Scale funding for small business

Decentralised funding via EIS to the thousands of small businesses that are unable to access other C-19 government support schemes.

Declaration: Prepared by EISA and Vala Capital

Up to **£600m+** of private capital mobilised

Deployment can start within **Weeks**

‘000s companies handed lifeline

£0 initial cost to Government

Funds deployed across the whole of the UK

2 years until tax is repaid

Context

Why this proposal is both urgent and complementary to other measures supporting UK small businesses:

- Existing EIS scheme and national infrastructure means **speed**
- Established systems and familiarity with concept means **scale**
- Private capital means cost efficiency with **no immediate cost to government**
- National infrastructure means **regionally dispersed capital**

Outcomes our recommendations can deliver

“Oven ready”

- **Speed of deployment:** Many members can invest quickly (immediate to 3 months). Others can provide later stage funding (within 3-12 months). Both have pre identified businesses ready to invest into and infrastructure in place to identify additional businesses rapidly. Thereby providing a staggered, escalator of funding
- **Significant private sector funding:** £600m+ can be raised to fund SMEs quickly. Its proven that increasing the EIS/SEIS income tax rate of relief is strongly correlated to an increase in funds raised from private investors.
- As a direct consequence, the number of early stage businesses receiving funding increases commensurately. The current market failure is on the supply side not the demand side

- **Indirect v Direct investment:** There doesn’t have to be an either/or approach. To maximise potential funding being delivered to SMEs at this time, a complementary solution is recommended. EIS fund managers could raise private capital *and* work with the BBB to deploy money quickly and effectively
- **“Oven ready”** – Nothing new to build. The infrastructure to run, administer, raise and deploy funds is already in place and works effectively at zero initial cost
- **Speed of fundraising:** Speed is vital. Our VC, fund/portfolio manager and crowdfunding members raise funds from private investors on a daily basis. All have an extensive database of existing and potentially new pool of investors i.e. High Net Worth Individuals, Angels and

Financial Planning/Wealth Management institutions

	EIS	SEIS
Business Lifecycle Stage	Early stage, Established	Early Stage, Pre Revenue
Finance Required	Growth Finance	Working Capital/Growt h Finance
Funding Requirement during Covid19	Imminent - 3 to12 months	Immediate – 0 to 6 months
Funding Use during Covid19	Consolidate then moving into growth implementation	Survival in short term

What's required?

How the Government can support SMES through the coronavirus crisis:

Temporary amendments to S/EIS as follows (for a period of around 3 months but with flexibility built in):

Raise the rate of income tax relief for EIS and SEIS to 60%	ITA07/S158
Temporarily remove - Maximum risk finance investments - Financial health requirement	ITA07/173A-173AB ITA07/S180B
- If Convertible Loan Notes are being considered for funding a centralised fund, a temporary relaxation in the EIS rules to allow compatibility	ITA07/S174 - For (S)EIS cash must be paid to the company for shares which are fully paid up in order to obtain (S)EIS relief, and (S)EIS relief is not available where someone gives the company a loan which is exchanged for shares at a later date. On this basis a convertible loan in the normal sense would not be a qualifying investment for (S)EIS purposes. A relaxation of this rule would be required

Array of Solutions

There is no silver bullet

Proposals that sit along side or work instead of CBILS and SRS to fund the equity gap include:

Runway Fund

A government backed direct investment fund with capital allocated via the British Business Bank to selected fund managers who then distribute capital from a central pot to suitable small businesses

Proposed as a £300 million fund to support c.600 companies with c.£500,000 working capital to each

Enhanced EIS

Decentralised private capital deployed by the existing network of regional EIS fund managers to support small companies

Proposal to release £600m+ of funds to support and unlimited number of companies with up to £5m of capital in any 12 month period

In short, we believe a direct investment fund, alongside an enhanced can deliver a belt and braces approach to funding at this time. The EIS industry stands ready to work with BBB or other direct funding initiatives in order to distribute funds quickly either on an allocation or matched funding basis

