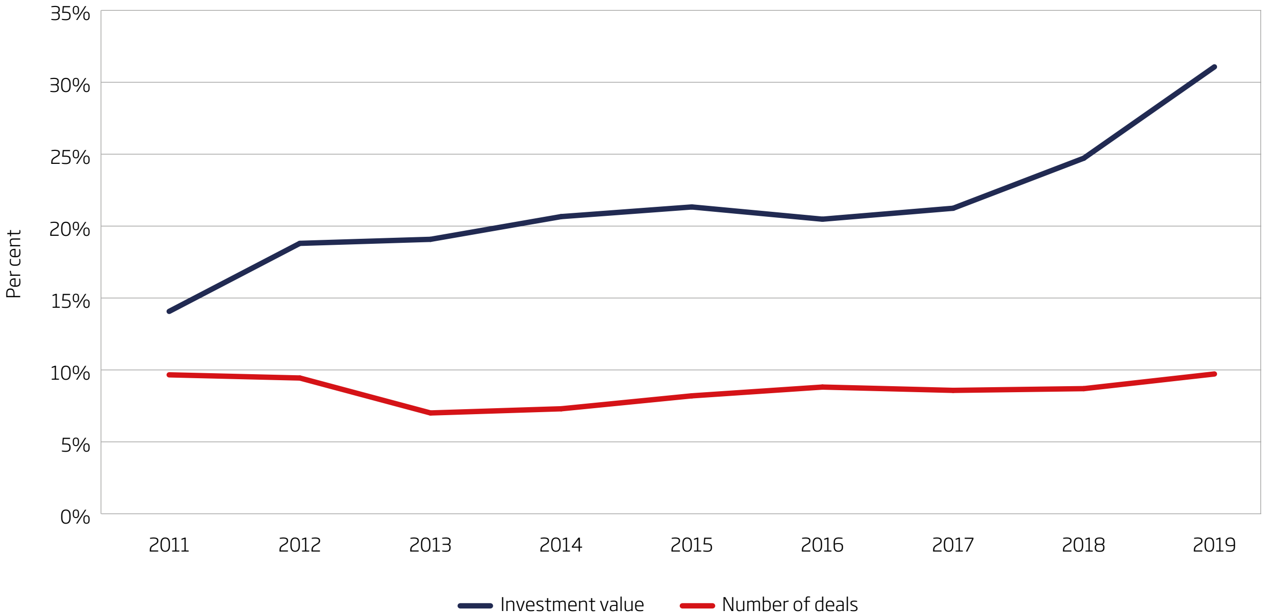


FIG 1.17

NUMBER AND VALUE OF CORPORATE VC DEALS AS PERCENTAGE OF MARKET

Source: British Business Bank analysis of Beauhurst



1.5 SECTORS, TECHNOLOGY SUB-SECTORS AND VERTICALS

Technology/IP-based businesses continued to attract both the largest number of deals and the majority of investment in 2019. Figure 1.18 shows there were 691 deals in technology/IP-based companies in 2019 which amounted to £4bn in value, which is a 27% increase on 2018. Whilst slightly below the 704 deals recorded in 2017, these are still extremely strong deal numbers and the investment value reached a further record high.

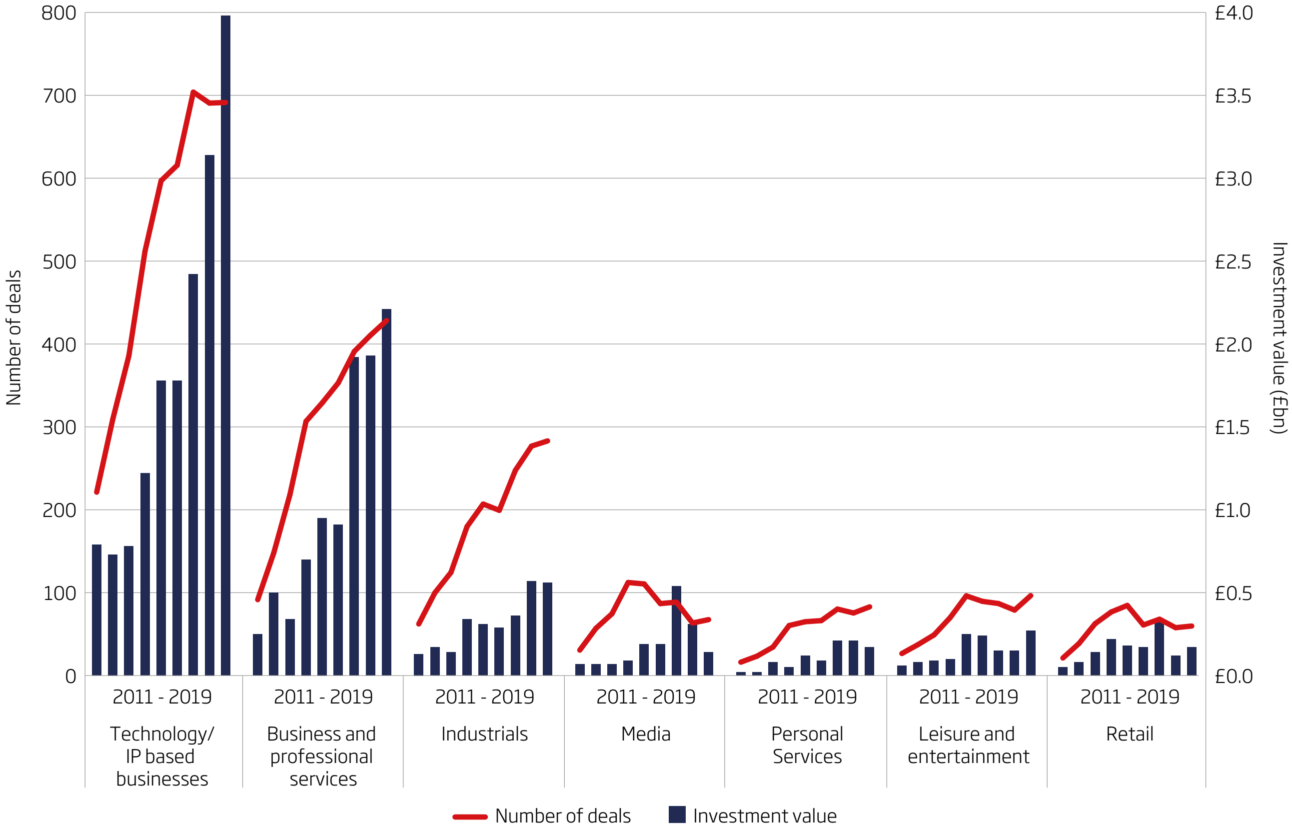
The proportion of deals going to technology/IP-based companies decreased by 1% to 38% of all equity deals. This proportion has stayed around 40% since 2012. The absolute number of technology deals has stayed flat between 2018 and 2019 and so the fall in the percentage of deals going to the technology sector is driven by an increase in the number of deals in the other sectors. In terms of value, investment in technology/IP-based companies increased as a proportion of overall investment from 46% in 2018 to 47% in 2019.

Business and professional services was the next largest sector by both number of deals (428) and investment value (£2.2bn), followed by industrials (283 deals, £556m investment value).

FIG 1.18

NUMBER AND VALUE OF EQUITY DEALS BY SECTOR

Source: British Business Bank analysis of Beauhurst



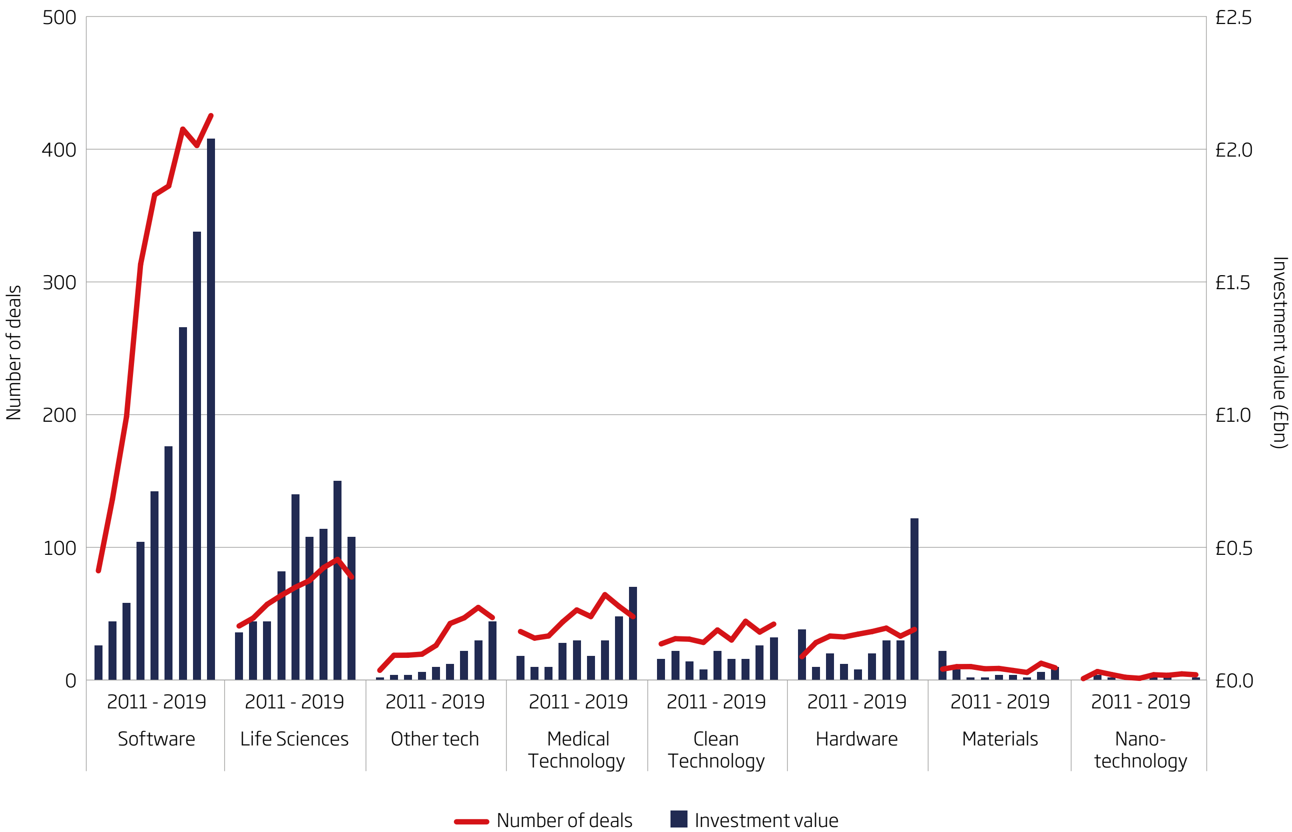
Beauhurst subdivides technology/IP-based businesses into eight technology sub-sectors which reflect the underlying activities of the companies. Two sub-sectors have traditionally formed the majority of the technology/IP-based business sector:

- Software continues to attract the most deals and investment out of the technology sub-sectors, with 425 deals in 2019 worth £2bn. Software deal numbers are up 6% relative to 2018 whilst investment in software saw growth of 21%.
- Life Sciences has consistently been the second largest technology sub-sector in terms of deal numbers and investment values. This year Life Sciences accounted for 78 deals worth £540m which represent a decline of 15% and 28% in deal numbers and investment respectively.
- Hardware was the second largest technology subsector in terms of investment in 2019. Whilst deal numbers increased by 15% to 38, investment increased by 306% to £600m. This is a result of one single equity deal of £940m into Oneweb, which is partly categorised as hardware.[23]

FIG 1.19

NUMBER AND VALUE OF EQUITY DEALS BY TECHNOLOGY SUB-SECTOR

Source: British Business Bank analysis of Beauhurst



Sectors like industrials and business and professional services cover a broad range of activities. Beauhurst has recently introduced an alternative way to classify companies based on the market the company serves or the delivery model of the company. This is known as a vertical. This is a more targeted classification approach, allowing investors to identify companies that offer niche products. Verticals better match the description fund managers use to describe the areas of the market they focus on. It is important to acknowledge that companies can be in more than one vertical e.g. software as a service and fintech, and so it is not possible to aggregate these verticals together.

Table 5 shows the ten verticals with the highest amount of investment in 2019. Software as a service was the largest vertical receiving £2.5bn of funding across 471 deals, followed by fintech (£1.8bn and 193 deals) and artificial intelligence (£880m and 173 deals). The top three verticals by value in 2019 follow the same order as in 2018, but the investment amounts going to software as a service increased by 69%, fintech by 21% and artificial intelligence by 14% in 2019 compared to 2018. The number of deals going to these verticals in 2019 also increased by 14%, 14% and 15% respectively compared to 2018.

TABLE 5

NUMBER AND VALUE OF EQUITY DEALS IN 2019 BY VERTICAL

Vertical	Number of deals	Value
Software-as-a-Service (SaaS)	471	£2.5bn
FinTech	193	£1.8bn
Artificial Intelligence	173	£880m
Subscription	102	£479m
Digital security	53	£458m
Big data	57	£365m
Alternative finance	34	£266m
Precision medicine	16	£250m
Robotics	16	£235m
Challenger Bank	11	£232m

Source: British Business Bank analysis of Beauhurst

1.6 FOLLOW ON FUNDING ENVIRONMENT

The British Business Bank has identified first time deals in companies that have not previously raised equity finance before ('new companies') and follow on funding deals in companies whom had previously raised a round of equity finance. The funding environment for new companies raising equity finance is essential as it both supports seed stage activity and creates the pipeline of companies for equity investors to invest in the future.

Figure 1.20 shows that the number of deals in new companies has declined every year since 2015 from 1,005 deals to 868 deals in 2019. It is noticeable that 2019 marks the first year where there are a higher number of deals involving follow on rounds than deals involving 'new companies' which have not raised equity finance before. This trend was identified in last year's Equity Tracker report, but additional deals have been announced in the subsequent 12 months following publication meaning that this is no longer true for 2018. There is often a delay in the announcement of deals in companies that have not received equity finance before as these deals are smaller and the companies at an earlier stage.

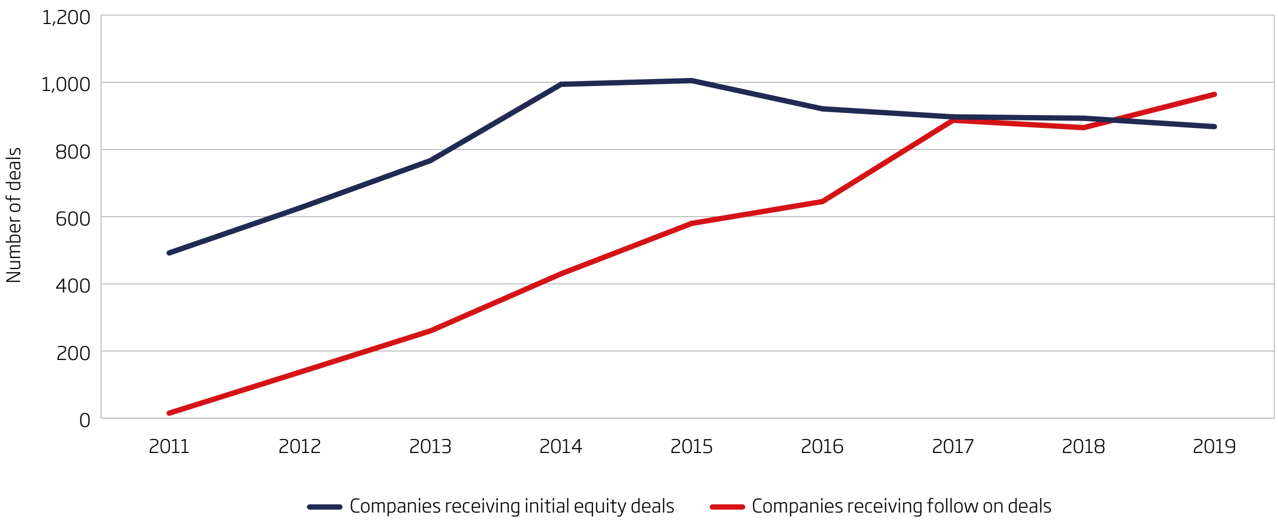
The success of early stage VC-backed companies is contingent on them raising multiple rounds of equity finance, or 'follow on funding', to fund continued growth. This is because these firms are inherently high growth and often loss-making during the initial years, and therefore rely on external capital to finance their expansion. Although there are some outlier cases of companies bootstrapping their way to huge valuations, in practice most companies achieving 'unicorn status' did so through multiple rounds of equity finance. British Business Bank analysis of Beauhurst data shows companies raise a new equity round every 18 months on average, regardless of funding stage.

The next section looks at the extent to which companies can raise follow on funding by assessing differences between sectors and investor types.

FIG 1.20

NUMBER OF EQUITY DEALS, FIRST TIME COMPANIES COMPARED TO COMPANIES RAISING FOLLOW ON FUNDING

Source: British Business Bank analysis of Beauhurst



SECTORS

Figure 1.21 examines a cohort of companies that received initial funding at the seed stage between 2011 and 2013. For this cohort, the graph shows the proportion of companies within each sector (with technology/IP-based businesses broken down into sub-sectors where possible) successfully raising a second round of equity funding.

