JUNE 2024

Backing Breakthrough Businesses

The first report of the Private Business Commission

THE ENTREPRENEURS NETWORK IS A THINK TANK FOR BRITAIN'S MOST AMBITIOUS ENTREPRENEURS.

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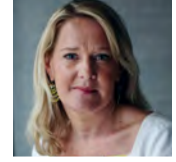

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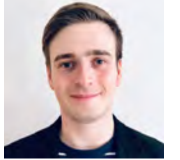

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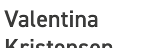
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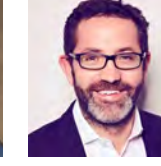
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A PROJECT BY

IN PARTNERSHIP WITH

FOREWORD

STEVE RIGBY
Co-CEO,
Rigby Group

"By removing barriers to business growth, we can support Breakthrough Businesses and help the UK regain its standing on the world stage."

Rigby Group, the second-generation family business where I am Co-CEO, is a great British business success story. We are Europe's largest private technology company with some 9,000 colleagues and are one of the UK's top ten family owned businesses. We invest in startups, scaleups and late-stage companies, and operate internal private equity investments. This diverse experience allows for a unique view of the landscape of the UK private sector.

From this vantage point, we see huge opportunities for private companies in Britain, especially in the area of business we call Breakthrough Business. These are the companies of above 100 employees that have scaled (but aren't scaleups) and have the potential to become structurally important in their region or industry. By focusing on removing barriers to business growth, we can support this critical but frequently overlooked cohort and help the UK regain its standing on the world stage.

Working with The Entrepreneurs Network, this report aims to start the debate on the interchange between businesses as they mature. Much good work has already taken place in the startup and scaleup communities, but there is a knowledge gap when it comes to the sort of private businesses that form such a large part of the economy. These are the tax-paying, scaling companies that form the majority of the UK's 43,000 mid-sized firms.

The UK's inherent entrepreneurial spirit means we often crystallise value on sale – and do not scale our brightest companies to their full potential. This is in stark contrast to Germany and other leading private business economies. Understanding the motivation and implications of our 'for sale' culture will be an important component of the solution.

This report aims to open the debate on private business, and I would like to extend my personal thanks to my fellow Commissioners and all those who took the time to share their views, and of course to The Entrepreneurs Network who have produced this report.

We will not find every solution, but I hope that from this foundation, a more wide-reaching review can be undertaken to harness the power that the private sector growth engine can provide for the ambition and productivity of the country.

EXECUTIVE SUMMARY

Britain has long been a global leader in business ambition and we continue to punch well above our peers. We have established ourselves as an excellent place in which to start a business, and tower above our European counterparts on various entrepreneurial metrics. One area of concern that has emerged of late, however, is how successful Britain is in properly scaling those companies to their full potential.

Recent and increasingly frequent reports of entrepreneurs feeling they can only grow by moving to America signals a new and negative trend for the UK. Only in the past few months, major British companies such as BHP, DS Smith, Direct Line and Wincanton received bids, Darktrace decided to sell to America, and TUI has confirmed it will delist from London in favour of Frankfurt.

Although the government by itself cannot be responsible for accelerating or sustaining business growth, it can act as a safe harbour for the ships to sail from.

It's the government's role to provide the right tax and regulation environment to enable businesses to grow. As Britain prepares to elect a new government, the Private Business Commission attempts to unpack some of these key issues that will allow the government to provide a framework to help and guide businesses. Specifically, we concentrate on four distinct policy areas:

Access to funding

Britain now has a healthy venture capital (VC) ecosystem, but the weight of responses to our Call for Evidence indicate that there is still an underlying conservatism among investors and other finance providers which denies high-potential companies from getting the sorts of capital they need to scale.

Tax incentives

Taxes have a huge influence on both the shape and size of the economy. While there are some bright spots in Britain's tax system, such as the various reliefs on investment for fledgling companies, the overwhelming reaction to our Call for Evidence on tax policy was negative. Many highlighted the variability and complexity of the tax system as being detrimental to business growth.

Functioning of capital markets

All founders need some kind of path to liquidity, and even for private companies, the alternatives available from potential listing or being acquired by private equity influence the investment they can attract. How this has evolved in the UK will be imperative, including the recent developments in the Edinburgh and Mansion House Reforms, including the Private Intermittent Securities and Capital Exchange System (PISCES).

Employee incentives

Building big, enduring businesses requires a committed, skilled and productive workforce. Employee incentives – such as the Enterprise Management Incentives – are useful levers to attract and retain top talent in growing enterprises. However, our Call for Evidence showed that static eligibility criteria for these schemes disincentivise high-growth firms from adopting them.

The Entrepreneurs Network sees this as the start of the debate on the role high-growth private businesses can play in making Britain more productive and prosperous. We end our report with a series of policy recommendations to enable the growth of Britain's Breakthrough Businesses. Though by no means exhaustive, we believe that if enacted they would improve the underlying business environment in Britain. They are as follows:

ONE
Government must engage more closely with large private businesses, recognising the crucial role they play in the business landscape and their long-term vision;

TWO
Support for the Edinburgh and Mansion House Reforms must be maintained but more work is required to ensure the intended results are realised, including consolidating smaller pension funds into larger ones and allowing greater founder control of companies;

THREE
Abolish the Stamp Duty Reserve Tax which biases investment away from British companies;

FOUR
Bolster the independence of the British Business Bank to enable it to act in the best possible way and over a longer time horizon;

FIVE
Ensure investment conditions for commercialising British university research are fit for purpose by implementing the Spinout Review in full;

SIX
Use lotteries and fast-track schemes to expedite grant funding for innovation;

SEVEN
Improve the administration of R&D tax relief to restore confidence in the system;

EIGHT
Modernise SEIS and EIS to ensure they're able to deliver what scaling businesses require;

NINE
Reconsider the implementation of Basel 3.1 to not hurt SME lending;

TEN
Reform employee incentive schemes' eligibility criteria to increase adoption and effectiveness.

"For all our success in starting companies, we do not scale them to be our national champions."

CHAPTER 1
INTRODUCTION

In the past decade or so, Britain has established itself as an excellent place in which to start a business. A long list of reasons helps explain Britain's vibrant startup scene – including our strong skills base, world-leading universities, a thriving VC industry, carefully crafted tax incentives for startup growth, a flexible labour market and a broadly sensible approach to regulation. It may be fashionable to complain about Britain's economy – and to be sure, weaknesses do exist – but the fundamental truth remains that there are few better places in the world than Britain in which to strike out and launch a new company.

We should celebrate the fact that so many entrepreneurs – whether born here or abroad – have decided to set up shop in the United Kingdom. There is a wealth of literature on the positive impact that startups have on the economy – not least in terms of new jobs, investment and innovation they bring.[1] That being said, for all our success in starting companies, there is an increasing recognition that we do not then scale them to their full growth potential, into globally recognisable companies which can serve as our national champions. Moreover, high-profile technology companies' decisions of late – such as Arm Holdings choosing to list on the Nasdaq rather than the London Stock Exchange in 2023,[2] Darktrace's recent sale to US-based Thoma Bravo,[3] and Google's acquisition of DeepMind in 2014[4] – reinforce the sense that the UK is struggling to retain its best companies.

To investigate these concerns, we established the Private Business Commission. Chaired by Steve Rigby, Co-CEO of Rigby Group, one of Europe's largest technology businesses and investors, and supported by eleven expert Commissioners from the worlds of business, finance and politics, the Commission sought to answer the question of what can be done to make Britain a better place in which to scale a business to a truly significant level.[5]

This report is the culmination of the Commission's work. The research underpinning it drew on various different methods – including extensive desk-based research, a series of roundtable discussions and a Call for Evidence. We have focused this report on four distinct policy areas that stood out as being especially critical to ensuring we have an environment in which large, private companies can thrive: funding; taxation; capital markets; and employee incentives. This is not to say that there aren't other important aspects which policymakers will need to ensure are fit for purpose if Britain is to succeed in creating the best possible framework for businesses to scale – but we believe making progress in these four broad policy areas would do a considerable amount of the heavy lifting required.

1 Tim Kane (2010). The Importance of Startups in Job Creation and Job Destruction.
2 Dominic Rushe (2023). UK chip designer Arm soars on Nasdaq debut to notch $65bn valuation.
3 Rob Davies (2024). Cybersecurity firm Darktrace agrees $5.3bn sale to US private equity business.
4 BBC (2014). Google buys UK artificial intelligence start-up DeepMind.
5 The Entrepreneurs Network (2024). Private Business Commission.

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NUMBER OF JOBS MEDIUM AND LARGE BUSINESSES PROVIDE

REVENUE GENERATED BY MEDIUM AND LARGE BUSINESSES

The case for scale

Medium and large private businesses, which make up only a fraction of the overall business environment by number, provide 14.4 million jobs and generate nearly £2.9 trillion in revenue.[6] It is essential for Britain to be a place in which businesses can scale into significant enterprises – whether judged by the revenues they turn over each year, the number of people they employ, or a combination of the two. Many of these businesses are household names, but many more are on cusp of greatness. These businesses rarely seek external capital and provide a critical part of the UK economic system – we call them 'Breakthrough Businesses'.

Perhaps the most important reason to back their growth is the productivity benefits that these firms bring. Britain has a well-documented productivity problem, with growth in worker output per hour having barely moved since the 2008 Financial Crash.[7] Our multifactor productivity growth rate, meanwhile, has not been above 2% in two decades, and since 2010 it has been negative almost as often as it has been positive.[8] This stagnation is the fundamental reason why real wages have remained flat in recent years.[9] If we want to raise living standards and generate money for the Treasury to fund better public services, boosting productivity is the only sustainable way to do so in the long run.

Plenty of research points to the productivity benefits that firms of significant scale can have for an economy. According to the ScaleUp Institute, scaleups can be up to 65% more productive than other firms in the same sector,[10] while the CBI's recent work on 'decacorns, unicorns and soonicorns' found that jobs in these types of businesses generate 30% more value-add than the British average – £97,050 compared to £74,650.[11] Data from the OECD show that the value-add per employee increases as firms move through from being small, to medium, to large.[12] Meanwhile, the 8,000 or so businesses that employ more than 250 people in Britain are responsible for almost half the total business population's turnover.[13] Fundamentally, when businesses are able to scale, it's a sign that all is well with growth.

Following on from this, one of the clear benefits of a thriving economy from a government perspective are the tax revenues it generates. Having a growing population of productive, well-paid workers is naturally going to shore up public finances – not just in terms of the income tax and National Insurance contributions they generate, but also the taxes they pay and jobs they support when consuming goods and services. Of course, there are also the taxes paid by the corporations employing these workers – taxes that would be lost if the firms in question were to relocate in order to maximise their growth potential. While not a perfect proxy, PwC's analysis of the 100 Group – a collection of FTSE 100 and other large companies – finds that they paid £90 billion in taxes in 2022/23, equivalent to 10% of total government receipts.[14]

6 Department for Business and Trade (2023). Business population estimates for the UK and regions 2023: statistical release.
7 Office for National Statistics (2024). UK Whole Economy: Output per hour worked SA: Index 2019 = 100.
8 Multifactor productivity growth measures the overall increase in efficiency of labour and capital, and is regarded as particularly important for sustained, long-run economic growth, as it is about doing more with the same stock of resources; OECD (2024). Multifactor productivity.
9 Torsten Bell and Charlie McCurdy (2023). Wages are flatlining.
10 ScaleUp Institute (2023). ScaleUp Planet: Annual Review 2023.
11 CBI (2023). Decacorns, Unicorns and Soonicorns: the powers behind UK growth.
12 OECD (2021). Productivity in SMEs and large firms.
13 Department for Business and Trade (2023). Business population estimates for the UK and regions 2023: statistical release.
14 PwC (2023). UK's largest listed companies contribute nearly £90bn in taxes in 2022/23 as taxes borne increase by 9.9%.

"FTSE 100 companies paid £90 billion in taxes in 2022/23, 10% of total government receipts."

Aside from the quantifiable benefits of having a business environment in which companies can grow considerably, it's also worth keeping in mind the sorts of signals that are sent out to the rest of the world by virtue of having strong, globally recognisable brands in an economy. Markets aren't irrational, but nor are they ruthlessly cold and calculating. To put it colloquially, vibes matter. If an economy is seen to be a thriving, dynamic, vibrant place, conducive to building strong businesses, it almost becomes a self-fulfilling prophecy. If an economy gains a reputation as somewhere where the chances of success are constantly stacked against you, negative cycles can ensue. Of course, the extent to which these perceptions take hold is driven largely by underlying policy decisions and getting the fundamentals right[15] – but perceptions matter nonetheless.

Finally, beyond the economic arguments, there are social and political consequences to having businesses of a certain scale within Britain as opposed to elsewhere. The world has taken a number of turns in recent years – with conflicts, technological developments and other exogenous shocks, such as the recent pandemic, causing many to believe that we need to take more seriously what we might term 'economic sovereignty'.[16] Whether it is in semiconductor manufacturing, energy generation, or the development of artificial intelligence (AI) technologies, nations are increasingly placing value on having the firms involved in the production of these critical goods and services based within their borders rather than outside them. And the firms within this debate almost invariably need to be of a certain scale to have the desired impact. If smaller yet innovative companies feel they cannot attain that scale in Britain, and consequently move abroad, then the loss is more than just economic – it becomes strategic too.

For all of these reasons, we believe that the time has never been more apt to forensically examine what more can be done to ensure businesses have the ideal set of conditions in which to fulfil their growth potential.

History and recent trends

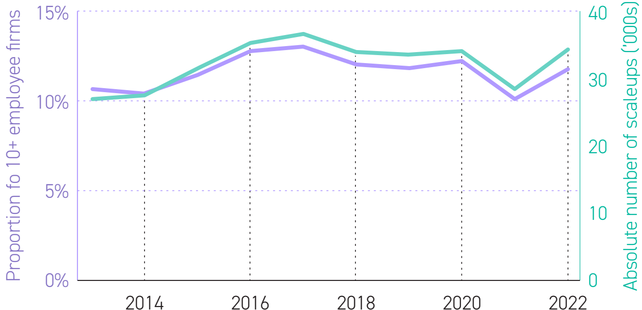
The first question to ask is straightforward – how is Britain doing? The answer, however, is more complicated. There are plenty of different data we can consult in order to get a rough picture, but at times it isn't necessarily clear, while at others the evidence appears conflicting.

With that in mind, a good place to start looking is the number of high-growth businesses. This is a specific OECD definition, referring to those companies that have ten or more employees and also experienced an average growth in employment or turnover of greater than 20% per year over a three-year period. These firms are proven employers with strong turnover, and studies have found them to be more R&D-intensive and productive.[17]

In the ten years that the ScaleUp Institute has been monitoring these firms between 2013 and 2022, there has been an overall increase of 27% in the total number of UK high-growth businesses. In 2022, these businesses employed over 3.2 million people, with 9,650 employing over 50 staff and 1,740 over 250 staff.

15 Eamonn Ives, Anton Howes, Derin Kocer and Philip Salter (2024). Building Blocks: Our vision for securing Britain's entrepreneurial future.
16 The Economist (2024). The world's economic order is breaking down.
17 OECD (2000). High-Growth Firms and Employment; Geoff Mason, Catherine Robinson and Chiara Rosazza Bondibene (2015). Sources of labour productivity growth at sector level in Britain, 1998-2007: a firm-level analysis.