Scale of the problem

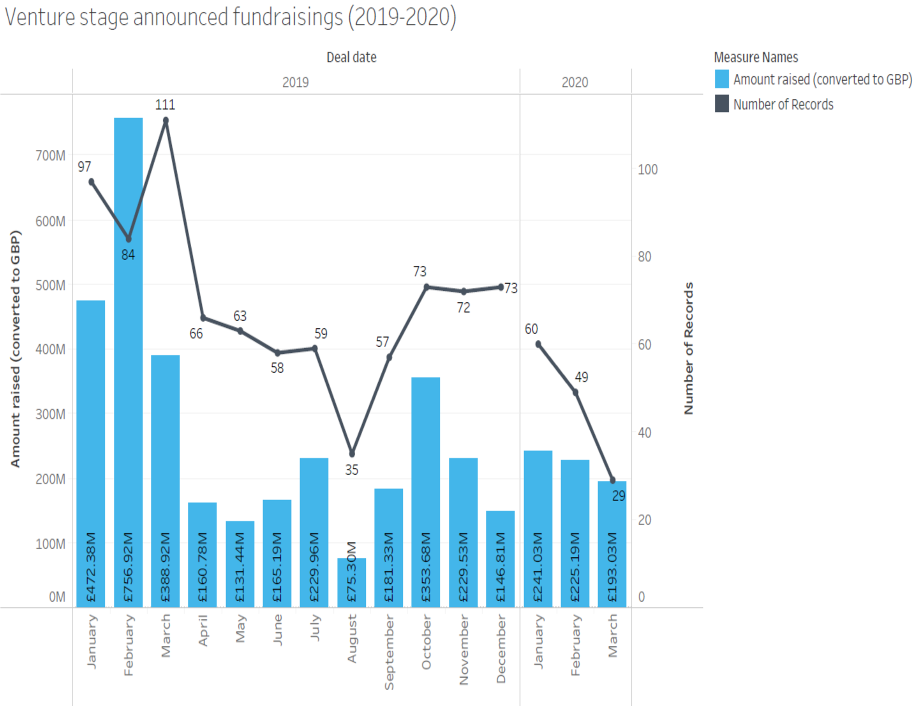
- 800,000 small UK businesses cannot access CBILS* → 20% of the £196bn+ annual contribution to the UK economy
- Equity funding for small businesses has collapsed by 70% or more since the outbreak of C-19
- EISA survey indicates 9 out of 10 growth businesses needing investment now may disappear within 12 months if Government fails to act**
- 42% of small firms could go bust if lockdown continues for 3 months+
- SMEs provide 23 million jobs; 20% failure = 5 million people lose their jobs – at 42% failure 10 million people stand to lose their jobs
- Once these companies are lost, recovery for most of them will be irreversible
- Need to remove bottlenecks in current solutions and ensure regions are served
- Unknown time scale of C-19 crisis creates huge uncertainty: investor appetite at all time low creating **national equity gap** that needs filling now
- Government resource hugely constrained

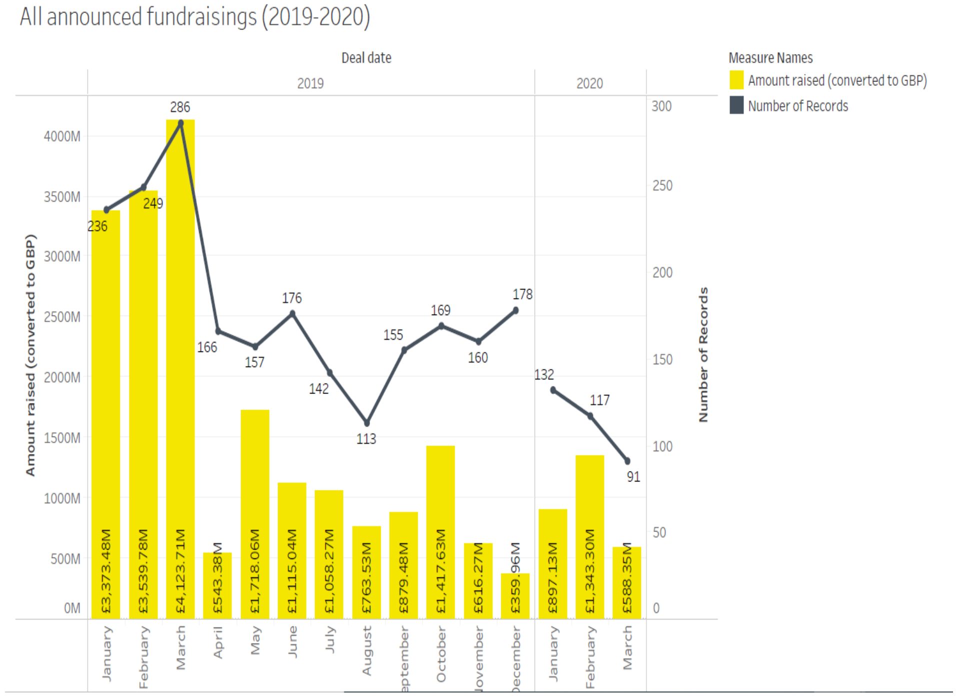
* Corporate Finance Network report published 31st March 2020,
** EISA survey, April 2020

