Igniting the Spirit of Growth, Innovation and Success in the UK

A research study conducted by the VCTA

VCTA
Venture Capital Trust Association

Introduction

At what remains a difficult time for the UK economy, with heightened macroeconomic risks and geopolitical tensions depressing investor sentiment, the Venture Capital Trust (VCT) sector has continued to deliver a high level of capital support for many of the UK's most dynamic, fast-growing businesses.

In contrast to other areas of private and public investment, which in many cases have seen sharp falls in activity, support, and performance, including the wider Venture Capital market, VCTs have held up very well – a compelling testament to the strength of the VCT funding model, the benefits to the businesses themselves, and professionalism of the VCT industry.

The most recent tax year once again saw VCTs raise over £1 billion, showcasing their resilience in the context of wider UK venture capital funding, which saw levels drop by 23% in 2022. VCTs also showed flexibility and the ability to continually deploy capital, investing a total of £664 million into early-stage start-ups last year.

The VCTA's latest research, through our member firms' investee company, helps gauge the extent to which their ambition and confidence has been impacted by current barriers to growth.

What we found was that: insufficient capital was seen as a major barrier to growth and success. Despite the wider market conditions, VCT backed firms remain ambitious, with the vast majority – more than 90% – aiming to expand outside of the UK and capture international opportunities.

It is also clear that optimising the benefits of technology, including Artificial Intelligence, will continue to play a pivotal role in the competitiveness of scale-up firms and ultimately in their ability to fulfil their growth potential. Indeed, most firms don't see AI as a threat – a sign, again, of their opportunistic mindset and tech expertise.

Our research was run in the wake of the Treasury Select Committee's report on the venture capital industry published at the end of July. The VCTA welcomed the Committee's report and its call for continued investment in the UK's highly valuable class of fast-growing, early-stage businesses through an expanded VCT sector.

Will Fraser-Allen,
Chair, Venture Capital Trust Association

Flavius Plesu
OutThink

Executive summary

35% of VCT-backed business leaders cite insufficient capital as the biggest growth barrier, rising to 55% among earlier stage businesses with annual revenue of less than £1 million

Over 90% of respondents are looking to expand significantly outside of the UK

53% of firms already have a presence in North America, more than in Europe (42%)

73% see the UK as an attractive place to build a technology business

60% of firms do not see AI as posing a threat or challenge to their own business

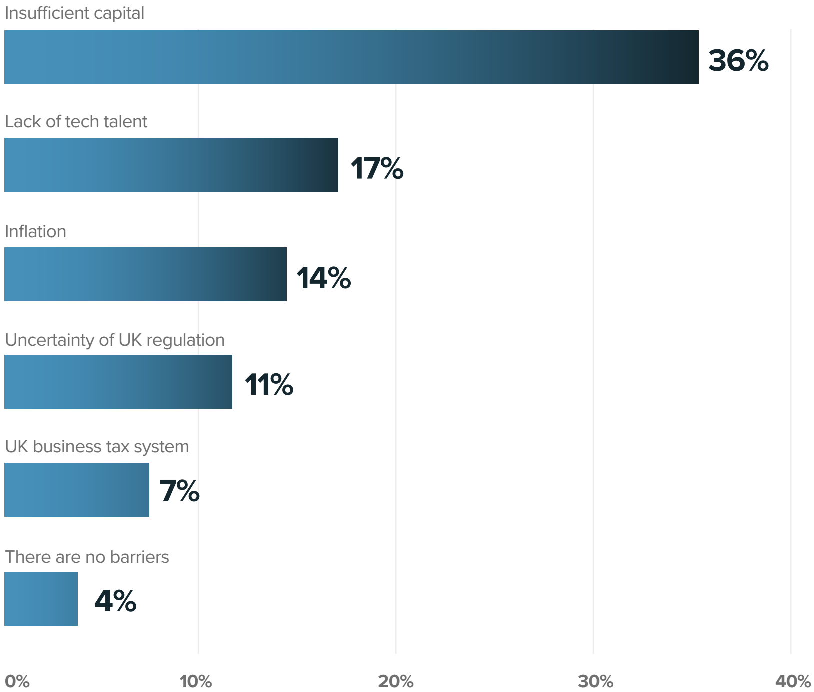
“VCT-backed entrepreneurs rely most on growth equity and talented people to realise their aspirations.”

