ICAEW
REPRESENTATION 48/22

THE VENTURE CAPITAL MARKET

Issued 10 June 2022

ICAEW welcomes the opportunity to comment on the call for evidence, *The venture capital market*, published by Treasury Committee on 28 April 2022, a copy of which is available from this link.

For questions on this response please contact our Corporate Finance Faculty at CFF@icaew.com quoting REP 48/22.

This response of 10 June 2022 has been prepared by the ICAEW's Corporate Finance Faculty. The faculty is ICAEW's centre of professional expertise in corporate finance. It contributes to policy development and responds to consultations by international organisations, governments, regulators and other professional bodies. It provides a wide range of services, information, guidance, events and media to its members, including its highly regarded magazine Corporate Financier and its popular series of best-practice guidelines. The faculty's international network includes member organisations and individuals from major professional services groups, specialist advisory firms, companies, banks and alternative lenders, private equity, venture capital, law firms, brokers, consultants, policy-makers and academic experts. More than 40 per cent of the faculty's membership are from beyond ICAEW.

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OUR INTEREST AND KEY POINTS

1. ICAEW's strategy includes enabling its members to contribute to the transformation of trade and economies, the achievement of the Sustainable Development Goals (SDGs), and the mastering of technology and data. Investment in innovation and technology and sustainable business transformation, including through venture capital, forms a significant part of the work of ICAEW's Corporate Finance Faculty. The faculty's work in the past decade has included collaboration with UK government, other stakeholders and market participants on the creation of the British Business Bank; publication of the Business Finance Guide, good practice for cyber security in corporate finance activity, and the use of AI in corporate transactions; amendments to the tax-advantaged venture capital regime; responding to the 'Patient Capital Review'; and giving feedback on emergency business funding measures in response to the COVID-19 crisis.
2. Further interaction of public and private funding, including where currently under-represented, will be vital for maintaining and boosting the health of the venture capital landscape in the UK.
3. In the short-term, the government needs to provide certainty regarding the future of the EIS and VCT schemes.

ANSWERS TO SPECIFIC AREAS IN THE CALL FOR EVIDENCE

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.

4. The May 2022 issue of member magazine, *Corporate Financier,* provides a timely report of a vibrant entrepreneurial community, including in regions such as Liverpool[1] where ICAEW co-hosted a recent conference on funding innovation. Reports from ICAEW members that there is no shortage of capital for early-stage, investable businesses, are backed up by data including Beauhurst's equity market update for Q1 in 2022. Other insights are included in paragraph 28 of this response
5. Certain sectors become highly regarded by venture capital – at present, tech and tech-enabled businesses as well as the renewable energy sector have no trouble attracting capital. The VCT Association reports[2] that its members support sectors including digital technology, medicine development, specialist manufacturing and online retailing. According to HMRC data, companies in the Information and Communications sector have received the largest share of all EIS investment (34%) and SEIS (41%) in recent years.
6. There has been more consolidation in the UK fund manager market but there continue to be both generalist and specialist firms. The committee's question focuses on availability of domestic capital for UK business growth, and we show below ICAEW-collated data from the past six months on new UK-based venture capital funds:

	€m	£m	$m	Backed by
Nauta Capital	150			British Patient Capital
Edge Investments		85		British Business Bank

[1] Corporate Financier, May 2022, Next-Gen Pioneers, page 14
[2] https://committees.parliament.uk/writtenevidence/10430/pdf/

	€m	£m	$m	Backed by
Backed	150			
Balderton Capital			600	British Patient Capital
Sure Valley Ventures		95		British Business Bank
Hiro Capital	300 (raising)			
Elbow Beach Capital		20 (raising)		
SuperSeed		50 (raising)		British Business Bank
Avellinia Capital (lender)			150	
Creator Fund			20	
Cambridge Innovation Capital				British Patient Capital
Hoxton Ventures			215	British Patient Capital
FOV Ventures	25 (raising)			
FPE Capital LLP		185		
Praetura Ventures		100		
Northern Gritstone		215		

7. Undoubtedly the flow of domestic capital to business is important, but so is the ability of UK businesses to compete for, and continue to attract, foreign investment.

8. For early-stage businesses, non-domestic capital often drives large-scale funding rounds and the valuations, which then attract domestic capital. Our members report that US private investors are very interested in tech and also bring the necessary scale. This is consistent with a survey by EY[3] measuring international investment that has resulted in the creation of new facilities and jobs. According to the survey, the UK ranks second in the top European countries for foreign direct investment (FDI) in 2020/21. Data for the UK is extracted in the table below:

Rank Country	FDI Projects	Change 2020/21	Top three sectors	Top three activities	Top three investing countries
2. UK	993	2%	Software and IT services Business services Finance and transportation manufacturers	Business services Sales and marketing Manufacturing	US India France

[3] EY Europe Attractiveness Survey 2022

9. Whether businesses attract domestic or international capital, the ability to maintain manufacturing and R&D operations in the UK is of course hugely desirable, and greatly helped by factors that government policy can influence and that will attract investment. We refer to possible government interventions later in this response.

