Business, Innovation and Skills Committee
Digital Economy Inquiry
House of Commons
London
SW1A 0AA

28th October 2015

About the IoD:

The IoD was founded in 1903 and obtained a Royal Charter in 1906. It is an independent, non-party political organisation of approximately 35,000 individual members. Its aim is to serve, support, represent and set standards for directors to enable them to fulfil their leadership responsibilities in creating wealth for the benefit of business and society as a whole. The membership is drawn from right across the business spectrum. 71% of FTSE 100 companies and 51% of FTSE 350 companies have IoD members on their boards, but the majority of members, some 70%, comprise directors of small and medium-sized enterprises (SMEs), ranging from long-established businesses to start-up companies. IoD members' organisations are entrepreneurial and growth-orientated, and more than half (57%) export goods and services internationally.

Context

The IoD welcomes the opportunity to contribute to the Business, Innovation and Skills Select Committee's inquiry into the digital economy.

Britain's digital economy should be a matter of pride.

It is worth stating before answering the Consultation's particular questions just how far Britain leads the rest of the world in the adoption of the digital economy. The Boston Consulting Group estimate that next year 12.4 per cent of UK GDP will come from what it terms the "internet economy," which is significantly ahead of the second placed nation, South Korea, at 8 per cent. The European average is 5.7 per cent, the US comes in at 5.4 per cent, and Germany at just 4 per cent.[1]

Furthermore, online retail is expected to entail nearly a quarter of all UK retail transactions in 2016. At 23 per cent, we are almost double that of our closest competitor (Germany: 11.7 per cent) and streets ahead of the developed market average of 8.5 per cent.[2]

It is important, however, that British businesses or the Government don't rest on what are quite considerably digital laurels. There is no question that internet technology – and digital communication innovation more generally – will allow economies across the world to rapidly catch up with digital leaders, far quicker than would be the case with manufacturing. We therefore welcome the Committee's review of the digital economy.

[1] Boston Consulting Group, "The Internet Economy in the G-20," May 1 2015, http://on.bcg.com/1JTDYFB
[2] Ibid

What are the major barriers to UK business success in the digital economy?

We stated earlier that the UK's digital economy should be a matter of national pride – yet it is not. The reasons for this are numerous but the key element is that – across the world – some 51 per cent of people believe that innovation is moving too fast.[3] Even in the UK, less than 50 per cent of people say they have "trust" in recent business developments, largely in the digital economy. This dichotomy is striking and one which needs to be addressed.[4]

It is crucial that these people are bRought along with the digital revolution, and are given a stake in the entrepreneurial spirit that is powering it. We will touch further on how to do this later.

We also note that there is real concern about a skills shortage in the digital economy and, connected, concerns about Britain's policy towards skilled migration. We will discuss this extensively later in our response (What actions could the Government take to ensure the availability of a workforce with the skills to support businesses in the digital economy?). Though there have been some reasons for optimism – the relaxation of restrictions on coding experts via Tech City announced in October 2015[5] – there are few more dark clouds than sun spots. It is worth noting that some 95 per cent of IoD members believe the immigration process is too bureaucratic, inevitably making it harder for them to recruit necessary skills from abroad.

Furthermore, while the IoD recognises the Committee's statement that this inquiry will not cover the delivery and implementation of broadband services, we feel it worth noting that perhaps the greatest threat to the continued growth of our digital economy is our subpar broadband infrastructure. We note a couple of recent studies in that regard.

London, for instance, is ranked as the best city in Europe for start-up businesses in the European Digital City Index 2015 – yet it is noticeable that it ranks no higher than 12th on so-called "digital infrastructure," within which the capital sits at 26th on internet download/upload speeds, and 28th on mobile interest speeds.[6]

Cambridge ranks as the 11th best European city for start-ups, but again, lags heinously in digital infrastructure. Download/upload speed is the 22nd best in Europe, mobile speed the 31st. It is a similar story in Oxford; 13th overall, but 20th for download/upload speed and 32nd for mobile internet. Clearly, this is holding back the success of start-up firms growing and providing the next wave of innovative and exciting firms growing the digital economy further.

On a wider scale, Britain ranks 18th for broadband infrastructure. We mentioned earlier that South Korea had the second-largest amount of its GDP bound up in the digital economy, behind Britain. It should be noted that, in that damning survey of Britain's broadband infrastructure, South Korea came out on top. [7]

What steps could the Government take to help business to overcome these barriers?

