Reigniting the UK's entrepreneurial ecosystem

What is EISA?

The Enterprise Investment Scheme Association (EISA), represents young, innovative, embryonic high growth companies with the potential, through the Government backed Enterprise Investment Scheme (EIS) and the Seed Enterprise Investment Scheme (SEIS), to attract equity investment into their business from private investors.

EIS/SEIS have established a long and demonstrable track record as a trusted and crucial source of equity funding, most notably to those companies at the forefront of technological and knowledge-based development with the most productive potential. Exactly the type of companies the UK will be relying on most to restart and grow our economy in a post pandemic world. Founders of such companies are risk takers, knowing the risks of failure are high but so are the rewards. Investors know this too. EIS and SEIS work so efficiently as they have been designed with this in mind, seeking to both offset some of the risk to investors by incentivising them via targeted tax reliefs and at the same time providing early stage businesses with scarce but much sought after equity funding. Without this ecosystem, the UK would struggle to develop the innovative, future focused businesses that will power the economy in the coming years.

However, Covid-19 has severely disrupted this ecosystem. Companies desperately need funding to survive, reset and grow but investors have taken risk off the table and withdrawn investments.

Covid-19 has significantly altered the economic landscape and widened already existing funding gaps and market failure.

The result is a demand and supply problem. Demand for funding from companies has understandably risen but as the level of uncertainty is now higher, so has the risk for investors who are withholding the supply of funding. However, the knowledge intensive economy cannot afford to wait for the current instability to end before promising, high growth potential companies are lost. The result? Job creation opportunities lost, tax revenue foregone and game changing innovations left undeveloped.

Pre pandemic, early stage businesses often struggled to raise equity finance due to market failure and 'funding gaps,' where credit markets failed to supply sufficient finance to fulfil demand. Covid19 has widened these gaps. The pandemic has adversely affected the supply of debt and equity finance for all firms, but young, small and innovative companies face a disproportionate burden and many were not eligible for any of the Government's Covid related funding schemes. In response, EISA has commissioned a report on the impact the pandemic has had on equity-financed firms during Covid-19 as well as investors' ability and willingness to invest in 'risky' start-ups. What follows are some of the key findings:

The total equity gap by investment stage in 2019 suggests £768m is required at seed stage; £1.45bn at venture stage and £4.45bn for growth finance. The northern regions, East Midlands, Yorkshire and Humberside, West Midlands, and the North West, have the largest shortfalls.

- 60% of EIS/SEIS eligible companies think they will not be able to operate longer than 12 months if current circumstances persist.
- Over 35% of EIS/SEIS eligible companies were turned down when asked for bank finance or government Covid-19 support.
- 15% of companies report they will run out of capital within 3 months, 22% will run out of funding in six months and 26% of EIS/SEIS businesses believe they do not have enough capital to last a year.

> *Pre-revenue businesses that had spent time and money developing the business have been caught in the middle. There has been no help with funding or grants and cash reserves are diminishing. Banks are not providing loans to companies that are caught in the middle ground.*
>
> *Survey respondent*

> *Debt is not an effective solution for early stage businesses as this adds an interest burden and cash flow challenges due to short term repayment obligations. In the face of uncertainty, companies need access to risk capital (equity).*
>
> *Survey respondent*

Investments levels have decreased substantially compared to last year and have continued to deteriorate quarter to quarter in 2020. For example:

1. EIS eligible deals represent over 70% of the total number of deals and around 40% of the total value of deals (investment value) since 2011
2. The number of investments in EIS eligible companies decreased by 29% in Q2 2020 compared to the previous quarter and 33% compared to the same quarter in the previous year. Businesses therefore lost out on £341M of investment
3. The drop in SEIS eligible companies was similar. 24% quarter-on-quarter and 33% year-on-year decreases.
4. The drops in invested value were of similar magnitude. Analysis of the 12 most invested industry sectors shows that, for most sectors, the number of deals and investment value dropped substantially in 2020. In nearly all the 12 analysed sectors the proportion of EIS eligible deals fluctuated around 70-80%

EIS/SEIS as an enabler of the recovery

Without a robust and sufficiently incentivising EIS/SEIS, local recovery from the ground upwards becomes much harder, as does the generation of new jobs. The perceived impact of Covid-19 on a company is seen very differently. Companies with previous SEIS/EIS experiences, for example, are more optimistic, both in terms of the impact on revenue and employment.

1. Over 89% of surveyed companies feel that relaxing SEIS/EIS rules would lead to a rise in equity funding available to businesses from investors.
2. Almost 97% (121 out of 125) of the surveyed companies agreed that EIS/SEIS investments were important for the growth and development of their company. In turn, 103 out of 125 surveyed companies reported increased revenue as a result of EIS/SEIS investment. Nearly 70% of them reported revenues increasing by more than 50%.
3. As far as the government support in the current situation is concerned, the majority of the surveyed companies said that the measures enabling the access to finance would be the most helpful while other types of support such as tax cuts, fewer bureaucratic hurdles or more flexible labour laws were much less important.
4. 84% of companies agreed or strongly agreed that investments under the EIS/SEIS also have an important impact on employment. 119 out of 125 companies reported hiring more employees as a result of EIS/SEIS investments. Further analysis shows the average number of employees hired is 6 per company. Overall, average employment growth was 86%. Every £1M invested in EIS creates at least 4 jobs within a year of investment. 4,000 companies received EIS funding in 2018/19 meaning the schemes can justifiably claim to have created 24,000 jobs in that one year alone!
5. Companies they perceived that without the schemes it would be difficult for them to find other financing for the company. The investors have a positive impact on revenue or employment and are key to financing their further investment

We have very supportive existing investors, but they are hampered by the current EIS & SEIS rules to invest more at this stage when we absolutely need it to survive the uncertainties around Covid-19 and Brexit.

Survey respondent

We would not have existed without the help provided by the SEIS & EIS scheme and the government grants. We have gone from 2 employees to 20 in one year and plan to grow to 60 next year. We are a Fintech and we are thriving because of these schemes helping us when we were most vulnerable and attracting angel investors willing to support us.

Survey respondent

We are calling for...

1. **An increase in the SEIS lifetime allowance from the current £150,000 to £250,000**
2. **Replace the "age restriction" on eligible recipients of State Aid with a different threshold**
3. **Ministerial assurances that every effort will be made to ensure the continuation of the EIS & SEIS schemes, particularly beyond the current sunset clause of 2025**
4. **Further investigation into how money held in pension funds can be used to fund EIS and SEIS qualifying companies.**