Nurturing success, delivering growth
VCT investment 1995 to 2014
About the AIC

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

AIC members include 67 Venture Capital Trusts, which manage some 95% of the sector’s £3.2bn of assets.

To discuss the issues raised in this paper please contact:

**Guy Rainbird**
Public Affairs Director
guy.rainbird@theaic.co.uk
020 7282 5553

**Nina Paul**
Public Affairs Executive
catharina.paul@theaic.co.uk
020 7282 5588
Contents

1 Chief Executive's foreword 2
2 Executive summary 3
3 An alternative to bank finance 4
4 Overall impact 5
5 Impact of investment in 2014 12
6 A value for money intervention 14
7 Other policy priorities 16
8 Appendix 1: Data breakdown 17
9 Appendix 2: Methodology 18
10 Acknowledgements 20

Important information
This document has been prepared using data collected by the AIC from VCT managers. The AIC accepts no responsibility for any errors or omissions in this document or for any loss occasioned to any person or organisation acting or refraining from action as a result of any material contained in this document or any omissions. This document is based on our current understanding of law and practice. This can change over time and information contained within this document is based on our understanding as at time of print.
1 Chief Executive’s foreword

In 2014 the European Commission announced its intention to strengthen the EU Capital Markets Union. It wants to reduce the EU’s reliance on bank finance to support economic growth. Across the UK, and in a variety of sectors, VCT investment presents a viable and commercially attractive alternative to bank finance for SMEs. The example set by the VCT scheme should be one that policymakers across the EU want to emulate.

In today’s fiscal environment it is also important to recognise that in many ways the Government is the biggest investor in the VCT sector. The tax reliefs given to retail investors are an integral part of balancing the risks and rewards of investing via a VCT. It is therefore vital that VCTs offer value for money to the taxpayer by supporting the growth of companies to generate profits and create jobs to boost the UK economy.

The publication of the AIC’s sixth annual survey of Venture Capital Trust (VCT) investment comes as the scheme marks its 20th year. Consistently positive results are vital to ensuring sustained support for any investment company and I am pleased to see the VCT sector continues to deliver for its shareholders.

VCTs address market failures which prevent smaller UK businesses securing development capital. These problems are compounded where businesses do not have sufficient collateral, or trading track record, to convince banks to act as a source of finance. The role of VCTs is as important today as it was when the scheme was introduced in 1995.

I am grateful to the VCT fund management teams who have helped the AIC collect this data. This year’s report takes a closer look at investment trends in terms of both sector and geography. It is encouraging to see that with regard to both, there is a breadth and depth to VCT investment and its impact on SME growth.

This year we have explored more stories of SMEs that have benefited from VCT investment. We have fantastic examples of the value of VCT intervention to the companies they support.

I am pleased to be presenting another positive report on the VCT sector. VCTs are delivering the Government’s priorities as part of the UK’s long-term economic growth plan. It will also be important to assess how impending rule changes affect future investment plans. I look forward to watching the success of VCTs and their investments continue in the future.

Ian Sayers
Chief Executive, AIC
2 Executive summary

Investment

£2.31m
Average size of initial VCT investment per SME

Jobs

51
Average number of new employees per SME since VCT investment

Turnover

£12.71m
Average turnover increase in each SME since VCT investment

Largest sectors in 2014

- Technology and IT
- Business Services
- Manufacturing and Engineering

First investments in 2014

- 26%
- 22%
- 19%
- 13%
- 20%
3 An alternative to bank finance

VCTs offer more than money to support the growth and development of the SME. Often a VCT representative joins the company board or takes on a consultative role.
4 Overall impact

Investment

VCTs address an ongoing structural issue affecting SMEs seeking between £250,000 and £5m – the so-called ‘finance gap’. This level of investment is beyond the means of most individual investors, but too small to be attractive for traditional private equity firms to invest.

The VCT scheme has been particularly important in recent years as the financial crisis severely impacted the willingness of banks to back small businesses. The role of VCTs as providers of crucial business support has been reinforced.

Average overall investment size of £3.01m per company

80% of 2014 investments made in the ‘finance gap’

128 companies received £255.99m of new and follow-on investment in 2014
Turnover

VCTs and their managers have strong incentives to deliver shareholder returns by seeking out SMEs with growth potential. Targeted companies tend to be high risk businesses. This means that not every investment will work out, but some will be very successful. The potential for high growth is most exciting when market disruption (for example, technology) presents a new opportunity for an innovative business.

VCT-backed SMEs achieved turnover growth of 183% since initial VCT investment

Average turnover per SME increased by £12.71m since initial VCT investment

85% of companies have seen an increase in turnover since initial VCT investment
Jobs

There is no ‘typical’ VCT investee company, but those likely to secure capital will be actively seeking to grow and develop their business model. VCT support enables them to create jobs.

Sometimes transforming a business will mean some reductions in headcount but, overall, the process creates a more robust and sustainable platform for growth in the future.