---

[3] Edelman, "Edelman Trust Barometer 2015," http://bit.ly/1yGJdoe
[4] Ibid
[5] Daily Telegraph, "Government agrees to relax tech visa system amid skills shortage," 15 October 2015, http://bit.ly/1QyCFOy
[6] NESTA & European Digital Forum, "European Digital City Index 2015," http://bit.ly/1RnsQmN
[7] Akamai, "State of the Internet Report 2014," 2014, http://akamai.me/1GLt2VT

Away from the obvious need to build adequate broadband infrastructure, there are a number of steps that government can take to boost the digital economy.

In particular, we think the government should think of the digital economy as a way of expanding the equity economy. If we are to persuade the 51 per cent of people who believe that innovation is moving too fast that in fact disruptive technology is a good thing, it is crucial they are given more of a stake in its success. To that end, we have been heartened by the success of the Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS), two vital but underutilised government initiatives which have the potential to unlock a new wave of investors in small and growing businesses, build up equity finance in the UK and cement our position as one of the best places in the world to start, set-up, run and invest in a digital business.

However, EIS and SEIS are underutilised, largely due to a lack of knowledge about them. One third of IoD members – an educated audience – have not heard of EIS, and two thirds remained unaware of SEIS. This is problematic. We firmly believe that BIS should promote and advertise EIS and SEIS more widely to make more businesses, investors, financial advisers, accountants and lawyers aware of the schemes.

The IoD has published a report on the equity economy and these two particular schemes, *Opening the Equity Economy.* That report is attached to this submission and can also be found on the IoD website at http://bit.ly/1NaGusz. There are a number of recommendations on improving the EIS and SEIS schemes included within that report which we would encourage the Committee to consider as it draws up its conclusions.

Our thoughts on improving Britain's policy for recruiting skilled migrants are included later in our response, in the skills section.

How effective are UK financial markets in supporting the digital economy

Broadly, UK financial markets are supportive of the digital economy. British financial institutions in fact seem to be among the most forward-looking in the world when it comes to investments in new technology and, at a time when those institutions remain the bête noire of public discourse, they should be given credit for this.

It is important too to note that the financial markets are increasingly just a part (admittedly an important one) of the capital raising environment, rather than the be-all and end-all that they may have been twenty to thirty years ago. New developments in crowdfunding and the imminent arrival of digital-only banks like Mondo and Atom – which one anticipates will develop business banking in due course – are diversifying the market for capital and demonstrate that it is more likely that technological innovation, rather than heavy-handed regulatory intervention, will deliver the competition that we all want to see in the banking and financial sectors. It is crucially important that, as these developments continue, the regulatory environment is such that they can prosper and thrive.

What actions could the Government take to improve their effectiveness?

As we have alluded to, government must keep up with the new ways firms are using to access capital. That means creating a regulatory and taxation framework that allows real competition between numerous different providers of finance, from traditional and non-traditional sources. Different firms need different kinds of financing at different times in their life cycles, and Government must recognise this. We are slightly concerned, for instance, by the new bank tax surcharge announced in the summer budget which could damage so-called challenger banks' ability to lend. We share the concerns of Andrew Tyrie MP, Chairman of the Treasury Select Committee, who rightly has expressed concern that the new regime could limit rather than enhance competition in the sector.[8] We also note the views of numerous leaders of challenger banks, who have warned that the new surcharge will affect their ability to lend to small businesses and who have called on the Chancellor to "level the playing field."[9]

Though competition in the banking sector would benefit consumers and businesses alike, instinctively we would imagine that businesses in the digital economy – and partial to disruptive technology – are more likely to look at challenger banks or digital banks than established businesses in established sectors. As such, we think taxation structures that hit challenger banks hard would hit businesses in the digital economy disproportionately. We would encourage the Government to look again at the structure of the new bank tax surcharge.

It is worth noting at this point a policy we would *not* advocate. Across the continent, much venture capital funding into start-ups has come from central government – as much as 40 per cent at a central European level. Not only is there potential for this to squeeze out private venture capital, it is also worth noting that the nature of state-financing means that often returns are lower than they might be – immediate returns to recoup taxpayers' money are valued over the sort of long-term bets that private venture capitalists tend to take in firms with the most exciting futures. We would urge the BIS Select Committee to be sceptical of funds dished out by, for instance, the European Investment Fund. There are a number of reasons that venture capital in Europe has delivered returns of 2.1 per cent a year since 1990 compared to double-digit returns in the United States – the perverse incentives of state investment are no doubt one reason.

What lessons can be learned from the Government's support of tech start-ups and other measures targeted at the digital economy?

