Business, Innovations and Skills Committee
House of Commons
London
SW1A 0AA

9th February 2016

Re: Access to Finance Inquiry

The **British Private Equity and Venture Capital Association ("BVCA")** is the industry body and public advocate for the private equity and venture capital industry in the UK. With a membership of over 500 firms, the BVCA represents the vast majority of all UK based private equity and venture capital houses including 16 managing VCT or EIS funds, as well as their professional advisers. Our members have invested over £30 billion in nearly 3,900 UK-based companies over the last five years. Companies backed by private equity and venture capital in the UK employ around 490,000 people and 88 per cent of UK investments in 2014 were directed at small and medium-sized businesses.

The **Enterprise Investment Scheme Association ("EISA")** is a not-for-profit organisation which exists to aid the provision of capital to UK small and medium-sized businesses through the Enterprise Investment Scheme and Seed Enterprise Investment Scheme. EISA has 140 members, including all the major EIS fund managers, lawyers, accountants, tax advisers, corporate financiers, IFAs and wealth managers, both in London and throughout the UK.

The **UK Business Angels Association ("UKBAA")** is the national trade association representing angel and early stage investment in the UK. Each year private investors, including the 18,000 business angels represented by UKBAA, account for between £800 million and £1 billion of early stage investment in the UK – the largest source of early stage capital in the country. The UKBAA represents and connects all those involved in the angel investment market, including early stage VC funds, banks and non-traditional sources of finance, as well as advisers and intermediaries, policymakers and academics, with a view to ensuring a coherent ecosystem for financing the growth of start-up and early stage businesses.

Introduction

Over the past six years the economy has gradually returned to a state of good health. With stable growth, falling unemployment, and relative stability and certainty in tax, the UK remains a highly competitive location to raise funds and invest in growing businesses. Despite this promising situation at home, increasing perturbations in the broader global economy - ranging from the economic slow-down in China, the raising of interest rates in the US, and the ongoing impact of fluctuating oil prices - mean that the Government must seek to ensure the resilience of the British economy in the coming years. A substantial element of this effort will be the maintenance of investment in all sizes of businesses, but most crucially the flow of finance for start-ups and scale-ups - the small and medium-sized enterprises which continue to disproportionately contribute to growth and job creation across the length and breadth of the country.

Business angels, venture capital, and private equity firms provide an essential source of funding for innovative businesses along each stage of their growth journey. Unlike other sources of finance, their investment is not limited to simple cash injections, with each also offering significant managerial advice and expertise to ensure that the recipient can make the most of their funding and develop into a healthy business with strong fundamentals and good growth prospects. At a time when bank finance remains restricted, the existence and improvement of this investment continuum is of utmost importance if the UK is to fully harness its vibrant entrepreneurial culture and create the next generation of global British brands in fields as diverse as technology, media, health and energy.

The current Conservative Government and its Coalition predecessor have both maintained a broadly positive approach towards entrepreneurship, and we will look to work with ministers over the remainder of the Parliament to ensure that this outlook is maintained. This will be achieved by underpinning the attractiveness of the tax-incentivised venture capital schemes, enabling the development of a more diverse, transparent and well-resourced finance market, improving connectivity amongst existing market participants, and providing for as stable an investment environment as possible. We appreciate the decision of the BIS Committee to investigate this area, and hope that our submission provides a positive contribution to your efforts to maintain Britain's role as a global leader in entrepreneurship, innovation and trade.

The Landscape for Finance since the Financial Crisis & Market Competitiveness

As recent figures from the British Business Bank have shown, the finance markets continue to improve in line with developments in the economy more broadly, and the UK maintains a stronger equity culture than the majority of other European countries. Notably, overall equity finance in small businesses grew 43 per cent in the year to October 2015.[1] Whilst bank lending is also gradually increasing, retrenchment in the sector in the wake of the financial crisis means this funding remains restricted. As loans remain the most widely sought after source of business finance, many companies find themselves with substantial growth potential but a lack of capital to achieve it. These 'scale up' businesses which, having successfully commercialised their product, are often seeking to expand their staff, access new markets, and develop new offerings, have also struggled to secure their first significant equity funding through series A rounds. A further issue exists in that there are very few UK venture capital funds which are able to invest from seed through to growth capital stages. This results in a 'start-stop' approach to growth for businesses which often leads to the seeking out of better-resourced US investors who are able to provide substantial funding to fuel a company's expansion stage. This process, by extension, often leads to innovative British companies being sold to larger American corporates when investors exit, sending intellectual property, jobs and economic growth overseas. Resolving this issue remains a priority if we are to bolster Britain's high-growth business community, and with government support in this area relatively limited, it represents an area ripe for policy innovation.

