The Association of Investment Companies

Giving great companies a flying start

How VCTs power economic growth

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The Association of Investment Companies (AIC) represents closed-ended investment companies whose shares are traded on public stock markets.

The AIC's members include 44 venture capital trusts (VCTs), which manage 99% of the sector's £6.2 billion assets.

To discuss issues raised in this paper please contact:

Megan Charles
Policy and Technical Manager
megan.charles@theaic.co.uk

Janette Sawden
Tax and Legal Adviser
janette.sawden@theaic.co.uk

Celebrating 30 years of venture capital trusts

VCTs were first announced in the 1994 Budget statement by the then Chancellor Ken Clarke and were first launched in 1995. Since that time they have been going from strength to strength.

Contents

30 years and counting

The Labour government has committed to a growth agenda. Small and medium sized enterprises (SMEs) lie at the heart of the UK economy. Numbering in the millions, SMEs not only make up a substantial part of the UK economy but also are vital to its continued success.

However, for SMEs, securing finance is an ongoing challenge. Often overlooked by traditional sources, venture capital trusts (VCTs) have become a lifeline for the continued success of their often fledgling and/or growing businesses.

Launched in 1995, VCTs were a bold initiative to encourage investment by retail investors in small businesses while delivering much needed growth capital to SMEs. Recognising the significant risk associated with early-stage investment, the government provided tax incentives to investors prepared to risk their savings in often high-risk ventures. The funds offer 30% upfront tax relief on purchases of new shares – so a £10,000 investment reduces the investor's tax bill by £3,000 – as well as providing tax-free income and capital growth. There had been concern that these tax incentives would cease. However, I am pleased that the government has extended the VCT scheme beyond 2025 to 2035, allowing these reliefs to continue. A result that is sure to add to the celebration of the 30th anniversary of the launch of the first VCTs in 1995.

Since their launch, VCTs have supported thousands of companies operating in markets including healthcare, social care, retail, manufacturing and information technology. The sector's record is even more striking given the disruption caused by the Covid-19 pandemic.

HM Revenue and Customs (HMRC) figures showed that VCT investors were not deterred by Covid, with 2021-22 proving to be a record breaking year for venture capital trusts.[1]

The support offered by VCTs is not only financial. Early-stage businesses are, by definition, more likely to flounder or even to fail not only through reduced funding but uncertainty about navigating the world of business. Mitigation is provided by the considerable investment experience and expertise poured into SMEs by VCT managers, offering a unique resource to help support future economic growth. That makes VCTs a vital component of the government's growth agenda, deserving of the government's continued support.

As always, I am grateful to the VCT fund management teams for providing data and case studies to make this report possible. Its findings make a compelling case for the benefits offered by VCTs as they continue to help SMEs create jobs, innovate, inspire and above all, grow.

Richard Stone
Chief Executive
richard.stone@theaic.co.uk

VCTs help SMEs innovate and grow.

GoodLifeSorted

Good Life Sorted (GLS) is helping elderly and vulnerable people to live independently in their own homes. Its purpose-built platform offers an online helper marketplace that introduces elderly people and their families to fully-vetted, hand-picked local 'Helpers' who provide a range of home help services for a fee. Since its launch in 2019, GLS has delivered over 200,000 hours of help across the south of England. Its services provide a cost-effective alternative to traditional home care agencies, helping to alleviate loneliness by providing companionship, improving wellbeing, and increasing social interactions for individuals that need it most. GLS received funding from Blackfinch Ventures.

A British success story

VCTs are a British success story – and a vital part of the UK's venture capital ecosystem.

VCTs are publicly traded investment companies, each of which invests in a diversified portfolio of early-stage businesses. These ambitious, entrepreneurial businesses often struggle to raise capital from traditional sources, such as banks and mainstream investment funds. They are too small to gain investment from private equity houses.

VCTs have played a significant role in democratising investment in new businesses by providing a vehicle through which individual investors can access this high-growth, high-risk sector.

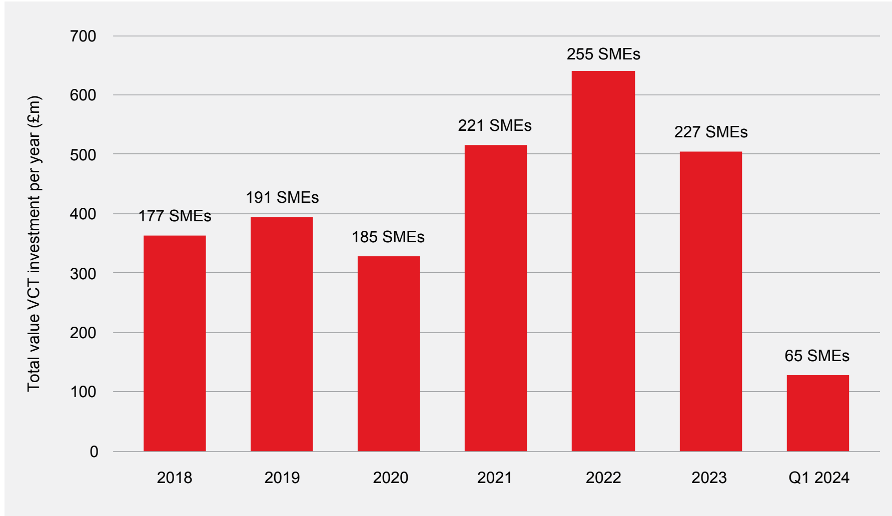
Investment in these companies is risky; many will fail. However, VCTs manage this risk by diversifying their investments. The profits from a few very successful companies can outweigh the losses from others that do not succeed.

Successive Labour and Conservative governments have provided support in the form of tax incentives to UK taxpayers to invest in VCTs. This compensates investors for the risk they are taking in providing long-term financing to the underlying businesses.

Over the years these tax incentives have become more targeted to ensure that VCTs direct their funding to the most promising but risky companies with growth potential. This report focuses on investments made since 2018, following changes introduced by the 2017 Patient Capital Review.[2] Figure 1 shows the number and value of VCT investments made per year from 2018. The higher investment figures for 2022 reflect the record VCT fundraising achieved by VCTs in 2021.

VCTs have played a significant role in democratising investment in early-stage businesses.

Figure 1: Value of VCT investment (and number of SMEs receiving funds by year)



Incentivising investment

So that VCTs can play this role in the venture capital ecosystem, retail investors investing in VCTs receive tax incentives to encourage them to allocate their savings to the sector. These incentives include income tax relief of 30% on investments up to £200,000 per tax year, tax-free dividends, and capital gains tax exemption on disposal of VCT shares. Investors must hold their VCT shares for at least five years to benefit from tax relief (if shares are sold before then, any income tax relief that has been claimed must be repaid).

This government support helps offset the higher costs, and additional risk, of investing in early-stage businesses and addresses a significant market failure. VCTs mobilise this capital to support entrepreneurs who want to grow their businesses, in turn developing new products and services and creating jobs. This support to these businesses would not be available without the tax incentives to retail investors.

VCTs are not just for the very wealthy. HMRC's statistics[3] show that most investors tend to invest under £50,000 into VCT funds. The average amount invested by an individual in 2022 to 2023 was around £37,000.

Navigating the valley of death

Since 2018, VCTs have invested £2.9 billion into 783 different small businesses.[4] This represents significant support for companies facing a finance gap.

This finance gap, sometimes known as the 'valley of death', refers to the difficulty businesses face in securing financing during their early stages of development. This gap arises for several reasons:

- **High risk:** Startups are inherently risky investments. Many new businesses fail within their first few years, making them less attractive to traditional lenders and investors who seek lower-risk opportunities.
- **Lack of collateral:** Traditional banks often require collateral to secure loans. Startups, especially those in technology or service sectors, may not have significant assets to offer as collateral, making it hard to obtain bank loans.
- **Limited track record:** Early-stage companies typically have limited or no operational history. Without a proven track record of revenue and profitability, it is challenging to convince investors or lenders of their potential for success.
- **Inadequate cash flow:** Startups often do not have steady cash flow, which is crucial for meeting regular loan repayments. This uncertainty makes traditional lenders wary of extending credit.
- **High initial costs:** The initial costs for developing products, building a customer base, and scaling operations can be substantial. Startups may require more capital than friends, family, or personal savings can provide.
- **Private equity constraints:** Although private equity houses are interested in high-growth startups, they often focus on companies that have already demonstrated some market traction or have a viable product, leaving very early-stage companies underserved. The capital requirements of new companies are small in comparison with other private equity type investments. This makes it proportionally more expensive to invest in early-stage companies as the pre-investment due diligence requirements are still complex, requiring specialist expertise, time and resources.

VCTs can save small businesses from the difficulty of securing finance.

This funding gap can impede the growth and development of startups, preventing innovative ideas from reaching their full potential.

