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Treasury Committee

Venture Capital: Government Response to the Committee's Nineteenth Report of Session 2022-23

Ninth Special Report of Session 2022–23

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The Treasury Committee

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Contents

Ninth Special Report

The Treasury Committee published its Nineteenth Report of Session 2022–23, Venture Capital, (HC 134), on 24 July 2023. On 22 September, we received a letter from the Financial Secretary to the Treasury, Victoria Atkins MP, and the Economic Secretary to the Treasury, Andrew Griffith MP, containing HM Treasury's response to our Report. That response has been appended to this Special Report.

Appendix: Response from the Financial Secretary to the Treasury

Letter from the Financial Secretary and Economic Secretary

Dear Harriett,

We are writing in response to the Treasury Committee's (the Committee) report of 24 July on Venture Capital. We would like to thank your Committee for its inquiry and recommendations and we welcome the opportunity to respond.

In preparing this response, HM Treasury has carefully considered the issues that the Committee has highlighted.

HM Treasury agrees with the Committee that the sunset clauses for the Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT) should be extended. The Chancellor has already stated his firm intention to extend the sunset clauses and will provide further details on the schemes beyond 2025 at a future fiscal event.

HM Treasury also agrees with the Committee on the importance of a diverse UK venture capital market, and that the transparency and consistency of diversity data could be improved. The Treasury will explore ways in which this can be achieved. However, the Treasury does not agree that eligibility for the venture capital schemes should be contingent on the provision of this data.

Improving diversity within the UK venture capital ecosystem—both for recipients and for investors—is complex, with multiple possible solutions. The British Business Bank (BBB) is committed to improving diversity in venture capital allocations and is already making an impact through several of its programmes.

These include the Enterprise Capital Funds (ECF) programme which is designed to lower the barriers to entry for fund managers looking to invest in the Venture Capital market, thereby backing fund managers with a variety of backgrounds with a broad skills base. The Bank also publishes practical research, such as the 'Finding What Works: Pathways to Improve Diversity in Venture Capital Investment', which sets out effective actions that fund managers can take to reach more founders from underserved backgrounds.

The BBB will explore what further actions it can take to improve diversity within venture capital allocations; will continue to track its own performance; and ensure that it performs and publishes valuable research on diversity in access to finance.

The Treasury also recognises the importance of the Investing in Women Code and Women in Finance Charter. In practice, as set out in detail in the response to the Committee's recommendations, the BBB operate a 'comply or explain approach' to the Investing in Women Code. Whilst the Treasury remains to be convinced that implementing a formal 'comply or explain' policy to access the EIS or VCT schemes would be appropriate, given their design, it continues to support these initiatives.

HM Treasury does not agree that extending the EIS and VCT company age limits and funding limits is the best way for the government to support regional and scale up investment. The tax-advantaged venture capital schemes are predicated on a market failure of information asymmetry which impacts start-ups and SMEs and causes an equity gap in early-stage financing for high-risk companies. The venture capital schemes are designed to tackle this equity gap by providing a range of generous tax reliefs to incentivise individuals to invest in higher-risk small and growing companies that would otherwise struggle to access the finance they need to grow and develop. Given this underlying policy objective, extending either the company age limits or the funding limits to support scale-up businesses would run the risk of displacing investment away from smaller companies which face the greatest challenges in accessing finance. Nonetheless, the government continues to keep tax reliefs such as these schemes under review to ensure they remain effective and appropriately targeted.

HM Treasury has reflected on each of the Committee's suggestions in further detail in the appendix to this letter.

Thank you again to your Committee for its continued interest in this area and for its valuable contributions.

Yours sincerely,

VICTORIA ATKINS MP ANDREW GRIFFITH MP

The Government's response to the Committee's recommendations

This appendix sets out the Government's response to each of the Committee's conclusions and recommendations. The Committee's text is in bold and italicised, and the Government's response is in plain text. Paragraph numbers refer to corresponding paragraphs in the Committee's Report.