There is a clear sectoral theme when looking at the proportion of companies raising at least one follow on funding round. The four sectors most successful in raising a second funding round were all within the technology sub-sectors:

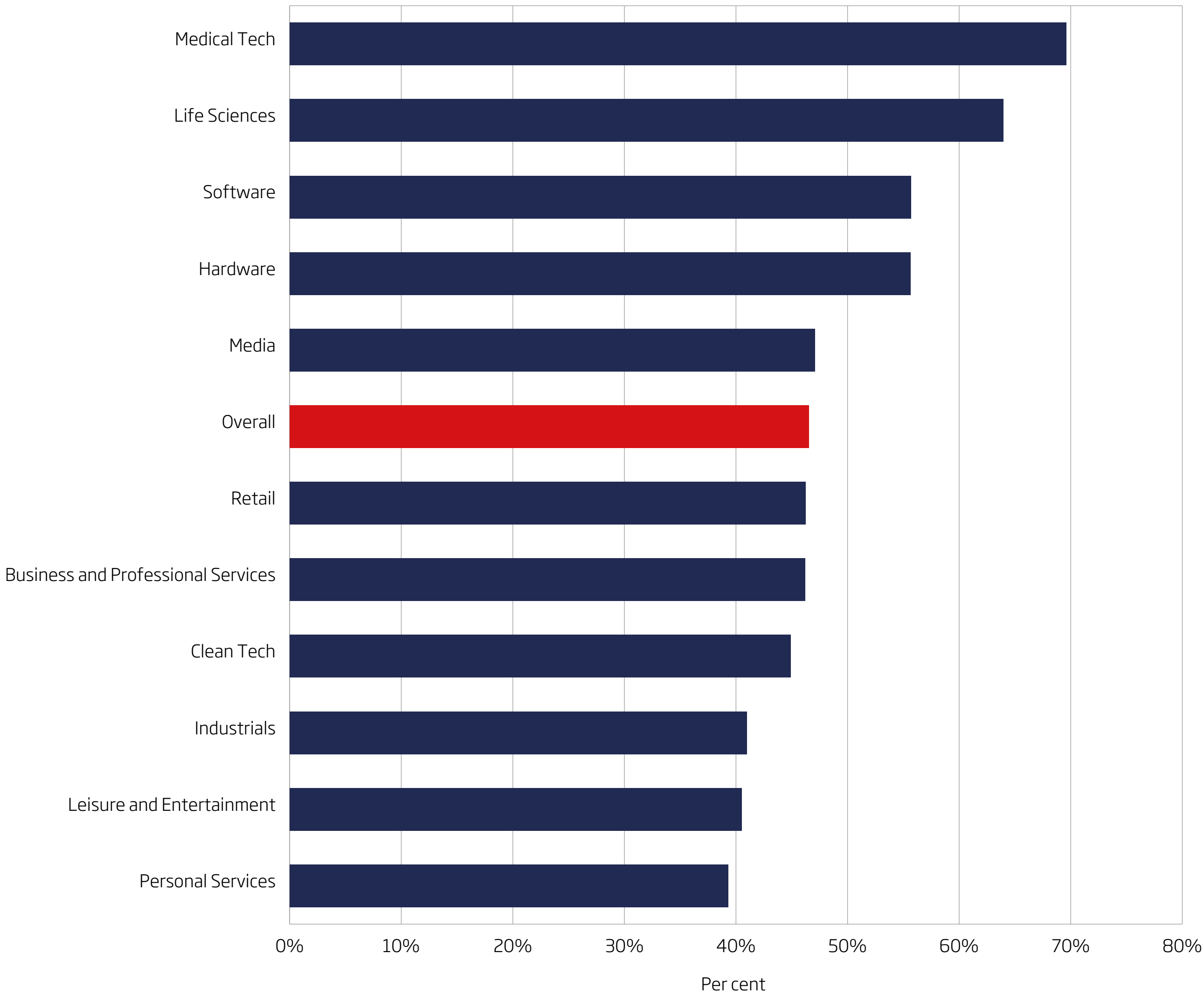
- Medical tech and life sciences companies were the most likely to raise a second funding round, with 70% and 64% of companies in the cohort raising a second round respectively.
- Companies in the personal services sector are the least likely to secure a second round of equity funding, with only 39% of companies in the sector managing to do so relative to 47% of the overall cohort.

The fact that technology companies are the most successful in raising follow on funding is unsurprising. Most VC funds have a technology focus and therefore technology companies will likely have a large pool of potential investors to choose from.

FIG 1.21

PROPORTION OF COMPANIES RAISING A SECOND ROUND OF EQUITY FUNDING, BY SECTOR

Source: British Business Bank analysis of Beauhurst



INVESTORS

Figure 1.22 uses the same cohort of companies as above that received initial funding at the seed stage between 2011 and 2013 but shows the proportion of companies securing a second round of funding by initial investor type.[24]

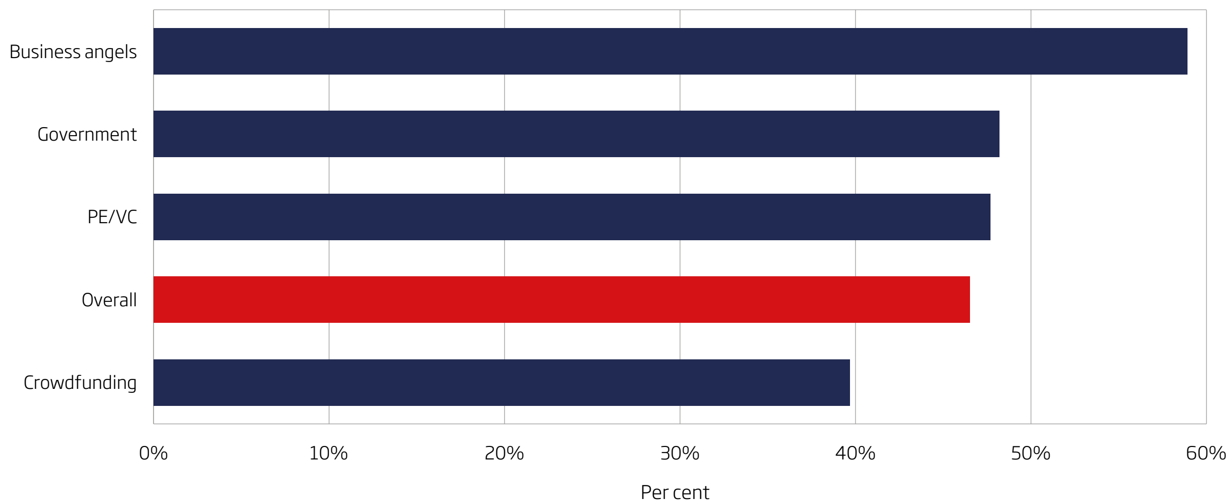
- Companies initially funded by business angels were the most likely to raise a second round of equity finance, with 59% of companies managing to do so relative to 47% of the overall cohort. This finding may reflect some bias if Beauhurst identifies equity deals involving angels which are largely unannounced, from subsequent fund-raising rounds involving other equity investors.
- Companies initially funded by crowdfunding platforms were the least likely to raise a second round of funding at only 40%.

The average size of the first funding round differs greatly with deals involving crowdfunding platforms raising only £146k in the first round on average compared to £2.6m for the overall cohort, and £4.7m for deals involving PE/VC funds.

FIG 1.22

PROPORTION OF COMPANIES RAISING A SECOND ROUND OF EQUITY FUNDING, BY INITIAL INVESTOR TYPE

Source: British Business Bank analysis of Beauhurst



1.7 VALUATIONS

Beauhurst includes information on company pre-money valuations[25], allowing analysis of trends over time. Figure 1.23 shows the mean average pre-money valuation of companies receiving equity finance since 2011, by stage.

- **Seed:** Average pre-money seed stage valuation fell between 2011 and 2013 – from £1.5m to £1m. It then consistently increased year on year to 2018, reaching £3.3m. Valuations in seed companies remained relatively flat in 2019 – declining 2% to £3.25m
- **Venture:** Average pre-money venture stage valuation fell from £10.1m in 2011 to £4.3m in 2013 and didn't recover to 2011 levels until 2017, when it has increased in the subsequent years to £11.5m. Venture stage company valuations increased 10% in 2019, the only stage to show an increase.
- **Growth:** The growth stage is the only stage for which pre-money valuations consistently trended upwards between 2011 and 2018 – from £15.6m in 2011 to £75.8m in 2018. In 2019 this upward trend stopped as pre-money valuations declined 36% in 2019 to £48.2m

The increase in overall valuations over the last few years was primarily driven by a large increase in pre-money valuation of growth stage companies from investor confidence in the growth prospects of such companies and the emergence and increasing frequency of unicorn status businesses.[26] The mean average pre-money valuation can be affected by a few very large valuations in outlier companies. An analysis of the median pre-money valuation is therefore useful to provide a fuller picture of what is happening to company valuations. This is presented below in Figure 1.24. The seed stage median company pre-money valuation increased from £1.8m to £2m, the venture stage increased from £6m to £7.4m and the growth stage increased from £23m to £27m in 2019.

2018 serves as an example of a year when the average pre-money valuation was affected by outlier companies such as Improbable with a valuation of £1.5bn and Graphcore with a valuation of £930m. There were four equity deals going to unicorn status companies in 2018 compared to just two in 2019. PitchBook notes that there is a disparity between the top and bottom level quartile valuations which suggests that some 'prized' companies are receiving the majority of the capital but are not representative of the growth stage as a whole.[27]

The median therefore better reflects the valuations of the majority of the companies. The median pre-money valuation decreased from £29m in 2017 to £23m in 2018, but 2019 saw the median pre-money valuation recover to £27m. Furthermore, 2019's mean average pre-money valuations are more similar to 2017 levels, with 2018 average figures being seen as an outlier year. For example, the average pre-money valuation of a growth stage company was £49m in 2017 and £48m in 2019. PitchBook notes that 'valuation growth cooled across the board in H1 2019 which signals a potential shift in sentiment around VC'.[28]

There was an increase in the proportion of 'down rounds'[29] in 2019, with down rounds forming 12% of all deals in 2019 compared to 9% in 2018. The number of down rounds in growth stage companies has also increased to 15% in 2019 from 14% in 2018 and 9% in 2017. With the average time between funding rounds being about 18 months this suggests that some investors are slightly more cautious than they were in 2017 resulting in this cohort of companies having lower valuations than in 2017.

FIG 1.23

AVERAGE PRE-MONEY VALUATION BY BUSINESS STAGE

Source: British Business Bank analysis of Beauhurst

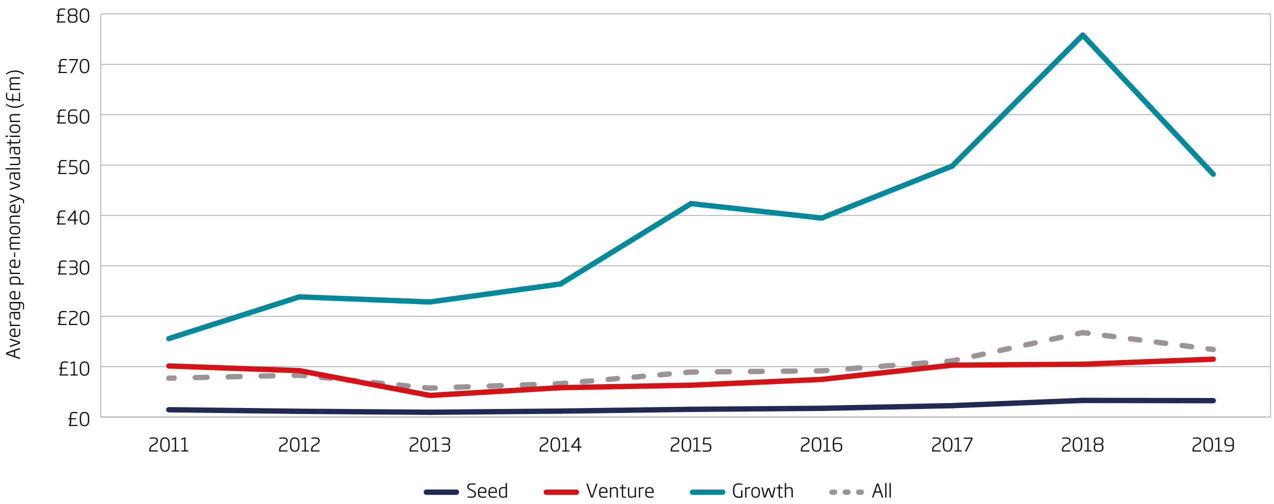
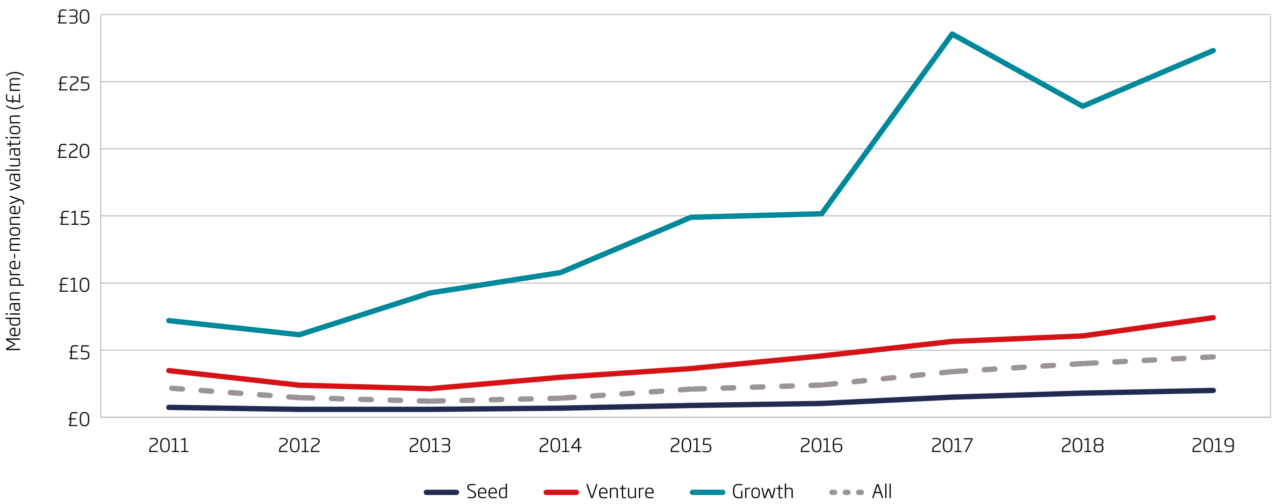


FIG 1.24

MEDIAN PRE-MONEY VALUATION BY BUSINESS STAGE

Source: British Business Bank analysis of Beauhurst



1.8 OVERSEAS INVESTORS

Beauhurst provides information on the country in which investors participating in the equity deal are located. Figure 1.25 outlines trends in UK equity deal numbers based on investor location.[30] It is not possible to quantify the amount of funding overseas investors contribute to each equity deal and the investment values mentioned in this section relate to equity deal size overall.

The number of UK SME equity deals involving an overseas investor has increased every year since 2011, from 91 (with an investment value of £655m) in 2011 to 350 (£5.2bn) in 2019. The depreciation of Sterling since 2016 has likely increased the attractiveness of the UK VC market to overseas investors. Deals including an overseas investor made up 19% of UK SME equity deals in 2019. Overseas investment is important to the UK equity ecosystem as it increases the pool of capital available to UK SMEs.

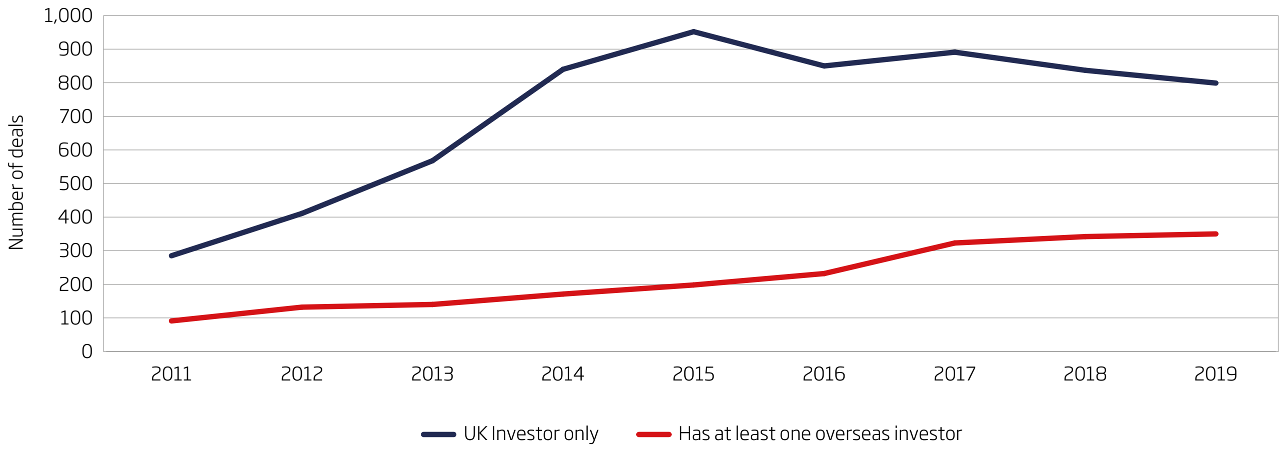
In terms of investment value, 2019 follows the trend established in 2017 and 2018 with the majority of equity investment in UK SMEs from deals involving at least one overseas investor. Deals involving at least one overseas investor had an investment value of £5.2bn, forming 61% of the overall investment value for 2019. Overseas investors are much more likely to invest at a later stage, with 34% of deals involving an overseas investor in 2018 going to growth stage companies compared to 19% of overall equity deals. Overseas investors are also more likely to invest in London than the wider investor population, with 66% of overseas investor deals in 2018 going to companies located in London (compared to 48% of overall equity deals). Of deals involving overseas investors, nearly half (49%) involved US investors, but there was a sizeable proportion of deals involving investors from Germany (15%), Japan (7%) and France (5%).

Deals involving only UK investors have been declining since 2015, with 2019 continuing this trend. Over the last few years, deal sizes have been increasing and the proportion of deals going to growth stage companies has also increased. These types of deals are more likely to involve a larger number of investors, and therefore less likely to involve just UK only investors.

FIG 1.25

NUMBER OF EQUITY DEALS IN UK SME BY INVESTOR LOCATION

Source: British Business Bank analysis of Beauhurst



1.9 FEMALE FOUNDERS

Beauhurst also includes information on the gender composition of the founding team for the UK companies they track. Figure 1.26 shows the proportion of UK equity deals and investment value going to companies with at least one female founder. In 2019, the proportions are similar to 2018 at 20% and 11% respectively. However, these are still below 2016 levels where 21% of deals went to a company with a female founder and 17% of UK equity investment. Companies with an all-female founding team comprised only 6% of deals (2% of investment value) in 2019. This is substantially lower than the 80% of deals (89% of investment value) going to all-male teams.