In marked contrast to the state of the market for scale-up businesses, the environment for start-up finance is vibrant and flourishing. Notably, venture capital investment in the UK by BVCA members increased by over 14 per cent in 2014, reaching £4.7bn compared to £4.1bn in 2013.[2] Furthermore, according to analysis by think tank Policy Network, venture capital investment is far higher in the UK than comparable European states - between 2007 and 2013 the UK had the largest absolute level of such funding in the region.[3] The story is similar for business angel funding, with investment levels in 2013 more than twice those of Germany, and seven times the amount reached in Italy.[4]

The popularity of the tax-advantaged Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs) in particular has resulted in retail investor and business angel money being productively channelled into thousands of small businesses which required an initial injection of funding to get their operations off the ground and begin their journey towards product development and commercialisation. This segment of the funding market has also recently undergone significant innovation with the emergence of crowd equity platforms and the digitalisation of investment more broadly. This has democratised finance to a degree, allowing individuals to invest the amounts they

---

[1] British Business Bank, 'Small Business Finance Markets Report 2015/16', 2 February 2016, p.28. (http://british-business-bank.co.uk/research/small-business-finance-markets-report-201516/)

[2] BVCA, 'Report on Investment Activity 2014', p.3. (http://www.bvca.co.uk/Portals/0/library/documents/IAR%20Autumn15.pdf)

[3] Policy Network, 'Supporting Investors and Growth Firms', June 2015, p.44. (http://www.policy-network.net/publications/4916/Supporting-Investors-and-Growth-Firms)

[4] *Ibid* p.45.

want, when they want. The strength of UK markets is perhaps most stark with regard to online alternative finance - in 2014 €998m of funding was raised through peer-to-peer platforms in Britain, whilst the rest of Europe collectively raised €93m.[5] Whilst it is vital that this nascent sector is properly regulated and monitored to ensure adequate protection for investors and investee companies alike, it represents a pioneering new source of funding, enabling more businesses to kick-start their operations.

Unfortunately, the funding ecosystem also remains relatively imbalanced across the United Kingdom. The so-called 'golden triangle' of London, Cambridge and Oxford continues to produce the majority of new innovative businesses and is the destination of a majority of equity finance. These characteristics should ideally be present across the country, however there is negligible co-investment between the north and south, and in many areas business angels and venture capital firms are less visible or poorly connected. Indeed, in 2014, 58 per cent of BVCA member funding went to firms in the capital and the south east.[6] As a result entrepreneurs outside of these areas may often struggle to access significant growth capital. Such a situation can be partly attributed to a lack of diversity in the finance market - most companies continue to approach their bank for finance and are unaware of alternatives. Encouraging a more equitable spread of all types of finance across the entire United Kingdom will be central to a balanced economic recovery and ensuring that businesses outside of the capital are able to grow and produce jobs for their respective regions.

The Government should also be aware of the fact that some sectors have been better served by the surge in early stage support whilst others are critically short of venture funding. Digital and tech firms continue to attract substantial sums in contrast to industries such as clean tech and the life sciences. Whilst generalist funds will sometimes back companies in these areas, a funding crisis is becoming increasingly evident as so few investors have the expertise to make informed decisions on sectors they are becoming increasingly unfamiliar with.

Successful Government Policies & Opportunities for Improvement

As we have highlighted, ensuring that businesses looking to start or scale up have access to adequate funding will be central to the strength of the British economy in the coming years. This will boost economic growth, generate jobs, and, through the resulting additional taxes paid to the Exchequer, contribute to the ongoing reduction of the deficit. Whilst securing institutional funding for this type of investment is of course important (a point we will return to), retail investors present a further source of capital which can be channelled towards small business growth. The continued existence of the Government's tax-advantaged venture capital schemes - the Enterprise Investment Scheme (EIS), Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs) - remain an essential cornerstone in this effort.

EIS and VCTs, which primarily provide relief to investors on income and capital gains tax, were initially introduced in the mid-1990s in order to ameliorate the market failure in business finance which had occurred as mid-market private equity firms moved on to larger buyouts. They continue, along with the newer SEIS, to perform this function, helping early stage businesses bring in angel investors and enabling venture capital investors to enter companies at an earlier stage than would otherwise be possible. Notably, their broad appeal and flexibility has created an environment of experimentation and innovation in financial services leading to the development of crowdfunding and angel syndicates. Since its launch EIS has provided over £12.2bn of funding to almost 22,900 individual companies, whilst SEIS enabled over

[5] *Ibid.* p.46.
[6] BVCA, 'Report on Investment Activity 2014', p.10, table 14.
(http://www.bvca.co.uk/Portals/0/library/documents/IAR%20Autumn15.pdf)

