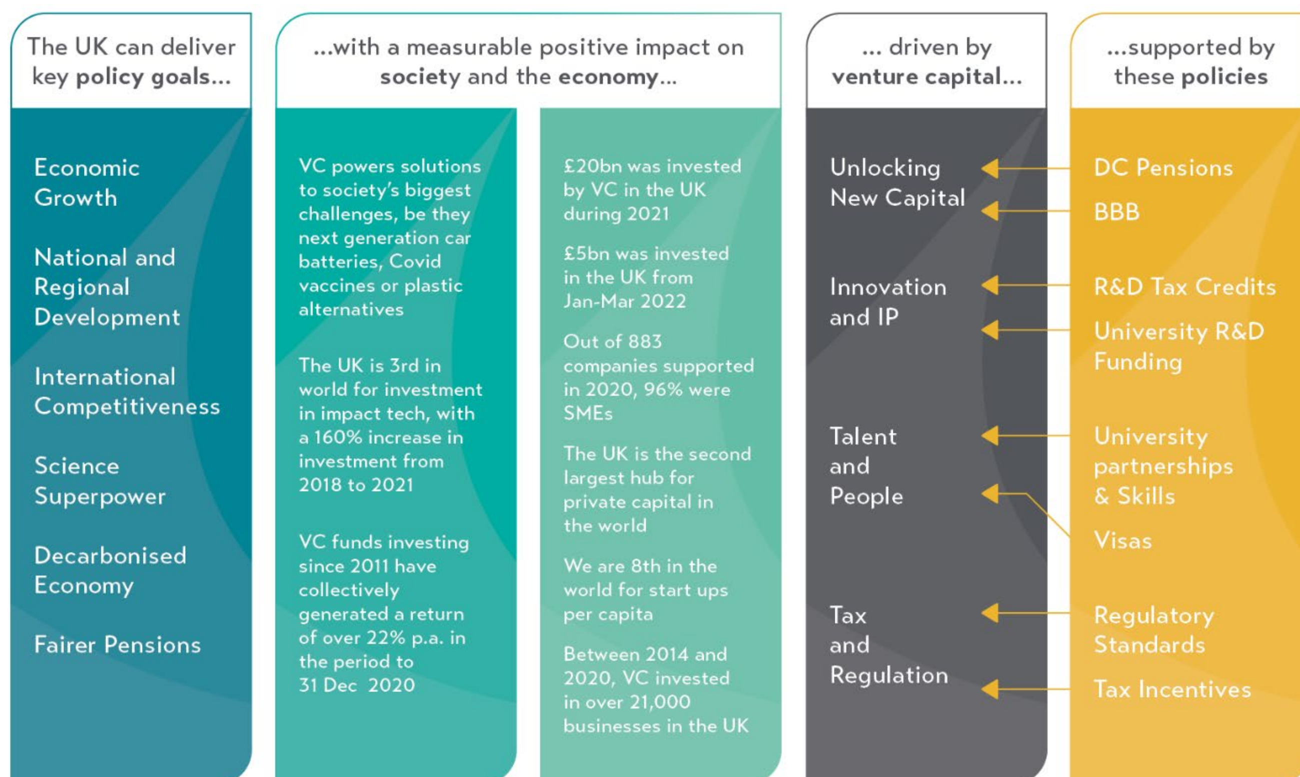
## Venture capital is **invested in a better future** – powering the **new economy** and **reshaping society**




## What is Venture Capital and Why Does It Matter?

Venture capital (VC) is **investing in a better future** for the UK. It powers the new economy, helps reshape society and enables companies to innovate and flourish. It fosters innovation, creates jobs, drives growth and generates long-term value for pension savers, entrepreneurs, universities and communities in all regions and nations of the UK.

Investing in early stage, innovative businesses with high growth potential (businesses which can grow at rates of more than 100% a year), **VC provides both funding and operational expertise for entrepreneurs and start-up companies** – typically technology companies but also companies that require long term R&D.

VC in the UK also plays a vital role in **developing businesses which will help solve society's biggest issues – and ensuring these are based in the UK.** For example, today, UK VCs are investing in sustainable aviation fuel investments in North East England, hydrogen batteries in South East England and biodegradable alternatives to plastic in Cambridge. London also has the most "purpose-driven" tech companies, those that aim to overcome social and environmental challenges, with over 430 companies and is second place in terms of capital invested in these companies.[1]

**The UK is the second largest hub for VC investment outside of the USA**[2] and the industry has seen exponential growth in recent years. This is an important benefit to the UK – by 2020, more than 21,000 companies were backed by venture capital3, 96% of those were start-ups employing 50 people or less[4]. However, we know that **European states are keen to tempt VCs in the UK to the continent**, with President Macron wooing VC's at the Elysée Palace and floating attractive regulatory and tax benefits.

[1] State of European Tech Report 2021 – available here
[2] Evening Standard – London Tech Week opens to record-breaking investment in UK tech sector – available here
3 BVCA Innovation Nation 2020 Report – available here
[4] Ibid

The size of the prize to the economy can be quantified in recent industry statistics. **In 2019, BVCA members raised £2.4bn, treble the £770m figure in 2017**[5]. In 2021, despite the uncertainty caused by the pandemic, the VC industry invested a record high of £20bn/$27bn (increasing from £11bn/$15bn in 2020) into UK tech[6], whilst **between January – March 2022 alone VC investment came close to $7bn** (approximately £5bn)**, more than 30% of total European investment**[7]. VC investment also leads to increased productivity, with research showing that **the typical angel and VC-backed business is also 60% more productive per worker than the UK private sector average**, contributing £88,100 per annum to UK GDP compared to £54,700 in 2019.[8]

Case Study

## Oxford Nanopore Technologies

Oxford Nanopore Technologies developed a new generation of sensing technology that uses nanopores - nano-scale holes - embedded in high-tech electronics, to perform precise molecular analyses. Its genetic sequencing technology has been instrumental in tracking the variants of COVID-19, making the UK a world leader in this field. The company has been supported by a number of VC firms across its lifespan, before listing in 2021. It was the eighth-biggest listing in London that year and the third-largest biotech float globally in 2021, according to Refinitiv.

Powering Success in the UK

**VCs have already supported some of the UKs most successful start-ups.** From Skyscanner, which revolutionised flight bookings by offering real time price comparison across airlines, to Revolut and Wise which have changed the way we bank and transfer money. Beyond the household names, VCs have also backed the technology in your mobile phone which turns text to voice for GPS mapping, the company which made the UK a leader in sequencing Covid variants, and the company that is supplying Nike with their sustainable leather.

And the impact of this success is not simply felt by the companies themselves or their regional or national base. This can be measured in the size of funding rounds, which have also grown rapidly. **In 2021, the UK saw 68 "mega rounds" of $100m plus**, almost five times more than the 14 rounds of $100m plus in 2017[9].

This is not only happening in London and the South East of England. **VCs are great spotters of talent – where it is located, does not matter**. Skyscanner was a great Scottish success story, backed by a Scottish VC (Scottish Equity Partners). Cambridge-based IQ Capital is backing Belfast-based Neurovalens who are transforming the treatment for diabetes and other metabolic and neurological diseases – in a non-invasive way without the need for drugs. And Par Equity and Mercia (both major regional VCs) back Nova Pangaea in Redcar in England's North East, who have created a sustainable aviation fuel with rapid scale-up plans.

And the success is not merely for the companies and their regional or national base**. Investors in VC funds are often pension funds or insurance companies**, alongside sovereign wealth funds and family offices. Today, defined benefit (DB) pension holders will directly benefit from the success of UK start-ups, via the investment of their pension pots in VC funds. This is not currently possible for the majority of the country, overwhelmingly younger generations, who are in defined contribution (DC) pension schemes. **By backing the current movement to enable DC pension schemes to invest into VC, we will ensure younger generations have better pensions, and are supporting the growth of innovative companies in the UK.**

The examples above represent just a handful of VC-backed companies, sectors and opportunities, and by

[5] BVCA Quarterly Review, October 2020 Report – available here
[6] State of European Tech Report 2021 – available here
[7] City AM - UK venture capital surges ahead of Europe as investors shake off market jitters – available here
[8] BVCA Innovation Nation 2020 Report – available here
[9] State of European Tech Report 2021 – available here

backing the continued growth of venture capital across all corners of the UK, policymakers will be able to accelerate the wider public policy agenda, in particular:

a. A more balanced and diversified UK economy
b. Sustained UK economic growth
c. International competitiveness
d. Transforming the UK into a science superpower
e. Decarbonising the UK economy
f. Creating fairer, more accessible, and more sustainable pension funds

<u>What do we need to grow VCs and VC investment in the UK?</u>

To deliver on the opportunities for the UK provided by VCs and VC investment, we are asking the Treasury Select Committee to consider four core areas of policy and regulation – accessing and unlocking new capital; innovation and intellectual capital; talent and people; tax and regulation – as follows:

1. Accessing and unlocking new capital

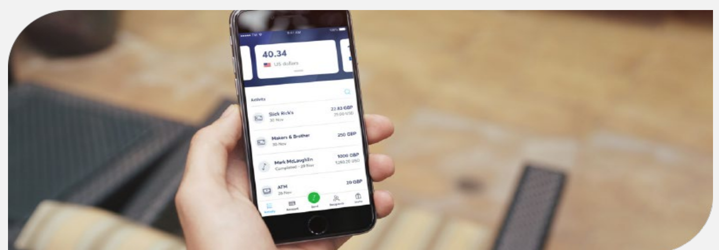
    a. **Increase levels of later stage funding for UK VC and growth funds:** UK companies often look overseas for expansion and growth capital. We must ensure venture and growth capital funds have sufficient scale and expertise to invest in innovative companies so that they remain and grow in the UK (section 1)

    b. **Unlock DC pension investment:** continue work that will enable DC pension schemes to invest in VC and growth funds by removing well-designed performance fees from the charge cap. This will unlock domestic capital for VC funds to invest in innovative businesses, as well as increase returns to ordinary pension savers not lucky enough to be in DB schemes (section 1 and 6)

Case Study

## Skyscanner

Skyscanner is an online travel technology established in 2002 and headquartered in Edinburgh. Scottish Equity Partners, which first invested in 2016, supported the company's internationalisation through M&A activity and the opening of 10 global offices across the US, Europe and Asia. Scottish Equity Partners also helped the company with its strategic development and growth and led a number of financing events, including investment from Sequoia and Baillie Gifford. Scottish Equity Partners played a lead role in the company's exit to NASDAQ-listed Trip.com. The firm's headcount went from 30 to 800+.