One of any Government's most powerful tools is what might be called the bully pulpit – the ability to use the platform that it clearly has across the media and the wider business landscape to throw its weight behind certain sectors. This it has very much done with the digital economy, through initiatives like TechCityUK, for instance. Government signalling can be crucially important in getting 'buy in' from non-government actors required to stimulate growth in an industry.

Such government championing is useful too in signalling to foreign investors, innovators and institutions that Britain is open for business in certain sectors – in this case the digital economy. Other than on immigration, as we have discussed already, the Coalition Government and the current Government should be praised for their work in encouraging the rest of the world to think of Britain as "the home" of the digital economy in Europe.

---

[8] City AM, "Andrew Tyrie ramping up efforts to block George Osborne's proposed new bank tax," 8 October 2015, http://bit.ly/1KEQh5D

[9] Financial Times, "Challenger banks appeal to George Osborne over UK tax rules," 22 September 2015, http://on.ft.com/1RAXyZC

On more specific schemes, we have already noted the success of, but limited uptake, of EIS and SEIS. As previously, it's crucial to publicise schemes if they are to work as effectively as we want them to. Any further schemes targeted at the digital economy, particularly around venture or equity capital, need to be highly publicised – business groups, including the IoD, may well be useful channels for this publicity.

How is this developing around the regions and nations of the United Kingdom?

There is no question that certain areas of the UK have certain particular strengths in the digital economy. London has a thriving financial technology sector (fintech), perhaps unsurprisingly considering the proximity of the City. Cambridge, by contrast, has incredible strength in science technology start-ups, which have surprisingly high cross-over with the "digital" economy. The key is – without picking winners – ensuring that there are partnerships in place to build on those strengths and allow promising start-ups to "scale-up" into bigger businesses.

One such partnership can be seen in Bristol, at the Engine Shed. The Engine Shed is a collaboration between Bristol City Council, the University of Bristol and the West of England Local Enterprise Scheme. A collaborative working space which brings together entrepreneurs, academics, investors and established businesses, it includes a business lounge co-founded by Bristol Media, the Institute of Directors, and the Universities of Bath, Bath Spa, Bristol and the West of England. It is an example of local authorities working closely with other bodies in the area – local business representatives, existing firms, and universities – to build useful mutual relationships. Such partnerships are replicated in other areas across the country, but central Government should use its platform to encourage more.

While we acknowledge that the digital economy has its own specific needs and requirements, it's worth noting that it isn't entirely separate from the rest of the economy and shares many of the complaints of, for instance, a traditional manufacturing firm. Quite apart from digital infrastructure, they share concerns around business rates, transport capacity, and free land for housing. As such, we heartily welcome the Chancellor's plan to devolve business rates to Local Authorities, creating increased accountability in local areas on business rates, planning and local transport infrastructure. We also welcome the Government's focus on delivering infrastructure across the country, and would urge them to push ahead with the "less sexy" infrastructure improvements that keep the economy growing – upgrading capacity on existing inner- and inter-city lines, ensuring road maintenance is continuing, etc – as well as the grander projects such as HS2. It is tempting to think of the digital economy as being separate from the traditional economy, but ensuring (for instance) venture capitalists based in London can get to tech firms in Newquay, Newport and Newcastle without undue delay remains an important part of ensuring that the digital economy can grow.

What actions could the Government take to foster the development of potentially disruptive technologies?

In short, not be hostile to them. We have already acknowledged the lack of trust in "innovation" and Government must be alive to those concerns. However, we firmly believe that the benefits of disruptive technology outweigh the negatives, and the Government must endeavour to give more people the chance to enjoy those benefits.

Much of the most “disruptive” technological developments are happening in what is generally described as the sharing economy, which allows individuals who previously would never have considered themselves entrepreneurial to be just that. Uber and AirBnB are the most regularly cited examples, but ride-sharing, errand firms (in which an individual might offer their services to run errands for another if they have two hours free), and “skip the middle man” platforms like Hassle.com are totally subverting traditional business models. Almost all of them rely on digital technology to bring individuals together with potential clients.

Allowing more people “in” to the sharing economy is crucial to giving people a stake in the success of that same economy and addressing the innovation trust deficit, which itself may be the biggest threat to the growth of our digital economy and disruptive technology.

To give an idea of how much potential there is within the sharing economy, PwC has calculated that on a global basis, the sharing economy is worth around £9 billion today but could be worth as much as £230 billion by 2025. In the UK alone, five sectors of the sharing economy are worth around £500 million today, but could be worth £9 billion to the UK in a decade.[10] That is a considerable prize.

