Enabling investment in productive finance

techUK’s response to the DWP’s consultation on enabling investment in productive finance

January 2022

About techUK

techUK is a membership organisation launched in 2013 to champion the technology sector and prepare and empower the UK for what comes next, delivering a better future for people, society, the economy and the planet.

It is the UK’s leading technology membership organisation, with more than 850 members spread across the UK. We are a network that enables our members to learn from each other and grow in a way which contributes to the country both socially and economically.

By working collaboratively with government and others, we provide expert guidance and insight for our members and stakeholders about how to prepare for the future, anticipate change and realise the positive potential of technology in a fast-moving world.

**Introduction**

The UK tech sector is one of the UK’s modern success stories, when it comes to starting and scaling new tech companies. The UK is now home to more than 115 tech unicorns[[1]](#footnote-1) as well as hosting 12 $10bn plus valued ‘decacorns’.[[2]](#footnote-2)

The latest data shows that collectively the digital sector contributed £150.6 billion to UK overall GVA in 2019, accounting for 7.6% of total UK GVA.[[3]](#footnote-3) This data also shows that the GVA of the tech sector has increased by 6.1% between 2018 and 2019 and by 26.5% between 2010 and 2019 in real terms, and that the GVA contribution rate to the wider UK economy has steadily increased averaging 7% per year since 2016, growing six times faster than the wider national economy in 2019, and outpacing the US and China to lead global growth.[[4]](#footnote-4)

These accomplishments were made possible by the investments needed to transform brilliant ideas into viable business models and for small ventures to scale-up. Fortunately, the UK tech sector experienced a record amount of investment in 2021, with £29.4 billion raised by tech firms, up 2.3x from last year's estimates of £11.5 billion.[[5]](#footnote-5)

This consistent growth and estimates that if the UK’s digital ecosystems are supported the sectors contribution to annual GVA could grow by an additional £41.5 billion by 2025[[6]](#footnote-6), shows that there is still enormous potential to be unlocked if the UK can continue to drive investment into the sector.

Although the UK is the world's third largest destination for VC investment, it is still far from the top, with the US raising ten times more capital than UK tech businesses and Chinese companies raising three times more.[[7]](#footnote-7)

Raising capital is still a major difficulty for most businesses, particularly for women and non-white founders, and while we have seen an increase in hubs outside of London, investment remains concentrated in a few urban hubs.[[8]](#footnote-8)

Furthermore, there are still gaps in domestic investment in venture capital, with most of the money flowing into UK tech coming from the United States (37% of total funding). Domestic funding accounts for only 28 percent of UK venture capital funding.[[9]](#footnote-9) This funding is especially low when it is provided by UK institutional investors such as DC scheme managers.

Lowering the barriers to investment will be critical to the UK's economic recovery from the COVID-19 pandemic, but it will also help to support the growth of emerging sectors like green infrastructure or the country's most innovative companies, thereby helping to sustain employment, our communities, and the environment.

techUK welcomes the DWP's consultation on enabling investment in productive finance as we agree on the importance of removing investment barriers, encouraging performance fee innovation and competition, and incentivising investment in long-term, illiquid assets like venture capital, all while protecting workers' and pensioners' money.

**Enabling investment in productive finance**

techUK supports the DWP's proposal to remove performance fees from the charge cap for DC pension schemes. If implemented, it would give DC pension scheme trustees more leeway to focus on generating returns to members rather than only on costs, increasing the return on people's savings, and aligning them with development objectives outlined in the UK Government's Plan for Growth.

The current charge cap prevents schemes from imposing charges of more than 0.75% annually on a member’s pot. However, techUK members have stated that variable fees (like performance-based fees), are not suitable for regulation through a flat cap, and that this charge restriction imposed on DC schemes is regarded as limiting DC schemes' ability to engage in long-term, illiquid assets such as venture capital and other kinds of private equity.

techUK also agree with the DWP’s assessment that this proposal will give such schemes the flexibility and freedom to enter into performance-based fee structures if they think this will be in the financial interest of their members.

Furthermore, techUK members believe this consultation responds to a real and measurable problem: UK pension fund capital is being underutilised. This is a problem that many experts believe was inherited from pre-Brexit regulations, which is substantiated by the fact that only 0.018% of European assets under management by pension funds schemes (including the UK) are allocated into VC.[[10]](#footnote-10)

However, even within Europe, data from Atomico’s State of European tech 2021 shows that UK and Irish pension funds are the most underinvested in the continent, accounting for only 6% of overall pension fund investments into European VC and representing only 2% of total VC investment raised by UK and Irish VC.

