Association of Accounting Technicians response to HM Treasury, “Financing growth in innovative firms”

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1. Introduction

1.1. The Association of Accounting Technicians (AAT) is pleased to have the opportunity to respond to the consultation paper on Financing Growth in innovative firms, published on 1 August 2017.

1.2. AAT is submitting this response on behalf of our membership, especially the 60% of whom work for an SME or run their own SME, as well as AAT's 4,250 licensed accountants who provide accountancy services to over 400,000 British Businesses.

1.3. AAT has added comment in order to add value or highlight aspects that need to be considered further.

2. Executive summary

2.1. **Short-termism, a lack of awareness and the regulatory system are three oft stated barriers to the effective deployment of patient capital.** However, as detailed below (3.5-3.12) there are positive signs emerging in each of these areas.

2.2. **Government should press for continued UK participation in the European Investment Fund (EIF).** There are a number of non-EU countries who already do so and shareholders in the EIF are not just EU member states but a number of public and private banks and financial institutions, several of which are based in the UK. If this does not prove possible then the British Business Bank should fill any funding gap that may arise.

2.3. **Intervention must be kept to a minimum.** A new patient capital ISA is not needed, the Innovative Finance ISA should be replaced with an investment allowance and crowdfunding is already growing exponentially so does not require further intervention or taxpayer support. Likewise, all the available evidence suggests the UK is performing extremely well in relation to University spinouts so there seems little reason to interfere with this economic success story.

3. AAT response to the consultation paper

3.1. The following paragraphs outline AAT's response to the proposals detailed in the consultation paper. Only those questions where AAT has a comment to make have been listed.

Question 1
Do a material number of firms in the UK lack the long-term finance that they need to scale up successfully?

3.2. The consultation document answers this question at 2.4:
"In particular, it appears that slightly fewer firms in the UK receive some form of initial investment than the global leaders. More importantly, those that do receive significantly less investment on average as they scale up"
and at 2.14:
"The secretariat of the industry panel supporting this review has separately modelled an overall range of between £3 billion and £6 billion per year between the current annual supply of capital and that in a fully functioning UK system."

3.3. AAT agrees with this analysis.

Questions 5 & 6
What are the main root causes holding back effective deployment of and demand for patient capital?

3.4. Short-termism, a lack of awareness and the regulatory system are three oft stated barriers to the effective deployment of patient capital.

3.5. A desire for short term gains is often seen as the reason for a lack of patient capital but this does appear to be changing. For instance, patient capital overtook traditional venture capital as a source of investment for the UK technology sector in 2015.

3.6. A lack of patient capital represents an untapped investment opportunity that funds such as the Woodford Patient Capital Trust, established in 2015, have entered the market to exploit. They have noted that demand for capital from early-stage companies and early-growth companies is high, but the supply was low, making the returns on capital deployed attractive.

3.7. Inevitably more funds will begin to recognise these benefits and as they do so the scope for Government intervention reduces.

3.8. Another considerable stumbling block has been a lack of awareness amongst advisers and managers as well as a fear factor given the higher risk nature of patient capital (which can largely be combatted by ensuring a balanced portfolio). Again there are signs that this is beginning to change.

3.9. The regulatory structure of the investment landscape in the UK is another concern. BEIS and Treasury are understandably keen to deliver greater investment via patient capital in recognition of the significant benefits to the economy but the higher risk nature of such investment is of concern to the Financial Conduct Authority who are keen to prevent investment losses.

3.10. This is something that the FCA has recently acknowledged, having published a discussion paper[1] in February 2017 that asks, "…whether a more fundamental reassessment might be valuable, focusing particularly on ways in which different forms of primary market structure and regulation might better support scale-up and patient capital…"

3.11. The same consultation document states that some have suggested there is *"…a perspective amongst regulators that has produced market regulation which gives priority to the immediate and general dissemination of information, versus long-term engagement, and so reinforces a short-term focus."*

3.12. This suggests that the FCA is aware of the problem and is willing to take action to address it. It is essential that the review panel engage directly with FCA on these issues. A brief review of unintended (perhaps even intended) regulatory barriers to patient capital barriers would be useful. In addition to the FCA, this should include the Pensions Regulator and the Financial Reporting Council.

3.13. Ontario Teachers' Pension Plan, a pension plan with over $175 billion in net assets making investments on behalf of over 300,000 working and retired teachers, is often portrayed as a great example of a large fund which effectively deploys patient capital. However, their own Chief Executive Ron Mock stated, *"…size, whilst important, doesn't lead to an obvious advantage…what's more important is clarity of purpose, what to focus on…and governance."* (CFA Annual Conference, 10 May 2016). AAT agrees with these sentiments and does not think arguments about size are particularly productive.

3.14. With regard to the future applicability of the EIF, the starting point should be to seek the continuation of UK participation in the EIF. There are a number of non-EU countries who already do so e.g. Turkey and so enabling the UK to continue may not be quite as exceptional as some commentators would have us believe. In addition shareholders in the EIF are not just EU member states but a number of public and private banks and financial institutions – several of which are based in the UK - who would doubtless be keen to continue investing in high growth, high return sectors in the UK economy.