"...one of the key market frictions was the 'valley of death' for early-stage innovative companies, who were yet to generate revenue and struggled to bridge the gap between informal/angel finance and formal VC funding. Research from the Department for Business, Innovation & Skills noted that this gap was generally found to exist for funding amounts between £250,000 and £2 million. The issue was compounded by the fixed cost of due diligence leading fund managers to focus on fewer, larger investments in more established businesses." British Business Bank: Small Business Finance Markets 2023/24.[5]

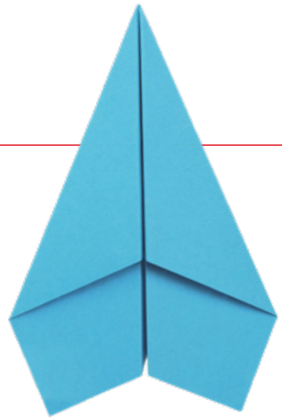
VCT support can be counted on even during difficult times. The pandemic was hugely disruptive for business, including to entrepreneurial plans. Capital raising was especially impacted. VCTs, however, rose to the challenge and continued to make investment during this difficult period.

REVOLUTIONARY CONCEPTS

Revolutionary Concepts Ltd (RCL) is an engineering company. In 2023, Oxford Technology invested £100,000 in RCL. The purpose of the investment was to enable the founder to design and build a prototype of an improved, smaller, more efficient, air-source heat pump, about the size of a washing machine. The aim was to design a prototype that would fit inside a house to replace current air-source heat pumps which are typically too large to be fitted indoors. The idea is that the heat pump will eventually be a replacement for a gas boiler as these become outlawed.

velocity composites plc

Based in Burnley, Velocity Composites manufactures advanced carbon fibre and ancillary material kits for the aerospace industry. The company is responding to the drive towards more sustainable air travel through the greater use of carbon fibre in aerospace manufacture. It uses its knowledge, business processes and proprietary software to reduce the waste that results from making aircraft parts. This helps to reduce manufacturing costs. This is helping the aerospace industry achieve its sustainability targets. The company received funding from Amati Global Investors.



The funding ladder

VCTs are a vital rung on the funding ladder. They are one of a number of sources of capital that provide funding at various stages for businesses:

- **Early-stage investors, often family, friends, and business angels**
- **Seed Enterprise Investment Scheme (SEIS)**
- **Enterprise Investment Scheme (EIS)**
- **VCT**

Together, they provide a step up to investment by larger private equity investors, trade buyers or a stock market flotation. They offer essential financial and commercial support for the small business community and contribute to the overall vibrancy of the UK's venture capital market. VCTs often serve as cornerstone investors, providing a foundation of support that can attract additional investment and resources. As cornerstone investors, VCTs typically commit substantial capital early in the funding rounds of a startup, signalling confidence in the business's potential and encouraging other investors to follow suit. This initial investment can be critical for startups, offering them the financial stability needed to develop their products, expand their operations, and enter new markets.

Growing businesses fuel economic growth and job creation. Supporting these companies is fundamental to the success and growth of the UK economy.

Enabling growth and creating jobs

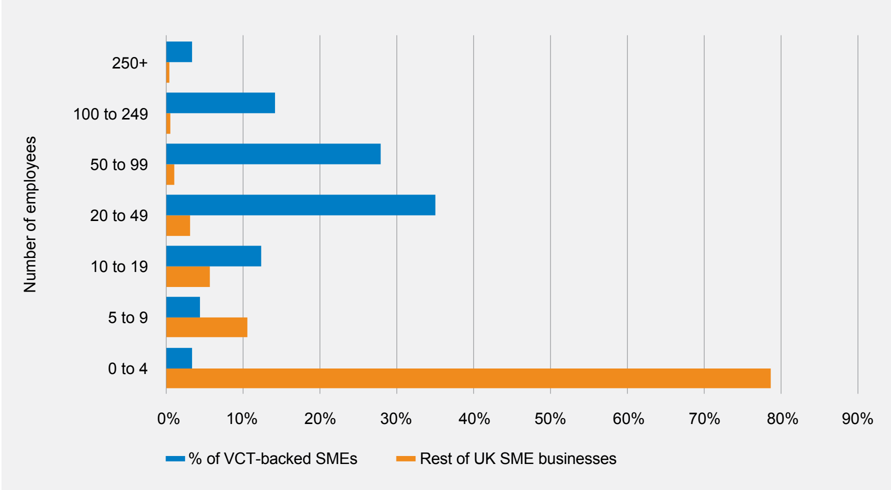
The fundamental aim of VCTs is achieving growth. By supporting SMEs, VCT investment sustains business growth and enables job creation which, in turn, leads to wider economic growth. VCTs make a valuable contribution by supporting employment and investment across the whole of the UK even in areas that historically have suffered from economic downturns.

Figure 2 shows the employee numbers of VCT-backed SMEs compared with the average UK SME business. 73% of SMEs researched as part of this report reported an increase in headcount following VCT investment.[6]

SMEs invested in by VCTs since 2018 employ 44,244 staff. The average number of staff per SME is 68.

35% of VCT-backed businesses employ between 20 and 49 employees, compared with 3% in the rest of the economy. 45% of VCT-backed businesses employ over 50 members of staff, compared to 2% of businesses in the wider UK economy.[7]

Figure 2: VCT-backed SMEs employ more people than the average UK SME[7]



Source: Office for National Statistics, 2023

Laverock Therapeutics (Laverock), founded in July 2021, is a biotechnology company developing a new generation of advanced therapies via its 'programmable' gene silencing platform. It harnesses the cell's natural gene regulatory mechanisms to control gene silencing in a way that ensures genes have a transformative therapeutic effect. Laverock is working on programmes to develop new treatments for cancer and degenerative diseases. With support from Calculus Capital and Maven Capital Partners, it has expanded its lab facilities, increased its headcount by 60%, and continues to develop safer, more effective, and accessible cell and gene therapies.

VCTs making an impact

High inflation has led to increased interest rates which have made it more expensive for companies to borrow money from traditional lending sources, even if they are able to do so. This is likely to have made the funding gap even more pronounced in recent times for SMEs.

VCTs make a real difference by providing money that would otherwise not be available to fledgling businesses. Different businesses have differing capital and funding requirements. Many companies often only need a small amount. However, the investment amounts SMEs seek tend to be beyond the reach of their own resources but equally can be too small for some conventional private equity investors, who often prefer larger deals.

An investment from a VCT can help a business on their road to growth.

The average amount invested since 2018 was £1.7 million.

47% of the investments made by VCTs since 2018 were for amounts under £1 million.

Figure 3 shows the average deal size of VCT investment by year. It excludes investments by VCTs over £5 million in knowledge intensive companies, or KICs, which are subjects to higher investment limits. This shows that VCTs cater for growing businesses' capital requirements irrespective of size.

Figure 3: VCT deal size

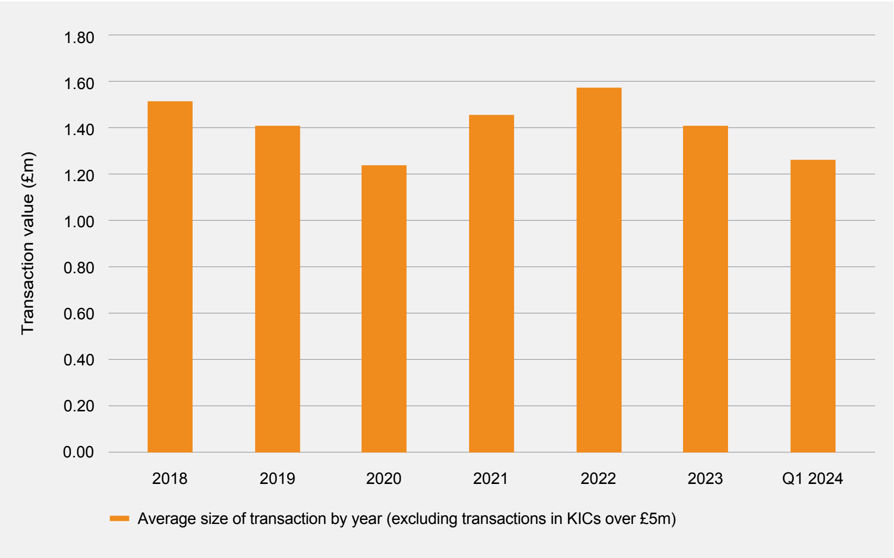
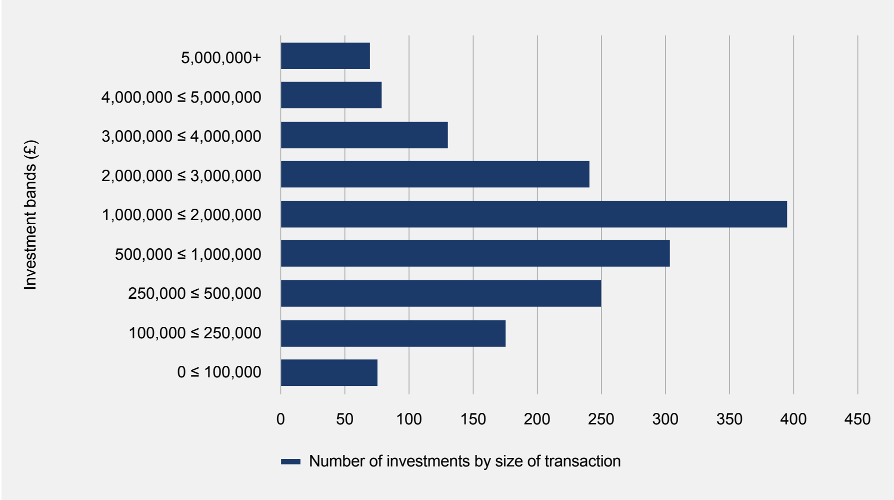


Figure 4 shows the distribution of VCT investments in SMEs by number and transaction size, with amounts invested varying from less than £100,000 to more than £5 million in KICs, reflecting their greater funding needs. The figures show that 1,713 investments, totalling £2.9 billion, have been made into eligible SMEs since 2018.

