BIA submission to the Treasury Select Committee inquiry on venture capital

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UK BioIndustry Association

Summary

The UK biotech and life sciences sector has seen significant increases in the availability of venture capital (VC) in recent years. However, much of this investment is coming from the United States, which means economic returns and activity (including jobs and IP commercialisation) risk being lost overseas. This could hinder the long-term sustainability of VC-backed industries in the UK, most acutely biotech and life sciences. It is crucial that government policy is focused on increasing the number and scale of UK-based VC funds, which can be best achieved by encouraging UK financial institutions to allocate to the VC asset class, whilst continuing to support and attract foreign investors to the UK. The BIA proposes the UK creates a British version of the French Tibi Scheme, which brought together institutional investors with VC funds to facilitate greater investment into innovative businesses. Such a scheme will need to be championed at the highest levels of Government and we also recommend the creation of a Life Sciences Investment Envoy, with expertise in the life sciences and financial sectors, to drive the agenda forward.

The state of venture capital investment in the UK biotech and life sciences sector

The BIA publishes annual and quarterly figures for investment in the UK biotech and life sciences sector[1]. A record £2.5bn VC was invested into private UK biotechs in 2021, comprising 55% of total equity investment in the sector that year (the rest was sourced from public capital markets). The £2.5bn represented a 79% increase on the total raised in 2020, and the average round size also increased from £8.8m to £22m. In our latest figures, for Q1 2022, £453m was raised in VC, which itself is the best first quarter we have recorded. Overall, this signals a very healthy environment for VC-backed biotech and life science companies in the UK.

However, there are two important caveats to this positive picture. The first is that the public markets on both sides of the Atlantic been suppressed since Autumn 2021, with company stock prices significantly down and companies unable to raise fresh capital. This demonstrates the fragility of capital markets supporting the life sciences sector and could impact VC investment in the coming months and years, as venture capitalists (VCs) will be more reluctant to invest in private companies without a route to launch on the public markets (an Initial Public Offering), which is where they recoup their investment. It may also impact VC funds' ability to attract investors, meaning there will be smaller and/or fewer VC funds in the years ahead.

The second caveat, which is chronic and structural to the UK, is that much of this investment is coming from overseas sources, predominantly the United States. This is especially true for the larger later-stage investments required to scale-up companies; of the 140 investors named in the 40 life sciences VC deals valued at £20m or more in 2021, 54% were US, and 27% were in the UK[2]. Although these foreign investors and their capital is very welcome and we must ensure foreign capital continues to flow into the sector, it poses two challenges for the UK ecosystem:

1. Companies and their staff will be more likely to move to the US to be closer to their source of capital; of the 40 companies that raised over £20m+, 24% had a Chief Executive Officer or Chief Financial Officer in

[1] https://www.bioindustry.org/policy/finance-tax-and-investment.html
[2] BIA analysis of Pitchbook

the US, and 12% had both their CEO and CFO in the US (so over a third have a CEO/CFO presence in the US)

2. The dominance of overseas capital means a positive feedback loop is less likely to form, in which UK investors see financial returns and reinvest in the sector. Wealth-creation will occur overseas and the long-term sustainability of the UK ecosystem will be undermined.

For these reasons, it is crucial that government policy is focused on increasing the number and scale of UK-based VC funds, including encouraging UK financial institutions to allocate to the VC asset class, whilst continuing to support and attract foreign investors to the UK.

This policy focus must be complemented by continuing broader policies that provide direct support to VC-backed companies, which in turn helps incentivise VC investment. These policies include: R&D tax credits and R&D grants, which help de-risk and leverage private investment; increasing the supply of innovation and entrepreneurial talent through our education and immigration systems; and maintenance of an internationally-competitive tax and regulatory environment.

Tax incentives for venture capital

The tax-advantaged Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCTs) have underpinned the increase in investment across a range of sectors in the past decade. Changes in 2015 to introduce the Knowledge Intensive Company (KIC) definition appropriately targeted these incentives to sectors like the life sciences that face higher barriers to attracting investment.

Due to the £20m cap (for KICs) on the company lifetime fundraising amount that is eligible for tax relief, these schemes support the earlier stages of VC financing in the life sciences sector. The long and expensive R&D and regulatory process for medicines means the life sciences sector uniquely requires much greater sums of capital before reaching market and generating revenues than other sectors. As such, the £20m limit places a limit on the usefulness of EIS and VCT for life sciences compared to other less capital-intensive sectors. Increasing it, to perhaps £50m, would help drive more capital into the sector.

There is currently a “sunset clause” in place in relation to EIS and VCT, which means that without Government approval, this relief will cease to exist from 6 April 2025. These schemes must be continued past this point and the Government should also take this opportunity to review whether they are appropriately targeted to sectors that face the greatest market failures for availability of capital and whether sector-specific limits should be increased.

Key bodies in the UK venture capital ecosystem

The British Business Bank and its subsidiary British Patient Capital (BPC) are crucial pillars in the Government’s policy support for the UK’s VC ecosystem. BPC provides capital to VC funds that invest in life sciences businesses and, through the £375m Future Fund: Breakthrough programme, BPC is now investing directly in deep tech and life sciences businesses. The BPS’s £200m Life Sciences Investment Programme, which is targeted to VC funds that invest in later-stage financing rounds (scale-up phase), appropriately reflects the scarcity of UK-based investors participating in these scale-up rounds, as described earlier in this submission.

Through these activities, BPC leverages additional private VC activity and also provides a source of capital uncorrelated with market conditions, which can be particularly valuable for innovative businesses when capital market conditions worsen (as we are currently observing). Our members have reported a positive experience with Future Fund: Breakthrough to date. It is vital that the current and future governments maintain long-term support for BPC. Investing in life sciences requires specific expertise; BPC must be appropriately resourced to be

able to operate with the knowledge and speed of private investors if it is to be an effective and complementary player in the UK VC ecosystem.

