



HM Treasury

Financing growth in innovative firms: one-year on

October 2018

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Executive summary

The UK is one of the best places in the world to start and grow a business. Thanks to our global leadership in science and innovation, researchers and entrepreneurs across the country are developing technologies that will power the economy of the future.

Alongside this, the UK has a healthy equity finance market providing long-term investment to businesses. In the first half of this year, small businesses raised equity finance worth £3.2 billion.¹ This builds on the success of 2017, in which UK SMEs raised £5.9 billion in equity, a 6% increase in the number of deals and 89% increase in investment value compared to 2016.² The UK continues to be the top destination for venture capital (VC) investment in Europe, attracting around a third of total European VC investment so far this year.³

Nonetheless, the government recognises that the UK still lags some of its competitors in scaling up our most innovative firms. To address this, in 2016 the Prime Minister announced that HM Treasury would lead the Patient Capital Review to strengthen the UK as a place where high-growth, knowledge-intensive firms can obtain the long-term 'patient' finance that they need to scale up. The Patient Capital Review formed part of the government's Industrial Strategy and was supported by an industry panel convened by Sir Damon Buffini. Following the review, at Autumn Budget last year the government announced a 10-year action plan to unlock over £20 billion to finance growth in innovative firms.

In addition to the 10-year action plan, last Autumn the government committed to work with the pensions industry and its regulators to unlock further investment into our innovative high growth firms. Budget 2018 announces a new package of measures to achieve this, including regulatory reforms and a commitment from industry leaders such as Aviva, HSBC, L&G, NEST, The People's Pension and Tesco Pension Fund, to work with the British Business Bank to explore options for pooled investment in patient capital. With total assets under management expected to exceed £1 trillion by 2025,⁴ DC pension funds have the potential to be a major source of finance for innovative, growing firms in the UK.

¹ Markets Update October 2018, British Business Bank (available at: <https://www.british-business-bank.co.uk/markets-update-october-2018/>)

² Small Business Equity Tracker 2018, British Business Bank (available at: <https://www.british-business-bank.co.uk/wp-content/uploads/2018/07/Equity-Tracker-Report-2018.pdf>)

³ Q3 Investment Update for Europe and Israel, Dealroom.co (available at: <https://blog.dealroom.co/q3-2018-investment-update-for-europe-israel/>)

⁴ UK Defined Contribution: Looking Beyond the Passive Approach, Spence Jonson Market Intelligence, 2016 (available at: <http://www.spencejohnson.com/products/market-intelligence/retirement/18/uk-dc>)

Since Autumn Budget 2017, the government, working with the British Business Bank, has taken significant steps in implementing the measures in the action plan. A new £2.5 billion investment programme, British Patient Capital, launched in June and has already made commitments of £123.6 million this year, including the British Business Bank's first investment in an evergreen fund. The British Business Bank has also launched a further three programmes to provide patient capital to high-growth firms: the Managed Funds programme (fund of funds), the Regional Angels programme, and the National Security Strategic Investment Fund (NSSIF).

The extension of Enterprise Investment Schemes (EIS) and Venture Capital Trusts (VCTs) has benefited knowledge-intensive companies and re-directed investment from low-risk areas. The government has taken further action by consulting on Entrepreneurs Relief, and coming into effect from next year, the government will change the qualifying rules to prevent entrepreneurs from being discouraged from seeking external investment.

The Department of International Trade is on track to support more than £1 billion of investment into UK venture capital over 5 years, and the British Business Bank has undertaken further research on issues including female access to venture capital funding and the talent we need to grow the UK venture capital industry. The research will be published by the end of the year.

The government is committed to supporting the UK's fast growing and innovative firms to secure the external finance they need as the UK leaves the EU. The European Investment Fund (part of the European Investment Bank Group) has been a major investor in venture capital, though the substantive new government support announced following the Patient Capital Review means that the British Business Bank has the capacity this financial year to make venture capital commitments that would exceed the combined average annual commitments from the European Investment Fund and British Business Bank in the years preceding the UK's vote to leave the EU. As we leave the EU, the government continues to actively explore options for a future relationship with the European Investment Bank Group, and at Budget 2018 the Chancellor announced that if no future relationship with the European Investment Bank Group is in place before the UK leaves the EU on 29 March 2019, the government will provide the British Business Bank with the resources to enable it to make up to £200 million of additional investment in UK venture capital and growth finance in 2019-20.