Above all else, fast-growth firms need access to capital and tech talent

According to our study, insufficient capital is by far the biggest barrier to growth in the eyes of VC-backed entrepreneurs. Interestingly, the data showed that firms generating less revenue are most concerned about insufficient capital (c. 55%), with concern falling for larger firms. This suggests that the need for capital is likely to be most acute among earlier stage firms that have yet to scale their operations in the form of expanding their customer base or product range, for example.

Wendy McDougall
Firefish

What is the biggest barrier to growth for your business?

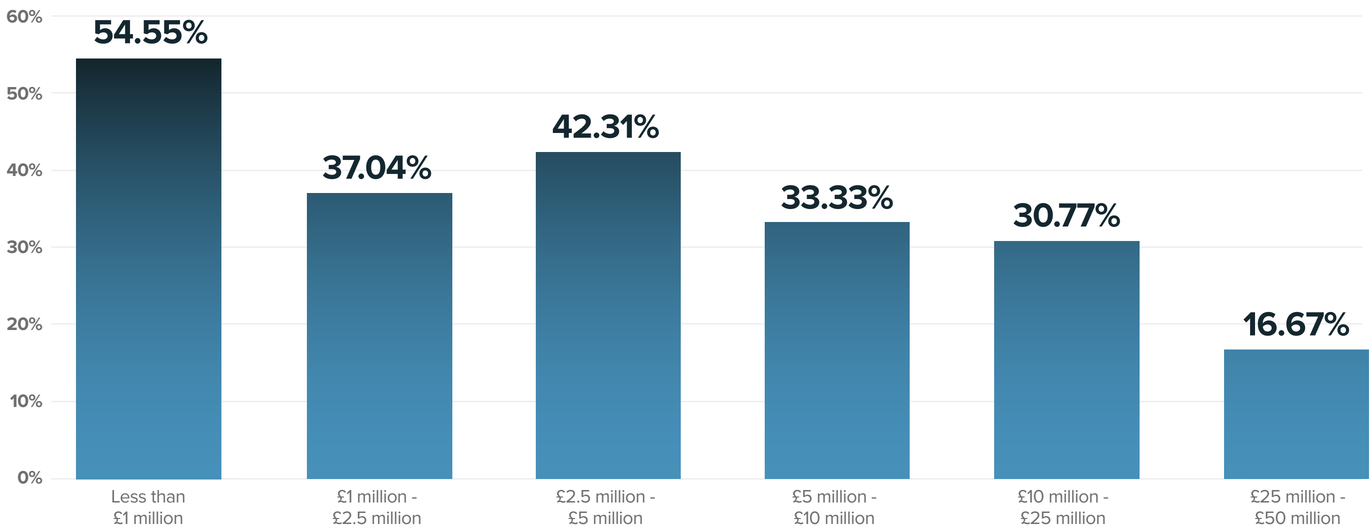


Despite the UK's reputation as an international centre of tech excellence, accessing top tech talent remains an ongoing challenge for many companies, particularly those at the cutting edge of innovation. Put simply, there is a finite pool of leading tech professionals and high levels of demand. It speaks to the mindset of ambitious company leaders that macro issues are seen as smaller obstacles than having limited access to the core drivers of growth, namely capital and talent.

Ruben Van den Bossche
Gorilla

For us, it also highlights the crucial role that VCTs play in the UK's start-up ecosystem. Without the necessary funding, businesses will be unable to seize opportunities, either in the UK or internationally, invest in new products or in areas such as technology, and compete on both a national and global level.

Businesses identifying insufficient access to capital as their biggest barrier to growth



Source: VCTA Member Survey July 2023

The Treasury Select Committee backs further improvements to VCTs

We welcomed the Treasury Committee's report published in July and their recommendations (Venture capital needs to venture further, says Treasury Committee); these clearly addressed the concerns of the VCT community and represent a positive future vision for continuing growth in the sector. Among the key recommendations of the report:

- Continued support for venture capital tax reliefs
- A clear HM Treasury plan for the extension of sunset clauses on venture capital reliefs beyond April 2025
- Provision of diversity statistics
- Extending the seven- and 10-year company age limits for support through the EIS and VCT schemes
- A Government Consultation on higher funding limits on the EIS and VCT schemes

Extending the seven- and 10-year company age limits for support through EIS and VCT schemes respectively and a Government consultation on higher funding limits would, in our view, enhance support and generate significant, long-term benefits for some of the UK's fastest-growing small companies, which have the potential to drive the UK's economic growth agenda.