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

10. Examples of co-operation of this kind are described in the aforementioned article[4]. The terms offered by corporates investors to start-ups have to be weighed up against those available from other partners, such as private funds.

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.

11. The current tax incentives have been successful in attracting private capital higher risk businesses. As HMRC statistics[5] below illustrate, the current tax incentives have become a critical part of fundraising at the seed and early stages of business growth, raising just over £2.5 billion in the tax year 2020/21, up from £899 million in 2010/11.

Funds raised by tax incentive	2020/21 £m	2010/11 £m	First year of relief: 1995/96 (VCT) 1993/94 (EIS) 2012/13 (SEIS) £m
VCT	668	350	160
EIS	1,658	549	4
SEIS	175	n/a	87
Total VCT, EIS and SEIS	2,501	899	

12. EIS, SEIS and VCT rules have been amended a number of times, to better target the schemes and facilitate the processes of application and investment management. Regulatory responsiveness is valuable although amendments can have their supporters and critics. For example, the EIS fund structure, while considered helpful by some in that it can bypass the fragmented angel landscape, is seen by others as enabling a risk averse approach to what is expected to be high-risk investment.

13. There is currently a sunset clause in place in relation to the income tax relief offered by the EIS and VCT schemes (but not SEIS). This means that, without government approval, these reliefs will cease to exist from 6 April 2025. In 2020/21, funds raised under VCT and EIS together amounted to £2.3 billion that is available to be reinvested in the economy. Allowing these schemes to lapse will lead to a significant gap in early stage equity finance.

14. The schemes have also contributed to wider policy objectives. One example is the green agenda. When fossil fuel corporates have been reluctant to invest in renewables, EIS and

[4] Corporate Financier, May 2022, Next-Gen Pioneers, page 14
[5] Venture Capital Trusts statistics: 2021 (January 2022) and Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Social Investment Tax Relief statistics: 2022 (May 2022) and EIS Table 8.1 and SEIS Table 8.11 (National Statistics)

VCT fund managers (including ICAEW member firms) have delivered investments in renewable energy via these tax reliefs [6].

15. It is time for the government to provide certainty both to businesses making future funding plans and to managers preparing to raise and/or invest funds. Certainty in the short term could be achieved with an extended date for VCT and EIS. This will allow time for the government to give careful consideration to the form and impact of possible permanent schemes. Such consideration will usefully incorporate evaluations such as the following:
    - are there simplifications that could be made to the process?
    - have (a) the annual and lifetime caps and (b) investment holding periods kept pace with the scale-up needs of innovative businesses (such as pre-production and pre-revenue costs and periods)?
    - could there be grounds for pivoted / disrupted business models to be considered qualifying trades?
    - are there more measures that could reduce the risk of abuse of the reliefs?

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

16. We have no specific comments.

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.

17. ICAEW's relationship with the Bank began on inception of the institution and continues to strengthen. ICAEW and its Taskforce of market participants worked with the Bank to develop and release the Business Finance Guide[7] as part of the Bank's initial objectives which was to raise awareness among businesses of funding options for each stage of business growth. ICAEW has supported the Bank to connect with the business and advisory communities, including outside London and the South East. In our view, the British Business Bank has a vital role.

18. Together with private funds, British Patient Capital (BPC) is an enabler of business growth beyond the venture stages and picks up where tax incentives have been utilised. The BPC can further support the venture market by focusing on growth companies that emerge from the Industrial Strategy Challenge Fund[8], in the areas of net zero, transformative technologies, and health, wellbeing and ageing. These are directly aligned with the BPC's key portfolio themes[9] such as digital health and life sciences, future of work and education, clean growth, sustainability and mobility, cyber security and frontier tech. They are also consistent with current government objectives around regional inequality and the UK's science and technology capabilities.

19. As an emergency measure, the Future Fund had a different objective to that of other funds set up by the British Business Bank. Under this measure, convertible loans of £1.14 billion were received by 1,190 companies - at approximately 17% of the number eligible to apply[10], this was a significant intervention and not without controversy. Questions were clearly expressed by the Bank's board in a statement of reservation to the government before the launch of the Future Fund, BBB FF reservation notice FINAL (british-business-bank.co.uk). Market commentators and participants, including ICAEW members, were also not persuaded that the funds were being used to support those businesses in most need. Since the

[6] Corporate Financier, March 2021, Rise of the renewables, page 18
[7] The Business Finance Guide | ICAEW
[8] Industrial Strategy Challenge Fund – UKRI
[9] BBB-BPC_Annual-Report-and-Accounts-2021.pdf
[10] According to Beauhurst, 7,629 UK companies were eligible, Future Fund Recipients Identified So Far | Downloadable Spreadsheet (beauhurst.com)

measure was withdrawn, the Bank has taken stakes in 335[11] businesses and it remains to be seen if the Future Fund will represent value for money for the taxpayer.

