Invested in a better future

13/10/23

Dear Chancellor,

As you consider your package of measures for the Autumn Statement on 22 November, the British Private Equity and Venture Capital Association (BVCA) is pleased to share its recommendations with you, which we believe will support the Government in achieving its ambitions for economic growth, job creation and Net Zero innovation. We remain supportive of the Government's vision to make the UK one of the best places in the world to start, scale and grow a business, and believe that the policies below will better enable private capital to contribute to sustainable, economic prosperity in the UK.

Given the uncertain economic climate, increasing pension schemes' access to private capital is vital to boosting economic growth. Broadening access to capital would drive funding towards UK businesses whilst improving the retirement prospects of UK workers. The BVCA believes that access to capital remains a fundamental challenge for the UK and therefore this is the main theme of our submission.

The BVCA welcomed your announcement at Mansion House in July of reforms to encourage pension funds to invest in private capital, therefore boosting investment in businesses and improving pension savings for UK savers. As we approach the Autumn Statement, we urge you **to maintain the momentum** and **take the next steps to deliver the Mansion House Compact**, and ask the Government to **work with industry to ensure the consolidation of the pensions sector** to facilitate an increase in the investment of pension capital into UK private capital funds and UK businesses.

Beyond this, in order to ensure the UK economy continues to grow and the UK remains the best place to start and scale a business, we make the following recommendations to ensure certainty and to help businesses to grow.

- **Clear frameworks** - to give certainty around Net Zero and ensure proportionate regulation in other areas (including investment screening): we encourage the Government to ensure certainty for businesses in relation to Net Zero, including clear frameworks, proportionate regulation for SMEs, clear reporting standards, as well as a clear and consistent Net Zero roadmap. Regulations around investment screening for national security also need to be proportionate.

- **Training and retaining talent** - work with industry to foster and attract the right skills for business: we ask the Government to work with industry to identify skills gaps and use this information to feed into visa requirements and education planning to ensure that businesses across the country can thrive and grow.

- **Support for innovation -** in order to encourage innovation and support small, fast-growing businesses, we ask the Government to remove the EIS and VCT sunset clauses entirely to signal strongly that investing in these businesses is key to UK economic growth.

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The BVCA is the industry body and public policy advocate for the private equity (PE) and venture capital (VC) (private capital) industry in the UK. With a membership of around 650 firms, we represent the vast majority of all UK-based private capital firms, as well as their professional advisers and a large base of UK and global investors. In 2022, £27.5bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. There are over 12,000 UK companies backed by private capital which currently employ over 2.2 million people in the UK. Over 55% of the businesses backed are outside of London and 90% of the businesses receiving investment are small and medium-sized businesses.

Maintain momentum with reforms to unlock Access to Private Capital Funding

Despite the UK having one of the largest pension sectors in the world, UK pension schemes, relative to global peers, currently invest very little in this asset class. This means UK workers are missing out on higher returns, whilst overseas pension savers benefit from the strong returns generated by the growth of UK private companies.

UK businesses need to attract this capital. Despite such eye-catching figures, in practice, UK businesses face significant challenges accessing the funding they need to grow, and often look overseas for expansion and growth capital. As a result, the UK is losing talent and intellectual property, which puts the brakes on economic growth. UK pension savers need secure retirements. Moreover, pension trustees need to work ever harder to deliver those secure retirements for today's workers. UK private capital can help them achieve this, because, as an asset class, it has consistently delivered better returns for savers than public markets for decades.

While the BVCA welcomes your Mansion House reforms and the increased opportunities for investment in alternative assets announced in July, reforms could go further to address the structural and cultural blockers to Defined Contribution (DC) pension funds investing in private capital funds.