13,508 new jobs were created in SMEs with VCT investment taking the total to 30,101 employees – an increase of 75%

51 new employees on average per VCT investee company

80% of companies have seen an increase in employment since initial VCT investment
Sector

VCTs are commercially focussed. Managers must ensure that they deliver results for their investors. A healthy spread of investment across various business sectors is one way of mitigating the risk of investing in small, unproven companies. Strong growth in different commercial markets indicates the benefit of this approach.

Top sectors in current VCT portfolios

- £1.26bn
- Technology/IT
- Leisure/Hospitality
- Business Services
- Manufacturing/Engineering
- Energy (renewable)
- Healthcare

Top sectors for turnover increase since investment

- £4.2bn
- Business Services
- Technology/IT
- Retail
- Leisure/Hospitality
- Financial Services
- Manufacturing/Engineering

Top sectors for jobs growth since investment

- 13,508
- Technology/IT
- Leisure/Hospitality
- Healthcare
- Business Services
- Media
- Retail

13,508
Mangar is a Welsh company specialising in the design, manufacture and supply of inflatable equipment to help move and care for immobile people. The products Mangar manufactures provide independence and reduce the physical demands placed on carers. The company is receiving increasing international attention and the £2m VCT investment received in 2014 is being used to replicate Mangar’s UK market position in key overseas territories and deliver overseas growth.

The Goonhilly Earth Station, based in Cornwall, transmitted images of the first moon landing to televisions across Europe. Goonhilly Earth Station Ltd has re-established commercial operations on the site. VCT investment will fund site upgrades and opportunities to diversify income. This includes operating a radio telescope for a consortium of universities, developing data and visitor centres, and undertaking deep space communications to support NASA and ESA.

FairFX is a London based international payment services and travel money provider, established in 2007. This financial services company has developed a cloud-based peer-to-peer payments platform.

The platform enables personal and business customers to make easy, low-cost multi-currency payments in a broad range of currencies and countries and across a range of foreign exchange products via a single system.
Geography

VCT managers seek out companies with commercial potential across the UK. The geographical spread of investments is an important feature of the scheme given the Government’s continued focus on regional growth.

Changes in regional focus

Investments pre-2014

Investments 2014

Egress is a London-based cyber-security business founded in 2007. The company has developed cloud-based and onsite encryption services designed to secure all forms of electronic information.

Egress counts over 25% of UK local authorities and 14 central government departments among its customers. Albion’s VCT investment in 2014 was used to support investment in the product suite and further expansion into the UK private sector, and overseas markets.

Crawford Scientific, based in Scotland, provides technical services and products in the specialist field of chromatography (laboratory techniques for separating complex mixtures).

The company helps its clients in their efforts to develop activities such as quality control and environmental analysis across a variety of sectors including pharmaceuticals and oil & gas. Crawford Scientific has diversified its income by providing technical consulting and training services.
ALL GOOD.

A snack food manufacturer based in the North East of England, the company received £3.5m from NVM in early 2014.

Since investment, the business has invested around £2m in plant machinery and staff numbers have more than doubled to 80 employees. In only two years of trading sales in the region of £10m have been achieved.
5 Impact of investment in 2014

The benefits of VCT investment are often immediate. Analysis of SMEs that received initial VCT investment in 2013 shows excellent initial growth results.

Turnover

Aerospace Tooling is a manufacturing and engineering firm that has increased turnover from £6.7m to £11.1m since receiving investment from Foresight Group in 2013.

Online furniture business Swoon Editions trebled its turnover since receiving investment from Octopus Titan VCT in late 2013.

Frontier Developments received VCT investment in 2013 to become a self-publishing video games developer. In a single year, the company’s turnover increased by almost £7m.

77% of companies have increased their turnover by an average of £1.5m

34% increase in turnover for investee companies in Scotland
Jobs

Grapeshot is an adtech company providing keyword technology for ad buyers and sellers using programmatic trading. Its employee numbers have grown from 34 to 55 since investment.

15 new jobs per company

Buoyant Holdings, a furniture manufacturer based in the North West, has created 133 new jobs since receiving investment in 2013.

31% increase in jobs for the North of England

Ideagen’s employee numbers have increased from 38 to 72 since Livingbridge invested in the company. This SME provides compliance information management software enabling clients to meet regulatory standards, helping to reduce costs and improve efficiency.
6 A value for money intervention

Tax
The Government offers retail investors an ‘upfront’ 30% income tax relief on investment in a VCT. This makes the UK taxpayer the biggest investor in the success of the VCT scheme. The track record of VCTs in supporting growth demonstrates that this commitment secures real value for money.

In 2014, 271 SMEs that received VCT investment confirmed that they paid tax totalling £451.92m. This represents 87% of the value of the upfront tax relief received by investors in respect of the money invested in these companies being paid back to the Government in a single year.

VCT divestments 2014
VCTs seek to sell their investments in SMEs when the company is in a stronger position than on investment but still has the capacity to deliver future growth. This approach attracts the best possible price for the shares the VCT is seeking to sell.

Fourteen VCT fund managers provided details of divestment in 2014. Of the 95 sales reported, 79% saw the VCT exit the business as a going concern. Given the risk involved in supporting small and innovative SMEs, it is unsurprising that a proportion of the reported exits saw the investee company go into administration. Indeed, the risk of failure is part of the justification for Government support for the scheme.
Supporting future growth

The total fundraising figure for the 2014/15 tax year was £429m. A conservative estimate suggests that VCTs have up to £832m of capital to make further investments in SMEs over the next three years.