VCTs can make a real difference by providing money that would otherwise not be available to small businesses.

Figure 4: VCT investments by transaction size



VCTs have funded businesses that have gone on to become 'unicorns' (worth more than £1 billion), many of which are household names: Zoopla, Cazoo, Gusto, Depop and Interactive Investor.

Leo Scott

Case study: Tended

What does business success look like? Cutting-edge innovation? Revenue growth? Social impact? Tended, the Lincoln-based safety equipment manufacturer, can claim all these attributes and more.

Tended has developed a wearable locating GPS device 150 times more powerful than a typical smartphone GPS, capable of pinpointing an individual's position to within 10 centimetres. This powerful technology is now used by workers in dangerous locations such as railways, construction sites and utility facilities, to alert them if they unwittingly drift into an unsafe area.

Leo Scott, the 30-year old founder and CEO, was struck with the idea when working in the perilous environment of Nepal's disaster zone following its 2015 earthquake. At the age of just 20 he was in charge of a team of 45 people who were providing critical aid in highly unstable situations, yet it was his job to help ensure their safety.

He said, "*I had a duty of care over these people and that meant keeping them out of danger as much as possible. I had a process where they called me once an hour to say they were OK, but cell phone towers would go down, people would forget to call, they would be too busy in a rescue. I thought there must be a better solution, and it was then I developed the ambition of building a tech company that allows employers to monitor workers' safety.*

We started targeting the retail market with devices such as fall detectors and proximity devices during the pandemic to help with social distancing. That's when Network Rail approached us and said that they were losing one or two employees a year because of accidents on the track, due to maintenance workers losing spatial awareness and drifting onto live tracks."

Tended won their first round of EIS investment through Blackfinch Ventures EIS portfolios in 2019.

"*Once we reached a certain revenue threshold we moved into its VCT fund, which really enabled our growth from that point onward. I have enormous respect for the team at Blackfinch, they are all ex-founders and they know how to navigate the complexities of startups. It's often hard to get capital for hardware ventures because they require a lot of upfront investment, but they could see the potential. Now, we are targeting an exit for around £100 million in the next two or three years when we achieve annual recurring revenue (ARR) of around £7 million. Our ARR is up by over 300% in the past six months and we only need 3% of the rail contracting industry in the UK to hit our targets, so we're well on the way.*"

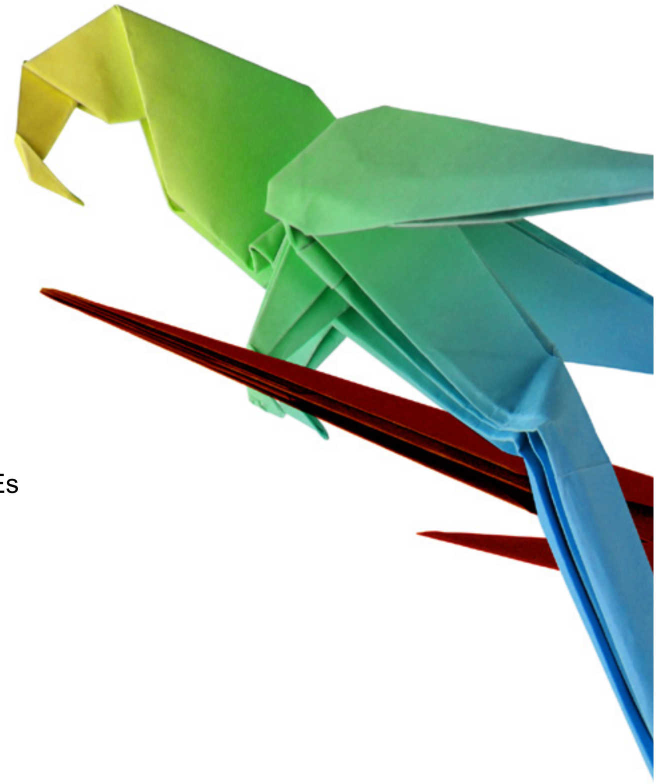
A continuing source of support

The ability of VCTs to provide follow-on funding to these early-stage companies is crucial in ensuring their growth and success. These companies often face funding gaps after their initial funding rounds. As they grow, they may require additional resources to scale up their operations, develop new products, and enter new markets.

When a VCT provides follow-on funding, it signals confidence in the company's potential and its management team. The ambition for SMEs is to reach the point where investment without government support can be made.

This can attract additional investors and enhance the company's credibility in the market as the SME matures. The VCT's commitment can be reassuring to other stakeholders, including employees, customers, and partners.

By providing follow-on funding, VCTs can increase their equity stake in promising companies. This not only supports the companies but also has the potential to deliver higher returns to the VCTs' investors. Along with financial support, VCTs often provide strategic guidance, mentoring, and access to networks, which can help companies remain focused on development milestones and strategy.



ANDERSEN

Andersen (formerly EVIOS) is a Bedfordshire-based manufacturer of premium smart charge points for electric vehicles (EVs). Merging Scandinavian-inspired design with 75 years of technical expertise, Andersen offers innovative and stylish charging solutions. Its signature design discreetly hides cables and plugs, ensuring a clean and elegant look. Intelligent features allow users to monitor charging progress and track energy usage. Customers can also personalise their charge points with a variety of colours and finishes through the company's online configurator. Andersen received funding from the ProVen VCTs, managed by Beringea.

By ensuring that companies have the necessary resources to overcome unexpected challenges or weather economic downturns, follow-on funding can reduce the likelihood of business failure in these early-stage ventures.

Figures 5 and 6 show the first and follow-on investments received by early-stage businesses from VCTs broken down by both the amount received and by number of transactions.

Figure 5: Value of first and follow-on investments

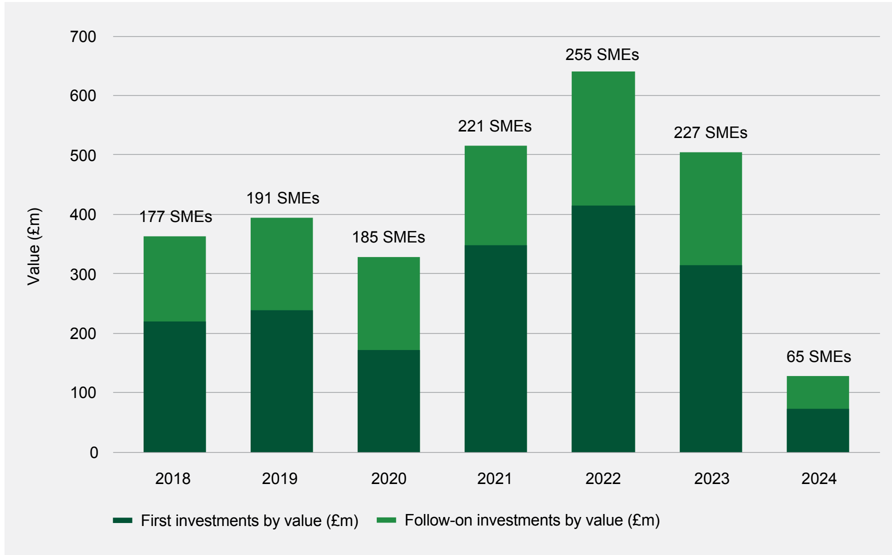
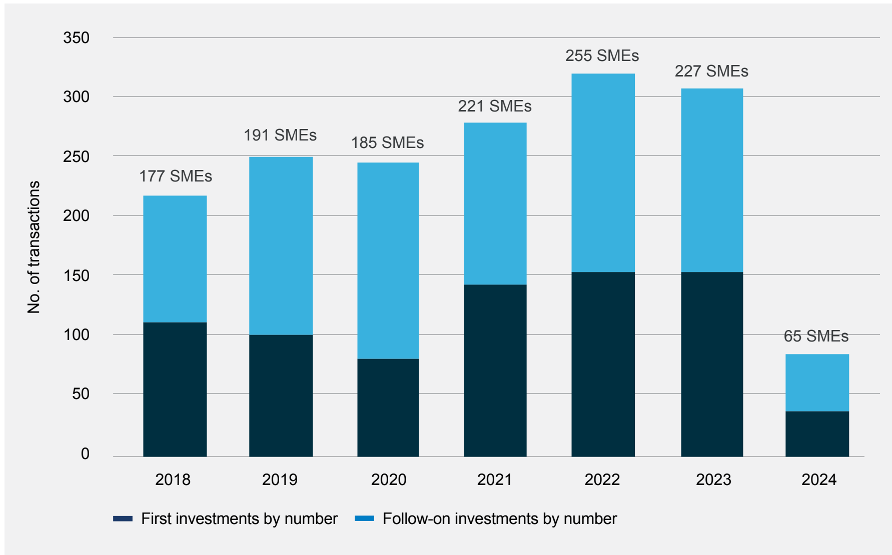


Figure 6: Number of first and follow-on investments



When a VCT provides follow-on funding, it signals confidence in the company's potential and its management team.