Evidence

Equity funding to SMEs effectively frozen

Beauhurst reports that only 95 equity deals were announced in March 2020, which totalled £595m, compared to 174 in March 2019, which totalled £1.46b and in the week to 2nd April, a meagre 14 rounds were announced. This is the lowest number of deals in a week outside of a Christmas period since August 2014. Deals at the Venture stage have been the hardest hit (see below)





Evidence

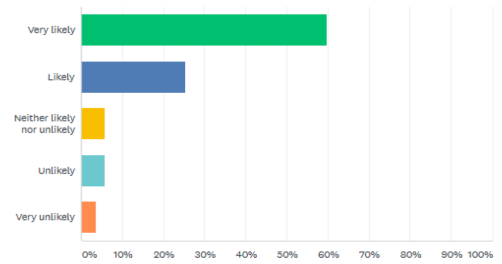
The effect of Covid19 on SMEs fundraising

EISA surveyed over 250 SMEs who are currently undertaking fundraising for their business to gain the insights of SMEs during this period. They paint a desperate fundraising picture:

- 81% say that coronavirus has affected their fundraising “a lot” or “a great deal”
- 44% say that they will achieve less than 20% of their fundraising target due to the coronavirus outbreak.
- **71% say their business won’t survive 6 months** without funding
- 59% say relaxing the EIS/SEIS rules would lead to a rise in equity funding available to them

In your opinion, would relaxing the rules for EIS and SEIS (including raising the tax relief) lead to a rise in equity funding available to your business from investors?

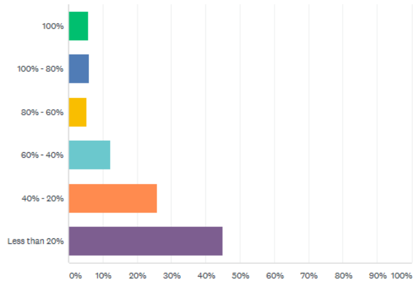
Answered: 249 Skipped: 2



ANSWER CHOICES	RESPONSES	
Very likely	59.84%	149
Likely	25.30%	63
Neither likely nor unlikely	5.62%	14
Unlikely	5.62%	14
Very unlikely	3.61%	9
TOTAL		249

As a result of the coronavirus, how much of your fundraising target do you think you will now be able to raise?

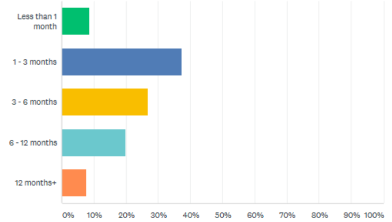
Answered: 247 Skipped: 4



ANSWER CHOICES	RESPONSES	
100%	5.67%	14
100% - 80%	6.07%	15
80% - 60%	5.26%	13
60% - 40%	12.15%	30
40% - 20%	25.91%	64
Less than 20%	44.94%	111
TOTAL		247

Without funding how long will your business be able to survive for?

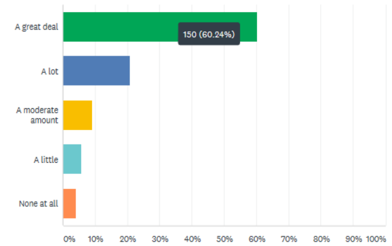
Answered: 247 Skipped: 4



ANSWER CHOICES	RESPONSES	
Less than 1 month	8.50%	21
1 - 3 months	37.25%	92
3 - 6 months	26.72%	66
6 - 12 months	19.84%	49
12 months+	7.69%	19
TOTAL		247

Has your fundraising been affected by the coronavirus outbreak?

Answered: 249 Skipped: 2



ANSWER CHOICES	RESPONSES	
A great deal	60.24%	150
A lot	20.88%	52
A moderate amount	9.24%	23
A little	5.62%	14
None at all	4.02%	10
TOTAL		249

Cost / Benefit analysis

EIS can be a cost-effective mechanism for the Government to raise funding for SMEs as outlined below

Cost to Govt	
EIS Tax relief	60%
Additional tax rate	30%
Funds raised due to increase in tax relief*	£600M
Additional tax cost to Exchequer	£180M
Estimated ongoing cost (share loss relief/CGT)	£200M
Total Estimated Additional Cost for £600M of funding	£380M

Investors could also generate returns on these investments over a 3-7 year period would provide further economic stimulus as they mature and cash is returned in to the economy

