VCM0022

Written evidence submitted by Enterprise Investment Scheme Association (EISA)

I am writing on behalf of the Enterprise Investment Scheme Association (EISA) which is an independent, not for profit, trade association, which exists to assist the flow of capital and resources to smaller, British, growing companies through the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS).

Our comments reflect the representations received from our technical committee and members of the Association. EISA's 270 strong membership represents a broad spectrum of interested parties: entrepreneurs and small business founders, EIS fund managers, promoters, solicitors, accountants, platform operators, financial intermediaries, financial advisers, and other service providers closely involved in the operation of the EIS and SEIS.

The EIS was introduced to incentivise private investors to risk funds by investing in smaller businesses which otherwise struggle to raise equity finance. Since its introduction, every Chancellor improved and/or widened the EIS prior to the 2015 changes, recognising its value to the UK economy. In 2011 and 2015, certain restrictions were introduced in order to meet EU State aid obligations. There are now opportunities to reconsider whether those restrictions are still appropriate, particularly as they have inadvertently had the effect of exacerbating regional disparities.

Investment by members of the EISA, or where members have advised on or facilitated investment, covers the broad spectrum of start-up investment throughout the UK. Companies in a wide variety of industries have received investment under the EIS and SEIS including healthcare, technology, life sciences, the creative industries, environmental, leisure and hospitality, manufacturing and many more. EIS investment has contributed to job creation, innovation in products and services and increased competition. The SEIS has attracted talent to the UK and has enabled many entrepreneurs to begin their own business.

We welcome this inquiry. We believe that the SEIS and EIS can continue to play a major part in closing the funding gap that exists in the UK. The SEIS and EIS also play a huge role in developing world class UK businesses that help establish the UK as both the start-up hub, and tech hub, of Europe. The money raised to date has played an important role in providing early-stage funding for a wide range of innovative, productive companies who, without SEIS and EIS, would not have been able to start their business.

In our view, fast developing, smaller, entrepreneurial businesses are more likely to be leading the UK in terms of diversity, opportunity and inclusion. We also believe that if the scope of the EIS were expanded, more could be done to provide scale up capital, to help entrepreneurs in all regions of the UK and to facilitate funding to assist with the levelling up agenda and in reaching net zero carbon targets.

Our detailed feedback on the specific questions of greatest relevance is set out in the attached response. We would be pleased to engage with you further.

SUMMARY

The EIS and SEIS are extremely important parts of the investment ecosystem. Since their inception, 52,000 start-ups have used the SEIS and EIS to secure nearly £27billion of investment. It is thanks to EIS and SEIS that the UK has such a vibrant start-up scene, and many founders believe that they

would not have got the private investment needed to grow their businesses without the schemes. The SEIS and EIS are the leading schemes of their kind. They are crucial to patient capital and have helped to position the UK as a world leader in innovation and entrepreneurship.

Whilst the SEIS and EIS are working well, some changes could be made to enable them to work more effectively across the whole of the UK. These suggested changes also show a huge opportunity for the SEIS and EIS to play a greater role in helping to achieve the government's goals regarding levelling up, net zero and securing the UK's position as a global science and technology superpower.

We are aware that the Committee is interested in opportunities to improve the effectiveness of EIS and SEIS. With this in mind, the Enterprise Investment Scheme Association (EISA), the trade association for EIS and SEIS, recommends the following:

1) **Abolish the Sunset Clause on the EIS**
   We strongly recommend that the Sunset Clause be extended, or preferably removed, so that the EIS is placed on a permanent footing enabling it to continue to fuel entrepreneurs beyond 2025.
2) **Increase the limit for SEIS from £150,000 to £250,000**
   We recommend the SEIS limit be increased to £250,000, as this better reflects the funds needed to begin a business and also takes into account the effect of inflation since 2012.
3) **Extension of the EIS and SEIS age limits**
   Both the EIS and SEIS impose age limits on the companies that are able to seek investment through the schemes. Extending the age limits could enable more companies outside of the South East to secure vital investment through the schemes. This, in turn, would facilitate more job creation, investment and economic growth and could play a vital role in addressing regional imbalances and contributing the government's levelling up agenda.
4) **Relaxation of the Financial Health Requirements**
   We recommend a relaxation of the financial health requirement, which was brought in to meet EU State aid obligations.
5) **The EIS and SEIS Infrastructure, Education and Local Champions**
   We recommend a greater focus on education and raising awareness of the SEIS and EIS across the whole of the UK. We also recommend that MPs be empowered to become local champions for the SEIS and EIS within their constituencies.
6) **Knowledge Intensive Companies and Supporting Net-Zero**
   To help support the net-zero agenda, we recommend that the higher limits which apply to "knowledge intensive" companies should also apply to clean tech and green tech companies.

The most crucial of our recommendations is the abolition of the Sunset Clause, as the termination of EIS would be one of the most colossal threats to the UK start up scene and the wider economy.

The current state of the venture capital industry in the United Kingdom, including opportunities and threats, such as the availability of domestic capital to allow firms to scale up in the UK.