Patient Capital Review: Delivering our action plan

Since Autumn Budget 2017, the government has made considerable progress on delivering its 10-year action plan to unlock over £20 billion to finance growth in high-growth innovative firms, including:

- launching British Patient Capital, which has been given resources of £2.5 billion to invest in innovative firms, in June 2018
- extending the Enterprise Investment Schemes (EIS) and Venture Capital Trusts (VCTs) to support innovative knowledge-intensive companies
- launching the Managed Funds programme, a fund of funds seeded with £500 million by the British Business Bank, in May 2018
- investing in first-time and emerging fund managers through the British Business Bank's Enterprise Capital Funds
- backing overseas investment in UK venture capital through the Department of International Trade, securing £240 million of investment this financial year
- launching the National Security Strategic Investment Fund in September 2018 with up to £85 million to invest in advanced technologies that contribute to our national security mission
- launching the Regional Angels programme run by the British Business Bank in October 2018 to support developing clusters of business angels outside London
- carrying out research led by the British Business Bank on female access to venture capital funding, the talent we need to grow the UK venture capital industry and access to growth finance for intellectual property-rich firms
- consulting on the technical details of a change to Entrepreneurs' Relief (ER) so company founders are not discouraged from seeking external investment due to the dilution of their shareholding.

At Budget 2018, the government announces a pensions investment package that aims to better enable defined contribution (DC) pension schemes to invest in patient capital:

- the government and regulators will bring forward a range of measures to ensure that the UK's regulatory environment enables DC pension schemes to invest in patient capital as part of a prudentially diverse portfolio
- a number of leading pension providers have committed to undertaking a feasibility study with the British Business Bank, to explore the options for pooling patient capital investment within a joint investment vehicle

Chapter 1

Introduction

- 1.1 The UK continues to be a world-leading place to start and grow a business, with 1.2 million more businesses in 2018 than 2010¹ and a new business starting every 75 seconds.²
- 1.2 Alongside this, the UK has a healthy equity finance market with £5.9 billion invested into small businesses in 2017.³ Strong equity finance markets are important for ambitious and innovative businesses to access the finance they need to scale-up. In 2017, the UK saw an overall increase in the number and value of equity deals, with a 6% increase in the number of deals and investment value increasing by 89% from 2016.⁴ This trend continues into 2018, with over 700 equity deals worth £3.2 billion signed by the end of June.⁵
- 1.3 Access to equity finance is particularly important for knowledge-intensive businesses such as those creating and developing new technologies. These businesses build on the UK's global strength in science and innovation to create the technologies and jobs that will deliver the Industrial Strategy Grand Challenges and power the economy of the future. In 2017, UK technology-based businesses received a record high of £2.1 billion equity investment,⁶ the largest share of any sector. Ensuring that the businesses at the forefront of the new economy can access the capital they need to grow remains crucial.
- 1.4 To support the UK's most innovative firms to secure the finance they need to grow, in 2016 the Prime Minister announced that HM Treasury would lead a review to strengthen the UK as a place where high-growth innovative firms

¹ Business Population Estimates 2018, Office of National Statistics (available at: <https://www.gov.uk/government/statistics/business-population-estimates-2018>)

² Industrial Strategy White Paper 2017, Department for Business, Energy and Industrial Strategy (available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/664563/industrial-strategy-white-paper-web-ready-version.pdf)

³ Small Business Equity Tracker 2018, British Business Bank (available at: <https://www.british-business-bank.co.uk/wp-content/uploads/2018/07/Equity-Tracker-Report-2018.pdf>)

⁴ Small Business Equity Tracker 2018, British Business Bank (available at: <https://www.british-business-bank.co.uk/wp-content/uploads/2018/07/Equity-Tracker-Report-2018.pdf>)

⁵ Markets Update October 2018, British Business Bank (available at: <https://www.british-business-bank.co.uk/markets-update-october-2018/>)

⁶ Small Business Equity Tracker 2018, British Business Bank (available at: <https://www.british-business-bank.co.uk/wp-content/uploads/2018/07/Equity-Tracker-Report-2018.pdf>)

can obtain long-term 'patient' finance. The review recognised that there was a gap in the supply and use of patient capital that was holding back firms from growing to scale. In response, at Autumn Budget 2017, HM Treasury announced a 10-year action plan to unlock over £20 billion to finance growth in innovative firms.⁷

