IoD *Inspiring* business

Opening the equity economy

How to realise the potential of the Enterprise Investment Scheme and Seed Enterprise Investment Scheme

An IoD Policy Report
by Jimmy McLoughlin

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Executive Summary

Britain is in the midst of an entrepreneurial revolution. Businesses are being started at record pace, more people than ever are working for themselves and new ways of doing business, winning customers, and raising finance are booming. The UK has embraced the digital revolution like no other country on earth, and is home to the most advanced internet economy in the world. Three-quarters of Europe's alternative finance market is based in the UK, and more and more young people are choosing to start their own business.[1]

Entrepreneurship and investing are on more peoples' radars than ever before. It is important, therefore, to make sure that the benefits of this disruption, innovation and creativity are spread as far across Britain as possible. It is just as important to ensure that as many people as possible can take part in these exciting new opportunities. If people understand the risks, have spotted a company they like, or just want to diversify their investment portfolio – however large or small – bureaucratic barriers should not stand in their way.

The Government has made much of its plans to devolve power to the nations and regions of the United Kingdom, and businesses are excited about the prospect of having a bigger say on local decision making. A review is also being conducted, led by Michelle Mone OBE, into how to make sure the entrepreneurial revolution does not leave poor or disadvantaged communities behind. The Institute of Directors supports both these initiatives. If the UK is to lead not only Europe, but the world, then the entrepreneurial fever must be spread far, wide, and more evenly.

Although new businesses in Britain have a more open attitude towards financing expansion through equity, rather than debt, we still lag the world leaders, North America, when it comes to our equity infrastructure. The UK's biggest weakness, on various measures of entrepreneurship (see next page), is on our attitude to risk capital. This report will outline how Britain can capitalise on two vital but underutilised government initiatives, the Enterprise Investment Scheme (EIS) and its younger sibling, the Seed Enterprise Investment Scheme (SEIS), to unlock a wave of new investors, build up equity finance in the UK and cement its position as one of the best places in the world to start, set-up, run and invest in a business.

The IoD is calling on the government to:

- Include EIS and SEIS investments in a new Super-ISA wrapper, which will include peer-to-peer loans as well as crowdfunding investments.
- Promote and advertise EIS and SEIS more widely to make more businesses, investors, financial advisers, accountants and lawyers aware of the schemes.
- Establish an industry-led board of advisors to explore the possibility of creating an EIS/SEIS investment 'aggregator'
- Launch a pilot scheme of higher tax relief through SEIS for investing in businesses based in the North West, with a view to a higher rate of regional tax relief.
- Scrap the threshold which requires 'Knowledge Intensive' companies to have at least 20% of their workforce with a Masters degree
- Introduce a new 'Lecturer SEIS' to promote closer collaboration between universities and businesses
- Simplify and digitise the tax returns process for investors claiming relief through the schemes, with a super-simple streamlined process for those who have invested less than £2,000.
- Abolish rules which prohibit parents and family members from investing in businesses through the schemes.
- Extend the SEIS qualifying criteria to allow companies up to 4 years old to raise funds through the scheme, not just those younger than 24 months.

If enacted, these measures could help propel the UK to the top of the league tables for entrepreneurialism, help thousands of businesses access finance and give hundreds of thousands of people across the country a stake in the entrepreneurial revolution.

[1] University of Cambridge/EY, *"Moving Mainstream: The European Alternative Finance Benchmarking Report"*, February 2015; The Telegraph, *"More young entrepreneurs launch start-ups in the wake of recession"* October 2

Measuring entrepreneurialism

New business start-ups

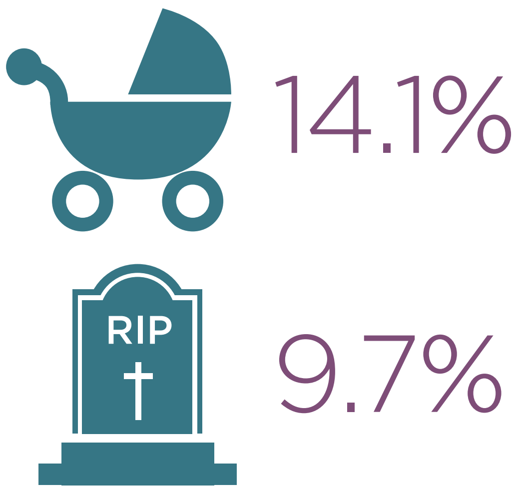
In 2014 there were a record 586,000 business start-ups in 2014/15, bringing the total number of new companies incorporated in the UK in the last four years to more than two million.[2]

Encouragingly, the rate of business success and firm survival has also picked up over recent years. In any given year, although hundreds of thousands of businesses are being created, a large number of companies also stop trading. Growth in the number of businesses registered with Companies House and the total number of businesses and sole traders operating in the UK, however, has increased significantly. The Department for Business estimates there were 5.2 million companies in 2014, up from 4.3 million at the start of the crisis.[4] Both the 'birth rate' and 'death rate' for companies in the UK are at their highest and lowest levels, respectively, since before the crisis, with the gap between the two the largest in more than a decade.[5]

Chart 1

UK Start-ups

Source: Office for National Statistics



Global Entrepreneurship Index

The Global Entrepreneurship and Development Institute ranks countries around the world on a range of factors crucial to supporting new businesses and entrepreneurs in their Global Entrepreneurship Index. It looks at the behaviour of individuals and citizens within a country along with national economic, business and political infrastructure.