CHART 1: THE NUMBER AND PROPORTION OF HIGH-GROWTH FIRMS IN BRITAIN'S ECONOMY FLUCTUATED IN RECENT YEARS, BUT IS BROADLY ON AN UPWARD TRAJECTORY

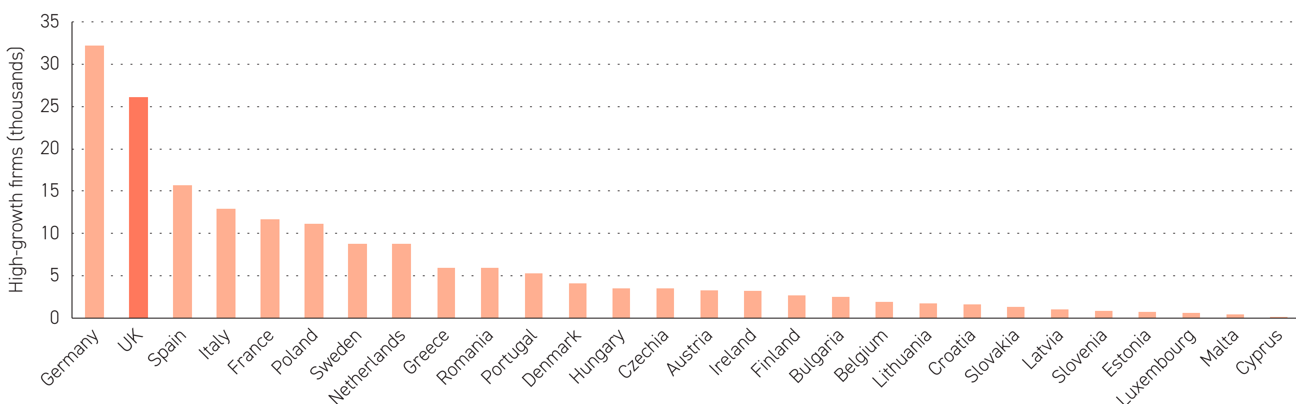


Source: ScaleUp Institute Analysis of Office for National Statistics IDBR (2010-2022).

Research shows that high-growth firms exist across all areas of the UK, with 65% of scaleup companies based outside London and the South East. However there remain significant regional disparities and still much to be done in optimising regional growth.

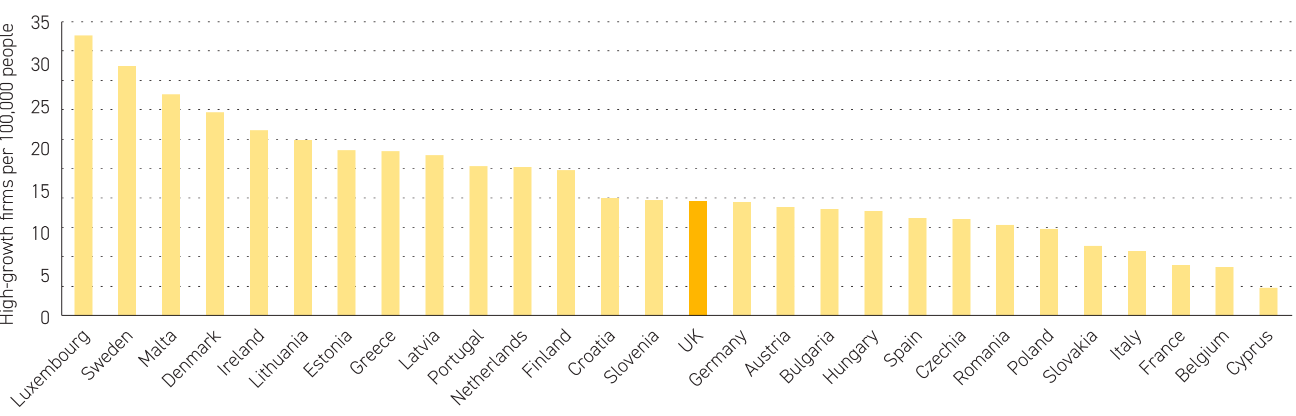
We can also consider how the UK fares compared to other European nations on the European Eurostat metric, which looks purely at employment growth of at least 10%. On paper, the UK performs comparatively well. Though second to Germany, which boasted 32,200 high-growth firms in 2021, the UK counted 26,115.[18] Even Spain, the European Union member state with the second-highest number of high-growth firms, has less than 16,000.

CHART 2: BRITAIN COMES SECOND ONLY TO GERMANY IN EUROPE FOR THE NUMBER OF HIGH-GROWTH FIRMS IT BOASTS



Eurostat (2024). High growth enterprises and related employment by NACE Rev. 2 activity; Office for National Statistics (2022). Business demography, UK: 2021.

CHART 3: ON A PER-PERSON BASIS, BRITAIN HAS A MIDDLING NUMBER OF HIGH-GROWTH FIRMS COMPARED TO OTHER EUROPEAN COUNTRIES



Eurostat (2024). Eurostat (2024). High growth enterprises and related employment by NACE Rev. 2 activity; Office for National Statistics (2022). Business demography, UK: 2021; Eurostat (2024). Population and Demography – Database; Office for National Statistics (2022). Population estimates for the UK, England, Wales, Scotland and Northern Ireland: mid-2021.[19]

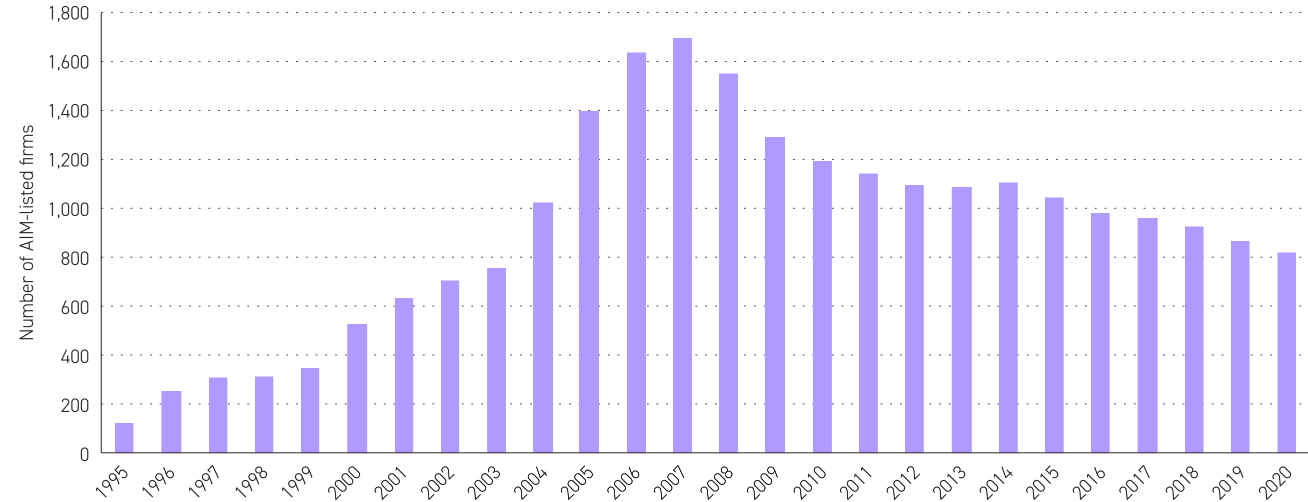
18 N.B. For equivalence with European nations, these data classify a business as high-growth if it experienced an average annualised increase in employee numbers of more than 10% per year over a three-year period and having at least ten employees when this growth began, hence the higher figure for the UK compared to earlier in the report.

19 N.B. Population data for European Union member states is for 1 January 2021, whereas population data for the UK is for mid-2021.

Yet, on a per capita basis, things begin to look much worse for the UK. Britain sits right in the middle of the pack – ever so slightly ahead of Germany, and well ahead of countries like France and Italy, but quite a way behind many other countries, especially those in Scandinavia and the Baltics."

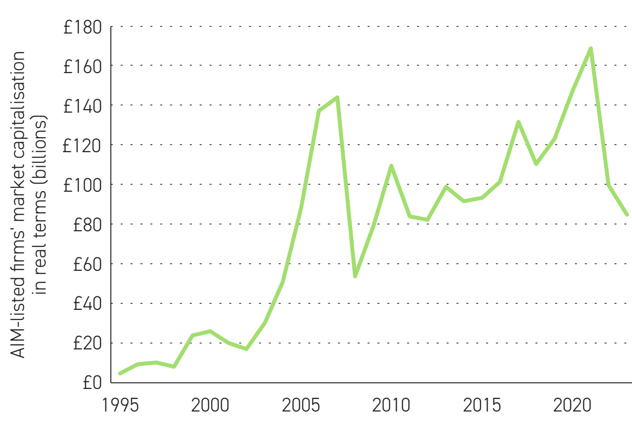
Other data also allow us to understand how Britain's scaling firms are doing. The Alternative Investment Market (AIM) is the growth market owned by the London Stock Exchange, designed to help smaller companies access capital from the public market. Among some of the more well known businesses listed on AIM (either currently or historically) are Domino's, ASOS, Hornby, YouGov and Fevertree Drinks.[20]

CHART 4: THE NUMBER OF FIRMS LISTED ON AIM HAS BEEN IN STEADY DECLINE SINCE 2007



Source: AIMListing (2024). AIM Primary Market Summary Since Launch.

CHART 5: AIM-LISTED FIRMS' MARKET CAPITALISATION IN REAL TERMS HAS PLUMMETED IN THE LAST TWO YEARS



Source: AIMListing (2024). AIM Primary Market Summary Since Launch.

AIM launched in 1995 with just ten companies listed but grew at a healthy rate over the next several years.[21] In 2007, the number of companies it comprised stood at 1,694. However, this was to be AIM's peak. Following the Global Financial Crisis, in line with other exchanges, the number of listings fell markedly. In the past decade, the number of LSE-listed companies fell by a quarter.[22] One positive note, however, is that consistently around one third of the total number has been made up of high-growth firms.

Meanwhile, the market capitalisation of AIM-listed firms has held up slightly better – although, in common with other exchanges around the world recent years have not been promising.[23]

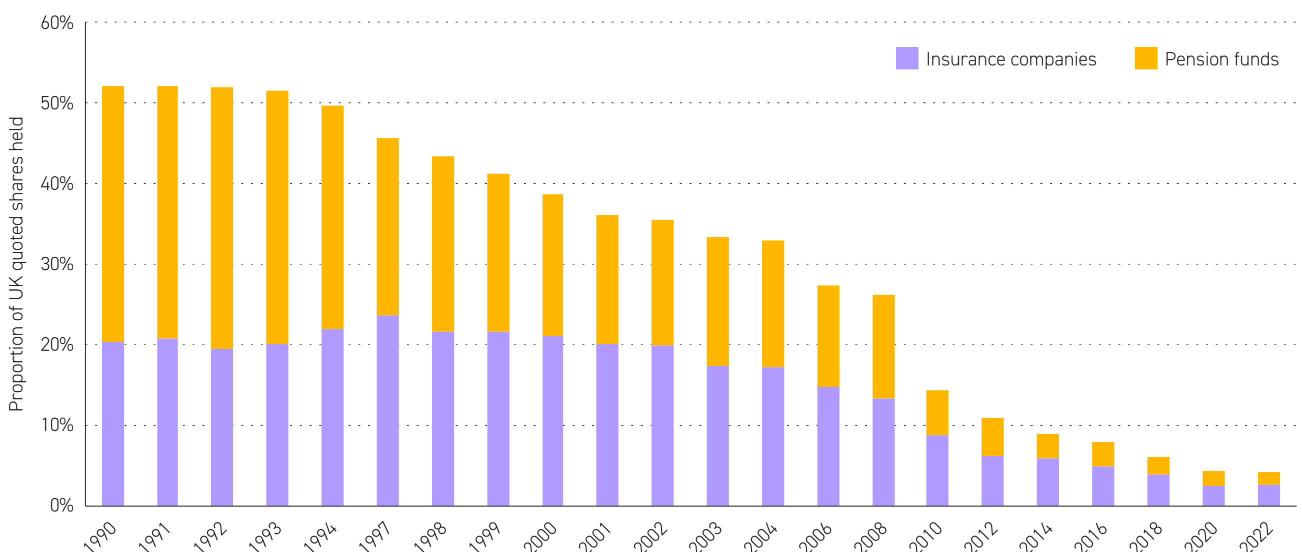
20 London Stock Exchange (2024). AIM.

21 AIMListing (2024). AIM Primary Market Summary Since Launch.

22 John Colley (2024). Why is the London Stock Exchange failing?

23 AIMListing (2024). AIM Primary Market Summary Since Launch.

CHART 6: THE PROPORTION OF UK QUOTED SHARES HELD BY INSURANCE COMPANIES AND PENSION FUNDS HAS FALLEN DRAMATICALLY SINCE THE 1990s"



Source: Office for National Statistics (2023). Ownership of UK quoted shares: 2022.

From 1995 through to the early 2000s, valuations steadily increased, before then skyrocketing to just shy of £150 billion in 2007. Collective market capitalisation then suddenly contracted, before rallying and enjoying a healthy trend rate of growth through the 2010s – eventually peaking at £169 billion in 2021. In the past two years, however, there has been a sharp decline globally, and it remains to be seen whether valuations will rebound or continue to shrink or plateau. Eventually, many AIM-listed firms will eye a move up to the main market. Yet recent mood music around the London Stock Exchange has been anything but positive – from underwhelming IPOs for companies like Deliveroo or Dr Martens, to existing firms delisting and others choosing to list elsewhere. In 2023, IPOs in the UK experienced their worst year since 2009 with only around $1 billion being raised.[24]

Fingers have been pointed in various directions for this poor performance. One explanation is that insurers and pension funds have slashed their ownership of UK-listed shares, as they moved into lower risk assets such as fixed income gilts and bonds to liability match.[25] Others have blamed stringent regulations, low executive pay and the ongoing impact of Brexit taking the shine off the UK as a place to do business.

According to the Quoted Companies Alliance's latest update to its *Small and Mid-Cap Sentiment Index*, feelings about listing in the UK have scarcely ever been worse.[26] Almost one in four quoted companies currently see no advantage to maintaining a share listing in London, though it must also be noted that a larger proportion (36%) note it being an important route to access to capital, and 31% highlight it as improving their reputation. However, three fifths report having a 'negative experience' of being a publicly quoted company in 2023.

Looking forward

There is now substantial policy focus on improving Britain's listings environment and access to institutional capital for scaling firms. Initiatives such as the Edinburgh and Mansion House Reforms, the PISCES initiative and the London Stock Exchange-led Capital Markets Industry Taskforce have critical roles to play in improving liquidity options for growth companies in the UK, and will be vital to follow through on. However, there are still other policy levers available to the government – across funding, taxation, capital markets and employee incentives – to leverage further progress which are outlined in this report.

24 Swetha Gopinath, Michael Msika and Joe Easton (2024). Why London's Once-Vibrant Stock Market Is in a Rut.
25 Office for National Statistics (2023). Ownership of UK quoted shares: 2022.
26 Quoted Companies Alliance (2023). Small and Mid-cap Sentiment Index / November 2023.

CHAPTER 2

FUNDING

If our Breakthrough Businesses launch here but leave at their high-growth phase, years of British investment would flow to other nations.

A founder might have a brilliant idea for starting or growing a business, but without the resources to turn it into something tangible, it'll only ever remain an idea. Access to funding is one of the principal determinants of whether or not a Breakthrough Business can scale and reach its full potential.

Firms that wish to scale need large amounts of funding, to spend on research and development and specialist capital equipment, to expand into new markets, and for hiring top talent.

Increasingly, the successful companies of today and tomorrow are those which are characterised by intangible assets – such as patents, branding or networks. Yet the shift to intangibles transforms the question of funding, and how investors and lenders operate. It may be that a company remains loss-making for several years before turning a profit, and while that does not necessarily render it a bad business, it does alter what sort of funding landscape it requires – namely one with deep and patient pools of money. The typically intangible nature of these businesses also means there often isn't anything to credibly secure debt against, requiring investors to have a greater appetite for risk. Ensuring that these businesses grow and stay in Britain is essential for turning their success into long-term value for Britain. If these companies start in Britain but leave at their high-growth phase, as many do, then years of British investment flow to other nations and not to the UK economy.