The report also highlighted the need for a greater portion of capital to be allocated to growth companies based outside London and the South East. In addition, greater flexibility in terms of the age of businesses that qualify for VCT funding as well as the size of qualifying firms have also been raised as a way to expand and optimise funding - both of which would, in our view, greatly benefit firms throughout the UK.

Over the coming months, the VCTA will continue to engage in positive dialogue with the Treasury to ensure those entrepreneurs who rely on equity capital to fuel their businesses' growth continue to receive the funding they need, as well as delivering value for all stakeholders.

Luke Boase
Lucky Saint

International growth mindset dominates

As a proxy for ambition and a growth-focused business model and mindset, expanding overseas can be a powerful way for businesses to capture new markets and customers. It is not a straightforward process but, executed well, it dramatically boosts growth and is entirely commensurate with the mindset of VCT-backed entrepreneurs.

Do you plan to grow your business significantly outside of the UK?

90% Yes

9% No

Source: VCTA Member Survey July 2023

VCT investors identify and back many of the UK's most ambitious entrepreneurs, and management teams of small businesses. Given the scale of their growth aspirations, it's of little surprise that more than 90% of firms we polled are looking to expand overseas.

Despite being one of the world's largest economies, entrepreneurs rightly understand that the UK market is in most cases not big enough on its own to build and sustain billion-pound businesses. To scale rapidly by accessing new overseas markets, early-stage businesses with limited track records rely heavily on VCT funding to transform their plans into reality.

Case Study

Supporting the UK's most ambitious companies

Company: YardLink
Sector: Construction
Investor: Beringea

YardLink is reinventing the future of construction procurement for SMEs across the UK with its full-service supply chain management software. VCTA member Beringea led a £16 million Series A funding round at the end of 2022, to double YardLink's headcount and expand its supplier network nationwide.