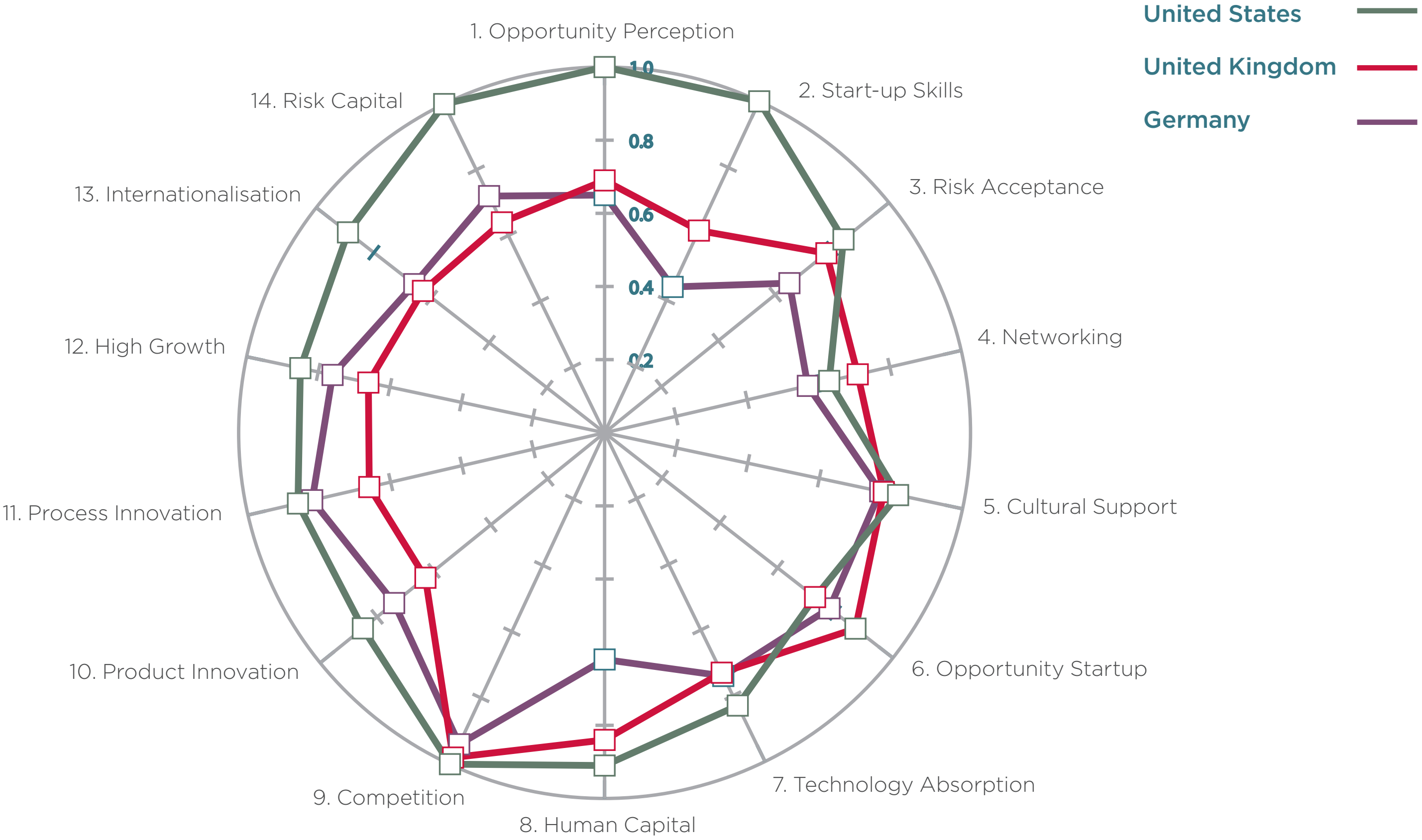
Between 2012 and 2014, the UK rose from 14th to 4th in the global rankings and is top of the European league table.[6] We excel at early-stage entrepreneurial activity due to a competitive marketplace and a relatively high acceptance of risk, along with a good digital infrastructure, the most advanced internet economy in the world, and world-leading education institutions.

[2] Companies House, *"Incorporated companies in the United Kingdom"*, July 2015.
[4] Department for Business, Innovation and Skills *"Business population estimates 2014"*, November 2014.
[5] Office for National Statistics, *"Business Demography, 2013"*, November 2014.
[6] The Global Entrepreneurship and Development Institute, *"Global Entrepreneurship Index"*.

Nevertheless, the Global Entrepreneurship Index shows that the UK lags on areas such as skills, access to finance and product development. To close the gaps on those countries at the top – the US and Canada – the UK needs to develop more risk capital opportunities and better support innovation.

Chart 2

International comparisons



Source: “The Global Entrepreneurship and Development Institute

The GEI measures a country’s entrepreneurialism on 14 different pillars. On each pillar, countries are given a score between 0 and 1. The higher the number the better that country performs on that particular pillar. In short, the larger the area covered by a country’s data points, the higher that country appears in the overall rankings.

> **"One crucial area which has underpinned the UK's start-up strengths is the speed and enthusiasm with which we have embraced the digital revolution"**

Where we are now

Britain's entrepreneurial spirit stems from many areas. Many reports and commentators have noted Britain's natural strengths in areas such as corporate governance, stable politics, strong legal framework, open and flexible economy, history as a trading nation, and even advantages gifted by language and time zone. The World Bank says Britain is the 8th easiest country in the world to do business in.[7]

One crucial area which has underpinned the UK's start-up strengths is the speed and enthusiasm with which we have embraced the digital revolution. Britain has always adopted new technologies quicker than most nations. As research from the Boston Consulting Group demonstrates, this has not changed with the most recent and dramatic disruptions to the way business is conducted in the internet age. Next year, 12.4 per cent of Britain's GDP will be made up from the 'internet economy', the consultancy firm estimates, streets ahead of our nearest competitor in the G20, South Korea, on eight per cent.[8] While America may have the mecca for start-ups in the shape of Silicon Valley, across the country penetration rates are still relatively poor, with the internet set to account for just 5.4 per cent of the US economy, no better than the average developed economy.