Already, the UK starts from a position of relative strength in terms of the availability of funding for startups. It has a healthy and ever-maturing VC ecosystem, with $20.1 billion being invested in 2023, up from $2.2 billion in 2010.[27] The government also plays an active role in supporting especially innovative companies through a range of grants, loans and tax credits, as well as offering tax relief on some forms of investment. There has also been considerable policy movement of late in terms of reforms to key sources of potential funding, such as the pensions industry, that could also unlock additional capital for businesses looking to scale.[28]

27 Dealroom (2024). Funding rounds.
28 HM Treasury (2023). Mansion House 2023.

Scaling firms are more likely to use external finance when compared to their smaller peers, with around eight in ten using some form of business funding compared to seven out of ten for SMEs who are not scaleups.[29] Core forms of finance, such as traditional debt products, are most commonly used, while three in ten are using or plan to use equity finance.[30]

Although policies have been implemented to help businesses grow, there are still some areas of weakness. According to Beauhurst's *The Deal 2023*, both the value and number of deals have fallen precipitously since the heady highs of 2021.[31] Looking at seed (and even early stage) investment only – which is critical for ensuring new firms can get up and off the ground – the data show a general plateauing.

Comparisons to the US might not always be entirely fair, given some of the unique advantages firms have on the other side of the Atlantic, but it's hard to look past the fact that in 2022, 0.8% of the US GDP was invested in VC, while for the UK it was just 0.1% of GDP.[32] Meanwhile, as shown in Table 1 below, VC-backed firms receive far smaller amounts of follow-on investment in funding rounds subsequent to their first. It's little wonder why so many entrepreneurs view America as the place to raise the funding needed to meet their growth ambitions.

TABLE 1: AMERICAN VC-BACKED COMPANIES ENJOY FAR LARGER DEAL SIZES ON AVERAGE THAN BRITISH ONES DO

	United Kingdom		United States	
Funding Round	Deep tech	Overall VC	Deep tech	Overall VC
1	£2.0 million	£1.9 million	£2.5 million	£2.1 million
2	£1.3 million	£2.5 million	£4.8 million	£4.6 million
3	£2.9 million	£4.3 million	£9.7 million	£9.0 million
4	£4.6 million	£6.5 million	£15.9 million	£14.0 million
5	£6.1 million	£8.4 million	£28.6 million	£24.9 million
6	£7.6 million	£14.0 million	£51.9 million	£41.7 million

Source: British Business Bank (2021). Small Business Equity Tracker 2021.

UK's funding landscape – types, trends and comparisons

Equity and VC investment

In 2023, across 2,179 individual deals, private companies in the UK raised £12 billion of equity investment.[33] How well that contrasts with previous years really depends on what time frame one uses as a reference. Compared to 2021, the record high year for both the number (3,045) and value (£23.7 billion) of deals struck, the picture looks gloomy. However, considering that this was a peak and therefore not a normal reference point, it must be highlighted that investments have been getting a lot rosier since the early 2010s.

Similarly, international comparisons of VC investment present a mixed picture depending on one's perspective. One reading is that the US ($149 billion invested in 2023) and China ($49 billion) are streaking ahead, leaving all other nations in the dust.

29 ScaleUp Institute (2023). Scaleups Debt Finance Journey.
30 ScaleUp Institute (2023). ScaleUp Planet: Annual Review 2023.
31 Beauhurst (2024). The Deal 2023.
32 OECD (2024). Venture capital investments.
33 Beauhurst (2024). The Deal 2023.

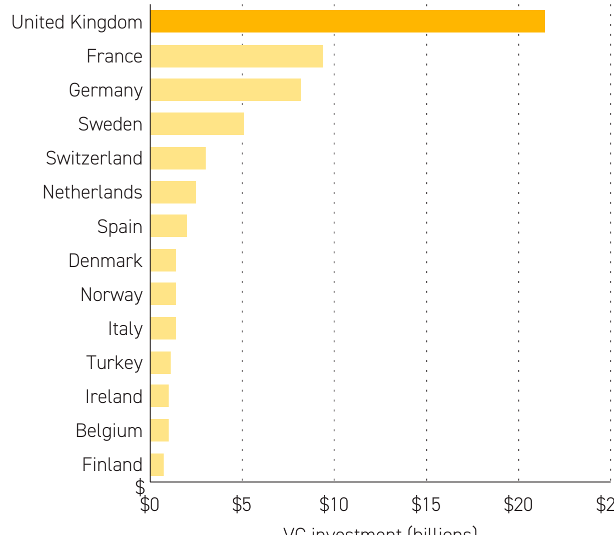
2,179 **£12BN**

THE NUMBER AND VALUE OF INVESTMENT RAISED FROM INDIVIDUAL DEALS IN 2023

Another reading is that this should be expected – those economies are much larger in absolute terms and it would be foolish to attempt to draw comparisons based on the total amount invested.

More fitting would be to compare figures between Britain and its European counterparts, as well as selected other economies from around the world. On this measure, the UK performs much better.[34] In 2023, France mustered only $9.4 billion of investment, Germany $8.1 billion, Canada $6.7 billion, Japan $5.8 billion, South Korea $5 billion and Italy $1.3 billion. Even the population superpower that is India only saw $11.2 billion of VC investment in 2023.

CHART 7: BRITAIN LEADS ALL OTHER EUROPEAN COUNTRIES WHEN IT COMES TO VC INVESTMENT



Source: Dealroom (2024). Location fundings heatmap.

Despite this, however, the general sense is that British firms could be doing better. Whether at roundtables, in newspaper columns, or in political speeches, we're frequently reminded that promising businesses often feel compelled to look abroad to get the size and shape of the investment they need to grow.

It should also be noted that while the UK performs strongly relative to its European peers, some are starting to catch up. As already mentioned, other large VC markets in Europe like France and Sweden are still some way behind the UK with mere $9.4 billion (France) and $5.2 billion (Sweden) relative to the UK's $21.3 billion invested in 2023. However, between 2019 and 2023, French VC investment grew by 53% and Swedish by 66%, while the UK's grew by 19%.[35]

Debt

Loans are one of the most common ways that businesses secure the funding they need to both get by and grow. In 2023, the gross lending flow from bank deposits to British SMEs stood at nearly £60 billion.[36] While this represents the joint-third highest year for lending to SMEs on record, in truth there has been little fluctuation in overall numbers since the mid-2010s (excluding 2020, where lending hit £105 billion due to the impact of the Covid-19 pandemic).

The success rate of SMEs applying for loans from the UK's seven largest banks has fallen markedly since the start of 2020. Between 2012 and 2020, the number of loan applications being successfully granted was generally between 80-85%. In 2023, however, the figure stands at less than 50%.[37]

34 Dealroom (2024). Location fundings heatmap.
35 Dealroom (2024). UK Innovation 2024 Forward Look.
36 British Business Bank (2024). Small Business Finance Markets Report 2024.
37 British Business Bank (2024). Small Business Finance Markets Report 2024.

110,000 £1+BN

THE NUMBER AND VALUE OF START UP LOANS ISSUED TO BUSINESSES TO DATE

The British Business Bank notes that this has been driven by banks "applying more cautious affordability tests to loan applications."[38]

OECD data on the percentage of SMEs applying for bank lending reveals that Britain seems to have a particular aversion to it. While in places like the US, some 60-70% of SMEs apply for loans, and in Europe between a fifth and a third do, in the UK in 2021, just 8% of SMEs did.[39]

The APPG on Fair Business Banking has been calling for structural change in the SME banking sector, potentially utilising not-for-profit Community Development Finance akin to Germany's Sparkesse system of regional mutual banks.[40] Although achieving foundational change in the UK banking system would be a rather challenging objective in the near term, it's clear that more thinking needs to be given to innovative asset-backed lending, such as annual recurring revenue funding for Software as a Service businesses secured on future revenue or IP-based funding, as was recently launched by NatWest.[41]

"While in places like the US, some 60-70% of SMEs apply for loans, and in Europe between a fifth and a third do, in the UK in 2021, just 8% of SMEs did."

Start Up Loans

One particular form of loan that is accessible to newer, smaller businesses in the UK, is that offered through the government-backed Start Up Loans scheme.[42] These are personal unsecured loans of up to £25,000 per business owner (up to £100,000 per business). They have a one- to five-year repayment period and have a fixed interest rate of 6% per annum. Successful applicants are also offered a free business mentor for 12 months to help grow their business, as well as various discounts on business services.

The rationale for the Start Up Loans scheme is that startups can often struggle to access credit if they lack collateral and trading histories. Moreover, lenders can be unwilling to offer low-value loans as the due diligence costs related to doing so makes them less profitable.

To date, over £1 billion worth of Start Up Loans have been issued to more than 110,000 businesses.[43] Forty percent of loan recipients have been women, and 20% have been people from minority ethnic backgrounds, while 26% of recipients were unemployed before applying.[44] An evaluation of the Scheme published in 2019 found that "the benefits in terms of GVA are expected to be higher than the costs associated with delivering the programme" with benefit-cost ratios ranging from 3:1 to 5.7:1 depending on the cohort in question.[45]

38 Ibid.
39 OECD (2024). Financing SMEs and entrepreneurs.
40 Joe Ahern and Christina Bovill Rose (2021). Scale up to level up: Reforming SME Finance.
41 Richard Tyler (2024). NatWest offers loans against value of intellectual property.
42 British Business Bank (2024). Start Up Loans.
43 British Business Bank (2024). Impacts and achievements.
44 Ibid.
45 British Business Bank (2019). Evaluation of Start Up Loans: Year 3 Report.

90,000

NUMBER OF CLAIMS FOR R&D TAX RELIEF IN 2021-22

AMOUNT OF R&D TAX RELIEF CLAIMED IN 2021-22

R&D tax relief

Since 2000, successive governments have incentivised private companies to undertake research and development (R&D) by allowing them to claim tax relief above the normal corporation tax relief available for business expenses.

Such additional relief has been available in different guises over the years. Until recently, there were separate schemes for SMEs and larger enterprises, but these were merged in April 2024 following concerns about the legitimacy of some R&D claims. Now, profitable companies can claim a taxable expenditure credit of 20%, and loss-making ones can claim a subsidy of 16.2% for every qualifying pound of R&D spent.[46] Additional tax relief is also available for 'R&D-intensive SMEs', defined as those which spend at least 30% of their relevant expenditure on R&D.

In 2021-22 – the most recent fiscal year for which data is available – the provisional amount of R&D tax relief claimed stood at £7.6 billion (corresponding to around £50 billion of R&D expenditure) and comprising over 90,000 claims.[47] In constant prices, investment has plateaued in the last few years, with computer programming and pharmaceutical industries standing out.[48]

Compared internationally, the UK stands out as one of the most generous countries in the world for R&D tax relief.[49] In 2021, tax support as a percentage of GDP for business enterprise expenditure on R&D stood at 0.33% in the UK, slightly lower than Iceland's 0.37%, but higher than France's 0.28%, America's 0.12% and Japan's 0.12%. Of course, tax relief is not the only way to support private sector innovation, and different countries take different approaches. But the fact remains that businesses in the UK face a relatively attractive set of financial incentives when it comes to undertaking research.

UK Export Finance

For British businesses that are looking to export, UK Export Finance (UKEF) can offer funding support through various products, tailored for various objectives – such as helping companies to win contracts, fulfil orders and get paid. Examples of the support that UKEF offer include export insurance, bills and notes guarantees, lines of credit, and even direct lending (for instance, through the Direct Lending Facility, loans within an overall limit of £8 billion can be provided to overseas buyers to enable the purchase of goods and services from British firms).

In 2022-23, 251 businesses were direct recipients of UKEF assistance – of which 84% were SMEs – and in total it provided £6.5 billion of financial support to further UK exports.[50] This supported an estimated 55,000 full-time equivalent jobs, and contributed £4.1 billion gross value added to the economy.[51]

46 HM Revenue and Customs (2024). Research and Development (R&D) tax relief: the merged scheme and enhanced R&D intensive support.
47 HM Revenue and Customs (2023). Research and Development Tax Credits Statistics: September 2023.
48 House of Lords Economics Affairs Committee (2023). Research and development tax relief and expenditure credit.
49 OECD (2024). Tax incentives for R&D and innovation.
50 UK Export Finance (2023). UK Export Finance Annual Report and Accounts 2022 to 2023.
51 Ibid.

"Few people responding to our Call for Evidence had a positive impression of the current state of the funding environment. Multiple founders described it as 'extremely challenging', with most bemoaning the excessive conservatism, in their eyes, that potential financiers have towards startups and scaleups."

Grants

Grants are a way for businesses to access funding without giving away equity or taking on debt. Generally speaking, grants are awarded by the government – or via government agencies, such as Innovate UK – and tend to be offered to businesses heavily underpinned by R&D. This is because they are usually tailored to meeting specific objectives – such as devising therapeutics for particular medical conditions, or developing technological solutions to certain environmental issues – and 42 grant schemes are presently listed by the government's 'business finance and support finder'.[52] In the financial year 2023/24, Innovate UK awarded nearly £2 billion – with individual grants ranging from the low thousands in value, up to multiple millions.[53] However, numerous entrepreneurs who have gone through the process of applying for government grants suggest that they needed to hire consultants to help with the application. This translates into additional costs for bootstrapped companies.

Lately, the government also appears to have gained an appetite for novel ways of allocating finance to especially innovative businesses. New funding architectures include the Advanced Research and Invention Agency[54] – which was formally launched in 2023, and has powers to award funding in a variety of ways (including grants, but also loans, investments, and prizes for speculative breakthrough research) – and Focused Research Organisations – enterprises that adopt a highly targeted approach to solving very specific problems over a short time-frame.[55]

The success of these recent initiatives is too early to judge here in the UK, but evidence from similar ones across the world suggest that the funding they provide could play a central role in spurring innovation and the creation of world-leading companies in critical industries.[56]

52 Department for Business and Trade (2024). Finance and support for your business.
53 Innovate UK (2022). Innovate UK funded projects since 2004.
54 ARIA (2024). How we fund.
55 Department for Science, Innovation and Technology (2023). Plan to forge a better Britain through science and technology unveiled.
56 The Economist (2021). A growing number of governments hope to clone America's DARPA.

Call for Evidence responses

"Investors in the UK are not culturally inclined to take risk."

Few people responding to our Call for Evidence had a positive impression of the current state of the funding environment. Multiple founders described it as "extremely challenging," with most bemoaning the excessive conservatism, in their eyes, that potential financiers have towards startups and scaleups.

A founder from the tech sector, for example, told us that: "Investors in the UK are not culturally inclined to take risk and invest in early-stage companies, which leads to an abundance of conservative valuations," and that investors typically adopt an "overdefensive stance when it comes to deciding to fund new ventures." Another said they "have always felt that UK investor sentiment is far more risk averse than anywhere else I have operated."

Respondents reserved criticism for almost all private sources of funding. One founder singled out bank lending as a source of frustration, concluding that they "are not currently open for private company growth," due to the "absurdly cautious" approach they take. And a number of respondents drew attention to the fact that women and those from minority backgrounds faced particular barriers when it comes to accessing funding from private equity and VC, with one saying that access "hardly exists,"[57] while another highlighted that female founders don't get fair consideration because their businesses "often grow more slowly but consistently."

On the performance of government schemes, however, opinions were more mixed. One founder praised the idea behind Innovate UK, describing it as "excellent." Yet they did note that "these grants have become more and more competitive, making [them] almost impossible to access," suggesting that such schemes may need to be expanded.

Other respondents viewed government funding with indifference. One entrepreneur simply remarked that government support was "inefficient," while another told us: "I have never particularly engaged with any government grants," because they "dread to think how much bureaucracy and hoops you have to jump through in order to get anywhere." In a similar vein, another said: "Where [government finance] is available, the strings attached are generally not worth the bother."