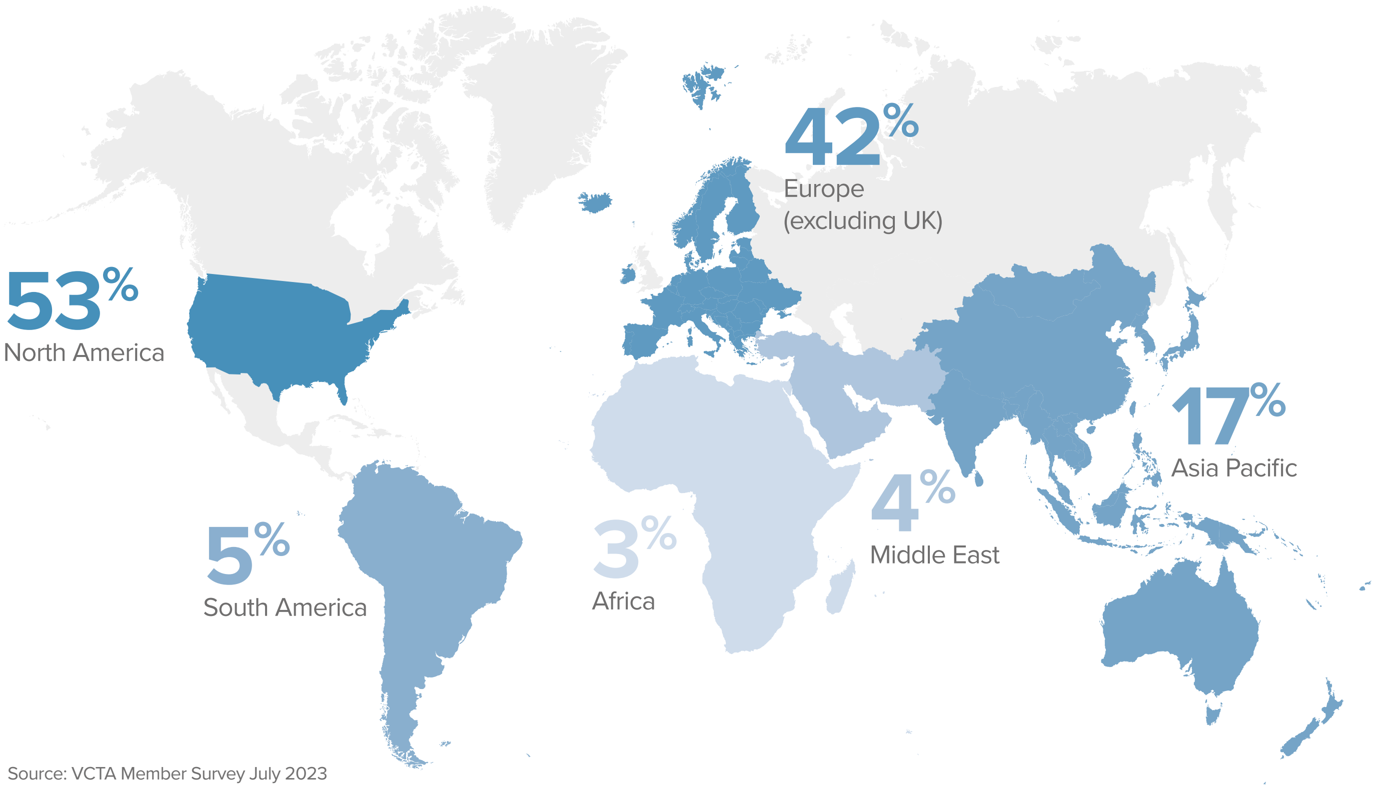
Yardlink's CEO Neeral Shah named the evergreen nature of VCT funds as one of the main advantages of the scheme: "As an entrepreneur, coming across a pool of capital that doesn't exhaust was a huge benefit." The team also highlighted that the thorough due diligence processes undertaken by VCT firms manifests greater transparency and trust between the company and investors.

Beringea's focus on 'capital-efficient' companies means they target stable, long-term investments, a unique selling point for Yardlink as it aligned more closely with its business strategy and maturity. Additionally, Beringea's experience in B2B markets and their strong operational team, particularly in human resources, were crucial factors leveraged to support Yardlink's continued growth and success.

YardLink is currently UK-based, but the team looks to expand into the US over the next 12-24 months, utilising Beringea's presence in the region where they are also an active investor.

As the world's biggest economy with an entrepreneur-led business culture, it is understandable that over half (53%) of the companies we surveyed already have a presence in North America, followed by (42%). A fifth are established in Asia-Pacific markets, while the Middle East and Africa – two very exciting, fast-growing markets in their own rights – were also represented.

Do you have operations in any regions outside of the UK?



Source: VCTA Member Survey July 2023

VCT-backed businesses are making a growing contribution to UK plc

- Total 2022 sales of £18.18 billion, with annual sales up 54.3% from 2021
- R&D expenditure grew 6.3% between 2021-2022. R&D investment in 2022 was worth £549 million
- There are currently over 92,000 people employed by investee companies, representing growth of 34.4% since 2021
- Export sales worth £3.77 billion in 2022, growing 29.8% vs. 2021
- £353 million in PAYE and National Insurance contributions were made by employees in 2022, representing growth of 35% since 2020
- 54% of companies have female executives, while 27% have BAME representation at executive level