The entrepreneurial revolution is not limited to digital products, of course, but for start-ups in Britain, the internet can represent a fast, easy and cheap route to big markets. With the world's most advanced internet economy permeating every area of British life, it provides opportunities even for non-digital firms to start, operate and flourish. A strong digital presence is a must for most start-ups, with the BCG estimating that one in four retail transactions will take place online next year, UK firms can tap into an advanced and rapidly growing market for online products and services.[9] As a comparison, Germany is the UK's nearest competitor in this regard, where less than one in eight transactions will take place on the internet in 2016.

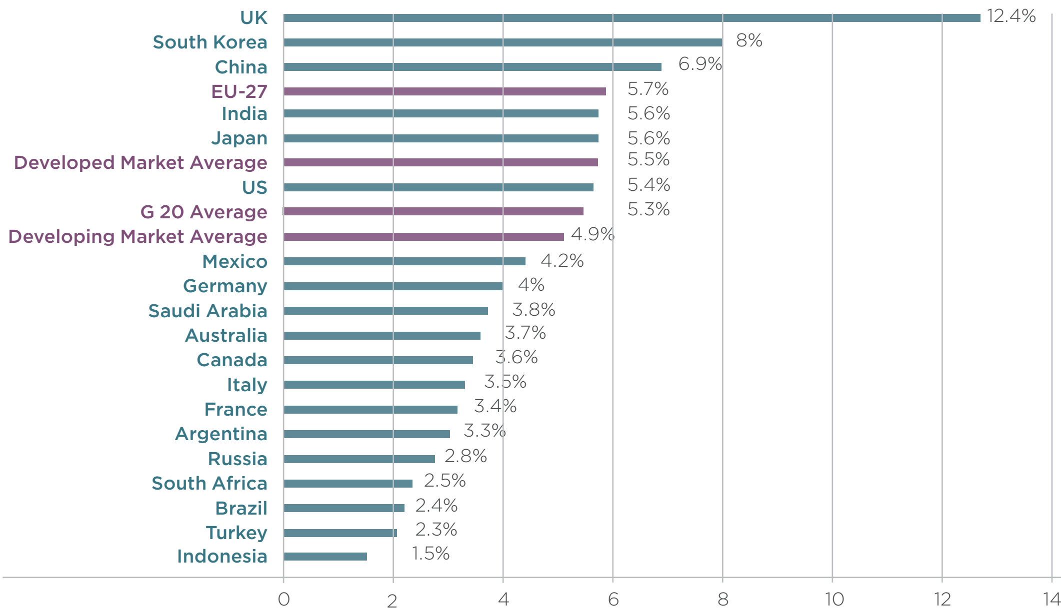
1 in 4

retail transactions will take place online in 2016

Source: Boston Consulting Group

Chart 3

Internet economy as % of GDP



Source: Boston Consulting Group

[7] World Bank Group, "Doing Business: Ease of Doing Business".
[8] Boston Consulting Group, *"The Internet Economy in the G-20"*.
[9] Boston Consulting Group, *"The Internet Economy in the G-20"*.

The government has embraced its important role as a 'signposter' for entrepreneurs. It has already promoted new industries such as the sharing economy and fintech through a few supportive comments and cheap initiatives. In 2014, the coalition supported an open consultation on steps to support the sharing economy, and Matt Hancock, now Minister for Cabinet Office, wrote in the New York Daily News how the US should follow the UK's example of openness to innovation.[10] He even urged ministers to use Airbnb accommodation when on official trips.

In the 2015 summer Budget, George Osborne announced the first 'Fintech ambassador', Eileen Burbridge, along with a consultation on equity crowdfunding.[11] While French authorities were arresting senior Uber officials, Sajid Javid, business secretary, signalled his support for "disruptive technology" and criticised European nations who want to "ban Uber." The Government is clearly determined to be an ambassador for Britain's entrepreneurs and disruptive technologies.

Industry has, of course, played the leading role in fuelling the UK's success in this area. London is a hub for the alternative finance market, and countless equity crowdfunders and peer-to-peer lenders have thrived in recent years. Both small and large investors, excited and intrigued by these opportunities have flocked to invest in the wide array of businesses which raise funds through these platforms.

The UK's angel investor network is strong. As the UK Business Angels Association and Centre for Entrepreneurs have pointed out, angels offer far more than just money.[12] They take an active interest in the company, help it run better and also act as promoters and spokespeople for the businesses within their own networks. At a time when institutional investors are being pressured to do just this, the fact that individuals want to connect with the businesses they own is a very encouraging development, and we should be making it easier for more people to become angel investors.

The root of the alternative finance industry's success has been the simplicity of their products. Not only are the platforms advertised heavily, but they are easy to use. Once somebody has done their research and decided to invest, they can do everything online. Peer-to-peer lenders have also promoted diversification strategies, where an investor's money can be spread across hundreds of companies with similar risk profiles but in different sectors, to help protect against any potential losses.

The underlying investment infrastructure and climate of entrepreneurialism, then, is undoubtedly strong. But there are measures which can be taken to build on these early successes. Problems accessing finance and skills shortages are a threat to future success and could pose big problems to UK entrepreneurialism. On the finance front, successive governments have recognised this and highlighted the need to help direct investment into British businesses, through great schemes such as Start-up loans, which has funded more than 25,000 businesses and directed nearly £130 million of funding into new businesses at a negligible cost to the Treasury.[13]

Government policies timeline

1994 EIS launched

2012 Start-up loans

2013 Crowdfunding regulation consultation

2014 Sharing economy consultation

2015 First Fintech ambassador appointed

Start-up Loans

The Start-up Loans scheme was introduced in 2012 to provide loans to entrepreneurs aged between 16 and 24. The loans proved so popular that they were extended shortly after to include people aged up to 30. The amount of money set aside that businesses can access has also been increased over the past three years.