In 2021, addressing the CBI, the Prime Minister said … "The true driver of growth is not government, it is the energy and dynamism and originality of the private sector."[1] Post Brexit Britain will prosper only if it is hospitable to innovation and entrepreneurship. The EIS and SEIS play a vital role in encouraging entrepreneurs across the UK to start businesses and commercialise their ideas. The SEIS

[1] https://www.gov.uk/government/speeches/pm-speech-at-the-cbi-conference-22-november-2021

and EIS also bring significant additional benefits often not seen in institutional investing. Many of the private investors who invest in companies through these schemes bring experience and expertise which provides guidance and mentoring to entrepreneurs at a critical stage in the development of their businesses.

EIS and SEIS empower and encourage the private investors who can focus on different areas of interest and may have different risk appetites, thereby supporting young business across a very wide array of sectors from artificial intelligence and the metaverse to cancer treatment and gene therapy to the creative industries.

Other sources of investment are reluctant to invest at such an early and high-risk stage in the development of new businesses. Evidence suggests, for example, that pension fund trustees are holding back in supporting investment in so called illiquid assets due to fears that members could be negatively impacted by non-transparent valuations and see cash trapped for the longer term.

Data produced at the time of the Patient Capital Review indicated the UK lags behind the US and other leading economies in the relative proportion of businesses that scale significantly. We do not believe this situation has improved markedly. Consideration needs to be given to the challenge of how successful companies can have access to the later stage venture capital investment that would enable them to become significant companies in international terms. Such investment would build upon the important role that SEIS and EIS investment play in supporting the growth of successful, new, dynamic companies.

We believe the UK is one of the best places to start and grow a business, and this is no small way due to the tax-advantaged investment through the SEIS and EIS, and to the complementary investments by Venture Capital Trusts (VCT). Talent has been attracted to the UK, and many entrepreneurs would not have grown their businesses without the funding which the SEIS and EIS facilitate. We have a thriving start-up community, recognised around the world, providing financial support at the earliest stages of starting a business by encouraging investment in small, unquoted trading companies. A 2020 report[2] collating data on general economic factors ranked the UK as the second-best country in Europe for start-up businesses.

According to a recent report by the BVCA, "PE and VC-backed businesses delivered £102 billion of GDP in 2021. This is approximately 5% of UK GDP. In terms of jobs, PE and VC-backed businesses employed 1.9 million workers last year. That represents 6% of the total jobs in the UK, and half a million more than the NHS. In other words: the share of jobs backed by private capital is greater than its contribution to national wealth. What is particularly encouraging is that these jobs are spread across the length and breadth of the UK: over 50% are based outside of London and England's Southeast, and nearly 10% of PE and VC-backed jobs are in North West England".[3]

The UK economy depends on these high growth small businesses, which contribute greatly in terms of productivity, job creation and tax revenues. They are not without risk, however, which is why the government provides tax advantaged money to leverage private investment. Significant sums have been raised from the UK's retail investors through the SEIS and EIS.

[2] https://www.nimblefins.co.uk/best-countries-europe-startups#rank
[3] https://www.bvca.co.uk/Portals/0/Documents/Research/2022%20Reports/EY-BVCA-Economic-Contribution-Report-2022.pdf

The operation and effectiveness of the current tax incentives (such as the Enterprise Investment Scheme (EIS), the Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs)) in the venture capital market, including any options for change.

Operation and Effectiveness:

Since their inception, 52,000 start-ups have used the SEIS and EIS to secure nearly £27billion of investment. In the 2020/21 tax year alone (the latest year for which figures are available), 3,755 companies raised a total £1.658billion through the EIS and 2,065 companies raised 175 million through the SEIS [4].

The SEIS has been in existence for 10 years, and the EIS for 28 years. As such they are well established programmes that resonate well with investors and the entrepreneurs in whom they invest. The tax reliefs have provided capital investment for businesses, that would otherwise have difficulty securing investment, in exchange for targeted tax reliefs to individual investors. They play a vital role in providing a continuous ecosystem from early-stage funding for companies from angel investing through to venture capital. They help create a culture of private capital investment in smaller growing companies.

SEIS, EIS and VCTs are the three government schemes focused on facilitating investment into early stage start-ups. These schemes set the global benchmark and several countries have tried to replicate them including Australia and Ireland. It is the complementary nature of the UK's three schemes that makes the UK such a successful place to start and scale a business. SEIS allows for very early stage, EIS provides for further advance in maturity, and VCTs for further scale up before moving on to venture capital. However, both EIS and VCTs face considerable near term uncertainty due to the existence of an end date (colloquially known as the 'Sunset Clause') in April 2025 (see below).

52,000 start-ups have used the SEIS and EIS to secure vital private investment. These companies vary greatly in terms of what they do and are based across the whole of the UK. Many founders believe that their companies would not exist without SEIS and EIS investment and some examples below illustrate how important the EIS and SEIS are to the UK's position as a world leader in facilitating the creation and growth of innovative, fast growth, early-stage companies.