Finally, one entrepreneur highlighted how important it is for stability and certainty when it comes to support on offer. They told us of how their business was built around a subsidy scheme to encourage the generation of renewable electricity, but that "through a lack of political will, patience, understanding or a combination of all three, the scheme changed more quickly than the time it takes to get a project through planning and permitting. We wasted around five years chasing a moving target, which in the end we abandoned entirely." Ultimately, this entrepreneur is now "extremely sceptical about building or investing in a business that requires any kind of government incentive to be worthwhile."

One of the more significant ways in which the government has tried to improve the funding landscape for startups and scaleups in the UK of late has been the Edinburgh and Mansion House Reforms. Unveiled by the Chancellor in July 2023, the package of changes should, in the government's words, "enable our financial services sector to unlock capital for our most promising industries."[58] Given the bold rhetoric, we were eager to understand what people thought of the Reforms.

What we found was a spread of views – from one respondent saying they will make "a massive difference," to another saying they're a "starting point," to another saying: "In all honesty, when you are at the coalface managing a business, the Mansion House Reforms are unlikely to make a material difference." According to one submission: "we can talk as much as we like about the need to 'change risk culture' in pension funds, but at the end of the day if this culture is driven by certain market conditions, it will probably be easier to try to change these conditions than to change culture." Discouragingly from a government perspective, one founder told us they were: "not aware of any specific scheme following the announcement of the Mansion House Reform," while another simply said: "I can't see how (or, to be honest, why) investors could be forced to invest in UK stocks."

57 Previous research from The Entrepreneurs Network has clearly shown the gulf in equity investment female-led firms receive – at the last count, in 2023, just 3.5% of total equity investment went to female-founded startups (a further 11.4% goes to firms with female and male founders, but the vast majority – 85.1% – went to male-led teams); The Entrepreneurs Network (2024). Female Founders Forum.
58 HM Treasury (2023). Mansion House 2023.

“Private business can be the antidote to the government’s financial troubles.”

CHAPTER 3
TAXATION

An economy’s tax system can have profound effects on businesses, steering countless decisions. Taxes ultimately affect what and how much of something ends up getting produced. They can determine whether someone becomes an entrepreneur or an employee, and influence how hard they will work. The stroke of a Chancellor’s pen can be enough to empower or endanger a business, and so taxation policy remains one of the most heavily scrutinised areas of government decision-making. In a sentence, getting tax policy right matters.

In 2023-24, HMRC collected £827.7 billion in taxes.[59] Of this, Income Tax, Capital Gains Tax and National Insurance Contributions were collectively the biggest contributors, netting the public purse £446.5 billion. ‘Business taxes’, which include Corporation Tax, and sector-specific taxes like the Electricity Generator Levy, raised £95.2 billion.

Of course, the reason for raising taxes is to pay for public services and the cost of government debt. This is a central concern of any government. And while some quarters may baulk at the size of the state today, in the absence of wholesale reforms or a productivity growth miracle there is every reason to imagine that it will only need to get bigger. Indeed, trends like an ageing population – while a good thing in that people are getting to live longer – pose looming questions in terms of pensions and healthcare costs. Even in the near term, taxes are forecast to rise as a percentage of GDP, and without a step change in economic growth, they will necessarily need to increase further if public services are simply to be maintained at their current levels.

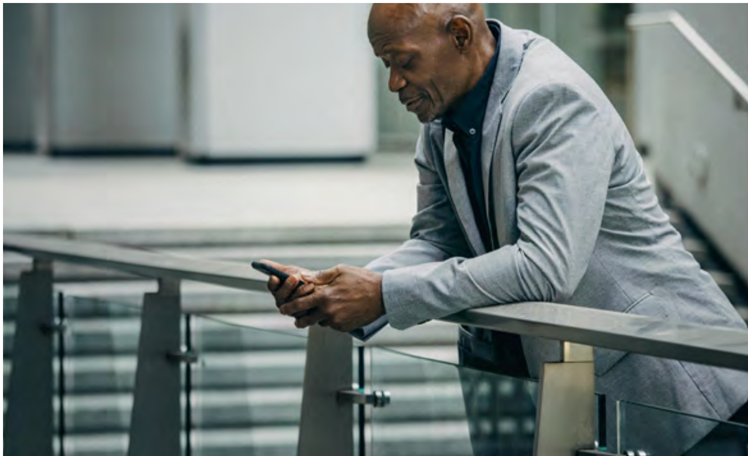
Amid this context, Breakthrough Businesses should be seen as an antidote to our troubles. But it is not sufficient just to see the absolute number of private businesses increase, or even the share of the economy they comprise. We should instead be aiming to create a durable and robust economy, characterised by a greater proportion of mature businesses turning over significant quantities of revenue and employing sizeable workforces. Not only will this lead to the generation of more tax receipts, but it will also help to tackle emerging problems like economic inactivity, which are adding further pressure onto public finances.

TABLE 2: TAX COMPETITIVENESS INDEX

	International Tax Competitiveness Index ranking
1.	Estonia
2.	Latvia
3.	New Zealand
4.	Switzerland
	...
30.	United Kingdom

Tax Foundation (2023). International Tax Competitiveness Index 2023.

59 HM Revenue and Customs (2024). HMRC tax receipts and National Insurance contributions for the UK (annual bulletin).

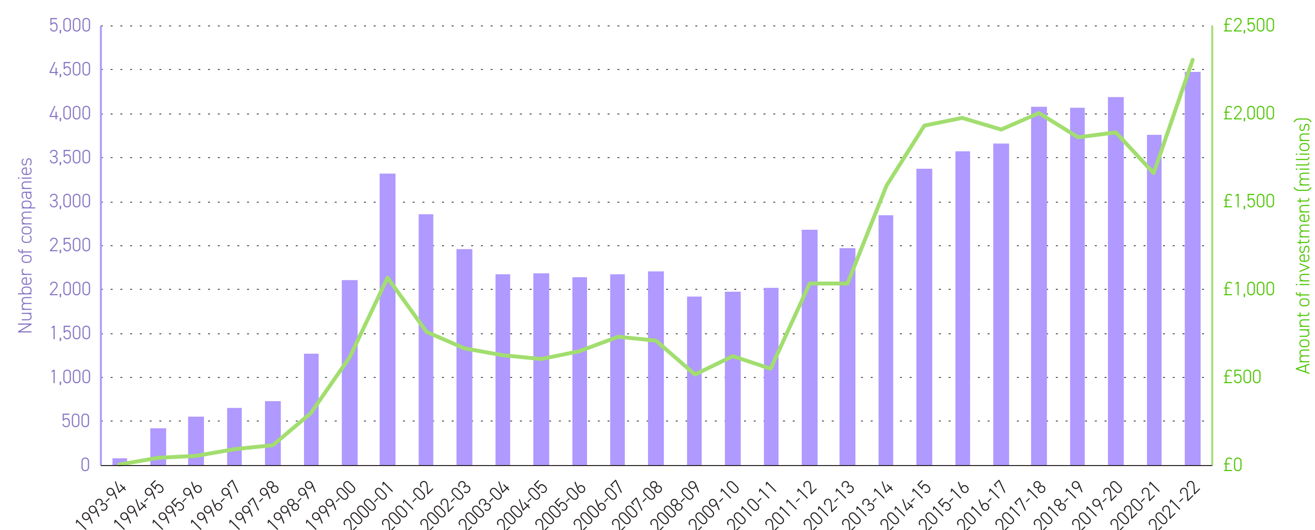


A whole report of its own could be written on what an ideal tax system would look like, but our remit here is to single out the taxes that are especially important for corporate decision-making at the margin, for instance, whether a business decides to grow or hold back. With the UK coming in 30th out of 38 countries on the Tax Foundation’s 2023 *International Tax Competitiveness Index*, there is clearly plenty of room for improvement.[60]

The Enterprise Investment Scheme and the Seed Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS), and its counterpart for even earlier-stage businesses, the Seed Enterprise Investment Scheme (SEIS), are tax reliefs to incentivise private investors to invest in British companies. The two schemes have been routinely hailed by the entrepreneurial community – within and outside of the UK – as genuine success stories spurring the creation and growth of new businesses in Britain,[61]

CHART 8: BOTH THE NUMBER OF COMPANIES RAISING FUNDS THROUGH EIS AND THE AMOUNTS RAISED EACH YEAR HAVE INCREASED MARKEDLY SINCE IT BEGAN



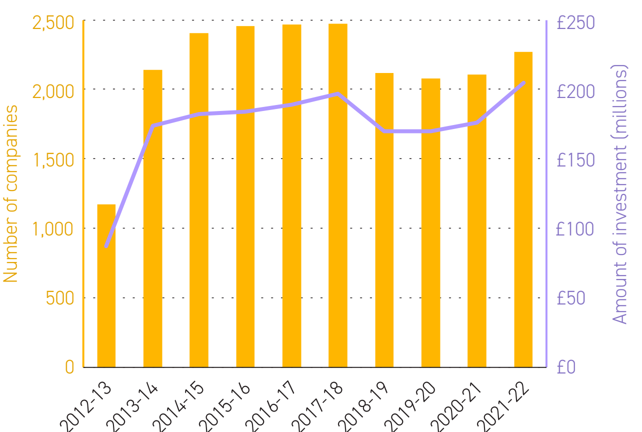
Source: HM Revenue and Customs (2023). Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Social Investment Tax Relief statistics: 2023.

60 Tax Foundation (2023). International Tax Competitiveness Index 2023.
61 Sam Dumitriu and Aria Babu (2023). Funding to Flourish: The Case for Tax Relief on Early Stage Investment.

and they have won praise from the Kalifa Review and the Patient Capital Review.[62]

According to the latest data from HMRC, in 2021-22, 4,480 companies raised a total of £2.3 billion of funds under EIS – up 39% on the previous year.[63] This is the highest number of companies and highest total amount raised since the scheme was introduced. For SEIS, 2,270 companies raised a total of £205 million of funds, which was also its highest year on record since it was introduced in 2012.

CHART 9: BOTH THE NUMBER OF COMPANIES RAISING FUNDS THROUGH SEIS AND THE AMOUNTS RAISED EACH YEAR HAVE REMAINED RELATIVELY STABLE



Source: HM Revenue and Customs (2023). Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Social Investment Tax Relief statistics: 2023.

Both policies have been subject to recent changes. Legislation was laid as part of the 2023 Spring Budget to reform SEIS – increasing the amount of investment a company can raise and on which investors can claim relief, the value of gross assets an eligible company can have, the age limit for an eligible company and the annual limits for investments on which individuals can claim Income Tax and Capital Gains Tax reinvestment relief.[64] Then, in the 2023 Autumn Statement, the Chancellor confirmed that EIS will have its sunset clause extended until 2035.[65]

Venture Capital Trusts

A third option for tax-advantaged investment is to use Venture Capital Trusts. These are companies that invest in or lend money to smaller unquoted companies, and are exempt from Corporation Tax on any Capital Gains arising on disposal of their investments. Investors can also claim Income Tax relief at 30% on up to £200,000 annual investment, as long as their shares are held for at least five years.

Figures from the Association of Investment Companies revealed that VCTs raised £882 million in the 2022/23 tax year – the third-highest annual amount since VCTs were introduced in 1995.[66]

Business Asset Disposal Relief

Business Asset Disposal Relief (BADR) allows entrepreneurs to pay less Capital Gains Tax when they sell their business – gains on qualifying assets are taxed at 10% instead of 20%. There is a cumulative lifetime limit for qualifying gains of £1 million for disposals (under the previous system, introduced by Gordon Brown in 2008 and known as Entrepreneurs' Relief, the limit was £10 million).

Opinions have differed on the effectiveness of relief on Capital Gains Tax for founders. Groups including the Institute for Fiscal Studies have previously called for the relief to be scrapped,[67] on the basis that they believe it does not significantly boost investment, while entrepreneurs have argued that it played a significant role in making the UK attractive to founders from other countries, as well as increasing the number of serial entrepreneurs and investments by exited founders.[68]

62 Ron Kalifa (2021). The Kalifa Review of UK FinTech; HM Treasury (2017). Patient Capital Review.
63 HM Revenue and Customs (2023). Enterprise Investment Scheme, Seed Enterprise Investment Scheme and Social Investment Tax Relief statistics: 2023.
64 HM Revenue and Customs (2023). Increasing the limits of the Seed Enterprise Investment Scheme.
65 HM Treasury (2023). Autumn Statement 2023.
66 Association of Investment Companies (2024). VCT fundraising is third highest on record.
67 Helen Miller and Kate Smith (2019). Low rates of capital gains tax on business income lead to large tax savings but do not boost investment.
68 Sifted (2020). UK government slashes tax relief for entrepreneurs.

Call for Evidence responses

"There is no tax incentive to maintain a business, sell to a UK company or seek UK investment."

Britain's tax regime is certainly a major preoccupation for business owners, palpably affecting their decision-making processes. One respondent criticised the overall tax environment for encouraging businesses to be sold prematurely: "There is no tax incentive to maintain a business, sell to a UK company or seek UK investment," adding that "this leads to most of our scalable business being sold or invested in by overseas organisations."

Meanwhile, a founder of multiple high-growth companies bluntly stated that "by far and away, the UK is the most expensive place for us" due to taxes and other reasons like employment laws. This situation was leading them to look for funds in the Gulf region in order to grow at a much lower cost. Another founder pointed to Ireland as an example of success, claiming that low corporation tax rates helped "fund the country with foreign investment."

Unsurprisingly, the Capital Gains Tax received a considerable amount of attention. Numerous respondents said that changes to it over the years have created the wrong set of incentives. A financial services expert offered a possible solution, arguing that tapering Capital Gains Tax, whereby the tax burden is reduced for shares held for a longer period, worked well to encourage longer-term investment.

Another common criticism in the Call for Evidence was uncertainty. Multiple respondents to the Call for Evidence highlighted frequent changes to the tax system, hindering stability for businesses. Similarly, one trade group described the tax system as "overly complex and burdensome" for all actors in the economy, and is even encouraging businesses to offshore themselves.

As evidenced by another respondent, having a longer-term, more certain approach might be more helpful than where tax rates stand.

Not everything was negative though. The EIS and SEIS reliefs on investment are generally popular among entrepreneurs and investors. One respondent described them as "excellent and effective," while another said they are the "only functioning government-funded initiatives" that act as a major support line for entrepreneurs.

But the schemes are far from perfect. Another trade group noted how many productive scaleups miss out on EIS because of the £20 million limit for eligibility. They highlight that a medical technologies company could spend over £100 million to develop a single product before making any revenue. Similarly, one respondent from the advanced manufacturing sector claimed that the schemes were not flexible enough to support their industry. A further trade group suggested that the SEIS limit should be "formally linked to an inflation measure to ensure the relief's value is not eroded over a duration of time."

Respondents to our Call for Evidence were also overwhelmingly supportive of R&D tax credits. However, multiple entrepreneurs and policy professionals highlight that they have had difficulties engaging with the HMRC. Small businesses, especially, report that administrative challenges make them less attractive. One membership organisation noted that: "two-thirds [of their members] believe the tax authority's services are having a negative impact on the productivity of individuals and businesses with small businesses bearing the brunt of this issue."

4%

VALUE OF UK-LISTED COMPANIES WITHIN THE INTERNATIONAL CAPITAL MARKET

CHAPTER 4

CAPITAL MARKETS

A private business can have many different trajectories. It may pass on from generation to generation within a family, steadily generating dividends for their owners. It may be purchased by private equity firms, bringing with them a range of institutional investors, who will attempt to improve the firm's profitability and sell it on again to others. It may be acquired by, or merge with, a competitor. Or it may eventually decide to cease being a private business, offering shares to the public on a stock exchange. What a great many routes have in common, however, is that they involve an exit, with large shares of the company being sold.

