Enterprise Investment Scheme Association (EISA) – Response and recommendations to Coronavirus crisis

A long track record of supporting early stage businesses

The Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) were introduced to incentivise private investors to risk their private wealth by investing in small, high potential businesses which otherwise struggle to raise equity finance.

Since its introduction, every Chancellor improved and/or widened the scheme prior to the 2015 changes, recognising its value to the UK economy including the Conservative manifesto which quoted *"Some of our work has been spectacularly successful - such as the SEIS & EIS, which we will continue in the next parliament"*

Investment by members of the EISA, or where members have advised on or facilitated investment, covers the broad spectrum of smaller company investment – mostly early stage or pre-profit investment - throughout the United Kingdom. Companies in a wide variety of industries have received investment under the EIS including healthcare, technology, life sciences, the creative industries, environmental, leisure and hospitality, manufacturing and many more.

The EIS scheme provides the UK's most innovative and progressive startups and scaleups with access to long-term capital and by doing so benefits the UK economy, creates jobs, supports the growth of businesses across the UK and been responsible for the launch of new products and services and increased competition. **However, many of those innovative companies now face an existential threat from the coronavirus outbreak and urgent support and funding is required to ensure, through no fault of their own, these companies don't suffer a premature demise.**

We believe our recommendations below have the potential to unlock approx. £100M - £200M from private investors as well as saving a significant number of jobs from being put at risk. Furthermore, many EIS and SEIS investee companies are the forefront of fighting coronavirus and relieving pressure from the NHS with innovative healthcare solutions. Just one example is given in the appendix. This work can only continue if such companies get access to finance in the short term to guarantee their long term future.

Why now is the time to act

We believe an exceptional set of circumstances such as presented by coronavirus demands an exceptional response.

The existing EIS and SEIS legislation does a sufficiently reasonable job of directing equity investment into early stage businesses who would otherwise not be able to obtain finance. But with some temporary, legislative changes, we believe the scheme can go further.

Increasing the threshold for EIS and SEIS investment, and potentially removing it all together, will encourage faster follow-on investments, and allow additional immediate investment into companies requiring working and development capital at this time.

Additionally, the EIS primary legislation is very long and highly detailed, and contains many restrictions which are viewed as uncommercial, but we are advised that they are necessary to meet State aid Risk Finance Guidelines. Further liberalisation of the State aid rules would also lead to faster deployment of funds raised from individuals to provide greater support for SMEs and knowledge-intensive mid-caps.

Most importantly, our members are already witnessing investor sentiment falling rapidly and the availability of capital decreasing. As a result, we expect the size of the EIS market to drop substantially (circa £100M - £200M). This, at a time of crisis for many start ups, means that a large part of the start up ecosystem could be at risk of failure (please see the example in the appendix)– many of them good companies that have the potential to be the next generation of FTSE 100 companies in the UK. If investors are to back companies at a time of great uncertainty, they need a much stronger incentive thus the reason we are asking for a short term, temporary increase in the EIS/SEIS income tax rate to 60%. The objective is to prevent losing high potential companies and remove the threat of unemployment.

Clearly, raising the income tax rate to 60% incurs a cost to the Exchequer. Our sense is that this cost is far below the cost of the loss of revenue that this companies currently provide to the economy in terms of tax revenue paid as well as the human cost.

Our temporary legislative change recommendations

EISA recommends the following temporary changes (in some cases, relaxations) to the EIS legislation which we believe are achievable to implement in the short term and will facilitate faster and increased deployment of capital to entrepreneurial businesses.

1. The rate of income tax relief for EIS and SEIS be raised to **60%** until such time as the Government see fits to reduce back to the current 30%/50% level - ITA07/S158

2. The following requirements are relaxed;

- The growth and development requirement - ITA07/S174

3. For investments made before 1 April 2021:

The following requirements of Part 5 ITA 2007 are disapplied:

- Maximum risk finance investments – ITA07/173A-173AB
- The permitted maximum age requirement – ITA07/175A
- The financial health requirement - ITA07/S180B
- Connection – directors excluded - ITA07/S168
- Connection – existing shareholdings requirement – ITA07/S164A

The EIS primary legislation is very long and highly detailed but we are advised that many provisions are necessary to meet State aid Risk Finance Guidelines. Simplifying the EIS legislation in the short term can streamline further the State aid Risk Finance Guidelines and lead to fewer unnecessary restrictions on investment and with a reduced administrative burden. This would lead to faster deployment of funds raised from individuals to provide greater support for SMEs and knowledge-intensive start and scaleups Lifetime limit

In addition, to enable businesses within EIS and SEIS portfolios to benefit to the fullest extent possible from additional measures announced by the Government, such as the Coronavirus Business Interruption Loan Scheme, request that scheme be made available to businesses that have already received state-aid funding.

We view these changes as temporary and only available in exceptional circumstances. Once these circumstances change we fully expect to return to the current legislative environment. We are of course aware the Chancellor has already committed to a significant and well directed raft of measures to support business needs in the UK during this time. Our recommendations align to and complement these but direct action to a specific group of high potential companies that fall in between many of the measures already announced. They also seek to support and uphold investor confidence in the early stage sector which is crucial if VCs are to continue supporting investee companies now and into the future.

For brevity purposes this note doesn't go into the detail required to enact these changes. We, as the EIS Association, however are readily and immediately available to discuss the implementation and effect of our proposed recommendations.

Appendix – Company examples

Football Survivor

A similar concept to the Premier League's 'Fantasy Football'; Football Survivor allows friends join a 'league' and wager against each other who they think will win a game, each Premier League football game week. When a player guesses wrong they are eliminated, until only one Survivor remains, taking the winnings from their league's pot.

Football Survivor take a 15% admin fee on all league entries and the remainder of the 'pot' stays in the league for the winner. This 15% admin fee is there to cover all the costs of development and KYC, so that players can now use an easy app, where before one player would have been manually entering all this data into excel spreadsheets each gameweek.

At such low gross profit margins, FS would rely heavily on volumes to be profitable. Over the summer months the plan had been to have a Euro 2020 version of the game to generate revenues to help support the necessary development of the app. FS started trading in December, and now with the Premier League ending early and Euros postponed, the company will generate nil Revenue until at least August-2020, over 5 months away.

What Football Survivor need is capital to invest in the development of the app, so that when the Premier League resumes they can continue where the season ended in March.

Mologic Ltd, a leading developer of lateral flow and rapid diagnostic technologies, as well as as receiving EIS funding has been awarded c £1 million as part of the UK government's £46 million international COVID-19 prevention and research funding package. The funding will be used to develop a point-of-need diagnostic test for the virus.

On the back of this announcement, the Prime Minister Boris Johnson visited Mologic's lab in Bedfordshire in early March, where the company is building on their experience of previous epidemics including the Ebola virus. The creation of a new hand-held diagnostics device to detect COVID-19 will allow health officials to test for the virus at home or in the community, providing results in 20 minutes, without the need for electricity or a laboratory. Rapid identification of the virus enables quicker quarantine and access to care, to support global efforts in preventing further spread – especially in vulnerable countries that have limited specialist facilities.