The UK's pensions sector remains fragmented, with around 28,000 DC schemes, over 5,000 Defined Benefit (DB) schemes and incomplete 'pooling' of Local Government Pension Scheme (LGPS) assets. The Mansion House Reforms do not fully address the structural and cultural blockers to DC pension funds investing in private capital funds, such as risk, cost, lack of skills and networks, liquidity, and lack of scale. Therefore in order to increase access to capital for businesses across the UK, driving economic growth and boosting retirement savings, the BVCA recommends:

- **Encouraging consolidation of the sector into fewer, larger schemes** to facilitate an increase in the investment of pension capital into UK private capital funds and UK businesses.
- Seizing opportunities to **help increase pension scheme trustees' knowledge and understanding of private capital.** This will help them recognise where private capital offers opportunities to increase their savers' retirement pots, and give them the confidence to invest.

- **Fostering a regulatory environment that affords more flexibility in pension scheme investment,** and considers the proposals outlined by the BVCA. This will ensure the UK continues to be a leading destination for investment and remains competitive on the international stage.

This would not only boost UK economic growth through enabling domestic scale-up investment capability in productive, knowledge-intensive sectors, but would also allow UK retirees to benefit from the strong returns offered by private capital. The latter was supported by DWP's own analysis in its 2018 White Paper on Protecting Defined Benefit Pension Schemes, which concluded that consolidation would reduce UK pension schemes' running costs, improve their investment strategies (including by allowing a greater focus on illiquid investments), and bolster their governance, leading to improved outcomes for members.

Nonetheless, the BVCA recommends the Government is mindful of, and takes steps to mitigate, the risk of unintended consequences from consolidation, such as the potential for fewer low-level regional investments. In the context of LGPS, for example, this could be addressed by encouraging a certain proportion of capital be allocated to smaller, regionally focused funds to maintain a level of regional investment that supports levelling up and can generate strong returns for scheme members.

Access to capital for start-ups through VC funding has grown in recent years, and one of the main reasons is the growth of the British Business Bank (BBB), which is the largest funder of UK VCs, and the creation of British Patient Capital (BPC). The BBB was the largest UK-based LP investor in UK VC funds between 2017 and 2022, based on both the amount committed and the number of funds committed to. The BBB and BPC have a significant role in facilitating investment in UK businesses and their position in the wider ecosystem outlines its importance in drawing institutional capital to support UK businesses.

Our recommendations would also help tackle the gap in UK scale capital and investment capability. It is at the scale-up stage that the financing of these companies transitions to syndicates led by US, Asian and European investment groups. Overseas investment is welcome, validates the quality of UK companies and investment opportunities being created in the UK knowledge-intensive sector. However, it is a concern that the UK lacks a domestic scale-up investment capability in these knowledge-intensive sectors. Relying on foreign investment to scale-up companies exposes the UK to geopolitical risk and fluctuations in global capital allocations. It also prevents the UK from growing a generation of investment managers experienced in scaling knowledge-intensive businesses, which is vital to ensure UK start-ups can continue to grow.

Additionally, to boost investment in fast growing companies, we recommend:

- **Implementing the LIFTS process** to ensure money is unlocked for UK VCs to invest in the most innovative and fastest growing UK science and technology companies.

- **Continuing to support, and increases funding for the British Business Bank (BBB)** and its current programmes, the Enterprise Capital Funds, Future Fund Breakthrough, and British Patient Capital (BPC).
- **Expanding the remit of the British Business Bank (BBB)** to cover the full continuum of start-up funding needs, including for funds which take majority stakes, particularly in the latter stages of a company's growth journey.

Clear frameworks – to give certainty around Net Zero and the direction of travel on sustainability and ensure proportionate regulation on investment screening

Businesses need certainty about both policy and regulation to invest and we look to the Government and regulators to provide an indication of future direction, whilst ensuring that regulation is clear, proportionate and doesn't have an adverse impact on investment decisions.

Across Net Zero and wider sustainability, as well as investment screening, we urge the Government to emphasise its commitment to a clear strategy and direction to ensure that investors have the confidence to invest in the UK. Our research shows that members have commitments for over £145bn of capital to deploy – known in the industry as "dry powder" – in the next three to five years to help businesses innovate and grow. It is vital that we find ways to encourage private capital to invest in UK businesses in order to grow the economy and help our businesses to thrive.