We recommend that HM Treasury extend the EIS and VCT sunset clauses beyond April 2025 at the earliest opportunity. HM Treasury should provide more certainty for founders and investors alike by announcing the length of the extension and a clear timeline for implementing it as soon as possible. (Paragraph 24)

HM Treasury agrees with the Committee that the EIS and VCT sunset clauses should be extended, and the Chancellor has stated his firm intention to extend the schemes beyond the current sunset clause on 6 April 2025. HM Treasury recognise the need to provide certainty to founders and investors and will provide further details on the schemes beyond 2025 at a future fiscal event.

HM Treasury should make provision of diversity statistics a requirement for eligibility to receive EIS, SEIS and VCT tax reliefs. Firms should be required to disclose the gender and ethnic breakdown of both recipients of their funding and their own staff. This should take effect from the renewal of the sunset clauses in April 2025. (Paragraph 41)

HM Treasury agrees that a diverse and inclusive business ecosystem is good for customers, entrepreneurs, businesses, and investors. There are a number of government-led initiatives which aim to promote a more diverse and inclusive investment landscape. For example, the Investing in Women Code, mentioned in the Committee's report, helps drive the change necessary to improve venture capital markets for female founders, so they can raise the capital they need for their businesses to reach their full potential.

Data from Beauhurst on the gender make up of founding teams and key employees shows that in 2022, 27% of all deals went to teams with at least one female founder, the highest proportion ever and an increase of ten percentage points since 2012.

HM Treasury agrees with the intention behind the Committee's recommendation in that understanding the demographic diversity of those venture capital firms that make investment decisions and the recipients of their funding is important. However, HM Treasury does not agree with the Committee's recommendation to make provision of diversity statistics a requirement for eligibility to receive the EIS, SEIS and VCT tax reliefs as this would be both difficult to implement within the current structure of the schemes and would not deliver the intended outcome.

That is because these reliefs are not claimed by those firms making these investment decisions, they are claimed by individual investors through the Self-Assessment system. Requiring them to provide such information about the companies they have invested in would be challenging, as they would not necessarily have access to this information or any particular right to receive it. The companies that do receive the benefit of the SEIS, EIS or VCT funding and are currently required to report certain details about their investment to HMRC are smaller, younger businesses, for whom the disclosure of protected characteristics of their staff as a requirement for eligibility for receiving this funding would introduce legal complexity as well as further administrative burdens.

As set out in the 2023 update from the UK Statistics Authority on implementing Inclusive Data recommendations[1], HMRC, which operates the schemes, has been reviewing ways to obtain additional demographic data for individual customers which may in future include individuals that claim venture capital tax reliefs. In addition, the Integrated Data Service—a cross-Government initiative that aims to bring together large administrative datasets for Government use—may offer a potential source of information in this area in the future.

All relevant organisations in the venture capital industry ought to become signatories to both the Women in Finance Charter and Investing in Women Code, if they have not done so already. We have not determined that compulsory membership is appropriate at this time but recommend that HM Treasury and the BBB adopt a "comply or explain" policy with regards to both. Organisations ought to comply with the Charter or Code or explain why they are not, as a condition of EIS, SEIS and VCT eligibility. This approach

1 Embedding Inclusivity in UK data: 2023 update on implementing Inclusive Data recommendations – UK Statistics Authority

will communicate to the market that the default expectation is that firms become signatories. Should diversity statistics and reporting not improve quickly enough, we will instead consider calling for compulsory membership. (Paragraph 50)

HM Treasury agrees with the Committee that the Investing in Women Code and the HM Treasury Women in Finance Charter have an essential role in improving diversity in venture capital allocations.

The HM Treasury Women in Finance Charter aims to foster productivity, competitiveness, and innovation in the financial services sector. Over 400 firms, of various sizes and employing over one million people across the financial services sector, have signed up to the Charter's commitments. Not only have a substantial proportion of firms in the sector signed up to the Charter, but each year this number continues to grow. An updated list of signatories is published every quarter on https://www.gov.uk/government/publications/women-in-finance-charter.