By 2015, more than 25,000 businesses had accessed loans worth nearly £130 million through the scheme.

Start-up Loans have been heavily promoted by the government, and are easy and simple for businesses to understand. The IoD would like to see the government promote EIS/SEIS in the same way and expand the schemes to help them realise their full potential.

[10] The Rt Hon Matthew Hancock MP, *"Why the UK is writing new laws to help Uber, Airbnb and other sharing-economy businesses compete — and why New York should follow suit"* March 2015.

[11] *"ISA qualifying investments"* July 2015", HM Treasury.

[12] UK Business Angels Association and Centre for Entrepreneurs, [italics]A Nation of Angels[end italics], January 2015

[13] Department for Business, Innovation and Skills, *"25,000 new businesses supported by Start Up Loans"* January 2015.

> **"Problems accessing finance and skills shortages are a threat to future success and pose big problems to the future of UK entrepreneurialism"**

However, as the Global Entrepreneurship Index shows, the UK lags even Greece and Russia in some rankings such as start-up skills and human capital. Nevertheless, the UK's immigration policy has become much less welcoming to high-skilled immigrants that the UK's entrepreneurial economy has come to rely on. The Institute of Directors has raised concerns that the general thrust of policies and rhetoric from some corners of the British media and politics could be damaging the UK's reputation as a place for skilled migrants to come and work. There is also a danger that the catch-all 'immigration' banner fails to distinguish between the very different categories of illegal immigration along with legal immigration from inside the EU and outside the EU, a fact which has been compounded by the recent refugee crisis across Europe and disruption in Calais.

Fundamentally, in the short-term the UK needs to attract high-skill entrepreneurs and employees from around the world. One in seven migrants set up their own business in the UK – almost twice the rate of British citizens, according to the Centre for Entrepreneurs.[14] The problem is seen as so pressing that Coadec - the Coalition for the Digital Economy - launched a review into the Tier 2 (skilled non-EU) visa system in July 2015 to highlight the value of high-skilled migrants to the British economy.[15]

In the longer term, the UK must focus on developing the skills of people who work here – both through formal educational systems at school and university, along with continual training and development once people enter the workforce. The benefits of having both an open and welcoming economy and a talented and highly-skilled domestic workforce will only serve to bolster the UK's entrepreneurial strengths.

Creating the infrastructure for universities and colleges to become hubs of innovation and enterprise will be one of the key strategies in this process of 'upskilling.' A record 80,000 students set up a business while at university, according to research by Santander, but student entrepreneurs remain a great untapped resource.[16] The government has made a tentative start in this area with attempts to emulate effective strategies from around the world and create catapult centres around universities.

There are some great tools at the disposal of businesses and investors which can boost the UK start-up scene and drive much-needed capital to thousands of small businesses in the shape of the Enterprise Investment Scheme and Seed Enterprise Investment Scheme. But they are underused and poorly understood. With the right promotion by government and some common-sense reforms, this can change.

[14] Financial Times, *"Migrants set up one in seven companies, study reveals"* March 2014".

[15] Coadec, *"Save Skilled Migration"* August 2015.

[16] Santander, *"A quarter of students start a business at university"* June 2014.

The Enterprise Investment Scheme and Seed Enterprise Investment Scheme

Investing in a company should not be the preserve of those who have the time, resources and connections to do so. The government should do all it can to spread the benefits of company ownership across the entire country. As it stands, the majority of investments through both EIS and SEIS are made in London and the South East.[17] Moreover, there is widespread acknowledgment from the investment community that the schemes are primarily used by investors who have the most to gain from income tax relief and the investment experience to understand the risks. That these investors are able to spot opportunities in the schemes and invest in companies as part of a broad portfolio is no bad thing.

There is no reason this strong base of investors cannot be complemented by a sprawling network of smaller investors, putting a portion of their investment into a company which qualifies for EIS/SEIS. With the UK riding the crest of an entrepreneurial wave, now is the time to capitalise on this appetite for investment and unlock the equity economy to millions of people around the country.

If we split the EIS/SEIS investor community into camps of 'small' investors (those investing less than £10,000 a year), and 'big' investors (those investing more than £10,000 a year), then the potential to bolster the ranks of small investors who take a stake in private companies becomes clear. More than ninety-five per cent of money raised by companies through the two schemes came from big investors.

The 'long tail' of small investors, at just over 10,000 in 2012-13 is clearly far too stubby. In fact, if we look at the smallest investors, those investing less than £2,500 a year, the numbers dwindle even further. Just 3,600 people invested less than £2,500 through EIS and only 730 through SEIS, raising just £4.5m for companies.

The potential to boost the ranks of investors – in all income groups – is huge. For instance, seven million people in Britain subscribe to a Stocks and Shares Individual Savings Account (ISA). ISAs allow individuals to save a set amount each year (£15,240 in 2015/16) and not be liable for income or capital gains tax on the investments held within the ISA wrapper.

EIS and SEIS barely scratch the surface of this pool of investors. In 2013-14 three million people subscribed to a Stocks and Shares ISA, compared to a maximum of 24,000 people who claimed relief through EIS or SEIS. In money terms, more than £18 billion was ploughed into stocks and shares through ISAs, up against £1.6 billion through EIS and SEIS. The total market value of investments held within Stocks and Shares ISAs in 2014 was £241 billion.[18]

That means the market for EIS/SEIS, as measured by both the penetration rate and total amount invested, is less than 1 per cent that of the Stocks and Shares ISA.