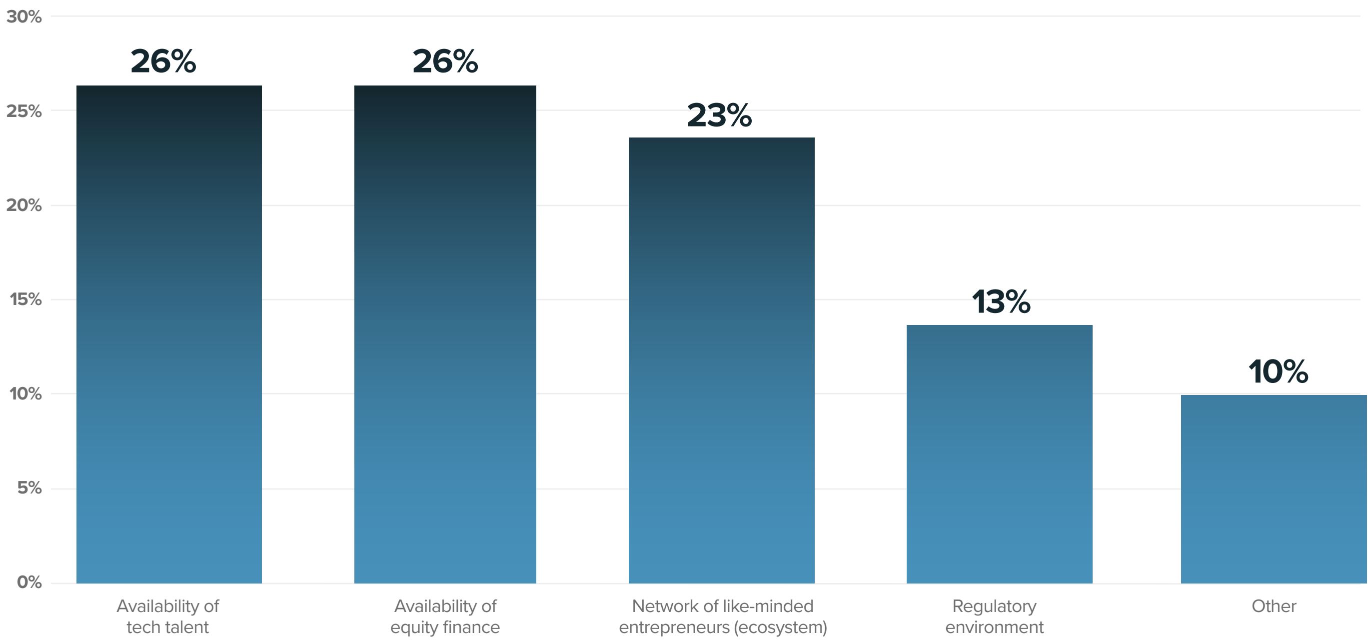
Source: VCTA

The invaluable role that technology continues to play in success

Many VCTs already back early-stage companies that are developing emerging and potentially transformational technologies across a range of industry sectors. Some of the most exciting investment opportunities come from companies that combine technologies, such as robotics and machine learning, to deliver a groundbreaking solution. Against this backdrop, it's encouraging to see that almost three quarters (73%) of respondents view the UK as a great tech hub, underlining our country's continued attractiveness for scaling tech-enabled businesses.

When exploring the key reasons for this, respondents identified the availability of tech talent and access to equity finance as equally important, closely followed by the UK's extensive network of like-minded entrepreneurs. This country has a long history of a thriving venture capital sector cultivating digital innovation and entrepreneurship and in recent years it has extended its dominance in these areas over other similar-sized economies.

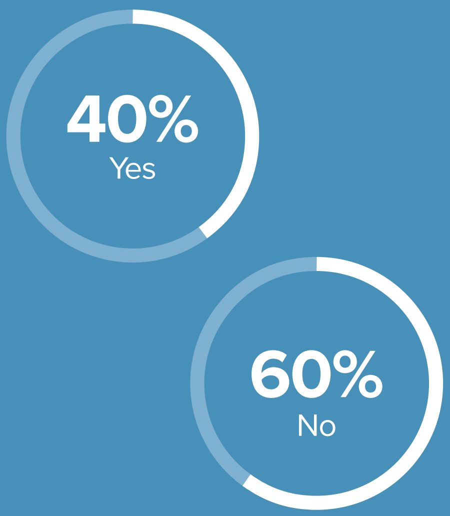
Why do you believe the UK is an attractive place to build a technology business?