This section deals with the markets for shares of private companies, both private and public, which are ultimately the draw for many investors into private companies in the first place. Even if the plans for an exit are remote or long-term, investors hope to make a capital gain, or at least have the option of doing so. Indeed, even for private businesses with no intention of going public, the ease with which they *might* raise capital through public listing still greatly matters, as such alternatives necessarily influence the company valuations that private buyers must accept. It is thus worth bearing in mind, when assessing the health of different exit strategies, that all the different sources of capital, from larger competitors hoping to make an acquisition, to private equity firms, to members of the public in different countries hoping to become shareholders, are also in competition with one another.

Public listings

Companies that are listed in the UK make up just 4% of the value of the world's listed companies, as measured by the MSCI World Index, compared to 70% in the US.[69] The position worsened considerably since the results of the Brexit referendum in 2016. UK-listed companies had traditionally been valued 10-20% less than US-listed companies with comparable earnings, but this has since dropped to 40%. They have also dropped in price from parity with European-listed companies, to being about 20% cheaper.[70]

Fast-growing UK-based companies are increasingly expressing interest in listing in the United States. This is not necessarily a bad thing for British growth. After all, it means that more foreign capital ends up being invested into companies that are still based in the UK. Indeed, foreign listing is even a route for UK investors to more cheaply acquire stakes in UK-based companies too. There are essentially no barriers for any British investors to buy American-listed shares, and indeed foreign-listed shares are not subject to a 0.5% Stamp Duty Reserve Tax. An estimated 63% of the amounts invested by British retail investors in ISA wrappers free of dividend and capital gains taxes are into foreign-listed stocks and shares, largely through exchange-traded funds.[71] Likewise, of all UK pensions, insurance funds, direct retail investment, and endowments, only 12% of assets are invested in companies listed in the UK.[72] When it comes to raising capital even from British savers and investors then, UK-based companies likely benefit from listing abroad.

69 Duncan Lamont (2024). Six charts that show just how cheap UK equities are.
70 Ibid.
71 Claer Barratt (2023). How to make ISAs even nicer.
72 William Wright (2021). Unlocking Productive Investment.

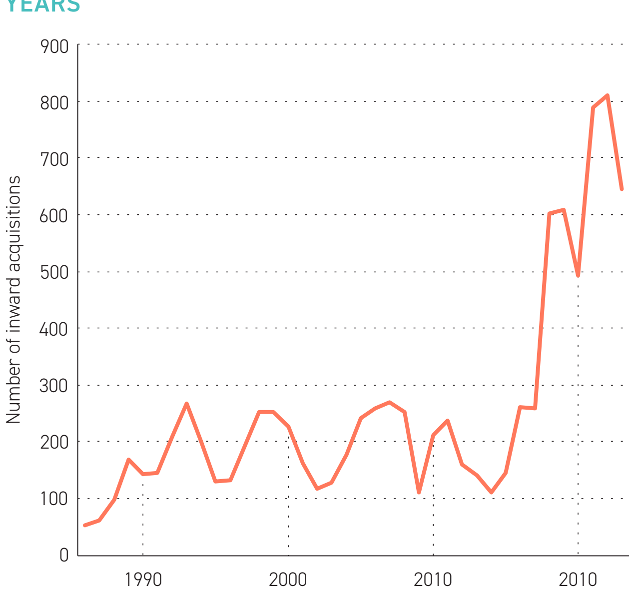
"UK-listed companies had been valued 10-20% less than US-listed companies, but this has dropped to 40% since Brexit."

Where there is a concern, however, is that getting UK-based companies ready for foreign listing may prompt them to move operations, with all the jobs and value-creation that they bring, to other countries. The pressure from investors to move banking and operations as part of an equity deal is widely known. It may also, much earlier in the lifecycle of a would-be public company, prompt British founders to set up abroad in the first place. Yet these potential effects are difficult to disentangle from many other advantages offered by starting a company in the US, not the least of which is its much larger market.

Private acquisitions

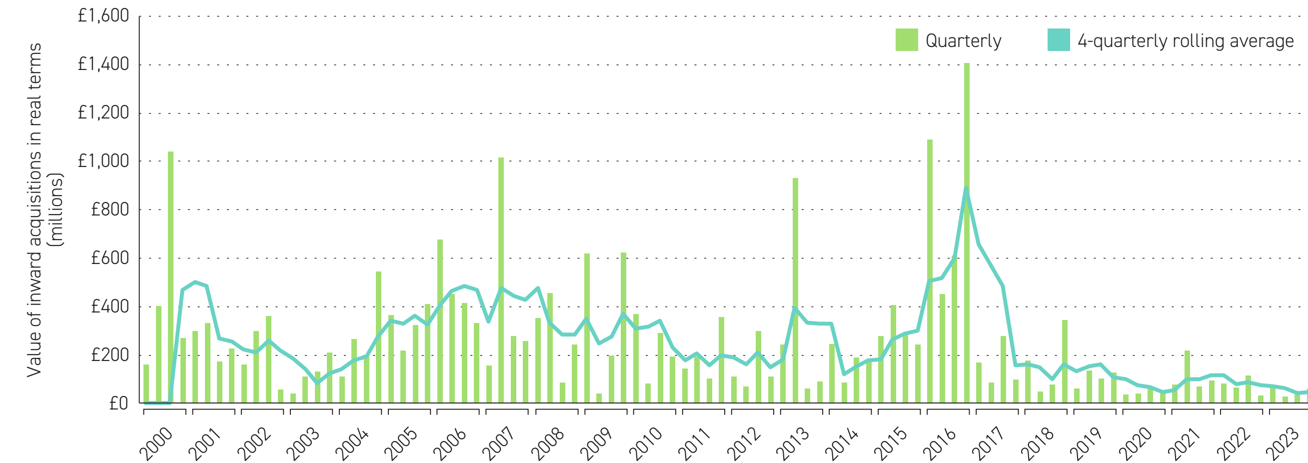
The fall in the value of public companies has made British companies cheaper for private capital too. The number of private British companies being acquired by foreign companies has grown dramatically since 2016, more than tripling from a base of roughly 200 or so per year. The most recent peak, in 2022, saw 810 such acquisitions.

CHART 10: THE NUMBER OF INWARD ACQUISITIONS OF UK FIRMS HAS INCREASED MARKEDLY IN RECENT YEARS



Source: Office for National Statistics (2024). M&A : Inward : Number of acquisitions.

CHART 11: THE VALUE OF INWARD ACQUISITIONS HAS CRATERED SINCE BRITAIN VOTED TO LEAVE THE EU



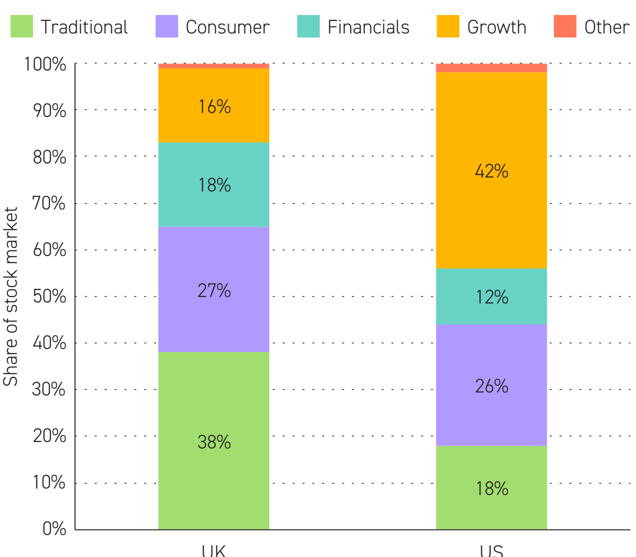
Source: Authors' analysis of Office for National Statistics (2024). M&A : Inward : Value of acquisitions : £m; Office for National Statistics (2024). M&A : Inward : Number of acquisitions.[73]

73 Figures have been adjusted for inflation to 2023 prices.

There is, of course, nothing wrong per se with British firms being acquired by foreign companies. It marks an influx of foreign capital into the UK, which can then be redeployed. But it reflects a general weakness in the domestic demand for UK companies, as, despite the higher number of such acquisitions, the price paid per inward acquisition has declined, even in the period since 2016 – from an average of £136 million per acquisition in 2017 to just £48 million in 2023.

Weak demand for publicly listed UK companies since 2016 has thus also resulted in cheaper prices for private capital too. And the decisions by founders, as to whether to set up and grow their companies in the UK rather than elsewhere, will inevitably be affected by the prospective rewards at the end of the tunnel.

CHART 12: 'GROWTH' SECTORS MAKE UP A MUCH LARGER PORTION OF STOCK MARKETS IN AMERICA THAN IN BRITAIN



Source: New Financial (2023). UK Capital Markets: A New Sense Of Urgency.

Lastly, policymakers should also recognise the importance of 'traditional' industries that make up over one-third of the UK stock market.[74] Compared to the US, Britain's business ecosystem is still more reliant on these industries. For that reason, policies must be designed not only for growth businesses but also to ensure the longevity and resilience of our traditional companies. This is a delicate balance but one that is crucial for the state of our capital markets.

Call for Evidence responses

Many of the responses in our Call for Evidence were dismayed at the state of public markets. Many noted the UK's valuation discount compared to the US, while one fintech founder went so far as to say that "the London Stock Exchange is dead." Another put it succinctly: "the liquidity and price premium for certain sectors such as technology make listing in the UK almost impossible." Similarly, one entrepreneur outlined how the "current lack of liquidity in smallcaps has led to large valuation discounts. However, generally, funding is available when you're growing successfully. But when something goes wrong, funding disappears until valuations are absurdly cheap. You can't afford a slip-up."

In terms of the way that public markets themselves are structured, founders and others blamed the high costs of going public compared to other markets, the bias against UK non-AIM equities from the Stamp Duty Reserve Tax, and excessively burdensome listing rules – "tick box regulation which adds no commercial value," in the words of one respondent. There were also some concerns expressed that these disadvantages were making private equity relatively more competitive, especially in light of their tax treatment and business model.

Some respondents also thought that UK institutional investors were partly to blame. As one put it, pension funds "think getting more money to listed UK equities might actually be harder than getting investment to private UK equities (objectives of Mansion House) because as opposed to the latter, the former just seems like a bad investment relative to the US." On the other hand, they also noted that this might be partly demographic, and could soon change: "As the defined contribution market ramps up, with more and more young members who can be invested heavily in equities given long investment horizons, we should see that money slowly replacing the money of legacy defined benefit schemes which have been increasingly pulling out of UK equities as their membership gets older, investment horizons shorten and equities start making less and less sense." Even so, this respondent noted that some of the default funds were often surprisingly heavy on bonds even for younger contributors, and recommended that some attention be paid to ensuring young people's pensions were more biased towards equities.

74 Growth sectors include biotech, life sciences, and technology, while traditional ones comprise industrials, energy, mining, and utilities; New Financial (2023). UK Capital Markets: A New Sense Of Urgency.

"Getting more money to listed UK equities might actually be harder than getting investment to private UK equities because as opposed to the latter, the former just seems like a bad investment relative to the US."

Otherwise, many respondents suggested that capital markets were attracting more attention than they deserved. As one put it, "access to capital receives disproportionate policy attention, perhaps because it is seen as an easy lever to pull," while also noting that capital markets provided more and less ambiguous data by which to measure performance compared to other areas that might merit more attention.

Indeed, most respondents framed the problems with UK listings as being downstream of other, underlying factors. One founder, for example, blamed the UK's lack of early-stage funding, which meant that businesses went abroad for it and then listed there: "If we can make accessing funds for smaller and growth businesses easier to come by in the UK, this will help retain UK listings." Another respondent questioned "to what extent LSE's valuation crisis is to do with the general weakness of the UK economy, and so international investors have been betting against it, to what extent is this simply the glut of private capital hoovering up anything in it can (private equity was a backwater 20 years ago, now it's where everyone wants to work) and to what extent is there something specific in UK financial regulation that is causing this."

Larger economic and political concerns have been undeniably affecting British businesses' performance. Brexit has accelerated the divergence of valuations between American and British listed companies.[75] Similarly, the stagnant productivity and economic growth of the UK could have also created a negative sentiment for the UK's future economic performance.

There was also a cultural dimension in many responses, with some noting that the UK had various public perception problems. They noted that compared to places like the US, public listing brought greater scrutiny of high pay and negative press. As one founder put it, there is "a propensity in the UK to shoot down successful businesses […] we need to do more to celebrate fintech success – in the press, in government, and through bodies like Innovate Finance – to ensure the UK is seen as a hotbed of fintech creativity and success internationally and nationally." Another founder agreed on the need to "celebrate success more."

Finally, although most respondents were uncertain or had little to say about the effects of competition regulation on mergers and acquisitions, a few did express concerns. One entrepreneur commented on how the "vagaries of the Competition and Markets Authority can be a pain when they target a sub-£300 million market where there is no serious monopoly threat."

Meanwhile, an industry body singled out the Digital Markets, Competition and Consumer Bill as a source of worry, explaining that "the new extensive powers" that it will grant the CMA "will add further friction to deals processes, require burdensome record keeping and close off exit routes. Costs may increase and timelines may be extended if the CMA intervenes more often than it does now." It also felt that even the CMA's current approach to looking at proposed mergers "can adversely affect private capital acquisitions and exits, and competition in the UK. Lastly, there has also been wide reporting that the National Security and Investment Act, implemented in 2022 to prevent foreign ownership of strategic businesses, is slowing down exits and investment processes.[76]

"Larger economic and political concerns have been undeniably affecting British businesses' performance."

75 Bloomberg (2024). British stocks set to still struggle to catch high-flying peers.
76 Financial Times (2023). UK to pare back new takeover screening powers, says deputy PM.

INCREASE IN PRODUCTIVITY IN EMPLOYEE-OWNED BUSINESSES

CHAPTER 5
EMPLOYEE INCENTIVES

A business is only as strong as the people who turn up to work for it every day. This is obviously true at the founder level, where attention naturally focuses. But it also applies at the employee level. Without a team that is committed to seeing the business they belong to scale, many will fall short of their growth potential. Being able to first attract and then retain the best talent available is of foundational importance for businesses wanting to grow.

Already, policy levers exist which enable firms to encourage and incentivise employees to take a more direct interest in helping the company they work for to flourish. Schemes such as Enterprise Management Incentives (EMIs), Save As You Earn (SAYE), and Share Incentive Plans (SIPs) are already widely used by SMEs on the rationale that they contribute to a more productive and more innovative workforce.

However, as companies expand and further prove their growth potential, they lose access to most of these schemes. In this way, they overwhelmingly support micro-businesses with poor growth trajectories and miss the small number of companies that are set to break through and grow to a significant size. For that reason, the government should better target these schemes to unlock the growth potential of the latter companies and provide them and their workforce with better incentives.

Benefits of employee incentives

If targeted well and used by ambitious firms with long-term goals, employee incentives can go a long way in sustaining meaningful growth. A workforce that has a stake in the long-term success of the business has the right incentives to build a lasting and successful career there. Three particular benefits associated with employee incentive schemes stand out: the boost they can give to productivity and growth; the way they aid longevity and resilience; and the better outcomes they can confer to the workers themselves.

Productivity and growth

Examples of high-growth employee-owned companies are not only anecdotal – there is a growing body of evidence that suggests sharing the ownership of companies with their workforces creates strong incentives for a more productive environment.

Studies conducted in the 1980s and 1990s, for instance, found productivity increases of up to 4-5%, on average, in the year employee ownership schemes are adopted.[77] Another found an even larger effect, suggesting that employee-owned businesses are around 8-12% more productive.[78]

TABLE 3: EMPLOYEE SHARE OWNERSHIP SCHEMES IN THE UK

Scheme	Coverage	Limit	Holding period	Tax advantage
Save As You Earn (SAYE)	All employees	Savings up to £500 per month, to buy shares later on	3-5 years	No Income Tax No National Insurance Contributions Interest and bonus tax-free No Capital Gains Tax if the shares are transferred to an ISA or to a pension
Share Incentive Plans (SIPs)	All employees	***Free Shares*** Up to £3,600 annually ***Partnership Shares*** Buy shares worth £1,800 or 10% of income before tax, whichever is lower ***Matching Shares*** Up to 2 per partnership share bought	5 years	No Income Tax, after 5 years of holding No National Insurance Contributions, after 5 years of holding
Company Share Option Plans (CSOPs)	All employees	£60,000 per employee	3-10 years	No Income Tax No National Insurance Contributions
Enterprise Management Incentives (EMIs)	Discretionary: Firms with assets of £30 million or less and fewer than 250 employees	£250,000 per employee in a 3-year period	Maximum 10 years	If bought at market value at the time of issue: No Income Tax No National Insurance Contributions

Source: Adapted from: Social Market Foundation (2020). Strengthening employee share ownership in the UK. Updated by the authors of this report, using Gov.UK (2024). Tax and Employee Share Schemes.