- *"Without the EIS/SEIS we would have not secured the funds for our pre-seed round and perhaps we would have not existed today."* – Dr Darko Matovski, Founder and CEO of causaLens, an AI company on track to employ 100+ people in the UK this year

- *"The SEIS and EIS scheme has been essential in enabling my company to exist and grow. The SEIS/EIS scheme breaks down barriers for individual investors and provides start-ups with precious - and rare - seed capital. The value of individual investors goes well beyond the cash that they inject. Their interest in the company, the doors they can open, the guidance they provide can be empowering for founders and transformative for early-stage companies. The UK Government should not underestimate the importance of the scheme, it sets the standards globally for supporting and accelerating entrepreneurship."* – Sabrina Del Prete, Founder and CEO of KoreLabs. Sabrina is an Italian Entrepreneur who chose to base her

[4] https://www.gov.uk/government/statistics/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-may-2022/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-statistics-2022

company in the UK. She is also on Innovate Finance's Women in FinTech Powerlist 2021.

- *"We'd never have raised the capital to expand into new premises and grow the team without the support of the Enterprise Investment Scheme. It's a critical scheme to help small start-ups."* Paul Rostand, CEO, The Artful Baker, Dorset, May 2022.

- *"EIS has been absolutely critical in helping our business raise the finance needed to fuel our growth, as well as connecting us with experienced investors that have helped us on our journey."* - Carlo Fedeli, CEO & Founder, FlexSea, an innovative, truly compostable biopolymer material derived from seaweed and other natural, sustainably sourced products.

- *"Raising EIS investment has been fantastic for Homethings, as not only has it provided us with vital funding needed to grow the business, but it has also connected us with investors that we believe can help further accelerate that growth too".* Tim Keaveney, Founder, Homethings, powerful, planet-positive products that make sense, keeping your home (and our planet) clean.

- *"Had it not been for SEIS/EIS we would not have been able to launch Revving, it's as simple as that".* Chris Pettit, CEO and Co-founder, Revving Ltd, capturing sales data at source to provide payment advances ahead of invoicing.

- *"The Enterprise Investment Scheme has not only helped find us more capital, but it's connected us with a network of investors who want to help you build a great business".* Stella Smith, CEO and Co-Founder, pirkx, providing affordable wellbeing benefits for everyone.

The demand for, and success of, SEIS, EIS and VCT investment has also been consistently noted by a series of independent reports over the last five years:

1) As the Patient Capital Review found in 2017, the "popularity of these schemes has contributed significantly to the development of a vibrant UK start-up scene"[5]. That review led to the introduction of enhanced limits to prioritise investment in 'knowledge intensive' companies undertaking research and development, thus strengthening the ability of these high growth small businesses to access capital.
2) The Future of Growth Capital Report, published by the Scale Up Institute in 2020, found that "approximately 80% of total investment in angels' investment portfolios were made through these [EIS and VCT] schemes in 2015[6], and the British Business Bank's Angel Market research report of 2018 revealed that 86% of total investment in angel investment portfolios were made through these schemes in 2017".[7]
3) The Kalifa Review of UK Fintech, commissioned by the current government and published in 2021, found that there is still a growing need for this support and that they are valuable tools which proved much needed private capital. A survey showed that "97% of founders have used tax-incentivised investment schemes including EIS, SEIS and VCT."[8]

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[5] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/661397/PCR_Industry_panel_response.pdf

[6] ERC (2015). A Nation of Angels. Assessing the impact of angel investing across the UK. https://www.enterpriseresearch.ac.uk/wp-content/uploads/2015/01/ERC-Angels-Report..pdf

[7] Future of Growth Capital Report 2020 - Scale Up Institute, https://secureservercdn.net/160.153.138.71/g8r.bcb.myftpupload.com/wp-content/uploads/2020/08/The-Future-of-Growth-Capital-August-2020-1-1.pdf

4) The Number 10 Taskforce on Innovation, Growth and Regulatory Reform found that the EIS and SEIS had "incentivised significant investment in early stage companies".[9]

EIS and SEIS are hugely important parts of the ecosystem and are working well. When entrepreneurs are aware of them and understand how to use them, they are extremely effective in helping founders to secure investment as well as enabling relationships and networks that can play a significant role in growing and scaling young businesses.

EIS and SEIS have been shown to be incredibly robust and investment through EIS and SEIS proved to be extremely resilient throughout the Covid lockdowns. The latest HMRC data shows that Covid 19 had very little impact on investment raised during the pandemic. Whilst there was a slight dip in investments made using EIS at the start of the 2020/21, the end of the year saw levels rebound above the corresponding quarter of the previous year. Interestingly, there was also more money invested through SEIS than before the pandemic with companies raising £175 million, an increase of 4% on the previous year.[10]

It is worth noting that 65% of EIS and 68% of SEIS investment is into companies whose offices are registered in London and the South East[11]. Whilst it must be mentioned that a company's registered office is not necessarily where the majority of their economic activity takes place, these statistics suggest a tremendous opportunity for EIS and SEIS to be used more widely across the whole of the UK to support entrepreneurs looking to secure investment in their companies. As mentioned below, we have the opportunity to remove some of the restrictions which have inadvertently increased the imbalance between investment in London and the regions.