Benefit to Govt - example
£250,000 invested via EIS
£150,000 used to employ 6 staff
6 employees= £25,000 per annum
Total tax per employee= £4432.36
Employer's NI= £20,700 Over 3 years= £62,100
Employer's Income Tax= £26,592 Over 3 years= £79,776
Total NI+Income Tax over 3 years = £141,876
Cost to the government= £150,000 - 60% (tax credit) = £90,000
Government Profit= £51,876

Additionally, there will be Corporation tax for the company to pay

* Assumes this money, in normal times would have been raised anyway and Exchequer would have paid £180M in tax relief on normal 30% rate

How enhanced EIS can deliver

- EIS is an existing framework used by government for almost 40 years. It works. Each £1 invested under EIS = £4 back in tax revenue for the government* Each £1m EIS investment = 9 jobs are created*

- The EIS industry already contains hundreds of investment managers and tens of thousands of investors ready to do business. Existing infrastructure (distribution, deployment, governance) motivates private investors

- EIS investment managers are connected with fundraising channels throughout the UK and with local and regional small businesses that are ready to receive funds

- EIS connects the British public (investors) with those companies that will provide the foundation of a recovery from C-19, that will create jobs, and which will support a stable UK economy in a post-Brexit environment

- EIS functions to inspire entrepreneurs and 'knowledge intensive' organisations to do business in the [post: CV-19/Brexit] UK

- Re-activate 000's of small businesses that have been turned away due to lack of EIS fundraising resulting from C-19

*EISA

Investment process for small businesses under these proposals

Existing national network already connected with EIS will be utilised: Accountancy Firms, Wealth Managers, Angel networks

→ Harnessing over 2000 industry professionals currently in place and specifically trained to help small businesses

→ Re-activate 000’s of small businesses that have been turned away due to lack of EIS fundraising resulting from CoVid-19

The EISA will list a repository of investment managers – including their investment strategies - for small businesses to access

→ All other businesses will approach one or more investment manager and pass through the investment manager's existing due diligence process

→ Investment Manager’s existing processes are employed: administration, capital deployment, company mentoring and oversight, investor reporting

Multiple Investment Committees – already in place for each Investment Manager and each trained experts in different sectors – will provide independent oversight on an ongoing basis

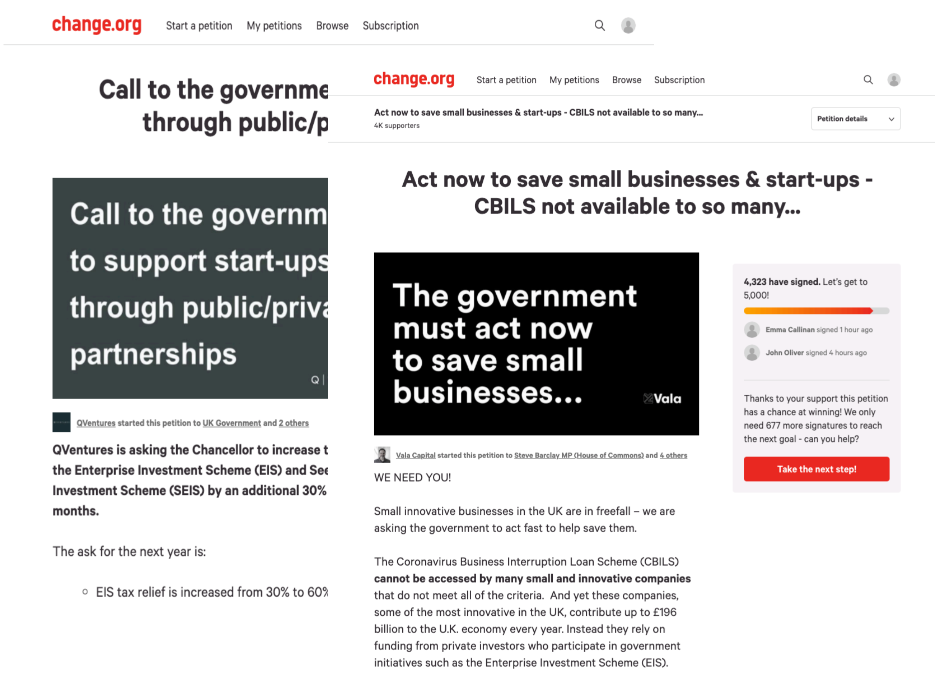
→ All current risk to capital EIS regulations remain in place

5000+ companies, funds & industry leaders in support in 10 days.