The Beauhurst data confirms that female founders form a higher percentage of seed stage deals with 26% of seed stage deals between 2017 and 2019 going to companies with at least one female founder. Female founded companies form a lower proportion of deals at the growth stage – where only 13% of deals between 2017 and 2019 went to a company with at least one female founder.

Female founders forming a higher proportion of seed stage deals compared to the growth stage may be an indication that the situation will improve in the future as these companies develop, but it is likely to take time. Going forward, we may see a higher proportion of venture and growth stage deals going to female founded companies in the future as these seed stage companies mature. Initiatives such as the Investing in Women Code continue to highlight the benefits of investing in diverse founding teams.

Figure 1.27 shows that the proportion of deals going to female founders differs across investor types. Crowdfunding platforms had the highest proportion of deals in companies with at least one female founder between 2017 and 2019 (26%), whilst PE/VC funds had the lowest proportion at 18%. This difference could be linked to investors on crowdfunding platforms having more diverse backgrounds than those in the VC/PE industry, and therefore more likely to invest across different founder types. Differences between the investor types in their sector focus may also explain these trends.

FIG 1.26

PROPORTION OF UK SME EQUITY DEALS AND INVESTMENT GOING TO BUSINESSES WITH AT LEAST ONE FEMALE FOUNDER

Source: British Business Bank analysis of Beauhurst

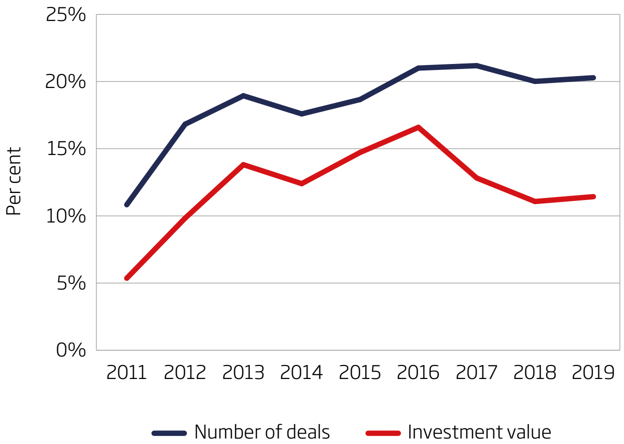
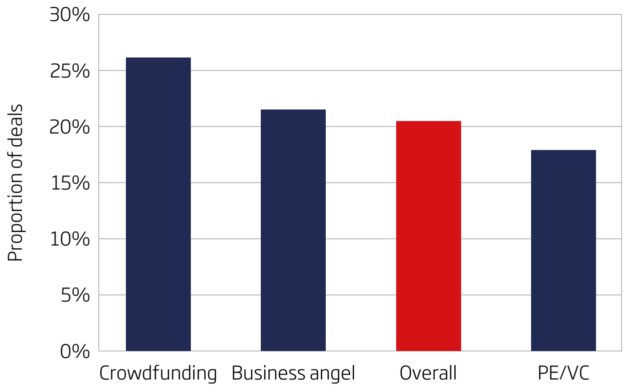


FIG 1.27

PROPORTION OF EQUITY DEALS GOING TO FEMALE FOUNDED COMPANIES BY INVESTOR TYPE (2017-19)

Source: British Business Bank analysis of Beauhurst



1.10 DEAL GEOGRAPHY

Previous Equity Tracker and Small Business Finance Markets reports have identified that equity deals and investment are concentrated in London, and this remains the case in 2019. Almost half (48%) of all UK equity deals were in companies located in the capital in 2019, with these deals accounting for two thirds (66%) of investment. These proportions are much higher than London's 19% share of the SME population[31] and 20% share of high growth businesses.[32] This means that companies in London receive a disproportionate amount of equity investment compared to the rest of the UK.

This imbalance is set out in Table 6, which shows that London had 8 deals per 10,000 SMEs and 33.2 deals per 100 High Growth Business (HGB) relative to 1.9 and 9.3 in the rest of the UK. London also received £51.5m of investment per 10,000 SMEs and £213m per 100 HGB in comparison with £6.1m and £28.4m in the rest of the UK.[33]

TABLE 6

EQUITY DEALS AND BUSINESS POPULATION BY REGION AND DEVOLVED ADMINISTRATION

	UK Deal Share (2019)	UK Investment Share (2019)	UK SME Share (2019)[34]	UK High Growth Business Share (2017)[35]	Deals per 100 HGB (2019)	Deals per 10,000 SMEs (2019)
London	48%	66%	19%	20%	33.2	8
South East	9%	9%	16%	15%	8.3	1.7
South West	5%	2%	10%	8%	8	1.5
East Midlands	2%	<1%	6%	6%	4	1
West Midlands	2%	2%	8%	8%	4.5	0.9
East of England	6%	11%	10%	10%	8.5	1.8
Yorkshire and Humberside	3%	1%	7%	8%	5.6	1.4
North East	3%	1%	3%	3%	12.9	3.2
North West	6%	4%	10%	10%	7.4	1.8
Northern Ireland	1%	<1%	2%	2%	9	2.1
Wales	4%	1%	4%	4%	14.7	3.3
Scotland	12%	3%	6%	6%	25.1	6.3
UK Excluding London	52%	34%	81%	80%	9.3	1.9
UK Total	100%	100%	100%	100%	14.2	5

Source: ONS, BEIS, British Business Bank analysis of Beauhurst

The growth rate in number of deals in London and the areas outside London are similar (4% compared to 5%) which has led to an unchanged proportion of UK deals in the capital between 2018 and 2019. However, the increase in the value of deals going to London has been much higher. London saw a large (37%) year on year increase in investment in 2019, increasing by £1.5bn, whilst areas outside of London only increased by 6% (£160m). As a result of this, London's share of investment has increased from 60% in 2018 to 66% in 2019. One contributing factor to London's increased proportion of investment is the impact of megadeals (deals greater than £100m). Only two of the seven megadeals went to companies outside of London in 2019.[36]

The picture for individual regions is mixed, with most regions seeing an increase in investment, but the South West, Yorkshire and Humber, East Midlands and the North East experienced a decrease in 2019 compared to 2018.

Alongside unevenness within regions, it is important to acknowledge that equity clusters cross over administrative boundaries. Figure 1.29 below reflects these issues by aggregating deal volumes using a superimposed grid of identically sized hexagons.[37] It is clear to see, for example, that the London equity cluster spans beyond the geographic boundary of Greater London.

Unevenness in equity investment is also seen in London itself. For example, the City of London received 14% of London equity investment in 2019 in comparison with the 20 Outer London boroughs combined who received 2%. This is despite the combined Outer London boroughs having over ten times as many SMEs as the City of London.

Collectively, these insights provide support for geographic focused funds like the Northern Powerhouse, Midlands Engine Investment Funds and Regional Angels Programme that are targeted at developing equity clusters outside of the capital.

FIG 1.28

NUMBER AND VALUE OF EQUITY DEALS OVER TIME BY AREA

Source: British Business Bank analysis of Beauhurst

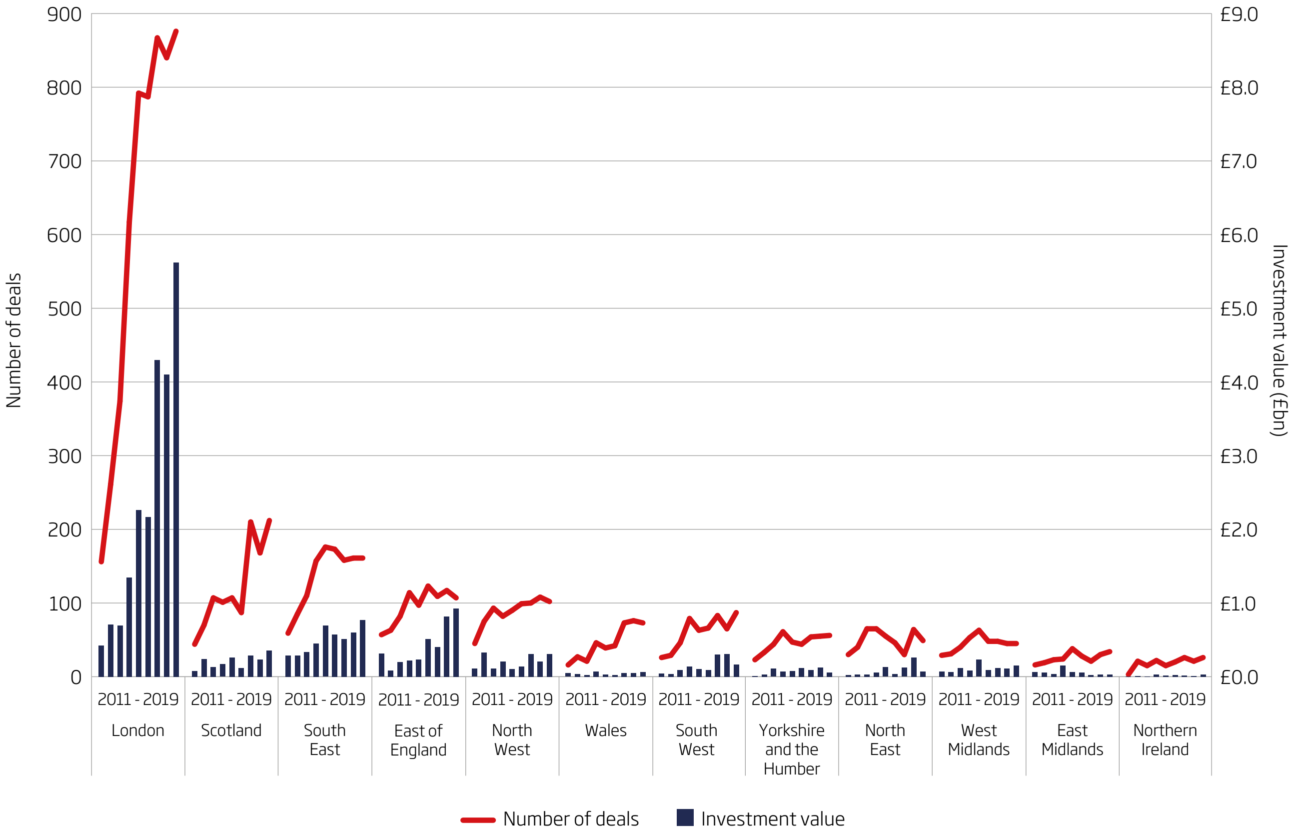


FIG 1.29

UK EQUITY DEALS IN 2019

Source: British Business Bank analysis of Beauhurst

Deal Count 2019

- No Deals
- 1 to 5 Deals
- 6 to 10 Deals
- 11 to 20 Deals
- 21 to 50 Deals
- 51 to 100 Deals
- More than 100 Deals

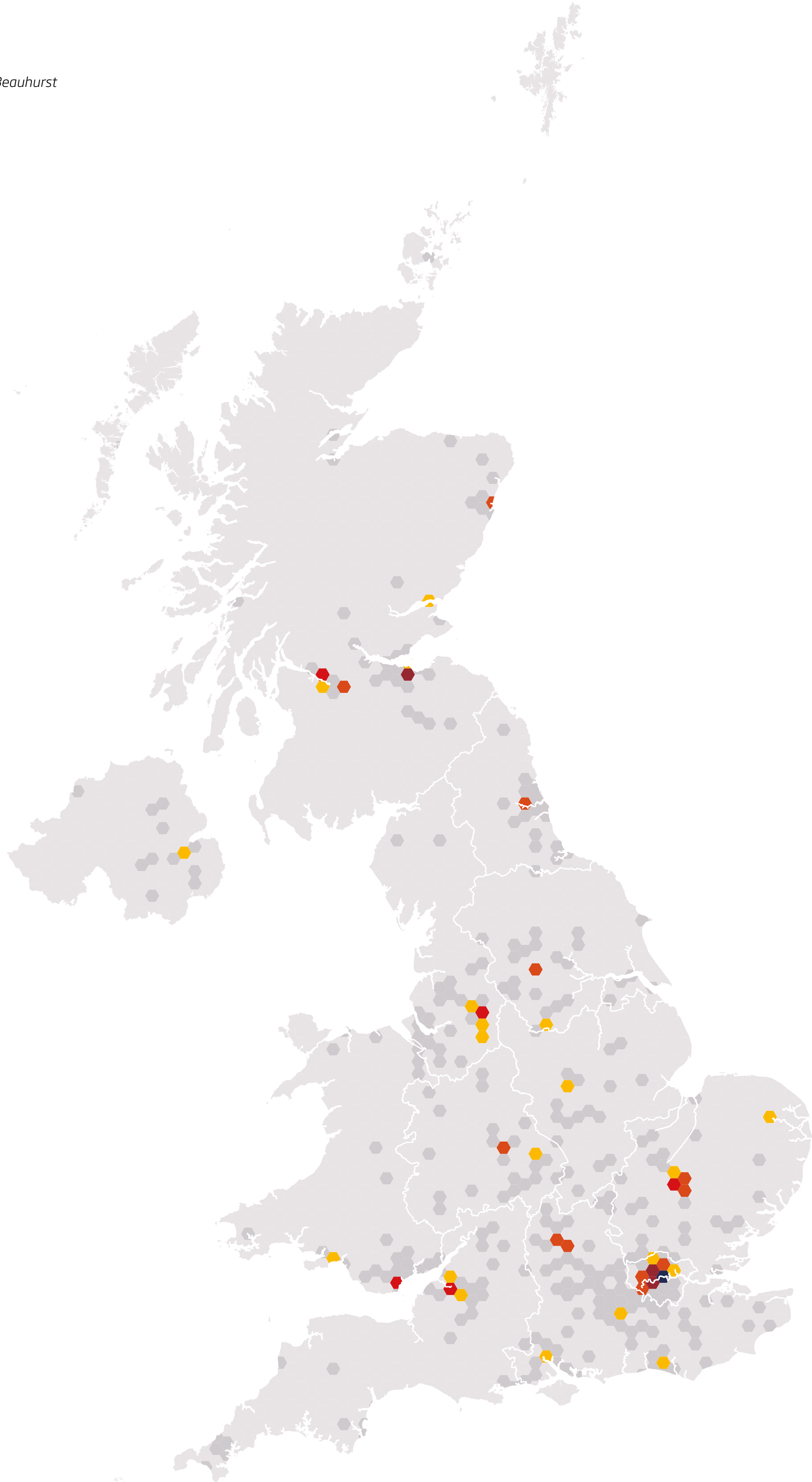


Table 7 lists the 25 Local Authority Districts (LADs) with the highest number of announced equity deals in 2019. 11 of the top 25, and 7 of the top 10, LADs with the most equity deals in 2019 were in London. Cambridge and Oxford were also on the list (11th and joint 15th respectively) due to the established communities of angel investors and VC funds that have developed around the universities. Cities including Edinburgh, Manchester, Glasgow, Bristol, Leeds, Newcastle and Birmingham are also important equity hotspots where deals are clustered.

TABLE 7
LOCAL AUTHORITY DISTRICTS WITH HIGHEST NUMBER OF ANNOUNCED EQUITY DEALS IN 2019

Rank	Local Authority Districts	Number of deals (2019)	Sector with highest number of deals	Sector with second highest number of deals	Number of deals (2018)	Rank (2018)
1	Westminister	143	Technology	Business and Professional Services	134	1
2	City of London	121	Business and Professional Services	Technology	105	2
3	Islington	111	Technology	Business and Professional Services	96	4
4	Hackney	104	Technology	Business and Professional Services	99	3
5	City of Edinburgh	94	Technology	Business and Professional Services	76	7
6	Camden	92	Technology	Business and Professional Services	87	5
7	Southwark	75	Technology	Business and Professional Services	85	6
8	Tower Hamlets	57	Technology	Business and Professional Services	72	8
9	Glasgow City	38	Life Sciences	Software	22	17
10	Manchester	35	Technology	Business and Professional Services	35	11
11	Cambridge	34	Technology	Business and Professional Services	24	16
12	Lambeth	30	Technology	Business and Professional Services	36	10
=13	Bristol, City of	28	Technology	Business and Professional Services	27	15
=13	Cardiff	28	Software	Business and Professional Services	31	=13

Rank	Local Authority Districts	Number of deals (2019)	Sector with highest number of deals	Sector with second highest number of deals	Number of deals (2018)	Rank (2018)
=15	Kensington and Chelsea	27	Business and Professional Services	Technology	19	19
=15	Oxford	27	Medical Technology	Life Sciences	18	20
=15	South Cambridgeshire	27	Life Sciences	Medical Technology	33	12
18	Hammersmith and Fulham	25	Technology	Industrials	38	9
19	Wandsworth	20	Industrials	Technology	12	=24
20	Leeds	19	Business and Professional Services	Technology	21	18
21	Birmingham	17	Technology	Business and Professional Services	16	21
=22	Aberdeen City	16	Technology	Business and Professional Services + Energy	12	=24
=22	Newcastle upon Tyne	16	Technology	Industrials	31	=13
24	Belfast	15	Technology	Business and Professional Services	11	=26
25	Cornwall	14	Industrials	Technology + Business and Professional Services	5	=50

Source: British Business Bank analysis of Beauhurst

Table 8 lists the top twenty Local Enterprise Partnerships (LEPs) by number of announced deals, although an important caveat for using LEP geographies is that they are only in England. Hence areas such as Glasgow or Edinburgh are not included in this analysis despite featuring in the LAD table. This further reinforces the idea of equity hotspots, clusters, in certain geographic areas of the UK. The advantage of using LEPs over LAD to look at equity clusters is that areas can be made up of multiple LADs. For instance, Greater Manchester comprises 10 LADs. Therefore, an analysis based on LADs does not fully capture the scale of equity activity in Manchester. Whilst City of Manchester LAD is ranked 10th in the LAD rankings with 35 equity deals, the Greater Manchester LEP covers the full Greater Manchester area and is ranked third behind the London and Greater Cambridge and Greater Peterborough LEPs with 62 deals and is ahead of Oxfordshire.

