THE WORSHIPFUL COMPANY OF WORLD TRADERS
How Patient Capital can Transform High Growth Businesses
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Introduction

Britain has a proud tradition of being among the best places in the world for entrepreneurs and innovators to start their own business.

However, once those businesses become established many are unable to fulfil their high growth potential, due to a lack of patient capital.

They might have an innovative idea they want to prove through investment in R&D or a new product to bring to market but struggle to obtain the larger amounts of long-term, venture and growth capital required to scale their businesses.

It often means too many high-growth potential businesses are forced to grow at a slower rate or look abroad when they want to scale up.

The Government's Patient Capital Review 2017 highlighted this problem and warned that Britain was lagging behind the US in this kind of funding and that this is a 'serious impediment' to the success of UK entrepreneurs.

The lack of such investment slows these firms' growth, dampens their ambition and means that some firms are sold to trade buyers rather than growing to maturity in the UK.

Overall levels of productivity are reduced as a result as some firms do not fulfil their economic potential.

About British Patient Capital

This is the reason why British Patient Capital was established.

First, what is patient capital? It is long-term equity investment into high growth potential, innovative companies.

At British Patient Capital, our mission is to enable long-term investment in innovative companies across the UK led by ambitious entrepreneurs.

We ensure they have access to the right type of funding at the right time helping them to expand, invest in people, develop innovative products and enter new markets.

British Patient Capital is an in-house fund of funds and a wholly-owned, commercial subsidiary of British Business Bank plc, the UK's government-owned economic development bank.

We have £2.5bn of resources to invest into venture and growth capital funds over the next 10 years.

British Patient Capital is currently fully funded by the Government, but the intention is that it will be listed or sold once it has built its portfolio and a strong track record.

In our first year of operation, we committed £335m to 12 funds and plan to commit a further £500m to venture and growth capital funds this year.

Other Patient Capital Programmes

The commercial arm also launched other patient capital programmes in addition to British Patient Capital. These include our Managed Funds programme and the Regional Angels programme.

Our approach to patient capital is to increase the volume, diversity and accessibility of longer-term finance so that smaller businesses can access the finance they need to achieve their growth ambitions; ensuring that the UK remains the key place in Europe to raise a fund and scale a business.

Managed Funds

Our Managed Funds programme, launched last May, invests in and encourages other institutional investors to invest in large-scale funds of funds run by experienced managers.

We will provide a significant investment in a number of large-scale, private sector-managed funds of funds with strategies that include primary fund investments, co-investments and secondary investments.

The successful funds of funds managers will invest in venture capital and growth funds that will provide capital to innovative, high-growth-potential businesses.

The programme expects to generate a market rate of return on its investments.

Regional Angels

The Regional Angels programme launched last Autumn, will help reduce regional imbalances in access to early stage equity by increasing the availability, supply and awareness of angel and angel-like equity investments across the UK.

We will commit funds for investment, alongside angel investors, to act as a catalyst to longer-term angel equity investment into smaller UK businesses.

We will make commercial investments via delivery partners who manage angel investments.

Routes to funding may include angel syndicates, angel investment funds, angel co-investment or 'sidecar' investment vehicles, crowdfunding platforms or other managed funding structures.

The programme expects to generate a market rate of return on its investments.

UK Equity Market

The British Business Bank's annual Small Business Equity Tracker report shows the UK equity investment market has grown 72% in just two years, as equity investment is typically the most appropriate type of capital to fuel a company's growth.

Smaller businesses in the UK received £6.7bn in equity investment last year, the highest amount ever recorded.

2018 was the second year in a row that investment has been more than £6bn.

And British Patient Capital is already having an impact in the market.

Funds supported by British Patient Capital were involved in three of the 10 largest UK SME equity deals in 2018, including the two largest investments in unicorns, businesses valued at £1bn or more, namely Revolut and Graphcore.

This highlights the progress British Patient Capital is making in supporting the UK scale-up ecosystem.

Closing the Regional Funding Gap

Another area where progress is being made is in the increasing value of equity finance investment outside of London, a key concern highlighted in the Government's Patient Capital Review.

Whilst London is still the largest market by region, 2018 saw the value of equity investment outside London increase by 29% (£616m), to stand at £2.8bn.

The East of England, North East and West Midlands are the three regions driving this growth with investment increasing by 118%, 115% and 81% respectively.

The Small Business Equity Tracker report also shows that growth stage deals, backed through British Patient Capital, are larger than the private equity and venture capital market average, ensuring that the scale up companies we back are better capitalised and therefore more resilient and better able to compete in global markets.

British Patient Capital continues to ensure finance markets work better for smaller businesses in whichever part of the country they are based.

The US Market

Historically, the US venture capital market was over two times the size of the UK's (accounting for size of economy) but the UK VC market has grown quicker over the last decade than the US VC market.

The UK now has a higher number of seed and early stage VC deals relative to GDP and the number of later stage VC deals is largely in line with the US.

Since 2016, the UK has had 18% more VC deals relative to GDP than the US.

This is a positive development and shows the success of the wider UK ecosystem in supporting companies at all stages of their development.

Deal sizes are larger on average in the US, but UK VC backed companies are now just as likely to receive follow on funding rounds as their US counterparts.

So, what are the root causes of sub-optimal patient capital in the UK?

Private investor perception of UK VC is influenced by low historical returns of the asset class, despite improvement in performance over the past decade.

Institutional Investors

Institutional investors remain wary of venture investment, and do not participate in the asset class sufficiently to develop the expertise, access, and scale required to successfully capture attractive returns.

For example, 98% of US VC fundraising comes from institutional sources like pension funds, insurance companies, foundations/ endowments, whilst in the UK it is much lower (59%).
British Patient Capital is trying to change that.
The institutional investor, community tends to adopt, change cautiously.
However, once the case for change is compelling, investors typically converge around a new set of higher standards to improve best practice.

Conclusion

British Patient Capital continues to work with the British Business Bank to ensure finance markets work better for smaller businesses in whichever part of the country they are based.
The report demonstrates that British Patient Capital's activities are already beginning to address the funding gap affecting scale up businesses across the UK, thereby helping to develop a venture and growth capital ecosystem that enables our highest potential businesses to scale up and thrive, resulting in better outcomes for the UK economy – patience pays!