BEIS Net Zero Review – BVCA response to Call for Evidence

The British Private Equity and Venture Capital Association (BVCA) is the industry body and public policy advocate for the private equity (PE) and venture capital (VC) industry in the UK. With a membership of over 700 firms, we represent the vast majority of all UK-based PE and VC firms, as well as their professional advisers and investors. Between 2017 and 2021, BVCA members invested over £57bn into around 3,900 UK businesses, 90% of which are small and medium enterprises (SME). These cover sectors across the UK economy and in all nations and regions (two thirds of UK investment was outside of London)[1].

The BVCA welcomes the opportunity to comment on the Government's call for evidence on its review of its Net Zero Strategy. We support the Government's efforts to achieve Net Zero by 2050 and the BVCA is committed to ensuring that the UK's PE and VC industry plays a leading role in decarbonisation.

Our feedback relates principally to the role of PE and VC in the Net Zero transition and explains our key recommendations to enable the sector to support the transition: i) Develop proportional and materiality-focused sustainability regulation; ii) Support SMEs to embrace Net Zero; ii) Develop common methodologies and facilitate collaboration; and iv) Net Zero Roadmap Blueprint.

1. The role of private capital in the Net Zero transition

The UK's private capital industry has a leading role to play in global efforts to eliminate the causes and combat the effects of climate change. As either majority or significant minority owners, principally of unlisted, fast-growing SMEs, private capital funds managed by BVCA member firms are well-placed to drive transition in areas of domestic and global economies that the public markets cannot reach.

Private capital backs the technological innovation needed to combat climate change

Our members are finding and helping to grow innovative UK and worldwide private businesses that offer solutions to global climate problems as well as contribute to avoided emissions. These private capital-backed portfolio companies are, for example, contributing to solutions to close the carbon data gap as well as invest in the companies developing the technologies to help us decarbonise such as converting biomass into sustainable aviation fuel, using hydrogen fuel cells to generate electricity, and powering commercial vehicles. To understand our industry's critical role in developing and growing the intellectual property that is indispensable for achieving Net Zero, please read the case studies included in the appendix.

Private capital grows the leading UK businesses of tomorrow and can green them today

As well as funding climate solutions, private capital also has a responsibility to embed climate and environmental considerations into businesses across the UK economy. For example, a company reliant on energy-intensive technology may not have the best environmental credentials today, but private capital firms have the expertise to gradually shift these companies towards green practices, whilst achieving growth. In this way, private capital can support the world-leading UK businesses of tomorrow to help realise the UK's climate and environmental ambitions and prepare for a low carbon future, today.

Private capital firms support organisations decarbonise, driving down emissions across the real economy

Private capital firms are well placed to actively support businesses over the long-term to reduce their greenhouse gas emissions (which are typically below the threshold of much of the UK's evolving sustainability regulation). This may be via funding investment in new infrastructure or technology, restructuring the business to optimise for realisation of green commercial and finance opportunities, or creating the trajectory for certain assets to be decommissioned. Given that SMEs account for around 50% of UK business emissions[2], this activity

[1] More information is available in the BVCA report – Growing Great British Businesses 2022

[2] Smaller businesses and the transition to net zero (british-business-bank.co.uk)

is key to the UK meeting its green objectives, and must be supported by government policy, across departments and amongst regulators.

2. Key Recommendations

As detailed above, PE and VC have a fundamental role to play in supporting the UK's government Net Zero target, both from a perspective of investing and helping grow the companies which will help us transition but also by helping the companies they invest in improve their green practices and decarbonise. To support with this and to ensure private market funding can continue to drive real change, our key recommendations are set out below. These recommendations are principles-based; our detailed feedback to specific UK policy developments (such as TCFD and SDR) can be found here.

i) Develop proportional and materiality-focused sustainability regulation

It is critical for the UK Net Zero ambitions, that effective and proportionate sustainability regulation covers the financing of both large, listed companies and private capital funds investing in the pool of unlisted SMEs from which the UK's future large, listed businesses will emerge. The success of the various legal and regulatory frameworks for private capital funds, and the largely unlisted companies they invest in, depends on the Government and regulators considering certain distinguishing features of the private capital industry:

- **Different assets – the Government should help foster buy-in from unlisted SMEs by focussing on proportionality and the particular green issues that are material to the different companies' activities.**