TABLE 8

LOCAL ENTERPRISE PARTNERSHIPS WITH HIGHEST NUMBER OF ANNOUNCED EQUITY DEALS IN 2019

Rank	Local Enterprise Partnership	Number of deals (2019)	Sector with highest number of deals	Sector with second highest number of deals	Number of deals (2018)	Rank (2018)
1	London	874	Technology	Business and Professional Services	835	1
2	Greater Cambridge and Greater Peterborough	77	Life Sciences	Software	69	2
3	Greater Manchester	62	Technology	Business and Professional Services	54	4
4	Oxfordshire	54	Medical Technology	Software	48	5
5	West of England	48	Software	Business and Professional Services	36	7
6	North East	40	Technology	Business and Professional Services	59	3
7	Leeds City Region	36	Technology	Industrials	39	6
8	Enterprise M3	27	Industrials	Technology	33	8
9	Coast to Capital	26	Technology	Industrials	30	9
=10	Solent	18	Technology	Industrials	12	=18
=10	South East	18	Technology	Industrials	24	=10
=10	Greater Birmingham and Solihull	18	Technology	Business and Professional Services	31	13
13	Thames Valley Berkshire	17	Technology	Industrials + Business and Professional Services	39	14
14	Cheshire and Warrington	16	Technology	Business and Professional Services	43	=10
=15	Coventry and Warwickshire	14	Technology	Industrials	27	=18
=15	Cornwall and Isles of Scilly	14	Industrials	Business and Professional Services + Technology	22	26
=17	Hertfordshire	13	Technology	Industrials	12	=10
=17	South East Midlands	13	Technology	Industrials	13	=21
=17	Sheffield City Region	13	Technology	Industrials	9	=23
=17	Derby, Derbyshire, Nottingham and Nottinghamshire	13	Technology	Business and Professional Services	29	16

Source: British Business Bank analysis of Beauhurst

1.11 ACADEMIC SPINOUTS

Universities undertake a large amount of research activity, and one way for them to commercialise this research is through the creation of university spinout companies. The university, or one of its connected venture funds, will usually provide the company with its initial capital, and will usually be a significant shareholder in the company at the start.

Beauhurst identifies companies that have spun out from universities based on the following criteria. If a company meets condition 1 and at least one other condition, then the company is classified as being an academic spinout:

1. The company was set up to exploit intellectual property developed by a recognised UK university. (This is broadly in line with the Higher Education Statistics Agency's (HESA) definition of a spinout)
2. The university owns IP that it has licensed to the company
3. The University owns shares in the company or it has the right (via an option or warrants contract) to purchase shares in the company at a later date

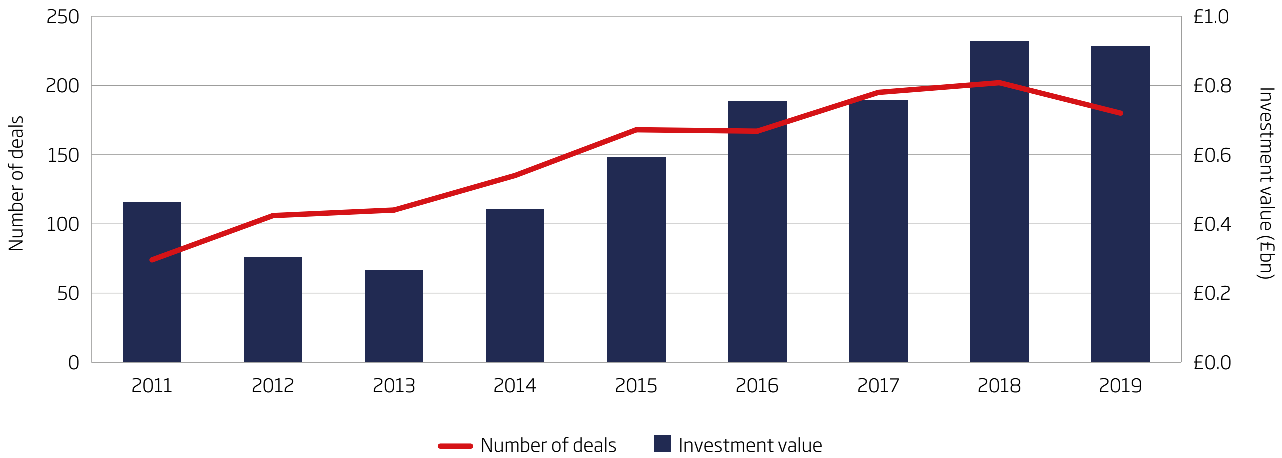
Figure 1.30 shows that between 2011 and 2018, both the number of equity deals and amount of equity investment going to spinout companies had been increasing year on year. In 2011 there were 74 deals with £462m invested, which increased to 202 deals (£928m) in 2018. 2019 saw the number of deals decline to below 2017's level with 180 equity deals completed, a 10% decrease on the previous year. Investment in 2019 also saw a decrease on the previous years', though on a much smaller magnitude, down from £928m in 2018, a 2% decrease to £914m.

Unsurprisingly, the universities of Oxford and Cambridge produced the highest number of spinout companies and these companies have also received the greatest amount of equity investment. Cambridge accounted for 60 companies that received equity investment of £569 million between 2017 and 2019, whilst the University of Oxford accounted for 50 companies that received equity investment of £565 million. Cambridge and Oxford both have a developed equity ecosystem centred round the universities, though there are encouraging signs that development is also occurring in other parts of the country in 2019.

FIG 1.30

NUMBER AND VALUE OF EQUITY DEALS IN UNIVERSITY SPINOUT COMPANIES

Source: British Business Bank analysis of Beauhurst



The Universities of Bristol, Edinburgh and Strathclyde have all spun out 11 companies that received equity investment in 2019, a similar figure to the University of Oxford in 2019 (17). Throughout the three-year period (2017-2019), University College London is also notable for creating 16 spinout companies that received £560 million in equity investment, a comparable investment value to Oxbridge. Companies spun out of the University of Bristol and Imperial College London also received over £100 million in equity investment between 2017-2019.

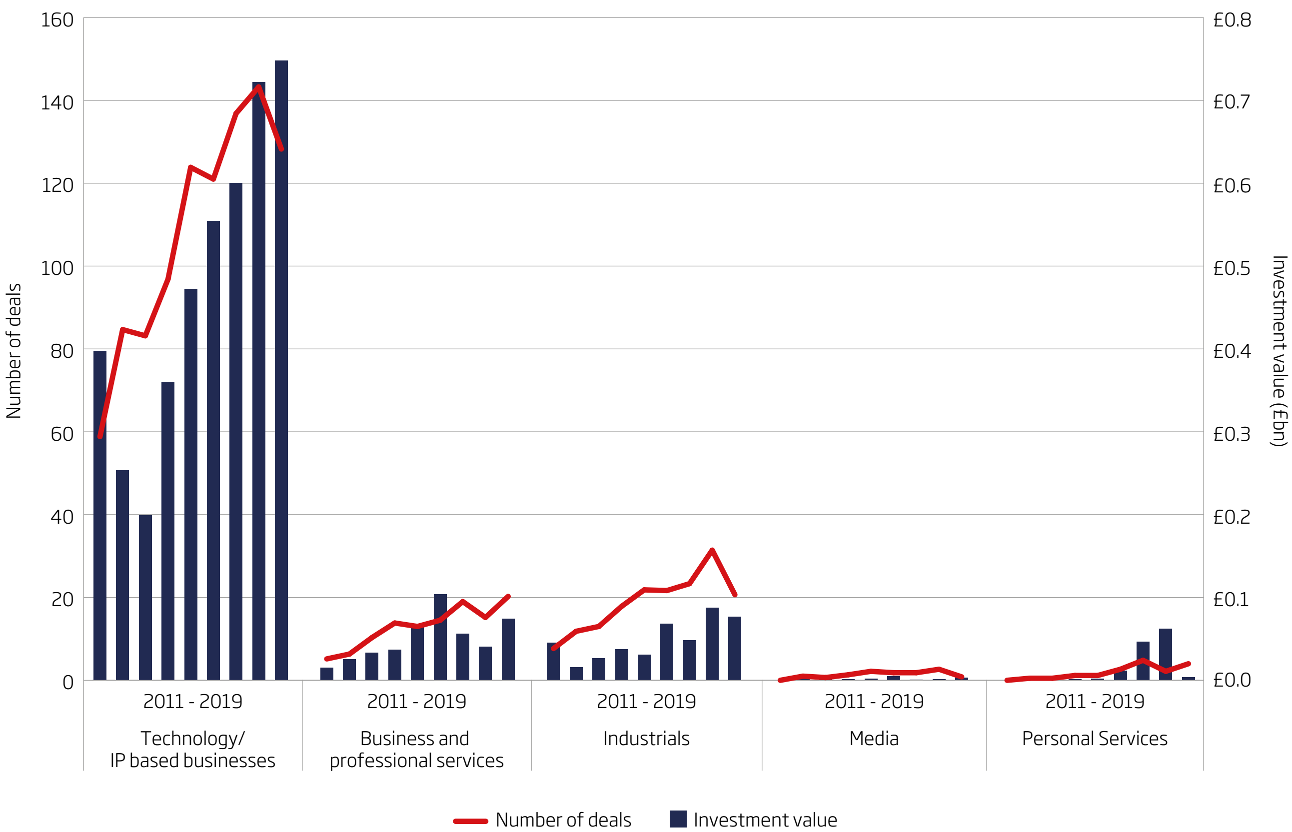
Equity investment and deals into university spinouts is concentrated into the spinouts of a few select universities. Five universities (Cambridge, Oxford, Bristol, Imperial College London and University College London) received 74% of equity investment and account for 44% of the equity deals in academic spinouts in 2019. Many universities have yet to produce spinout companies that have received equity finance from external investors.

Figure 1.31 shows the equity investment and deals segmented by sector per year. Technology/IP-based businesses have received the most deals and equity investment every year since 2011, which is not surprising considering both the wider equity ecosystems preference to invest in technology and the nature of academic spinouts as defined by Beauhurst. Business and professional services and industrials both received a significant amount of equity deals and investment every year.

FIG 1.31

NUMBER AND VALUE OF EQUITY DEALS IN UNIVERSITY SPINOUT COMPANIES, BY SECTOR

Source: British Business Bank analysis of Beauhurst



CHAPTER 2: BRITISH BUSINESS BANK ACTIVITY

2.1 INTRODUCTION

This chapter explores the characteristics of equity deals completed by funds supported by the British Business Bank's equity programmes, with comparisons made against the wider UK equity market.

As a government owned financial institution, the British Business Bank has the stated objective of increasing the supply of finance to smaller businesses in areas of the market that are not working as effectively as they could be. From 2018, the British Business Bank also has an objective to reduce regional imbalances in access to finance. The Bank's equity programmes are designed to address market failures in small business finance markets.

The Bank mainly does this by investing in VC funds as a Limited Partner (LP)[38] alongside private sector investors through the ECF, BPC and UKIIF programmes. More recently, the Bank has established the Managed Funds and Regional Angels Programme which also provide equity investment. The Bank has also established three region-specific programmes[39] which make both debt and equity investments to reduce geographic imbalances in the availability of finance in these areas:

- Northern Powerhouse Investment Fund (NPIF)
- Midlands Engine Investment Fund (MEIF)
- Cornwall and Isles of Scilly Investment Fund (CIoSIF)

British Business Bank analysis of PitchBook data shows the Bank to be the largest UK based LP investor in UK VC funds between 2017 to 2020 YTD[40], based on amount committed and also the number of funds committed to.

TABLE 9
DESCRIPTION OF BRITISH BUSINESS BANK EQUITY PROGRAMME ACTIVITY

British Business Bank activity	Description
BPC (British Patient Capital)	British Patient Capital is a £2.5bn programme designed to enable long-term investment in high growth potential companies across the UK. Investing alongside the private sector, British Patient Capital will support £7.5bn of investment for British businesses. BPC was seeded with the VC Catalyst programme, which was itself established in 2013 to invest in commercially viable venture capital funds that might otherwise fail to reach a satisfactory "first close". The programme was retargeted in 2016 to target the later stage VC funding gap and is now part of BPC.
Managed Funds Programme	The Managed Funds Programme is part of the Government's response to the Patient Capital Review and will help address the UK's patient capital funding gap. The programme will make additional cornerstone investments in a number of large-scale, private sector managed funds of funds that invest in venture and growth capital funds.
NPIF (Northern Powerhouse Investment Fund)	NPIF is a £400m debt and equity programme launched in February 2017 in collaboration between the British Business Bank and ten LEPs in the North West, Yorkshire and Humber and Tees Valley.
MEIF (Midlands Engine Investment Fund)	MEIF is a £250m debt and equity programme that is a collaboration between the British Business Bank and 10 LEPs in the East and South East Midlands and West Midlands
CIoSIF (Cornwall and Isle of Scilly Investment Fund)	The Bank has established the CIoSIF in partnership with the Cornwall & Isles of Scilly LEP. The £40m investment Fund will support access to debt and equity finance for SMEs in the area.
ECF (Enterprise Capital Fund)	The ECF programme was established in 2006 as a rolling programme of funds to increase the supply of equity finance to high growth potential businesses that would otherwise have faced difficulties raising finance due to a lack of supply within the "equity gap".
ACF (Angel CoFund)	The British Business Bank supported Angel CoFund was established in 2011 to increase the supply of business angel finance available to viable small businesses with growth potential, and to improve the quality of angel investment through setting high standards for due diligence and scrutiny of deals.
UKIIF (UK Innovation Investment Fund)	UKIIF was established as a fund of funds in 2009 to increase the supply of equity finance to viable growing technology businesses in strategically important sectors such as digital technologies, life sciences, clean technology and advanced manufacturing.
Regional Angels Programme	The £100m Regional Angels Programme was established to help reduce regional imbalances in access to early stage equity finance for smaller businesses across the UK.

Deals completed by British Business Bank supported funds are matched to deals in the Beauhurst dataset using their Company House ID Number (CHID), or by company name if the CHID is not available. Deals are then only classed as being backed by a British Business Bank equity programme if the name of the fund manager associated with the company is listed in the named investors for that specific deal. This cautious approach will likely underestimate the actual coverage of deals involving British Business Bank supported funds as not all deals have complete investor information, however this approach minimises the chance of misclassification.

Beauhurst also includes deals made by other Government funds including ERDF backed JEREMIE funds, as well as funds delivered by the devolved administrations including Finance Wales and Scottish Investment Bank and also local Government funds. British Business Bank funds delivered by private sector fund managers involving private sector sources of capital, such as the ECF and BPC programmes, are not included in Beauhurst's definition of Government funds. This chapter assesses deals made by British Business Bank supported funds overall, but it is important to recognise the wider contribution Government funds make to local equity markets. For instance, 60% of all announced equity deals in Wales and 56% of all announced equity deals in Scotland in 2019 involved a Government fund.

Between 2011 and 2019 there were 1,065 visible equity deals undertaken by funds supported by the Bank's equity programmes in the Beauhurst dataset (henceforth British Business Bank supported deals). This relates to £4.6bn of investment in 682 unique companies. Table 10 outlines the number of unique companies invested in by British Business Bank programmes, as well as the Beauhurst coverage of deals for each programme. The investments figures are likely to exclude follow on funding as these deals are less likely to be announced compared to new equity deals.

Beauhurst now captures 61% of companies that have received an equity deal from a fund supported by the Bank, with coverage varying by programme. Beauhurst coverage of British Business Bank fund deals appears to have increased compared to previous years as in last year's Equity Tracker report the coverage was 55%. This is due to high coverage of NPIF and MEIF deals which are announced via the programme or fund managers' websites, which offsets the slight decreases seen in BPC and ECF programmes. The British Business Bank encourages all fund managers, whether supported or not, to disclose their equity deals publicly to improve the quality of the data.

TABLE 10

BEAUHURST COVERAGE OF BRITISH BUSINESS BANK SUPPORTED FUND EQUITY DEALS BY PROGRAMME

British Business Bank Programme	Number of matched companies	Company population	Relative coverage
ACF/ Aspire	79	101	78%
BPC	154	292	53%
CIoS	3	4	75%
ECF	323	542	60%
MEIF	42	51	82%
NPIF	72	94	77%
UKIIF	73	134	54%
Overall	682	1119	61%

Source: British Business Bank analysis of MI data and Beauhurst

2.2 MARKET SHARE

Figure 2.1 shows the number of British Business Bank supported deals over time as identified in the Beauhurst dataset. The number of identified British Business Bank supported deals has increased from 37 in 2011 to 196 in 2019. This 2019 figure should be treated as preliminary, as Beauhurst will continue to identify deals and investors as more deals are announced over time. The ECF programme has made the most deals over the last three years, followed by BPC. Note that these figures only include deals identified in the Beauhurst dataset and therefore differ from those on the British Business Bank Management Information system, which has full coverage. In addition, Beauhurst is less likely to report follow on funding as these deals are less likely to be announced compared to new equity deals.

British Business Bank programmes are estimated to have supported 11% of UK equity deals between 2017 and 2019, with these deals forming 14% of the overall invested equity amount in that period. Although the numbers are not directly comparable, last year's Equity Tracker report found the Bank had supported 9% of UK equity deals between 2016 and 2018, with these deals forming 13% of the overall invested equity amount. The Bank's higher share of the market is due to increased number of deals made by BPC supported funds, with the number of deals identified by Beauhurst increasing from 48 deals in 2018 to 82 deals in 2019.