The Sunset Clause and the Future of EIS

The EIS is working well, and we strongly believe that it should continue to be backed by the UK government. However, entrepreneurs who have used the EIS to secure investment require certainty for long term investment, particularly when the nature of patient capital means that businesses require support from private investors for a considerable period of time.

As it currently stands, there is a Sunset Clause on the EIS (s.157 Income Tax Act 2007[12]) meaning it is due to expire on 5th April 2025. Unless the Sunset Clause is amended or removed, the last time new shares can be issued to subscribers who will still be eligible to claim EIS income tax relief is 5th April 2025. This is already starting to affect behaviour around the EIS.

International Comparisons

[8] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/971371/KalifaFintechReview_ExecSumm.pdf
[9] FINAL_TIGRR_REPORT__1_.pdf (publishing.service.gov.uk)
[10] https://www.gov.uk/government/statistics/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-may-2022/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-statistics-2022
[11] Ibid
[12] https://www.legislation.gov.uk/ukpga/2007/3/section/157

SEIS and EIS are key to the UK's global competitiveness in, and reputation for, a thriving and vibrant start up scene. These schemes genuinely draw entrepreneurs to the UK and lead to them start companies here, rather than elsewhere in Europe, bringing with them jobs, investment, and growth.

There are several examples where countries have created similar schemes to EIS, notably the Employment and Investment Incentive Scheme (EIIS) in Ireland[13] and the Employee Share Scheme (ESS) in Australia. Representatives from the French Ministry of Economy and Finance have also visited EISA in the past to learn more about how they could replicate EIS. The UK is considered the gold standard and Australia's leading publication for entrepreneurs noted that "international comparisons – with the United Kingdom's system for example – demonstrate how Australia's tax relief for start-ups and innovative companies has some way to go."[14]

SEIS is the leading scheme of its kind in the world. The European Commission published a report in 2017 comparing the effectiveness of tax incentives in fostering investment into SMEs and start ups[15]. The report noted that "venture capital and business angel investment has been shown to generate a number of positive macroeconomic effects, such as job creation and productivity gains."[16] The 46 tax incentive schemes observed by the study were benchmarked according to the principles of good practice. "The top three highest scoring tax incentives are, in descending order, the United Kingdom's Seed Enterprise Investment Scheme (SEIS), the United Kingdom's Enterprise Investment Scheme (EIS), and France's "Madelin" tax reductions scheme."[17]

In summary, EIS and SEIS are extremely effective in helping high risk, early stage start-ups access the private investment they need to scale and grow. They are tremendously important parts of the investment ecosystem and many entrepreneurs genuinely don't think their companies would exist without SEIS and EIS. The Sunset Clause has started to have an impact on confidence and needs to be addressed as soon as possible. The schemes are predominantly used in London and the South East, however this provides a huge opportunity for EIS and SEIS to be used more widely across the whole of the UK to support entrepreneurs looking to secure investment in their companies. There are a number of opportunities for change that could enable EIS and SEIS to play a more effective role in addressing key government priorities including levelling up and net zero.

Opportunities for change, improving the effectiveness of the SEIS and EIS

As previously discussed, in 2020/21, 65-68% of investment through the SEIS and EIS was to companies registered in London and the South East. We believe that the following six changes would enable the EIS and SEIS to be used more effectively across the whole of the UK and would make a significant impact in addressing regional inequality and supporting the government's levelling-up agenda.

1) Abolish the Sunset Clause on the EIS

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[13] https://info.sapphirecapitalpartners.co.uk/blog/comparing-eis-eiis

[14] https://www.smartcompany.com.au/startupsmart/advice/business-planning/what-australian-can-learn-about-startup-taxation-from-the-uk/

[15] https://ec.europa.eu/taxation_customs/system/files/2017-06/final_report_2017_taxud_venture-capital_business-angels.pdf

[16] Ibid

[17] Ibid

As previously discussed, the EIS income tax relief has been considered to be a form of State aid, and has needed to be notified to the European Commission. When EU State aid approval was last obtained for the EIS in 2015, it was a requirement that a "sunset" clause be included in the EIS legislation. Section 157(1)(aa) Income Tax Act 2007 provides that income tax relief is available for subscriptions for shares under the EIS prior to 6th April 2025[18]. This is colloquially known as the "Sunset clause". However section 157(1A) goes on to say that "The Treasury may, by regulations, amend subsection (1)(aa) to substitute a different date for the date for the time being specified there"[19]. This gives the Government the power to extend the Sunset clause by secondary legislation beyond 5th April 2025.[20]

Entrepreneurs who are considering plans for funding in the medium term are beginning to be concerned as to whether they will be able to continue to receive funding beyond the expiry date of the EIS in 2025. Furthermore, investor publications are beginning to include Sunset Clause warnings alongside information relating to EIS. It is starting to impact confidence in EIS investing at a time when confidence in the market is crucial to our economic recovery.

We understand that the Sunset Clause was a necessary imposition by the European Commission when the EIS last received State aid approval, but we believe that this can now be removed following the UK no longer being part of the European Union. We strongly recommend that the Sunset Clause be extended, or preferably removed, so that the EIS is placed on a permanent footing so that it can continue to fuel entrepreneurs beyond 2025.