[1] FCA Discussion Paper, February 2017: https://www.fca.org.uk/publication/discussion/dp17-02.pdf

3.15. Failing this then there is no reason why the British Business Bank could not take up the slack. There are also numerous benefits to doing so as the British Business Bank would be free from EU state aid rules which have arguably hampered investment in some areas. For example, EU state aid rules prevent investment in companies that have been trading for more than seven years – often a problem in the life sciences sector where companies may not seek scale-up finance until several years of trading have passed.

Question 19
What steps should the government take to support greater retail investment in listed patient capital vehicles?

3.16. A range of ideas have been put forward by other individuals and organisations, most of which AAT does not believe would make a material difference to increasing patient capital.

3.17. A recent example of this was the AIC recommendation for a patient capital ISA. As noted by HM Treasury, ISA investors can already invest up to £20,000 per year into these assets and therefore a specific ISA would be likely to have a very limited impact.

3.18. Together with politicians, journalists and industry professionals, the AAT ISA Working Group is currently working on proposals to simplify the existing ISA regime. The introduction of yet another new ISA, meaning there would be an ISA for every day of the week, would introduce further unwanted complexity to the ISA regime.

3.19. The consultation document notes at 3.14 that *"Crowdfunding platforms are currently involved in deals valued at around £100 million per year, up from £17 million per year in 2011."* This indicates that crowdfunding represents a good opportunity for retail investment in patient capital.

3.20. As also noted, some types of crowdfunding also appear to have helped to increase the depth of investment in particular sectors e.g. 34% of investment through Syndicate Room is being invested in life science companies.

3.21. The recent launch of the new Innovative Finance ISA – which AAT believes should be replaced with an investment allowance, largely achieving the same goals – demonstrates that Government has taken steps to encourage an area of activity that it is already flourishing. Further market interventions are therefore unlikely to be necessary and instead the market should be left alone to grow as the market dictates.

Question 24
What steps should government take to support the next generation of high potential fund managers to develop their knowledge and skills and to raise their first or next fund?

3.22. In April 2016 the CFA published a research paper titled, The Skills & Competencies of Today's Investment Professionals[2] which serves as a useful starting point for responding to this important question given it details feedback on what firms look for in their recruits, the technical and soft skills required by today's practitioners and the competencies demonstrated by exceptional performers.

3.23. Specific Government support is probably not needed given the success of the industry and strong performance of professional bodies in this area.

3.24. However, what might prove useful would be some nudges and prompts to ensure fund managers consider taking a slightly different approach to historical models. For instance, funding for scale-ups is unequally deployed with several £billion being invested in London and the South East per annum but only a fraction of this in the rest of the country. In contrast, according to the UK StartUp Institute, 8 out of 10 of the UK's most productive businesses are located outside London.

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[2] The Skills & Competencies of Today's Investment Professionals, April 2016
https://secure.cfauk.org/assets/1298/CFA1950_LD_Report_WEBv1.pdf

3.25. As a result fund managers should be encouraged to raise their first or next fund outside of London or the southeast to ensure capital is being deployed to the highest potential firms. This is something that could be achieved by raising fund managers awareness of the many opportunities in alternative locations.

Question 25
What further steps, if any, should government take to increase investment into university spin-outs specifically?

3.26. UK Universities have been responsible for well over 2,000 successful spinouts and the number is increasing rapidly.

3.27. As an example, Oxford University had 10 spinouts in 2015 and this more than doubled to 21 in 2016. 2017 is on target to be better still.

3.28. Barely a week passes without news of further developments in this area. PulmonIR, a medical device company based on the work of Swansea University, Predictimmune, a spinout company from the University of Cambridge and Roslin Technologies from the University of Edinburgh are just a few of the many spinout successes in the first half of 2017.

3.29. Oxford University Innovation puts this increase down to substantially increased investment, primarily from venture capital. Oxford University Innovation CEO, Matt Perkins confirmed in June 2017, that Oxford University now "…*finds itself at the epicentre of booming levels of entrepreneurial and innovative activity...*"

3.30. If private equity and venture capital is already contributing in this way, spinouts are rapidly increasing in size and number, and private investment is being attracted once spinouts commence, it is unclear why Government would want to intervene in the market by providing taxpayer money.

4. About AAT

4.1. AAT is a professional accountancy body with approximately 50,000 full and fellow members and over 90,000 student and affiliate members worldwide. Of the full and fellow members, there are over 4,250 licensed accountants who provide accountancy and taxation services to individuals, not-for-profit organisations and the full range of business types.

4.2. AAT is a registered charity whose objectives are to advance public education and promote the study of the practice, theory and techniques of accountancy and the prevention of crime and promotion of the sound administration of the law.

5. Further information

If you have any questions or would like to discuss any of the points in more detail then please contact Phil Hall, Head of Public Affairs & Public Policy, at:

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