Source: VCTA Member Survey July 2023

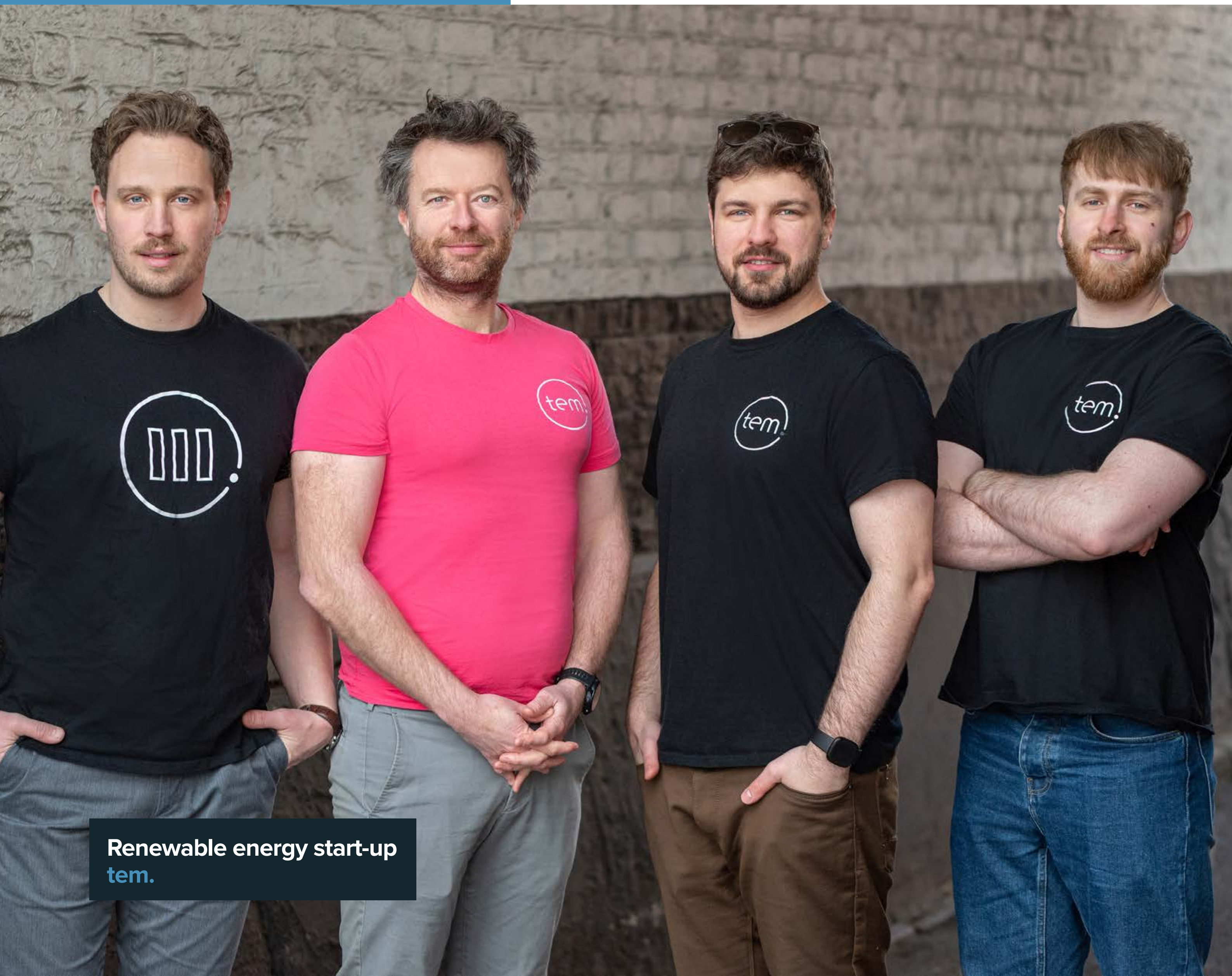
Artificial Intelligence (AI) has rapidly become one of the most widely discussed technologies and its impact on business, culture and society are to be fully understood. While there are no shortage of headlines warning of job losses, ethical dilemmas and high costs, the majority of respondents (60%) said AI did not pose a threat or challenge to their own business.

Does the growth of artificial intelligence pose any challenge to your business?



We believe AI will act, much like the broader tech sector has for the past two decades, as a business enabler. Smart, savvy firms will capitalise on new opportunities, create new revenue streams, and build long-term value. While challenges for some businesses will be material (possibly existential), given the innate power that AI is already delivering, we believe the net benefits of AI to fast-growth VCT-backed companies will be huge.