The IoD has previously called for a “Sharing Economy Allowance” to be matched at the level of the Personal Allowance, in our report on the sharing economy *Share the Wealth*. In 2014, we suggested that the “Rent a Room” scheme – which at the time allowed a tax-free income of up to £4,250 – should be extended to recognise areas of the asset sharing economy, such as room rentals, asset hire and ride sharing. The “Rent a Room” scheme *was* extended in the recent Summer Budget to £7,500 per year, which was welcome, but we’d urge the Government to go further and include other sharing economy elements into a higher allowance, pegged to the Income Tax Personal Allowance. While IoD members remain resolute in their support of the deficit reduction strategy, the revenue forgone by the Treasury as a result of the “Rent a Room” changes was marginal (£5 million in 2016-17 and £15 million in 2020-21 according to HM Treasury’s Red Book), and further moves to create the IoD’s “Sharing Economy Allowance” would also be eminently affordable even within the remit of the Government’s commitment to a budget surplus by 2020.[11]

Are further safeguards warranted to help existing businesses adapt to the impact of these technologies on their traditional business models?

If Britain is to hold on to its position at the top of the digital economy tree, it is crucial that regulation catches up with technology rather than attempting to put it in a strait-jacket.

However, we acknowledge that occasionally disruptive technology goes further than regulation was ever designed for – Uber being the perfect example, in which the High Court recently attempted to apply the Vehicles Act of 1998 (two years before the launch of the Nokia 3310) to a technology that relies on sophisticated smartphones and wireless high-speed internet.

The key thing is to strike an adequate balance between ensuring that new entrants into an established market are allowed to deliver their disruptive technology in such a way that consumers can benefit from increased competition without meeting their implied regulatory obligations. For

[10] PwC, “Five key sharing economy sectors could generate £9 billion of UK revenues by 2025,” 15 August 2014, http://bit.ly/10yEJCu
[11] IoD, *Share the Wealth,* November 2014, http://bit.ly/1PQZSy9

instance, in the current climate a bed and breakfast could feasibly cease to be an official bed and breakfast, and instead become a large house with separate rooms which it rents out via the Airbnb platform. In so doing, it would no longer have to comply with stringent fire regulations. It is beyond the scope of this consultation to suggest a solution to this quandary, but we would suggest that the key thing is that regulatory tweaking in response to new disruptive technology should be proportionate with a presumption in favour of less, rather than more, regulation. We would also strongly suggest that administration and bureaucracy around compliance with any new regulation should be made as simple as possible so as not to discourage new and emerging entrants into any market.

In short, regulatory moves should be the direct opposite of the current proposals tabled by Transport for London with regards to the future of Private Hire Vehicles (PHV) in the capital. Rather than attempting to create a level regulatory playing field which allows existing businesses to compete with new entrants such as Uber, it has chosen basic protectionism by for instance restricting the ability of Private Hire or taxi apps to display nearby taxis and placing a time delay on PHVs from accepting bookings to starting a journey of 5 minutes. Both, of course, place the immediately available taxis in the capital at a huge competitive advantage to PHV firms. It is not a regulators job to pick winners or dally in protectionism, but to ensure that competition is free and fair and beneficial to the consumer, and governments at European, national, and local levels must remember this as they attempt to deliver a regulatory framework that addresses the challenges thrown up by the sharing economy.

Ultimately, the best way for existing firms to compete with new entrants' disruptive technologies is to do just that – compete, either on service, on price, or by improving their business model. Governments and regulators should ensure that they are able to do so. This means, where possible, reducing the regulatory burden on all businesses – new and established – and focussing on light-touch, not heavy-handed, restrictions, and only implemented where absolutely necessary.

What actions could the Government take to ensure the availability of a workforce with the skills to support businesses in the digital economy?

Some studies have predicted that half of all jobs that exist today won't exist in 20 years' time due to technological change.[12] This presents very real challenges for ensuring that we are developing skills in tomorrow's workforce fit for tomorrow's economy – how do we train people for jobs that we've never even conceived of?