Case Study

## Wise

Wise enables international money transfers – allowing private individuals and businesses to send money abroad without hidden charges. Seedcamp, investing in 2011, worked very closely with the founders during the critical first days to help with team development and connecting into the UK ecosystem to make the UK the clear choice to set up their HQ. Seedcamp also significantly assisted with further rounds after the company's pre- seed round, and facilitated introductions during a critical US trip, where the Company met with a16z (its first US institutional VC) and other VCs. Its headcount increased significantly through investment (from four to 2,200) and it has opened offices globally.

c. **Expand the British Business Bank programmes:** continue to fund the current British Business Bank programmes, including the ECF and BPC, and expand the BBB's remit to cover the full continuum of funding needs, including impact and growth funds that make minority and buyout investments, to match the support offered by the European Investment Fund (section 1 and 5)

d. **Reform Solvency II:** address the risk rating rules that restrict UK insurers from investing in VC and growth funds and unlock further domestic investment in UK innovation (section 6)

Case Study

## ELeather

ELeather, based in Peterborough, takes unused leather offcuts, breaking it down to the fibre level, and then using its pioneering technology to create new sustainable, engineered materials. ELeather's proprietary, clean manufacturing process, which uses a closed loop recycled water plant, adds to the already impressive environmental credentials. In 2017, the company was able to enter into a long-term strategic partnership with Nike and introduce a new performance material in 'Nike Flyleather'. The company has been supported by ETF Partners (Europe's leading sustainable VC firm) since 2014.

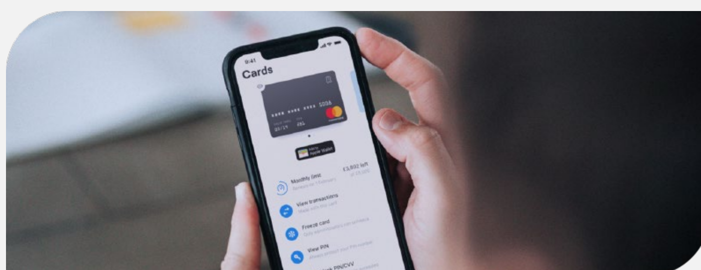
2. Innovation and intellectual property

a. **Support university spinouts by building more cluster ecosystems:** build closer relationships between universities, angel investors and VCs, to ensure that university spinouts can raise capital quickly and have the best funding ecosystem available to scale and grow companies (section 1)

b. **Scale investment into funds that focus on R&D-intensive sectors:** improve the investment landscape for companies in areas such as deeptech and life sciences, through further support to the British Business Bank or similar government supported investment scheme (section 8)

c. **Reform the SME definition to allow more companies to claim R&D tax credits:** update the EU SME definition so that companies backed by VC funds are not aggregated and therefore lose out on access (section 7)

d. **Support the growing impact investment funds sector:** by mobilising capital to help VCs looking to use their investments to address the UK's societal and




Case Study

## Revolut

Revolut is a British Fintech company offering both personal and business Banking services. In 2015 Revolut launched in the UK, offering money transfer and exchange. Today, their customers around the world use dozens of Revolut's innovative products to make more than 100 million transactions a month. Across personal and business accounts, they help customers improve their financial health, give them more control, and connect people seamlessly across the world. The business has been supported by Seedcamp, among others, since April 2015, helping its headcount go from 5 to more than 2000.

environmental challenges (e.g. expansion of BBB's remit, revisiting tax incentives to catalyse capital) (section 1)

3. Talent and people

   a. **Streamline the process for recruiting talent:** simplify the visa schemes to reduce costs and increase the speed of overseas recruitment so VCs, and the companies they invest in, can easily access the talent they need to grow companies (section 1)

   b. **Address the long-term skills gap for high growth tech and science companies:** continue to promote education in STEM, data science and other tech related skills, and promote enterprise and entrepreneurship at all levels of education. The government's recently announced Digital Skills Council is a welcome move and we look forward to working closely with them (section 6)

Case Study

## Nova Pangaea Technologies

NPT, based in Redcar, Teesside, takes unwanted plant biomass or offcuts – such as sawdust – and converts it into sugars. The sugars can be fermented into bioethanol for sustainable aviation fuels, and the biochar replaces coke within sectors such as the steel industry to create green steel and is considered carbon neutral. NPT has been supported by Par Equity and Mercia Asset Managers, among others, since 2017.

In Aug 2021, Nova Pangaea was one of eight winners who were chosen to take part in the Department for Transport (DfT) Green Fuels Green Skies project. NPT has since partnered with British Airways and LanzaJet (Project Speedbird) to deliver 113 million litres of sustainable aviation fuels in the UK. Project Speedbird is halfway through the feasibility study, which began in October 2021, will conclude in 2022.

   c. **Drive a diverse pipeline of VC talent and funding outcomes:** continue to fund and promote government-supported initiatives such as the Investing in Women Code, Rose Review and women-led high-growth enterprise taskforce, and industry-led initiatives such Diversity VC and Future VC, to ensure more women and people from different backgrounds and ethnicities are represented in VCs and the businesses they back (section 1)

4. Tax and regulation

   a. **Renew the EIS/VCT schemes:** the government should state that it intends to renew the schemes as soon as possible to remove uncertainty for EIS and VCT funds and the innovative companies they invest in, which are often outside London and the South East of England. The April 2025 sunset clause is already impacting early-stage funding, and resolving this uncertainty should be a priority for Government (section 3)

   b. **Refine the scope of the NSI Act to focus on key policy areas:** the mandatory sector definitions need to be clearly defined and additional guidance is needed to ensure the NSI Act does not negatively impact deal making in the UK. The ISU should be properly resourced to deal with increased notifications (section 7)

   c. **Enhance the UK's position as an international destination for IPOs:** continue to reform the UK listings rules, which will help improve the competitiveness and environment for innovative

companies listing in the UK, and will result in UK markets becoming more competitive against other financial centres (section 7)

d. **Improvements to the regulatory regime for VC fund managers:** introduce an improved funds regime, which will help facilitate investment and make the UK a more competitive place for VC managers to establish funds, raise capital and invest in early-stage UK businesses (sections 4 and 6)

The appendix to this submission goes into greater detail on each of these policy areas and we would be happy to present further details on this to the Committee in an oral session.

In addition, we believe that the Committee could helpfully consider the following three areas of government action.

1. **Levelling Up Access to VC.** The Government is currently working on plans for "clusters" and "super clusters" across the UK to boost the innovation landscape across the UK. HMT could further support these plans with local tax incentives, rates relief, marketing support and local investment opportunities for venture capital in the nations and regions across the UK. Firms with a base in these clusters could be entitled to preferential access in bidding for funds available through Government grants and funding schemes, including the Levelling Up Fund, the Transforming Food Production Programme, and all innovation funding programmes advertised through the UK Innovation Funding Service.

2. **To deliver this, we need an integrated strategy for backing venture capital investment across the UK** – a strategy which brings together policies and teams from the devolved nations, the Treasury, BEIS, Levelling Up Department and Metro Mayors across England with **the shared ambition of making Britain the best place in the world for venture capital.** Across national, local and devolved governments, there are many policy levers that are at the disposal of policymakers. **To measure the success of this work and the viability of Britain as a home for venture capital funding, we recommend a bi-annual benchmarking programme, assessing UK policies on Capital, Innovation, Talent, Tax and Regulation against other key VC markets across Europe.**

3. **Finally, it is important that policymakers also recognise the principle of supporting firms through all stages of their development, as they move from being a start-up with venture capital backing, to a fully-fledged scale-up backed by other types of private capital.** Growth capital firms that make minority as well as buyout investments are often – particularly in regions and nations outside London and the South-East – the exit route and next stage for start-ups supported by Venture Capital. They are also crucial to the success of the next generation of high skilled, high wage, high growth and high quality companies that we, as the private capital industry, are determined to nurture.

Case Study

## Neurovalens

Neurovalens, based in Belfast, is a medical device company with the vision to create technology designed to tackle the rapidly increasing global epidemics of metabolic and neurological disease. Current projects include non-invasive technology designed to treat a wide range of diseases by delivering electrical stimulation to deep parts of the brain. Neurovalens has been supported by IQ Capital, a specialist deeptech investor, since 2019.

APPENDIX – feedback on the Terms of Reference

**1. The current state of the venture capital industry in the United Kingdom, including opportunities and threats, such as the availability of domestic capital to allow firms to scale up in the UK.**

Our key recommendations are:

- **Increase levels of later stage funding for UK VC and growth funds:** UK companies often look overseas for expansion and growth capital. We must ensure venture and growth capital funds have sufficient scale and expertise to invest in innovative companies so that they remain and grow in the UK
- **Support university spinouts by building more cluster ecosystems:** build closer relationships between universities, angel investors and VCs, to ensure that university spinouts can raise capital quickly and have the best funding ecosystem available to scale and grow companies
- **Drive a diverse pipeline of VC talent and funding outcomes:** continue to fund and promote government-supported initiatives such as the Investing in Women Code, Rose Review and women-led high-growth enterprise taskforce, and industry-led initiatives such Diversity VC and Future VC, to ensure more women and people from different backgrounds and ethnicities are represented in VC and the businesses they back
- **Create BBB programme to invest in impact funds:** support the growing impact investment fund sector by providing more capital via the BBB to help VCs looking to use their investments to address the UK's societal and environmental challenges

## Current state of the venture capital industry in the UK

The UK venture capital industry has seen exponential growth in recent years. In 2017, BVCA VC members raised £770 million from the UK and by 2019 that figure had more than trebled to £2.4bn[10]. In 2020, in the face of unprecedented and extremely challenging macro-economic conditions caused by the COVID pandemic, UK venture capital demonstrated strong resilience with support from the Future Fund, recording its best ever year with investment reaching £11bn/US$15 billion[11]. Furthermore, VC investment in the UK between January and March 2022 came close to £7bn - or more than 30% of total European investment[12]. The size of funding rounds has also grown rapidly. In 2021, the UK saw 68 "megarounds" of $100m plus, almost five times more than the 14 rounds of $100m plus in 2017.[13]

VC funds are supporting many thousands of UK businesses to scale, innovate and create jobs. By 2020, more than 21,000 companies were backed by venture capital and 96% of these were start-ups employing 50 or fewer people.[14] This includes investment into sectors that are at the frontiers of the new technological revolution – health tech, deeptech, impact and climate solutions, and life sciences.

These are the sectors that can, and are, making a difference on a global scale, and sectors that are drawing funding from all over the world. UK companies continue to be attractive investments for international investors with 63% of investment into UK tech coming from overseas in 2020, up from 50% in 2016.[15] The UK is also third in the world for investment into impact tech – businesses looking to use their technology to address the world's biggest challenges, e.g. climate change – which has increased 160% since 2018 to $2.6bn[16].