Evidence has also found that sales per worker are higher in employee-owned businesses,79 and that they tend to be more profitable than their non-employee-owned competitors.80

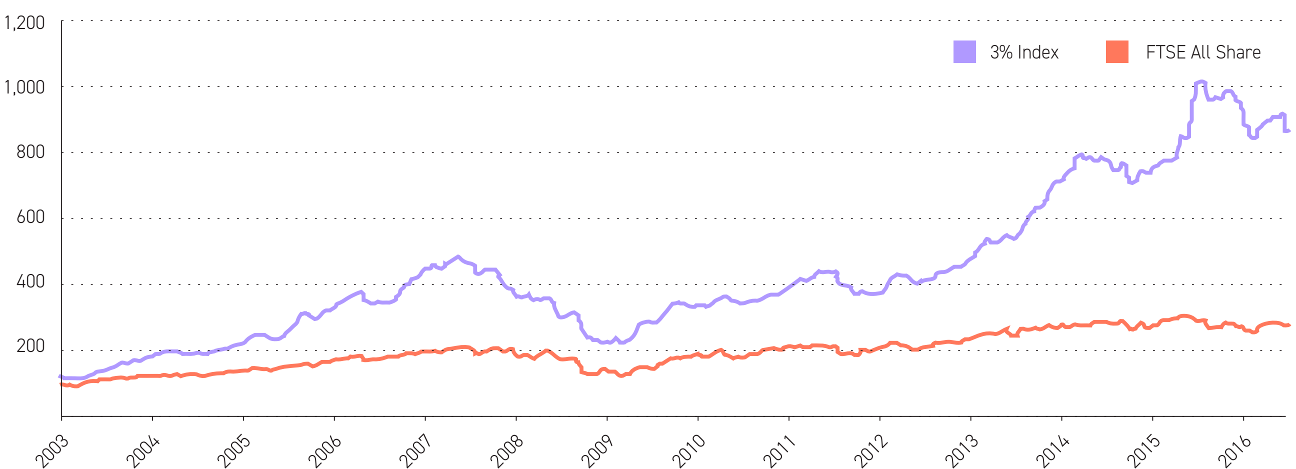
Unsurprisingly, given these performance indicators, the Employee Ownership Index of the UK showed in 2016 that listed companies which have at least 3% of their share capital held by employees outperformed firms in the FTSE All Share in ten out of the 13 years by an average annual margin of 13.9%.81

Academic researchers explain this phenomenon with the creation of a more entrepreneurial staff structure. Evidence from the US shows that workers in employee-owned companies are more likely to actively engage with management and put forward new ideas.[82]

77 National Center for Employee Ownership (2024). Research on Employee Ownership.
78 University of Stirling (2023). New data shows employee owned businesses deliver an 8-12% productivity boost.

Firm Survival and Performance in Privately Held ESOP Companies.
Employee ownership and firm performance: a meta-analysis.
Strengthening employee share ownership in the UK.
82 Joseph R. Blasi, Richard B. Freeman and Douglas L. Kruse (2011). Evidence: what the US research shows about worker ownership.

CHART 13: THE UK EMPLOYEE OWNERSHIP INDEX, WHICH TRACKS EMPLOYEE-OWNED BUSINESSES, OUTPERFORMED THE FTSE ALL SHARE INDEX BETWEEN 2003 AND 2016



Source: The Equity Project (2016). UK Employee Ownership Index.[83]

Longevity and resilience

Furthermore, employee incentives are also essential for building a workforce focused on the long-term prospects of the company. While quarterly objectives can serve as a useful accounting mechanism, relentlessly ensuring businesses stay on their toes, there is an argument that they excessively incentivise short-term gains over longevity. In 2012, the Ownership Commission cautioned that growing British businesses were at risk of adopting the short-termism of mainstream investment tactics, which depend on high-frequency trades rather than long-term ownership.[84] This makes businesses more susceptible to outside shocks and dependent on investors who look for short-term gains rather than long-term value.

Businesses with high rates of employee ownership, on the other hand, have proven to be more resilient, more capable of long-term goal-setting, and have the levers in place to keep key staff on board to achieve those goals. In the 1980s, the US legislated its first set of large employee incentive programmes to ease the transition of companies to the next generation.[85] As a result, many private companies restructured themselves to make use of these new schemes. In 2009, there were more share-owning employees than union members in the private sector.[86]

Historically, companies with high levels of staff-ownership schemes have tended to be more resilient against sudden shocks.[87] Employee-owned businesses in the US have also been more likely to survive recessions compared to their traditional peers.[88] Meanwhile, their British counterparts have also held onto their employees more steadily than their peers, forging a long-term relationship with them.[89]

Unsurprisingly, workers prefer to work for companies that give them a stake in the success of the business. A survey conducted by the Social Market Foundation of employees of listed companies found that 68% of them would like to hold shares in their companies, and 60% said that share ownership would incentivise them to stay with their current employer longer than they originally intended.[90]

Studies reveal that workers in companies with high employee ownership are more likely to think that they are "paid what they deserve" and feel more secure in their jobs.[91]

83 N.B. The UK Employee Ownership Index has not been updated since 2016.
84 The Ownership Commission (2012). Plurality, stewardship and engagement.
85 John D. Menke (2011). The Origin and History of the ESOP and Its Future Role as a Business Succession Tool.
86 Ibid.
87 The Ownership Commission (2012). Plurality, stewardship and engagement.
88 Douglas Kruse and Fidan Ana Kurtulus (2017). How Did Employee Ownership Firms Weather the Last Two Recessions?: Employee Ownership, Employment Stability, and Firm Survival in the United States: 1999-2011.
89 The Ownership Commission (2012). Plurality, stewardship and engagement.
90 Scott Corfe and James Kirkup (2020). Strengthening employee share ownership in the UK.
91 National Center for Employee Ownership (2024). Research on Employee Ownership.

> **"Employee incentive schemes are not available to the very businesses that should be making the most use of them."**

According to the Aspen Institute, employee ownership schemes contribute to the wealth-building of American workers as an average shareholding employee has above $150,000 in share options.[92] Consequently, high adoption of employee ownership schemes can even be a strong tool in countering wealth inequality.[93] Unsurprisingly, this translates into higher staff morale, more engaged workers, and growing productivity.[94]

Lastly, as employee incentives can help workers accumulate more wealth, this also translates into a healthy ecosystem for future founders and investors. For example, following Spotify's IPO, many share-holding employees earned enough capital to launch their own businesses or invest in other enterprises.[95] A similar pattern can be observed in Skype's history, whose former employees established countless businesses.[96]

While it is not our place to say whether one corporate structure is better than another (clearly, much will depend on the individual business in question), these are key signs of strength in building big, enduring businesses, and so making it easier for companies to involve their staff more directly could be an option which merits further consideration.

Call for Evidence responses

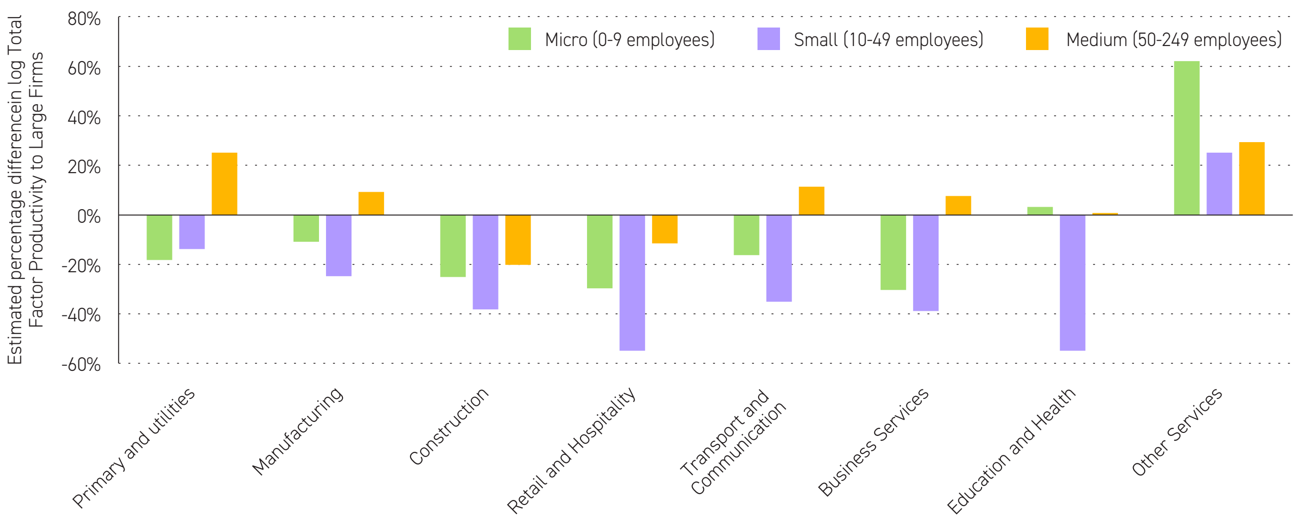
The overall picture is clear – incentivising employee ownership within growing companies can work as a strong tool to attract and retain top talent. The next question to ask should then be why only a handful of high-growth businesses adopt employee incentive programs. Just a few hundred companies use the Save As You Earn scheme to grant share options to their employees, and the Enterprise Management Incentives are mostly used by small businesses with low growth potential.[97]

Our Call for Evidence provided many cases where businesses were willing but disincentivised to opt into them. These are policy problems rather than business decisions – and that's why policymakers need to take notice and consider future reforms. The most common problem we heard from businesses is that the employee incentive schemes are not available to the very businesses that should be making the most use of them. These policies, by design, are made for SMEs to help them attract and retain top talent against more powerful competitors.

Indeed, many growing businesses use EMI – tax-advantaged share options for employees – to do just that. The founder of a leading financial services company described these schemes as a "great way to incentivise and align" employees, and noted that EMI is attractive for business owners because of its tax efficiency. But, they also said, the eligibility criteria are leaving many high-potential businesses out.

92 Joseph Blasi and Douglas Kruse (2023). Employee Ownership and ESOPs.
93 Thomas Dudley and Ethan Rouen (2021). The Big Benefits of Employee Ownership.
94 Todd R. Zenger and Sergio G. Lazzarini (2004). Compensating for Innovation: Do Small Firms Offer High-powered Incentives That Lure Talent and Motivate Effort?
95 Crunchbase (2024). Spotify Alumni Founded Companies.
96 Forbes (2019). The Skype Mafia: Who Are They And Where Are They Now?
97 Bartek Staniszewski and Thomas Nurcombe (2024). Mind Your Business: Expanding democratic business in the UK.

CHART 14: IN A VARIETY OF INDUSTRIES, MEDIUM-SIZED BUSINESSES COMPETE WITH LARGER COUNTERPARTS IN PRODUCTIVITY



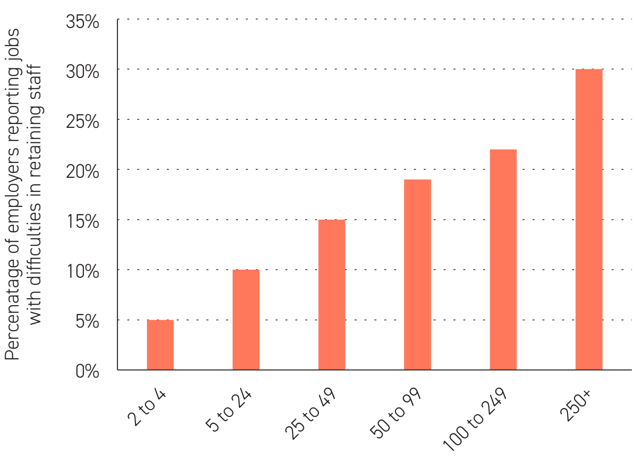
Source: Ipsos MORI (2018). Evaluation of Enterprise Management Incentive scheme.

Currently, EMI can be granted to businesses with assets of £30 million or less, and fewer than 250 full-time equivalent employees. Then, the businesses can only grant share options up to the value of £250,000 in a three-year period. As the founder of a group of companies bluntly told us, the employee ceiling "isn't ideal" for Breakthrough Businesses.

A survey of EMI shows that although the policy is popular among SMEs as a whole, participation is skewed towards businesses on the smaller end.[98] Yet despite this, the survey also shows that the larger a company grows, the more challenging it gets to retain employees.

Even though this might be aligned with the founding principles of the EMI scheme, which was to create a more favourable environment for small businesses competing with larger ones, it ends up excluding companies on a high-growth trajectory. These tend to be on the larger end of the SME spectrum, with the investment, revenue, and staff to scale. They are only a small fraction of businesses but, as noted earlier, they have an outsized impact on the job market and the overall economy. Additionally, the rigid eligibility criteria also create an environment of uncertainty for these businesses, as it gets more difficult to plan the growth trajectory and how the employee incentives can be used along the way.

CHART 15: AS FIRMS GROW LARGER, THE SHARE REPORTING THEY STRUGGLE TO RETAIN STAFF INCREASES



Source: Ipsos MORI (2018). Evaluation of Enterprise Management Incentive scheme.

Overall, EMI is less likely to help with the creation of large and enduring businesses – which are also essential in enhancing competition – and more likely to help businesses with limited potential. It's not designed to target the small fraction of businesses with high-growth potential. And, as a seasoned CEO explained: "It's very difficult to have an internal market in a small company's shares." This reduces the value of the scheme to those employees who take part.

98 Ipsos MORI (2018). Evaluation of Enterprise Management Incentive scheme.

"EMI is less likely to help with the creation of large and enduring businesses and more likely to help businesses with limited potential."

Targeting is not the only problem though. Numerous entrepreneurs who have used employee incentive schemes before told us that they had problems administering them. Responding to our Call for Evidence, founders of multiple high-growth businesses highlighted that HMRC has been unworkably slow, requiring months to respond to minor clarifications during the administration process. This is especially the case for agreeing upon company valuations with HMRC, which is essential when granting share options to employees.

The other common problem we heard from our Call for Evidence was that most employee incentive schemes were not well understood among the business community or not known at all. An investor described the EMI as a "helpful" policy but highlighted that it "needs to be better understood and marketed, especially within early-stage companies where there is less familiarity with the area generally." They summarised this as an "education gap" between people who need to use these schemes – entrepreneurs – and those who know and understand it well – lawyers and accountants.

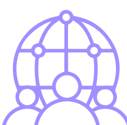
This leads us to the final common problem that respondents answering our Call for Evidence raised – that employee incentives are too complicated to be administered by many companies. The CEO of a fast-growing business described them as "highly convoluted and inflexible," saying that for companies with "unconventional corporate structures," which are likely to be growing enterprises, EMI is especially difficult to administer. Even though it can be compelling for new hires thanks to tax advantages, these difficulties hold companies back.

Another experienced business executive says that because of this, as a CEO, they only considered using EMI for the retention of senior management rather than to attract new talent. Echoing these sentiments was another founder, who said that profit sharing "via salary or bonus" can be preferable for companies even though they have tax disadvantages for employees. This situation comes at a cost, not only to businesses themselves but to their less senior employees as well.