2) Increase the limit for SEIS from £150,000 to £250,000

SEIS is absolutely vital for early-stage companies and provides the oxygen of investment that enables companies to grow and scale. Recent statistics published by the government show that 2,065 companies raised a total of £175m in 2020/21[21]. The maximum amount of funding that start-up companies can receive using SEIS is £150,000, which has been the limit since its inception in 2012. Since then, there have been significant economic, social and technological changes that have changed the context in which these limits must be viewed. The government has recently considered a number of plans to increase other limits in line with inflation and this, coupled with the changing needs of start-ups, is a compelling justification to increase the SEIS limit. We recommend that this limit be increased to £250,000, as this is a better reflection of the funds that are needed to begin a business and also takes into account the effect of inflation since 2012.

Furthermore, the current limits incentivise some unintended bureaucratic consequences. As noted in the Government's Taskforce on Innovation, Growth and Regulatory Reform 2021 report,

> "On average the majority of start-up companies are seeking investment in excess of £150,000 in their first investment round. Under current regulation, investors need to seek the first £150,000 from SEIS and the remaining sum from EIS or elsewhere. The effect of this,

[18] https://www.legislation.gov.uk/ukpga/2007/3/section/157
[19] Ibid
[20] https://eisa.org.uk/wp-content/uploads/2022/04/EISA-Sunset-Clause-Briefing-April-2022.pdf
[21] https://www.gov.uk/government/statistics/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-may-2022/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-statistics-2022

to be compliant with the SEIS rules, is that the investment must be tranched over two days. This added complexity requires more detailed and correspondingly expensive investment agreements to be drawn up, as a result of which many investments have failed to materialise."[22]

These additional administrative burdens impose unnecessary time and financial costs on start ups that could be put to better use elsewhere. Allowing SEIS and EIS shares to be issued on the same day (they currently have to be issued on separate days) could also be considered as a way to reduce the administrative and financial cost to entrepreneurs.

3) Extension of the EIS and SEIS age limits

Both the EIS and SEIS impose age limits on the companies that are able to seek investment through the schemes. To use the SEIS, it must have been no more than 2 years since a company first carried out a qualifying trade, and this is appropriate for start-ups. Similarly, a company can receive investment under EIS as long as it is within 7 years of their first commercial sale (10 years for Knowledge Intensive Companies).

These age limits obviously restrict the companies that are able to use the schemes but the impact of this is most significant outside of London and the South East. In 2021, the Government's Taskforce on Innovation, Growth and Regulatory Reform found that these age limits on SEIS and EIS

> "are exaggerating regional disparities in access to capital for early stage and growth firms in the rest of the UK compared to London and the south east. This is because companies outside Greater London tend to take longer to grow to a size at which VC will invest. Data from the British Venture Capital Trust Association (BVCTA) shows that business in Greater London appear to:
> a. Receive subsequent investments sooner with the average age of business being 6.01 years vs. 9.01 years for Rest of UK;
> b. Receive more funding rounds: 2.0 vs. 1.8 rounds for Rest of UK;
> c. Receive larger total amounts of investment £3.70m vs. £2.85m for Rest of UK.
>
> Data since 2015 shows this gap is widening, with Greater London increasing its share of total investment from 50.7% at initial Investment to 54.5% including follow-ons. In 2019 the Department for Business, Energy and Industrial Strategy identified a range of factors contributing to this trend, including:
> a. Supply side factors (e.g. London having more VC funds, international investors and angels investors) and importantly;
> b. Demand side factors (e.g. lower proportion of family company ownership in London, greater experience of taking investment, available talent pools etc).
>
> It is therefore crucial that we look to adjust SEIS and EIS to allow a more equal distribution of investment to all regions in the UK if these schemes are to continue to deliver much needed investment for growth companies across the UK.

[22] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994125/FINAL_TIGRR_REPORT__1_.pdf

> Currently, 80% of all investment made was into businesses where the age of a business was less than 7 years old (or less than 10 years old for Knowledge Intensive Companies), so under the current legislation 20% of businesses need to rely on an additional eligibility to access VCT funding.
>
> It's also worth noting that there is a wide disparity between regions with some regions of the UK; such as east of England, south west and Scotland where just 27% to 58% of businesses that received investment qualified under the age limits."[23]

Certain industries such as manufacturing are more predominant in the regions away from London, and the nature of these businesses mean they are often older. Whilst they are a critical part of the UK economy, such businesses often cannot access funding under the EIS due to the existence of the age limit. Evidence from the BVCA and others indicates that companies outside the South East take longer to develop and seek equity finance for significant growth.

Extending the age limits on companies using the EIS and SEIS could have a significant impact in enabling more companies outside of London and the South East to secure vital investment through the schemes. This, in turn, would facilitate more job creation, investment and economic growth and could play a vital role in addressing regional imbalances and contributing the government's levelling up agenda.