Achieving Net Zero is going to require large, long-term investments in both infrastructure and innovation. To find that amount of investment against a backdrop of ailing public finances is the reason why few governments will be able to tackle the climate crisis without the support of PE and VC. Furthermore, private capital funds are well placed to drive the transition towards Net Zero in areas of the economy that public markets cannot reach, through investment in unlisted SMEs and start-ups working towards Net Zero breakthroughs.

To enhance this, we would like to see more incentivisation of SMEs towards positive behaviours to achieving Net Zero. Therefore, the BVCA recommends:

- **Enacting clear and proportionate guidance for reporting standards,** proportionate reporting requirements, tax incentives, grants and guarantees for green finance.
- **Ensuring sustainability regulation is proportionate,** compatible with international standards and appropriately tailored to private capital markets and the SMEs they generally invest in.
- **Publishing a robust UK Net Zero roadmap**, with clear commitments and actions on public investment.

Joined up policymaking is essential, with proportionate sequencing and timely implementation. The development of a global reporting language and development of common methodologies and guidance which are cognisant of the sectors they reflect are required to allow organisations to commit meaningfully to Net Zero.

A similar approach – involving clear and proportionate regulation – is needed in other areas too. In recent years we have seen a host of new national security regimes both here and in the EU and US. Whilst we support the important objective of protecting national security and Britian's vital infrastructure, there is a need to encourage innovation and development of the technologies and industries of the future (such as AI) that will drive growth. Therefore, the BVCA recommends:

- The Government commits to reviewing the National Security and Investment Act to ensure that the Act is fit for purpose.
- In addition, when creating any new investment screening regime, to carefully consider what is in the best interests of the UK and its place as a global financial centre, balancing the need for national security with the need for economic growth and innovation.

Training and retaining talent: working with industry to foster and attract the right skills

Skilled talent is crucial to the growth of both funds and their portfolio companies, and lack of access to such entrepreneurs and innovators remains an obstacle for companies seeking to scale their business.

Small teams at VCs, start-ups and SMEs do not have in-house expertise in recruitment and often rely on expensive external advice. Simultaneously, the competition for talent across Europe has increased as new visa schemes are making it easier for tech and science talent, and their families, to settle in other countries for longer periods at a lower cost. With 9 out of 10 private capital investments being in SMEs, these factors have become a particular burden for the industry's ability to scale and innovate. Therefore, the BVCA recommends:

- **Streamlining the process for recruiting overseas talent:** Simplify the visa schemes to reduce costs and increase the speed of overseas recruitment so fund managers, and the companies they invest in, can easily access the talent they need to grow companies.

Members tell us that businesses that rely on skilled workforces, such as machine operators, are struggling to recruit new staff as workers retire. Businesses know what skills are needed locally, but finding the training is not always available. Therefore, the BVCA recommends:

- The Government, alongside devolved and local administrations, **works with industry to identify forthcoming skills gaps** and uses this to plan further and higher education offerings. In addition, we urge the Government to continue to **promote education in STEM, data science and other tech related skills,** and promote enterprise and entrepreneurship at all levels of education.

Driving innovation by supporting SMEs – remove the EIS and VCT sunset clauses

The SEIS, EIS and VCT schemes are vital parts of the patient capital ecosystem. SEIS supports very early stage businesses, EIS encourages a further advance in maturity and VCTs enable investment in a diversified portfolio of start-up companies. The Government has committed to extending the EIS/VCT sunset clauses but has yet to codify this. This kind of uncertainty makes it harder for investors to plan and therefore limits the money they are prepared to invest in the UK. The BVCA urges the Government to:

- **Remove the EIS and VCT sunset clauses altogether** (not just extend them) to remove uncertainty for investors and the innovative companies they support.

We are in discussions with Government on most of the recommendations above and look forward to continuing those discussions ahead of, and after, the Autumn Statement.

Yours sincerely,

Michael

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