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[10] BVCA Quarterly Review October 2020 – available here
[11] BVCA Quarterly Review January 2021 – available here
[12] City AM: UK venture capital surges ahead of Europe as investors shake off market jitters, 21 April 2022 available here
[13] State of European Tech Report 2021 – available here
[14] BVCA Innovation Nation Report 2020 – available here
[15] Tech Nation Report 2021 – available here
[16] Ibid

### The Global Challenge and Creating Fairer Pensions

Despite the tremendous success of UK VC – and the success of the firms it supports (the rate of tech GVA contribution to the UK economy has grown on average by 7% per year since 2016[17]) – there are still areas where it falls behind its global counterparts. Compared to US VC, the UK industry raises less domestic capital for VC funds. This is, in part, due to current regulation that makes it more challenging for defined contribution (DC) pension funds to invest into long term, illiquid asset classes which generally have higher fees for active management.[18]

UK VC funds deliver very strong returns. VC funds investing since 2011, as included in the BVCA Performance Measurement Survey, collectively generated an annualised return of over 22% return on investment to 31 December 2020[19]. Despite this, the majority of people in work today in UK DC pension schemes are unable to access these funds, in large part because if the returns are too high (i.e. if the fund is "too successful"), the variable performance incentives associated with them could breach the charge cap that applies to DC pension schemes subject to auto-enrolment. Similar rules do not apply to many other overseas DC pension funds, which make sizeable returns from their VC investments. The BVCA is working with the Productive Finance Working Group and the DWP to explore the ways in which the charge cap can be changed to exclude well-designed performance fees and carried interest. This will unlock UK DC pension fund investment in VC funds (supported by awareness-raising initiatives like the Productive Finance Working Group (PFWG)), opening up VC returns to the younger generations of UK savers in DC schemes (further details in section 6)

### Invested in a Better Future

The types of businesses that VC invests in are high growth businesses that are looking to scale over a 7-12 year period. These companies have different funding requirements as they develop and grow. Sometimes they simply need cash to fund expansion and, at other times, having the right network is key. VC and growth funds always seek to ensure they can bring value to the table – matching their insight and experience to the funding they also provide. As a result, as a business grows from a start-up to a leading tech company (a unicorn, which is a start-up worth $1bn, and far beyond) its ownership will change to reflect its developing needs – from venture to growth then to private equity (see section 2). This is a natural cycle of business growth, and private capital plays a vital role in this growth until a company is of a size and scope to become quoted on public markets, if its investors and board determine that this is the correct course.

The table below outlines the growth journey of a company with the types of funding that venture and growth capital provide. This chart is illustrative only and firms in different parts of the industry may operate in more than one part of this investment spectrum, depending on their fund strategies. For example, a traditional software tech business can scale much more quickly and raise larger amounts at the earlier stages (2-3 years), but R&D-intensive companies in areas such as deeptech and life sciences can take much longer to reach the later VC and growth stages (7-12 years). The picture is also different in the regions, where the VC ecosystem is more fragmented (see section 8).

| | Business development | Types of funding | Typical investment |
|---|---|---|---|
| VENTURE CAPITAL | **New idea generation**<br>1-3 founders<br>0-1 years | Bootstrapping (funding from family & friends), angel investors & pre seed capital | £0-£500k |
| | **Develop prototype and test product/service**<br>2-5 people<br>1-3 years | Seed capital including SEIS, EIS, funds | £500k-£3m |
| | **Launch product or service, generate revenues**<br>5-10 people<br>3-4 years | Early stage VC & series A round including VCT funds | £3m-£20m |

[17] Tech Nation Report 2021 – available here
[18] BVCA response to DWP consultation on the review of the default fund charge cap and standardised cost disclosure – available here
[19] BVCA Performance Measurement Survey 2020 – available here

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|---|---|---|---|
| | **Grow revenues, expand team**<br>10-20 people<br>5-7 years | Late stage VC & series B-C rounds | £20-£50m |
| GROWTH | **New product launches, generate profits**<br>20-50 people<br>7-10 years | Growth capital | £50m-£100m |
| | **New product launches, generate profits, improve processes**<br>c.50 - 300 people<br>10 years+ | Further growth & expansion capital | £100m+ |

To illustrate this business development pathway, BVCA members sold all, or part, of 563 businesses in 2020. Of these, 25% were at the venture stage and 43% at the growth stage on the date of first investment.[20]

VC funds act as a bridge between investors seeking high capital growth and innovative companies with high growth potential. Alongside capital investment, VCs also provide operational and strategic guidance for the companies they invest in. The investors at each stage of a company's growth (as outlined above) are different, and while some investors do reinvest as the companies grow, the initial investors are usually replaced by larger investors who offer different types of expertise. For example:

- **Seed stage investors** will work closely with the founding team to help develop products/prototypes and identify market fit for the portfolio company;
- **Series A investors** develop the product further and build out the team and company structure; and
- **Late-stage VC and growth funds** will bring the product to market and even expand the company internationally.

Each of these investors represent a distinct and valuable part of the VC ecosystem and the pipeline of high growth companies.

### Seed & early-stage deals – seed to series A funds

The UK is often rated as one of the best places to start a business in Europe with the largest availability of overall VC funding[21]. However, there have been signs that investment at the seed stage has declined in recent years, with the number of series A deals overtaking seed deals from 2018-2021[22]. Despite being rated as the best place to start a business, if you measure the number of start-ups per capita, then the UK is eighth in Europe in 2020 with 406 companies per 1m of the population, which is a long way behind the Netherlands (507) and Estonia (865)[23]. Investment in seed stage companies has also dropped since the pandemic, with rounds consolidating at later series A rounds but dropping at the earlier stages[24]. This happens when investors look to look to consolidate investments in successful companies at series A and beyond, rather than take more risks at the early stage.

Many of the funds that invest at seed to series A have been part of the Enterprise Capital Fund ("ECF") programme from the BBB, which has traditionally supported first time fund managers who invest in this space. The BBB has been a key driver of attracting capital to early-stage funds, and the ECF programme has successfully produced many of the now well-established VCs in the last 10 years and has continued to invest in them as they grow and generate returns. However, this has left a gap for first time fund managers, so more money should be allocated to new fund managers who invest at the early/seed stage, as noted by the BBB's interim analysis of the ECF programme[25].

[20] BVCA Report on Investment Activity 2020 – available here
[21] Tech.EU: What's the best place in Europe to start a business? - available here
[22] Beauhurst: The Deal 2021 – available here
[23] State of European Tech Report 2020 – available here
[24] British Business Bank: Small Business Equity Tracker 2021 – available here
[25] British Business Bank: Enterprise Capital Funds Interim Valuation – available here

SEIS and EIS investors are also very important, especially in the nations and regions outside London and the South East, where there are fewer early stage funds operating[26]. There are targeted ways to improve the availability of capital at this stage across the UK (see section 8), and the main threat is the EIS/VCT sunset clause (section 3).

### Early-stage deals – series A-B funds

The market for series A (the first round of financing a new business undertakes after seed capital) is generally well served in the UK. The number of series A deals has continued to increase in the last decade[27]. The growth and success of this area of investment has been one of the key foundations for the success of UK VC, although the nations and regions of the UK still require further scale to match the rounds seen in London and the South East (see section 8). The main threats to this part of the market, are linked to deal friction caused by new legislation such as the NSI Act (see section 5), and insufficient levels of government funding to meet market demand for the BBB programmes, such as the ECF and regional fund programmes.

### Late-stage deals – series B-C & growth funds

It is at the later stage of VC investing that there has long been understood to be a scale up financing gap, with UK companies reaching series B, C and growth rounds often looking for larger investments from the US and other sources. This is because UK VC funds lack the size to make these investments, which often require the largest rounds to create large-scale, independent, businesses. Since 2018 British Patient Capital ("BPC"), a subsidiary of the BBB, has been fundamental in driving growth in fund sizes in late stage and growth funds in the UK.

Even with the funding provided by BPC since 2018, the UK was still far behind the US in terms of VC invested as a % of GDP in 2020 (UK – 0.46%; US – 0.65%)[28] and the overall scale up gap for UK VC and growth funds is estimated to be around £15bn a year.[29] Despite the recent increase in late stage deals[30], the UK is still far behind the US in terms of the amount it invests in scale up capital for its most valuable companies, and none of today's top ten UK companies were founded or truly scaled up in the last 20 years, compared to 7 in the US.[31] UK companies often look overseas for expansion and growth capital, so we must ensure venture and growth capital funds have sufficient scale and expertise to invest in innovative companies so that they remain and grow in the UK. This can be achieved by continuing to support and fund BPC and unlocking institutional capital (from DC pension schemes and insurance companies) for investment into UK funds and later rounds, and addressing issues around investment culture outlined below.

### Investment appetite/culture

UK VC funds are underserved by domestic investors, and this is largely down to a lack of investment from domestic pension funds and other institutional investors. This means that the excellent returns being generated by VC funds are going to overseas investors rather than UK institutions, and their beneficiaries. In 2020, the total investment in UK VC funds by domestic pension funds was 0% and only 5% for growth funds, according to BVCA data.[32] We believe that a fundamental change is necessary – in mindset and culture – around investment into industries of the future and the VCs that support them. Part of this is also linked to making regulatory changes (section 6) and updates to the listings rules (section 6).

Investing in early-stage businesses is riskier than investing at other stages, especially those that are pre-product and pre-revenue (9 out of 10 start-ups end up failing[33]), and VC [funds] plays a key role in de-risking this by spreading investment across multiple companies. When there are economic shocks, VCs can also weather the

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[26] BVCA Report on Investment Activity 2020 – available here
[27] Beauhurst: The Deal 2021 – available here
[28] British Business Bank: Small Business Equity Tracker 2021 – available here
[29] The ScaleUp Institute, Innovate Finance and Deloitte Future of Growth Capital Report – available here
[30] BVCA Report on Investment Activity 2020 – available here
[31] Lakestar: The UK Financing Gap, June 2022 – available here
[32] BVCA Report on Investment Activity 2020 – available here
[33] Beauhurst: UK Startups That Failed in 2021 – available here

storm as they are long term investors (who typically invest in a company for 7-10 years, although it is often longer before returns are generated[34]) and can continue to invest and support the company through other ways (as seen during the Covid crisis where financial as well as non-financial support kept many start-ups afloat). Given the nature of the investment and the time taken to generate returns in a new portfolio, institutional investors need to commit capital for longer periods of time compared to other asset classes. Whilst this can be challenging for certain types of investors (specifically those that require more liquidity), longer term asset allocations should be viewed as a central part of the investment strategy for future UK economic growth.