Moreover, the people investing in Stocks and Shares ISAs are split evenly across the country. While the South East and London had the highest number of new subscribers – accounting for 31 per cent of the total number of new accounts,

In 2014:

3m

Stocks and Shares ISAs

24,000

EIS/SEIS investors

£18bn

invested in Stocks and shares ISAs

£1.6bn

invested in EIS/SEIS

[17] 69% of all investment goes to companies in London and the South East found in HMRC, "Enterprise and Seed Enterprise Investment Schemes" July 2015

[18] HMRC, "Individual Savings Accounts (ISA) Statistics" April 2015

people living in the capital were actually less likely to hold either a Cash or Stocks and Shares ISA than people living in any other region in England. Although not a direct comparison, companies in London and the South East have accounted for 69 per cent of all money invested through EIS between 2010 and 2013.

Investing in smaller, higher-risk companies will not be right for the majority of Stocks and Shares ISA holders, who will be less financially secure and more cautious than the typical EIS/SEIS user. Nevertheless, there is clearly pent-up investment demand in the UK, and there is no reason that the number of people using EIS/SEIS should not form a bigger chunk of the overall investment community.

What are EIS and SEIS?

The Enterprise Investment Scheme was introduced in 1994 to help smaller, higher-risk trading companies raise finance by offering tax relief to investors. The scheme allows qualifying investors to obtain income tax relief of 30 per cent of the value of their investment up to an annual maximum of £1,000,000 (£300,000 tax relief).[19]

By encouraging investment in these companies, it drives finance towards them, lowers the risk for investors, and boosts the amount which people are willing to invest. To benefit from the scheme, investors must hold their shares for three years. This has the dual benefit of incentivising a medium-term outlook for investors and giving businesses the security of capital for a significant period of time. This makes it more unlikely that investors will sell their stake if the firm faces a temporary hiccup or period of instability that typically besets most start-ups.

More than £12 billion has been invested in around 23,000 businesses since the scheme was introduced. In 2013-14, £1.4 billion was raised by 2,600 businesses, with around half the money going towards businesses who had not previously used the scheme.[20]

The Seed Enterprise Investment Scheme was introduced in 2012 as an extension of the EIS, with the aim of directing investment into very early stage companies by providing a higher rate of tax relief. Investors qualify for 50 per cent income tax relief through SEIS up to a maximum annual investment of £100,000 (£50,000 tax relief). The scheme was established to recognise the particular difficulties very young and small companies face to raise capital.[21]

To qualify for tax relief, investors must purchase newly-issued full-risk ordinary shares in a qualifying company and hold them for a period of at least three years. The amount of tax relief offered to investors and the companies who can apply for finance through the schemes differs, but EIS and SEIS share many characteristics.

Enterprise Investment Scheme

Investors qualify for tax relief at **30 per cent** of the amount they invest up to an annual maximum of **£1 million**

Investments are **exempt** from Capital Gains Tax on the disposal of shares, provided they have been held for three years.

Reinvestments **can qualify** for Capital Gains Tax, provided they are made in an EIS-qualifying company in a period of between one and three years after the original shares were disposed.

Companies must:

- Own assets valued, in total, at no more than **£15 million**
- Employ fewer than **250** people
- Raise no more than **£5 million** in any 12 month period

Seed Enterprise Investment Scheme

Investors qualify for tax relief at **50 per cent** of the amount they invest up to an annual maximum of **£100,000.**

Investments are **exempt** from Capital Gains Tax on the disposal of shares, provided they have been held for three years.

Reinvestments are **exempt** from Capital Gains Tax relief for a period of one tax year, subject to the £100,000 investment limit. To qualify, the original shares do not need to have been disposed, the investment can take place before those shares are sold, provided they take place in the same tax year.

Companies must:

- Own assets valued, in total, at no more than **£200,000**
- Employer fewer than **25 people**
- Raise no more than **£150,000** in total
- Be less than two years old

[19] HMRC, *"The Enterprise Investment Scheme"*, October 2013".

[20] HMRC, *"Enterprise and Seed Enterprise Investment Schemes"* July 2015.

> **“Investing in a company should not be the preserve of the wealthy and elite and the government should do all it can to spread the benefits of private equity ownership across the entire country”**

If shares are sold before the three year period is up, or in some cases if a company loses EIS/SEIS status within the three year period, a **tax clawback** is levied. This will be at a rate equal to the lower of the original tax reducer or 30% of the sale proceeds under EIS (50% under SEIS), if the value has gone down.

Investors are also afforded **loss relief** at the value of the loss minus any income tax relief already received. It can be offset in either the most recent tax year or the year in which the shares were disposed.

Table 1

EIS/SEIS investors

	EIS		SEIS	
	Number of investors	Total value of investments	Number of investors	Total value of investments
‘Small’ (< £10,000)	7,995	£33m	2,215	£11m
‘Big’ (> £10,000)	11,940	£848m	2,730	£106m
Total	19,925	£881.1m	4,945	£117m

Source: ONS

Data applies to 2012/13 totals may not sum due to rounding differences in sub-categories

Policy Recommendations

1. Promote and advertise EIS and SEIS more to businesses, investors, financial advisers, accounts, lawyers, business professionals and the wider public.

EIS and SEIS are primarily used by big investors as part of a large and diversified portfolio. When compared to ISAs – a tax relief product heavily endorsed, promoted and marketed by both Government and the private sector – even most well-informed individuals are unaware of the schemes.

While two-thirds of IoD members, typically directors of small and medium-sized companies, were aware of EIS, only 38 per cent said they were familiar with SEIS. Those IoD members who were aware of the schemes were primarily told about them through word of mouth or an accountant, presumably as part of their tax planning. Conversely, just six per cent said that they had heard about the scheme through either a Government official or a Local Enterprise Partnership.

