EU Financial Affairs Sub-Committee
House of Lords
Houses of Parliament
Westminster
London
SW1A 0PW

14 September 2018

Dear Sirs,

RE: Brexit – the European Investment Bank

I am writing on behalf of the British Private Equity & Venture Capital Association (BVCA), which is the industry body and public policy advocate for the private equity and venture capital industry in the UK. With a membership of over 700 firms, the BVCA represents the vast majority of all UK-based firms, as well as their professional advisers and investors. Over the past five years (2013-2017), BVCA members have invested over £32bn into nearly 2,500 companies based in the UK. Our members currently back around 3,380 companies, employing close to 1.4 million people on a full-time equivalent basis (FTEs) across the world. Of these, around 692,000 FTEs are employed in the UK.

We welcome this opportunity to comment and our response will focus on the questions relating to the the European Investment Fund (EIF) as it is of most relevance to our members. The UK remains a home for some of the most successful venture and private equity firms in Europe and as the UK leaves the European Union, the Government needs to create the right policy framework that maintains significant investment in UK funds.

The EIF has been an active investor in UK venture capital and private equity funds for a long period, and we believe that the British Business Bank (BBB) should look to replicate the EIF's investment programme where possible, and be given the funding to fill the gap created by the withdrawal of the EIF's investment into UK funds.

Yours faithfully,

Tim Hames
BVCA Director General

British Private Equity & Venture Capital Association
5th Floor East, Chancery House, 53-64 Chancery Lane, London WC2A 1QS
T +44 (0)20 7492 0400 bvca@bvca.co.uk www.bvca.co.uk

BVCA Response to the Inquiry: Brexit: the European Investment Bank

The European Investment Fund

1. The EIF was established in 1994 as an offshoot of the European Investment Bank (EIB) to promote investment in European SMEs. A material amount of this investment is made through European venture and private equity funds. The EIF invests both in funds with pan-European mandates and in funds with a country-specific mandate (including in the UK).

2. The EIF's investment mandate is set out in the EIF statutes. These limit the EIF's geographic scope to the Member States of the Union, candidate and potential candidate countries to the Union, and the European Free Trade Association (EFTA). As a result, following UK's exit from the European Union it is unlikely that the EIF will be able to continue to invest in funds that have a primary investment focus in the UK even if some form of future relationship is maintained.

Q2: How dependent is the UK SME sector on EIF financing? Are there particular sectors that will be more affected by any loss of EIF funding (e.g. FinTech)?

3. The EIF has been a significant player in the UK and European venture capital market. Between 2011 and 2015, the European Investment Fund invested €2.3 billion into UK venture capital, growth and mid-market funds, which in turn supported total investment of €13.8 billion into SMEs. Following the Brexit vote in 2016, while the EIF have stated that they would continue to fund UK venture capital firms, there have been press reports of a slowdown in the amounts received by UK funds.[1]

4. If no relationship is maintained with the EIF, there may be reduced access to funding for venture capital investments in SMEs, especially in companies that require long term financing. For example, the BVCA's Innovation Nation Report from 2017, revealed that 50% of venture capital investment in the UK was concentrated on the digital economy, typically in high growth areas.[2] It is high growth, high risk industries such as this that could be affected, as well as those that rely heavily on long term R&D funding. This could have an impact on the UK's research reputation and talent pool, especially for emerging tech firms ("access to talent" was highlighted as the biggest challenge for 83% of UK tech firms according to the latest Tech Nation report).[3]

5. A recent survey of European venture capital firms by the EIF, reveals that the UK is losing ground to its European partners as the most promising destination for venture capital investment. The survey also reveals the extent to which Brexit is causing concerns regarding fundraising for UK VCs, where 38% of UK venture capital firms said that the fundraising environment would deteriorate over the next 12 months compared to 12% of European firms, and the levels of pessimism regarding the growth prospects of the wider UK venture capital industry were also increasing.[4]

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[1] Financial Times, 20 April 2018 – *European Investment Bank pulls back on UK funding after Brexit* – available here

[2] BVCA Innovation Nation Report – available here

[3] Tech Nation report 2018 – available here

[4] European Investment Fund VC Survey 2018, pages 38-39 – available here

6. Pitchbook data from February 2018 shows that the total capital raised by Europe's venture groups fell by a quarter in 2017 to €7.4bn and the total number of new funds dropped to a 10-year low of 54 in 2017, compared with 75 the in 2016.[5] This demonstrates the importance of providing certainty for UK firms, and as the UK prepares to leave the European Union it is essential that the funding provided by the EIF is either maintained or replaced in its entirety by a domestic alternative.