Opening new pools of capital

As already noted, it is crucial to the long-term growth and sustainability of the UK biotech and life sciences sector, as well as other innovative sectors reliant on VC, to increase the number and scale of UK-based VC investors. To do this, new pools of institutional capital must be unlocked to invest in new UK VC funds. Unfortunately, UK institutional investors, including but not limited to pension funds, in general are not attracted to riskier, high-growth industries. This is despite the returns it can deliver: a study by the British Business Bank found that a 5% allocation to VC could increase a 22-year old's retirement savings by 7-12%.[3]

Pension savers should have the opportunity to gain exposure to sectors that produce health and social benefits *and* deliver real asset value growth for their savings to provide a comfortable income in retirement. There is an added injustice here, as taxpayers are funding a welcome and unprecedented increase in government R&D spending, to create a science superpower, but those same taxpayers are not being given the opportunity to benefit from the financial upside of this science through their State-mandated defined contribution (DC) pension. As a result, much of the wealth created is being accumulated by overseas investors and the lack of a positive financial feedback loop will hamper UK start-ups' and scale-ups' contribution to the UK achieving science superpower status.

Australian and Canadian pension funds have structured themselves to be able to invest knowledgably and successfully in innovative life science opportunities in the UK and Europe in the last decade. They have successfully learnt how to invest in innovation and scaled to employ in-house experts to understand emerging areas of science and technology. It is the outdated UK pensions industry that is holding back the allocation from Britain's investors and savers into British growth companies to support the science superpower ambition and drive economic growth. Since the UK state now by law mandates citizens to invest in the UK pension industry for their retirement, the UK state has a duty to ensure that that industry is open and innovating to deliver the financial return citizens need, rather than passively taking a rental percentage from its State-guaranteed income. Teachers in Ontario and Brisbane invest in UK biotech stock as part of their diverse and growing pension portfolio, teachers in Ormskirk and Birmingham should be able to benefit from the same opportunity.

Multiple reports have pointed to regulatory barriers that prevent pension funds - especially DC schemes, which are fast becoming the main way most workers save for retirement – from investing into illiquid assets like VC[4]. The Financial Conduct Authority (FCA) and other regulators are making welcome progress changing regulation or providing clarity where misunderstanding of regulation was found to be a barrier. The Department for Work and Pensions (DWP) has also committed to amending the charge cap for DC pensions, which may be preventing allocations to VC funds, but progress is unacceptably slow. The charge cap and other regulatory barriers have been held up by the pensions industry as the reason they don't invest, so the Government's elimination of them is helpful to move us forward. There is also a need for greater transparency in pension funds' allocations to different asset classes, so that consumer choice can drive change. We welcome the DWP's recent consultation on increasing disclosure and encourage a high level of granularity is required from pension funds[5].

[3] https://www.british-business-bank.co.uk/research/the-future-of-dc-pensions-enabling-access-to-venture-capital-and-growth-equity/
[4] See for example: https://www.bankofengland.co.uk/financial-stability/working-group-on-productive-finance
[5] https://www.bioindustry.org/resource-listing/bia-submission-to-the-dwp-consultation-on-facilitating-investment-in-illiquid-assets-pdf.html

A new UK scheme to increase institutional capital allocation into VC

Another barrier to unlocking institutional capital is that lack of interaction and understanding between large UK institutional investors and the UK's relatively under-developed VC industry. Even if regulatory barriers were removed to allow or even encourage UK pensions funds to invest in VC, they may choose to invest in the larger and more established US VC industry.

The BIA has studied the French Tibi Scheme and believe a similar approach could be taken in the UK to increase the interaction of institutional investors and VC funds, and channel any unlocked capital into the UK VC ecosystem.

The French government launched the Tibi Scheme in 2020 to address the lack of willingness amongst its own institutional investment community to invest in the French tech industry. The scheme, championed by President Macron, secured the commitment of institutional investors to invest €6bn into French tech companies by December 2022. It was delivered through strong political involvement and the appetite of French institutional investors to support the country's strategic interests. Crucially, government spending was not required.

Institutional investors agreed to allocate a small proportion of their funds to VC firms accredited through the scheme. The institutions were then brought together with accredited VC firms and allowed to make their own decisions on which VC fund to invest in. We believe that by creating this opportunity for conversation between the UK's institutional investors and VC funds, both can adapt their investment strategies to suit each others' requirements and overcome the non-regulatory barriers to enable greater investment in VC. Such a scheme will need to be championed at the highest levels of Government and we also recommend the creation of a Life Sciences Investment Envoy, with expertise in the life sciences and financial sectors, to drive the agenda forward.

To date, 56 accredited investment funds have raised €3.5bn directly from Tibi investors, and a further €15bn from non-Tibi participants, demonstrating its success in facilitating large capital raises at speed from institutional investors within and outside the scheme. A similar approach in the UK could unlock even more, given the growing assets under management of the DC pensions industry.

About the BIA

The BIA is the trade association for innovative life sciences in the UK. Our goal is to secure the UK's position as a global hub and as the best location for innovative research and commercialisation, enabling our world-leading research base to deliver healthcare solutions that can truly make a difference to people's lives.

Our members include: start-ups, biotechnology and innovative life science companies, large pharmaceutical companies, universities, research centres, tech transfer offices, incubators and accelerators, and a wide range of life science service providers: investors, lawyers, IP consultants, and IR agencies.

We promote an ecosystem that enables innovative life science companies to start and grow successfully and sustainably.

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