WealthClub

Vala

intelligent. partnership*



crowdcube

SEEDRS

Centology.

par equity

KIN CAPITAL

CO INVESTOR

Kuber

Sapphire CAPITAL PARTNERS LLP

SYNDICATE ROOM
Intelligent Equity Crowdfunding

RW Blears
Solicitors

SEEDLEGALS

GROWTH INVEST

Collated evidence of the scale of the problem and how EIS can be a solution

HMT tasked EISA with providing feedback and evidence from our diverse membership. This evidence is presented over the next few slides as unattributed quotes direct from our members.

The full data set has also been provided as an attached spreadsheet

Evidence: Impact

Evidence to show impact of C-19 on SME funding from the VC community

- Within EIS, fund managers report fundraising, which is traditionally at its strongest in March and April, as being **down on corresponding levels last year by more than 70%.**

- Crowdfunding sites are seeing similar declines. Crowdfunding fundraising is down from £4,209,729 in Jan 2020 to £2,245,465 in March 2020, a fall of 58%. Taken together, fundraising for early stage businesses via EIS/SEIS is likely to be down from £2Bn last tax year to between £1Bn and £0.5Bn this year. Direct single company deals tell us similar falls are occurring from Angel syndicates

- Our 3 biggest IFA intermediaries report fundraising in EIS is down, on average, 71% in March compared to the previous year

-70%

Evidence: Fundraising

Evidence for how difficulties in fundraising by managers is translating into effects on investee companies

- “The decline has been stark and dramatic in weeks commencing 16th March and 23rd March 2020; with these weeks showing a decrease of c.75% compared to the same period in 2019 (usually the busiest two weeks of the year). In £ terms, this equates to over £5m of EIS funding which was expected and required to fund a number of EIS companies in the life sciences and technology sectors. The companies which were expecting funding account for >300 jobs which are potentially now at risk over the short-term and highly innovative IP which may not be progressed.”

- “We were expecting £6M of investments into EIS and SEIS funds to invest across 18 companies. Now slashed to £1.5M and just 10 investments being considered. We now focus on those companies that have the greatest likelihood of survival overlooking many which otherwise from a perspective of innovation and scale would be considered equally appealing. This means that 45 jobs are now potentially at risk and this ignores the potential for these companies to employ greater numbers and flourish."

- “We had 3 of 7 companies seeking to raise additional equity within the next 6 months at the start of March, with cash runways of a similar length. In normal circumstances, the businesses would expect to be profitable / cash-generative within the period that the additional funding would permit We are now unable to support any of these.”

- “At the beginning of the process we were told to expect £2-£6m in investor funds over the course of 2020. As of yesterday we have been told that number will be AT LEAST 70% lower. This means we effectively lose the ability to invest in around 12-15 companies this year alone. Companies pitching to us are reporting zero uptake in existing rounds.”

- “Over the next 12 months, based on our anticipated fundraising, we would have supported another 15 or so businesses with circa £30m of equity. It’s difficult at this stage to put an accurate number of the impact but as things stand it looks like the figure could be as low as £5m and consequently 3 or 4 businesses.”

Evidence: Numbers

Evidence of how many firms are failing to get EIS investment they would previously have expected, and over what timescales

- “We had 15 companies that are looking for follow on funding that we were considering, we have only been able to invest in 5.”
- “Investment deals in the past 30 days have been closing with 28% fewer investors than previously.”
- “We are still investing in 8 companies, hopefully, by next week. Usually that number is 22/23.”
- “We are astill assessing which companies will receive funding, but it is likely that there will be 16 companies expecting EIS funding in the next 3 months that will not be receiving it, and a further 13 which will receive less than expected.”
- “We are now investing in 9 companies from our EIS fund next week, but we were going to invest in 14 before the virus. Also, the sharp decrease in funds raised means that our investee companies will receive considerably less money.”
- “For 3 of the portfolio, given contractor / outsource cost structure and with no further investment under current situation, nor line of sight to revenue, I imagine they may be likely to close, resulting in up to 18 additional staff members being unemployed, who were earning c £40 - 70kpa.”
- “Over the next 12 months, based on our anticipated fundraising, we would have supported another 15 or so businesses with circa £30m of equity. It’s difficult at this stage to put an accurate number of the impact but as things stand it looks like the figure could be as low as £5m and consequently 3 or 4 businesses.”

Evidence: Investor retreat

Evidence for how the Govt can know whether the reported falls in investment from private individuals is a long-term situation (i.e. they now dislike the EIS category as an asset class); or rather whether this is a short-term pause, as investors wait for market conditions to settle somewhat. Obviously, if investors are merely waiting for short-term volatility to settle, then it's less clear why the Govt should implement a measure that lasts for at least a year (e.g. IT relief) or more.