4) Relaxation of the Financial Health Requirements

HMRC's guidance on the Financial Health requirement states that a company will be regarded as being "in difficulty" when it meets the criteria for insolvency under the Insolvency Act[24]. We agree that this is a sensible requirement, however, in addition to this:

> "where more than seven years have passed since a company's first commercial sale, it will also be regarded as being in difficulty if more than half of its subscribed share capital has disappeared as a result of accumulated losses."[25]

Whilst it is not consistently applied, it can inappropriately categorise growing companies as 'in distress' when they are on a growth trajectory and have committed financial backing from their investors. This additional clause can, therefore, be extremely problematic for the following reasons:

- This guidance, if applied, is likely to cause an issue for many EIS supported companies. By their nature, these companies are investing in their future and are likely to be loss-making in their early years. Indeed, this is usually a requirement to meet the "growth and development" test and the requirement to use EIS funds within 2 years of investment.
- We understand that the intent behind this guidance is to prevent government support for 'good money after bad', however, the historical losses as a proportion of invested capital is not a good test of the commercial prospects of a company going forward.
- If this guidance is to stand, it is unclear why the period of seven years from the first commercial sale would apply to KICs (rather than the 10 year period from £200k of

[23]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/994125/FINAL_TIGRR_REPORT__1_.pdf
[24] https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm13040
[25] https://www.gov.uk/hmrc-internal-manuals/venture-capital-schemes-manual/vcm13040

commercial sales which is the KIC initial investing period).

We therefore recommend a relaxation of the financial health requirement, which was brought in to meet EU State aid obligations. The SEIS, EIS and VCTs are designed to encourage investment in companies which are typically cash negative. This is because they are growing their businesses - they may be creating intellectual property or designing products – and, for a while, costs are greater than revenues. Often these companies have negative reserves, due to the early stage costs incurred. Whilst we agree that the funding should not be given to companies which are insolvent, there should be no prohibition on investing in companies with negative reserves so long as the companies are a going concern. We believe that, in line with earlier EU Guidelines, the definition of "a firm in difficulty" or an "ailing or insolvent enterprise" should be one where it cannot recover through its own resources or with the funds it obtains from its owners/shareholders or from market sources, and that negative reserves should not, of themselves, prevent EIS investment.

5) The EIS and SEIS Infrastructure, Education and Local Champions

When and where entrepreneurs are aware of the SEIS and EIS, they are used extremely effectively to secure investment into early stage, high risk, start-ups. Many founders learn about EIS and SEIS from other founders, accountants who are familiar with them and angel investors. A 2019 BEIS report found that it was "clear that in regions where there is already a pool of individuals/directors that have experience and knowledge of equity finance, more funding is attracted to the region."[26] The entrepreneur networks and supporting infrastructure therefore play a fundamental role in communicating the opportunities that the EIS and SEIS can offer founders looking for investment to grow their businesses.

The South East has the highest concentration of EIS and SEIS service providers and it is therefore unsurprising that that is where the majority of EIS and SEIS investment is currently focused. There are also several hubs elsewhere in the UK where there is a very effective and growing EIS community and supporting infrastructure. The most notable examples include Manchester, Edinburgh, Belfast and, more recently, Bristol, but there are also smaller hubs emerging across the home nations.

EISA has seen numerous examples of entrepreneurs with companies clearly ripe for SEIS and EIS investment who have never heard of the schemes and haven't used them. There are also instances where founders, unaware of the SEIS and EIS, have initially sought debt when equity finance (and the additional mentorship and networking benefits that often come with it) may have been more appropriate for their start-up. EISA is concerned that there are entrepreneurs in the UK (most likely outside of the South East, in areas where the EIS infrastructure does not exist to such a great extent), starting businesses with significant potential who have not found the investment they desperately need because they haven't heard of the EIS and SEIS. This is something we are working hard to address but it is clear that much more could be done to raise awareness of the EIS and SEIS across the whole of the UK.

Education has an extremely important role in to play and it is crucial that we increase the awareness of the EIS and SEIS and the transformative impact that they can have on UK start-ups. This applies across the board to founders, financial advisors, accountants, lawyers and even the general public.

[26] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/821902/sme-equity-finance-regions-research-2019-012.pdf

Many of the 52,000 companies that exist, in part thanks to these fantastic schemes, are having a huge impact on our day to day lives. Yet very few people in the wider population have heard of the schemes and even fewer are aware of the full extent of the role the EIS has played in their success. Even within Parliament, the SEIS and EIS are relatively little known, and a 2017 study found that only 57% of MPs had heard of the EIS, whilst only 39% had heard of the SEIS[27].

As previously shown, the EIS and SEIS are tremendous channels for investment, bringing with them job creation, innovation and economic growth. These schemes and the start ups that use them can have a huge impact on the surrounding geographical area and this is particularly important when we consider the current economic challenges facing families across the UK. As well as education around the schemes, local champions could have a huge impact on the number of businesses using the EIS and SEIS to secure investment outside of the South East.

EISA believes that MPs could play a crucial role in championing the EIS and SEIS within their constituencies, increasing awareness of the schemes, supporting local entrepreneurs, and powering a vibrant start-up culture. The job creation, investment, innovation, and economic growth that this could fuel could have a tremendous impact, particularly in constituencies where the government has identified a need to address regional imbalances. We therefore recommend that MPs be empowered to champion these schemes within their constituencies and be provided with the relevant resources required to do so. This recommendation could be achieved at very low cost to the taxpayer and could dramatically shift the geographical distribution of the schemes within the UK, playing a key role in addressing regional imbalances across the UK.