With ISAs, the government made a concerted effort to get buy-in from both the private sector (typically banks, who stood to make obvious gains in terms of new customers) and aggressively market them to the general public. Santander estimates that the increase in the annual ISA limit from £11,520 to £15,000 inspired 2.5 million people to open an account for the first time.[21] This shows the simple effect that a government announcement can have on awareness and behaviour. Raising awareness of both EIS and SEIS to a similar level will be a crucial part of linking more members of the public who have an appetite to invest with the thousands of startups across the country desperate for capital. This would allow more people to share in the entrepreneurial revolution and increase the availability of risk capital, helping the UK to become an even better place to start and grow a company and compete with Canada and the US at the top of the entrepreneurship league tables.

We would like to see both EIS and SEIS more widely promoted and advertised by the Government. Part of this could be completed by including EIS/SEIS investments within ISAs (see policy below), as well as making a concerted push to boost understanding of the schemes among private sector providers and interested parties. This could even involve a standalone marketing campaign.

It is important, however, that the government highlights that investments in startups and smaller companies come with higher risks and should only form a small part of a diversified investment portfolio. The greatest opportunity, arguably, lies in increasing awareness of the schemes among higher rate taxpayers, since they have a greater income tax liability to offset and will typically be looking to put their savings to use in a simple and effective way which generates returns.

2. Simplify and digitise the tax returns process for investors claiming relief through the schemes, with a super-simple online-only process for those who have invested less than £2,000.

Both EIS and SEIS are used heavily by hi-tech and online firms to win investment. Nearly one-third of all companies raising finance through SEIS were in a hi-tech industry, with another fifth operating in business services.[22] Owners and customers of these companies are used to running their lives online. It makes no sense, therefore, that people investing in these companies have to navigate a laborious and complicated offline system to receive their tax returns.

This may be acceptable for large investors or those using some kind of investment trust, but it puts off savvy would-be small-time investors. Few people want to complete numerous forms to receive a tax rebate which might be in the low hundreds of pounds – far easier simply to top up your Stocks and Shares ISA or stick it in a FTSE tracker. The UK has one of the most advanced internet economies in the world, yet the way we pay our taxes is stuck in the twentieth century. We are urging the Government to

[21] Santander, "37.4 million Brits unaware of ISA allowance" March 2015".
[22] HMRC, *"Enterprise and Seed Enterprise Investment Schemes"* July 2015

act quickly to introduce the reforms, promised in the 2015 Summer Budget, to allow people to make EIS/SEIS claims online.

For those who have invested less than £2,000 in particular, the tax bureaucracy must be kept to a minimum. The new system would allow government to process claims easier, quicker and cheaper, and should be monitored to keep bureaucracy and tax costs down. Moving to an online system would also make it easier for HMRC to gather feedback on the effectiveness of the system and use it as a test-bed for future digitisation of tax returns.

3. Include EIS and SEIS investments in a new Super-ISA wrapper which includes peer-to-peer loans and crowdfunding investments.

As mentioned throughout the report, the flagship personal savings and investment product is the Individual Savings Account. The government is keen to build on the success of the ISA by allowing more and more products to be included within the wrapper and extending tax relief (and even top-ups in the form of the Help-to-Buy ISA) to an array of financial products. In the 2015 Summer Budget, a consultation was launched on including equity crowdfunding within the ISA, following the announcement in 2014 that peer-to-peer loans would be included. [23]

This is a sensible move and one supported by the IoD. ISAs are easily the most successful, understandable and widely-used wrapper for most investors, and we support extending the range of products which can be included within an ISA. Crowdfunding has many of the key characteristics of the existing equity and debt securities included and is also well regulated. We believe, however, that the crowdfunding industry is not yet established enough to market the new product to an audience of large enough scale. The Government, therefore, should support providers to boost awareness.

To provide protection for first-time investors, we also recommend people are alerted to the higher risks of equity crowdfunding when they make their first investment. Since this is a relatively new and exciting product, but nonetheless one that is very different from investing in listed companies or a simple cash ISA, this would be an easy way to raise awareness of the higher risks along with the different types of investment opportunities.

In the long-term, EIS/SEIS investments should also be included within the ISA wrapper. The two products are complementary, and we believe that inclusion would serve the twin purposes of boosting awareness and simplifying the tax infrastructure surrounding EIS/SEIS investments. Since EIS/SEIS investments already provide significant tax incentives to investors, the main reason for including them within the ISA wrapper is to promote simplicity. People who may be investing hundreds or thousands - not hundreds of thousands - will value having all of these products in one place. It also makes sense from a promotional perspective to build on the huge public awareness of the ISA scheme, while making sure that potential investors understand the different risks associated with investing in companies which qualify for EIS/SEIS.

4. Establish an industry-led board of advisors to explore the possibility of creating an EIS/SEIS investment ‘aggregator’

We recommend that the government acknowledges the importance of broadening access to investment opportunities in new and growing businesses by incentivising investment. Companies which qualify for EIS/SEIS, however, inevitably have a higher risk profile than most mainstream investments. Therefore, to incentivise investments and help make the process easier to understand, the government should facilitate the launch of ‘aggregator funds’, which allow people to invest in multiple companies with a single investment, spreading out their risk and diversifying in the same way peer-to-peer loans are often bundled together.

[23] HM Treasury, *“ISA qualifying investments”* July 2015

We recommend the funds:

- Provide the same level of tax relief as other EIS/SEIS investments
- Be of sufficient scale to pool, but not eliminate investment risk
- Be marketed to investors with simplified investor protection requirements
- Can only be used to invest in companies which meet the same EIS/SEIS eligibility criteria
- Are introduced with a lower investment threshold (e.g. £2,000) than standalone EIS/SEIS investments, to make clear these should be used as part of a diversified investment strategy

After the government lends its support to the creation of such funds, many more would follow and competition would drive down management charges and offer investors a wider range of choice. Once more businesses become aware of the opportunities, funds could grow large enough to be based on sector-specific businesses or carve out specific niches, such as an ethical EIS/SEIS investment fund.

