BVCA response to Labour's National Policy Forum: Britain Reconnected

The British Private Equity and Venture Capital Association (BVCA) is pleased to offer its views to Labour's National Policy Forum's 'Britain Reconnected' policy commission. With a membership of over 600 firms, the BVCA represents UK-based private capital, as well as the wider ecosystem of professional advisers and investors.

Private capital consists of private equity and venture capital which makes long-term investments to grow British businesses and build a better economy. Private credit and venture debt also provide active and engaged debt finance to businesses.

The private capital industry backs 13,000 UK businesses, nine in 10 of which are small or medium-sized enterprises. Businesses backed by the industry employ 2.5 million people across the UK and contribute 7% to GDP.

In 2024, £29.4bn was invested by private capital into UK businesses in sectors across the UK economy, ranging from consumer products to emerging technology. This increased investment has fuelled the growth of businesses across the UK, with six in ten (58%) of the businesses backed in 2024, located outside of the capital. These investments are long term, with an average investment period of six years, in contrast to less than a year in public markets.

UK-based private capital specialists have raised £178bn of funds, known as dry powder, expected to be invested over the next three to five years.

The industry invests for a better future by backing the UK's best loved businesses, developing the companies of the future and delivering solutions to global problems.

The proposals below will support the Labour Party's ambitions to making the UK safer, more secure, and increasingly resilient against global threats, through supporting private capital to invest in and scale innovative companies in the UK defence sector.

1. How can we ensure our national security strategy responds effectively to possible future threats and rapidly changing global events?

If Britain's national security strategy is to respond effectively to new threats and ensure the UK remains resilient in today's geopolitical environment, the Government must facilitate a massive increase in private investment into UK companies whose business activities support those aims. The best of British innovation, capability and skills in the defence and security sectors needs to be identified, nurtured and scaled through capital investment and hands-on business growth support.

Identifying and scaling the most innovative British businesses, by investing global institutional capital and deploying commercial growth expertise, is fundamental to the UK private capital industry's business model (be it venture capital, private equity or private credit). Unlike any of its potential adversaries, Britain is home to the second largest private capital fund industry in the world (after the US). Our private capital firms already provide active ownership and investment to a wide range of complex UK technology businesses led by innovative entrepreneurs in the defence space. If the Government wants the UK to outpace the competition on innovation and growth in defence capability, it must do all it reasonably can to encourage private capital firms to do more of this; to invest as much as possible of the £178bn as-yet undeployed capital they control into more UK defence companies.

During period of profound global change, with global events creating economic pressures in the UK, the private capital sector has a clear role to play in the Government's mission to embark on a new era for UK Defence, as outlined in the 2025 Strategic Defence Review.

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UK Government must show political leadership to encourage private capital to invest in businesses building UK defence capabilities while explicitly legitimising investors to generate appropriate returns from the capital deployed.

'Economic security' and 'national security' are deeply intertwined. A key area where they intersect is investment in defence technologies, which not only enhances the UK's security and resilience but also drives economic growth.

To achieve economic security and the ability to invest in the defence sector, the UK needs to retain its global position as a home for investment. Government policy and regulation must be guided by four key principles: ensuring a stable economy; world class regulatory standards proportionally applied; competitive advantages to maintain the scale and breadth of talent; and predictable policy frameworks for growth sectors. An investment ecosystem which abides by these principles will ensure global capital remains attracted to the UK.

The Government's Industrial Strategy and the Strategic Defence Review will be crucial to achieving UK's economic and national security. The success of these initiatives will rely on the correct regulation and incentives in the key sectors work to attract private capital investment in businesses of all sizes.

The BVCA has identified five priority opportunities for the Government to ensure the UK remains an attractive destination for investment internationally and that the domestic ecosystem allows innovative businesses in the defence sector to start and scale in the UK:

1. *Improve National Security and Investment Act processes*

   Whilst the NSI Act is broadly meeting its objectives, feedback from our members suggests that the regime does not strike the right balance between protecting national security and encouraging investment in the UK. Without clarifications and improvements, it is our view that the difficulties faced by private capital investors will continue and could potentially lead to the UK becoming a less competitive location for attracting investment, impacting negatively on innovation, growth and therefore economic security.

   There are specific areas where small improvements could help to address these issues:

- *Narrow the scope through reforms that reduce regulatory barriers to low-risk deals, thereby supporting the Government's goal of stimulating investment into the UK:*

  - The Government should look to narrow and focus the scope. Mandatory sectors should be refined, and types of transactions (such as internal restructuring) should be removed from scope.