Q3: How reliant is the UK's venture capital sector on EIB and EIF funding? How much funding from other sources is contingent on that EIB or EIF funding? Will UK venture capital funds face any challenges in securing funding elsewhere in the absence of EIF funding?

7. Of the European Union's public investment programmes, the EIF has had the biggest impact on the UK market. This has largely been a function of its scale, and the stage at which it invests, frequently providing cornerstone funding for managers. In 2017, we surveyed BVCA members who have received EIF investment and 19 firms responded. 30% of respondents said that without EIF investment, they would have had difficulties reaching a first close. A further 47% said that without the EIF they would have raised a smaller amount. Only 12% of respondents said there would have been little or no impact had the EIF not invested.

8. The EIF has historically supported our sector through investment in three distinct parts of it, namely venture capital, growth capital and the lower mid-market end of private equity. This last category consists of UK-based funds with smaller funds investing largely, if not exclusively, in this country. They would typically focus on small but high potential businesses and their model is one based on generating value through strategic and operational improvements through their equity stakes, not financial engineering. In reality, therefore, the distinction between such funds and growth capital is all but artificial. There is a strong element of overlap in their ethos.

9. Mid-market funds actually outnumber the total levels of venture capital investment by the EIF (mid-market firms accounted for 39.3% of its overall private equity and venture capital investments compared to 36.6% for venture in 2017[6]). The EIF has funded a number of UK lower mid-market as well as venture capital funds, and according to its 2017 portfolio, it fund investments included 21 venture funds, 18 mid-market and 7 lower mid-market funds in the UK.[7] If no future relationship with the EIF is agreed, the British Business Bank should broaden its mandate and receive additional funding. We note the 2017 Conservative party manifesto stated that the government would repatriate EIF funds to the BBB after Brexit[8].

Q6: Are there options for the UK's future participation in the EIF, or should the Government focus on the Investment Fund to be incubated by the British Business Bank?

10. We have been supportive of efforts by the Government to maintain an ongoing relationship with the EIF, given its significant investment in UK funds, which account for more than any

[5] Financial Times, 7 February 2018 – *European venture capital groups struggle to attract investors* – available here

[6] European Investment Fund Annual Report 2017, page 34 – available here

[7] European Investment Fund: Equity Portfolio 2017, pages 17-18 – available here

[8] 2017 Conservative manifesto – available here

other country in its portfolio (it accounted for 20.1% of its overall investments in 2017, the next highest was France with 14.8%[9]).

11. In terms of the implications of Brexit on the UK's place in the EIF, it is possible that the UK could retain a role as an investor if the Government agreed it is as part of the final Brexit arrangement. The EIF is in effect a private company operating as a subsidiary of the EIB. As a result, investment in the fund is open to anyone. The EIB holds a 58.4% stake, the European Commission, on behalf of the EU holds a 29.8% stake, but the rest is held by financial institutions, including two from the UK (Barclays Bank PLC and Scottish Enterprise) which each have five shares, as well as non-EU institutions in Turkey[10].

12. However, any such investment has not yet been outlined by the Government (there was no mention of it in the recent Brexit White Paper[11]). In terms of scale, the Government should seek at least to match the EIF's investment in UK equity finance. Between 2011 and 2015 this was €2.3 billion. Whilst the £2.5 billion assigned to the BBB in the 2017 Autumn Budget will go some way to address the gap in funding, the BBB will require further resources to meet the scale and mandate of the EIF.

13. The BVCA supports the role of the British Business Bank (BBB) as a national resource for UK venture firms and the innovative firms they support, and it needs to be able to develop the kind of scale, portfolio diversity and international reach that the EIF enjoys.

Q7: What difference has the additional £400 million available to the British Business Bank made to funding opportunities for the UK's venture capital industry?

14. The BVCA has been supportive of the outcomes of the Government's Patient Capital Review process, and the additional £400 million is a welcome boost to the BBB's resources, but it is still early in the process to see the results of this additional funding. Anecdotal evidence from BVCA members has been positive, and the BVCA has played a role in communicating the role of the BBB to its members and promoting the British Patient Capital and the Managed Funds programmes.

15. However, more work needs to be done to raise the profile of the BBB, and further funding and resources for the BBB is required in order to meet the needs of the venture capital industry post-Brexit if the UK has no further relationship with the EIF. Planning for such a scenario should begin now, in order to prevent a potentially disruptive period of uncertainty for UK private equity and venture capital firms.

[9] European Investment Fund Annual Report 2017 – available here

[10] European Investment Fund: Register of Members of April 2018 – available here

[11] HM Government Brexit White Paper – *The future relationship between the United Kingdom and the European Union* – available here