- 1.5 The government has continued to drive the patient capital agenda forward and today announces a package of proposals to better enable defined contribution (DC) pension schemes to invest in patient capital. The government welcomes the ongoing work of The Pensions Regulator (TPR) and the Financial Conduct Authority (FCA) to ensure that the regulatory environment fosters DC investment in these assets as part of a prudentially diverse portfolio. A number of leading pension providers have also committed to undertaking a feasibility study with the British Business Bank, to explore the options for pooling patient capital investment within a joint investment vehicle.
- 1.6 Since Autumn Budget 2017, the government, working with the British Business Bank, has taken significant steps in implementing the measures in the action plan. British Patient Capital (BPC), a new £2.5 billion investment programme, was launched in June. BPC is seeded by the British Business Bank's VC Catalyst programme and builds on the British Business Bank's successful track record of investing in high-growth innovative firms, including investments into 5 UK-based unicorns⁸. In addition, the British Business Bank has set up the Managed Funds programme (a fund of funds), the Regional Angels programme (to tackle regional imbalances), and the National Security Strategic Investment Fund (NSSIF).
- 1.7 The extension of the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) has benefited knowledge-intensive companies and re-directed investment from low-risk areas. To build on this, the government is also publishing today a separate response document to the consultation on changes to the HMRC's 'approved fund' structure within EIS. The government has taken further action by consulting on changes to Entrepreneurs' Relief (ER) and is introducing changes to the qualifying rules to prevent entrepreneurs from being discouraged from seeking external investment.
- 1.8 This year the British Business Bank has undertaken research into the venture capital (VC) ecosystem and potential barriers firms face when seeking equity finance. The findings of the British Business Bank and Intellectual Property Office's joint study were published today analysing the difficulties IP-rich firms have in accessing finance, and setting out steps to address these issues. Further research on female founders seeking VC and findings on talent in VC will be published in the coming months. In addition, the Women in Finance Charter welcomes the VC firms that have signed the Charter and strongly encourages other VC firms to sign up.

⁷ Financing growth in innovative firms: consultation response, HM Treasury, November 2017 (Available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661398/Patient_Capital_Review_Consultation_response_web.pdf)

⁸ 'Unicorns' are defined as start-ups that reach a \$1 billion valuation.

- 1.9 The Department of International Trade has secured commitments from overseas investors of £240 million this financial year, and has a strong pipeline of potential investments from USA, Japan, France and Singapore.
- 1.10 The government is committed to continuing to strengthen the UK's position as a global centre for innovative businesses and investors. The European Investment Fund (part of the European Investment Bank Group) has been a major investor in venture capital, though the substantive new government support announced following the Patient Capital Review means that the British Business Bank has the capacity to make venture capital commitments this financial year that would exceed the combined average annual commitments from the European Investment Fund and British Business Bank in the years preceding the UK's vote to leave the EU. As we leave the EU, the government continues to actively explore options for a future relationship with the European Investment Bank Group, and at Budget 2018 the Chancellor announced that if no future relationship with the European Investment Bank Group is in place before the UK leaves the EU on 29 March 2019, the government will provide the British Business Bank with the resources to enable it to make up to £200 million of additional investment in UK venture capital and growth finance in 2019-20.

Chapter 2

Unlocking long-term pensions investment

- 2.1 With long-term investment horizons, a positive cash-flow and £1 trillion in assets forecast by 2025,¹ DC pension funds have the potential to become key institutional investors in UK patient capital. The government has therefore championed efforts to explore how pension funds can support long term investment in the real economy.
- 2.2 Following the Patient Capital Review, HM Treasury committed to setting up a taskforce of stakeholders to identify and address barriers to DC investment in patient capital and other illiquid asset classes. Alongside this, The Pensions Regulator (TPR) committed to clarifying guidance on how pension fund trustees can invest in assets with long-term investment horizons.
- 2.3 Through the pensions investment taskforce, DC pension providers have expressed substantial appetite for more active investment in the UK economy, including through patient capital-type investments. However current levels of DC investment in illiquid assets are low, and tend to be focused on real estate. This contrasts with DC schemes in countries like Australia, where there is greater investment in high-growth alternative asset classes.
- 2.4 To ensure that DC pension members have access to the potential premium associated with patient, illiquid investment, the government is now making clear that DC pension schemes can invest in patient capital as part of an appropriately diversified portfolio. To facilitate this investment, HM Treasury has announced a series of measures to remove barriers and support pension funds in accessing this asset class. These measures will not interfere with the rights and responsibilities of trustees and pension providers to determine investment allocations, but will ensure that those who have shown appetite for investing in patient capital are not unduly restricted.

Addressing regulatory barriers to patient capital investment

- 2.5 The first step in facilitating DC investment in patient capital is ensuring that there is an appropriate regulatory framework in place. Through the pensions investment taskforce, the government has worked with regulators to agree a package of proposals to ensure the UK's regulatory environment is fit for this purpose. This package includes:

¹ UK Defined Contribution: Looking Beyond the Passive Approach, Spence Jonson Market Intelligence, 2016 (available at: <http://www.spencejohnson.com/products/market-intelligence/retirement/18/uk-dc>)