- "The comments I am getting from investors is that the risk has increased too much for early-stage companies and for this reason they are pulling their EIS allocations. Even though we are assuring investors these are long term investments they feel that small businesses are going to worst hit and therefore they are holding back their investments."

- "From speaking to HNW investors and wealth managers that would have had appetite for investment into EIS, they're now very much taking a step back to try and assess the impact. What we are seeing is a shift away from VC and risk which is causing a dramatic impact on our ability to rise finds for existing investee businesses and new businesses looking for funding."

- "The crisis is just beginning - this is not a short term market correction."

Evidence: Effect of changes

Evidence for the incremental effects of any new EIS change compared to the status quo

- "This is impossible to state with certainty, but at present I would not be surprised if we do not raise any EIS money from investors during Q2 …and perhaps Q3 as well. Only an extraordinary offer can induce a radical shift in EIS investor sentiment, unless the coronavirus situation is completely resolved in the next two or three months, which very few people would predict."

- "Whilst it's difficult to put an exact figure on the impact of an increase to 60% tax relief on EIS investments, we know that this would encourage further investment given the reduced risk to capital. We'd anticipate that the impact to fundraising would be significant as it was when tax relief moved from 20% to 30% in 2011." See next slide for the effect.

- **Quote from EU Commission:** "Effectiveness of tax incentives for venture capital and business angels to foster the investment of SMEs and start-ups report" - Tax incentives reduce the effective marginal cost of investing in smaller companies. As a result, in theory more investors should be willing to supply more capital to smaller companies through venture capital funds and/or as business angels benefitting from tax incentives, and at lower expected before-tax rates of return."

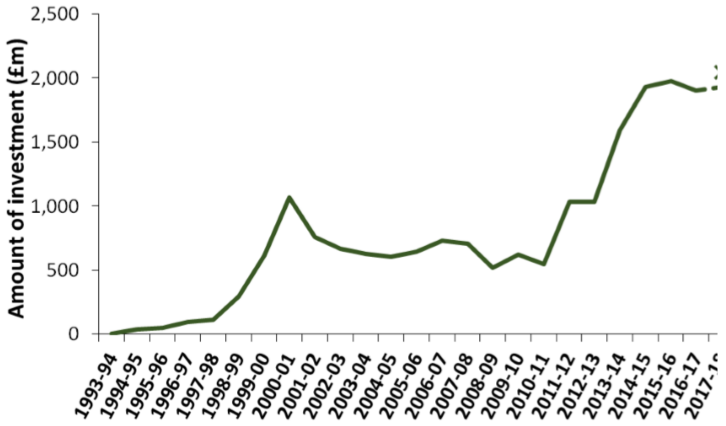
Increasing tax rates works

The correlation between tax rates and funds raised/companies raising funds

Note the two spikes in both funds raised and companies raising funds:

- In 1999, CGT exemption was introduced to EIS – there followed an immediate rise in both funds raised and companies raising funds
- In 2011, the income tax rate of relief was increased from 20% to 30% - there followed an immediate rise in both funds raised and companies raising funds

Figure 1(a): Amounts of funds raised through EIS, 1993-94 to 2017-18.



*Source: EIS1 forms. Figures for 2017-18 are provisional. * represents estimated value after all returns proce*

Figure 1(b): Number of companies raising funds under EIS, 1993-94 to 2017-18.

*Source: EIS1 forms. Figures for 2017-18 are provisional. * represents estimated value after all returns proces:*

Evidence: Pace of change

Evidence for how quickly any increased tax support will be passed onto businesses that need additional cash injections

- “Because we offer regular allotments this means the companies normally begin to receive the money and can start deploying it within a few weeks of us launching a campaign. Evidence of this includes Aparito EIS – a company improving the way the way medical trials are conducted. We raised £1 million in 7 days. Acamar the production company behind the now enormously successful children’s TV show Bing raised £3 million in 34 days City Unscripted, a travel platform raised £1.25 million in 22 days.”

- “In the first six-months of the 2019/20 (up to and including September), Deepbridge deployed over £8m into EIS companies. We believe that a short-term increase in tax reliefs would enable us to match that again in 2020/21.”

- “Historically we’ve raised funds and deployed the funds into a portfolio over the following six months. We have 98 businesses on our active pipeline of businesses we would potentially look to support and deploy funds into with six months, if not sooner.”

- “Within our fund we have a portfolio of companies ready for investment and can deploy within a matter of days if required.”

- “Any improvement in the tax benefits in SEIS / EIS will increase flows of EIS investment into our Startup Series Fund, which in turn can be passed to businesses in our portfolio within 3 months maximum.”