CHAPTER 6
POLICY PROPOSALS

Successfully confronting the challenges which prevent British businesses from fulfilling their growth potential will neither be quick nor easy. As various respondents noted in their answers to the Call for Evidence, many of the headwinds facing them are cultural in nature, and it will be these which prove hardest to change. But that does not excuse policy makers from taking decisive action to address them – rather, it underscores the importance of doing precisely that.

In this final section, we put forward a series of policy proposals which we think will point Britain in a better direction when it comes to scaling its most promising businesses.



PROPOSAL ONE

Government must closely engage with large private businesses

The government has done much to support the startup and scale up community in the past decades, and we are now clearly reaping the rewards of these sustained efforts. On the other end of the spectrum, the government has been engaging proactively with the largest publicly listed businesses, with many of the same household name CEOs serving in taskforces and business roundtables, helping to shape policy.

This is mainly driven by well-structured relationships leading business representative groups have formed with business-facing departments within the government. Public companies are overrepresented in these enterprise bodies, even though they do not make up the majority of Breakthrough Businesses.

As a result, the upper segment of private companies are not seen as much of a priority. This is despite their size and job creation performance. This is in stark comparison to the Upper Mittelstand in Germany, which is beloved by German politicians.

While these capable businesses can generally fend for themselves with healthy balance sheets and capable management teams, engagement with the government can be key in maintaining and retaining them. These businesses will be typically growing faster, will have internationalised and be more dynamic than other parts of the market.

It is recommended that this cohort has clear representation across Whitehall, but in particular the Department for Business and Trade and the Treasury, and is recognised as a key component of Britain's business landscape. To achieve sustainable and constructive engagement, this can be done through the building of a new institutional business group that represents the interests of Breakthrough Business in Westminster.

PROPOSAL TWO

Edinburgh, Mansion House and Capital Market Industry Taskforce Reforms should continue to be implemented

One of the most significant policy developments with respect to improving the funding landscape of late has been the Edinburgh and Mansion House Reforms. More broadly, there has been a high degree of political consensus around the idea that more needs to be done to leverage capital from institutional investors into British firms with growth potential.

Yet from our Call for Evidence there was more pessimism than optimism about the Reforms, with most believing they will fall short of their stated ambitions, or may have other, less desirable, unintended consequences. Many respondents echoed sentiments of large parts of the pensions industry at the time they were first being floated – that it is not wise for the government to dictate their asset allocations, and that the fiduciary duty they have to their scheme members must not be undermined.[99]

From other stakeholders, we heard that an almost inherent conservatism within the UK's institutional investors means that many of the ambitions of the Mansion House Reforms will fail to materialise. During one of the roundtables we held while undertaking this research, it was noted how reforms to the Pension Charge Cap – while not criticised per se – will ultimately be irrelevant, because many funds operate nowhere near it.[100] In the eyes of many, competition on price rather than performance will continue to be how plans are evaluated, and changing this will require a shift in culture.

In light of this, policymakers don't necessarily need to act more aggressively, for instance by mandating – rather than just encouraging – pension funds to invest more money into certain kinds of assets.

However, this does not mean that we should give up, far from it. As the British Private Equity & Venture Capital Association's recent *Manifesto for Growth* suggested, a roadmap should be published by Spring 2025 to outline the next steps.[101] At the same time, a consultation should be launched into the pros and cons of consolidating smaller pension funds into larger ones to benefit from the economies of scale and enhanced expertise to invest in riskier assets – either directly or through venture capital. Again though, it needs to be acknowledged that there are risks here, which a thorough open consultation will need to weigh up.

On a slightly more positive note, at least in terms of having a more tractable policy solution, some have suggested that one of the reasons for the apparent conservatism of institutional investors can be traced back to unclear regulations set by the Financial Conduct Authority (FCA) and Prudential Regulation Authority (PRA). While steps have been taken through the Edinburgh Reforms to empower regulators to put a greater onus on growth and international competitiveness, it may be worth further clarifying what is and is not permissible in their eyes.

There was more optimism expressed about the FCA's recent plans to make it easier to list in the UK, along with reducing the reporting requirements for acquisitions. Some of the ideas suggested by our respondents match well with the FCA's current plans. So the pace of reform in this regard should not be slackened.

Finally, although IP-secured finance is still very small in relative terms, it will likely grow in lockstep with the share of intangible capital, which is growing quickly: in 2023 total value of intangibles was estimated at $61.9 trillion (£49.4 trillion) up 8% from $57.3 trillion (£45.6 trillion) in 2022.[102] Further, the UK is uniquely positioned to take advantage of this market, given it combines a world-class financial centre with a very strong scientific base.

99 Josephine Cumbo (2023). UK pension funds warn of roadblocks to Mansion House reforms.
100 Indeed, research published in 2021 by the Department for Work and Pensions found that average charge to be significantly below the cap as it was then; Department for Work and Pensions (2021). Pension charges survey 2020 – summary.
101 British Private Equity & Venture Capital Association (2024). Manifesto for Growth.
102 BrandDirectory (2023). Brand Finance Gift 2023.

The government has already launched a new initiative this year – a working group led by the Intellectual Property Office – to accelerate the development of IP finance in the UK.[103] As recommended elsewhere, the working group should closely examine initiatives in South Korea which led to rapid growth of the sector there.[104]

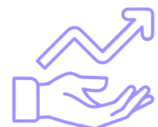
PROPOSAL THREE

Abolish the Stamp Duty Reserve Tax which biases investment away from British companies

Policymakers have been devoting a great deal of attention in recent months and years to making it easier and less costly to list on UK stock exchanges. Most of our respondents were strongly in favour of the general direction of travel, praising ideas such as the proposed easing of shareholder approval and reporting requirements for acquisitions by listed companies of smaller firms. However, there has been a lack of movement in removing the current tax disincentives to invest in UK-listed equities – specifically the 0.5% Stamp Duty Reserve Tax on non-AIM UK share trading.

Revenues from this tax brought in £3.8 billion in 2022/23.[105] This was not much more than it did 20 years ago, meaning it has dropped considerably in real terms. Yet the tax is also highly distortive, affecting decisions about share turnover, suppressing share prices, and biassing investors against UK-listed equities at a moment when we need the exact opposite – something that also biases entrepreneurs against listing in, or indeed setting up in the UK. It disproportionately punishes marginal investments too. Whereas Corporation Tax taxes the return on investments and relieves the cost of investing through allowances, SDRT has no such allowances and effectively taxes both the investment itself and the return on it, even when those returns are negative.[106]

It is recommended that a review be undertaken to examine the benefits of abolishing SDRT. It is potentially the most straightforward intervention that can be made to bolster British public markets and investment, without running significant risks of major unintended consequences, as would be the case with intervening in the ways that pensions direct their funds, or by introducing further distortions by creating special exemptions from taxation for certain kinds of investments. The lost revenue from SDRT needs to be considered as part of a broader review of business taxes, exemptions and reliefs to allow for a rebalancing.



PROPOSAL FOUR

Bolster the independence of the British Business Bank

As was noted in Labour's *Start-up, Scale-up Review*, the British Business Bank (BBB) could benefit from further independence from the government.[107] Currently, the BBB's business plan must be reviewed annually and get government approval, along with any changes to that business plan.

This arguably forces the BBB's hand, subjecting it, consciously or not, to the political priorities of whoever is in Downing Street, rather than necessarily allowing it to provide funding in the best way possible. Crucially, it also limits how long-term it can be in its ambitions. Electoral cycles last five years, but as recent history has taught us, much can happen in that time. And for many of the sorts of businesses that will – hopefully – one day end up as globally significant entities, they will require certainty and stability over a duration of perhaps 10-15 years or more.

103 Intellectual Property Office (2024). Report launched into UK's IP-backed finance landscape.
104 Inclusive Growth Commission (2024). Financial Capital: 2nd Report of the Inclusive Growth Commission.
105 HM Revenue and Customs (2023). UK Stamp Tax statistics 2022 to 2023 - Commentary.
106 Mike Hawkins and Julian McCrae (2002). Stamp duty on share transactions: is there a case for change?
107 Labour Party (2023). Start-Up, Scale-Up: Making Britain the best place to start and grow a business.

It is recommended that the British Business Bank be given true independence and work with a mandate of growth which matches our scale-up ambitions.

PROPOSAL FIVE

Ensure the Spinout Review is fully implemented

Britain's universities are a wellspring of potential world-beating companies. Spinouts – startups which are based on academic research – heavily populate lists of some of the most sought-after and lucrative businesses. As the likes of Oxford Nanopore and Darktrace show, there is enormous economic, social, scientific and strategic value in ensuring that academics are able to commercialise their research.

Yet despite these successes, the idea that they occurred in spite of, not because of, British universities' approach to spinouts is commonplace among academics, investors, and others in the ecosystem. The major point of contention generally centres on how university tech transfer offices – the bodies tasked with helping academics to commercialise their work – demand relatively large equity stakes in the resulting spinouts. This makes them less investable propositions, rendering it harder for spinouts to access the funding they need to go from demonstrating a proof of concept to scaling up as a mature business. Slow timelines and burdensome bureaucracy are also cited as being barriers to rapid growth – many of the same frustrations that were voiced in the responses about government grant funding.

These sentiments have not gone unheard, and last year the government commissioned and published a review into what can be done to increase investment into British spinouts. It made several recommendations, but the most important was the recommendation that spinout deals should be made on market terms, explicitly citing a figure

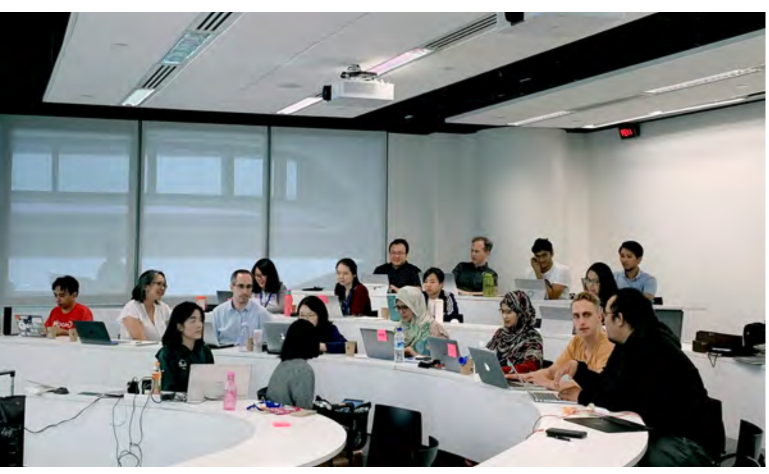
of "10-25%" as a useful starting point – and possibly less for instances of less intellectual property-intensive sectors.[108]

It is recommended that the review's recommendations should be fully implemented, as they represent a step in the right direction for Britain's spinout landscape. But we should not assume that means the job is complete. One of the recommendations the review made was that more data on spinouts and typical deal terms should be released. If after a while we see from this data that the situation does not appear to be improving, we should not hesitate to demand further reforms be made.

While the review was ongoing, The Entrepreneurs Network released a report arguing that academics should be granted far more control over the intellectual property they generate, given the strong evidence from other countries that this leads to the creation of more spinouts, and more and better patenting by academics.[109] It should be noted that in 2023, the average stake taken by universities grew from 19.2% to 22.2%.[110]

It is recommended that external commercial guidance is sought to guide universities to provide an effective commercial model that better capitalises on the opportunity which will inevitably recommend taking smaller equity stakes.

108 Department for Science, Innovation and Technology (2023). Independent review of university spin-out companies.
109 The Entrepreneurs Network (2023). Academic to Entrepreneur: Unlocking the Potential of UK Spinouts.
110 Beauhurst (2024). Spotlight on Spinouts 2024.



PROPOSAL SIX

Use lotteries and fast-track schemes to expedite grant funding for innovation

Grants represent a good way for companies to get funding to undertake research and development. Yet the application processes involved can often be complex and time-consuming affairs. Indeed, many businesses will apply for grants via a grant-writing consultant, who will be better placed to understand what makes for a compelling application. Of course, contracting it out also saves busy founders the time needed to fill out forms, but this is only efficient when the amounts on offer are sufficiently large. As many responses noted, however, grant funding amounts are often not considered worth the bother of applying.

Competition to win funding can often be greater than expected, however. We have previously noted how in some cases thousands of bids are made for schemes worth only low-tens of millions of pounds.[111] If even only some of the applicant firms pay grant writers to help them, then the cost of doing so ends up representing a sizeable portion of the final grant. Yet there's also a risk that many of these attempts are made only by lower-quality businesses, whose attention to grants is the result of rightly having no other options available to them, or whose founders are demonstrating poor judgement by making the costly applications for such small sums.

It is recommended that the UK adopts a process of lottery selection for smaller grants. In this approach, experts would still be required to ensure that applications are of a sufficient standard, but assuming they pass a threshold, successful bids would then be entered into a random lottery to determine which gets funding. This removes any potential self-selection by founders with less business acumen, while considerably reducing application costs. This method of allocating grant funding is used elsewhere to good effect – a majority of researchers who applied for lottery-chosen grants from New Zealand's Health Research Council said they favoured the lottery system.[112]

Another way in which we can expedite the process of awarding grant funding is to consider fast tracking applications from certain companies. These might be companies which fulfil a certain size criteria – for instance turnover or employment – or those which have previously been successful in applying for funding. Of course, processes would need to be in place to prevent abuse of the system – perhaps applications for particularly large quanta of funding would not be eligible for fast tracking, or there could be larger penalties for cases of genuine misuse. In all likelihood, such a system would probably need to be trialled and rigorously evaluated before being more widely rolled out, but the fact remains that if successful it could be a novel way of ensuring innovative businesses can get the funding they need quickly and in a more cost-effective manner, not only for them but also the government.

111 Sam Dumitriu and Philip Salter (2020). Unlocking Growth: How to Expand Access to Capital.
112 Ibid.

PROPOSAL SEVEN

Improve the administration of R&D tax relief

Tax reliefs for R&D are another crucial way for companies to gain access to the funding they need to grow. As noted earlier, they have been around in one form or another since the year 2000, and in 2021-22 the provisional amount of R&D tax relief claimed stood at £7.6 billion.

Recently, however, the government has grown concerned about the level of fraud which may be occurring with regards to bogus R&D claims. To be sure, nobody denies that some level of abuse of the system does occur – with businesses claiming for innovation that is anything but innovative. But there is a risk that the wrong lessons are being learnt in response. HMRC, the agency responsible for administering claims, has been accused of being overzealous in its pursuit of clawing back money by bodies like the Chartered Institute of Taxation (CIOT), who have said: "Valid claims are being rejected and businesses are being deterred from challenging HMRC by the disproportionate financial and time cost of doing so. Those businesses that do seek to challenge HMRC's rejections seem to meet a brick wall, finding it very difficult to get a hearing for their case."[113] Meanwhile, reporting from the BBC and *The Financial Times* has highlighted how legitimate entrepreneurs are being chased to repay sums of thousands of pounds.[114]

The recent crackdown on R&D claims has taken the entrepreneurial community by surprise. The impact of HMRC's change in stance will likely have a chilling effect on businesses considering applying for innovation funding, and in some cases will leave firms unable to operate. For a nation which aspires to be a science and technology superpower, having an R&D tax credit system which appears reluctant at best to offer support is far from ideal.

Admittedly, positive reforms do appear to be underway. The CIOT issued an update which explained in detail the concerns it has around HMRC and what can be done to address them.[115] The two bodies are now working closely to improve the process of R&D tax relief claims, and with hope these new measures will ensure that the system begins to work better for valid claims, while still rooting out poor quality or downright fraudulent ones. Yet with that being said, it should not simply be assumed that the job is done.

Unless and until the system is truly working as well as it must for innovative businesses, scrutiny of HMRC should continue. Moreover, some of the reforms may require extra resourcing, and the government should not rule out providing this (perhaps paid for out of funds no longer going towards fraudulent claims).