So far, technology is an area in which the UK continues to thrive – our ecosystem is unrivalled outside of the US, in terms of: funding, talent, the quality of many businesses, and the market dynamic. AI-related innovation represents an exciting chance for the UK to continue this global role.



Renewable energy start-up
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Case Study

Supporting innovative companies across the UK

Company: Pure Pet Food

Sector: Consumer

Investor: Mercia

Pure Pet Food, located in Cleckheaton, Yorkshire, produces high-quality air-dried pet food using natural ingredients. The firm received its first Venture Capital Trust investment from VCTA member Mercia in 2019.

Founded in 2013 by Daniel Eha Valdur and Mathew Cockroft in their home kitchen, the business grew organically in the early years, with the founders appearing on Dragons' Den in 2014 and winning over two dragons, whose offers they choose not to pursue.

Seeing the rise in competition from peers in London who raised venture capital funding, Pure Pet Food sought out investment avenues and successfully secured a £2 million investment from Mercia Ventures in 2019. The funding resulted in a 15x increase in revenue and expansion from a five-person team to 75 people, in addition to 120 brand ambassadors across the UK. The funding has allowed them to collaborate with top vets and nutritionists, expanding their brand and adding dog treats and apparel to their offerings.

Fiercely proud of their Yorkshire roots – the team at Pure Pet Food advocate for better awareness of funding opportunities for small businesses outside London, engaging with local universities and providing work experience opportunities. Additionally, Dan is an Enterprise Advisor with the West Yorkshire Combined Authority, promoting entrepreneurship in local schools. In 2021, they secured another multi-million-pound investment from Mercia Ventures, further fuelling their success.

Conclusion

Venture Capital Trusts continue to play a critical role in nurturing young, fast-growth companies through the provision of patient, evergreen capital. This is particularly important during market downturns when funding from other sources becomes much harder to access. In many cases, VCTs are the only source of capital that entrepreneurs can access, and often make the difference between success and failure.

It is hugely encouraging that our members' investee firms continue to demonstrate such optimism and confidence in the UK as an environment in which to grow and develop their fledgling businesses. Unlike many companies that cite the wider business environment as a constraint on growth, VCT-backed entrepreneurs rely above all on growth equity and talented people to realise their aspirations.

Our research clearly underlines the importance of harnessing new technology to achieve outstanding levels of growth and become tomorrow's unicorns.

Despite the challenges facing the wider venture capital sector, VCTs have remained able to attract new investor capital and rapidly direct it towards funding many of the UK's most promising young companies.

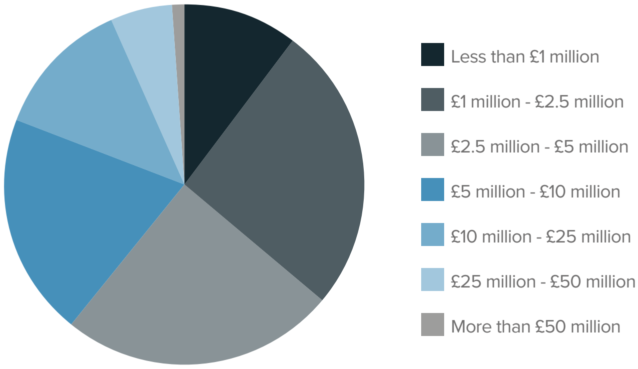
We look forward to continuing our work on behalf of member firms to ensure that funding is directed into more companies across the UK that strengthen the economy, help the UK meet its net zero target of 2050, and are led by females and ethnic minorities.