### Attracting the Best Talent

The UK VC industry would also benefit from incentives that attract international talent to work with them and in the businesses they support. London is Europe's leading tech-hub and the leading destination to grow a tech business outside of Silicon Valley[35]. Across the UK, tech clusters have grown with expertise in areas such as EdTech, HealthTech and climate tech[36]. London, Cambridge, Bristol, Edinburgh and Oxford are often listed in the top 20 European cities for tech investment[37]. The development of these clusters supports calls for easy relocation for global talent to set-up and work in UK businesses. This would increase our nation's competitiveness, attracting the best and the brightest to the UK.

VC firms support businesses across the UK's nations and regions, and the level of funding that VCs are putting into these businesses is growing. For example, England's North West is home to six of the UK's unicorns[38] and VC investment in the North East accounted for 5% of all UK VC investment in 2020[39]. This national and regional development would benefit greatly from an increased talent pool and further incentives to establish businesses in these areas (further details in section 8).

### Building the "science and technology superpower"

The UK is well placed to enhance its status as a global science and technology superpower. There has been a significant increase in investment by VCs in R&D intensive companies over the last decade in this sector, although it still makes up a relatively small section of overall VC investment[40][41]. The UK must build on areas where it has long term strengths in R&D, such as life sciences, and capitalise on recent successes in areas such as climate tech and deeptech. The link between universities and VCs and angel investors is often key to the developing companies in this space, but they can also develop outside of universities.

The UK is a leading global hub for life sciences investment, and there has been significant increased investment in innovative companies in areas such as biotech and medtech[42]. The BPC's Life Sciences Investment Programme has been an excellent way to catalyse investment in the space[43], and it is well served by a pipeline of companies from the UK's leading universities. The majority of R&D and drug development in the UK is now undertaken by start-ups which are often backed by specialist VCs and corporate venture capital funds (CVCs) from larger corporates[44], and although they have longer investment horizons, they have a clear exit route with leading UK and global corporates should trials prove successful. However, to create new companies that can stand alone, and become new global players in this space, the risk appetite and quantum of capital invested in these companies would need to be greatly increased.

[34] Jumpstart: How long until a VC makes returns? – available here
[35] Private Equity Wire: London maintains its crown as one of the world's top startup hubs, 29 September 2021 – available here
[36] 2021 Tech Nation Report – available here
[37] 2020 Tech Nation Report – available here
[38] BVCA Nations & Regions Report: North West England – available here
[39] BVCA Nations & Regions Report: Yorkshire, the Humber & North East England – available here
[40] British Business Investments: Regional Angels Programme – available here
[41] BVCA Report on Investment Activity 2020 – available here
[42] BVCA/ ABHI Access to Finance Report 2020 – available here
[43] British Patient Capital: Life Sciences Investment Programme – available here
[44] Opportunity on your doorstep: A guide to investing in the UK biotech sector, BIA 2020 – available here

Investment in deeptech (companies that look to develop significant scientific advances), is a relatively new area of growth for UK investment[45], but the average investment in deeptech companies in the UK is still on average behind the US and the rest of Europe[46]. Deeptech is well supported in specific clusters in areas such as Cambridge, and deeptech companies can often access funding from seed to series A rounds, but struggle to then push on through later stage rounds, and often look to the US for funding and building the infrastructure necessary to scale. This is for similar reasons outlined earlier in this paper. The strategic importance of deeptech companies for future scientific advancement and growth is also now better understood, and the UK needs to do more to bridge the gap with Europe and the US.

More should also be done to build closer relationships between universities, angel investors, and VCs to ensure that university spinouts can raise capital quickly and have the best funding ecosystem available to scale and grow companies. For example, a recent survey of spinout founders found that they had to wait more than six months to complete an investment, whereas regular seed investment takes around three months, and UK universities take much greater equity stakes in spinouts (19.8%) than Europe (7.3%) and the US (5.9%), making it more difficult to bring in external investors to help scale the company.[47]

The UK is well placed, given the specialist knowledge of investment advisers across the country and in the City of London, to help develop investing expertise in areas such as life sciences, and help bridge the gap between VCs and large institutional investors who have not traditionally invested in this asset class. There is a massive opportunity to build on our inherent strengths in these areas, but if the UK is to create new companies of unicorn or even decacorn size, more must be done to unlock institutional investment to create more growth capital and appropriate risk appetite, as outlined above. The government is also well placed to support these sectors by facilitating investment given the unique criteria required and fostering links between universities and investors.

### Enhancing Diversity and Inclusion (D&I)

The VC industry knows that it must improve diversity and inclusion in the sector given the low levels of funding going to female and diverse founders, as well as the low proportion of women and people from different backgrounds and ethnicities in VC investment teams. The BVCA promotes the participation of people from all socioeconomic backgrounds and of all ethnicities, genders and sexual orientation in the VC industry. This includes representation in investment and senior roles. We support and partner with industry groups, including Level 20, Diversity VC, the British Business Bank, the UK Business Angels Association, the Rose Review Council and other organisations to champion as well as deliver meaningful policies to improve diversity in private capital.

The VC industry is involved in relevant government initiatives, most recently the Investing in Women Code (IWC). The IWC commits all financial institutions to the principles of gender equality and transparent reporting of gender funding data. The 2022 progress report on the Rose Review[48] into female entrepreneurship highlighted the significant uptake in VC signatories to the IWC over the past year, from 50 to 90, and the BVCA and British Business Bank have been tasked with increasing this number. The BBB's Annual Small Business Equity Tracker reported that around 2% and 5% of total VC investment was received by all-female teams in 2019 and 2020, out of record high levels of £8.5 billion and £8.8 billion, respectively, of total annual VC investment. The IWC, alongside other industry initiatives, seeks to improves levels of funding for female and diverse founders. The BBB, BVCA and UKBAA are also working on a pilot to expand the IWC data collection to cover investment into founders from different ethnicities.

In a drive for industry transparency, the BVCA and Level 20 published a survey report[49] in March 2021 after collecting data on diversity across VC and private equity. The report revealed some positive progress on gender

[45] Dealroom – 2021: The year of Deep Tech – available here
[46] British Business Bank: Small Business Equity Tracker 2021 – available here
[47] Air Street Capital: Rewriting the European spinout playbook – available here
[48] The Alison Rose Review of Female Entrepreneurship: Progress Report 2022 – available here
[49] BVCA/Level 20: Diversity & Inclusion Survey 2021 – available here

diversity but indicated further improvements must still be made. The report was also the first of its kind to gather detailed data from firms on ethnicity and the results indicated that much more progress is needed.

The VC industry participates in forums (including via the BVCA and Diversity VC) to share intelligence on new and topical areas to assist their efforts. We host regular face-to-face and digital networking events which are designed to be inclusive and provide a convivial and open environment to exchange experiences, share best practice, debate the issues in our industry and showcase what firms are doing to improve D&I. In 2021 we published best practice guidelines to help increase investment in under-represented founders and drive diversity and returns across the investment sector. The guidance focussed on four key areas:

1) Talent acquisition, retention and development;
2) Internal education, culture and policy;
3) Outreach, access to deal flow, and unconscious investment bias; and
4) Influence, external guidance and portfolio management.

Further details can be found on the BVCA website[50]. Measures to enable change inside venture capital firms can include: demystifying the process of seeking investment and collaborating with early-stage investors (as this attracts a more diverse pipeline); expanding networks to facilitate more 'warm' introductions; setting ambitious diversity targets; incorporating D&I into VC investment term sheets; and appointing senior champions of this work.

The government should continue to fund and promote government-supported initiatives such as the Rose Review, Investing in Women Code and women-led high-growth enterprise taskforce, and industry-led initiatives such Diversity VC and Future VC.

### Climate and sustainability

For the VC industry, the desire to invest sustainably, tackle climate change and support national governments to reach Net Zero is no new thing. VCs such as Environmental Technology Fund Partners (ETF Partners) were set up in the early 2000s, at a time when the concept of delivering investment returns alongside environmental aims was hotly disputed.

VCs are and will remain key to global and national efforts to reach Net Zero. We need the innovations and ideas which venture capital, and the wider private capital lifecycle, will nurture and scale to national and global applications. Ideas such as the next generation of electric batteries for cars (such as those developed by Advanced Electric Machines, backed by Northstar Ventures), or the methods to scale hydrogen fuel cells flexibly and at low cost for ordinary consumers and manufacturers (such as those developed by Bramble Energy, backed by BGF).

Furthermore, the long-term view taken by the VC industry helps to support existing business to tackle their impact on climate change – be that funding investment in new infrastructure or technology, fundamentally restructuring a business, or creating the trajectory for certain assets to be decommissioned. It takes the time, patience and expertise, found at the heart of VC investment, to address these difficult questions.

Through the prism of VC investment, we can see an exciting future for the UK as a possible home of the global greentech and climatetech sectors. Today, UK VCs are investing in the low carbon energy solutions we know work (such as technology for offshore wind), low carbon energy solutions we know we need (such as next generation battery technology), as well as new low carbon energy solutions we need to make work (such as hydrogen technology). They are backing the companies who are leading the way for sustainable consumer products across the globe and adapting urban transport with sustainability at its heart. With transparency in mind, VCs are also transforming the effectiveness of carbon offsetting, as well as working together to set a path for the industry to do more to support the companies they back on their own sustainability journey. Supporting UK VCs to grow and flourish, as set out in this document, will help drive the very real solutions we need to tackle climate change.

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[50] BVCA: Leading investors and professionals come together to create a next-generation blueprint for Diversity and Inclusion in the investment industry – available here

### Growing start-ups with ESG at their core

Not only does the VC industry have a leading role to play in funding climate solutions, but it also has a responsibility to create companies, from the ground up, which have ESG considerations at their heart. A company with one founder and a reliance on energy-intensive technology may not have the best governance, diversity or sustainability credentials today, but it is the responsibility of VC backers to ensure that company has the plans and the capability to grow in a way which is mindful of diversity and sustainability challenges and has the highest standards of governance. This is not only good for the VC – ensuring that the business will be future-proofed to tackle ESG requirements as it scales; but it is also a requirement of many VC investors, who themselves have high standards for ESG, which they expect all their investments to adhere to. Many VCs have adopted and report under existing ESG-related initiatives (including being signatories to UNPRI) or provide bespoke ESG reporting to investors.