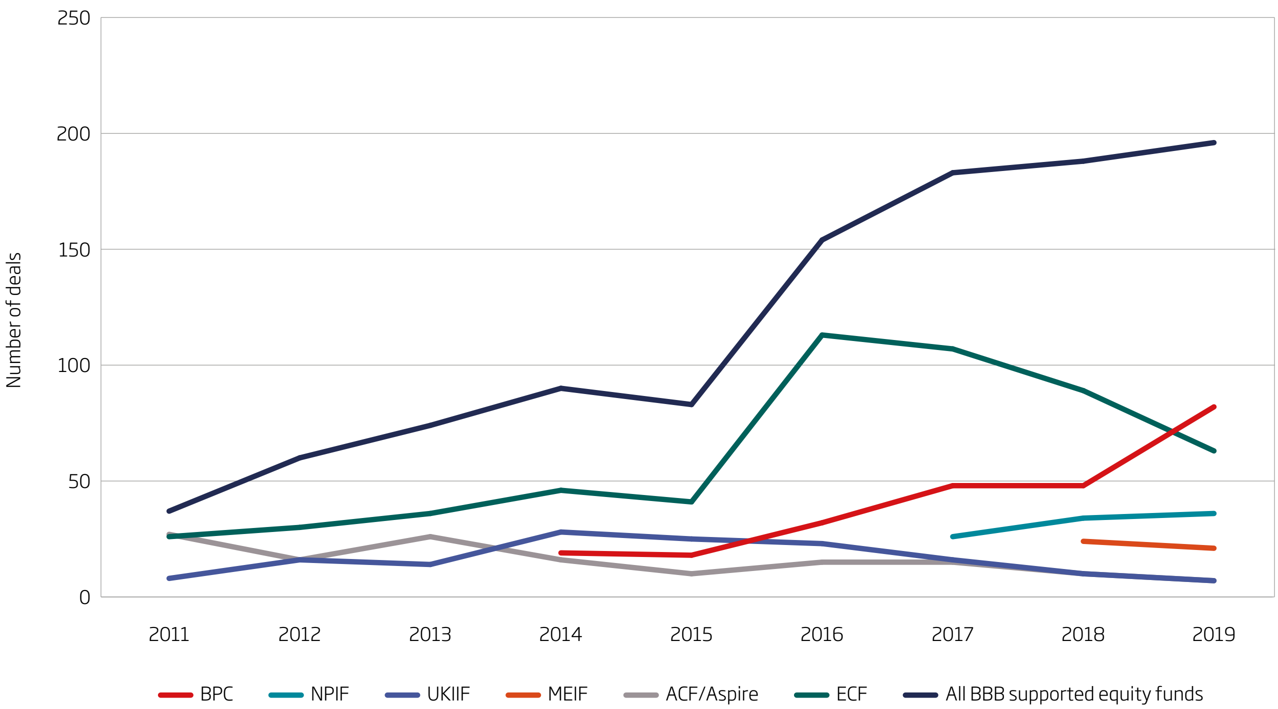
BPC's share of identified BBB deals rose from 26% in 2018 to 42% in 2019.There are slight differences by stage, with British Business Bank supported funds involved in:

- 10% of seed stage deals (9% by value)
- 9% of venture stage deals (13% by value)
- 11% of growth stage deals (15% by value)

FIG 2.1

NUMBER OF ANNOUNCED EQUITY DEALS INVOLVING BRITISH BUSINESS BANK SUPPORTED FUNDS

Source: British Business Bank analysis of MI data and Beauhurst



2.3 BUSINESS STAGE

Figure 2.2 shows that the stage distribution of deals completed by British Business Bank supported funds between 2017 and 2019 was broadly similar to the wider equity market. Although British Business Bank programmes mostly operate through VC funds, some of these funds are classified as non-PE/VC investor types. For example, the ECF programme has invested in Entrepreneur First, which is categorised as an accelerator by Beauhurst. In light of these developments, and the large number of deals funded through this non-PE/ VC investor category, it now makes sense to compare deals supported by the Bank's equity programmes with the overall equity market.[41]

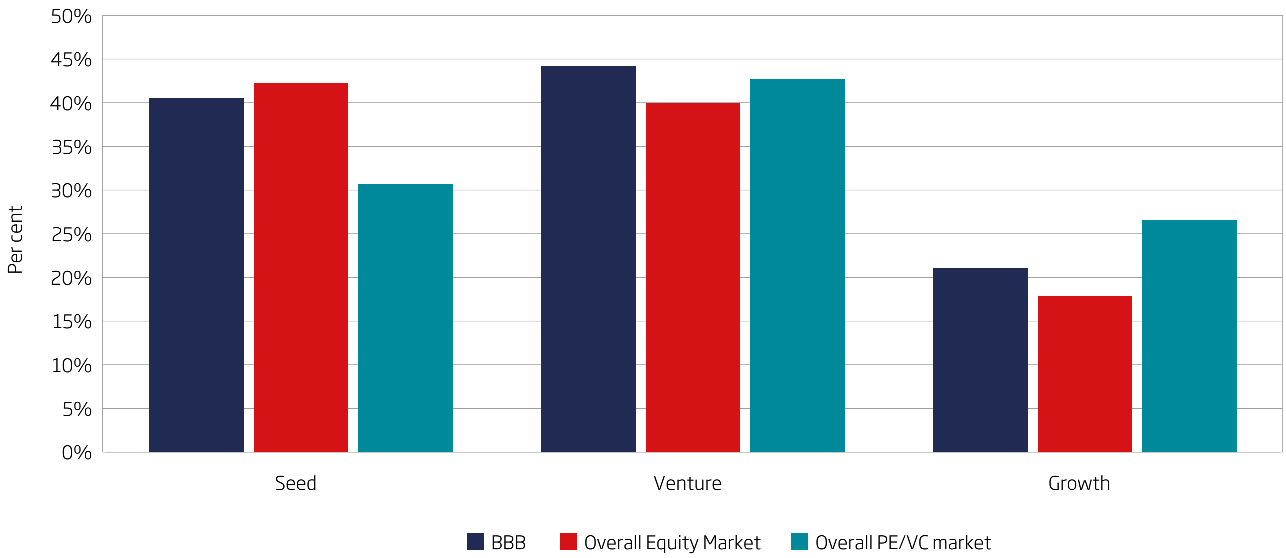
The venture stage received the highest proportion of deals completed by British Business Bank supported funds with 44% of deals going to venture stage companies, slightly more than the overall equity market where 40% of deals went to venture stage companies. British Business Bank supported funds completed slightly fewer deals than the overall equity market at the seed stage (40% of deals compared to 42%), and slightly more at the growth stage (21% of deals compared to 18%). These results are likely due to funds supported by BPC, which focus on later stage companies.

In terms of investment value, most British Business Bank supported fund investment between 2017 and 2019 (60%) was in growth stage companies, slightly higher than the overall equity market (58%) and the same as PE/VC investors (60%). The Bank has slightly less investment in seed (8% of investment compared to 10%) and a slightly higher amount invested in venture (32%) stage companies than the wider equity market (31%) and PE/VC (31%). The large amount of investment by British Business Bank supported funds at the growth stage is driven primarily by BPC, with 75% of British Business Bank growth stage investment between 2017 and 2019 coming from funds supported by the BPC programme.

FIG 2.2

PROPORTION OF DEALS BY STAGE (2017-2019)

Source: British Business Bank analysis of MI data and Beauhurst



As demonstrated by Figure 2.3, the stage composition of British Business Bank supported deals is volatile and has changed over time. Between 2011 and 2014 there was a shift away from deals at the seed stage to venture/growth stage deals, with seed stage deals falling from 32% of all British Business Bank deals in 2011 to 22% in 2014. Conversely, the proportion of British Business Bank supported deals at the venture stage increased from 43% in 2011 to 56% in 2014.

Between 2014 and 2016 there was a large shift back towards seed stage investment, with the proportion of British Business Bank fund deals in seed stage companies increasing from 22% in 2014 to 52% in 2016. This transition was largely due to the ECF programme investing in Entrepreneur First in 2016, an accelerator fund backing a relatively high number of early stage businesses. The number of British Business Bank fund investments at the seed stage increased from 19 in 2015 to 80 in 2016, with Entrepreneur First involved in 62 of the 2016 deals.

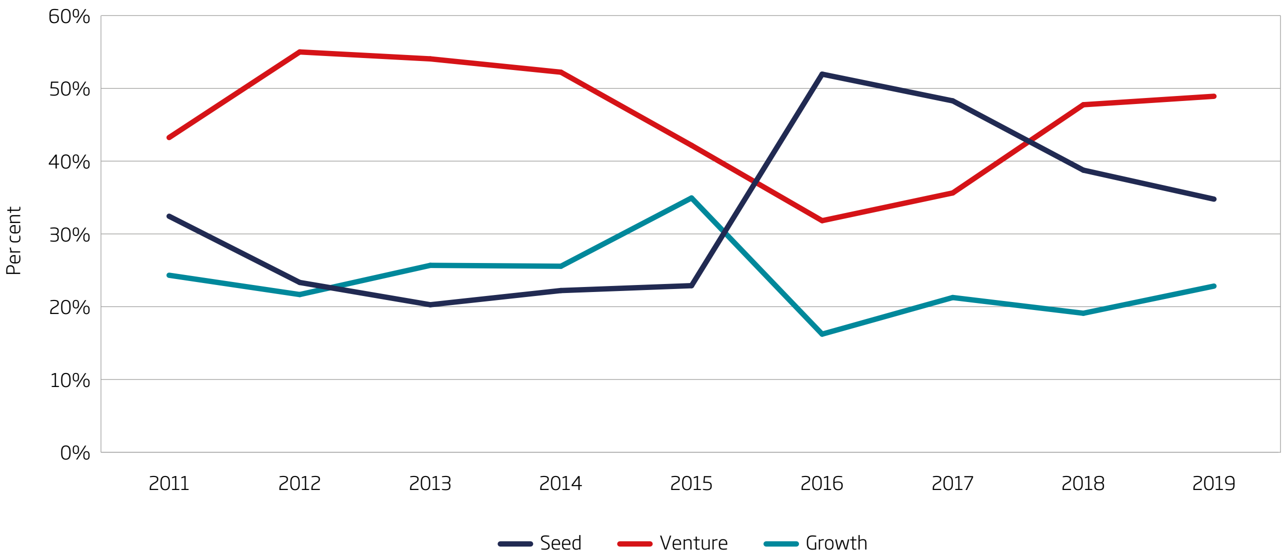
Since 2016 there has been a reduction in the percentage of deals at the seed stage, to 35% in 2019. This is due to a combination of Entrepreneur First reaching the end of its investment period, causing the number of seed stage deals completed by British Business Bank supported funds to fall, but also the number of growth and especially venture stage deal numbers increasing. This shift in investment focus is a result of the Bank focusing on supporting the UK patient capital ecosystem following the 2017 Patient Capital Review and the investments of BPC.[42] Nevertheless, the Bank's Enterprise Capital Fund programme continues to address market failures affecting smaller deal sizes at the earlier funding stages.

Although Figure 2.3 shows there was an increase in the proportion of investment by the British Business Bank's backed funds going to growth stage companies from 19% in 2018 to 23% in 2019, there was a 21% decline in amount invested. Investment in growth stage companies fell from £801m to £630m. 2018 can be considered an outlier year as several of the bank's backed funds were involved in 'mega-deal' funding rounds involving unicorn status businesses. 2019 saw an increase in the number of growth stage deals, from 34 to 42 showing that capital is being deployed to a greater number of growth stage companies. This shows the success of the Bank's programmes, especially BPC, in supporting the UK ecosystem. BPC were involved in 20 of the 42 British Business Bank supported deals in the growth stage in 2019.

FIG 2.3

PROPORTION OF BRITISH BUSINESS BANK FUND DEALS BY STAGE, OVER TIME

Source: British Business Bank analysis of MI data and Beauhurst



The average size of deals, shown in Table 11, completed by British Business Bank supported funds varies widely by stage:

- **Seed:** The average size of British Business Bank supported fund seed stage deals between 2017 and 2019 was £1.2m, compared to £1.1m and £2.0m for the overall equity and PE/VC market, respectively.
- **Venture:** The average size of British Business Bank supported fund venture stage deals between 2016 and 2018 was £4.2m, compared to £3.4m and £4.9m for overall equity and PE/VC market respectively. The size of venture stage deals completed is therefore largely in line with the wider PE/VC market, which is as to be expected since most of the Bank's supported deals at this stage are completed by VC funds.
- **Growth:** The average size of British Business Bank supported fund growth stage deals between 2016 and 2018 was £17.5m, compared to £15.4m and £17.2m for overall equity and PE/VC markets, respectively. The average size of growth stage deals completed by funds supported by the Bank's programmes is therefore larger than the wider PE/VC market. The average size of the Bank's deals has increased sharply from £8.7m in 2016 to £15.7m in 2019. The success of the BPC programme in supporting UK scale-ups in 2018 is a major driver of this increase in deal sizes, so that companies are now better capitalised.

TABLE 11
AVERAGE DEAL SIZE (2017-19)

Deal stage	British Business Bank	Overall market	PE/VC market
Seed	£1.2m	£1.1m	£2m
Venture	£4.2m	£3.4m	£4.9m
Growth	£17.5m	£15.4m	£17.2m

Source: British Business Bank analysis of MI data and Beauhurst

2.4 SECTOR

Figure 2.4 shows that funds supported by the British Business Bank were more likely to invest in technology/IP-based businesses than the overall equity market between 2017 and 2019, with 50% of British Business Bank supported deals in this sector compared to 39% of the wider market. The same holds for investment value, with 52% of investment by the Bank's supported funds going to technology/IP-based companies, compared to 43% of overall equity market investment. The second highest sector in terms of proportion of deals was the business and professional services (forming 30% of all British Business Bank supported deals), followed by industrials (10%). These rankings follow the wider market, although industrials make up a higher proportion of overall equity market deals (15%).

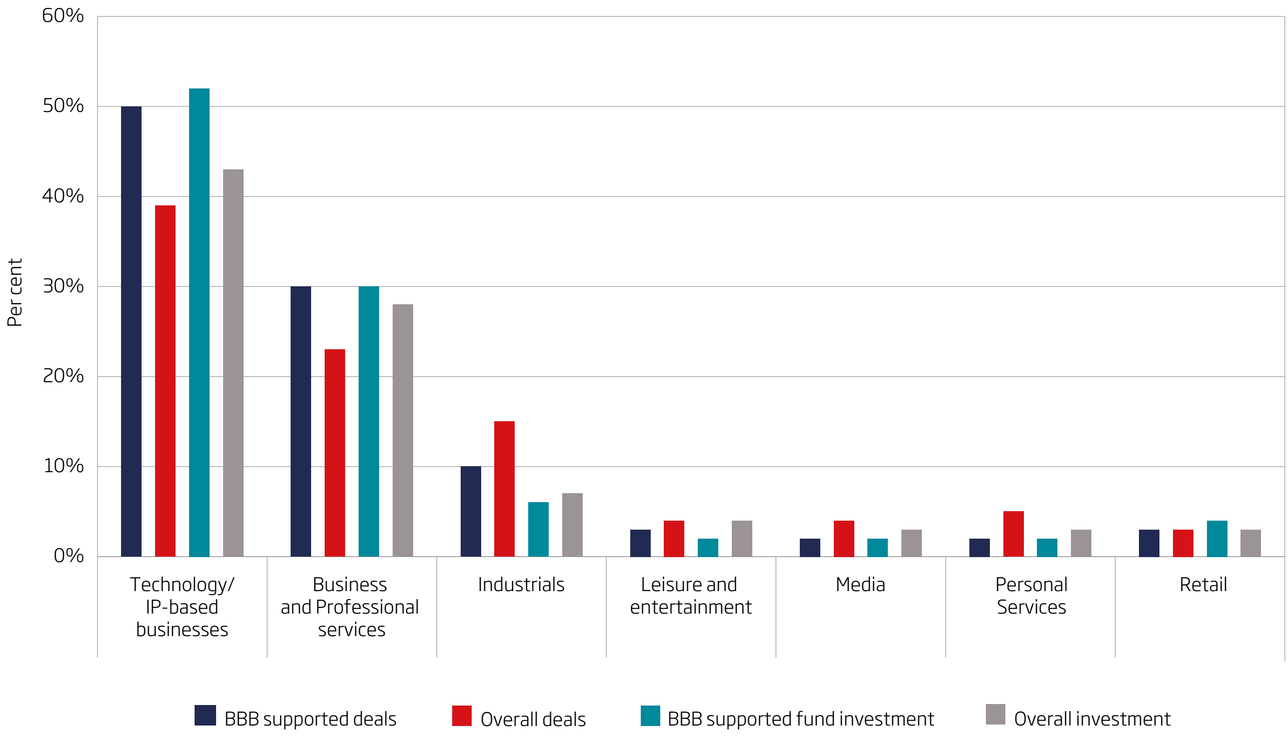
The proportion of British Business Bank deals and investment in technology/IP-based businesses is higher than for PE/VC investors where 42% of deals (47% by value) went to the sector between 2017 and 2019.

Of the 270 deals completed by British Business Bank supported funds in technology/IP-based businesses between 2017 and 2019, 64% were in software and 10% were in life sciences which is largely in line with the overall equity market. In terms of value, 69% of the investment by the Bank's supported funds in the technology sector was in software, compared to 53% for the wider market, with investment in life sciences forming 11% of British Business Bank investment compared to 20% of wider market investment in technology. Going forward, the British Business Bank is likely be more aligned with the wider equity market in terms of life sciences investment, with BPC having already made investments in life sciences funds such as the Dementia Discovery Fund.

FIG 2.4

PROPORTION OF DEALS AND INVESTMENT VALUE BY SECTOR (2017-19)

Source: British Business Bank analysis of MI data and Beauhurst



2.5 ENGLISH REGIONS AND DEVOLVED ADMINISTRATIONS

Figure 2.5 shows that the concentration of deals undertaken in London by British Business Bank supported funds has reduced sharply over the last couple of years, from 73% in 2016 to 47% in 2018, before slightly increasing to 48% in 2019. The proportion of deals completed by British Business Bank supported funds in companies based in London is now in line with the wider equity market, although it is lower than for PE/VC funds where the proportion was 53%.