With an average total investment size of £3.01m, the current resources available to VCTs could fund a further 276 enterprises.

On current trends, these businesses would then have the potential to create over 14,000 new jobs.
7 Other policy priorities

Research and development

Over the year, VCT-backed SMEs spent more than £120m on R&D

Approximately a third of investee companies reported making an investment in R&D in 2014

The average spend per SME that invests in R&D was £920,000

Exports

39% of investee companies generated turnover from exports in 2014

Overseas markets accounted for 30% of the turnover of exporting investee companies

£1.17bn of overseas earnings reported by investee companies in 2014
8 Appendix 1: Data breakdown

Investment

Total VCT investment received by UK SMEs (1995-2014)

![Bar chart showing number of investments by investment size (£m).]

VCT investment received by UK SMEs (2014 only)

![Bar chart showing number of investments by investment size (£m), with categories for New investment and Follow-on investment.]
9 Appendix 2: Methodology

VCTs currently have active investments in just over one thousand UK SMEs, and since their inception will have invested in – and successfully exited from – significantly more. Collecting detailed data on these investments is difficult.

This survey records the impact of £1.27bn of investments into 422 SMEs from 1995 to 2014. This data provides a strong indication of the impact of VCT investment. The consistency of results with previous surveys supports this view.

The general turnover and employment findings do not analyse companies receiving first-time investment in 2014 as this time frame is not sufficient to identify the full impact of VCT investment.

Data for 2014 investments has also been excluded for the sections on R&D, exports and taxation as this covers expenditure that cannot yet be linked to the VCT investment.

The size of data pool used for each section are detailed below:

<table>
<thead>
<tr>
<th>Category</th>
<th>Number of investee companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment</td>
<td>422</td>
</tr>
<tr>
<td>Turnover</td>
<td>331</td>
</tr>
<tr>
<td>Jobs</td>
<td>267</td>
</tr>
<tr>
<td>Geography</td>
<td>416</td>
</tr>
<tr>
<td>Sector</td>
<td>416</td>
</tr>
<tr>
<td>R&amp;D</td>
<td>135</td>
</tr>
<tr>
<td>Exports</td>
<td>163</td>
</tr>
<tr>
<td>Tax</td>
<td>271</td>
</tr>
</tbody>
</table>

Calculating tax relief

VCT shares are listed on the London Stock Exchange. An upfront income tax relief is available to retail investors subscribing for new VCT shares i.e. on launch of the VCT or when a VCT raises new money. VCT income tax relief benefits have changed over time as detailed below:

<table>
<thead>
<tr>
<th>Amount of income tax relief on subscription</th>
<th>6 April 1995 to 5 April 2000</th>
<th>6 April 2000 to 5 April 2004</th>
<th>6 April 2004 to 5 April 2006</th>
<th>6 April 2006 to date</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20%</td>
<td>20%</td>
<td>40%</td>
<td>30%</td>
</tr>
</tbody>
</table>
VCTs must adhere to a number of rules to secure this relief (and the other benefits of VCT status) set out in legislation. These include a requirement that 70% of their investments must be in ‘qualifying investments’ e.g. shares in SMEs which carry on certain qualifying trades.

Tax relief calculated throughout this report assumes that VCTs invest 70% of available funds in qualifying investments. Most mature VCTs usually hold 80% or more but this calculation assumes the minimum to ensure a conservative assumption of the cost versus benefit.

Similarly, the calculations in the report assume all investors receive an upfront income tax relief of 40%. Again this is designed to ensure a conservative estimate which maximises the possible cost to the taxpayer for the purposes of analysis as the 40% relief was only available to VCT funds raised for 2 of the 20 years of the VCT scheme. As such, funds where a 40% tax relief was paid must have been invested for the first time between 2004 and 2009. Otherwise investments will have been made either from VCT funds benefiting from a lower rate of relief, or where the investment is being recycled (in effect without the benefit of any further upfront income tax relief).

Example calculation

<table>
<thead>
<tr>
<th>Description</th>
<th>Calculation</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total qualifying investment</td>
<td>70p</td>
<td></td>
</tr>
<tr>
<td>Total VCT funding</td>
<td>(70p ÷ 70%)</td>
<td>£1</td>
</tr>
<tr>
<td>Total income tax relief</td>
<td>(£1 × 40%)</td>
<td>40p</td>
</tr>
</tbody>
</table>
Acknowledgements

The AIC is grateful to the following managers for their contributions: Albion Ventures LLP, Amati Global Investors Ltd, Beringea LLP, Downing LLP, Foresight Group, Elderstreet Investments Ltd, Livingbridge VC LLP, Mobeus Equity Partners, NVM Private Equity, Octopus Investments Ltd and YFM Equity Partners.

Copies of previous versions of the AIC’s annual research into the impact of VCT investment on UK employment and economic growth can be found at the following link:

www.theaic.co.uk/vct-research