In order to track progress, HM Treasury publishes the Women in Finance Charter Annual Review report which assesses whether the Women in Finance Charter signatories are meeting their voluntary self-declared targets to increase gender diversity at senior levels. It provides a factual update on the data and trends reported by signatories, and highlights examples of signatory progress and notes challenges experienced by Charter signatories. HM Treasury has published an Annual Review every year since March 2018, found at: https://www.gov.uk/government/collections/new-financial-analysis-women-in-finance, as well as a 5-year review in 2021. The Annual Reviews have shown that the Charter has stimulated positive change in the sector. Female representation in senior management at signatory firms have risen steadily–the first wave of signatories to the Charter started out with an average level of representation of 27%, compared to 35% today. Although these two figures are not comparable due to the Charter's signatory base being much larger now that it was in 2016, it is evident that the Charter has had, and continues to have, a positive impact on the sector.

Separately, the Investing in Women Code was founded in 2019 as a landmark government-led initiative in response to the Rose Review's findings that a lack of finance continues to be one of the most significant barriers to women seeking to start and scale a business. The Code is a commitment to support the advancement of women entrepreneurs in the United Kingdom by improving their access to the tools, resources and finance they need to achieve their goals. It addresses the lack of investment going to women-led businesses from all parts of the financial services and investment landscape, from early stage and seed funding, to venture capital investment and bank loans. The Government leads the Code with four partner organisations who manage data collection, share good practice and encourage their members to become signatories. They are UK Business Angels Association, British Private Equity & Venture Capital Association, UK Finance and the British Business Bank.

Starting with 12 founding signatories in 2019, the Investing in Women Code now has over 200 organisations that have committed to collect data on their performance in providing finance to women entrepreneurs and to act on the results. Signatories to the Investing in Women Code account for 40% of UK Business Angel Association investment groups and four of the 'big 5' High Street banks. Venture capital firms that have signed up to the code represent a larger share of the market than ever before and include British Patient Capital, the UK's largest domestic investor in the venture capital market. The proportion of UK venture capital deals involving a signatory has risen from 24% in 2020 to 39% in 2022. The Code partners report annually on the steps taken by signatories and the outcomes achieved.

The government is committed to ensuring that the UK is the best place in the world to start a business, regardless of gender. The number of deals made by venture capital firms with all-female teams rose from 6% in 2021 to 9% in 2022 in the broader market. We recognise that we must keep pushing forward to bridge the finance gap for female entrepreneurs.

At the point of application, the British Business Bank already ask fund managers whether they are signatories of the Investing in Women Code. If they are not, then the British Business Bank requests that these applicants either join the Code or provide a reason why they do not wish to become a signatory. In practice, therefore, a 'comply or explain' approach is already in place for applicants seeking investment from the British Business Bank.

However, the government remains to be convinced regarding the Committee's recommendation to adopt a 'comply or explain' approach to EIS, SEIS and VCT eligibility. The schemes offer tax relief to individuals who invest in higher-risk, early-stage companies. Both the HM Treasury Women in Finance Charter and Investing in Women Code are targeted towards the wider financial services industry and their recommendations are not suitable for the individual investors who claim the tax relief and may not be applicable to the start-ups and SMEs that receive the funding if they operate in industries outside of financial services. Introducing a 'comply or explain' policy on EIS, SEIS and VCT eligibility would not achieve the desired results and would place an undue burden on the early-stage companies who benefit from these schemes.

We recommend that the Government and British Business Bank consult on the creation of one or more venture capital funds with the specific purpose of promoting greater diversity in venture capital allocation. (Paragraph 55)

HM Treasury agrees with the Committee on the importance of promoting greater diversity in UK venture capital allocation. The British Business Bank is committed to improving diversity in venture capital allocations and is already making an impact through several of its programmes.