- **Financial Conduct Authority (FCA) consultation on changes to permitted links:** the government welcomes the FCA’s commitment to launch a consultation on its permitted links framework before the end of 2018.² The taskforce identified areas where clarifying and updating the FCA rules would allow further unit-linked investment in a broad range of patient capital assets. The benefits of updating the rules were also outlined in the Law Commission’s report on Pension Funds and Social Investment.³
- **Review of the UK fund regime:** the taskforce received several representations from stakeholders making the case for changes to the UK’s authorised fund regime to better enable open-ended patient capital investment. The government recognises that the current system may restrict certain investors from accessing private equity and other forms of patient capital. In response, the FCA has committed to publishing a discussion paper to explore how effectively the UK’s existing fund regime enables investment in patient capital.⁴ HM Treasury’s Asset Management Taskforce is also working with the Investment Association to explore how the UK fund framework can be improved, including the feasibility of a new long-term asset fund.
- **Department of Work and Pensions (DWP) consultation on performance fees and the charge cap:** the charge cap on default DC schemes sets the ceiling for member-borne charges at 75bps, and has been put in place to protect DC members from excessive fees. However, the taskforce found that the current methods of calculating compliance with the cap do not easily accommodate performance fees – a fee structure often used to access venture capital, infrastructure and other patient assets. The government will therefore consult in the new year on regulatory changes to ensure that investment strategies are not unduly inhibited by restrictions on fee structures, whilst robustly defending existing member protections.
- **The Pensions Regulator (TPR) guidance on long term investments for pension funds:** on 23 October TPR published updated guidance for pensions trustees considering investment in patient capital, following the announcement made at Autumn Budget 2017.⁵ This guidance makes clear that an allocation to patient capital can be a prudent investment decision by pension schemes as part of a diversified portfolio. It also clarifies the potential benefits and risks associated with patient capital, and outlines relevant factors that trustees will need to account for when considering such investment.

² Policy Development Update, Financial Conduct Authority, Oct. 2018 (available at: <https://www.fca.org.uk/news/policy-development-update>)

³ Law Commission: Pension Funds and Social Investment, 22 June 2017. (available at: <https://s3-eu-west-2.amazonaws.com/lawcom-prod-storage-11jxou24uy7q/uploads/2017/06/Final-report-Pension-funds-and-social-investment.pdf>)

⁴ Consultation on illiquid assets and open-ended funds and feedback to Discussion Paper DP17/1, Financial Conduct Authority, Oct. 2018, p.7 (available at <https://www.fca.org.uk/publication/consultation/cp18-27.pdf>)

⁵ Managing DC benefits: Investment governance, The Pensions Regulator, 2018 (available at <http://www.thepensionsregulator.gov.uk/trustees/investment-management-in-your-dc-scheme.aspx#s27185>)

- 2.6 The taskforce also worked with the Prudential Regulation Authority (PRA) to explore concerns that the “prudent person principle” prevented pension funds investing in patient capital. The taskforce concluded that there is no such restriction in the current regulations, provided the risks associated with such investments can be properly assessed.

Facilitating pooled investment in patient capital

- 2.7 Regulations are not the only barriers to pensions investment in patient capital. Other barriers identified by the taskforce include the difficulties associated with the daily pricing and dealing of illiquid assets, the high fees associated with venture and other forms of patient capital, and the need to identify investment options with an appropriate risk profile for DC.
- 2.8 Following the taskforce, a number of DC pension providers have expressed an interest in pooling their investment to create a new joint vehicle for patient capital. By investing at scale, the aim of a joint vehicle would be to reduce the costs of patient investment, facilitate access to a more diverse range of assets than might be available to schemes in isolation, and direct that investment towards assets matching the risk and return profile most suitable to DC.
- 2.9 As a first step towards that ambition, several of the largest DC pension providers in the UK, including Aviva, HSBC, L&G, NEST, The People’s Pension and Tesco Pension Fund, have committed to explore options for pooled investment in patient capital. Chaired by the British Business Bank, this group will lead a feasibility study in collaboration with the wider pensions industry, with the aim of establishing a design for pensions investment in patient capital and other forms of finance for innovative, growing companies.

Wider reforms in the pensions investment market

- 2.10 The work of the pensions investment taskforce has been complemented by a number of other developments in pensions policy over the last year. The government’s focus on enabling safe and appropriate consolidation in DC and defined benefit (DB) pensions should help create the conditions for trustees to consider a well-diversified portfolio that includes some exposure to patient capital-type assets, by providing greater scale for investment. This might include investment in later-stage venture capital, or growth-capital for small-medium enterprises (SMEs). A consultation on consolidation of DB pension schemes will be published later in the year.
- 2.11 The Competition and Markets Authority (CMA) has also been conducting a market investigation into investment consultants, with a provisional decisions report published earlier this year. The government welcomes the provisional recommendations of the report, and particularly those that seek to improve competition in pension fund investment performance while better aligning incentives with the interests of pension members. The pensions investment taskforce identified investment herding and a focus on costs over returns as key barriers to pensions investment in assets like patient capital. This work will therefore inform the government’s response to the recommendations included in the CMA’s final report, which is expected for publication before the end of 2018.