6) Knowledge Intensive Companies and Supporting Net-Zero

To qualify as an EIS Knowledge Intensive Company (KIC), a company must have less than 500 full-time equivalent employees[28] and either:

- be carrying out work to create intellectual property and expect the majority of your business to come from this within 10 years
- have 20% of employees carrying out research for at least 3 years from the date of investment - these employees must be in a role that requires a relevant Master's or higher degree

Companies that qualify as knowledge intensive can make use of increased annual and lifetime funding limits, £10 million and £20 million respectively (compared to £5 million and £12 million for non KICs), and these KICs can receive their first EIS or other risk finance investment up to 10 years from first commercial sale, as opposed to the normal limit of 7 years[29].

There are an increasing number of green tech and clean tech companies using the EIS but many of them do not qualify as knowledge intensive. Investors often gravitate to sectors that promise

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27 https://static1.squarespace.com/static/58ed40453a04116f46e8d99b/t/5a490347652deacfabd709d9/1514734422330/SNAPSHOT_2017.pdf

28 https://www.gov.uk/guidance/use-the-enterprise-investment-scheme-eis-to-raise-money-for-research-development-or-innovation

29 https://www.gov.uk/government/statistics/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-may-2022/enterprise-investment-scheme-seed-enterprise-investment-scheme-and-social-investment-tax-relief-statistics-2022

financially driven returns. Net-zero initiatives have a greater purpose and are often more risky and are likely to take longer to develop. The SEIS and EIS are essential for supporting this sector but these companies would often benefit from longer age limits and larger investment limits due to the nature of the work. To help support the net-zero agenda, we recommend that the higher limits which apply to "knowledge intensive" companies should also apply to all clean tech and green tech companies. We believe this could help accelerate investment in these necessary areas.

The effectiveness of government policy around venture capital in meeting wider government objectives

Levelling-up and tackling regional inequality within the Union

We believe the EIS can support greater levels of regional investment across the whole of the United Kingdom as part of the levelling up agenda, encouraging investment outside of London and the South East.

In late 2020, the EISA commissioned a report[30] which analysed regional investment activity data with a specific focus on age of business and the impact of the current legislation. The report analysed the regional distribution of equity investments and also the regional 'equity gap' broken down by company stage. The results of the report, undertaken by Professor Nick Wilson of Leeds University, confirm and extend findings reported in the 2019 BEIS report, 'Equity Finance and the UK Regions'[31]. These are:

- trends of increasing concentration in the three regions with the greatest investment activity (London, The East of England and the South East). During the analysed period 49% of all equity deals and 59% of all invested funds were invested into companies located in the London region.
- The concentration of activity in London increases over time with an average annual growth rate of 24% in equity finance deals and 40% in investment volume. By far the highest average equity deals are in the London region (£2,025,377) and in the East of England (£1,969,604). The patterns for EIS eligible companies are very similar. If the trends continue, the concentration in the London region and the South East is going to increase further.
- Comparing the regional shares of equity funding with the demography of high-growth firms (HGF) using the methodology of location quotients does not explain the high concentration in the London region i.e. London gets a greater share than can be rationalised by the number of HGFs in the region. Employing the results of the BEIS report[32] we present regional estimates of the equity gap. Analysis that breaks down the total equity gap by investment stage in 2019 suggests £768million is required at seed stage; £1.45billion at venture stage and £4.45billion for growth finance. The northern regions, East Midlands, Yorkshire and Humberside, West Midlands, and the North West, have the largest shortfalls, i.e. biggest equity gaps.

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[30] https://eisa.org.uk/wp-content/uploads/2020/11/Equity_Finance_and_the_Pandemic.pdf
[31] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/821902/sme-equity-finance-regions-research-2019-012.pdf
[32] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/821902/sme-equity-finance-regions-research-2019-012.pdf

Venture Capital is a positive force supporting the Union and venture capital investment is a national activity. Whilst many new companies may start and secure EIS investment in London, experience shows a number moving out to less costly locations and to parts of Britain where the much-needed labour is available.

Scotland is an example of an area outside of the South East with a thriving EIS and SEIS industry. It is worth noting that the BEIS report found that "Scotland and Wales seem to receive a higher number of equity deals but it is not the case for invested amounts."[33] The report also found that "Scotland and the East of England receive more equity deals than would be predicted by the corporate sector demography in these regions over the whole period from 2011 to 2016."[34] Furthermore, "a company in Scotland has 24% higher odds of being funded than a similar company located in London."[35]

According to HMRC, £251million was invested into businesses located in Scotland through EIS and SEIS between 2018 and 2021.[36] The corresponding figure for Wales was £124million and for Northern Ireland it was £42million.[37] Investments in start ups using EIS and SEIS are made throughout the United Kingdom, irrespective of where the investor is based and this is hugely advantageous in terms of widening networks and knowledge. This is also important for cementing business ties and business relationships across, and throughout, the United Kingdom.