The British Business Bank's Enterprise Capital Funds (ECF) programme is designed to lower the barriers to entry for fund managers looking to invest in the venture capital market, thereby backing fund managers with a variety of backgrounds with a broad skills base. The Bank assess prospective fund managers' approaches to diversity as an integrated part of its due diligence process. Through this programme, the Bank has allocated funding to fund managers that specifically target and fund a diverse network of founders. Particular highlights of this approach have been the Bank's cornerstone investments into Ada Ventures' Fund II and into Zinc's 2 Fund.

Ada is aiming to build the most diverse pipeline in venture capital, to increase funding for underrepresented founders. The portfolio of Ada Ventures' Funds I was amongst the most diverse in Europe, with approximately 55% female founders and 30% ethnic minority founders. Zinc's new fund will back 500 diverse entrepreneurs to create brandnew ventures from scratch and invest in 100 of the ventures they create. In Zinc's most recent venture builder programme, more than 50% of founders were women and 15% Black, with the cohort having a Founders average age of 38.

In Summer 2018, the British Business Bank launched its Finance Hub, a website that offers independent and impartial information for businesses. The Hub includes a comprehensive range of support and guidance for various groups, including female entrepreneurship, financial support for diverse and inclusive hiring, business finance jargon and much more.

The British Business Bank undertakes research on diversity and inclusion. In 2023, the Bank published 'Finding What Works: Pathways to Improve Diversity in Venture Capital Investment', which sets out effective actions that fund managers can take to reach more founders from underserved backgrounds. The Bank will now be able to track these specific actions against actions taken by signatories of the Investing in Women Code, to develop the evidence base and ensure fund managers have the tools they need to target founder underserved communities.

The British Business Bank will continue to track its own performance, work with others to ensure that it performs and publishes valuable research on diversity in access to finance.

Outside of the British Business Bank, DSIT have committed £12 million of funding through the Digital Growth Grant to provide a two-year programme of specialised support for aspiring and existing tech entrepreneurs, including specific activity to improve outcomes for underrepresented entrepreneurs. Activities were launched in April 2023 and are being delivered by Barclays Eagle Labs in collaboration with industry partners such as Foundervine and AccelerateHER. Activities to support underrepresented entrepreneurs include the Black Venture Growth Programme and the Female Founder Programme–dedicated programmes that focus on growth and removing barriers to fundraising through targeted support and connectivity to investors.

The Government should extend the 7 and 10 year company age limits for support through the EIS and VCT schemes. HM Treasury should consult on revised limits, with the objective of not disadvantaging regional businesses. This revised limit should take effect from the renewal of the sunset clauses in April 2025. (Paragraph 68)

HM Treasury agrees with the Committee that regional businesses should not be disadvantaged and is committed to helping businesses across the UK thrive.

We recognise that current UK venture capital activity is concentrated particularly in London. British Business Bank data shows that up to Q3 of 2022, London received 52% of all UK equity deals and 61% of total UK equity investment. In 2022, 50% of the UK's overall deal count and 65% of the total investment value occurred in London.

That is why the British Business Bank has an explicit objective to identify and help to reduce regional imbalances in access to finance for smaller businesses across the UK.

There are several programmes and funds the Bank operates to address regional imbalances: the Regional Angels Programme, Northern Powerhouse Investment Fund (NPIF), Midlands Engine Investment Fund (MEIF) and the Cornwall and Isles of Scilly Investment Fund (CIOSIF). These programmes play an important role in increasing the supply of finance in all areas of the UK and are delivering well. An interim evaluation report published in April 2022 showed that the Northern Powerhouse Investment Fund has increased productivity, employment and skills across the North.

At Spending Review 2021, the government announced a £1.6 billion commitment to a new generation of British Business Bank's regional investment funds, including an expansion into the North East and South West of England as well as new regional funds in Scotland (£150 million) and Wales (£130 million) and to build on its existing programmes in Northern Ireland (£70 million), working closely with the Devolved Administrations.