- 2.12 There has also been a greater emphasis on the long-term financial sustainability of investments and the government has been supportive of efforts to make clear the long term financial opportunities associated with social impact investing. New DWP regulations to clarify and strengthen trustees' investment duties make clear that environmental, social and governance (ESG) considerations are likely to present long-term financial risks and opportunities to pension schemes. Such changes will help to foster decisions by institutional investors to consider more active, diversified and long-term investment strategies.

Case Study: Dementia Discovery Fund

The Dementia Discovery Fund is a specialist life science venture capital fund, managed by SV Health Investors based in London and Boston, that invests in novel science to create meaningful new medicines for dementia including Alzheimer's disease thereby generating attractive returns for investors.

The Fund was formed through the collaboration of leading pharmaceutical companies, the UK Department of Health and Social Care and the charity Alzheimer's Research UK.

British Patient Capital invested £9 million into the Dementia Discovery Fund announced in June 2018. The fund was oversubscribed and raised £250 million, making it the first and largest venture fund focused entirely on discovering and developing novel therapies for dementia.

Chapter 3

Strengthening the UK as a leader in patient capital

British Patient Capital

- 3.1 British Patient Capital (BPC), which has been given resources of £2.5 billion to deliver a new programme to invest in high-growth innovative firms and crowd in private investment, was launched in June 2018 as a commercial subsidiary of the British Business Bank. It builds on the British Business Bank's successful heritage of investing £1 billion into UK venture and growth equity over the past decade, including investments into 5 UK unicorns. The programme is being grown with a view to future private sale or listing once it has built its portfolio and track record.
- 3.2 BPC's mission is to enable long-term investment in innovative companies across the UK led by ambitious entrepreneurs who want to build successful, world-class businesses. Its approach to patient capital is to increase the volume, diversity and accessibility of longer term finance so that smaller businesses can access the finance they need to achieve their growth ambitions; ensuring that the UK remains the leading place in Europe to raise a fund and scale a business.
- 3.3 BPC invests in venture and growth capital. It invests in both-fixed term and evergreen funds and will consider co-investment alongside its portfolio funds. As at the end of June, BPC (and its predecessor the Venture Capital Catalyst programme) had £395 million of existing and approved venture and growth fund commitments, including its first investment into an evergreen fund, and a good pipeline of future prospects.

Managed Funds

- 3.4 At Autumn Budget 2017, the government committed to investing in a series (up to three waves) of private sector fund of funds of scale, with the British Business Bank seeding the first wave of investment with £500 million.
- 3.5 In May 2018, British Business Investments – which sits within the commercial arm of the British Business Bank – launched the Managed Funds programme. The Managed Funds programme invests in, and encourages other institutional investors to invest in, large-scale funds of funds run by experienced managers. Through the programme, the British Business Bank will cornerstone a small number of large scale, private sector managed funds of funds, which will in turn catalyse patient investment into high-growth potential businesses.

- 3.6 The programme will seek to crowd-in private capital, expand investor diversity, and use and develop private sector fund management expertise. The British Business Bank expects to announce its first commitment through the programme in Spring 2019.

Enterprise Capital Funds

- 3.7 At Autumn Budget 2017, the government committed to make up to £1 billion of further commitments through the Enterprise Capital Funds (ECFs) programme.
- 3.8 ECFs increase early-stage venture capital and encourage new fund managers to enter the market. ECFs make equity investments of up to £5 million in early-stage, high-growth companies. ECFs predominantly invest in tech, science and professional service firms. The British Business Bank invests up to two thirds of the size of the fund and forgoes some of the upside potential of these investments to encourage private investors to invest in areas of market weakness.
- 3.9 To date in this financial year, the British Business Bank has made £70 million in commitments. Since its inception, £1.19 billion (including third party investors) has been committed through the programme, with 28 funds facilitating finance to 473 UK SMEs.

Case Study: FiveAI

The business FiveAI is bringing together leading artificial intelligence, engineering and mobility talent to deliver a fully autonomous shared transport service. The UK-wide company with bases in Bristol, Cambridge, London, Oxford, Edinburgh and Millbrook is building its own autonomous driving system with initial road trials due to start in London in early 2020.

As well as receiving a government grant for \$15m, FiveAI has raised \$21m of investment across Seed and Series A rounds, including investment from British Business Bank partners Kindred Capital, Amadeus Capital Partners and Notion. This is a first step in long-term patient capital necessary to develop the complex systems required to make FiveAI's vision a reality.

Amadeus Capital is supported by the British Business Bank's Enterprise Capital Funds programme. Kindred Capital and Notion both received investment from British Business Investments' VC Catalyst, which now forms part of British Patient Capital's seed portfolio.

Regional Angels programme

- 3.10 At Autumn Budget 2017, the government announced that it would set up a new commercial investment programme through the British Business Bank to support developing clusters of business angels outside London.
- 3.11 The British Business Bank launched the Regional Angels programme in October 2018. The programme will seek to increase the availability and supply of capital for early-stage investment across the UK by investing

commercially alongside clusters of professional business angels, who play a vital role in the economy, bringing patient capital, business experience and skills to support the growth of smaller businesses.