It is crucial for the Government's 'levelling up' agenda that companies outside of London are more able to access the benefits of EIS and the venture capital tax reliefs. The 2015 changes to the venture capital tax reliefs brought in to meet EU State aid restrictions have inadvertently concentrated investment into London and the South East, compared with a more even split of investments around the UK before there was an age requirement. This is reflected in the report from the Number 10 Taskforce on Innovation, Growth and Regulatory Reform[38] which published a series of recommendations calling for the EIS and SEIS to be expanded in order to unlock investment outside of London and the South East as part of the levelling-up agenda. There are some notable examples of successful EIS hubs across the UK and, in particular, the EIS and SEIS play an important role in encouraging investment throughout the Union. There are some clear factors limiting further expansion of these hubs and EISA believes that raising, removing or refining the permitted maximum age limits would have the greatest effect on companies in the regions outside London.

The UK as a science and technology superpower

The government has made a clear commitment to strengthening the UK's position as a global science and technology superpower and this can only be achieved with significant investment from the private sector. In 2020/21, £963 million of private money was invested in the science and technology sectors[39] through the SEIS and EIS[40]. The EIS is hugely important in this area, particularly in life sciences.

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[33] Ibid
[34] Ibid
[35] Ibid
[36] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1072635/eis_seis_sitr_tables_2022.ods
[37] Ibid
[38] FINAL_TIGRR_REPORT__1_.pdf (publishing.service.gov.uk)
[39] Standard Industrial Classification 2007 J. Information and Communication and M. Professional, Scientific and

The UK leads in Europe in terms of the strength of its emerging technology and biotech industries. Tech entrepreneurs are drawn to the UK as a supportive environment for develop their businesses. UK universities are incredible generators of raw scientific IP. The EIS plays a significant role in the development of these businesses. Outside of 'family and friends' funding, there is little capital available at the start-up and early stages of a business. The size of investment required at this level is uneconomic for institutional investors and the high-risk nature of businesses at this stage is unattractive. If EIS were removed as a source of funding, it would risk the UK's tech and scientific leadership by undermining those industries at their most vulnerable level.

In order to help achieve the Government's 'scale up' agenda, and to reflect the effect of inflation since the limits were introduced, certain restrictions on the amount of investment should be revisited. In particular, the lifetime limit of £20 million of EIS investment for KICs is not sufficient to support businesses in life sciences.

Net Zero

As mentioned previously, many investors gravitate to sectors that promise financially driven returns. Net-zero initiatives have a greater purpose and are often more risky and are likely to take longer to develop. The SEIS and EIS are essential for supporting this sector. To help support the net-zero agenda, we recommend that the higher limits which apply to "knowledge intensive" companies should also apply to all clean tech and green tech companies. We believe this could help accelerate investment in these necessary areas.

CONCLUSION

- The EIS and SEIS are absolutely crucial to the UK's thriving start up scene. They have facilitated nearly £27billion of investment into 52,000 British start ups since their inception. The companies using EIS and SEIS span many different sectors, and the investments made through the schemes are crucial to job creation, innovation, and economic growth. Many founders genuinely do not think their companies would exist today without the schemes.
- Whilst the EIS and SEIS are highly effective at facilitating the flow of private capital into early stage, high risk start ups, there are a number of opportunities for amendments that would enable the schemes to more effectively support key government priorities including levelling up and addressing regional inequalities, net zero, and the UK's position as a science and technology superpower. With that in mind, EISA has made the following 6 recommendations:
    1) **Abolish the Sunset Clause on the EIS**
    We strongly recommend that the Sunset Clause be extended, or preferably removed, so that the EIS is placed on a permanent footing so that it can continue to fuel entrepreneurs beyond 2025.

Technical
[40]https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1072635/eis_seis_sitr_tables_2022.ods

2) **Increase the limit for SEIS from £150,000 to £250,000**
   We recommend that the SEIS limit be increased to £250,000, as this is a better reflection of the funds that are needed to begin a business and also takes into account the effect of inflation since 2012.
3) **Extension of the EIS and SEIS age limits**
   Both EIS and SEIS impose age limits on the companies that are able to seek investment through the schemes. Extending the age limits on companies using EIS and SEIS could have a significant impact in enabling more companies outside of London and the South East to secure vital investment through the schemes. This, in turn, would facilitate more job creation, investment and economic growth and could play a vital role in addressing regional imbalances and contributing the government's levelling up agenda.
4) **Relaxation of the Financial Health Requirements**
   We recommend a relaxation of the financial health requirement, which was brought in to meet EU State aid obligations.
5) **The EIS and SEIS Infrastructure, Education and Local Champions**
   We recommend that there is a greater focus on education and raising awareness of SEIS and EIS across the whole of the UK. We also recommend that MPs be empowered to become local champions for the SEIS and EIS within their constituencies.
6) **Knowledge Intensive Companies and Supporting Net-Zero**
   To help support the net-zero agenda, we recommend that the higher limits which apply to "knowledge intensive" companies should also apply to all clean tech and green tech companies.

- The most crucial of our recommendations is the abolition of the Sunset Clause, as the termination of EIS would be one of the most colossal threats to the UK start up scene and the wider economy.

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