Evidence: Direct vs Indirect

Evidence for why the Govt should want to support companies only indirectly via investors, rather than pursuing non-tax measures that target companies them-selves

- “Indirect allows distribution of opportunity & cash beyond direct support, and using regionally dispersed skills that have taken decades to establish. Increasing EIS income tax relief to unlock dormant private capital is fast and cheaper for government. £600m of EIS funds being deployed would cost the Treasury an additional £120m via income tax relief but would provide £600m of active funding, compared to a direct cost of £600m if this funding support was provided directly. Investors could also generate returns on these investments providing further economic stimulus for the economy”.

- “Why would it be best to go through people like us? Very simply we know the companies and the ones that deserve the support.”

- “The advantage of an indirect strategy such as this, versus a direct strategy is that it relies on professional investors and the market to make investment decisions that but for current macro-economic conditions they would have otherwise made. It also maintains a level of risk with the individual, ensuring that investment decisions retain a qualitative element and are not made indiscriminately.”

- “By incentivising Indirect investment, the Government is applying a “screening process to look to mitigate the amount of support an ailing business would receive. The average failure rate of an early stage business in the first three years is almost 50%. Our failure rate is currently sat at less than 15%.”

- “The cash will get through much faster as we have investee companies ready to take to due diligence.”

- “It is difficult for individuals apart to access the VC market except through VCTs or investing directly via the EIS scheme. The schemes therefore allow the wider public to become a stakeholder in entrepreneurial Britain. Investment programmes such as BBB’s are generally small and niche and have a very limited investor base (corporates, family offices and UHNWI and certainly not retail investors like EIS – it is a different capital market). EIS can and has supported more and bigger investment programmes which has yielded some success already in the past. Investment programmes also do not have the quantity impact that EIS does and it can’t match EIS’s scale and is not a major source of capital in the context of the market need.”

Evidence: Direct vs Indirect

EU Commission
2017 Report

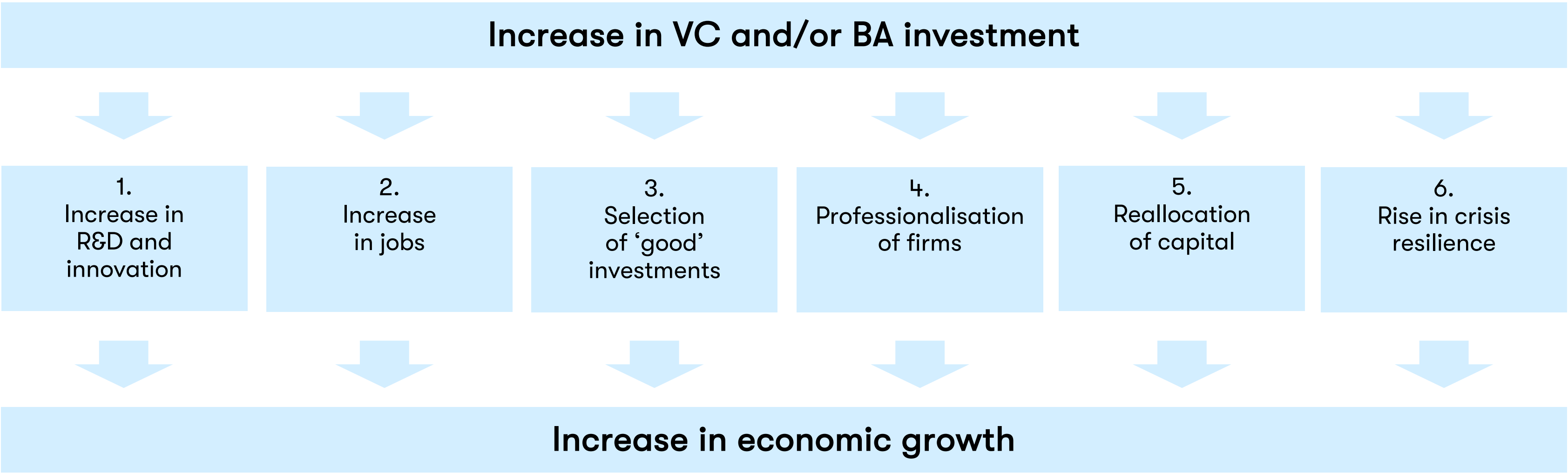
Effectiveness of tax incentives for venture capital and business angels to foster the investment of SMEs and start-ups”

The report identified a number of areas where indirect Government policy action benefits investment into SMEs. **“The problem of ‘picking winners’:**

Tax incentive design should recognise that governments rarely, if ever, have the necessary resources and information to successfully target support to specific firms, sectors or technologies. Instead, tax incentive design should target entrepreneurial firms based on a number of criteria, such as age and size (financial and headcount).”