  - For sectors that the Government is targeting for investment (as named in the new Industrial Strategy), fast track and pre-approval processes should be incorporated for investors from countries considered allies (outside the most sensitive transactions).

  - There should be a specific carve-out for UK domestic investors to allow them to invest in government targeted sectors.

- *More official guidance and communication from the ISU:*

  Private capital firms are finding that the ISU can be inconsistent in its approach and slow to communicate. This creates uncertainty and delay in a transaction and the risk is that it could cause the business, for example a small startup looking for venture capital investment, to collapse due to cost pressures. We would therefore advocate for a case officer to be assigned to each filing from the outset to allow parties to follow up on the progress of a notification and for any queries the parties have. We also recommend that existing guidance should be updated to clarify matters in response to queries and requests for feedback, and new guidance should be created via engagement with the investor community.

- *Administration issues:*

  Members find that reviews are often slow and there are many duplicative aspects of applications. The ISU should aim to speed up the timing of their reviews, and remove the aspects of duplication which are commonly seen in the application process. For example, the ISU should add a way for repeat notifiers to pre-populate sections of the notification form.

The BVCA's full response to the National Security and Investment Act Call for Evidence 2023 can be found here: BVCA Feedback to the National Security and Investment Act Call for Evidence 2023.pdf

2. *Expand the NSSIF*

Private capital already plays an important part in the UK's national security. So, the Government's announcement of a Defence Growth Board, and a focus on developing innovative domestic start-ups that will have greater access to MoD contracts through procurement reform, will give investors greater confidence that defence will sit at the heart of industrial strategy.

The Government's corporate venturing model, which has successfully been deployed by the National Security Strategic Investment Fund (NSSIF), should be expanded to other strategic sectors to align with the Industrial Strategy. This will help increase collaboration between Government, venture capital firms and innovative companies. This would also improve procurement processes and access to the latest technologies, which will be critical to achieving economic growth.

The NSSIF is now well established and has a strong track record of investing in funds and investing directly in companies. It is well respected by entrepreneurs and venture capital firms as it provides data and insights on emerging sectors as well as routes to procurement and commercial traction for startups.

Defence is one of the eight growth-driving sectors identified by the Government. To ensure NSSIF continues to grow and diversify, its remit should be expanded to ensure it is able to partner with funds beyond those accredited by the BBB (as "NSSIF Fund Managers"), in order to build partnerships with other UK companies and funds in NATO or allied countries. To achieve this, NSSIF should be formally established as a separate entity to the BBB and be able to ring fence its own capital and recycle returns into new investments. NSSIF currently receives £100m annually to invest across its programmes.

The BVCA has previously set out the need to ensure NSSIF continues to grow and diversify, its remit should be expanded to ensure it is able to partner with funds beyond those accredited by the BBB (as "NSSIF Fund Managers"), in order to build partnerships with other UK companies and funds in NATO or allied countries.

3. *Prepare for technological change and advancements*

The Government has stated that the defence sector must embrace its role in seeding innovation and growth. Ensuring the UK remains a hub for technological innovation and investment is essential for bolstering UK resilience as it not only drives growth, but it will also enhance UK international competitiveness, provide homegrown advancements in critical industries such as defence and cybersecurity, and enable the UK economy to adapt to risks and evolving geopolitical circumstances.

To achieve this, the UK must ensure its regulatory framework keeps pace with technological advancements in the defence sector, while its R&D regime must actively encourage private capital investment in critical technology. This approach will help retain and expand UK innovation domestically, safeguarding the nation's economic and national security for the future.

Addressing lack of regulatory agility in innovative sectors

Regulation must be able to keep up with the pace of technological change, and enable firms to invest in defence. Government funded regulators should have funding that is fit for purpose given changing economic, security and technological demands, alongside a commitment to annual, inflation-linked budget increases.

Many technology startups are working with innovative technologies – from artificial intelligence and cybersecurity to quantum technology and drones – which are rightly subject to regulation but where their regulatory status is unclear, because regulations have not kept pace with what is now technologically possible. This makes it much more difficult for investors to understand what their return on investment is likely to be, whether a product has a path to market and how quickly it will get there, and indeed whether a business is viable at all.

In our BVCA member survey conducted under the Investment Commission with Public First, we found that 91% of respondents say a faster and more agile regulatory system would make it easier for them to invest in UK businesses.

Government should build on the launch of the Regulatory Innovation Office and conduct a cross-cutting review of regulation of innovative technologies, focused on areas where regulatory capacity is holding back innovation and investment in defence, and where legislation has not kept up with technological possibilities.