2,000 companies to raise £168m of funds in 2013-14 alone.[7] VCTs have also proved successful raising a total of nearly £6bn since 1995.[8]

Recent changes to these schemes, negotiated between the Government and the European Commission and announced in the 2015 Summer Budget, are likely to restrict their ability to support the growth of SMEs. The new limits on companies over seven years old raising finance, alongside the restriction on businesses using EIS investment monies to purchase a subsidiary, a trade, intangible assets or goodwill, do not recognise how companies grow and develop, and fail to help ensure that capital flows to companies that cannot raise it from banks, which is the very raison d'etre of the schemes. We continue to make presentations to ministers regarding this matter and believe that at a time when the European Union is developing its Capital Markets Union strategy with a view to improving business finance, efforts should be made to ensure that schemes such as EIS, SEIS and VCTs remain completely able to fulfil their vital role.

Other government initiatives such as the £100m Angel CoFund - which co-invests with angel investors to back early stage businesses - have also been highly successful. Unfortunately however, demand for this funding massively outstrips supply and many UK businesses suffer from chronic underfunding, with management teams forced to focus on fundraising rather than developing their business. As such we would welcome increased investment into such schemes, but would also like to see the Government re-evaluate its commitments to funds more generally. By contributing money to a smaller number of larger funds it would be able to take advantage of efficiencies in how these funds can recruit, support and provide follow-up investment, helping fill the aforementioned funding gap for high-growth businesses.

In 2014, the Coalition Government launched the Social Investment Tax Relief (SITR) which allows retail investors to receive relief on income tax and capital gains tax for money invested into social enterprises and charities. Such firms are currently eligible for up to £250,000 of tax-advantaged investment over three years, enabling them to increase their reach and impact as they tackle a broad range of issues from childcare provision to local transport needs. The Government is currently working with the European Commission to secure an expansion of the scheme which will increase the limit on the amount of SITR investment an organisation can receive to £5 million per year and £15 million in total. We look forward to a swift approval of this change, and believe that it will lead to a new wave of social investment across the UK at a time when new and innovative means of tackling public service challenges are increasingly required.

All of the schemes mentioned above will only be truly effective if they are properly communicated. HMT, BIS, UKTI, Innovate UK and the expanding network of Catapult Centres should all look to spend more time and effort ensuring that SMEs and the supporting ecosystem (including Local Enterprise Partnerships) are aware of EIS, SEIS, VCTs and SITR, and how to access them. Feedback from events held by EISA has shown that knowledge remains limited in this area and is in need of substantial improvement.

Regulation and Monitoring of Alternative Finance

As highlighted, the business finance market has undergone significant innovation with crowdfunding platforms in particular expanding at an impressive rate in recent years. A number of products are now household names as a result of investments made online by individual consumers and professional investors. Whilst significant numbers of people are now able to invest small amounts of money into early stage companies, many of them are inexperienced, taking investment decisions without a thorough understanding of the market. This has tended to encourage high and sometimes unrealistic valuations

---

[7] HM Revenue & Customs, 'Enterprise Investment Scheme and Seed Enterprise Investment Scheme - Statistics on Companies Raising Funds', July 2015, p.5. (http://www.eisa.org.uk/wp-content/uploads/2014/08/July_2015_Commentary_EIS_SEIS_Official_Statistics.pdf)

[8] HM Revenue & Customs, 'Inland Revenue Statistics: Venture Capital Trusts', September 2015. (https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/467263/150930_Table_8.6_publishing_version_draft_v0.1.pdf)

which may make it harder for companies to raise money from institutional investors further down the line. In a similar vein, these investors may not appreciate the potential of their investment and have unrealistic expectations of outcomes. The lack of ongoing support offered by crowdfunding investors, unlike with business angels and venture capital, can also prove problematic, with no structure in place to provide management expertise and work towards an advantageous outcome for the fundraising entrepreneur or the investor. There is also a danger of such investors, who enter a company at a very early stage, getting diluted or ignored in later investment rounds.

The regulatory approach introduced for crowdfunding by the FCA has successfully allowed the sector to flourish whilst providing a level of protection for investors. With the issues above in mind, we recognise that significant challenges exist and must be addressed, although tighter regulation could prove damaging. Instead, improving the skills and knowledge of investors through high-quality online learning and accreditation could counter these issues, and improve general understanding of the crowdfunding process. Increased transparency within the crowdfunding market, with greater access to investment performance statistics, would also help counter unrealistic expectations of growth and outcomes. Overall, the model continues to evolve and stronger lead investors are beginning to use crowdfunding platforms. This is encouraging better due diligence, more realistic company valuations, and the development of greater shareholder protections. Given the relative youth of the sector, we can expect a degree of correction and consolidation in the coming years, with more successful models becoming more fully integrated into the business funding ladder.