The challenges in securing adequate financing faced by many typically higher risk SMEs in the EU, coupled with the positive macroeconomic outcomes associated with VC and BA investment, creates a compelling economic rationale as to why VC and BA investment is desirable.

Figure 1: Channels through which VC and BA financing increase economic growth



Source: PwC analysis

Responses from 19 fund managers

Q1. How much money have investors paid to you, but which is awaiting deployment to companies	9 fund managers have already deployed all their money and are sitting on zero cash. Overall Total = £22,260,967, Average = £1,171,629 However, figures are skewed by 3 larger managers who between them have £16.5M to deploy – these managers deploy over a 12-month period and as its tax year end this money has only just been raised. The majority of this money whilst not deployed, is allocated.
Q2. Is this number different compared to the number at a similar position last year?	6 report no difference (mainly those that deploy immediately). Of the rest, 2 report a higher position this year, 11 report being down this year – average being by 62%
Q3. In a "normal" world, how long would you expect the timescale to be between when individuals send their payment to the fund, compared to when that is ultimately deployed?	0 to 3 months = 7 funds 3 to 6 months = 6 funds 6 to 9 months = 2 funds 9 to 12 months = 4 funds
Q4. To what extent are investors requiring reimbursement for their as-yet-undeployed funds? Please reply either none or provide a figure/%	On average, across all managers only 7% of funds have been requested to be returned by investors.

Case studies

Digital marketing	Business Services	£130k had been committed with £70k lined up to get product into the market in 3-4 months.	All investors have paused in last two weeks. One employee due to start has been cancelled. Launch start date now unknown.
Socialising travel app	Travel	Previously raised >£1m through angel investors. Follow-on round to include first institutional investors due to close in April.	All prospective follow-on investors have fallen away; original angel investors unwilling to commit without new investors. Looking for emergency funding. Future is bleak.
Musical technology company	Entertainment	Raised £200k of £250k fundraise in Q1 2020.	Final £50k has been withdrawn. Redundancies, salary cuts and HMRC deferred payments will see the company through to June 2020.
Financial services app	Fintech	Pre-revenue company looking to complete £1m seed round; term sheets presented on £200-500k.	Prospective investors have pulled out so company considering options.
Personal financial management app	Fintech	Commitments to £1.5m funding round with term sheets agreed; lead investor committed to £1m.	Lead investor pulls out citing Covid-19; all other investors pull out without lead investor.

*Names withheld due to commercial sensitivity but available on request.

A selection of quotes

From the 250 small businesses we surveyed who are currently seeking funding

- Due to uncertainty, investors have been unwilling to part with cash. This has forced us to lay staff off and furlough them, and has put the entire business at risk
- People who would normally invest are keeping cash due to uncertainties in the economy. This affects our effort to deliver our device for monitoring COPD patients and potentially COVID-19 patients at home to alleviate burden on care workers and hospitals
- Investors are holding back even in growth areas to do with video conferencing, like ours. If we don't raise more investment within 2 months, our 11 people SME will go down under
- The economic climate has decimated EIS funding sources. As a result, we face potential closure if we cannot make up the shortfall in time
- There has been a distinct drop off in investor appetite to invest in our usual VC funds causing a shortfall in what is available for our needs. We have grown rapidly since starting 4 years ago and we employ 10 people today and this will grow to around 20 by end 2020 IF we secure the funding we need. If we can't it is likely that we will cease trading at the end of May!
- Everybody is nervous and therefore less willing to invest. Not securing this 2.5m EIS investment within the next 3 months means we have to close our R&D centre (Saietta Group Ltd) meaning 30 engineers loose their jobs
- We will run out of cash and have to shed 35 high paid jobs in the UK. We pay £3.5m a year in salaries
- The biggest impact has been uncertainty around how long the situation will last, which means investors are now wanting to wait. This has a major impact as timing and pace is so important for startup funding; three month may not seem a lot to an investor but can be critical to startup
- We are a very early stage startup looking for our first round. While discussions were going quite well before the outbreak, the current trend we are seeing is for Angels and Friends & Family in particular to focus on recouping existing investment losses and hence significantly reduced appetite to look at new opportunities like ours
- Our runway was planned until the end of June 2020, having raised pre-seed last year, and Seed A discussions planned to start March 2020. Obviously, this hasn't started now, and access to capital here and abroad will be severely impacted. If we don't get our raise, our company will go bust

Scale funding for small business

Thank you

Declaration: Prepared by EISA and Vala Capital