HM Treasury is not convinced that extending the company age limits of the EIS and VCT schemes is the best way to support regional funding. The tax-advantaged venture capital schemes, the EIS, SEIS and VCT, are designed to and continue to offer key support to start-ups and SMEs across the UK. The schemes are intended to incentivise investment into early-stage, higher-risk companies as these companies are most likely to be affected by market failures such as information asymmetry due to their lack of track record.

To ensure support is targeted at the companies who face the biggest challenges in accessing growth capital, the scheme rules set age limits on when a company must have received its first risk finance investment, after which further follow-on funding is allowed. For the EIS and VCT scheme, companies are eligible if at the time of initial investment less than 7 years has passed since their first commercial sale. This is extended to a more generous 10 years for knowledge intensive companies as research shows that the equity gap in early-stage financing is greater for knowledge intensive companies such as biotech, life sciences or deep tech companies.

These age limits are informed by the evidence which supports the market failure early-stage companies face. Extending the age limits would allow larger, more mature companies to access the schemes which would risk displacing investment away from the smaller companies the schemes are designed to target, reducing their value for money. The government continues to keep these schemes under review to ensure they continue to meet their policy objectives in a way that is fair and effective and that the scheme limits remain appropriate.

HM Treasury should consult on higher funding limits on the EIS and VCT schemes with the objective of better supporting scale-up businesses. These revised limits should take effect from the renewal of the sunset clauses in April 2025. (Paragraph 77)

HM Treasury has carefully considered the Committee's recommendation. Supporting scale up businesses to grow and prosper is important and the government continues to do this in a number of ways.

The British Business Bank continues to support start-ups and scale-up businesses throughout their growth development through a variety of interventions.

For example, in 2018, British Patient Capital, a commercial subsidy of the British Business Bank, was launched following the government's Patient Capital Review. The review found that whilst the UK provides a fertile ground for innovation to thrive, a lack of access to long-term finance, or patient capital, has prevented some UK companies from scaling up and fulfilling their full commercial potential. British Patient Capital was created with an initial £2.5 billion fund to invest over 10 years in venture and venture growth capital.

In 2021, two new products were introduced, the £200 million Life Sciences Investment Programme and the £375 million Future Fund: Breakthrough programme for direct investment into R&D intensive companies. At Spring Budget 2023, the government extended British Patient Capital to 2033–34.

At the Mansion House speech in July, the Chancellor announced an ambitious package which reforms the pensions market to boost returns and improve outcomes for pension fund holders whilst increasing funding liquidity for high-growth companies. The Mansion House Compact saw 9 of the UK's largest defined contribution pension providers commit to the objective of allocating 5% of their default funds to unlisted equities by 2030. Should the ambition to allocate 5% to unlisted equities be replicated across all defined contribution workplace schemes, it could unlock £50 billion of finance by 2030, which could support the UK's most innovative, high-growth businesses to grow and secure their future in the UK.

HM Treasury disagrees with the Committee's recommendation that the Treasury should consult on higher funding limits within the EIS and VCT schemes with the objective of better supporting scale up businesses. The schemes are popular and world leading in terms of their generosity, with over £3.6 billion funds raised across the three tax-advantaged venture capital schemes (SEIS, EIS and VCT) in 2021–22.

The schemes are designed and targeted to meet an identified market failure. These schemes are kept under review to ensure the limits are appropriate and effectively targeted to meet this specific market failure. This includes reviews as part of HMRC's published tax relief evaluation plan.

Revising the funding limits of the schemes to target them towards scale-up businesses risks undermining the policy rationale and could displace investment away from those they are targeted to support. This would increase deadweight in the schemes, reducing value for money. Extending the schemes in a way that reduced value for money would be inconsistent with HM Treasury's aim to ensure the reliefs are effective and well targeted.