- 3.12 The Regional Angels programme will invest via business angels, syndicates or platforms. The British Business Bank expects to make its first commitment under this programme during this financial year.

National Security Strategic Investment Fund

- 3.13 At Autumn Budget 2017, the government announced that it would establish a National Security Strategic Investment Fund (NSSIF) to invest in advanced technologies that contribute to our national security mission.
- 3.14 The British Business Bank launched the £85 million programme in July. The NSSIF programme will build on the UK's role as both a leading centre for advanced technologies and as a global hub for venture capital. It aims to combine the best expertise from the public and private sector to foster the growth of high potential UK companies and at the same time contribute to the national security mission.
- 3.15 The NSSIF programme operates in conjunction with the British Business Bank's existing Enterprise Capital Fund (ECF) and British Patient Capital (BPC) programmes, but has additional requirements and features over and above these existing programmes. For example, selected fund managers are able to access a dialogue with government, to support the development of advanced technologies which have dual-use applications for national security and in a commercial setting.

Case Study: Azimo

Founded in 2012, Azimo is a market-leading digital money transfer service which allows users to transfer money across the world as a lower cost alternative to traditional foreign exchange service providers and high street services within the growing global remittance market. Money can be transferred to a recipient's bank account or mobile phone in minutes via secure payment, or collected as cash in person. Unlike traditional remittance companies, Azimo only accepts inbound electronic transfers, making anti-fraud checks more simple and secure.

Frog Capital invested £4.2 million in Azimo in May 2015 leading a funding round worth £10 million, and has invested in subsequent rounds, to a total investment of £7.6 million. Frog Capital is a European venture capital investor focused on software-enabled 'scale-up' companies in industries undergoing significant digital change. The British Business Bank invested in the Frog European Growth I fund through British Business Investments, and this investment was seeded into British Patient Capital and now forms part of its portfolio.

SBIC feasibility study

- 3.16 The British Business Bank undertook a feasibility study to implement a 'Small Business Investment Company' (SBIC) programme in the UK through a new guarantee programme. The study found that while there is an active and mature debt fund manager base within the UK, currently there is unlikely to be sufficient demand from experienced debt fund managers for such a product to be viable.

Chapter 4

Supporting innovation through tax

Enterprise Investment Scheme and Venture Capital Trusts

- 4.1 Following the Patient Capital Review, the Finance Act 2018 introduced a number of changes to the Enterprise Investment Scheme (EIS) and Venture Capital Trust (VCT) schemes:
- extending the EIS and VCT schemes for particularly capital-intensive and R&D intensive 'knowledge-intensive' companies, specifically:
 - doubling the annual investment limit for EIS investors from £1 million to £2 million, provided any amount above £1 million is invested in knowledge-intensive companies
 - doubling the annual investment limit for knowledge-intensive companies from £5 million to £10 million through the EIS and by VCTs
 - providing greater flexibility for knowledge-intensive companies to determine when the 10-year age limit on receiving an investment begins
 - a new principles-based test, the 'risk-to-capital' condition, to ensure that investment through the schemes is at genuine risk and is made in companies seeking investment for their long-term growth and development; this came into effect from 15 March 2018
 - changes to VCT rules to promote faster deployment of capital, to prevent abuse, and to encourage the reinvestment of VCT gains in growth companies
- 4.2 These changes significantly expanded the support that innovative knowledge-intensive companies can receive through the EIS and VCT schemes, while preventing and re-directing low-risk investment. This is expected to unlock £7 billion of new and re-directed investment in high-growth firms over the 10-years.
- 4.3 The government believes the introduction of the risk to capital condition has been successful in preventing abuse and re-directing capital towards higher growth areas. Since its introduction, the overall volume of advance assurance applications for the EIS and VCT schemes has dropped by more than 15%. To support implementation of the risk-to-capital condition, HMRC consulted on draft guidance. This was published on 4 December 2017, and

the guidance was updated on 9 April 2018.¹ HMRC continues to update its guidance to help clarify points of uncertainty.