Helping owners maintain control

VCTs' ability to provide both debt and equity funding plays a critical role in the growth and development of early-stage companies.

At least 10% of the total amount invested in an SME must be in equity. Overall, the portfolio of a VCT must comprise 70% equity investments.

Being able to provide a proportion of debt funding allows the founders and existing shareholders to retain a greater percentage of ownership and control over the company, as it does not dilute their equity stake.

However, equity does not require regular interest payments, which helps companies manage their cash flow more effectively, especially during the early stages when revenue might be limited. A strong equity base can improve the company's financial stability and make it more attractive to other investors and lenders.

This flexibility is very attractive to the companies VCTs invest in.

definely

Definely is a UK legal tech company created to make legal documents easier to read, edit and understand. It was founded in 2020 by two former lawyers, one of whom is registered blind. Their solution to make legal documents more accessible to those with visual impairments has helped make documents easier to read for all lawyers. Headquartered in London, Definely has over 60 employees located globally. Investment from Octopus Ventures helped the company add to its existing base of 40,000 active users from companies and law firms in the UK, US, Canada and Australia. The company was named in the top 25 of the prestigious Deloitte UK Technology Fast50 in 2023.

pear bio

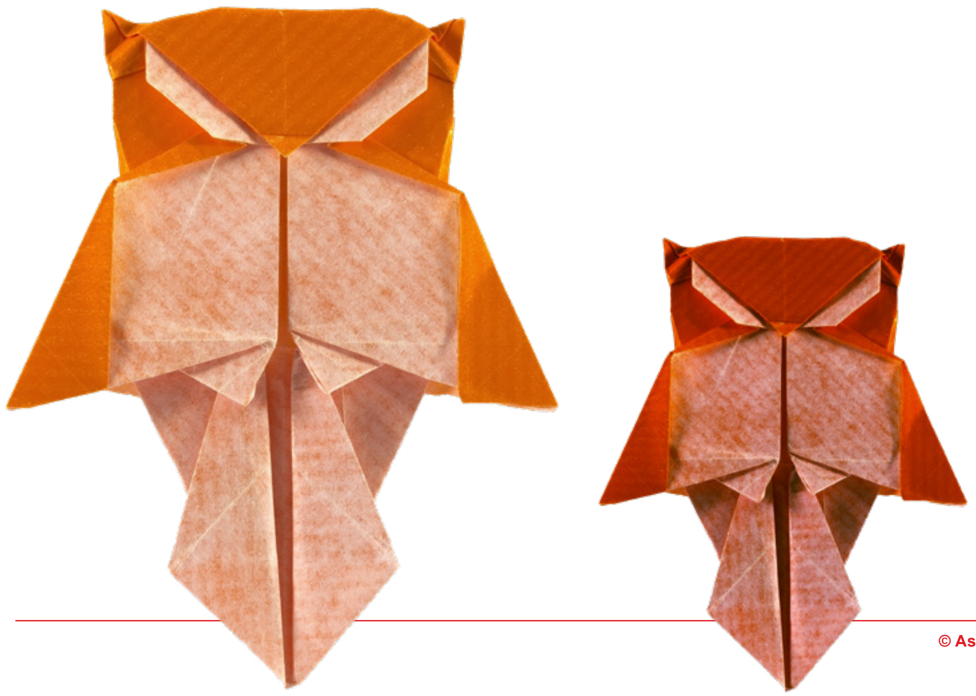
Founded by Duleek Ranatunga in 2017, Pear Bio is revolutionising the way cancer treatments are assigned to patients. The AI-enabled biotech company's novel platform uses a sample of a patient's tumour to directly test different drugs and try to predict which drugs might work best for different patients. Pear Bio's initial focus is on patients with breast and kidney cancer but it has now begun to use the platform to discover more effective treatments to take through to clinical trials. Pear Bio received funding from Octopus VCTs.

Providing more than just finance

VCTs do not just provide financial support to the companies they invest in. They also provide vital support to help companies scale and compete, delivering expertise in areas such as HR, IT, operations, management and financial guidance. VCT managers often take a seat on the board of their portfolio companies challenging directors' thinking and providing valuable advice gathered from years of smaller company investment experience. This can be critical to the success of these young companies.

Of the investments made by VCTs since 2018, VCT managers have had a presence on the board for over 70% of these companies.[8]

VCT managers give SMEs the benefit of their wide-ranging expertise.



Case study: Egress

Think about venture capital, and you immediately think of wealthy entrepreneurs buying a stake in a business, and hoping the business succeeds.

But providing capital is only a small part of the VCT investment process. VCTs play a vital role in the growth and success of the business, as the journey of cyber security specialist Egress shows.

Egress is a now a leading global cloud email security provider with over 2,500 customers worldwide. Clients include governments, financial services businesses, law firms and other regulated industries across the UK, US and Australia.

It offers a broad suite of services from email encryption, data protection and anti-phishing, and other elements of human-related cyber risk management.

Back in 2014, it was an ambitious startup with just 12 employees, a handful of clients, an intensely motivated team, and an idea around cloud-based email security before the 'cloud' was even common parlance (most firms at that time still had their own server rooms on site).

While it showed promise and was generating around £1 million a year in revenue, it lacked the capital, and experience, to scale up and realise its potential.

That all changed when Albion Capital led a funding round in 2014. Together with the investment came Albion's expertise, with senior Albion directors including Ed Lascelles partnering with the firm to help with strategy, team building, introductions to commercial partners and general advice as the firm grew.

Albion was instrumental in recruiting a Chief Financial Officer, People Officer, Marketing Officer and a Chairperson, as well as helping with other management changes.

Along the journey, Albion invested in three rounds of funding, and advised on strategy throughout, including leading the board discussion on how to prioritise the correct financial metrics to help build value for all stakeholders. Albion was also the sole voice in successfully rejecting an earlier bid for the company that would have resulted in a fraction of the ultimate exit value being created.

The end result was the largest exit by value in Albion VCTs' history, and one of the largest software companies to have been created in the UK in recent memory having increased employees to over 300 people and revenue from £1 million ARR to almost £50 million (which is still growing by circa 30% a year), leading to an exit of $400 million (£309 million) from an initial valuation of £10 million.

Ed Lascelles

Championing diversity

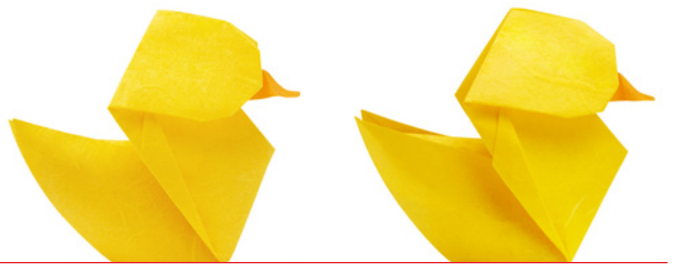
VCTs can play a significant role in promoting diversity within the business ecosystem, particularly among small and growing companies. They often invest in a wide-range of businesses, including those that are traditionally under-represented in mainstream finance. This can include businesses led by women, ethnic minorities, or those based in underserved regions.

VCTs may also encourage diversity by backing innovative companies that prioritise inclusive practices, whether in their hiring, product development, or customer engagement strategies. Moreover, the involvement of VCTs in the governance and strategic direction of these companies often brings diverse perspectives into decision-making processes, further enhancing the growth and inclusivity of these businesses. Through these efforts, VCTs not only contribute to the success of diverse enterprises but also help to build a more inclusive and representative business landscape.