As the VC industry is inherently collaborative, a number of initiatives have been built from the ground up to help VCs to work with their founders and fledgling companies to set a path to be fit for the ESG challenges of today and tomorrow. Initiatives such as ESG_VC and VentureESG provide free-to-use tools to assess ESG practices within companies today and plans to improve ESG practices in the future. This allows data to be aggregated and standards to be set to encourage best practice and help identify what good looks like for start-ups. Alongside the BVCA, these initiatives also help to train people and investors in making ESG plans a reality and provide a forum for continual learning and sharing best practice.

### Impact investment

Impact investors intentionally seek to achieve positive, measurable, social and environmental impact. For UK VCs, this is a fast-growing investment approach. The VC ownership model is uniquely positioned to provide the capital, strategic insight and operational support that will help this new generation of businesses succeed at scale – allowing them to achieve tangible social and/or environmental benefits alongside attractive financial returns.

The government should facilitate investment in the UK's growing impact investment funds industry as fundraising continues to be challenging for smaller VC impact funds. Smaller funds are less able to raise large amounts from institutional investors because ticket sizes for smaller funds are typically below the minimum level at which it is viable for larger institutional investors to commit. The British Business Bank could have a broader mandate to invest in impact investment as this is an area the European Investment Fund had previously invested in.

The Social Investment Tax Relief (SITR) had significant potential to unlock private capital for social good, but take-up was limited. We would encourage further investigation to understand what changes could be made to support greater investment via the SITR

The BVCA also hosts forums with the impact investment firms to share best practices and promote the sector to investors in the broader private capital industry.

As explained above, VC firms are well placed and incentivised to integrate climate and broader sustainability considerations (including diversity) into their operations. UK sustainability regulation for private capital investment must be proportionate (e.g. Sustainability Disclosure Requirements), whilst being compatible with international frameworks.

## 2. The level of co-operation/integration between start-ups and established industry

Established industry and private equity (PE) investors, along with other routes such as IPOs, are a key source of exits for VC investments. There is also a level of vertical integration, as they are also directly investing at the VC stage via CVCs investing on behalf of large companies and PE firms setting up growth funds that invest in minority stakes at a much earlier stage. This is driven in part by the improved returns of VC more generally, to help create deal flow, and as a way to integrate technology and IP into larger companies.

The connections with established industry are more important in the regions and nations of the UK outside London and the South East, where established industry is often the most likely customer and exit route for local start-ups (see section 8).[51] We are also seeing larger PE firms investing more in the VC space and buying out VCs in strategic areas such as life sciences[52], which will provide these funds with larger pools of capital to invest in R&D-intensive businesses.

## 3. The operation and effectiveness of the current tax incentives (such as the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs)) in the venture capital market, including any options for change.

Our key recommendations are:

- **Renew the EIS/VCT schemes:** the government should state that it intends to renew the schemes as soon as possible to remove uncertainty for EIS and VCT funds and the innovative companies they invest in.
- **Incentives for impact investment:** The Social Investment Tax Relief had significant potential to unlock private capital for social good, but take-up was limited. This could be reviewed again.

Further detail is set out below.

### EIS and VCT schemes - the sunset clause

The combination of EIS, SEIS and VCTs are a vital part of the early-stage and growth investment ecosystem. SEIS facilitates for very early-stage investments, EIS provides for a further advance in maturity and VCTs for further growth and scale up capital. All of these reliefs play a critical role for a range of smaller, entrepreneurial companies in securing the funding that they need. We support the recommendations of the EISA and VCTA for changes that can help improve the effectiveness of the regimes.

As a condition for EU state-aid approval, the 2015 Finance Bill contained a sunset clause that would restrict EIS/VCT tax relief to shares issued before 6 April 2025. Anecdotally, the BVCA understands that the sunset clause is now being used by advisers as a possible risk for future EIS and VCT investments, and this is expected to have a knock on effect on investment. We urge HMT to renew the EIS, SEIS and VCT schemes and state its position as soon as possible to avoid creating further creating uncertainty in a sector that is vitally important to the UK SME and start-up sector, particularly outside London and the South East.

For further recommendations, we refer the Committee to the submissions made by the EIS Association and VCT Association.

### Incentives for impact investment

The Social Investment Tax Relief (SITR) had significant potential to unlock private capital for social good, but take-up was limited. We would need to investigate further what changes could be made to support greater investment as it has been some time since it was reviewed. Factors that have inhibited its growth:[53] a lack of awareness of the relief; widespread belief that SITR was too similar to EIS and not targeting the specific needs of the social investment sector; slow administrative processes around the relief; unclear or insufficient guidance on its use; and complex eligibility restrictions.[54]

## 4. The operation and effectiveness of the regulatory regime(s) concerning venture capital.

Our key recommendations are:

[51] See Mercia submission to the Treasury Select Committee Inquiry for further details
[52] See recent PE investment in Abingworth and Sofinnova – available here & here
[53] Social Investment Business, A review of Social Investment Tax Relief for charities and social enterprises, 2019 – available here
[54] HM Treasury, Social Investment Tax Relief: call for evidence, 2021 – available here

- **Improvements to the regulatory regime for VC fund managers:** introduce an improved funds regime, which will help facilitate investment and make the UK a more competitive place for VC managers to establish funds, raise capital and invest in early-stage UK businesses

Further detail is set out below.

### Improving the UK regime for VC vehicles

To facilitate more investment in UK VC, and enhance the UK VC ecosystem, the Government should consider improving the existing regime for VC managers and fund vehicles to make the UK a more competitive place for VC managers to establish funds, raise capital and invest in early-stage UK businesses.

We believe it is not necessary to introduce a new type of vehicle to achieve this. Instead, this can be achieved by improving the regime which the UK inherited from the EU (known as EuVECA). The onshored UK version is the Registered Venture Capital fund (RVECA) regime. There has been low take up of this vehicle due to its rigidity, for example its strict limitations on debt finance and the fact that successful portfolio companies can threaten the fund's RVECA status if they grow too much and too quickly (the very outcome that venture capital support is designed to achieve). Amendments should seek to remove unnecessary investment barriers and ease inherited administrative and organisational burdens on VC managers, while maintaining high regulatory standards. Examples are set out in the next paragraph.

The current RVECA regime limits investments in early-stage UK businesses to equity or quasi equity only, while those UK businesses actually need investment at all levels of their balance sheet. In addition, several operational and organisational requirements, and the high regulatory capital requirement, make the regime less attractive to UK VC managers than those of other jurisdictions.

With a few amendments, the RVECA, or a similar new VC-focussed regime, could be a significant driver of increased investment in early-stage UK businesses, supporting more VC managers and VC funds to set up in the UK, and enhancing the UK VC ecosystem.

### Improving speed to market

The time taken to complete regulatory application and notification processes is a key consideration for investment firms when considering where to locate. This can be the difference between success and failure for start-ups and early-stage businesses where speed to market can be critical.

While we fully recognise the importance of the FCA maintaining robust and high standards, the lengthy waits of up to and beyond 12 months for new manager authorisations and regular delays of several months experienced by our VC members regarding relatively straightforward approvals are frustrating and disruptive to industry. To address these issues, we recommend more case workers at the FCA to assess applications and notifications, automation of low-risk processes and proportionality to simplify certain processes. For example, change of control notifications for portfolio companies is currently the same as that would apply when acquiring a controlling stake in a large banking group.

### The Appointed Representatives regime

The Appointed Representatives (AR) regime allows a firm to carry on regulated activities on behalf, and under the responsibility, of an FCA authorised person. It provides a valuable and flexible alternative to full authorisation, which can take up to 12 months, and is important when speed to market is critical – for example, in the context of new businesses.

We support the FCA's recent consultation proposals to improve the existing regime and enhance consumer protection following Greensill.[55] However, we have cautioned against any changes that will reduce the advantages of the AR regime to VC firms and wider industry, without a commensurate increase in consumer protections (e.g. the proposed 60-day notification period for new ARs).[56] We have also responded to HMT's Call for Evidence on the AR regime with our view that the AR regime is working well for VC. Considering the FCA's consultation proposals, we do not believe that legislative changes are necessary.[57]

See also section 6 for regulatory recommendations to support further investment into VC funds.

**5. The role of other key bodies, such as the British Business Bank and the programmes which it oversees (including the Future Fund and British Patient Capital), and the Advanced Research and Invention Agency, and how they can support the venture capital market.**

Our recommendations are:

- **Expand and diversify the British Business Bank programmes:** continue to fund the current BBB programmes, including the ECF and BPC, and expand the BBB's remit to cover the full continuum of funding needs including impact and growth funds that make minority and buyout investments, to match the funding criteria of the European Investment Fund

Further detail is set out below.

### British Business Bank and investment

The Government must continue to strengthen and bolster the scale of the UK's venture and growth capital funds industry by continuing to fund (as well as increasing the funding available to) the British Business Bank (BBB) and British Patient Capital (BPC). In respect of the funding gap, HM Treasury's work on patient capital in 2017 set out the evidence around a gap in the supply of patient capital in the UK[58]. More recently, a report from the ScaleUp Institute, Innovate Finance and Deloitte identified a £15bn funding gap for growth capital[59]. The BBB/BPC are playing a key role in facilitating investment in UK businesses, and this was particularly critical during the pandemic with successful interventions such as the Future Fund. As outlined in our recent investment report[60], record amounts of investment have been made by BVCA members to the nations and regions of the UK and this was also seen in the Future Fund's statistics.

The Government has created the right policy framework that now means the BBB/BPC is a significant investor in UK funds, and we strongly support the steps taken to increase co-investment in sectors such as life sciences[61]. The BBB/BPC's position in the ecosystem demonstrates its important role in drawing in further institutional capital to support UK businesses as they seek to recover and grow from the pandemic. This catalytic effect in drawing in additional capital can be enhanced to help fill the funding gap.

We would welcome continued and increased funding for all BBB/BPC programmes which have supported VC's growth and success in recent years, including the Enterprise Capital Funds programme (which also furthers diversity and innovation objectives in respect of new fund managers), the regional programmes (Northern Powerhouse and Midlands Engine) and new initiatives such the life sciences programme and the National Security Strategic Investment Fund (which support other strategic objectives too).

[55] FCA consultation CP21/34: Improving the Appointed Representatives regime – available here
[56] BVCA response to FCA consultation on improving the AR regime – available here
[57] BVCA response to HMT Call for Evidence on the AR regime – available here
[58] Patient Capital Review: Industry Panel Response – available here
[59] The ScaleUp Institute, Innovate Finance and Deloitte Future of Growth Capital Report – available here
[60] BVCA Investing with Integrity Report – available here
[61] British Patient Capital Life Sciences Investment Programme – available here

We would appreciate further dialogue on investment in the UK's growing impact investment funds industry and lower mid-market funds (that invest in minority and buyout investments) which primarily operate and invest across the regions and nations of the UK.