- 4.4 Operational changes were also made in the way advance assurance applications are handled and there has been a significant reduction in advance assurance waiting times for the majority of cases. More than 90% of cases are now receiving a response within 15 working days, with some larger, more complex cases taking up to 40 working days.
- 4.5 As the EIS and VCT schemes are a notified state aid, all changes were subject to the normal state aid approval process, and received approval in July. Regulations were made to bring the changes into effect, backdated to 15 March and 6 April, depending on the measure.
- 4.6 To ensure that we continue to provide the most effective support for investment in UK innovation, we continue to monitor the effects of these changes. The government wishes to ensure that the EIS, SEIS, and VCT schemes support investment in early-stage growth companies and provide value for money for the taxpayer.
- 4.7 Some changes to VCTs announced at Autumn Budget 2017 will come into effect for accounting periods starting in or after April 2019, to give VCTs time to adjust to their implementation. These changes will:
- raise the minimum proportion of VCT funds that must be held in qualifying holdings from 70% to 80% so that a larger proportion of tax-advantaged investment flows to qualifying early-stage companies
 - increase the period in which gains from investments must be reinvested from 6 months to 12 months to encourage reinvestment
- 4.8 As part of the wider package of Patient Capital Review reforms, at Spring Statement the government launched a consultation on changes to HMRC's 'approved fund' structure within EIS², with the intention of specifically adjusting it to encourage investment in knowledge-intensive companies. The consultation ran from 13 March to 11 May 2018, with over 40 respondents and found broad agreement that knowledge-intensive companies experience a particularly acute capital gap. The government has published a separate comprehensive response document to this consultation, outlining changes to HMRC's 'approved' fund status for EIS funds. This policy is intended to remove potential administrative barriers to patient investment in knowledge-intensive companies.

Entrepreneurs' Relief

- 4.9 The government announced at Autumn Budget 2017 that the qualifying rules of Entrepreneurs' Relief (ER) would be changed to ensure that

¹ Venture Capital Schemes: risk-to-capital condition, HMRC (available at: <https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm8500>)

² Financing growth in innovative firms: Enterprise Investment Scheme knowledge-intensive fund consultation, HM Treasury (available at: https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/689229/PU2158_Financing_growth_in_innovative_firms_web.PDF)

entrepreneurs are not discouraged from seeking external investment due to the dilution of their shareholding. The new rules will allow individuals who have been diluted below the minimum 5% shareholding threshold due to a new share issue to retain ER on any gains that were made up until that point. These changes are being introduced in Finance Bill 2018-19, and will take effect from 6 April 2019.

Case Study: Draper Esprit

Draper Esprit's mission is 'to empower Europe to invent the future through its investment into Europe's technology companies.' Draper Esprit looks for high-growth companies with strong intellectual property, powerful technology and an ambitious management team.

Draper Esprit listed on the stock market in 2016 enabling it to invest in for longer in emerging companies and provide it with the flexibility to invest across the company lifecycle.

British Patient Capital made a £30 million cornerstone investment in Draper Esprit's £115 million capital raise in June 2018. This is British Patient Capital's first evergreen investment, expanding the market for long-term investment in the UK.

Chapter 5

Building the UK venture capital ecosystem

- 5.1 To further strengthen the UK's position as a global centre for high-growth companies and investors, the government is working to further support the wider UK venture ecosystem by exploring ways to overcome any barriers to female entrepreneurship, to expand the pipeline of talent in UK venture capital, and to create an environment in which businesses can leverage their innovation to access the finance they need.

Venture Capital and Female Founders

- 5.2 In May 2018, the British Business Bank, Diversity VC and the British Private Equity and Venture Capital Association (BVCA) launched an industry-wide initiative to build the first clear picture of the representation of women in the pipelines of UK venture capital firms, and how this corresponds to the deals that are made. In total, 45 VC firms representing more than £13 billion of assets have contributed data on over 4,000 businesses and 900 investment decisions. The findings will be published later in the year.
- 5.3 In addition, as announced on 21 September, HM Treasury has asked Alison Rose to lead a review to identify barriers to female entrepreneurship and ways to overcome them. The review will look into the disparity in rates of entrepreneurship between men and women, including the role played by access to finance. The review will report in Spring 2019.

Case Study: Improbable Worlds Limited

Improbable Worlds Limited is a technology company that has developed a platform for third parties to build vast virtual and simulated worlds for video games and corporate use. Founded in London in 2012, it now employs more than 300 people with offices in the UK, North America and China.

In 2014, Improbable received funding from Amadeus Capital Partners and three other investors in a seed round. Following a \$502 million Series B funding round, led by SoftBank in 2017, Improbable was valued at over \$1 billion, classifying it as a Unicorn.

Amadeus Capital Partners is a multi-strategy investment manager operating venture capital funds that invest at different stages and in business of different sizes. Amadeus is supported by the British Business Bank's Enterprise Capital Funds programme, through investment into the Amadeus IV Early Stage Fund and Amadeus Angel Seed Fund.