  Despite falling largely outside the direct scope of much of the existing and incoming climate-related regulation in various jurisdictions, the unlisted SME market forms an important piece of the Net Zero puzzle, not least because SMEs account for around half of UK business emissions[3]. The British Business Bank estimates that 76% of UK SMEs have yet to implement a decarbonisation strategy[4]. Private capital firms have an important role to play in reducing this figure because the industry invests extensively across the unlisted SME market, and because the private capital ownership model typically enables them to have varying degrees of influence (and in some cases 'control' (in the legal sense)) over investee company boards. Private fund managers often engage daily with portfolio company management teams, sit on boards, and can influence, to some extent, climate discussions. The private capital industry therefore (a) understands unlisted SMEs and (b) is well-placed to help drive emission reductions amongst them.

  Private capital funds also often invest in entrepreneurs with great ideas and SMEs with promising growth trajectories at a relatively early stage. This gives private capital firms the opportunity to help embed in those businesses, earlier on in their development, the culture and systems required to achieve Net Zero and other environmental outcomes. This can be far less challenging and costly than 'retro-fitting' the necessary changes into larger, longer-established companies.

  Regulation has also not yet effectively rewarded or accommodated the positive potential impact on environmental goals of strategies that aim to support companies in their transition (i.e., "brown-to-green" assets). Private capital firms are well-placed to improve portfolio companies' green performance over time, given firms often have significant influence over boards and their strategy of making operational improvements more generally to increase their investors' returns on exit.

  It is therefore vital that private capital firms are empowered to frame emissions reduction initiatives, transition plans and other environmental impact frameworks in a positive manner that focusses management teams on the benefits to their business that these frameworks bring e.g., radically cutting

[3] British Business Bank
[4] British Business Bank

back on GHG emissions can reduce costs, strengthen brand, increase exit value, build resilience etc. **This requires regulation applicable to private capital firms investing in SMEs to embed a respect for materiality and proportionality, which will allow tailored approaches for different sized businesses operating in different sectors/geographies**, such that management teams for example recognise Net Zero plans and other environmental objectives as credible and engage with them fully, as a positive opportunity for their companies.

- **Different fund structures - the Government should ensure regulation is tailored for private markets and promotes a focus on outcomes over misleading disclosures.**

  Private capital funds are typically closed-ended funds (i.e., investors commit capital for a defined period with no possibility of withdrawing their capital during that time). This allows private capital firms the necessary time (typically over three-to-seven year holding periods) to embed operational improvements in portfolio companies, without the risk of investors withdrawing their capital before such improvements have been achieved. These long hold periods are critical to private capital funds' ability to have a deep and long-lasting impact on portfolio companies' emissions and other sustainability performance. **It is critical that regulatory frameworks designed for liquid funds investing in listed assets, whose investors can invest and divest freely and whose composition can be fine-tuned on an ongoing basis, say to maintain a fund's sustainability categorisation, are not simply copied over into a private markets' context.** Failure to adapt sustainability regulation for private markets will only lead to misleading disclosures and product categorisation that risks discouraging private capital fund managers from focussing on effectively greening their portfolios over the long term.

- **Different relationships with investors – the need to promote outcomes over box ticking.**

  The relationships between private capital firms and the relatively limited numbers of institutional investors in their closed-ended funds are inherently close and long-term. Communication between a firm and its investors is primarily direct, discussions on climate-related issues often occur in person, and public methods of communication are less relevant as investors base investment decisions on extensive, direct due diligence on the manager and the fund. In this context, it is extremely important, both to the effectiveness of climate regulation and the attractiveness of the UK to private capital firms as a place to base themselves, **that sustainability regulation does not lead to meaningful climate communications between firms and their institutional investors being supplanted by formulaic, inflexible, and potentially misleading disclosures**. Such disclosures may make more sense for more commoditised and intermediated products but must be very carefully adapted for the private markets context to avoid discouraging investors from engaging in detailed conversations with private capital managers about actually achieving positive climate outcomes.

ii) Support SMEs to embrace Net Zero

It is also important that strategy and regulation fully recognises the data limitations faced by SMEs, whose entry into a private capital fund portfolio will often represent their first encounter with sustainability-related reporting requirements. The fast-growing, unlisted SMEs that constitute the bulk of our members' funds' portfolios typically have limited resources with which to manage and prioritise a range of often competing economic, commercial, and operational pressures.

