Government support for private finance for innovation

Government support for private finance for innovation refers to various policy initiatives aimed at stimulating finance for innovation from private sources, such as venture capital, business angels, money and capital provided by family and friends, entrepreneurs' personal financial resources and crowd funding.

Governments have used several interventions to increase the availability of equity finance for innovation. These programmes include fund-of-funds and public/private co-investment funds (see Venture capital [1]). A Fund-of-Funds is an investment strategy which consists of holding a portfolio of other investment funds rather than investing directly in start-up firms. These public funds invest in private venture capital firms, often with the requirement that other private institutional investors also invest. This approach has become more prevalent during the past five years (OECD, 2012). Co-investment funds use public money to match private investment. These programmes usually match public funds with those of private investors (on the same terms – pari passu), who are approved under the scheme. These programmes appear to have been increasing in the past five years (OECD, 2012). Co-investment schemes are often seen not only as a way to leverage private money but also as a driver in building, growing and professionalising the seed and early stage investment market by providing a more structured investment process.

The three generic options can help support equity guarantee/enhancement schemes; these are: a) providing insurance against the venture fund's losses; b) providing upside leverage (e.g. through a co-investment model); and c) subsidising part of a fund's operating costs (Murray, 1999). Providing a financial safety net for a small fund can be important, but may weaken the fund managers' incentives to ensure good investment decisions. Instruments to provide upside leverage multiply the financial benefits of success to the disproportionate advantage of venture capital funds and their investors. Moreover, the leverage exclusively rewards successful investment activity and does not insulate management from the consequences of unsound decision making.

Various types of risks are important consider when designing public interventions to support VC. For instance, very large interventions can have counterproductive effects, not only crowding out current investment but also damaging the future development of the industry. Without additional investment propositions, more public money may only reduce the opportunities available for private venture capitalists, reducing their returns, and thus forcing them out of the market or making it more difficult for them to raise follow-up funds in the future. The "additionality" of public intervention in this domain has to be guaranteed.

Other public support for private finance for innovation may include: training of angel investors and provision of some financing for angel networks, groups, associations and federations (see Business angels [2]), support to crowd funding, and bankruptcy regulations that do not deter entrepreneurs from investing their own resources in innovative businesses (see Private sources of funding [3]).

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