Fundraising continues to be challenging for smaller VC funds and recently international, and especially European investors, have become less inclined to invest in UK-focussed funds. Additionally, the pooling of Local Government Pensions Schemes has significantly affected the ability of smaller funds to access. Smaller funds are less able to raise large amounts from institutional investors because ticket sizes for smaller funds are typically below the minimum level at which it is viable for larger institutional investors to commit. Alongside, the European Investment Fund, Local Government Pension Schemes were invaluable cornerstone funding (especially for lower mid-market), making BBB investments ever more critical for smaller funds. Most of the BVCA's membership comprises of smaller, domestic funds that invest across the country, so the challenges outlined above will be more acutely felt throughout the UK outside London and the South East.

### Future Fund

The Future Fund (FF) was a crucial source of funding for many smaller pre-revenue businesses in the aftermath of the pandemic as many companies, especially those in R&D intensive sectors, were at risk of failure. Start-ups often have a short cash runway (the timeframe that their cash lasts before the next funding round) and given the uncertain nature of the market, the companies required extra funding to extend their liquidity. For example, early-stage life sciences companies, whose value is linked to IP created by R&D, no longer had access to labs and trials had to be delayed or even abandoned, so they required extra funding to see out this period of uncertainty. The FF was vital in ensuring these companies could continue during the pandemic and keep the teams together to further their research and reach their growth potential.

As with any portfolio of companies, there will be successes and failures. The portfolio of companies which the FF has invested in need to be considered as a whole – a small percentage of companies with significant growth will cover losses made in many other companies and it is too early to tell the overall picture of the performance of the scheme. Further to this, the government could allocate extra funds to make further investment in successful companies to maximise the returns to the taxpayer, especially those companies who are outside the scope of Future Fund Breakthrough.

### Future Fund Breakthrough

Future Fund Breakthrough, which encourages private investors to co-invest with the government in R&D-rich companies in areas such as deeptech, will ensure that successful companies in strategic areas are provided with further funding. The government must continue to deploy the funds in the Future Fund Breakthrough programme to provide later stage and scale up growth capital to outstanding UK deeptech UK businesses.

### Advanced Research and Invention Agency

The Advanced Research and Invention Agency (ARIA) has the potential to be a key component in driving the UK's future research into science and technology. In a similar way to DARPA in the US, ARIA can play a complementary role in building a strategic technical advantage for UK in future technologies that require long and exploratory R&D, especially in areas of "high-risk, high-reward" research. It is important that the organisation will establish strong interaction with the universities, VCs and the wider tech community so that it can identify future trends, especially in areas of deep science that address long term developments in physical and technological infrastructure.

**6. The merits of policy proposals for strengthening the venture capital industry in the United Kingdom, such as:**

- **Opening new pools of capital for venture capital investment, such as pension funds, retail products (e.g. investment through ISAs)**
- **Generating home-grown talent through the education system**

- Attracting international talent through the visa system
- Any other possible Government or public sector intervention

Our key recommendations are:

- **Unlock DC pension investment:** continue work that will enable DC pension schemes to invest in VC and growth funds by removing well-designed performance fees from the charge cap. This will unlock domestic capital for VC funds to invest in innovative businesses, as well as increase returns to ordinary pension savers not lucky enough to be in DB schemes
- **Reform Solvency II:** address the risk rating rules that restrict UK insurers from investing in VC & growth funds
- **Remove other barriers to investment in VC funds:** resolve outstanding issues such as Limited Partner (LP) reform and ensure that rules regarding individual investors (Financial Promotions & Appointed Representatives regimes) in VC are appropriately targeted
- **Streamline the process for recruiting talent:** simplify the visa schemes to reduce costs and increase the speed of overseas recruitment so VCs and the companies they invest in can easily access the talent they need to grow companies

Further detail is set out below.

**Opening new pools of capital for venture capital investment**

*Facilitating DC pension investment into venture capital*

The BVCA is very supportive of the steps being taken to address the barriers preventing DC pension savers and sophisticated individual investors from investing in long-term, illiquid assets. High level attention has been brought to this issue by initiatives such as the Khalifa Review, and by the Prime Minister and the Chancellor in their Investment Big Bang announcement. We are participating in the HMT, BoE and FCA working group to facilitate investment in productive finance and provided supportive and constructive feedback to the FCA's consultation on the creation of the Long Term Asset Fund (LTAF), to which we brought the VC industry's expertise in investing in long-term illiquid assets. Through our ongoing participation in the Productive Finance Working Group (PFWG), we are supporting the implementation of the group's recommendations that are relevant to us, including the preparation of industry guides for DC schemes on the particular considerations of investing in illiquid and long-term assets like VC.

There is a growing body of research and analysis demonstrating that allocations to VC offer powerful potential for improving the retirement outcomes of DC scheme members, which we have referred to in our previous responses to DWP consultations[62] and which were highlighted in the PFWG's Roadmap for Increasing Productive Finance Investment[63]. In particular, from an investor perspective, when comparing the performance of the UK VC industry with public markets, the five-year and ten-year annual returns were 17.6% and 14.1% respectively, compared to the FTSE All-Share, which returned 7.5% and 8.1% to investors over the same respective time periods[64].

There are various market and operational hurdles for DC schemes wishing to invest in VC funds, which the PFWG has been tasked with solving. However, there is one, significant *regulatory* obstacle for VC and growth funds trying to access UK DC pension schemes, namely the calculation method for the 0.75% charge cap applied to DC default arrangements. Performance related fees such as carried interest, which reward VC fund managers for generating long-term and consistent market beating returns, are (perversely) denying pension funds access to those returns. Carried interest is an established long-term, high risk participation model that aligns the interests of VC and growth fund managers with those of other investors in the funds. Carried interest payments are not

[62] BVCA response to DWP consultation on the review of the default fund charge cap and standardised cost disclosure – available here
[63] Productive Finance Working Group Report: A Roadmap for Increasing Productive Finance Investment (Chapter 2) – available here
[64] For further comparative data see the BVCA Performance Measurement Survey 2020 – available here

guaranteed and will typically only be received by a VC manager when a fund generates value above a challenging hurdle rate or preferred return and realises profits (i.e. cash) for investors – this can only be achieved over a long term period of many years. This model also rewards the generation of sustainable growth and value in the businesses in which VC funds invest and is recognised as a capital gain for tax purposes – in line with international practice in the USA and on the continent of Europe, which is significant for the UK VC industry's global competitiveness.[65]

Whilst we understand the rationale for the cap, to minimise costs, it is also a key barrier, as the inclusion of performance fees within the rules fails to recognise that carried interest is only secured after challenging returns have been made and significant value (net of fee costs) achieved for DC pension schemes. This 'cost rather than value' focus dissuades many DC schemes, for fear of breaching the cap. We continue to stress that the best way of helping to improve outcomes for DC scheme members in this context would be for DWP to exclude well-designed performance fees and carried interest from the charge cap calculation. We are therefore encouraged by DWP's recent commitment to excluding performance fees from the charge cap calculation. We also support the Government's intention to take a principles-based approach that would provide guidance to DC trustees on how performance fees can be structured in a manner that protects scheme members' interests. This approach will ensure that over-performance is encouraged, UK pensioners benefit from increased returns (as highlighted in the PFWG Roadmap) and VC firms are better able to fund UK businesses to grow and succeed. We look forward to DWP consulting further on this issue as soon as possible.

*UK Solvency II for insurance companies*

Institutional investors, including insurers, have a key role in committing capital to and supporting the UK's VC market. However, the risk weighting of VC investments under the solvency capital ratio (SCR) in Solvency II is too high, meaning that UK insurance companies must hold back more regulatory capital when investing in VC than is necessary. Solvency II thus has a detrimental impact on UK insurers' ability to invest in unlisted equity and support UK start-ups through VC funds. This has forced a trend of insurers withdrawing from this asset class (UK insurers represented a mere 1.4% of the total investment to VC and growth funds in 2020).[66]

HMT is undertaking a review of Solvency II in the context of improving the post-Brexit regulatory framework. The rules have been improved in the EU, with the introduction of a Long-Term Equity (LTE) category of equity investments, but this only partially addressed the issue and the position is still evolving. The BVCA position and recommendations are summarised in our response to HMT's consultation last year,[67] including a suggestion to amend the SCRs to reflect more appropriately the characteristics of venture and growth capital fund investments and we look forward to positive change what will enable more UK insurers to invest in innovative businesses through UK VC & growth funds.

*The Financial Promotions regime*

The FCA has recently consulted on a wide range of proposals to change the Financial Promotions regime. Financial promotions are the way in in which VC funds market to prospective investors. While we recognise that change is needed considering there have been several mini-bond mis-selling scandals, we are concerned that the government and the FCA's policy response will have unintended consequences on the marketing of legitimate investment products and business interests.

We are particularly concerned by the proposals to treat units in professionally managed VC funds, such as EIS funds, in the same way as investment products in crowdfunding and cryptocurrencies. This will subject VC funds to a new package of marketing restrictions. We are firmly of the view that the existing marketing restrictions that apply to VC funds managed by authorised and regulate investment managers, or internally managed by small registered alternative investment fund managers (AIFMs), are working well and should be preserved.

[65] Further details on the role of carried interest can be found in BVCA comment on Carried Interest and Capital Gains Tax – available here
[66] BVCA Report on Investment Activity 2020 (based on breakdown of data contained in the report) – available here
[67] BVCA response to HM Treasury Review of Solvency II – available here

We believe that the FCA's proposed changes will deter appropriate investors and incur large and unnecessary costs for firms operating VC funds. As we said in our response to the FCA[68], we regret that the opportunity was not taken to significantly simplify the rules and definitions on financial promotions, which contain "bear traps" for firms and pose significant risk.

We also responded to HMT's consultation on reforming the Financial Promotion Order (FPO) exemptions.[69] The FPO exemptions for high net worth individuals and sophisticated investors are of particular importance to VC fund managers that invest in early-stage, high growth businesses.

The imposition of new marketing restrictions by the FCA or a removal or any material reduction in scope of the FPO exemptions would restrict an important source of capital for early-stage UK companies and VC funds focused on investing in UK SMEs (where there is no obvious replacement for that capital) and damage the growth of early-stage innovative businesses and UK competitiveness as a location for founders to establish and scale-up businesses.