Women in Finance Charter

- 5.4 At Autumn Budget 2017, the government encouraged venture capital and other financial services firms to sign HM Treasury's Women in Finance Charter.
- 5.5 The government welcomes the venture capital firms that have signed the Charter and strongly encourages other venture capital firms to sign up. The British Private Equity and Venture Capital Association signed the Charter in February 2018 and is working to help more firms from their membership to sign up.
- 5.6 Since it was launched in 2016, 270 financial services firms have signed the HM Treasury's Women in Finance charter and committed to improve gender balance at the top of their firm. As outlined in the Charter's first Annual Review, published in March 2018, the average target set by signatory firms is 36% female representation in senior management roles. This is above the recommendation from the 2017 Hampton-Alexander Review of 33% female representation in senior management roles. More than half of signatory firms have a target of at least 33% female representation in senior management roles.
- 5.7 Charter signatory firms will be reporting on their progress against their targets in the autumn, and we expect to see continued improvements. The second Annual Review will be published in March 2019.

Talent in Venture Capital

- 5.8 The British Business Bank is currently undertaking research to assess how to support the next generation of high potential fund managers to develop their knowledge, skills and networks and to raise their first or next fund. The findings will be published in the coming months.

Intellectual Property

- 5.9 The British Business Bank and the Intellectual Property Office have today published research into the barriers to high growth, intellectual property-rich firms using their intellectual property to access growth funding, and how these may be overcome.¹ As part of this work, the British Business Bank and Intellectual Property Office conducted a series of roundtables of experts and analysed the default rates and losses for companies with intellectual property using the Enterprise Finance Guarantee (EFG) programme. The roundtables surfaced the challenges faced by the different players in the intellectual property market and provided a platform for exploring potential responses. The EFG analysis showed that loans to companies with registered intellectual property rights are less likely to default, and the resulting losses to the banks from these defaults are lower than for companies without intellectual property.

¹ Using intellectual property to access growth funding, British Business Bank and Intellectual Property Office, October 2018
(Available at: <https://www.british-business-bank.co.uk/research/>)

Case Study: Quantexa

Quantexa is an enterprise intelligence company using artificial intelligence-based technology to uncover hidden connections and behaviours within an organisation's data to solve major challenges in financial crime, customer insight and data analytics.

In August 2018, Quantexa raised £15.2 million in Series B funding in a round led by Dawn Capital. British Patient Capital has invested into Dawn Capital's 'Dawn III' fund, which focuses on investments in early-stage B2B businesses that develop world-leading technology to provide both innovative offerings and massive productivity improvements.

The new funding will enable Quantexa to support international expansion and further develop their unique technology, providing security and data solutions across financial services, corporate and public sectors, around the globe.

Chapter 6

Backing overseas investment in UK venture capital

- 6.1 At Autumn Budget 2017, the government committed to backing overseas investment in UK venture capital through the Department for International Trade (DIT), expected to unlock over a £1 billion investment over the next 5 years.
- 6.2 In the last financial year, DIT had secured commitments from overseas investors of over £240 million. This financial year the team has secured several significant venture capital commitments to the UK, with a healthy pipeline of prospects including from USA, Japan, France and Singapore.

Case Study: Lockheed Martin Ventures

The Department for International Trade (DIT) has strong relationships with the world's leading investors. DIT organised a UK engagement event over two days for Lockheed Martin Ventures (LMV), whose key technology interests are in autonomy, sensors, materials, quantum technologies, cyber, space and data analytics/artificial intelligence. This was part of a DIT deliverable under the Prosperity Framework signed by the UK government and Lockheed Martin, also involving the Cabinet Office, Ministry of Defence and Department for Business, Energy and Industrial Strategy, and drew on the bespoke service offered to certain entities. Thirteen organisations presented to LMV leadership visiting from the USA, including VC funds, accelerators, incubators, leading universities, the British Business Bank and the new National Security Strategic Investment Fund.

LMV is an early-stage investor making direct investments in advanced technology companies and funds. LMV has expressed strong appreciation for their UK engagement and has advanced discussions following the UK engagement. LMV and Lockheed Martin UK are now developing a follow-up action plan, supported by DIT, enabling LMV to further its relationships with the venture ecosystem in the UK and could lead to LMV making its first venture capital investments in the region.

- 6.3 DIT plays a crucial role in promoting the UK as the number one destination in Europe for international venture capital. The department supports international investors by connecting them with exciting UK start-up companies, venture capital funds and the wider UK innovation ecosystem. Engaging with investors from selected markets, from the Gulf to the USA, the team highlights investment opportunities in sectors where the UK is world-leading, including those outlined in the Industrial Strategy.

- 6.4 Beyond its role backing overseas investment into UK venture capital, DIT is helping to increase the UK's attractiveness for venture capital investment through a variety of activities:
- facilitating and strengthening foreign investors' engagement with the wider UK innovation system, including incubators, accelerators and universities
 - identifying foreign investors who might partner with UK companies to develop new products and services, or provide access to customers and strategic partners in their home markets
- 6.5 DIT is on track to unlock over £1 billion investment into innovative firms by backing overseas investment into UK venture capital over the next 5 years and will continue to actively support the development of British Patient Capital and the Managed Funds programme.

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