In the regions

The funding gap can be particularly pronounced in regions outside London and the South East. This gap can significantly impact the economic development and growth potential of these areas, perpetuating a cycle of economic disparity.

iOpt is an award-winning property management solution designed to revolutionise the management of social housing across the UK. iOpt provides real-time data enabling proactive maintenance, reducing the need for costly emergency repairs. The solution facilitates early detection of potential issues such as damp, mould, and poor air quality, allowing for timely interventions that improve living conditions and prevent costly damage. This ensures homes are safer for tenants. iOpt aims to improve the quality of life for tenants in social housing and streamline property management for landlords. iOpt received funding from Mercia Ventures.



SMEs outside of London and the South East tend to take longer to reach a need for growth capital. This can mean that the age limit for companies a VCT can invest in can prevent VCTs investing in promising companies with growth potential.

Whilst all VCT managers aim to ensure that the VCTs they manage have a diverse portfolio of investments across the UK, many VCT fund managers actively support investments in regions outside the South East of England, focusing on a broader geographic distribution to help bridge the regional funding gap.

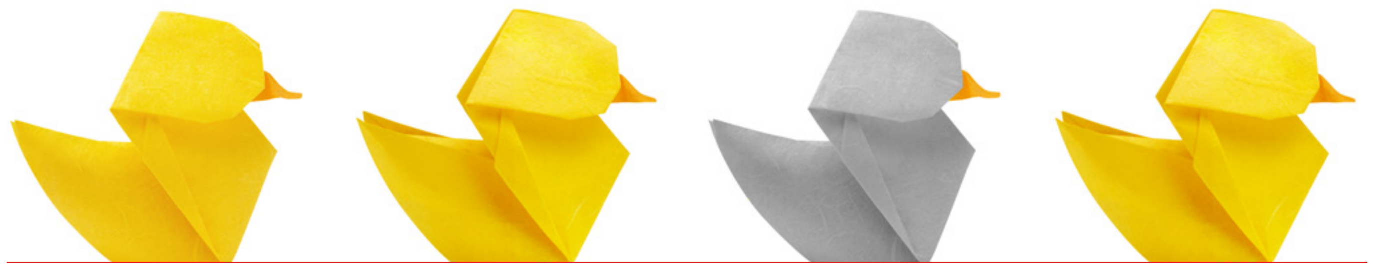
Maven Capital Partners has a strong emphasis on regional investments with a significant presence in the North of England, Scotland, and the Midlands. Maven manages multiple VCTs and regional funds, often partnering with local enterprise partnerships and development agencies to identify and support high-growth businesses outside the South East.

Mercia Ventures has a strong presence across the UK, including the North of England, the Midlands, and the South West. Mercia offers strategic and operational expertise, enabling businesses across a number of regions to scale successfully. With a focus on sectors such as software as a service, consumer, life sciences and deep tech/AI, Mercia plays a crucial role in fostering innovation working closely with local universities, incubators, and business networks to identify and nurture promising businesses in their target regions as well as driving economic growth throughout the UK.

Foresight Group also has a substantial investment footprint in the North West, Yorkshire, the Midlands and Scotland. YFM, originally Yorkshire Fund Managers, retain a strong presence in Yorkshire even though they are a national presence now.

The geographical reach of VCTs, facilitated by managers operating from various regional centres, gives greater scope to reduce funding disparities and stimulate economic development across all regions.

Many VCT fund managers actively support investments in regions outside the South East of England.



Supporting women

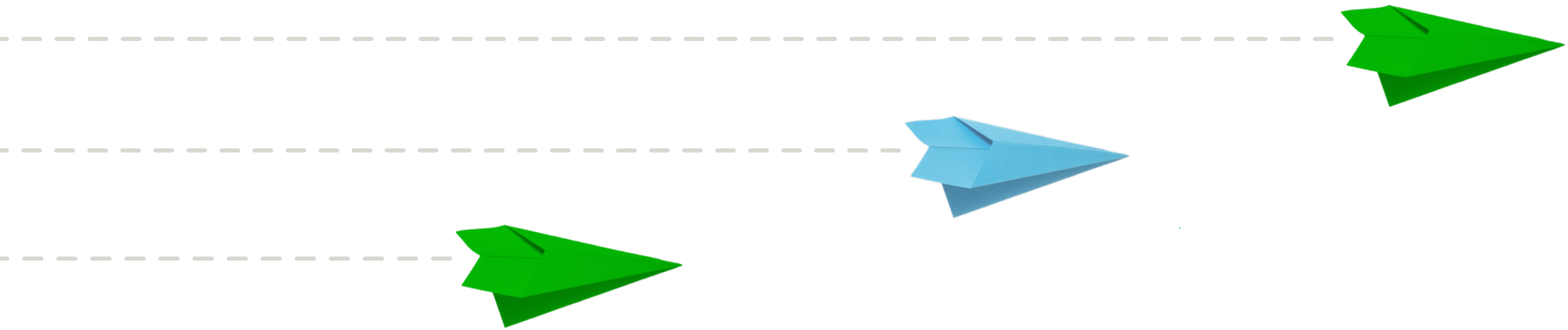
The female funding gap refers to the disparity in access to financial resources and investment capital faced by women entrepreneurs compared to men. This gap exists at various stages of business development, from seed funding to venture capital, and affects female-led startups and businesses in multiple ways.

The Rose Review found that up to £250 billion of new value could be added to the UK economy if women started and scaled new businesses at the same rate as men.[9]

Despite this, female-led startups receive a significantly smaller share of venture capital funding compared to male-led startups.

A British Business Bank report ‘UK VC and Female Founders’[10] (February 2019) found that for every £1 of venture capital investment, just 1p goes to all-female founder teams, all-male founder teams get 89p, and mixed-gender teams 10p. 83% of deals that UK VCs made in 2017 had no women at all on the founding teams. When female-led startups do receive funding, the amounts are often smaller than those received by male-led startups. Implicit and explicit biases can influence investors’ perceptions of women entrepreneurs, leading to unequal treatment and evaluation.

Female founders face challenges in accessing angel investment and other influential business networks that can provide introductions to investors and key resources, which can hinder their growth and development.



The ‘Investing in Women Report 2023’[11] found that female-led businesses continued to receive smaller amounts of loan finance. The gap widened in 2022, with the average (mean) amount approved in respect of female-led businesses standing at £174,000, which was 34% of the average of £507,000 approved for their male-led counterparts. More encouragingly, the report found that the number of deals made by venture capital funds for companies with all-female teams rose from 6% in 2021 to 9% in 2022.

Other positive steps are being made to address this imbalance. The Investing in Women Code was founded in 2019 as a landmark government-led initiative in response to the Rose Review’s findings. The British Business Bank’s own research through its Small Business Finance Markets report and Equity Tracker 2024[12] showed that the share of equity deals to teams with at least one female founder has increased by 10% over the past decade from 18% to 28%. However, the share of equity investment to all-female-led businesses has remained static at 3% over the last decade.

VCTs are also helping to change this. Mercia recently launched a fully funded programme called ‘Rise & Thrive: Navigating Investment as Women Entrepreneurs’ that offers half day workshops to female founders. The Radia accelerator scheme, led by Albion Capital, provides help to female-led early-stage companies and unicorns.

Since 2018, VCTs have invested in 101 SMEs with women founders, who have received £304 million.[13]

Women could add up to £250 billion of new value to the UK economy.

Karen Barrett

Case study: Unbiased

Like many entrepreneurs, Karen Barrett's light-bulb moment came in a moment of dire personal need where there was no obvious solution available on the market.

Barrett's first child was born with a serious heart condition and had open heart surgery twice in the first 10 weeks of his life. During that time, Barrett found herself contemplating a variety of outcomes for which she felt completely unprepared. What if she couldn't work again? What insurance would she need? What should her first steps be to shore up her finances? She needed advice but how could she find an expert she could trust, quickly and easily?

This led to the idea of Unbiased, a matching service for people in need of financial advice. Barrett had spent her entire career up to this point in financial services, leading sales and marketing operations for companies such as Mortgage Express and Santander. She had seen the potential for using big data to streamline systems. Now she saw how it could be used to match consumers quickly to the specific financial advice they're looking for – and so Unbiased was born.