5. Launch a pilot scheme of higher tax relief through SEIS for investing in businesses based in the North West, with a view to a higher rate of regional tax relief

The uptake of both EIS and SEIS is skewed towards London and the South East. While the dominance of the capital has waned in recent years, over sixty per cent of recent investments are still being fed into companies based in the region. The fact that there are more angel investors and venture capital firms based in London and the South East than the rest of the UK combined could explain why the area accounts for the lion's share of funds raised by EIS and SEIS.

Access to finance and a better spread of funding options across the UK has been described by Dr. Adam Beaumont, founder of NorthInvest as "the missing link." The need to encourage angel investors and venture capital firms to look beyond London and the South East is clear. There are hotspots of innovation, creativity and entrepreneurialism right across Britain, and we believe EIS and SEIS are the vehicles which can funnel investment towards them.

A report for Tech City UK found that 74% of digital startups were based outside London and the South East. There is no reason to suggest their financing needs are not as great.

The IoD recommends that a pilot scheme is launched to increase the relief on SEIS investments made in companies in the North West to 60 per cent. This is a slight increase which, hopefully, would not distort or needlessly complicate the system. Nevertheless, with the extra promotion that a higher rate of regional tax relief would receive, we believe the knock-on impact would be higher investment not only in the North West but across the UK. After a successful trial period, the higher rate of regional relief should be extended to other areas of the country to ensure they can make the most of the opportunity.

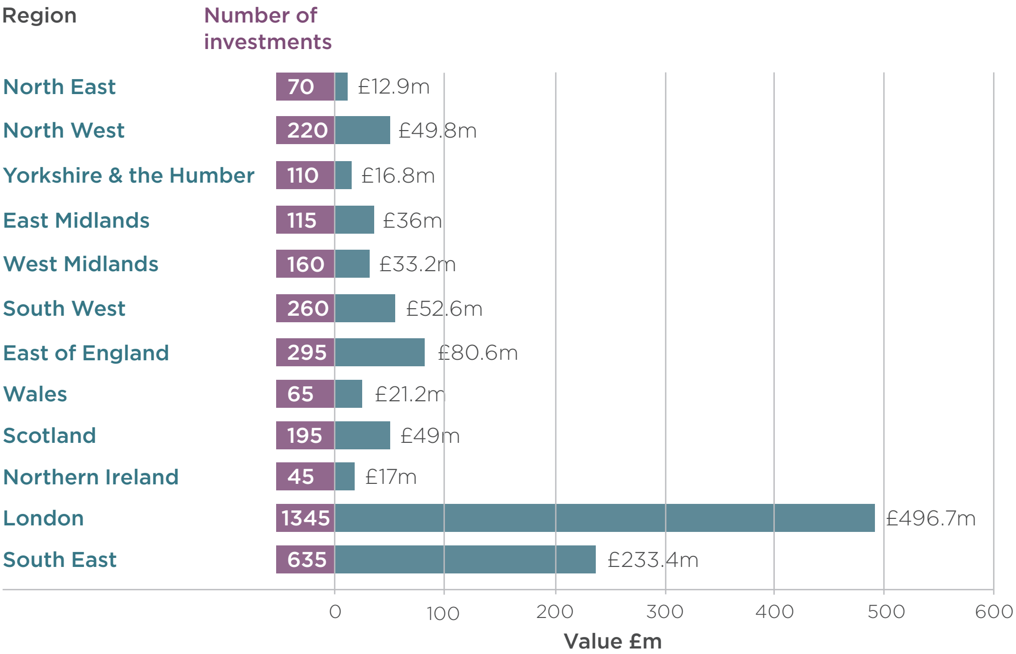
The North West has a small but notable pool of EIS and SEIS investors, with companies raising nearly £50m through the schemes in 2012/13. This number, however, could clearly be much larger. Given that the region is also being fast-tracked for new powers and is at the heart of plans for a 'Northern Powerhouse,' it makes sense to use the North West as the test region for this additional regional relief. If successful, the scheme should then be rolled out across the country.

We understand there will be issues surrounding EU state aid rules. However, we believe small business reliefs should be something that is put at the heart of David Cameron's agenda for renegotiating Britain's relationship with the EU. Targeted reliefs can kick-start investment wherever they are applied, in Aberdeen, Andalucía or Athens, and Europe should look to emulate the success of EIS and SEIS wherever it can.

> “Access to finance and a better spread of funding options has been described as ‘the missing link’ ”

Chart 4

EIS / SEIS Investments



Source: HMRC

6. Introduce a new ‘Lecturer SEIS’

The Government has worked hard to make the UK’s leading universities places of innovation and business as much as academic research and rigour. This is to be supported, and the IoD is leading the way to create better links between the business and university communities through our student membership and other outreach programmes. The UK should aspire to the level of crossover and collaboration that exists between academia and innovation at some US colleges. Stanford, for example, prides itself on the ‘revolving door’ between its campus and Silicon Valley which has led to such explosive innovation and growth in the region. Part of the reason why the best business leaders teach at leading universities is because it allows them to strike up business ideas and invest in their student’s companies, capitalising on tax reliefs at higher levels than the UK’s EIS affords.

We recommend, therefore, that a ‘Lecturer SEIS’ is introduced to supercharge investment from university professionals and college staff in undergraduate and postgraduate entrepreneurs.

The proposal for a Lecturer SEIS rate of as much as 80 per cent was met with a lukewarm reception from some business schools we talked to in the UK, who pointed out that many lecturers are not interested in entrepreneurship or investment. This is a barrier to growth which must be tackled and explains why senior university figures should qualify for a much higher rate of SEIS relief. With such generous incentives on offer, many more lecturers would take a closer look at their students’ extra-curricular activities. Even where it may not lead to direct investments, allowing lecturers the opportunity to buy a stake in how their students are applying new-found knowledge and skills can only be a good thing.