In addition, many currently have little or no sustainability capability within the organisation and are unable to begin implementing a Net Zero strategy or transition plan without significant help from their private capital investors and external parties. This is exasperated by the shortage of skilled and affordable service providers and advisers to support with the increasing demands of sustainability related disclosures.

In terms of assisting SMEs, the Government should look to incentivise positive behaviours by providing straightforward guidance on voluntary reporting standards alongside reduced reporting requirements, in addition to potential tax incentives, and grants and guarantees to support SME access to private green finance. To fully bring SMEs on board at the pace required, the Government will need to assume some of the costs, in the form of grants, and some of the risks, in the form of guarantees and funding programmes/products delivered by, for example, Innovate UK and the British Business Bank.

iii) Develop common methodologies and facilitate collaboration

A critical piece of the Net Zero puzzle is the development of common methodologies, guidance and approaches which are cognisant of the sectors they apply to. This is particularly essential for private capital which manage closed-ended funds pursuing multi-year growth strategies across portfolios, of mostly unlisted SMEs, and are therefore dependent on the availability of specific PE and VC focussed methodologies for obtaining and analysing the metrics required to set meaningful science-based targets.

A clear meaning of what 'Net Zero' means to the UK will also help organisations determine a credible definition and subsequently understand the risks and opportunities to their organisations, and most importantly implement an informed road map on how they are going to get there.

The PE and VC sector recognises the risk and opportunities Net Zero presents and the desire to support the Net Zero goals is clear with a number of BVCA members already actively supporting these businesses to reduce their greenhouse gas emissions and over 200 (and counting) UK and international PE and VC firms, representing more than $3.4 trillion AUM, joining climate change initiatives such as UN PRI-backed Initiative Climat International (iCI)[5]. However, to drive real systemic change at the pace required, provision of clear definitions, technical tool kits, and the facilitation of collaboration between industry leaders and engagement with initiatives such as the iCI, IIGCC, Science Based Targets Initiative (SBTi) and Ceres are a necessity. Common methodologies and best practice to measure, report, and setting science-based emissions targets is required to remove the barrier of hesitancy and inconsistency which surrounds the Net Zero agenda and organisations' ability to commit meaningfully.

Sustainability-focused legislation and best practice guidance is pushing for organisations to measure, monitor, reduce and disclose their Scope 3 greenhouse gas emissions. However, the value chain is the hardest part of any organisation's carbon footprint to quantify and influence, and can limit some organisations ability to set meaningful science-based targets which they are confident they can achieve. Whilst it is recognised that the value chain has to be considered to ensure Net Zero can be reached, support with helping organisations, particularly SMEs, overcome the barriers they face when measuring their value chain is critical to ensure this piece of the Net Zero puzzle does not delay the transition.

iv) Net Zero Roadmap Blueprint

To build confidence and clarity in the market and to continue to promote Net Zero-focused growth, innovation and opportunity, the UK Government needs to develop a detailed Net Zero Roadmap, setting out clear commitments and actions on public investment and policy covering how it is going to get the UK to Net Zero. This will catalyse investment into the areas that will be crucial to achieving Net Zero as it gives investors, including PE and VC, clarity on the industries the UK will support. Carbon offsets and how the market operates is another areas businesses will welcome further guidance and support on, particularly if those offsets can benefit the UK's environment directly.

The UK is leading the way, being the first nation to commit a Net Zero target into law, and if we can get this right, there will be opportunities from being able to export the outcomes from a market-leading and innovation focused '**Net Zero Roadmap Blueprint'** to other nations and promote green growth for the UK.

Please do not hesitate to contact us should you wish to discuss any of our suggestions or evidence in greater detail (please contact Harriet Assem: hassem@bvca.co.uk)

[5] Further information on iCI is available here

Appendix – Case Studies

Bramble Energy

Location – Crawley, Surrey
BVCA member – BGF, Parkwalk Advisors (growth capital)

Bramble Energy is a University College London and Imperial College London spinout, which has developed the only technology capable of producing gigawatts of hydrogen fuel cells using existing global manufacturing resources, dramatically reducing the time to market and investment needed versus existing fuel cell designs. Hydrogen fuel cells generate electric power from an electrochemical reaction rather than combustion, thereby eliminating carbon emissions from the power unit and producing only water and heat as by-products.