"*We grew organically but it was clear by 2018 we had a real opportunity to crack this market. So I hired a COO/CFO to help with a fundraise. We were successful, receiving five offers, but went with YFM Equity Partners as we thought they were the best fit in terms of people and how we saw our growth plans – and of course a valuation we were happy with.*"

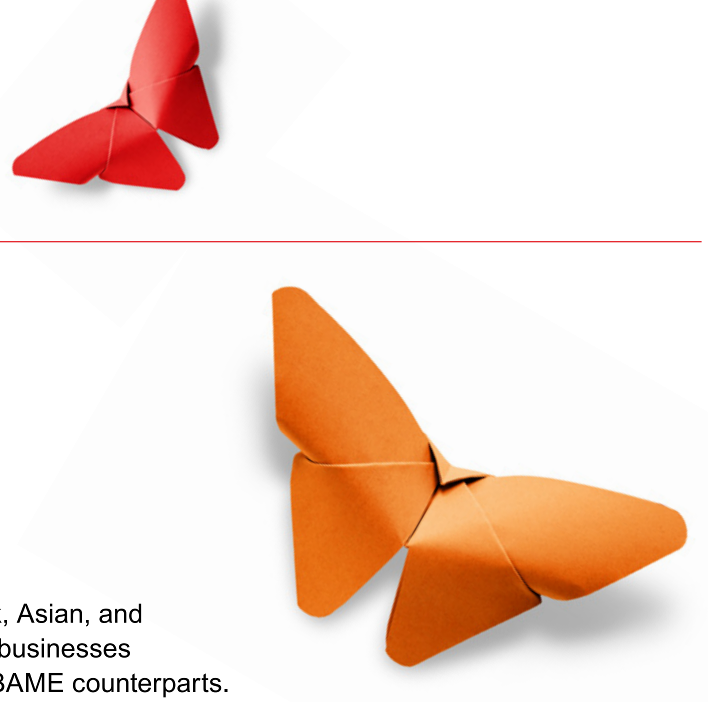
Although only 9% of startup funding traditionally goes to women founders, Barrett sought her first funding at a time when ESG and diversity awareness were coming to the fore. "*I think this culture shift meant being a female founder made me stand out,*" she says. "*I think that made our fundraising easier, not harder.*"

The initial £5 million cash injection in 2020 was followed by another £5 million in 2022, but YFM brought much more than just cash to the table.

"*The VCT had knowledge, they've seen many more businesses going through many more scale-up journeys. They were great at giving me independence but being there for advice at the right time. They introduced me to other founders and a variety of networks that helped with suppliers and planning for different scenarios.*

We now match clients and advisers in less than 60 seconds and deliver $20 billion in assets under management to our customers every year.

In short, our growth would not have been anything like it has without their support, both financial and otherwise."



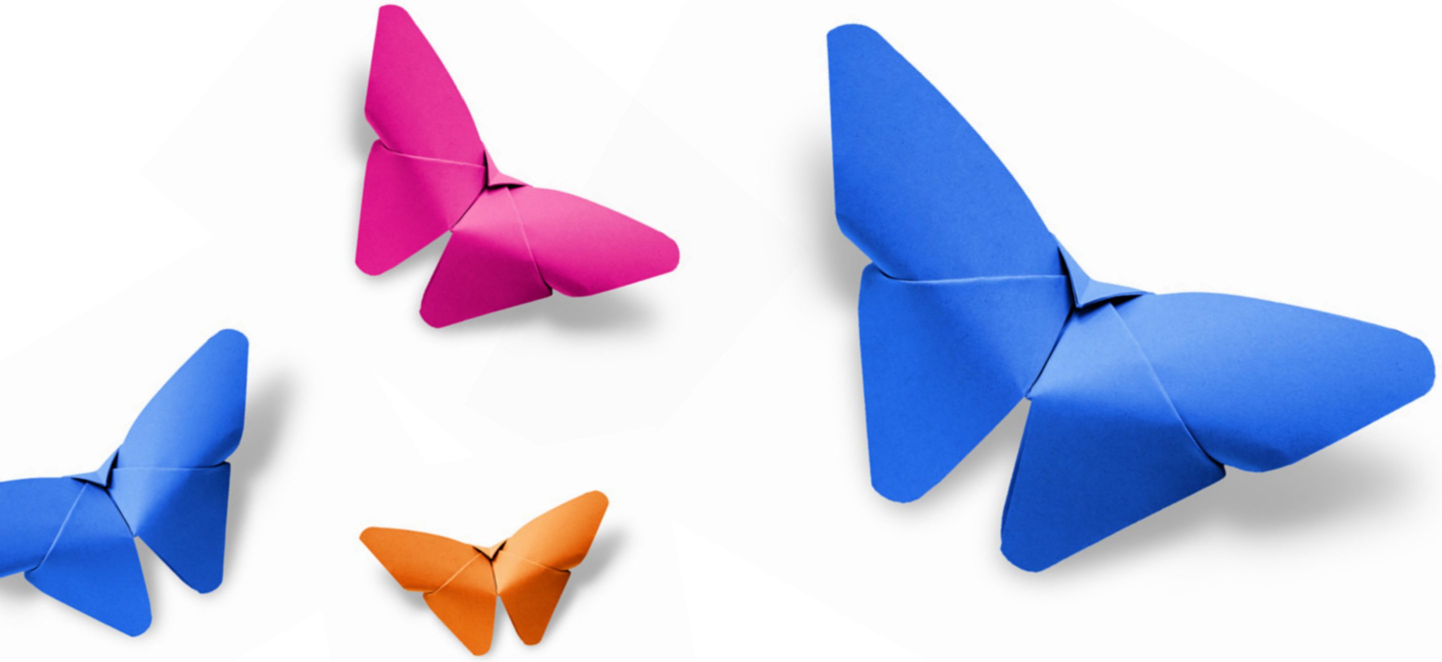
Supporting minorities

As well as a female funding gap there is a BAME (Black, Asian, and Minority Ethnic) funding gap. BAME entrepreneurs and businesses are less able to access funding compared to their non-BAME counterparts. When BAME entrepreneurs do secure funding, the amounts are often smaller compared to those received by non-BAME entrepreneurs.

Investing in Ethnic Minority Entrepreneurs[14] found that around 5%-8% of smaller businesses are led by individuals or teams identifying as ethnic minority, even though ethnic minorities make up about 18% of the population.

Again, this gap manifests in various stages of business development, from startup funding to growth capital, and is influenced by multiple factors, including systemic unconscious biases leading to unequal evaluation and funding decisions, lack of access to critical networks, and limited visibility of BAME entrepreneurs in the investment community. Many BAME entrepreneurs rely on personal savings or support from friends and family, which may be limited.

VCTs have helped to address this issue by investing in companies with BAME founders.



Case study: Quantexa

Quantexa, a global data and analytics company based in London, has been at the forefront of the emerging 'decision intelligence' sector since its founding in 2016.

Quantexa's decision intelligence platform helps organisations uncover risks and identify new opportunities by connecting and unifying siloed data at scale.

"*Creating and visualising connections between hundreds of data sources can reveal insights into people, companies, transactions, and relationships, enabling organisations to identify risks and opportunities more effectively, ultimately leading to better business outcomes*," said Vishal Marria, Founder and CEO.

Marria continued, "*For instance, a company wanting to ensure ESG risk is considered in its supply chain can use our 'knowledge graph visualisation'. This function shows connections among all suppliers, manufacturers, and transporters. By integrating internal and external data, any ESG-related risks, such as supply chain integrity issues, are immediately flagged, providing visibility that was previously unattainable.*"

Money laundering is another popular use case scenario that has numerous applications. "*In anti-money laundering, teams of investigators analyse vast amounts of data and transactions – sometimes billions – to detect possible illicit activities raised in suspicious activity reports*," Marria explains.

"*Quantexa's platform integrates the data into a comprehensive visualisation, showing transaction context clearly and accelerating the identification of potential red flags with greater accuracy than an individual could achieve on their own.*"

Marria credits VCT investment for the company's growth. "*We secured our first VC funding in 2016. Albion VC and Dawn Capital have supported us from the beginning, providing valuable advice and feedback.*"

Today, Quantexa is a leading global tech firm with a valuation of $1.8 billion, and annual recurring revenue of $100m, giving it 'Centaur' status. It has a robust lineup of innovative products coming to market, such as a Generative AI suite. Marria and the team are deepening relationships with existing partners including Microsoft, PwC, KPMG, and Accenture.