We can target certain areas, of course. Ensuring children leave school with computer literacy is a no-brainer, and that means sophisticated training in skills like coding and programming are inherently desirable rather than simply teaching children how to turn a computer on and learn excel formulas. Changes to the Information and Communication Technology Curriculum in 2014 were welcome, ensuring that coding and programming were a far greater part of the skills taught in schools. It's important that those teaching it are comfortable doing so, and we welcome the good work that organisations like Code Club Pro have done in this area to ensure that teachers are in a position to deliver useful lessons and would encourage the Government to support that and similar

[12] CBRE & Genesis, *Fast Forward 2030: The Future of Work and the Workplace,* October 23 2014, http://bit.ly/1KEWGhh

programmes, financially or through publicity. The TV programme "Girls Can Code" had a number of problematic elements, but we would urge Government to take away the lesson that role models for young people to really engage with the possibilities of the digital economy are important, and should again use its "pulling power" to bring together schools and academies with business representative bodies, entrepreneurs, and professional networks in the digital space to discuss how best to ensure that such role models are visible to the next generation.

Mentoring programmes exist in many other areas of the economy, but it would be a boon to the digital economy if tech entrepreneurs were encouraged to do more in that space, supported by government and other bodies such as the IoD. It is heartening that there are so many women leading the charge in the digital economy, from Debbie Wosskow (Founder of SharingEconomyUK and LoveHomeSwap.com) to Alex Depledge (Founder of Hassle.com and Chair of the Coalition for the Digital Economy) to Baroness Lane Fox to Dale Murray CBE. However, there are significant concerns that the industry as a whole remains male-dominated. Some estimates suggest just 14 per cent of the UK tech industry is female – this is, clearly, a concern.[13] We'd urge Government to think of ways to encourage more women into the tech sector, as effectively excluding 50 per cent of the population and the skills they possess is not a tremendous first step in addressing the shortage of necessary skills.

But we must not fall into the trap of thinking of skills development stops at the age of 18 or 21. If we take the aforementioned CBRE study as correct, then we will need to develop a culture of lifetime learning so that individuals are both willing and able to re-skill throughout their working lives. This will require a root-and-branch examination of the current education system to explore new ways of education delivery, such as Massive Open Online Courses (MOOCs) for example, for those who have already left formal education and are in full time employment.

Further, we must ensure that our immigration system is fit for purpose. We note the letter sent to the Prime Minister on the 27th October 2015 from more than 230 technology entrepreneurs which is worth quoting at length:

> *"Finding talent with the right skills and experience we need to grow our businesses remains one of the biggest barriers to achieving that ambition (of securing long-term economic growth in the digital economy). The UK has become a global tech hub thanks in large part to startup founders, investors and employees from across the globe, including many… who were not born in Britain but choose to invest time and talents here. We are very concerned that changes to immigration policy will make it more difficult to attract and recruit the talent high-growth companies need to compete and succeed in a global marketplace.*
>
> *"The government's Migration Advisory Committee is currently examining proposals aiming to further restrict the Tier 2 system of skilled work visas and to reform the Entrepreneur Visa. Further restrictions on skilled migration could restrict the growth of our businesses and hurt the UK's digital economy.*

[13] BBC News, "Sexism in Silicon Valley and beyond: tech wake-up call," 30 March 2015, http://bbc.in/1HZybiY

"We call on you to ensure that any future changes to the immigration system make it easier, not harder, for qualified digital entrepreneurs to come to the UK to start their business, and for growing startups to hire top international talent."[14]

We have talked about education changes and ensuring curricula are future-proofed as much as possible, but clearly those changes no matter how effective will take a number of years before they filter into the digital economy and address the skills shortage. It is crucial that the immigration system is flexible enough to allow our growing firms to fill skills gaps in the immediate term with employees with skills from abroad. We recognise that there is public concern about immigration, but limiting our most exciting and innovative firms from finding the best talent is a deeply counter-productive move. It is often asked why, despite Britain's thriving start-up scene, we have not produced a Google, a Facebook or a Twitter – a real internet titan. There is no question that a lack of available skills when firms are looking to expand is a big reason for that.

Conclusion

It is crucially important that the digital economy in the UK is allowed to thrive and prosper. It will be absolutely crucial to the UK's future economic success, and the connected benefits that growth brings.

The BIS Select Committee's focus on the particular challenges the sector faces is welcome. We would urge all members of the Committee to be a champion for the sector: supportive of disruptive technology, welcoming innovation, and open to new and exciting ideas that could reshape not just the business environment but the way we live our lives.

The IoD would welcome the opportunity to discuss the issues raised in the Committee's inquiry further.

Yours sincerely,

Jimmy McLoughlin
Deputy Director of Policy & Head of Entrepreneurship

[14] Daily Telegraph, "Immigration clampdown will hurt UK technology start-ups, warn top entrepreneurs," 27th October 2015, http://bit.ly/1S7YbL4