Access to Finance: Impacts of Publicly Supported Venture Capital and Loan Guarantees

This report examines government measures that have been taken to provide firms with access to finance. This covers measures that provide real financial help to firms, i.e. they are a form of financial assistance or subsidy to firms. The two types of policy measures considered are publicly supported venture capital and government backed loan guarantees. The report first introduces in section two the types of policy measures that we have reviewed while section three explains the scope of sources and material analysed. In general we find that evaluations conducted on these measures employ a range of approaches to assess performance, some of which are simply descriptive, some of which involve comparisons but very few of which attain the level that can control for the selection bias effects that would help to measure the net impacts of policy. Very few initiatives are specifically directed at causing innovation as such. Support in the form of venture capital assistance or loan guarantees is intended in the first instance to provide the resources that firms need to grow. Programme designers expect access to finance to lead to increases in turnover and employment which will accompany innovation. A number of measures seek to promote innovation but in some cases the schemes have been designed and implemented in such a way as to protect firms. This may weaken selection pressures. Few venture capital scheme reviews carry out comparison using matched pairs and account explicitly for selection bias. Impacts of programmes assessed are usually employment and turnover, with some consideration given to export performance (internationalization) in some schemes. Patenting is also considered in a small number of evaluations. Some venture capital programmes are very concerned with the creation of systemic effects. Systemic effects are where programmes seek to improve the private capability in the area of investment, i.e. the supply side, with a view to increasing the overall level of funds available for investment, thereby removing or ameliorating the market failure. This is because the investment infrastructure is less easy to preserve and is especially likely to decline in effectiveness during periods of economic difficulty. Some evaluations consider systemic effects on the demand side to be required to solve the problem of the low number of new firms created and the low growth rate of firms. While some of the evaluations we have examined have been attentive to the impact of finance upon innovation, an issue that we interpreted as at the core of this report, no work has taken the broad and long term economic impacts of the innovations thus funded into account. We therefore do not have a good sense of how important this form of funding is in terms of major impacts upon the economy. More fundamental lessons could be learned therefore about the economic impacts by widening the scope from innovation to commercialisation of innovation. We note that evaluations of schemes that take these effects into account have not been possible to find. With respect to publicly supported credit guarantee schemes, we note the following points: While metrics such as default rate and economic or financial additionality provide evidence about the performance of schemes, better comparisons are not possible as there is no consistent standard for measurement of the schemes. Credit guarantee schemes have not been particularly directed to supporting innovation activities and of the studies considered innovation has been the focus of attention of the KOTEC scheme in Korea. To the extent that there was credit rationing, credit guarantee schemes have contributed to relaxing this constraint for SMEs in many countries and in different economic climates. Credit guarantee schemes help businesses to grow. Several evaluations show a direct causal effect on output (sales) and employment. However the evidence when considered also indicates that some schemes did not impact of firm productivity, R&D or investment intensity. In such circumstances schemes may actually be supporting struggling firms and ultimately stifling innovative forces. Finally, one of the more common concerns in our analysis of venture capital support and credit guarantees is the issue of moral hazard. Credit guarantee schemes reduce the incentive and commitment of borrowers to repay loans. Evidence shows that even in the most 'careful' schemes borrowers adopt risky strategies. Moral hazard exists on the part of banks also as studies have shown that in some cases there was less incentive to supervise loans properly. Moral hazard also affects venture capital support measures that have government support. Evaluations of government supported venture capital funds show the importance of the design of the compensation arrangements in the sharing of risk between investing bodies and those organisations in which investments are made. The a priori assumption, which we ourselves have not made but which others may have done, that these two forms of government backed financial assistance would lead equally

to innovation within the firm and the economy is difficult to establish with the evidence provided by the studies we have evaluated. Moreover, these two forms of financial assistance do have different purposes in that they support firms at different stages of their evolution, and we would expect VC support schemes would target firms at the pre-market and more risky phase of development than credit guarantees.
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