"*Our decision intelligence platform is now active and utilising data in over 100 countries*," said Marria. "*We are a UK founded business... working with global industry leaders. Venture capital funds and the support of our investors continue to play a vital role in our growth trajectory.*"

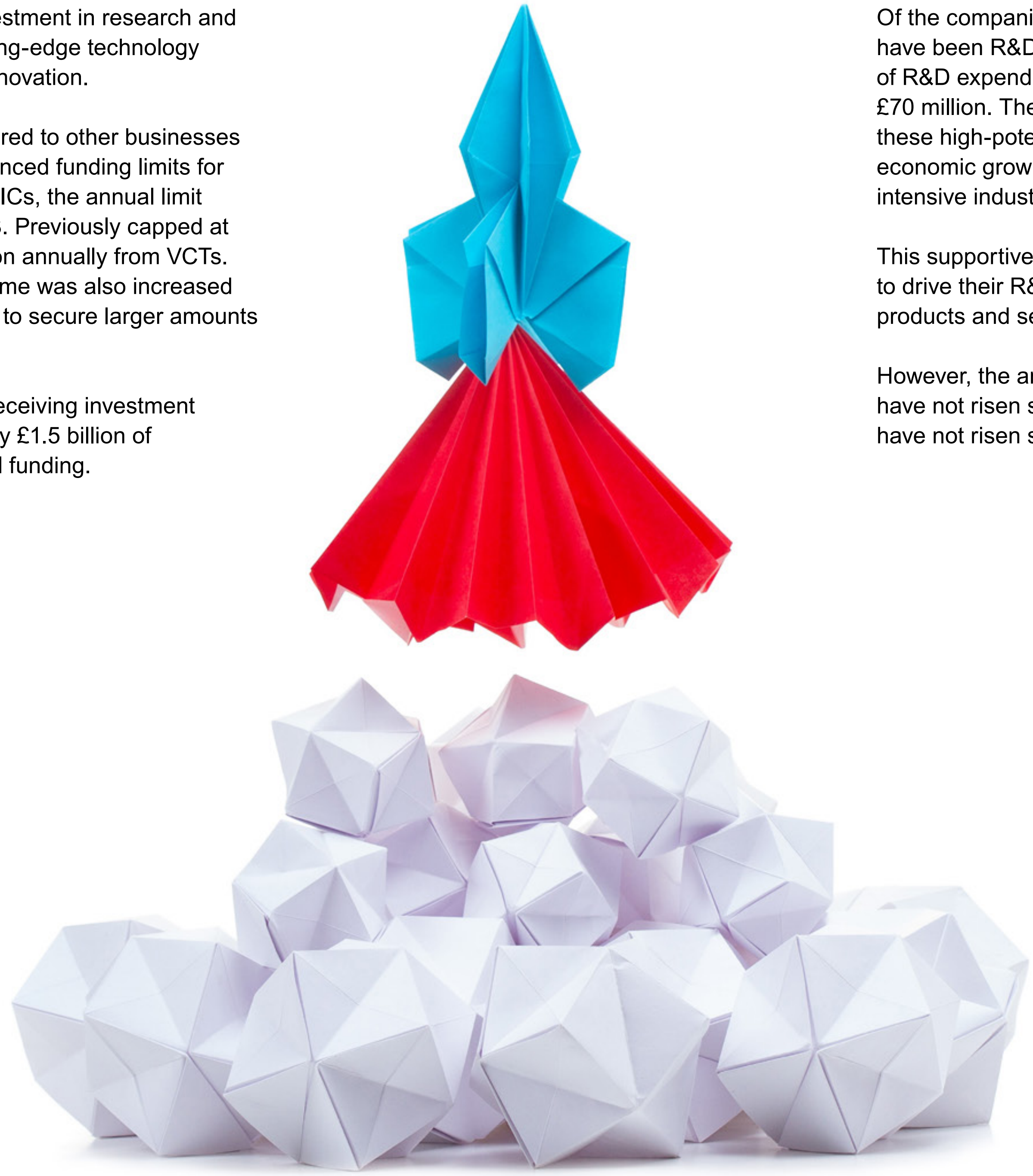
Vishal Marria

Fuelling innovation

VCTs identify innovative companies as targets for investment. These include knowledge intensive companies (KICs), which typically operate in sectors such as technology, biotechnology, pharmaceuticals and advanced manufacturing. These companies often face higher funding requirements due to their unique characteristics and the nature of their business activities. They require substantial investment in research and development (R&D), skilled personnel, and cutting-edge technology to maintain competitive advantages and drive innovation.

The higher funding requirements of KICs compared to other businesses have been recognised by government with enhanced funding limits for KICs to better support their unique needs. For KICs, the annual limit for investment from VCTs was increased in 2018. Previously capped at £5 million, KICs can now receive up to £10 million annually from VCTs. The total amount a KIC can receive over its lifetime was also increased from £12 million to £20 million. This allows KICs to secure larger amounts of capital throughout their growth stages.

VCTs have identified 316 SMEs (40% of those receiving investment since 2018) as KICs. These KICs received nearly £1.5 billion of development capital which represents 53% of all funding.



A company qualifies as a KIC if it spends at least 15% of its operating costs on R&D or innovation activities. Alternatively, a KIC can qualify if it has a significant proportion of highly skilled employees or meets other specific criteria that demonstrate its knowledge-intensive nature.

Of the companies receiving investment from VCTs since 2018, many have been R&D focused. The 10 SMEs reporting the greatest amount of R&D expenditure in their latest financial statements invested a total of £70 million. The higher annual and lifetime investment limits available to these high-potential businesses facilitate sustained innovation, support economic growth, and help position the UK as a leader in knowledge-intensive industries.

This supportive environment helps KICs access the necessary capital to drive their R&D activities, scale their operations and bring innovative products and services to market.

However, the annual and total funding caps for VCT investment in KICs have not risen since 2018. Some of the limits for non-KIC VCT investments have not risen since 2012, despite high inflation in recent years.

The total amount a KIC can receive over its lifetime has been increased from £12 million to £20 million.

COAT

Coat Paints (COAT) is a sustainable paint company. It operates a zero-waste manufacturing system meaning paint is not mixed until a customer orders it. COAT paints are low toxicity and low in volatile organic compounds. Instead of traditional tester pots it offers ‘peel & stick’ swatches made using COAT paint, which are recyclable and 95% less wasteful than a traditional tester pot. COAT has signed The Climate Pledge and is committed to its B-Corp Certification which requires high standards of social and environmental performance, transparency and accountability. COAT received funding from Pembroke VCT.


Kärt Tomberg

Case study: ExpressionEdits

Kärt Tomberg is pushing the boundaries of genetic therapies, in a way that could change the lives of countless people around the world.

Tomberg was working at Cambridge University when the pandemic hit. "*We were told to start working on Covid or go home!*" she said. "*So I began focusing on artificial instructions to programme cells to produce the Covid spike protein. What I noticed straight away was that the artificial instructions we were using were not working very well and they didn't really resemble their natural counterparts – the genes we have in our body. So I thought about how the process could be improved.*"

Unlike many other substances, proteins cannot be produced synthetically. Protein-based drugs have to be made by using living cells, such as yeast, animal or human cells (or sourced from live tissue like donor plasma). These cells are effectively used as little factories, and then 'instructed' to produce proteins that resemble the desired human versions. Examples of success stories in this field are proteins such as insulin, and Ozempic, a fat-busting drug that has recently hit the headlines.

But many proteins cannot be successfully produced in this way. "*The problem is that the 'instructions' commonly used to produce proteins are now 40 or 50 years old, and simply don't work very well.*" said Tomberg.

"*In order to enable us to better produce proteins at scale, we have developed a genetic syntax engine, a complex AI-driven machine that designs the DNA instructions that we give to the cells so they that know what protein to make for us. There is a list of around 200 proteins that are candidates for us to produce using this technology, with the potential to help patients suffering from a range of life-changing illnesses.*"

After building the prototype to ensure that the syntax engine worked, Octopus VCTs led a £7.5 million funding round of which £4.6 million came directly from the Octopus VCT funds.

"*Octopus has helped us in many other ways already.*" said Tomberg. "*They have helped us on the HR front, implementing performance management techniques, and also introducing me to a networking group with their other investee company CEOs, which is so useful to help discuss your challenges with others in the same position.*"

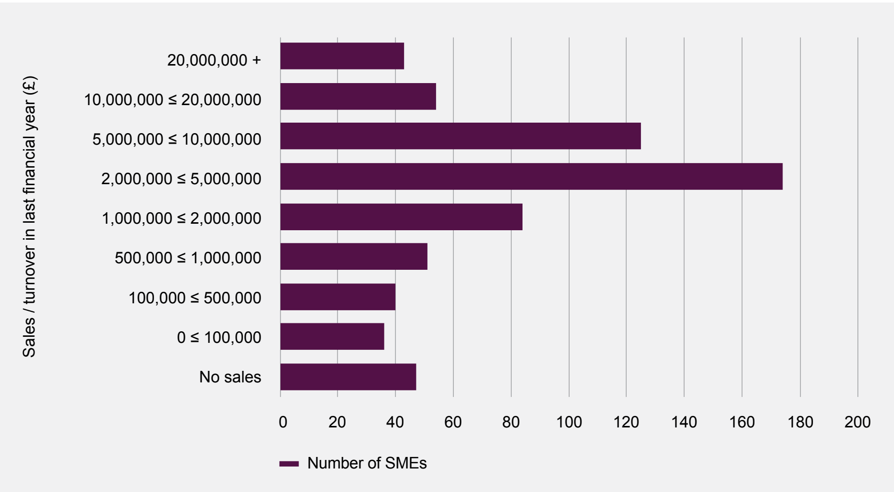
Tomberg says it will be five to six years before they are ready for human studies. "*There is a long way to go but eventually, if all goes well, we will choose which protein to target, partner with a multinational pharmaceutical company to develop it, then look to the next protein to synthesize. There is a long list of diseases we can help to manage, so we will not stop after the first success.*"

VCT-backed performance

The government can recoup the cost of tax reliefs granted to investors through the additional corporate and employment taxes levied on investee companies that VCT finance has helped to grow.