20. The establishment of ARIA is an acknowledgement of how public and private finance can build leading science and innovation research capabilities and commercialise technology. For ARIA to achieve the full potential of the funding it has been allocated, the criteria for using public funds must ensure that private investment is not crowded out. There have been early questions about the remit of ARIA, and the adequacy of its £800 million pot[12]. More recently, consultations with venture capital managers among our members revealed a lack of awareness of the agency's existence.

21. Regional inequality persists, according to the latest equity market update from Beauhurst[13]. The latest EIS and SEIS statistics show that companies registered in London and the South East accounted for the largest proportion of investment. The NAO's 2021 report[14] on the management of the Industrial Strategy Challenge Fund also revealed unequal distribution of funding. Bodies such as the British Business Bank and ARIA can and should do more to influence the regional balance of funding and the private capital leveraged.

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***

22. We strongly disagree with any proposals to enable venture capital investment with retail products. Such a policy would be inconsistent with the typical investor risk profile catered for by products such as ISAs. Moreover, the skillset of ISA fund managers is not interchangeable with that of EIS or VCT fund managers who have deep expertise in high risk asset classes. Large scale investment in venture capital by pension funds is also inconsistent with their risk profile and timeframes – in any case, Self Invested Personal Pensions (SIPPs) are possible via Defined Contribution schemes. Our positions have been consistently held, including in our response[15] to HM Treasury's consultation, *Financing growth in innovative firms*.

23. The government's wider objective of developing leading science and technology capability provides a platform for boosting relevant skills and attainment through early stages in the education for the innovators, the creators of investable opportunities, and scientists of future venture growth businesses. This pool is also likely to go on to invest in such businesses. At the same time, skills for managing such investments will be needed within public funds and bodies like ARIA and the UKRI.

24. High-quality research and innovation are demonstrably boosted by international cooperation. This is evidenced, in general, in the Horizon Europe programme and specifically in the success of the Oxford vaccine. The visa system must enhance and not create a barrier to the UK's objectives being achieved.

25. Policy proposals that would benefit the venture capital market should also be informed by the need to address under-representation. We have referred to regional inequality in our

[11] Press Release - April 28, 2022 - British Business Bank (british-business-bank.co.uk)
[12] Corporate Financier, June 2021, Innovation Talks, page 24
[13] UK Equity Investment Market Update | Q1 2022 | Beauhurst
[14] UK Research and Innovation's management of the Industrial Strategy Challenge Fund - National Audit Office (NAO) Report
[15] 20170921-ICAEW-REP-102-17 | ICAEW (preservica.com), paragraphs 55 and 58

response to the previous question. Female entrepreneurs also face obstacles to accessing investment[16] and the 2022 report of The Gender Index identifies what more needs to be done to support female-led companies to make the jump from small to medium and large size. Board and management diversity is becoming a widespread ESG indicator for venture capital-backed businesses and funds, and government can support market-led efforts, eg by way of co-investment criteria.

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

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).

26. There are several interventions that will help the venture capital industry, all of which are aligned with existing government policies. Improved infrastructure and connectivity; transport; availability of skills; career opportunities; an ecosystem of professional finance and business advisers; measures for universities to retain students in areas of research; visibility of and ease of application for follow-on finance, including from public funds.

27. There are some good examples as well as lessons to learn regarding the effectiveness of government intervention. Public funding, eg via the Local Energy Fund[17], can be successful in leveraging private investment to net zero efforts. Awareness of such funding in the business and advisory communities is hugely important. Our members however report that some funds are badly communicated so knowledge or awareness of them is patchy. In this context, there is demand for transparency on due diligence and governance of funds' distribution, funds strategy, accountability, and evaluation.

28. Other bodies should strive to support a diverse set of fund managers. ICAEW, working closely with Liverpool City Region LEP and Growth Platform-Liverpool City Region Growth Company, recently convened an Innovation Investment Summit. Demand for collaboration and partnerships was evident among participants, and key conclusions of this well supported initiative were that:

   - a dynamic regional investment programme, such as that described in the Liverpool City Region Innovation Investment Prospectus, can have a very positive impact on stimulating additional private investment;
   - enterprises in the Liverpool City Region should benefit from Innovate UK's Investor Partnerships programme;
   - ways should be developed for working more closely with the British Business Bank and ensuring that more innovative enterprises secure funding from the Bank's Northern Powerhouse Investment Fund 2; and
   - specific measures should be progressed to improve investment readiness, including via a new hub.

29. ICAEW called for[18] the establishment of the UK Infrastructure Bank and believes that, with recent legislative footing and a forthcoming new strategy, it will be critical for projects requiring major capital outlay or where private capital is harder to unlock[19]. Examples are in green investment - business transition and retrofit programmes and circular economy initiatives, that also make significant inroads towards net zero.

[16] Women mean business – but can they access investment? | ICAEW
[17] Corporate Financier, March 2021, Rise of the renewables, page 18
[18] Infrastructure finance consultation response (icaew.com)
[19] Corporate Financier, May 2021, New Builder, page 24