There are two key drivers of this reduction:

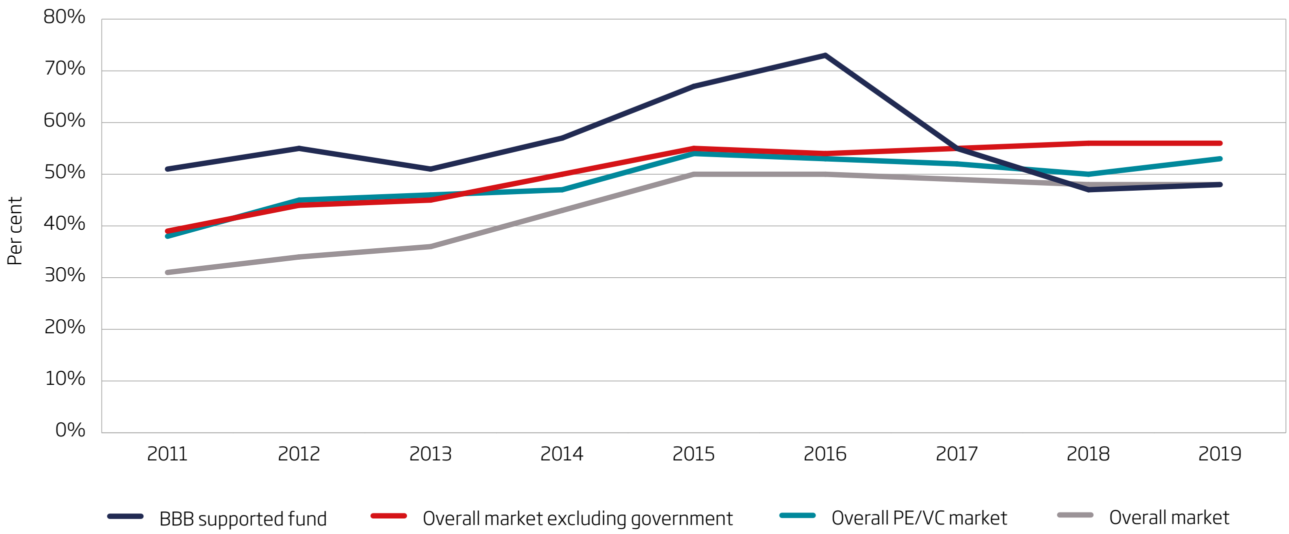
- Geographically focused programmes have started investing. NPIF began investing in 2017, with MEIF following in 2018. Beauhurst picked up 57 deals completed by these two regionally focussed funds in 2019, with MEIF and NPIF contributing to 19% and 16% of equity deals in the Midlands and North respectively. The share of MEIF supported deals in the Midlands has fallen from 23% in 2018. This is due to a 5% increase in the total number of deals in the Midlands as MEIF activity was broadly similar but may also reflect a time lag in MEIF deals being announced.
- Entrepreneur First, an investor within the ECF programme, has come to the end of its initial investment period. Beauhurst recorded ten Entrepreneur First investments in 2018 down from 61 in 2016. Entrepreneur First was a key driver of the concentration of British Business Bank supported deals in London previously due to its high number of deals and geographical focus. For instance, Entrepreneur First formed 43% of British Business Bank supported deals in 2016, with 89% of these deals occurring in London.

When considering the value of investment, the British Business Bank is in line with the wider equity market, with 66% of investment by the Bank's supported funds between 2017 and 2019 going to companies located in the capital. This is the same as the proportion of overall equity investment going to London-based companies.

FIG 2.5

FIGURE 2.5 PROPORTION OF DEALS IN LONDON OVER TIME

Source: British Business Bank analysis of MI data and Beauhurst



CHAPTER 3: LESSONS FROM THE 2008 FINANCIAL CRISIS

3.1 INTRODUCTION

The emergence of Covid-19 in China in late 2019 and its spread to the rest of the World in early 2020 has led to countries taking unprecedented steps to contain the disease and prevent a crisis overrunning the health system. The UK economy has been significantly impacted from the lock down measures introduced with the OBR suggesting that UK real GDP could fall 35% in Q2 2020 in a reference scenario.[43] As with all sectors of the economy, UK SME equity finance will also be negatively affected.

This chapter provides an overview of how UK and US VC markets were affected by the 2008 financial crisis to offer insights into how equity finance might react to the current crisis. There are obviously different causes to the crisis this time round. The 2008 financial crisis unfolded much more slowly with the first indications appearing in early 2007, the UK economy falling into recession in Q2 2008, but the most serious market turmoil happening in October 2008.

In contrast, the current crisis has intensified in a matter of months, with the UK entering a lock down period from 23rd March 2020 leading to a near shutdown of non-essential economic activity. The scope of the lock down restrictions and social distancing requirements has prevented face to face investor meetings, increasing the difficulty of undertaking face to face due diligence which negatively impacts new equity deals. These restrictions are also likely to impact on certain sectors more heavily than others. These impacts are explored in section 3.2.

It is important to acknowledge that the UK VC market has also changed since 2008, having become more diverse and mature. For instance, the emergence of other types of funding sources such as crowdfunding platforms, and the greater number of later stage companies than ever before. The 2008 financial crisis affected the availability of finance from banks to companies, as banks rebuilt their balance sheets, whilst Covid-19 has had a large negative shock to both the supply side and demand side in the wider economy. As a result of this, the impacts of Covid-19 are likely to be more widespread and having specific impacts on VC backed companies than those of the financial crisis.

There are multiple mechanisms by which an economic downturn affects equity finance activity leading to lower:

- Deal numbers and investment values
- Company valuations
- VC fundraising.

These are explored in more detail in the rest of the chapter.

3.2 IMPACT OF COVID-19 ON UK COMPANIES

To assess the current impact of Covid-19 on companies, Beauhurst have assigned a Covid-19 impact status to each company in their dataset.[44] The impact statuses include potentially positive, low, moderate, severe, critical and also permanent closure. Beauhurst produced these by looking at the reported effect that Covid-19 has on the business such as closing physical premises, offering online services only or causing a surge in demand. This relates to reported impacts on demand and delivering companies' product and service markets but does not take into account any impact on fundraising. Our analysis is focused only on SMEs that have raised at least one round of equity finance and are companies reporting they are at least moderately or severely negatively impacted by Covid-19. This may explain any difference between this analysis and analysis by Beauhurst.

Overall, 43% of equity backed companies were moderately impacted and 14% severely impacted. Figure 3.1 shows the impact on companies in each region. It appears that Covid-19 is having a more severe impact in some regions than others, with London the least affected and the East Midlands the most affected. However, looking at Figure 3.2 shows that the variation in impact on specific sectors is more noticeable. In sectors such as leisure/entertainment, tradespeople and transport operators at least 80% of companies have been at least moderately impacted whilst in telecomms only 25% of companies have been at least moderately impacted.

The difference between the regions is likely to be somewhat explained by the proportion of low and high-risk sectors within that region. London for example has a much higher proportion of less affected sectors than the East Midlands. There is also a sectoral difference in companies that have had a 'potentially positive' impact from Covid-19 such as in telecomms where the figure is 33%. This suggests that some companies might emerge more strongly from the crisis.

FIG 3.1

COVID-19 BUSINESS IMPACT STATUS, BY REGION

Source: British Business Bank analysis of Beauhurst

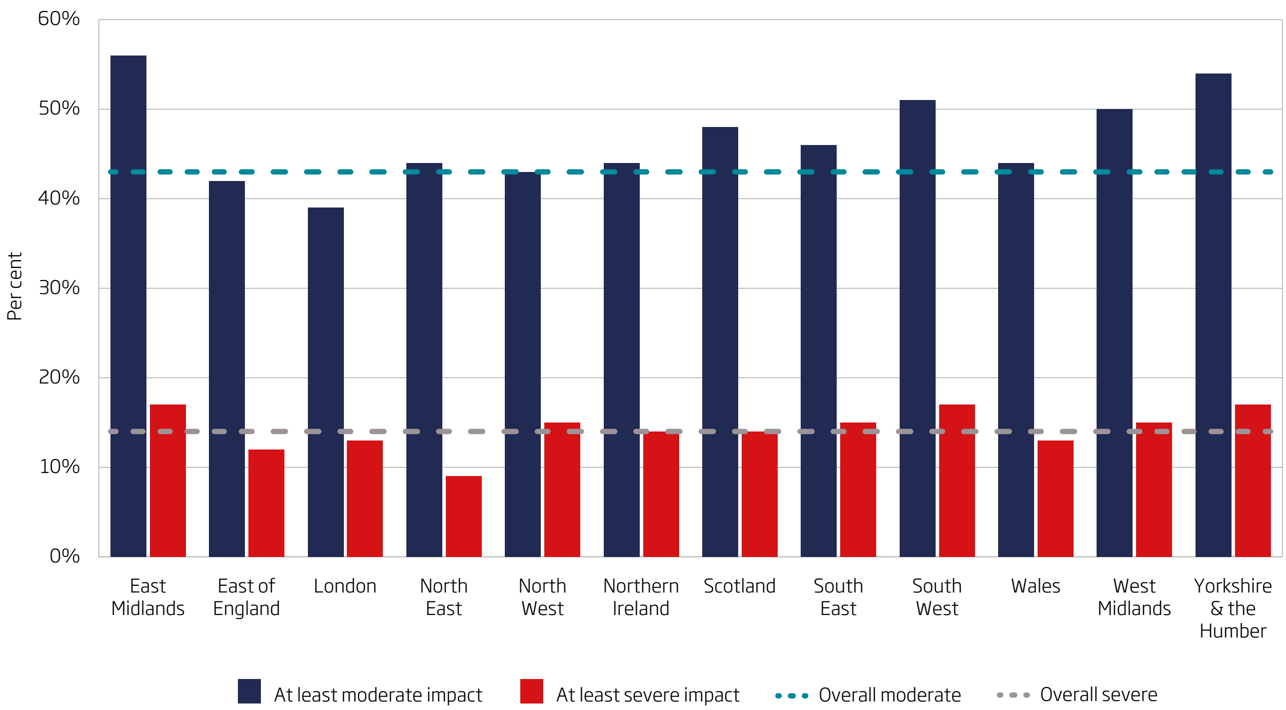
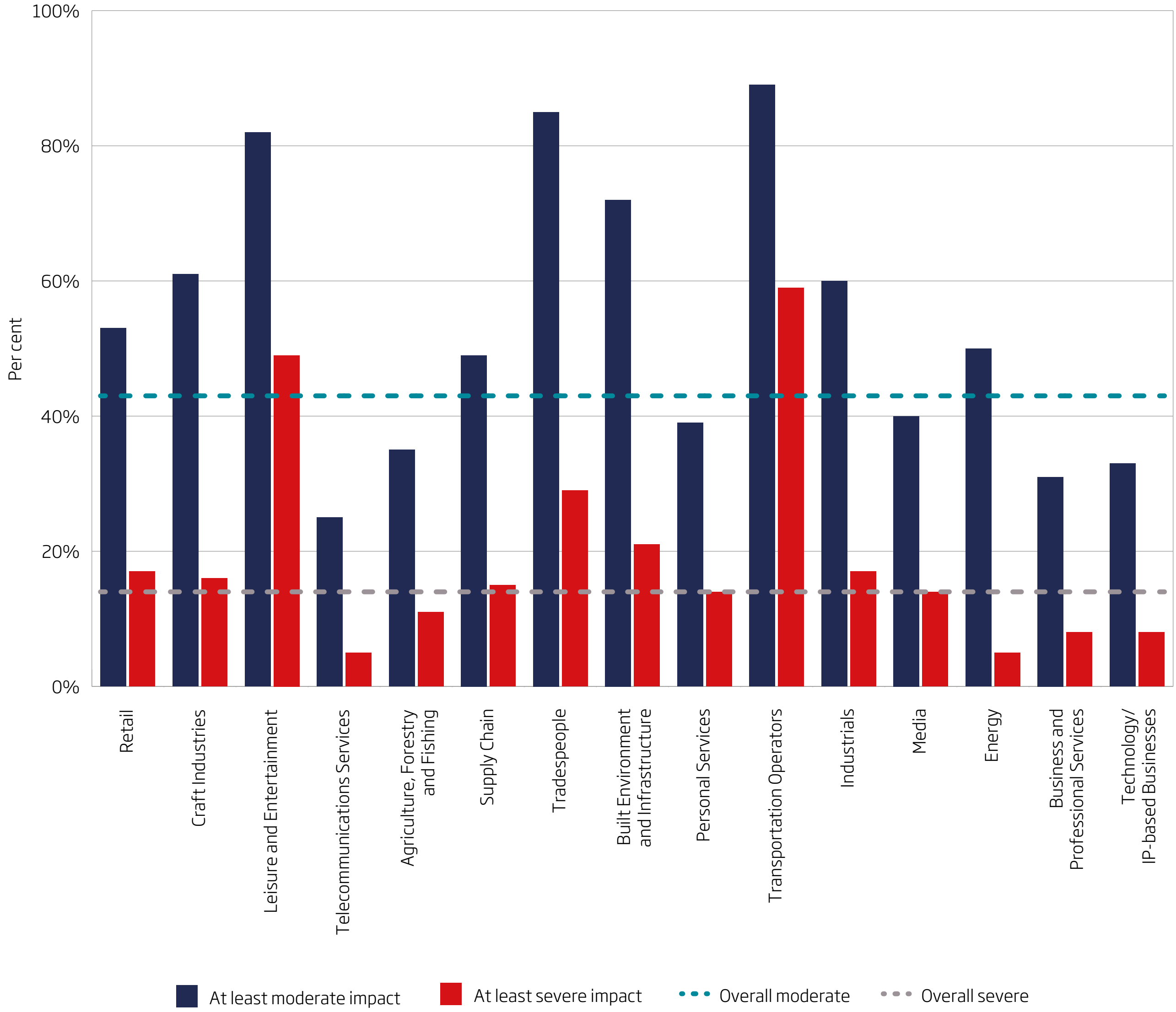


FIG 3.2

COVID-19 BUSINESS IMPACT STATUS, BY SECTOR

Source: British Business Bank analysis of Beauhurst



3.3 INVESTMENT AND DEAL NUMBERS

The number of equity deals and the investment value is likely to decline during an economic downturn as fund managers become more risk averse. Fund managers are likely to focus on keeping their existing portfolio companies alive, at the expense of making new investments. PitchBook[45] has found that fundraisings for companies receiving their first equity round fell more sharply than companies receiving follow on funding in Europe in the wake of the 2008 Financial Crisis. A mechanism unique to the current crisis are the social distancing measures imposed. These are likely to affect deal making as fund managers will be wary to deploy capital to founders and companies who they have not physically met. Many of the deals that are currently being closed were already in the pipeline, with some due diligence already undertaken. Whilst some business angel clubs are now reporting higher than usual attendance at pitch events with online delivery, a lack of social contact can make it harder to pull angel deals together involving multiple investors.[46]

This supports the hypothesis that VC fund managers will preserve their existing capital and will mainly focus their investment on existing portfolio companies, instead of making new investments. This is also the case in the angel market where "many angels are spending time (and money) supporting their existing portfolio".[47]

Given current economic uncertainties, companies are likely to appear less viable to investors due to reduced customer demand, difficulty in offering definite plans and forecast revenue streams. This uncertainty around the future is likely to be compounded by companies missing existing performance milestones due to the current conditions. As a result of these factors, fund managers are likely to become more selective in their investment focus and will concentrate on making deals in lower risk investments in later stage companies who can demonstrate existing revenue streams and viability post Covid-19. Seed stage deals are the most likely to be affected as they are the highest risk; despite being generally less directly affected by changes in product market conditions.

To quantify the impact of the previous financial crisis on the VC market, it is necessary to identify a date that determines the start of the crisis.[48] However, there is no clear date defining the exact moment when the crisis struck.[49] The 'credit crunch' emerged in 2007 with public market volatility and concern over Banks' exposure to US subprime mortgages. In August 2007, Northern Rock which relied on money markets for its funding, began to dry up, which subsequently led to a bank run one month later as people queued to withdraw their money. Northern Rock was then nationalised in February 2008. UK GDP started to decline in Q2 2008 onwards for five consecutive quarters. The crisis then intensified in September 2008 through Lehman Brothers filing for bankruptcy protection, Lloyds taking over HBOS and the Government taking over control of Bradford and Bingley's mortgage and loan portfolio. On the 13th October 2008 the government announced a £37bn rescue package for Royal Bank of Scotland (RBS), Lloyds TSB and HBOS. UK venture capital activity was already in decline when the crisis became visible.

The market assessment is therefore made from the top of the VC market to the bottom of the VC market, to provide an indication of possible market impact. This is likely to provide a worst-case assessment of market impact. Half year figures are used to minimise volatility in the data that occurs when using quarterly data. The number and value of UK equity deals peaked in H1 2008, which coincided with the economy moving into recession, but preceded the visible crisis that occurred in the autumn of that year.

PitchBook data[50] shows the financial crisis reveals a large decline in both the number and value of venture capital deals from their H1 2008 peak to their lowest level in H2 2008. Between H1 2008 and H2 2008, there was a 38% decline in deal numbers and between H1 2008 and H1 2009, the value of equity investment declined by 44%. The decline in investment value is greater due to the impact of smaller round sizes. These impacts are shown by Figures 3.3 and 3.4.

The 2008 financial crisis had a larger initial impact on the UK VC market than the US. The US saw deal numbers decline by 18% and equity investment decline by 19% between H1 2008 and H1 2009.

On a yearly basis, the decline from 2008 to 2009 was much lower. The number of UK equity deals fell 2% from 2008 to 2009, whilst equity investment declined 33%. This reflected strong activity in H1 2008 that was cancelled out by the weak activity in H2 2008. In the US, deals declined by 8% year on year whilst equity investment declined by 9%. The year on year decline was much smaller than the half yearly decline from peak to trough reflecting venture capitalists reacting very quickly to economic downturn, but also recovering quickly.

These effects on the US and UK VC markets were persistent. It took 2 years for the UK VC deal numbers to recover to their half yearly pre-recession levels and 2.5 years for investment. It took US half yearly VC deal numbers 3 years to recover whilst investment values took 2 years.