While not all VCT-backed companies are successful, the performance of some can be impressive. Figure 7 shows that from the companies surveyed, around 43 companies backed by VCTs reported sales of over £20 million. 54 reported sales of between £10 million and £20 million.[15] However, SMEs remain a risky proposition. Of the sample, 76 SMEs reported sales of less than £500,000. A further 47 reported that they had not made any sales at all. Often SMEs at an early stage represent a high risk in terms of investment. However, VCTs are stepping in to encourage the entrepreneurial drive that traditional funders are less willing to support.

Figure 7: Turnover of VCT-backed SMEs



Accessing the global market

One ambition of smaller companies is to grow. Many VCT-backed companies are working hard to increase their sales, not only nationally but also on a global scale.

Of the companies surveyed, 353 receiving VCT investment reported exports worth £1 billion based on latest financial statements. Exports made up 27% of the sales of VCT-backed businesses.

This is a significant level of exports for smaller businesses and is indicative of their appetite for growth and their potential value to the UK economy.

While not all VCT-backed companies are successful, the performance of some can be impressive.

Green impact

VCTs are well placed to contribute to the drive towards net zero carbon emissions and are supporting the development of the green industrial revolution. The data considered as part of this report found that VCTs had contributed £38 million to SMEs where the nature of their business involved projects related to the environment and sustainability.[16]

Gridcog

Gridcog's platform allows companies investing in clean energy projects to explore alternative solutions to achieve the best possible outcomes for their environmental, commercial and market needs. The Gridcog software gives companies a holistic view of their energy resources and simulates the impact of market and project changes. This helps firms model and test the most economically viable solutions for even the most complex projects across the energy value chain, allowing them to invest in energy transition projects with greater confidence. Funding from Albion Capital Group will allow Gridcog to expand across the UK and Europe.

Case study: Kelpi

Kelpi was conceived at a meeting at Bath University four years ago. Co-founders Neil Morris and Murray Kenneth took a plastic wrapped packet of fish to discuss with soon-to-become co-founder Professor Chris Chuck.

"*The fish had a fridge life of eight days, yet the packaging might last 1,000 years*", said Morris. "*Solving this problem became our common bond and we have been working on the solution ever since.*"

After more than two years of laboratory work, Kelpi had a viable core material that won a global competition called the Beyond Plastics Challenge organised by cosmetics giant L'Oréal. Kelpi's revolutionary packaging provided a very strong water barrier that could be used with a variety of products to replace plastic, but still increase shelf life, while meeting strict criteria on being marine safe, recyclable and compostable. It has since won R&D contracts with Diageo and Waitrose to help these firms develop bottles and other packaging for their own product ranges that meet the same sustainability criteria.

After initially 'bootstrapping' the business with their own money while based in Bath, Kelpi then found funding through various business angels and agencies, enabling a move to commercial laboratories in Bristol, before raising £4.3 million in a funding round in May 2024, led by Blackfinch Ventures. This money will help fund the growth of the business while its packaging awaits regulatory approval, expected by the end of 2025.

Blackfinch Ventures brought more than just capital to the table. "*We've been very careful throughout this journey to select investors not just for funds but for expertise in helping to build businesses,*" said Morris.

"*Blackfinch has monthly meetings with all founders of their investee companies so we can network with each other and raise issues that are common to all of us. It's incredibly useful. It can be a lonely journey building a business but being able to talk to others going through their own challenges is hugely valuable. On top of that, the Blackfinch guys have a wealth of expertise on growth and developing products to market and that has been brilliant.*"

Morris is confident the regulatory approval will be granted, and then the business will go from producing kilograms of specialist material, first to tonnes then to hundreds of tonnes each year. "*In the meantime,*" he said, "*we will scale up the manufacturing capacity in preparation for hitting the market. We are already a global business based in the UK, with UK investors and UK expertise. Regulatory approval is really all we are waiting for before take-off!*"

Neil Morris

Social impact of VCTs

The support provided by VCTs allows SMEs to respond to business needs across a range of sectors. One of the sectors receiving a significant amount of investment is the social care sector. Since 2018, VCTs have invested over £54 million in SMEs supporting social care causes, such as speech therapy, care homes, mental health and businesses that provide support to the NHS.

mable

Co-founded by Martha Currie and Elliot Agró, Mable Therapy is a digital health platform that delivers speech and language therapy and counselling to children aged 4 to 18. Mable uses games, activities and interactive resources to provide improved therapeutic outcomes. Mable is a 'telehealth' business, using technology to deliver services remotely that would otherwise require a clinician to be physically present. Sessions are undertaken in real time with two-way interaction between the patient and qualified paediatric clinicians. This can help to reduce anxiety and increase participation. The Leeds-based company received funding from the Gresham House advised VCTs.

Family Adventures Group

Founded in Bristol in 2019 by husband-and-wife team Tom and Laura Filer, Family Adventures Group provides children's leisure venues and day nurseries across the South West and West Midlands. The leisure sites mix educational and interactive play for children from 2 to 12, providing a combination of role play, theatre, and escape room-style activities to enhance cognitive development, social skills, and creativity. Funding from Foresight Group will allow Family Adventures Group to add new sites and create up to 140 skilled jobs a year.

A final word

VCTs are an indispensable element of the UK's funding ecosystem for SMEs that are the backbone of the economy. By providing crucial funding and strategic support to early-stage businesses, VCTs help bridge the significant finance gap that many startups face, thereby fostering innovation, job creation, and economic growth. The government's extension of the VCT scheme to 2035 reinforces its commitment to sustaining this vital source of support for SMEs. As VCTs continue to adapt to changing economic conditions, including the challenges posed by high inflation, they remain a pivotal resource in enabling the growth of ambitious enterprises across the UK. Through targeted investments and ongoing support, VCTs will continue to play a crucial role in driving the UK's economic success and innovation landscape.

Acknowledgements

The survey data highlighted in this report includes material collated for the AIC by the Venture Capital Trust Association (VCTA). The AIC is grateful for this assistance. In addition to the VCTA, we would like to thank:

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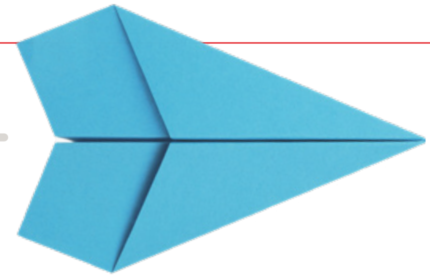
Methodology

The survey period covered investments made after 1 January 2018 up to end of Q1 2024. It does not capture all investments made as submission dates for data varied.

All SME financial data, including R&D and turnover, are based on the most recently available audited report and accounts. Exceptionally, some information may be provided from the most recent management accounts.



Footnotes

[1] Venture Capital Trusts statistics: 2023, HMRC, 24 January 2024

[2] HM Treasury "Financing Growth in innovative firms: consultation response" (November 2017)

[3] Venture Capital Trusts statistics: 2023, HMRC, 24 January 2024

[4] Investment data from January 2018. £2,875 billion invested in 783 companies

[5] British Business Bank: Small Business Finance Markets 2023/24, page 34

[6] 648 SMEs provided employee data to the survey from their most recent report and accounts, of these 265 SMEs reported employee data from a previous financial year from which to measure growth

[7] Business population estimates for the UK and region: Enterprises by employee size 2022 and 2023. Published 12 March 2024. Office for National Statistics

[8] 614 SMEs provided data to the survey pertaining to the VCT representation on its board, with the submitted information being either 'VCT director', 'observer rights' and 'none'. 70% of the SMEs in the sample reported either a 'VCT director' or 'observer rights'

[9] The Alison Rose Review of Female Entrepreneurship (2019), page 18

[10] British Business Bank 'UK VC and Female Founders' (February 2019), page 13

[11] Small Business Finance Markets report and Equity Tracker 2024

[12] Investing in Women Code Annual Report 2023 (June 2023), pages 4 and 8

[13] 617 SMEs provided data regarding female founders, with 101 self-certifying that the founding members of their organisation had at least one woman

[14] Investing in Ethnic Minority Entrepreneurs (Report and Data Analysis November 2023), page 4

[15] 722 SMEs provided data to the survey from their most recent report and accounts, of these, 389 reported R&D expenditure, 353 reported exports and 605 reported turnover data

[16] 783 SMEs self-certified their nature of business of which 3% were derived by the AIC to be involved in projects related to sustainability (i.e. relating to the environment and supporting social care initiatives)

Association of
Investment Companies

24 Chiswell Street
London EC1Y 4YY

enquiries@theaic.co.uk
www.theaic.co.uk

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