*Professional investor definition*

The onshored definition of a 'professional investor' in UK AIFMD does not represent the knowledge and experience needed to invest in private capital and is restricting the ability of otherwise suitable and qualified investors to invest. Annex II of MiFID, which determines what is a professional investor under AIFMD by virtue of the cross reference made to in Article 4(1)(ag), also has wider implications, such as the requirement to produce a PRIIPs Key Information Document (KID) for investors who do not meet the MiFID definition. We believe the approach taken in the UK for defining sophisticated and high-net-worth investors for the purposes of the financial promotion rules is more appropriate and recommend it is extended to UK AIFMD.

Further, the MiFID elective professional tests are calibrated for MiFID investment services provided in relation to liquid assets such as traded shares. The tests are extremely difficult to satisfy by individuals who invest in long-term VC funds, regardless of their wealth, sophisticated or experience. This is because VC funds make relatively few transaction and relevant experience is often in business, e.g. as entrepreneurs, rather than financial services. Our members often find that sophisticated and high-net-worth investors, family offices, entrepreneurs, academic endowments, executives, directors, and employees of the firm that are involved in the management of the fund must be treated as retail investors despite having suitable experience and expertise equivalent to institutional investors. We believe these categories of investor should be treated differently in these circumstances and recommend that it is made clear by the FCA that the definition includes "opted-up" investors under the UK standard, which pre-dates MiFID and is more appropriate for investors in VC.

*BEIS proposals for LP reform*

We strongly recommend that BEIS concludes its consideration of proposed reforms to UK limited partnership law as quickly as possible because the continuing review is causing uncertainty in the market and undermines the UK's reputation for legal clarity and stability. The review was triggered by concerns that some UK limited partnerships were being used for anti-money laundering or other criminal purposes. There has been no suggestion that these anti-money laundering concerns have any connection with VC funds, but the continuing uncertainty is damaging to the UK private fund sector. We think the UK implementation of the EU's fourth Anti-Money Laundering Directive, has already achieved this goal in relation to Scottish limited partnerships (whose misuse was the genesis of this review).

UK limited partnerships are particularly important for VC firms, including those based across the country and start-up/small firms with a few investors. These firms tend to use UK limited partnerships as their fund structures,

[68] BVCA response to FCA consultation on strengthening the financial promotion regime – available here
[69] BVCA response to HMT consultation on reforming the FPO exemptions – available here

as they are relatively straightforward and inexpensive to establish compared to overseas vehicles, which typically need input from law firms with a network of international offices.

The BVCA has been working with BEIS to address concerns about abuse. This has led to the development of some workable solutions that would meet any ongoing concerns. A single legislative initiative to implement these changes would be helpful (and send positive signals to investors); however, we would not want to downplay the important progress made by BEIS on its work, and are extremely grateful for government engagement on this issue.

*Consistent treatment of VC funds and portfolio companies*

We suggest that the UK takes a more consistent and coherent approach to the way in which VC limited partnership funds are treated for legal, regulatory and reporting purposes.

The vast majority of private funds are not required by UK and international accounting standards to prepare accounts which consolidate the portfolio investments, including in cases where the investment fund holds a majority of the shares and/or voting rights in the underlying company. This is appropriate because each of those underlying companies (together with its subsidiaries) is operated independently, with its own financing structures and management. It would not make sense to treat the companies as a single entity for financial reporting purposes and would give rise to misleading information for the users of the financial statements and narrative reports.

However, this treatment is not consistently applied across all legal, tax and reporting regimes, even though the same logic applies, and the differences frequently give rise to complexity and anomalous results. The EU definition of an SME and concept of linked enterprises is also another cause of these issues.

### Attracting talent

The recruitment, and retention, of talent is central to the growth of both VC funds and their portfolio companies and lack of access is one of main hindrances to a company being able to scale. The UK must do more to streamline the process for small teams at VCs, start-ups and SMES, who do not have in-house expertise in this area and often rely on expensive external advice to solve this. The competition for talent across Europe has increased and new visa schemes are making it easier for tech talent to settle for longer periods with their families at a lower cost[70].

Schemes that target individuals with certain qualifications or experience, such as the High Potential Individual, Global Talent and Scale-up visas, are helpful for certain types of individual, but the number of schemes makes it difficult for firms to identify the right route. For VCs and portfolio companies looking to recruit for very technical positions, the UK schemes must be faster, cheaper and easier to manage.

Clear criteria for recruiting talent into portfolio companies which recognise the role of VCs should also be considered. For example, a company that had secured £1 million of funding over a 12-month period would be a sensible and easily provable threshold for a company that is looking to scale, and therefore be able to recruit people with the skills required to grow and add value to the business. The creation of the Global Talent Network[71] is also vital to ensure that VCs and portfolio companies can quickly plug talent gaps.

In order to retain talent in innovative UK companies, more must be done to reward people who stay at start-up companies by way of "skin in the game", through schemes such as the Enterprise Management Incentive (see section 7).

## 7. The effectiveness of any other government or public sector intervention in the venture capital industry.

[70] Sifted: In Europe's war for tech talent, are visas the answer? – available here
[71] As announced by the Chancellor in November 2021 – see here

Our key recommendations are:

- **Narrow the scope of the NSI Act:** the definitions need to be clearly defined and additional guidance is needed to ensure the NSI Act does not negatively impact deal making in the UK. the ISU should be properly resourced to deal with increased notifications
- **Enhance the UK's position as an international destination for IPOs:** continue to reform the UK listings rules and improve the environment for tech firms listing in the UK
- **Reform Enterprise Management Incentives:** amend the legislation so that EMI options can be used by more of the companies the regime was originally targeted at and allow companies backed by VC & growth firms to access it
- **Reform the SME definition to allow more companies to claim R&D tax credits:** update the EU SME definition so that companies backed by VC funds are not aggregated and therefore lose out on access

Further detail is set out below.

**National Security & Investment Act**

The commencement date for the National Security and Investment Act was 4 January 2022 and as a member of the BEIS Expert Panel, the BVCA is continuing to review the regime's implementation. We responded to multiple consultations in 2021, including on, the 17 mandatory sector definitions, the use of the call-in power and a new power to block listings on national security grounds. We hosted a roundtable for members with the Centre for the Protection of National Infrastructure and published a guide for our members[72]. In May, the legislation was the subject of a formal ministerial review by Lord Grimstone, Minister for Investment.

In our continuing review, we have found that the breadth of the regime, the wide sector definitions and a lack of sufficient and clear guidance has made the regime challenging for VC investors and led to a considerable number of benign deals being notified – deals we do not believe the Act intended to capture. The guidance from the Investment Security Unit (ISU) comprises a significant number of documents, and is in its current form either too generic and unclear or simply re-states legislation. This is costing time, causing confusion and creating uncertainty. There is also inconsistency between BEIS guidance and the Act itself.

The ISU is not resourced adequately which means it is slow to communicate and sometimes inconsistent in its approach. Our understanding before the legislation was implemented was that the ISU would work closely with the business community to try and ensure a clear and efficient process. However, members are often finding this is not the case and this lack of and inconsistent engagement with the business community is leading to further delays and uncertainty.

The new rules may be jeopardising exits. VCs typical invest sufficient equity capital to support operations for 18-24 months, after which the portfolio company needs to complete another equity financing round, get acquired by or merge with another business/investment fund, or list on the public markets. At the time when an equity investment or deal/transaction is being negotiated, a business will typically have less than six months of operating cash left. Therefore, if the Act materially slows down this process or adds additional legal costs, the company risks running out of money before it can complete the transaction.

Exiting investments via IPO or secondary transactions is an essential part of our industry. Investors, such as pension funds, will not realise the high returns on offer if the appropriate exit cannot be made by its VC investor. We have found that the ISU often does not look beyond the nationality of the acquirer even though their jurisdiction may be an important market. Blocking the sale will have wider ramifications for the VC firm, its investors, the portfolio company and the markets it operates in.

We recommend the government puts in place measures to help narrow the scope of and have clearer drafted definitions as well as additional guidance and better engagement from the ISU. It should also consider the wider

[72] Further details on the BVCA website – available here

ramifications of intervening in a benign transaction in line with the idea of a "Global Britain" and keeping the UK an attractive place to invest. We plan to meet with government officials to discuss our feedback in the next few months.

### Lord Hill Listings Review

Launched in 2020, the review examined how the UK could enhance its position as an international destination for IPOs and improve the capital-raising process. The BVCA co-hosted a roundtable with Lord Hill and our members. Fourteen recommendations were made, and we responded to related consultations including on SPACs, the prospectus regime and the effectiveness of primary markets, and have hosted a roundtable on the secondary capital raising review.

There have been some positive changes to the Listing Rules, including to free float requirements, dual class share structures and special purpose acquisitions companies. However, we believe that these changes are not enough to resolve the culture and market environment issues in the UK. For certain types of companies our VC members invest in, including tech companies, listing in the UK remains problematic. For example, the environment for growth and depth of liquidity is still lacking in UK markets, when compared to the US. If our members can list and raise more capital in the US they will do so, for example on the NASDAQ. In a recent report by EY[73], we can see the scale of US IPO activity in comparison to the UK. It shows that in 2021 there were 416 IPOs in the US raising $155.7 billion compared to 97 IPOs in the UK raising US$21.2 billion. This gives an average per IPO in the US of $374 million compared to $218 million in the UK.

We will continue to work on the proposals and consultations as they are brought forward and would encourage the government to reflect on and continue its work to improve the UK's markets.

### Enterprise Management Incentives

We were disappointed that the government chose to make no further changes to the Enterprise Management Incentives ("EMI") scheme in the 2022 Spring Statement. The EMI regime's benefits would be attractive to VC backed companies as approximately 90% of companies invested in by BVCA members each year are SMEs. HMRC's evaluation report, published in 2018, concluded that EMI are only being used by a small number of the high risk, high growth, small companies that the regime was specifically designed for. The regime should help these companies to compete more effectively with larger firms to hire and retain highly skilled employees through share incentivisation.

The EMI regime is currently unavailable to companies that are backed by VC because of the way the independence requirement (paragraph 9(2)(b), Schedule 5 ITEPA 2003) interacts with the control aggregation rules (sections 993 and 995 ITA 2007) that apply to the partnership structures that are commonly used by VC funds. This is unfortunate as the EMI rules were designed specifically to benefit high risk, high growth, small companies, and this describes many VC-backed companies perfectly.

The BVCA recommendation is to amend the legislation so that EMI options can be used by more of the companies the regime was originally targeted at. This is a recommendation we have made in many BVCA Budget submissions. This could be achieved by amending the independence requirement and in particular by providing that the independence test will still be met where the control condition under paragraph 9(2)(b), Schedule 5 ITEPA 2003 is failed because a company which would otherwise be treated as having control is a partner in a CIS limited partnership (as defined by section 376(5) CTA 2009) or is the operator or a partner in the operator of a CIS limited partnership.