FIG 3.3

INDEXED NUMBER OF VC DEALS (2008 H1 = 100)

Source: British Business Bank analysis of PitchBook

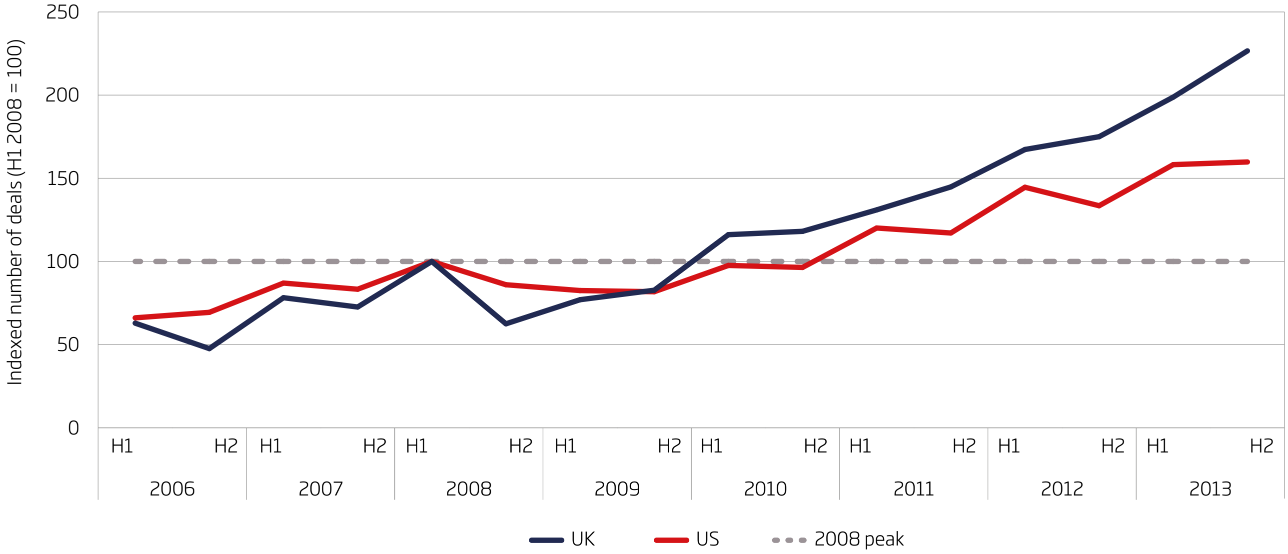
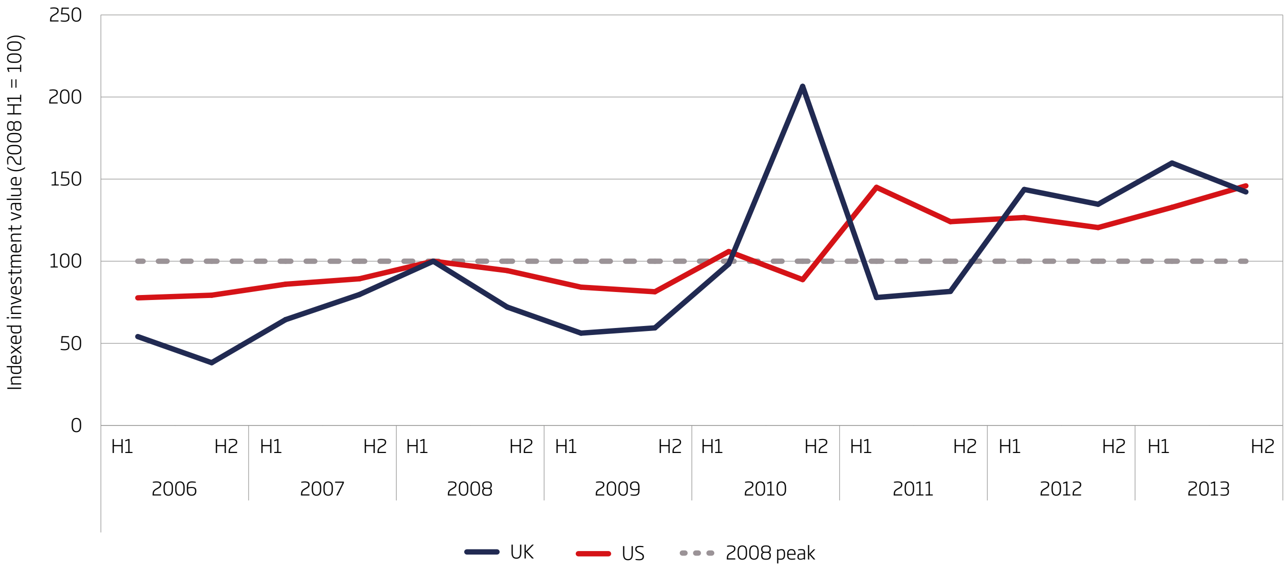


FIG 3.4

INDEXED VC INVESTMENT (2008 H1 = 100)

Source: British Business Bank analysis of PitchBook



3.4 BUSINESS STAGES

Figures 3.5 and 3.6 show the effect the crisis had on the number of deals and investment value by stage. In both the UK and US, seed stage deals were the worst affected in the immediate aftermath of the crisis. Between H1 2018 and H2 2008, seed stage deals declined by 68% while investment value declined by 78% between H1 and H2 2008. The impact was less severe in the US but seed stage deals still saw the biggest relative impact with deal numbers declining by 36% and investment value declining by 28% between H1 and H2 2008. However, seed stage investment in the US did recover very quickly, so by 2009, annual seed investment was 38% higher than 2008 levels. On an annual basis, this suggests seed investment in the US appeared to be less affected than other stages. Crunchbase suggests the widespread use of cloud computing, which enabled businesses to be created and scaled at lower cost than previously and the launch of the iPhone in 2007, created new opportunities in the market.[51] These factors helped offset the effect of the financial crisis and its impact on seed funding.

As discussed earlier, seed stage investments have the highest level of risk and so fund managers are less likely to undertake these deals. It is important to acknowledge that pre revenue seed stage companies are less directly affected by changes in product market conditions impacting on sales, so this perceived retreat to safety can be counter intuitive.

Some commentators suggest companies started during a recession can be highly profitable for their investors, due to greater quality, lower competition and cheaper factor inputs like staff and premises.[52] A number of the globally recognised companies that achieved unicorn status including Uber, Groupon, Airbnb and WhatsApp all started and received their first round of venture capital in the middle of the previous financial crisis, returning at least 10x for their early investors.[53]

Although these are equity supply side factors, it is also possible that there will be an impact on the demand side, leading to lower deals than pre-crisis. Some entrepreneurs may choose not to start their company or postpone development and growth plans until economic conditions stabilise, and because they do not expect to be able obtain adequate financing.[54] Later stage companies already progressing through the equity pipeline, experiencing monthly cash burn, do not have the option of delaying their fund raising.

The shift to later stage investments can also be seen in the US where the number of deals in later stage VC declined by 13% and amount invested declined by 15%, an impact less severe than the seed stage.

FIG 3.5

INDEXED NUMBER OF UK VC DEALS BY VC STAGE (2008 H1 = 100)

Source: British Business Bank analysis of PitchBook

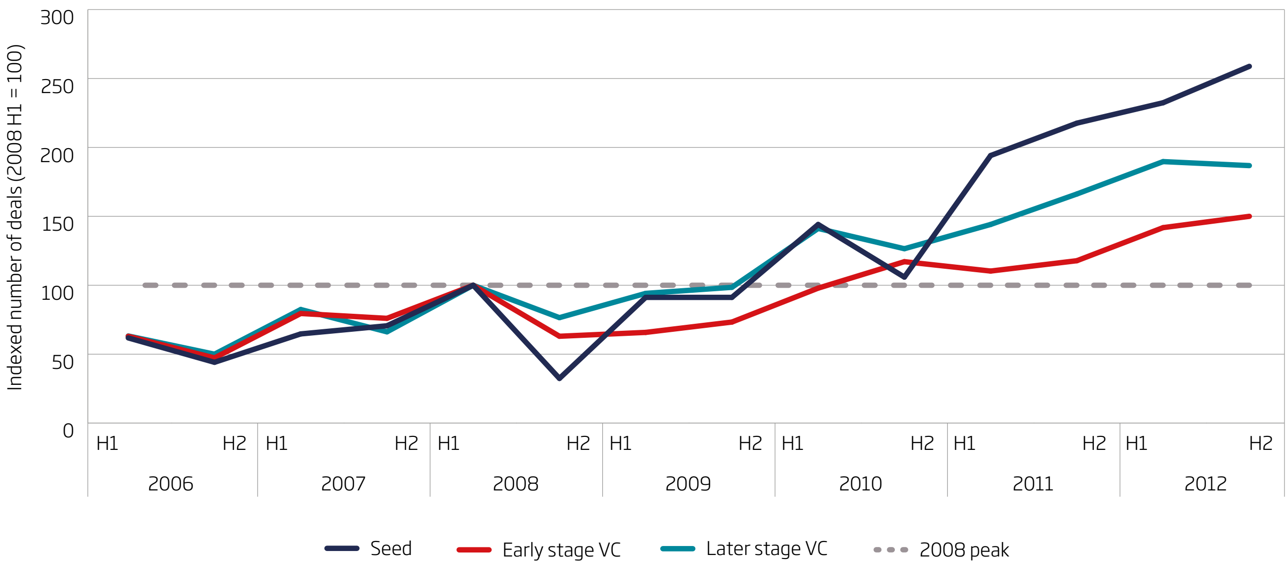
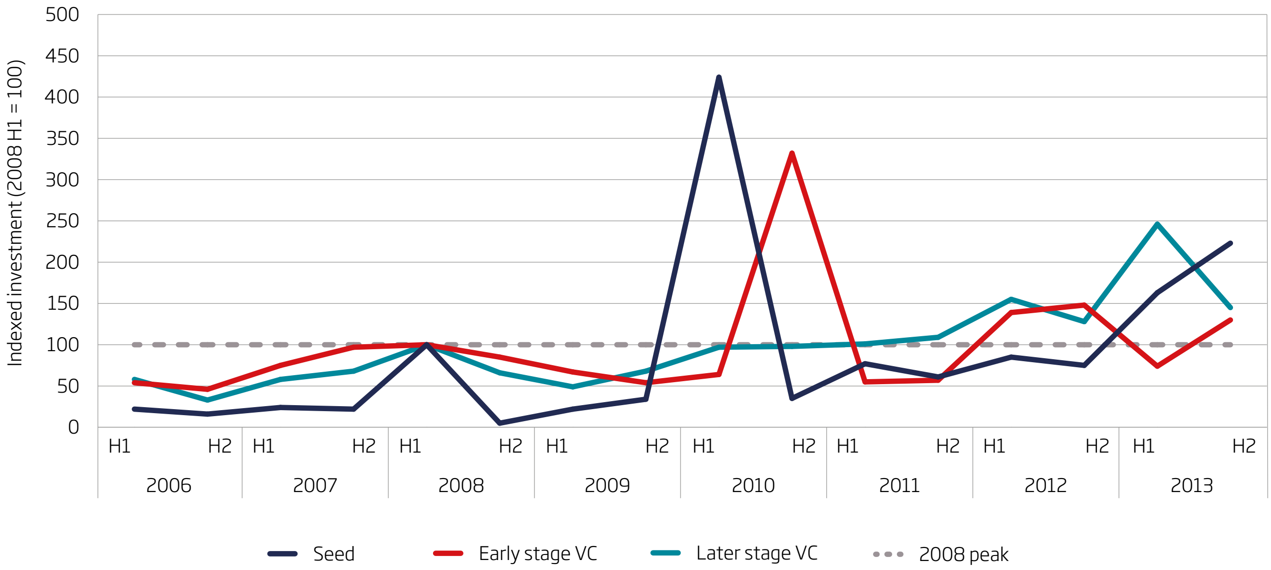


FIG 3.6

INDEXED UK VC INVESTMENT BY VC STAGE (H1 2008 = 100)

Source: British Business Bank analysis of PitchBook



3.5 VALUATIONS

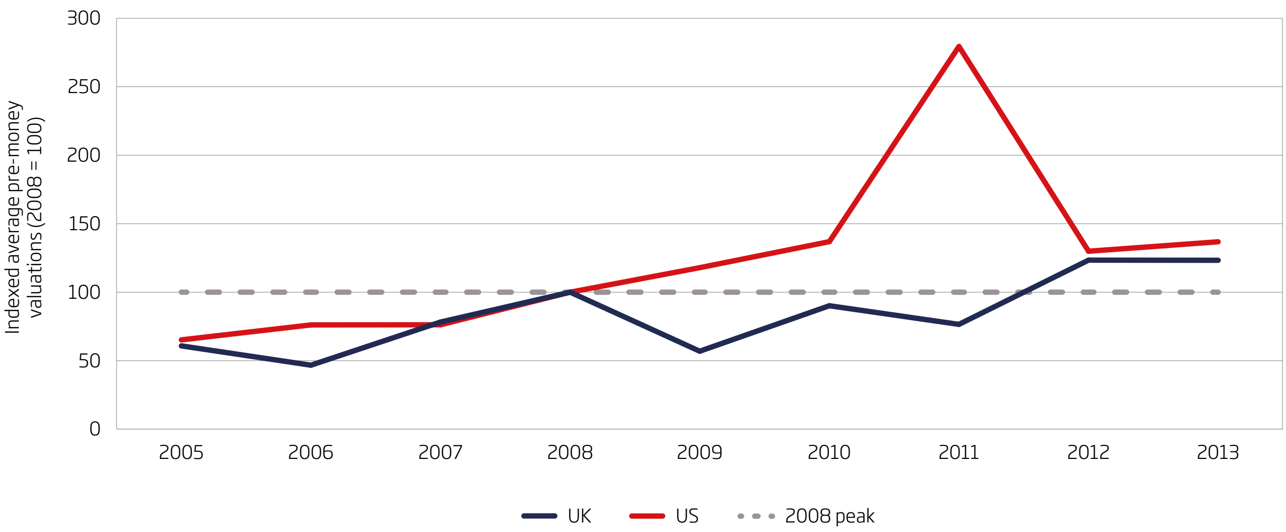
Company valuations are likely to be adversely affected, due to companies having lower forecast revenue streams due to lower customer demand. This coincides with a reduction in opportunities to exit due to public markets weakening for IPOs and a lack of trade buyers able or willing to take the risk in times of economic uncertainty. This could also lead to downward pressure on valuations and, because of these factors, an increase in the number of 'down' rounds is likely.

Figure 3.7 shows that the recession's impact on average pre-money valuations differed between the UK and US markets. UK VC-backed company valuations fell by 43% and took 4 years to recover to pre financial crisis levels. This is in stark contrast with the US where valuations increased year-on year through the 2008 financial crisis, largely immune from what was happening elsewhere in the US economy.

FIG 3.7

INDEXED UK AND US AVERAGE PRE-MONEY VALUATIONS (2008 = 100)

Source: British Business Bank analysis of PitchBook



3.6 FUNDRAISING

Fundraising will also be highly affected, although this impact may take longer to affect the market compared to the faster impact on equity deal numbers and investment values. The crisis will lead to institutional investors having a reduced appetite to take risk, and to be reluctant to invest in 'assets perceived to be riskier' such as VC.[55] An economic crisis directly reduces exit outcomes for portfolio companies but also reduces company valuations which reduce fund performance measures, e.g. TVPI (Total Value to Paid in Capital) multiples.

There is also the 'denominator effect'. Institutional investor Limited Partners (LPs) like pension funds and insurance companies have a set percentage of their overall investment portfolio allocated to VC. As such, reductions in public market share prices may lead to institutional investors having to rebalance their portfolios away from VC by stopping investment in new funds or secondary sales of existing fund assets in order to maintain their specified investment mandate. In the most severe cases, LPs may look to renege on previously agreed commitments. An important caveat is that VC firms are sitting on record amounts of dry powder in 2020, likely somewhat mitigating the impact of any decrease in fundraising. Preqin data shows UK VCs currently have £9.5bn of dry powder, which equates to about 13 to 17 months of investment based on 2018 and 2019 average investment amounts.[56] This may serve to reduce any impact on equity activity caused by a drop in new fundraising from LPs, although PitchBook evidence suggests existing fund deployment falls in recessions as funds concentrate on their existing portfolio companies.[57]

The decline in VC fundraising, shown in Figures 3.8 and 3.9, was the most persistent impact on both the US and the UK VC markets lasting many years after the start of the crisis. The number of VC funds closing in the UK fell 41% from their 2008 peak and the US experienced a similar decline falling by 36%. Even larger declines were seen in fundraising values with a 68% decline in the UK and a 46% decline in the US. UK data is more volatile due to a smaller number of funds, but in the US, the number of funds closed took four years to recover and the total fundraising took six years to recover.

Whilst the denominator effect was apparent in the previous 2008 crisis, PitchBook notes[58] 'LPs as a group are better positioned to combat the denominator effect today because many entered 2020 under allocated or at their targets to private markets. Additionally, many institutional investors have updated their investment policy statements to allow for more flexibility in volatile markets, like the one we're currently experiencing'. Therefore, the high levels of VC dry powder and greater LP investment flexibility could mitigate some of the potential tightening effects seen previously.

The Bank will continue to monitor market conditions very carefully and will respond as necessary to avoid damage to the long term health of the UK equity ecosystem.