Bramble Energy has created a patent protected fuel cell that can be manufactured in almost all printed circuit board (PCB) factories world-wide. This solves the key challenges of lead times, up-front investment, manufacturing cost and scalability in the production of hydrogen fuel cells. It was Bramble Energy's world-first in the production of hydrogen fuel cells that piqued the interest of BGF, who led a £5 million investment round into Bramble in 2020, alongside existing investors including IP Group, Parkwalk Advisors, and UCL Technology Fund.

Nova Pangea Technologies

Location – Redcar, Yorkshire
BVCA members – Mercia Asset Management, Par Equity (venture capital)

Nova Pangaea Technologies (NPT), based at Wilton International, Redcar in the Tees Valley, is leading the way to enable decarbonisation across sectors like transport and industry. Through its proprietary technology (REFNOVA), NPT converts biomass such as forestry and agricultural residues into sustainable sugars and biochar. The sugars can be fermented into bioethanol that is used as a drop in for sustainable aviation fuels, and the biochar replaces coke within sectors such as the steel industry to create green steel and is considered carbon neutral. When the biochar is used as a soil enhancer for agricultural purposes, it is also considered a carbon capture and delivers carbon negative. NPT received investment in 2017, with a total of £1.25m having been invested by Edinburgh-based Par Equity over the last four years. Par Equity has a particular focus on companies that solve considerable scientific challenges and its investment and business support – alongside funding from the Northern Powerhouse Investment Fund (NPIF) and Cambridge Angels – enabled NPT to increase headcount by 45% in 2020. Furthermore, it allowed NPT the ability to continue to enhance its technology.

In August 2021, Nova Pangaea was one of eight winners who were chosen to take part in the department for Transport (DfT) Green Fuels Green Skies project. NPT has partnered with British Airways and LanzaJet (Project Speedbird) to deliver 113 million litres of sustainable aviation fuels in the UK. Project Speedbird is halfway through the feasibility study, which began in October 2021, will conclude in 2022.

Ulemco

Location – Liverpool
BVCA member – The North-West Fund (venture capital)

ULEMCo are the global pioneers of technology that enables commercial vehicles (having started with diesel Ford Transit vans) to convert the fuel they run on to hydrogen. They work with operators who have fleets of HGVs and LGVs to deploy hydrogen-powered vehicles, using zero emission hydrogen fuel as part of their strategies to reduce transport-related carbon emissions. Their technical experts also provide practical solutions for more specialist vehicles such as refuse trucks and road sweepers. ULEMco are backed by Equity Gap and The North-West Fund, and the funds have been used within the overall business plans to build ULEMCo's capability to support customers in Scotland, where demand for the company's technology has accelerated particularly fast.

Vital Energi

Location – Blackburn (HQ), London, Glasgow
BVCA member – Scottish Equity Partners (growth capital)

Vital Energi installs and operates large scale, centralised, clean energy centres for the commercial and public sectors. It provides a total solution from initial design to project implementation, operation and maintenance across CHP boilers, fuel storage, thermal storage, pipes, and pumps. The company has a substantial track record of providing innovative and market leading solutions and key deployments include the Natural History Museum, Terminal 5 Heathrow and the energy centre for King's Cross Central. Scottish Equity Partners provided growth equity backing in 2012 and has allowed the company to increase headcount to 400, expand into Scotland with the opening of a new office and, in turn, give the business the capability to deliver more green energy solutions across the country. This includes the athletes' village at the 2014 Commonwealth Games in Glasgow, York's teaching hospital and Salford's Royal NHS Trust to name but a few.

Wood Thilsted

Location – offices in London, Bristol, Edinburgh, Pontypool, Wiltshire and Surrey Investor
BVCA Member - Inflexion Private Equity

Wood Thilsted is a leading global offshore wind engineering consultancy. Founded in 2015, the company designs the foundations for some of the world's largest offshore wind farms. The company operates in all the major wind energy markets of the world, providing its services to many of the leading wind developers, and is currently working on the three most significant wind development projects globally. The firm employs over 140 people in five countries. In 2022, UK wide mid-market private equity investor, Inflexion, invested in Wood Thilsted to scale and grow internationally, accelerating growth so that the business can continue to deliver the very best engineering solutions for offshore wind.