[73] EY report titled: Global IPO market has record-breaking 2021, prepare for headwinds in 2022 – available here

### The R&D tax credits system

The BVCA welcomed the changes to R&D tax credits announced in the 2021 Budget to expand their qualifying expenditure to include data and cloud costs, as well as plans announced earlier this year to allow businesses to claim relief on the storage of data and pure maths research.

However, BVCA members have reported portfolio companies encountering difficulties in obtaining repayable R&D tax credits where HMRC have suggested that, when testing whether a portfolio company meets the size requirement (taken from the EU definition of SME) the figures of all portfolio companies of funds with a common manager should be aggregated. There is no sensible economic justification for aggregating portfolio companies in a single fund (as each portfolio company "stands on its own" and the resources of other portfolio companies or the fund are not available to it), still less portfolio companies of different funds with the same manager. In our opinion, now that the UK is not required to follow EU law, the SME definition should be operated in a way which recognises portfolio companies as the independent enterprises they are.

## 8. The effectiveness of government policy around venture capital in meeting wider government objectives (for example: around "levelling-up" and tackling regional inequality, the aim for the UK to be a science and technology "superpower", net zero).

Our key recommendations are:

- **Improve the knowledge of VC and growth funds in the devolved nations and regions:** promote VC and growth funds in areas of the UK where there is less awareness of the different types of funding available to SMEs, and provide additional funding for the BBB's regional investment funds
- **Scale investment into funds that focus on R&D-intensive sectors:** improve the investment landscape for companies in areas such as deeptech and life sciences, either through further support to the British Business Bank or similar government supported investment scheme

### Tackling regional inequality & "levelling up"

VC firms support businesses across the UK's nations and regions, and the level of funding VC is putting into these businesses is growing. For example, England's North West is home to six of the UK's unicorns[74] and VC investment in the North East of England accounted for 5% of all UK VC investment in 2020[75].

BVCA data shows that London and the South East of England still dominate in terms of overall UK VC investment (49% in 2020) but there has been growth overall in the regions in recent years. The regions of the UK (see further details on the nations below) have different ecosystems and funding requirements so will be addressed separately.

### Supporting the UK's Regions & Nations

*The regions of England*

As stated above, BVCA data shows there has been growth in regional investment from 2018-2020[76], but the overall levels still lag far behind London and the South East, despite high quality companies being developed there[77]. There have been some positive developments for university spinouts in the regions, such as the £215m fund from Northern Gritstone, but companies still struggle to access funding, especially at later stages. Research from the University of Leeds and Imperial College shows that of the £2.4bn of UK VC funds raised in 2020, 75% of all invested funds went to London and the South East of England, and that businesses outside London are up

[74] BVCA Nations & Regions Report: North West England – available here
[75] BVCA Nations & Regions Report: Yorkshire, the Humber & North East England – available here
[76] BVCA Report on Investment Activity 2020 (table 11) – available here
[77] BVCA reports on the North West and North East England – available here & here

to 50% less likely to secure equity funding[78]. Start-ups in the regions are also behind London and the South East of England when it comes to valuations, averaging £5.09m to £7.36m, as well as total number of deals and overall investment.[79]

The role of the BBB, the Future Fund and EIS/VCT schemes is of even greater importance in the regions where the market is more fragmented. The BBB's regional funds play a central role in supplying capital to the regions, such as the Regional Angel Programme and associated funds including the Northern Powerhouse Fund and Midlands Engine Investment Fund, and plans to increase capital for regional start-up companies. High growth companies in the regions also have far closer ties to corporates (as discussed in section 2) as an exit given the low numbers of other investors, as are growth/lower mid-market private equity funds. Improvements should also be considered to the AIM market as a way for smaller regional companies to list, as they often struggle to reach sufficient scale to list on the LSE market.

The incentives provided by EIS and VCT funds are also very important in the regions, but they are often constrained by the limits placed on them that exacerbate the different nature of companies found there. Given that companies take longer to reach the stage when they are ready receive institutional investment from VCs, restrictions such as the 7-year rule, where any company over this age cannot access the schemes, is more of an issue in the regions than it is elsewhere[80]. The Future Fund was also vital for the continuity of companies in the regions. For example, 24 companies in Mercia's portfolio received backing from the Future Fund in key strategic areas such as deeptech and cleantech, several of which have delivered returns to the taxpayer[81].

Mercia Asset Management is a particularly active player in the regions and made 1013 investments in the last five years[82], and while there are others such as the Business Growth Fund, there are relatively few early-stage VCs in the regions. London and the South East of England have more integrated investment ecosystems of angel investors and seed stage funds that build a pipeline of companies for VCs to invest in, and these VCs don't have to rely on extensive groundwork to identify companies to invest in, and can rely on a team of a less than 10 to deploy funds from seed to series A. However, funds investing in the regions are far more "labour-intensive", and need more people on the ground to source companies to invest in - for example Mercia have a team of over 130 in their investment team in the regions.

More support is required for the BBB to develop the environment for start-ups, and thought should be given to changing the limits on EIS and VCT investments, given the different characteristics of companies in the regions. Efforts to support and build clusters of investment expertise must also be prioritised, so that investing in the regions becomes more attractive to a greater number of VCs and increase levels of investment. This regional development would benefit greatly from an increased talent pool and further incentives to establish businesses in these areas.

*Scotland*

Scotland performs relatively well for VC investment in the UK, and although accounting for only 2-2.5% of capital invested, it is one of the most active investment markets outside London and the South East of England[83]. Although there are relatively few Scottish-based venture capital firms, there are some notable and highly experienced ones, and a number of companies in Scotland have successfully attracted later stage and international investment. Scotland has a significant angel investment community and accounts for the second highest number of angel investments in the UK outside London and the South East. There is also a relatively high level of government intervention in the market in Scotland through economic development agencies, such as Scottish Enterprise, and government is the most frequent investor within Scotland, as set out below.

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[78] See Mercia submission to the Treasury Select Committee Inquiry for further details
[79] Beauhurst: The Deal 2021 – available here
[80] See EIS Association submission to the Treasury Select Committee Inquiry for further details
[81] See Mercia submission to the Treasury Select Committee Inquiry for further details
[82] Ibid
[83] Beauhurst: The Deal 2021 – available here

Research produced by data provider Beauhurst suggests that 2021 was a record year in terms of the value of venture capital investments in Scotland[84], although there was a year-on-year fall in the number of deals due to the high level of activity associated with Covid-related government interventions in 2020 (e.g. Scottish Enterprise's Early Stage Growth Challenge Fund accounted for 90 deals during 2020). These interventions are believed to have contributed to what was a limited uptake in Scotland of the Future Fund support during the pandemic.

The market in Scotland is relatively vibrant for deals of up to £10 million, but last year there were no single investments above £50 million. The market for early-stage investments below £2 million also continues to be more challenging, which is consistent with a broader UK trend to deals beyond series A. Amongst other things, this may reflect a relative lack of risk capital for that end of the market and also the fact that early-stage venture capital investors, business angels and others tend to form syndicates and pool their investments in order to target larger investments than they would otherwise be able to do on their own. Investment in smaller, embryonic companies that are raising capital for the first time is not increasing in the context of an overall market that has been growing and potentially this has implications for future later stage investment opportunities.

In terms of university spin outs, Scotland has been quite successful and ranks second in the UK behind London and the South East of England. However, the average deal size for university spin outs is typically substantially lower in Scotland than other strongly performing areas in the UK[85].

Scotland therefore has some strengths in terms of venture capital activity, but along with other parts of the UK faces significant competition for deals and in relation to the establishment and growth of entrepreneurial firms, given the dominance of London and South East England.

As for other parts of the UK, it will be important for Scotland to increase the number of high growth start-ups and the supply of investment for such businesses. The current lack of larger deals in Scotland may reflect a relative lack of high growth, scale up companies. It also seems likely that in less well developed and vibrant investment and entrepreneurial ecosystems, access to the management talent that is necessary to help companies scale may be more limited, and founders may be more likely to sell their businesses at a relatively early stage of development.

*Wales*

Wales has a strong track record in life sciences, cyber security and fintech start-ups[86], and recent successes include Space Forge, which successfully raised Europe's largest ever seed funding round for a spacetech company[87]. There are a number of active VCs in this region, with the Development Bank of Wales playing a key role in unlocking private capital investment.

However, Wales also has structural problems similar to other nations and regions of the UK and is behind them in some areas. While the number of deals has slowly increased from 17 in 2011 to 60 in 2021, it has also flatlined since 2018 and even decreased slightly in recent years, while the rest of the UK has increased.[88] The median size valuation is also the lowest in the UK, at £2.4m compared to £5.09m in the regions.[89]

As detailed above in the sections on the regions, the government must continue to support the BBB as a regional LP to help increase the funding in Wales to increase the numbers of VCs helping to grow the innovative companies being developed there.

*Northern Ireland*

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[84] Beauhurst: The Deal 2021 – available here
[85] Beauhurst: Equity Investments into UK Spinouts – available here
[86] Trade & Invest Wales: Key Industries – available
[87] Wales Online: Inside the Cardiff company at the forefront of the UK space industry – available here
[88] Beauhurst: The Deal 2021 – available here
[89] Ibid

Northern Ireland has come a long way to bridge the gap between itself and other nations and regions in the UK in the last decade. Starting from just 3 deals in 2011, this has steadily increased to 39 by 2021[90]. BVCA data also shows a recent increase in deals, up from 26 in 2018 to 37 in 2020, and it has maintained the overall share of UK VC investment (5%)[91]. The average deal valuation (£3.96m) has also increased sharply since 2011, and is now only just behind Scotland (£3.99m) and ahead of Wales (£2.4m)[92]. Recent successes include the medical device company Neurovalens (please see case study earlier in this document) which received backing from IQ Capital.

Northern Ireland still has some way to go to match overall investment Scotland and the UK regions, especially for venture investment beyond series A. There are a number of active seed investors such as Techstart Ventures based in Belfast, but there is lack of local funding from series A and beyond, which means companies have to look elsewhere to scale. Other structural problems are similar to elsewhere in the UK nations and regions, and the role of the BBB is key to help build pools of capital locally.

### Building the science and technology superpower

Please see section 1.

### Net Zero

Please see section 1.

[90] Beauhurst: The Deal 2021 – available here
[91] BVCA Report on Investment Activity 2020 – available here
[92] Beauhurst: The Deal 2021 – available here