Technology adoption and diffusion through R&D

R&D (research and development) support plays an important role in the companies that are backed by private capital, particularly in businesses that are at the cutting edge of innovation, such as deeptech and life sciences. The support provided to R&D intensive companies is an efficient way of supporting companies to reinvest in their future growth, and is particularly important for early-stage businesses in the period before they start to generate income. The UK economy needs these early-stage businesses to drive growth and employment for the future.

To support fostering and diffusing innovation in the UK economy, the Government must ensure that private capital firms are able invest in and commercialise R&D so that they can deploy more investment into companies driving UK innovation.

Feedback from our members indicates that there are significant concerns both over the amount of the relief, which is significantly less generous than before the April 2023 changes, and the way in which it is administered by HMRC.

2. How can Labour best ensure investment in defence and national security drives growth across the UK?

Currently, over half the 13,000 UK businesses invested in by the private capital industry are based outside London. This is good news, however a challenge remains that there is less capital deployed into businesses outside London. Removing barriers to investment in defence and national security can play a role in redressing that balance.

The UK faces a significant gap in scale-up funding, resulting in many fast-growing businesses across the UK failing to grow. The UK has a strong funding ecosystem at the early stage, with data from over the last 10 years showing that the average size of investments in new spinouts has increased, with growth of 111% from 2014 to 2023, bringing the average investment to £400m. However, as UK companies look to continue to grow from series B stage and beyond, investment is often found from the US and elsewhere as a result of the significant investment gap in the UK. The UK has a strong track record in science and technology research but it loses out on opportunities when companies move overseas to secure this funding, taking intellectual property, quality jobs and innovation with them – including in the defence sector.

It is important for economic security that the UK remains internationally competitive and establishes an environment that continues to support the innovative companies in these sectors as they grow. This is particularly important for AI, dual-use technology and defence companies, given the wider geopolitical challenges.

According to the British Business Bank's (BBB) Small Business Finance Market report 2024, US companies receive 1.4 times more funding compared to UK companies at the late VC stage. The BBB also recognise that there are significant funding gaps for research intensive sectors, which represented only 0.26% of GDP in 2019-2021.

The data indicates that the increasing importance of foreign investment is due to the UK not having sufficient funds of scale to invest in deals over £20 million. This is a far from ideal outcome, both for the companies and UK investors.

To generate economic growth and help close the scale-up gap for firms investing in the defence sector, greater levels of investment from UK pension schemes into private capital funds are needed. This can then be invested into UK businesses, can increase economic growth and improve the retirement prospects of UK savers.

The Government should leverage the below mechanisms to broaden access to capital and close the scale-up gap:

- **Address the public-private funding gap**: The largest direct support on offer from the BBB is £10 million, while the NWF minimum ticket is £25 million. While both organisations are essential for providing investment, there remains a scale-up funding gap between them. To address this, government will need to expand the mandate of one of the organisations. A full funding ladder is required across the BBB and NWF which leverages private investment at all stages, taking steps to ensure there is more capital available to UK projects and VC funds.

- **Introduce a "NOVA" scheme** The Government should introduce NOVA (New Opportunities for Venture and growth acceleration) to create a marketplace of accredited private capital funds for DC schemes to facilitate investment, potentially focused on strategic sectors. A partnership between industry experts, the BBB, or other appropriate Government department or subsidiary, could act as the gatekeeper of a certified accreditation process. This learns the lessons of France's Tibi scheme which has pulled around £20bn from institutional investors into private capital funds, supporting the French tech ecosystem.

- **A new fund-of-funds programme to build on the British Growth Partnership (BGP):** The BBB's British Growth Partnership (BGP) is a positive step in driving innovation through leveraging long-standing private capital markets investment experience, developing new and existing relationships and carrying out commercial product testing, all of which are needed for the UK market to learn how to invest UK pensions into private capital effectively and at scale. It is critical that the BBB is able to continue to develop a series of further initiatives to build on the BGP, including a fund-of-funds vehicle to enable investments at the right "ticket size" in order to access and benefit from returns generated by investments into smaller private capital funds.

A new fund-of-funds programme should focus on growing the UK's venture and growth capital investment ecosystem, by supporting growth equity and growth capital funds, and expand the BGP's target of "hundreds of millions" to at least £1bn of commitments. This target would be a positive starting point (with the opportunity to grow and expand into a series of vehicles as the programme develops). It could be built around a £300m government cornerstone investment to crowd in an additional £700m of investment from UK pensions (DC, DB and LGPS).

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