BEIS Select Committee 'Post-Pandemic Economic Growth' Inquiry

Venture Capital Trust Association (VCTA) response

1. About the VCTA and how VCTs support businesses

Venture Capital Trusts (VCTs) invest in high-growth small businesses, supporting employment and investment across the whole of the UK through the long-standing VCT scheme.

The VCT scheme sets out defined rules, applied through a combination of State Aid criteria and UK legislation, offering a tax relief to private individuals investing into VCTs, which then invest patient growth capital into a range of businesses that would struggle to attract conventional funding.

VCT funds under management total £4.5bn, deployed and managed by independent fund managers through an extensive regional network of local offices in more than 15 cities around the UK.

In 2019, VCTs invested over £470m, investing in more than 100 companies for the first time and providing follow-on capital to existing portfolio companies to support their scale-up plans. In addition to funding, VCTs also provide intensive business support and advice to help their companies develop new products, enter new markets and create new jobs.

The VCT scheme provides a framework for structuring investments into small, illiquid private companies in a way that makes them suitable for private investors. VCTs pool investors' commitments into companies listed on the Stock Exchange, similar to investment trusts and closed-end funds that many investors are already familiar with. VCTs then invest in a diversified portfolio of SMEs, thereby reducing risk for investors, while at the same time creating significant efficiencies for the managers in both raising funds and deploying capital.

Investors can achieve liquidity for their investment by selling their shares in the VCT. However, a sale within five years of subscription will result in the initial tax relief being lost, thereby locking in funds and ensuring a pool of truly patient capital. Transparency and accountability are ensured by the Stock Exchange listing and oversight by an independent board of directors.

The Venture Capital Trust Association (VCTA) represents ten of the largest VCTs, making up over 75% of the VCT industry. Our members support over 1,000 small businesses across the UK, with more than 70,000 employees and £13.5bn of sales, of which a quarter are exports. The businesses we support range across sectors as diverse as digital technology, medicine development, specialist manufacturing and online retailing.

The ten funds we represent are Octopus, Gresham House, Albion Capital, Foresight Group, Downing, Beringea, Mercia, Mobeus Equity Partners, Maven Capital Partners and YFM Private Equity.

2. VCT support to SMEs during COVID-19

Throughout COVID-19 the support VCTs have continued to provide to SMEs has been critical, as EU State Aid rules have prevented many VCT-backed businesses from accessing government schemes such as the Future Fund and CBILS.

The experience of the crisis has demonstrated that there are opportunities to look again at the current scheme rules following the end of the transition period in order to broaden the profile of businesses that receive VCT investment and to support the post-pandemic recovery.

The importance of VCTs and the potential for future expansion has been endorsed by a number of sector bodies considering how to support businesses through the post-pandemic economic recovery, including TheCityUK's recent report under its Recapitalisation Project, published in July 2020, and the Future of Growth Capital Report, published in August 2020 and led by Innovate Finance and The Scale Up Institute.

As policymakers consider the need to drive post-pandemic growth, it is essential to build upon the success of existing schemes that have an established, well-understood and effective investment model, such as the VCT scheme, which the Future of Growth Capital Report identified as 'a cornerstone of early stage growth capital'[1].

There are opportunities to build upon the success of the VCT scheme, both by protecting the investment provided for under the current rules and by developing its ambition and scope through future changes following the end of the transition period.

3. VCT support for levelling up post-pandemic

While equity investment into UK SMEs has been growing, differences in investment levels remain across the UK, which is crucial to redress as the UK charts a course for post-pandemic growth.

Although VCTs invest across the whole country, the existing VCT rules are designed to focus investment into early-stage technology companies, which tend to be more concentrated in London and the South-East. Addressing this imbalance would provide an opportunity to unlock further VCT investment across the UK, supporting the Government's levelling up agenda while providing much-needed capital for SMEs impacted by the pandemic.

The VCTA is keen to support solutions which provide more investment to other sectors, spread more widely around the UK. In particular, this may require a reconsideration of the age limits which currently apply to VCT investment, which these regionally distributed companies are less likely to meet. This would have the dual effect of supporting the UK's recovery from COVID-19 and levelling up the economy.

VCTA members have offices in more than 15 cities across the UK, making them well-placed to accelerate investment that supports the levelling up agenda.

4. VCT support for scale-ups post-pandemic

A funding gap exists for growth businesses which do not qualify for VCT funding under the rules set out in the existing legislation, and those companies which can attract investment from fully commercial VC funds.

[1] Future of Growth Capital Report, p11

This is a restriction on the ability of growth companies to continue to scale, where they have reached the lifetime limit on the funds they can raise from tax-advantaged schemes.

To support post-pandemic growth it is vital that these company can access the "patient capital" they need to reach their full potential, rather than finding themselves "stuck" in a mode of incremental growth, or accepting a trade sale as the most convenient exit, both of which are, ultimately, to the detriment of the UK economy, tax receipts and job creation[2], undermining the UK's recovery from the pandemic.

By addressing this funding gap, the Government has an opportunity to rapidly unlock much-needed investment in high-growth businesses through an established and successful scheme, supporting the post-pandemic recovery and additional jobs and growth.

We believe this funding gap can be addressed by changing the rules defining which companies are eligible for VCT funding, to widen the range of companies which can benefit from the scheme, increase the amount of capital deployed and distribute it more equally around the UK.

This opportunity was first identified by the Industry Panel Response to the Patient Capital Review in 2017.

This stated:

Extending the investment limits for existing EIS and VCT schemes: *The popularity of these schemes has contributed significantly to the development of a vibrant UK start-up scene. However, the hard limits on investment size create inefficiencies as businesses transition away from tax incentivised investment, particularly due to the inability of Angels and VCTs to provide follow-on funding. To minimise this impact, the limits could be extended or removed, smoothing the transition from EIS / VCT funding to venture and raising up to an additional £1bn*[3].

The Industry Panel Response went on to suggest that one way of achieving this while minimising the cost to government, would be to create a new "Growth VCT" with a reduced level of tax relief. This would have the ability to invest in a wider range of businesses than existing VCTs, while still being focused on smaller growth businesses which are not yet attractive to fully commercial investors.

An alternative approach would be to change the existing restrictions which apply to VCT investment to achieve the same objective of addressing the funding gap between VCT and venture funding. The VCTA is currently exploring both approaches.

Whichever approach is adopted, it would provide another rung on the "funding ladder" for scaling UK businesses, including those hit by COVID-19 and looking to grow and expand to support the post-pandemic recovery.

5. Conclusion

To support post-pandemic growth, the Government must prioritise investment in high growth companies that have the potential to support employment and growth in all regions across the UK.

[2] Patient Capital Review, Industry Panel Response, October 2017, page 7
[3] Patient Capital Review, Industry Panel Response, October 2017, page 7

The VCT scheme is an established, well-understood and successful part of the UK's investment landscape. VCTs have a proven track record in providing long-term patient capital that supports businesses that would otherwise not be able to access the support and funding they need to grow, enter new markets and drive employment in all parts of the UK.

As policymakers consider opportunities for growth and levelling up the economy, following COVID-19, it is essential that VCTs are backed to continue to provide support to new and existing businesses, and that opportunities to widen access to the scheme are embraced.

The VCTA stands ready to engage with the BEIS Select Committee to highlight the role of VCTs and to explore ways to build on the scheme's track-record of supporting UK business and employment to deliver post-pandemic growth.