Increasing the Number of Successful High Growth Businesses

For the business finance community, from the solitary business angel to large private equity firms, stability and certainty will always be the key foundations upon which greater investment rests. Over the remainder of the Parliament, we hope that the Government, through schemes such as the proposed business tax roadmap, will attempt to provide as benign an environment as possible to ensure that investors, who have a range of choices as where to place their money outside of risk finance, feel entirely comfortable and incentivised to do so. The fluid nature of capital requires that schemes such as EIS, SEIS, VCTs and SITR are improved and then left to operate. Taking any adverse action, outside of efforts to remove barriers to investment, over the next four years could lead investors to take their money elsewhere and restrict Britain's ability to invest in the next generation of innovative businesses.

Upon this stable foundation, the Government should look to further diversify the business finance landscape by incentivising more institutional investors - including insurance firms, pension funds, and sovereign wealth funds - to invest in venture capital. Such an influx of funding would enable venture capital firms to create broader and deeper portfolios, and take advantage of economies of scale, allowing companies to move further up the growth ladder and preventing the need for early trade sales to overseas buyers as we have often seen in recent years. We will be interested to see whether the six new British Wealth Funds (pooled from the UK's existing 89 Local Authority Pension Funds) utilise their combined funds and expertise to support investment into SMEs and the broader regional growth agenda, outside of their apparent limited remit from the Chancellor to focus on infrastructure.

We also hope that, amidst the substantial turbulence surrounding the upcoming referendum on Britain's membership of the European Union, the Government will seek to be thoroughly engaged in the European Commission's ongoing Capital Markets Union (CMU) project. This effort aims to improve access to capital across the continent by identifying and removing the barriers which stand between investors' money and investment opportunities, and overcoming barriers which prevent businesses from reaching investors. Notably the CMU action plan, released last September, states that venture capital has a "key part to play in supporting growth" and suggests that such funding to growing SMEs could be boosted through the use of new tax incentives, allowing larger fund managers to set up funds under the EU Venture Capital Fund Management Regulation (EuVECA), or through the development of pan-European public-private venture capital funds-of-funds.[9] In the wake of the changes mentioned above in relation to the tax-advantaged venture capital schemes, the Government should make a concerted effort to ensure that the action plan translates into a more liberal regulatory framework, in line with its own efforts to reduce the complexity of relevant domestic rules, which will enable long-term investors to carry out their core function of funding innovative, expanding companies.

As we have made clear throughout this submission, increasing the number of successful high-growth businesses across the country is entirely dependent on a strong financial ecosystem operating within a stable political and economic environment. There are currently a number of situations where this ecosystem is fragmented, and government could have a role to play in improving connectivity. Some of these opportunities are system-based, such as the development of deal-sharing platforms and secondary markets. Others require stronger structural links between institutions and market participants. On the public policy side investors and companies seeking finance would benefit from a more joined up-approach between start-up, innovation and general business support at BIS; tax incentives at HMT and HMRC; financial regulation at the FCA; and regional devolution at the Cabinet Office and DCLG. The considerable growth in the number of entrepreneurs and investors deserves to be met with government assistance to build their capabilities - equipping them with the skills, tools and information to help them become investment ready. The former Growth Accelerator programme, which was abolished with no prior warning in the 2015 Autumn Statement, was a significant blow to this effort. Whilst not perfect, its national coverage and access to sector specialists was well received by companies, and the Government should look to see how the successful aspects of its remit can be preserved.

Increasing transparency and improving collaboration within the business finance market itself should also be a key area of focus for the Government. With wider and faster access to more data, more players in the ecosystem - from business angels, to venture capital firms, to individual investors, syndicates or corporates - would be able to share and communicate their successes and failures, leading to a stronger foundation of knowledge upon which a greater number of investors can feel confident in providing funding. In particular, more robust statistics and data on outcomes are needed, including from HMRC who should open up access to EIS Tax Return data. There should also be greater sharing of knowledge on methodology and attitudes towards pricing and valuations. This increased clarity would prove particularly useful for the nascent crowdfunding market so that all those involved can have a better idea of what works and what does not.

If you would like the opportunity to discuss these issues we would be happy to do so at your earliest convenience.

Yours sincerely,

Sarah J. Wadham

Tim Hames	Sarah Wadham	Jenny Tooth OBE
Director General, BVCA	Director General, EISA	Chief Executive, UKBAA
BVCA Funding the future	eisa enterprise investment scheme association	UK Business Angels Association

[9] European Commission, 'Action Plan on Building a Capital Markets Union', September 2015, pp.8-9. (http://ec.europa.eu/finance/capital-markets-union/docs/building-cmu-action-plan_en.pdf)