FIG 3.8

INDEXED NUMBER OF UK AND US VC FUNDS REACHING FINAL CLOSE (2008 = 100)

Source: British Business Bank analysis of PitchBook

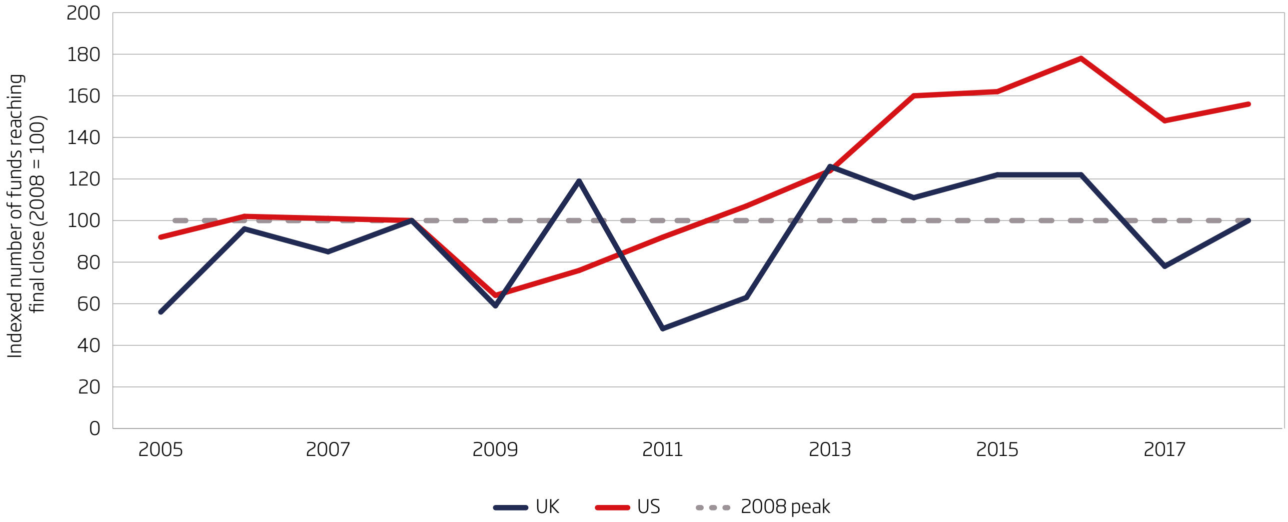
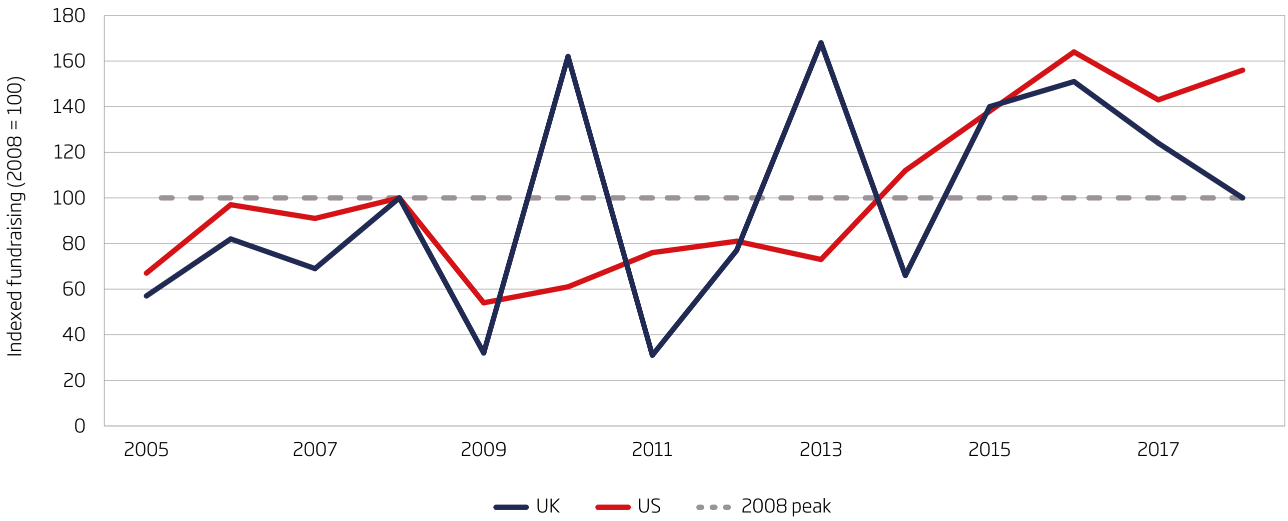


FIG 3.9

INDEXED UK AND US VC FUNDRAISING BY FINAL CLOSE YEAR (2008 = 100)

Source: British Business Bank analysis of PitchBook



APPENDIX

BEAUHURST METHODOLOGY SUMMARY

Beauhurst was founded in 2010 and provides in-depth data on the UK's fastest growing companies. The Beauhurst research team identifies a range of company events that indicate high growth. When a company meets one of these triggers it is tracked, and a broad range of data about it and its transactions is collected. The triggers are as follows; receipt of equity investment, securing venture debt, undergoing an MBO/MBI, attending a recognised accelerator programme, scaling up according to the OECD's definition of high growth, receiving an innovation grant, or spinning out of an academic institution

Beauhurst data on these events is comprehensive from the start of 2011, with the exception of unannounced equity deals, for which Beauhurst have comprehensive coverage from 2011.

This report focuses solely on announced equity deals for UK companies. However, Beauhurst also picks up on unannounced deals by monitoring Companies House filings. These deals make up over half of all UK equity investments, although less information is available on these deals. In cases where a deal is announced but the value is undisclosed, the value of the investment can sometimes be worked out using the Companies House filing that corresponds to the deal.

The announced equity deals included in this report meet the following criteria: (1) the recipient of the funding is a UK-based business; (2) there is no upper or lower limit for the sum invested; (3) the investment is visible, meaning that it has been publicly announced via press release or some other media; (4) The recipient of investment is a small or medium-sized business as defined by the European Commission.

When analysing cross-sector data, Beauhurst weights deal numbers and investment amounts across all the sectors the investee is in. For example, a company in the internet platform and theatre sectors will be counted as half a deal in each of these two sectors. Unless otherwise stated, this report omits single sector analysis to avoid double counted figures.

Where investment amounts have been provided in foreign currencies, these have been converted to GBP at the exchange rate on the day of the transaction.

The relatively simple breakdown by stage used by Beauhurst differs from organisations such as Invest Europe and BVCA, which tend to distinguish between seed and start-up, and between early and late stage venture.

The reasons for using the simpler taxonomy are:

1. In some cases there isn't enough information to decide on a principled basis which of the two seed or venture subgroups a company lies in.
2. The simpler taxonomy can be used for all sectors, whereas a more complicated one would be more difficult to apply consistently across sectors.
3. A less detailed breakdown reduces 'noise' in the data resulting from smaller numbers of deals being categorised into narrower stages – the small base sizes can lead to large swings in reported investment from one quarter to the next.

The following table summarises the differences between the Beauhurst taxonomy and the more detailed classifications of investment stage used by Invest Europe and BVCA, and offers some broad descriptors of the types of activity and company supported in each case.

BUSINESS STAGE CLASSIFICATION

Beauhurst stage classification	British Business Bank classification of Beauhurst stages	Invest Europe stage classification	BVCA stage classification	Broad Description
Seed	Seed	Seed	Seed	Young companies in the process of being setup or been in business for a short time, but have not yet made any commercial sales. Likely to have uncertain product-market fit or just started with regulatory approval process.
			Start-up	Company likely to be seeking finance to establish itself/ develop product/ service further.
Venture	Venture	Start-up	Other Early stage	Company that has been around for a few years and is in the process of gaining significant market traction or progressing with regulatory approval. Sales are growing rapidly but unlikely to be profitable.
		Later stage venture	Later stage venture	Company has high cash burn rate and is seeking finance to scale-up rapidly.
Growth	Growth			More established company that has been around for at least 5 years. Likely to have multiple offices or branches with substantial revenue streams (some of them may be profitable).
				Company likely to be seeking finance to grow core market further or expanding into new markets or products/services.
		Growth	Expansion or 'Growth Capital'	Company may be getting ready to exit shortly (e.g. Pre-IPO).
Established				Companies having been around for at least 15 years, or 5-15 years with a 3-year consecutive profit of at least £5m or turnover of at least £20m. They are likely to have multiple offices (often worldwide) and be a household name. The SME filter applied to our data ensures only SMEs are included.

INVESTOR CLASSIFICATION

Investor classification	Description of investor type
Family Office	Wealth management firms that manage the investments of wealthy individuals, families, or multiple families.
Angel	Individuals that invest their own wealth into growing companies. Angels may invest as an individual or as part of a syndicate involving other angel.
Angel Network	An angel network is an organisation (or sometimes a platform) that helps to originate and facilitate investments. The individual angels will be the shareholders in the investee.
Crowdfunding platforms	Online platforms enabling retail investors to invest into private companies.
Private Equity/ Venture Capital	Fund structures that invest institutional funding into private companies. Venture Capital Venture Capital funds typically invest in early stage, high growth businesses; whilst Private Equity funds invest in later stage established businesses.

BEAHURST METHODOLOGY DETAILED

LOCATION INFORMATION

This is based on the primary office location of the company receiving investment which reflects where the majority of the activity takes place, as determined by Beauhurst. In many cases this is the same as the registered head office location, but not in all cases. This differs to the ONS and BEIS data used to measure equity deal activity against regional business stock, which uses the company's registered head office.

SECOND CLOSING OF A ROUND

If a company completes a second closing of its Series B round for £5m and previously had closed £2m in a prior quarter, then only the £5m is included in the Beauhurst data for this quarter.

ONGOING FUNDRAISING

If a company indicates the closing of £1m out of a desired raise of £10m, Beauhurst data only reflects the amount that has closed.

CONTINGENT FUNDING

If a company receives a commitment for £10m subject to certain milestones being achieved but first gets £5m, the entire £10m is included in the data.

TIMING

Investments are allocated based on funding announcement date and not on close date. This is also true for deals backed by the British Business Bank. There is generally a lag between the announcement data and the close date, with the latter preceding the former.

EQUITY FINANCING

Funding comes from both 'organised' and 'unorganised' investors. The former includes institutional investors such as private equity firms, corporate venturing arms or formal networks such as business angel groups. The latter includes investments by business angels.

CROWDFUNDING INVESTMENT

Investments of money in return for equity from crowdfunding intermediaries are included, e.g. Crowdcube, Seedrs.

DEALS ONLY PARTLY EQUITY

Venture debt, loans or grants issued to private companies are included only if they have come alongside equity financing. The entire round (including debt) is added to the data as it is not always possible to separate out debt and equity from the total funding round.

INVESTMENT ONLY INTO PRIVATE COMPANIES

Publicly listed companies on any exchange are excluded from the numbers even if they received investment by an organised investor.

ONLY ANNOUNCED DEALS ARE INCLUDED

Investments are verified via (1) government regulatory organisations (2) confirmation with the investee or investor or (3) a press release or news source.

COMPANIES MUST BE HEADQUARTERED IN THE UK

The geographic data is based on the local authority where the company receiving investment is headquartered at the time of receiving investment. For example, if a company has offices in multiple cities or was founded in a particular city but has moved its headquarters, the data only reflect the headquarters.

WHAT BEAUHURST DOES NOT INCLUDE FOR THE PURPOSES OF THIS REPORT:

- Buyouts, mergers and acquisitions: These transaction types involve the change in ownership of existing shares (to buy out existing shareholders) rather than the creation of new shares (and the injection of new money into the company).
- Private placements: Private investment in public equities even if made by a venture capital or private equity firm.
- Solely debt/grant funding: Venture debt or grants issued to emerging, start-up companies without any additional equity financing.
- Cash for rewards: Investment into companies for nonfinancial rewards, e.g. Kickstarter.

ENDNOTES

1. Beauhurst uses the European Commission definition of an SME. See appendix for more information.
2. https://www.british-business-bank.co.uk/ourpartners/coronavirus-business-interruption-loan-schemes/future-fund/
3. Beauhurst (2020) 'The Deal: Equity investment in the UK 2019' https://about.beauhurst.com/research/the-deal/
4. Beauhurst also includes a fourth stage (Established businesses), but this report combines this stage within the growth stage.
5. This report does not look at public equity markets.
6. For more information on how Beauhurst identifies unannounced equity deals and the relative scale across time and deal stage see: https://about.beauhurst.com/blog/all-the-data-on-unannounced-fundraisings/?utm_campaign=Bulletin&utm_source=hs_email&utm_medium=email&utm_content=72745280&_hsenc=p2ANqtz-8nkMWyJ0fiDcugUeXh7q7UAwMiT0rTDH33WnJ93TIcS7hJX3_ZV11IB_SEE3T1JCjagD61cvcczNcgCPZ2D3lLmKHEr2qycQ19434p85G-UoNYcyTRs1fFYcJ3PCKVIHjqgOOT&_hsmi=72745280
7. European Commission (2015) 'What is an SME?' http://ec.europa.eu/growth/smes/business-friendly-environment/sme-definition_en
8. This can affect the historical time series due to deals being excluded if the company is now classified as large under the closest accounts being filed.
9. Beauhurst (2019) 'The Deal 2019' https://about.beauhurst.com/research/the-deal/
10. British Business Bank (2018) 'The UK Business Angel Market' https://www.british-business-bank.co.uk/wp-content/uploads/2018/06/Business-Angel-Reportweb.pdf
11. Beauhurst (2019) 'The Deal 2019' https://about.beauhurst.com/research/the-deal/
12. British Business Bank (2020) 'Small Business Finance Markets Update January 2020' https://www.british-business-bank.co.uk/small-business-finance-markets-update-january-2020/
13. Beauhurst (2019) 'The Deal 2019' https://about.beauhurst.com/research/the-deal/
14. Whilst the number of seed stage deals has increased overall and the value of seed stage investment has declined in 2019, average seed stage deal sizes have increased because they are calculated on deals with known deal sizes. In 2018 there were 697 deals with known deal sizes, whereas in 2019 there were 682 deals with known deal sizes. Therefore, it is possible to have a higher average deal size, despite higher overall numbers of deals and lower investment.
15. British Business Bank https://www.british-business-bank.co.uk/finance-hub/corporate-venture-capital/
16. BVCA 'Guide to Corporate Venture Capital' https://www.bvca.co.uk/Portals/0/library/documents/BVCA%20Guide%20to%20Corporate%20Venture%20Capital.pdf
17. https://www.gv.com/
18. https://www.intel.com/content/www/us/en/intel-capital/overview.html
19. https://www.dmgventures.co.uk/about-us/
20. https://globalbrains.com/en/whatwedo/cvc
21. CB Insights (2020) 'The 2019 Global CVC Report' https://www.cbinsights.com/research/report/corporate-venture-capital-trends-2019/
22. PitchBook (2020) 'Q1 2020 European Venture Report' https://pitchbook.com/news/reports/q1-2020-european-vc-valuations-report
23. Beauhurst categorises Oneweb as being 50% in the telecoms sector and 50% in the technology/IP-based sector. This means £470m is counted under the hardware subsector.
24. Note that companies can have multiple investor types. To be classed as being initially funded by a particular type of investor, the company had to have the investor type take part in the initial funding round.
25. Pre-money valuation refers to the valuation of a company prior to an investment round.
26. Privately listed companies with a valuation over $1bn
27. PitchBook (2020) 'PitchBook Q1 2020 European VC Valuations Report' https://pitchbook.com/news/reports/q1-2020-european-vc-valuations-report
28. PitchBook (2019) 'H1 2019 VC Valuations Report' https://pitchbook.com/news/reports/1h-2019-vc-valuations-report
29. A 'down round' is a financing round in which a company sells its shares at a price per share that is less than the price per share it previously sold shares for in an earlier financing round. Down rounds are viewed negatively by the VC industry as it implies company valuations are now lower, and companies are growing more slowly than the projections made at the previous funding round. Down rounds also dilute ownership for existing investors
30. Deals were only classed as having 'UK investors only' if the deal had complete investor-level information, and all of the investors were based in the UK. A deal could have incomplete investor information and be in the 'has at least one overseas investor' category, if at least one of the listed investors was located outside of the UK.
31. BEIS (2019) 'Business Population Estimates 2019' https://www.gov.uk/government/statistics/business-population-estimates-2019
32. ONS (2018) 'High Growth Enterprises 2017' https://www.ons.gov.uk/businessindustryandtrade/changestobusiness/businessbirthsdeathsandsurvivalrates/adhocs/009393highgrowthenterprises2017
33. This report uses Beauhurst's primary address, which may differ to the company's registered head office address, but better reflects where the activities of the company takes place. BEIS and ONS data use the companies head office location. At the regional level, the proportions are very similar, although greater differences may exist at sub-regional levels.
34. BEIS (2019) 'Business Population Estimates 2019' https://www.gov.uk/government/statistics/business-population-estimates-2019
35. ONS (2018) 'High Growth Enterprises 2017' https://www.ons.gov.uk/businessindustryandtrade/changestobusiness/businessbirthsdeathsandsurvivalrates/adhocs/009393highgrowthenterprises2017
36. CMR Surgical based in Cambridge and Achilles Therapeutics based in Stevenage.
37. The hexagons used have an inradius of 5km so cover an area of around 85km^2. Hexagons that cover parts of the UK coast are truncated so cover less land area.
38. Limited Partners are predominantly institutional investors that invest in private equity and venture capital funds. British Business Bank funds delivered by private sector fund managers involving private

sector sources of capital are not included in Beauhurst's definition of Government funds.

39. NPIF and MEIF funding is drawn from UK Government, European Investment Bank, British Business Bank, and the European Regional Development Fund. CIOSIF is established as a limited partnership with funding drawn from UK Government and the European Regional Development Fund
40. British Business Bank analysis of PitchBook (Data accessed on 05/06/2020)
41. When British Business Bank deals are limited to deals made by PE/VC funds only, the stage distribution largely falls in line with that of the wider PE/VC market.
42. HM Treasury (2017) 'Financing growth in innovative firms' https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/642456/financing_growth_in_innovative_firms_consultation_web.pdf
43. Office for Budget Responsibility (2020) 'Coronavirus Analysis' https://obr.uk/coronavirus-analysis/
44. For more information, see https://about.beauhurst.com/covid19/
45. PitchBook (2020) 'COVID-19's influence on the European VC Market' https://pitchbook.com/news/reports/q2-2020-pitchbook-analyst-note-covid-19s-influence-on-the-european-vc-market
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48. Block, de Vries and Sandner (2010) 'Venture Capital and the Financial Crisis: An Empirical Study Across Industries and Countries'. Available at SSRN: https://ssrn.com/abstract=1541602
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50. British Business Bank analysis of PitchBook (Data accessed on 05/06/2019)
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53. Bowery Capital (2019) 'What Will Happen To Venture Capital When The Recession Hits?'https://bowerycap.com/blog/insights/what-will-happen-to-venture-capital-when-the-recession-hits/
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