113 Chartered Institute of Taxation (2023). R&D tax relief crackdown deterring genuine claims, Institute warns.
114 Dougal Shaw (2024). 'HMRC gave me £49,000 tax relief, but wants it back'; Yasemin Craggs Mersinoglu (2024). HMRC undermining innovation by failing to award R&D tax credits, say start-ups.
115 Chartered Institute of Taxation (2024). CIOT update for members on R&D compliance activity and HMRC engagement.

PROPOSAL EIGHT

Modernise SEIS and EIS to ensure they're able to deliver what scaling businesses require

In 2023, changes came into effect which increased the generosity and scope of SEIS.[116] These reforms increased the company lifetime allowance for SEIS investment from £150,000 to £250,000; the qualifying trading period for SEIS eligibility increased from two years to three years from the date of commencement of trade; the upper limit of a company's gross assets increased from £200,000 to £350,000; and the maximum amount that an angel investor is able to invest in start-ups using SEIS in any tax year increased from £100,000 from £200,000.

These changes were widely welcomed by the entrepreneurial ecosystem, and without doubt will help at the margin to fuel the growth of new companies in the UK. And yet, there is still an argument that there is further to go. In our Call for Evidence, numerous respondents told us that even with the increased limits, for the most promising companies in the UK, they could still be too low. We believe there is a good justification for thoroughly reviewing where the various SEIS limits should stand to ensure that we are not arbitrarily capping their effectiveness for companies needing to make use of them.

It is recommended that a thorough review should be undertaken for EIS. Consideration should be given to the lifetime limit a company can raise (currently set at £12 million per company, or £20 million if deemed 'knowledge-intensive') and the level of gross asset limits should be increased in line with inflation on an annual basis, including a look back period where this has been frozen.

PROPOSAL NINE

Reconsider the implementation of Basel 3.1 to not hurt SME lending

The Bank of England's Prudential Regulation Authority (PRA) has launched a consultation on new standards for SME lending, under the label 'Basel 3.1'. PRA intends to lower risk for banks that lend capital to SMEs by removing the SME support factor, which means that banks would need to increase the amount of capital that they need to hold against each SME loan.

If implemented, the proposed reforms would hurt growing businesses, as the cost of lending would increase, disincentivising banks from working with these firms. Allica Bank estimates that this may reduce the supply of SME lending by up to £44 billion.[117] Inevitably, this would curb the growth potential and motivation of many Breakthrough Businesses – and indeed overall economic growth of Britain.

Numerous banks, including both established lenders and challenger institutions, voiced their concerns to the government and the PRA in a consultation last year.[118] As they said, the proposed policies would not only hurt SME finances but also they may make the UK an international outlier when it comes to SME lending. Peer jurisdictions, mainly the EU and the US, would subsequently have a competitive advantage in providing cheaper loans for SMEs.

It is recommended that the government reconsiders the PRA's proposed reforms, especially on SME lending. They should be redesigned in consultation with banks that lend to SMEs and without causing an international misalignment.

116 HM Revenue and Customs (2023). Increasing the limits of the Seed Enterprise Investment Scheme.
117 House of Commons Treasury Committee (2024). SME Finance.
118 Ibid.

PROPOSAL TEN

Rethink the eligibility criteria for employee incentives

Policymakers designed employee incentives with a clear objective of helping SMEs to attract and retain talented workers. This has been largely successful, with the overwhelming majority of business owners who used EMI reporting that it helped their companies grow.[119] However, given that most of these businesses are small enterprises, their growth potential is limited. This automatically constrains the potential impact of the existing employee incentives.

To target Breakthrough Businesses better, policymakers should start reforming the thresholds for employee incentives. Compared to small businesses, growing medium-sized businesses have an even more difficult time attracting and retaining skilled talent against larger enterprises.[120] Right now, these businesses make up only a small proportion of businesses that use EMIs.

The eligibility criteria of having assets under £30 million and fewer than 250 employees were set in 2000 when the scheme was introduced. They have stayed the same for over two decades, whereas if the asset cap had kept pace with inflation it would now be at £60 million. In the meantime, however, the UK economy embraced a much more startup-driven agenda, recently focusing especially on tech. As Index Ventures highlights, EMI criteria are not made for high-potential technology companies, many of which raise significant investments and grow their teams exponentially before making a profit.[121] Policymakers should recognise that these companies are trying to attract a similar set of people as Silicon Valley but they can generally only afford much lower salaries. Stock options are one of the strongest assets they can offer as a result.

Indeed, the government appears well aware of the need to simplify EMI, having recently brought forward reforms to do so.[122]

However, the Government still seems to be treating high-growth firms as peers to big businesses, given that they are incentivising them to make use of the Company Share Option Plan (CSOP), which is more inclusive but has a relatively low share option limit at an updated £60,000 and less compelling tax advantages. Additionally, the employer cannot sell them at a discount rate, unlike the EMI.

Although we support a more inclusive and expanded CSOP, these reforms fall short of maximising EMI's potential. Given that CSOP was designed for big businesses, it doesn't capture the rationale of preferring to work for a growing firm rather than an established one. The former is a safer option; the latter is a bet on the future of a company, and thus should be better rewarded.

It is recommended that policymakers should embrace more substantial reforms to EMI and rethink the eligibility thresholds. To prevent Britain's high-potential firms from losing out on talent, policymakers should consider increasing the current limits of EMI from a £30 million asset capitalisation to £120 million, to both update it for inflation and extend it beyond small businesses, and raise the employment limit from 250 to 500 employees.

Similarly, most other thresholds for employee ownership schemes have not been updated since they were introduced, including the Share Incentive Plans which are capped at a low £3,600 a year, and SAYE. It is recommended that the government should comprehensively review all of these thresholds and update them to match today's economic environment. This review should also take into consideration that some private equity owned SMEs cannot access the employee incentive schemes even though they maintain operational independence.[123] It is further recommended that a review of large company share schemes should be undertaken with the lens of international competitiveness to ensure we are retaining, developing and attracting talent as best as we can.

119 Ipsos MORI (2018). Evaluation of Enterprise Management Incentive scheme.
120 Ibid.
121 Index Ventures (2018). Rewarding Talent: Country by country review.
122 HM Revenue and Customs (2023). Enterprise Management Incentives: Improvements to the Process to Grant Options.
123 British Private Equity & Venture Capital Association (2024). Manifesto for Growth.

CHAPTER 7
CONCLUSION

Britain is a great place to launch a business but it could provide a much better environment for building enduring enterprises at scale. Although policymakers should not be responsible for resolving all business challenges, they can provide the core frameworks to enable entrepreneurial growth. The Private Business Commission was set up to better understand what these are, and to advocate for policy reforms to ameliorate them. In the end, the success – or not – of our Breakthrough Businesses will have profound implications for productivity, innovation and economic growth.

Britain's productivity malaise underscores the urgency of creating an environment conducive to fostering bigger, more productive enterprises. Moreover, a thriving ecosystem of large private and public companies is essential for bolstering government revenues and ensuring fiscal sustainability, as well as stimulating competition and shoring up national security. We can't afford to stand idly by as our high-growth firms leave Britain to scale elsewhere. Unfortunately, this has been the case for too long.

The Private Business Commission sees this report as the start of the debate. As we showed throughout this paper, policies need to be reconfigured to better understand and back Britain's future national champions. Britain is a coiled spring of potential. If we can create an environment where our Breakthrough Businesses are enabled and incentivised to scale into enduring enterprises, the British economy will prosper alongside them.

This requires a broad analysis by the government on Breakthrough Businesses, especially focusing on their life cycles, stages of maturity, and importance for the UK. For that reason, we believe that the next government should establish a formal task force to set out a five-year vision for the development of the private sector.

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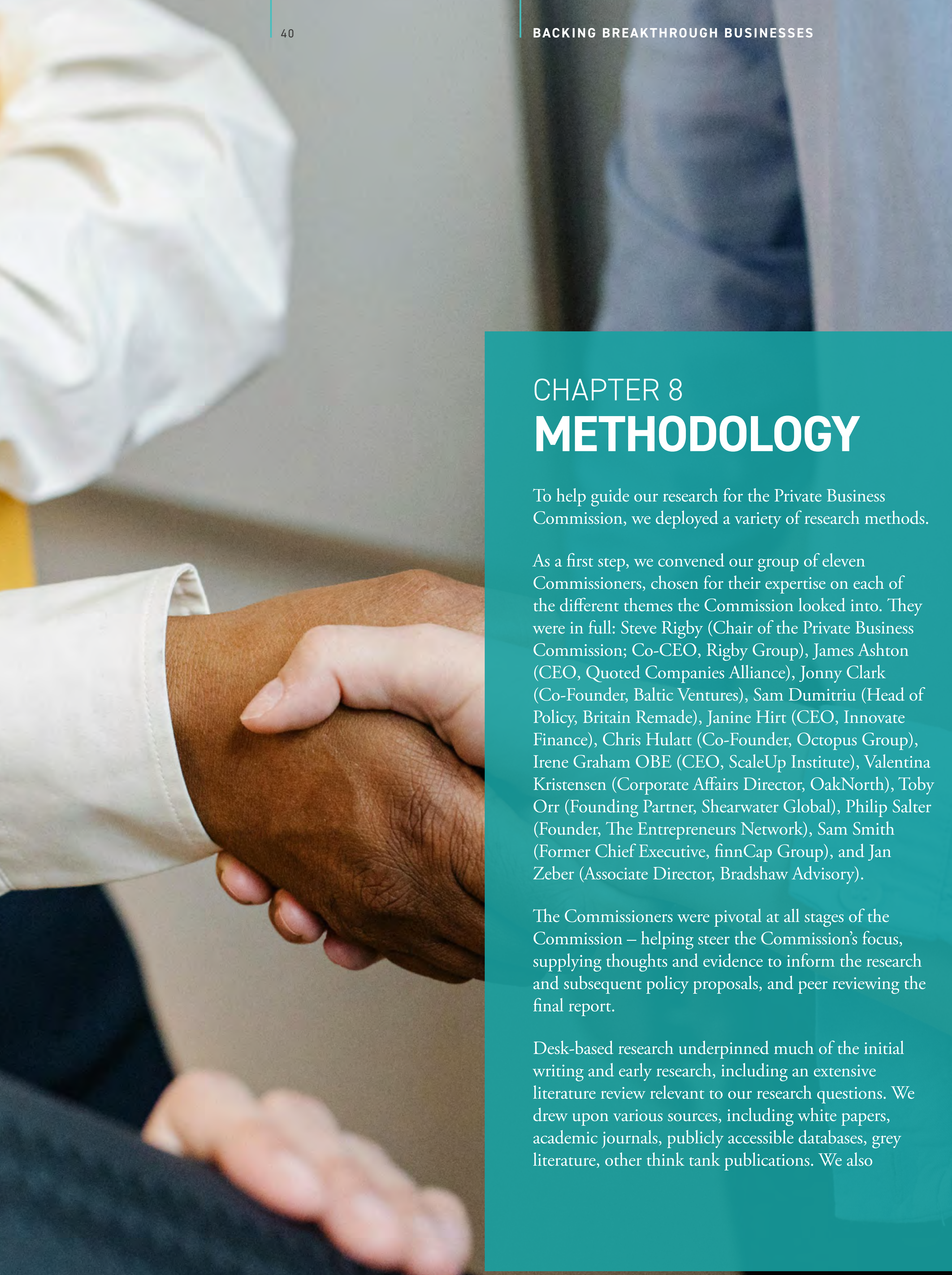

CHAPTER 8
METHODOLOGY

To help guide our research for the Private Business Commission, we deployed a variety of research methods.

As a first step, we convened our group of eleven Commissioners, chosen for their expertise on each of the different themes the Commission looked into. They were in full: Steve Rigby (Chair of the Private Business Commission; Co-CEO, Rigby Group), James Ashton (CEO, Quoted Companies Alliance), Jonny Clark (Co-Founder, Baltic Ventures), Sam Dumitriu (Head of Policy, Britain Remade), Janine Hirt (CEO, Innovate Finance), Chris Hulatt (Co-Founder, Octopus Group), Irene Graham OBE (CEO, ScaleUp Institute), Valentina Kristensen (Corporate Affairs Director, OakNorth), Toby Orr (Founding Partner, Shearwater Global), Philip Salter (Founder, The Entrepreneurs Network), Sam Smith (Former Chief Executive, finnCap Group), and Jan Zeber (Associate Director, Bradshaw Advisory).

The Commissioners were pivotal at all stages of the Commission – helping steer the Commission's focus, supplying thoughts and evidence to inform the research and subsequent policy proposals, and peer reviewing the final report.

Desk-based research underpinned much of the initial writing and early research, including an extensive literature review relevant to our research questions. We drew upon various sources, including white papers, academic journals, publicly accessible databases, grey literature, other think tank publications. We also considered less formal sources such as newspaper articles that still nonetheless give an impression of opinions surrounding the debates relevant to the Private Business Commission.

A Call for Evidence was issued in March and we received responses from entrepreneurs, investors, trade bodies, business groups, policy experts and the Commissioners themselves. Questions included in the Call for Evidence focused on each of the four themes considered in this report, and a request for any more general observations and ideas on the overall question of how Britain can get better at scaling businesses. The evidence respondents supplied was both quantitative and qualitative.

Finally, we also organised a series of policy roundtables to discuss each of the four themes of focus. These ran parallel to the writing process, enabling us to gather further evidence and to test policy ideas that we were developing during the research.

We believe our research methodology was rigorous and well-rounded. Our deliberate reliance on entrepreneurs and investors meant that we could get as close to the ground as possible when trying to understand what drives decisions that determine whether or not companies can fulfil their growth potential. We thank all of those who engaged with us during the research, without which it would not be the rich and robust exercise we believe it was.

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Tom Adeyoola
Valentina Kristensen
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Careology
Confederation of British Industry
British Private Equity and Venture Capital Association
Enterprise Investment Scheme Association
Federation of Small Businesses
GoHenry
The Institute of Export and International Trade
OakNorth Bank

Special thanks are afforded in particular to Steve Rigby, for generously supporting the Commission and acting as its Chair.

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The Entrepreneurs Network is a think tank for Britain's most ambitious entrepreneurs. We support entrepreneurs by:

— Producing cutting-edge research into the best policies to support entrepreneurship;
— Campaigning for policy changes that will help entrepreneurship flourish;
— Hosting regular events and webinars to bridge the gap between entrepreneurs and policymakers;
— Updating entrepreneurs on how policy changes will impact their business;
— Making the case in the media for entrepreneurs' contributions to society.

We are the Secretariat of the APPG for Entrepreneurship, which was set up to encourage, support and promote entrepreneurship and to engage with entrepreneurs; and to ensure that Parliament is kept up to date on what is needed to create and sustain the most favourable conditions for entrepreneurship.

Founded in 1975, Rigby Group is today Europe's largest private investor in technology. We are also one of the top ten wholly family-owned businesses in the UK and in the top 500 globally. Our Group values underpin our work: foresight, hard work and enabling others. The mission of Rigby Group is to balance sustainability and profit in the pursuit of technological innovation, and to deliver long-term benefits for our stakeholders and communities. Everything we do is founded on the belief that cutting-edge innovation, traditional values, and vigorous philanthropy can be harnessed to create a sustainable future – financial, social, environmental and governance.

Over nearly 50 years Rigby Group has built many market-leading companies, not simply through investments and acquisitions but by enabling businesses to realise their full potential by giving them the resources, management and scale they need. Though our portfolio spans airports, commercial, hotels, and residential assets, our strong technology focus continues. IT solutions pioneer SCC remains the cornerstone of Rigby Group's business, and the recent establishment of dedicated technology investment arm Rigby Technology Investments (RTI), positions tech firmly at the heart of our future strategy.

We are committed to scaling-up our social and environmental initiatives as we grow. The Rigby Foundation embodies the family's determination to contribute to the communities of which we are a part, and Rigby Group supports the Foundation to enable it to support social mobility in the West Midlands.

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