Other countries have taken active action in the use of their pension funds; for example, in the United States, 9 percent of pension assets are directed into private equity, funding companies all over the world.[[11]](#footnote-11) Australia's pension system, which is similar to that of the UK and one of the largest of the world, has 4% of its assets invested in private equity, compared to 0.3% in the UK.[[12]](#footnote-12)

It is vital to stress that the members of DC schemes, whose money will be utilised, should be the most important stakeholders in this debate. We believe that these proposals allow pension scheme trustees to spend in areas where they believe they can provide better value to members, while also encouraging genuine fee innovation and competition. The evidence is compelling in this regard; according to research conducted by the British Private Equity & Venture Capital Association, these kinds of assets have generated 14.2% of average annual returns for pension funds and other investors over the last ten years, outperforming other asset classes.[[13]](#footnote-13)

Unlocking this potential entails increasing investment in highly productive businesses, as well as in companies that will tackle future challenges and provide jobs to the UK economy, while also allowing more citizens (members of DC schemes) to benefit from our high-tech economy's achievements.

This regulation change will be an essential step toward that goal, but we also learned through wider discussions with officials and the Treasury that the UK pension system may need to promote a culture shift that encourages funds to invest in asset classes that support the tech economy. techUK would be delighted to assist the Government in achieving this goal, as well as to provide feedback on technical consultations such as this one.

1. [Department for Digital Culture Media and Sport (2021)](https://www.gov.uk/government/news/uk-tech-sector-achieves-best-year-ever-as-success-feeds-cities-outside-london) [↑](#footnote-ref-1)
2. [After raising ‘astonishingly high’ investment, UK tech scaleups must now consider their future impact](https://technation.io/news/uk-tech-scaleups-must-decide-on-their-future-impact-after-astonishing-vc-growth-in-2021/) – tech nation 2021 [↑](#footnote-ref-2)
3. [Department for Digital Culture Media and Sport Economic Estimates (2019) Gross Value Added](https://www.gov.uk/government/statistics/dcms-economic-estimates-2019-gross-value-added). [↑](#footnote-ref-3)
4. ‘Tech Nation Report 2021’, *Tech Nation*, 2021. https://technation.io/report2021/ [↑](#footnote-ref-4)
5. [Department for Digital Culture Media and Sport (2021)](https://www.gov.uk/government/news/uk-tech-sector-achieves-best-year-ever-as-success-feeds-cities-outside-london) [↑](#footnote-ref-5)
6. [Department for Digital, Culture, Media & Sport: Assessing the UK’s Regional Digital Ecosystems (2021)](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/1020407/Digital_Regional_Ecosystems_report_v9.1.pdf) [↑](#footnote-ref-6)
7. Tech Nation Report 2021’, *Tech Nation*, 2021. https://technation.io/report2021/ [↑](#footnote-ref-7)
8. [Atomico (2021) – State of European Tech 2021](https://2021.stateofeuropeantech.com/chapter/executive-summary/) [↑](#footnote-ref-8)
9. [Department for Digital Culture Media and Sport (2021)](https://www.gov.uk/government/news/uk-tech-sector-achieves-best-year-ever-as-success-feeds-cities-outside-london) [↑](#footnote-ref-9)
10. [Atomico (2021) – State of European Tech 2021](https://2021.stateofeuropeantech.com/chapter/executive-summary/) [↑](#footnote-ref-10)
11. [American Investment Council (2021).](https://www.investmentcouncil.org/what-they-are-saying-public-pension-funds-benefit-from-private-equity-investments/#:~:text=public%20pension%20funds%20allocated%209,followed%20by%20fixed%20income's%2024%25) [↑](#footnote-ref-11)
12. [Superannuation Statistics (2021)](https://www.superannuation.asn.au/resources/superannuation-statistics) [↑](#footnote-ref-12)
13. [New Horizons UK venture capital and private equity: creating public value (2021)](https://www.bvca.co.uk/Portals/0/Documents/Research/2021%20Reports/BVCA-New-Horizons-24-February-2021.pdf) [↑](#footnote-ref-13)