Cambridge

Cambridge is the UK's poster-child for successful collaboration between universities and the private sector. Cambridge Enterprise, the university's commercial arm, states its mission is to help students and staff commercialise their expertise and ideas.[25] University spin-outs can qualify for up to £500,000 of direct funding through the scheme and the network has excellent links with experts and investors throughout the city.

Support does not start – or end – with funding. Cambridge Enterprise provides assistance with everything from talking through potential ideas and inventions to negotiating licensing deals and commercial partnerships. Each academic department in the university nominates 'Enterprise Champions' from the ranks of senior professors to act as a first port of call for students and fellow staff, ensuring would-be entrepreneurs have access to both pioneering researchers and business experts.

Having a world-class, world-famous university at the heart of the city has powered this entrepreneurial surge. The Economist recently argued that Cambridge was "the most exciting technology cluster in Europe."[26] But the sheer concentration of excellent minds does not, in itself, explain the city's success. A dozen cities around the UK boast world-leading research facilities - Oxford, Manchester, Bristol, Birmingham, Liverpool, Leeds, York, Glasgow, Edinburgh to name a few – but trail Cambridge.

A healthy attitude towards enterprise, an education system which promotes commercialisation and, importantly, a hub of engaged and expert investors means academics with ideas meet businesses and investors with cash. Mirroring this pro-enterprise attitude and encouraging the UK's other world-leading universities to take a leading role in their region's start-up scene will go a long way to replicating Cambridge's success across the country.

7. Scrap the threshold which requires 'Knowledge Intensive' companies to have at least 20 per cent of their workforce with a Master's degree

The new rules which will require companies classified as "knowledge intensive" to have at least twenty per cent of their workforce educated at a post-graduate level could damage investment in some of the most dynamic and advanced business startups in the UK. The UK has introduced the new requirements to fit in with EU rules around state aid, but we would urge the government to resist the proposals, or develop a new definition. This is a misguided attempt to deliver the much-needed integration between universities and businesses which has served Silicon Valley so well.

They could have the opposite effect, however, excluding successful businesses because they don't tick the right boxes. Plenty of successful entrepreneurs are not educated to degree level, though doubtless could have succeeded had they not struck upon a business idea or decided to develop their career in a different way. The IoD are calling for the requirements to be scrapped in favour of policies which will genuinely foster collaboration between universities, businesses and innovation.

[25] http://www.enterprise.cam.ac.uk
[26] The Economist, "Getting to Cambridge" 22nd August 2015

> **“Encouraging the UK’s world-beating universities to take a leading role in their region’s start-up scene will go a long way to replicating Cambridge’s success across the country”**

8. Abolish rules which prohibit parents and family members from investing in businesses through the schemes

Parents and close family members of entrepreneurs are currently blocked from investing in those firms through EIS and SEIS. There are legitimate reasons for this, namely to reduce money laundering and fraud opportunities. With the right checks and balances, however, reforming these rules could help to unleash a new wave of business investment. For instance, steps will need to be taken to ensure companies being invested in are legitimate new enterprises, now just a new branch, store or version of an existing family business.

Since two-thirds of first-time house purchases are facilitated by the ‘Bank of Mum and Dad’, according to the National Property Federation, it makes sense to extend the possibility of parents using SEIS to fund their child’s business, rather than a house. Not only would this help nudge Britain away from a debt-and-asset obsessed country to an enterprising, equity-based one, but this also seems logical at a time when more and more students are leaving school and university with ideas for a new business rather than dreams of home ownership.

Conclusion

There can be no doubt that Britain's entrepreneurs have had great success in recent years. More companies are being created than at any time, more people are choosing to work for themselves and new industries like co-working spaces and crowdfunding are taking off across the country.

The Enterprise Investment Scheme and Seed Enterprise Investment Scheme have played a vital role in this, helping to channel more than £1.5 billion of funding towards small and medium-sized businesses a year. Combined with the most advanced internet economy in the world, the lion's share of Europe's alternative finance market, a flexible labour market and one of the world's best cities for international business, Britain has one of the best entrepreneurial ecosystems in the world.

In due course, equity crowdfunding firms could be the most revolutionary development in finance of this century. UK firms such as Seedrs and Crowdcube have been incredibly successful at opening up investing to a whole new section of the population. They are forging the equity economy. Schemes like EIS and SEIS provide a secondary nudge to further incentivise investment and help firms with high-growth potential access funds at the earliest stage.

The tools are in place, then, to make sure Britain harnesses the potential of these opportunities. The recommendations in this report go some way to starting a debate about how to make sure the EIS and SEIS frameworks contribute to this growth and ensure more people have a stake in the equity economy. They are initial proposals, based on consultations with IoD members and a range of industry experts, intended to promote discussion within the industry and government about what the purpose of these two schemes are, and whether their potential is being reached. The Institute of Directors will also play its role to promote the equity economy agenda to its members and the wider business community.

At the moment, EIS and SEIS are being used well, but only by businesses that know about the schemes, and by investors who are prepared to navigate the complex system. Developments like crowdfunding and peer-to-peer lending have democratised investing, but EIS and SEIS remain difficult to use. Now that investment tax relief schemes are in their maturity, the time is right to build on their success. As the GEDI outlines, in just two years Britain has moved from mid-table obscurity (14th) to the Champions League places (4th) in the entrepreneurial league table. If we want to mount an ambitious title challenge, then Britain needs to broaden its base of investors and increase access to risk capital.

With the right protections in place, the pool of investors using EIS and SEIS could be much larger and more businesses could access the finance and growth capital they need. A focus on areas outside of London, harnessing the potential of our universities and making it easier for people to invest through components like aggregator funds can help close the gap between the capital and the rest of the country. This would help shift Britain towards an equity based economy and ensure that every corner of the UK benefits from the entrepreneurial and digital revolutions.

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Investment disclaimer

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The Institute of Directors

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