Patrick de Boer & Michael Feldman
PeakData

Methodology

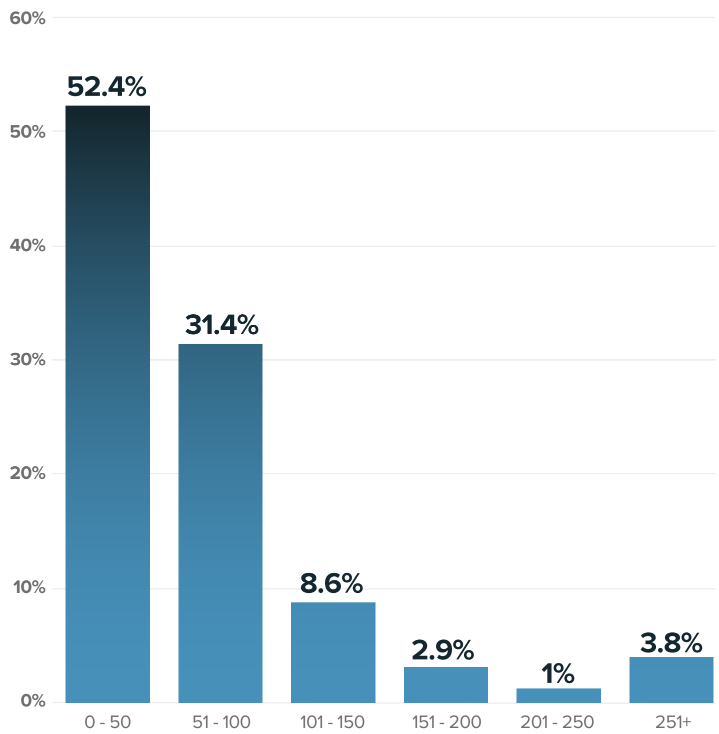
The VCTA conducted an online survey among members' portfolio companies at the end of July 2023. Overall, 119 firms took part, with balanced representation across the UK regions and by company size, according to revenue and number of employees. Participating firms employed on average 65 members of staff, with an average annual revenue of £7.7 million.

Participants by revenue

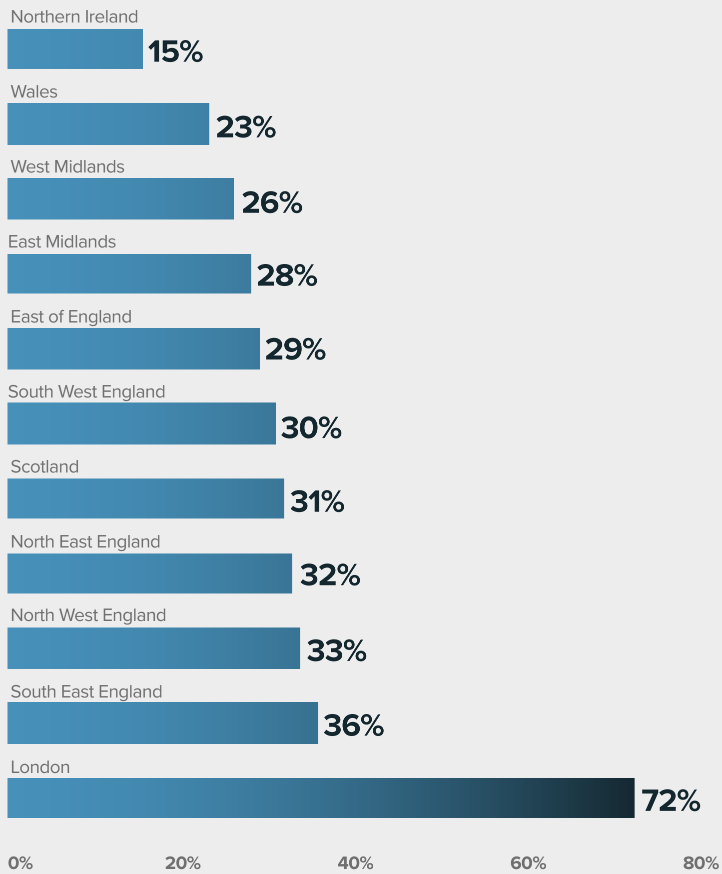


Jack Scott & Alex Wright
Dash Water

Participants by number of staff



Regional activity/ business operational focus



Venture Capital Trust Association

About the Venture Capital Trust Association

The Venture Capital Trust Association (VCTA) is the industry body representing twelve of the largest venture capital trust managers in the UK. Its members make up more than 90% of the VCT industry, with £6.1bn funds under management invested through an extensive regional network of local offices across the UK.

It is an industry body actively campaigning to support early-stage businesses during a period of significant economic disruption and create the regulatory landscape to unlock sufficient growth capital to accelerate the UK's recovery.