

# On the use of tax incentives to promote equity investment in smaller, innovative firms in the UK

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## Background

- The role of innovative small firms in promoting economic growth
- Availability of risk capital
- A role for public policy?
  - social optimum exceeds private
  - asymmetric information
  - knowledge spillovers
  - institutional framework as an impediment



## Enterprise Investment Scheme (EIS)

- Started in 1994
- Focus on individual
- Tax relief to private individuals investing in qualifying shares
- 20% relief for investment in qualifying companies up to £400k per annum
- Capital gains deferral at 40%



## Venture Capital Trusts (VCT)

- Started in 1995
- Individuals invest in enterprises through a managed fund (VCT)
- Each VCT can invest up to £1m per annum in a qualifying company
- Tax relief is given on shareholdings held for a minimum of 3 years



## Study aims

- Compare performance of EIS/VCT firms against a matched comparison group
- To consider how investments impact on performance dynamically (over time)
- To quantify the scale of any investment (scheme) effects
- Identify whether particular 'types' of firms benefit more (or less) than others



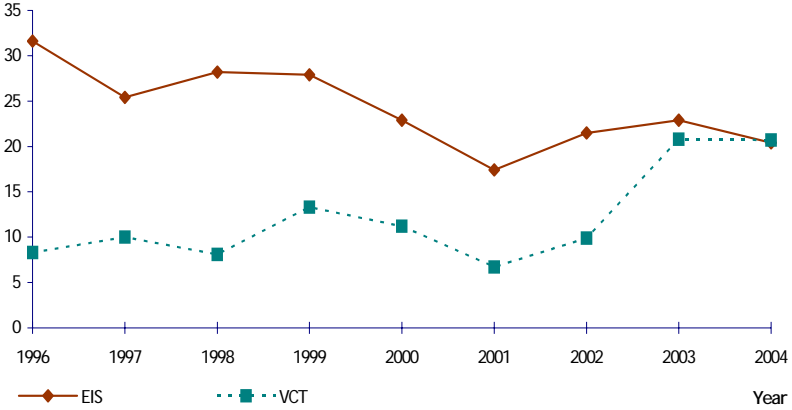
## Data and methods

- Period 1994-2006
- 12,000 EIS, 1,000 VCT, 80,000 Control
- EIS/VCT data (size of investment etc.)
- Company performance (profits etc.)
- Company demographics (age, sector etc.)
- Panel data methods  
(a cross-sectional and time-series element)



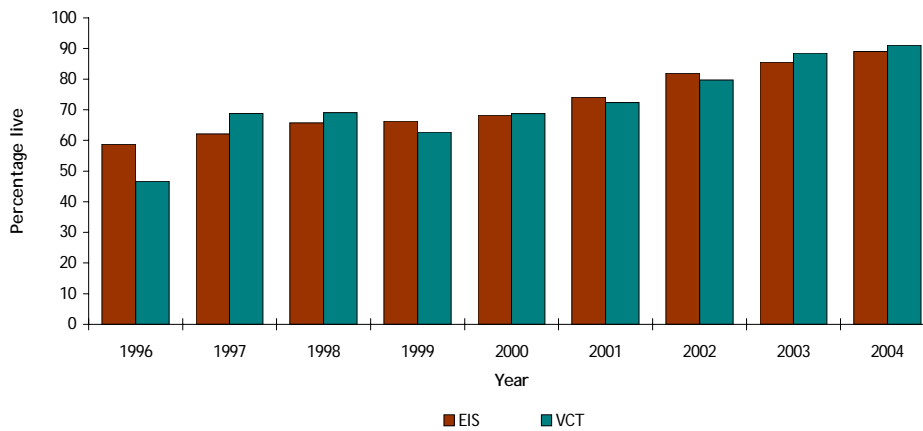
# Age profile of investees

Proportion of brand new companies (per cent)



Source: IES

# Survival?



Source: IES

## General findings

EIS and VCT:

- increase rate of accumulation of fixed assets (capital equipment etc.)
- increase rate of job creation
- increase sales turnover

But EIS and VCT

- have lower survival rates
- and
- lower profit margins



## Summary

- EIS and VCT provide tax incentives to promote equity investment in young innovative firms.
- Both schemes have contributed (albeit in a small way) to capacity building and growth.
- But there is also evidence of accelerated 'natural selection'.
- We suggest that the greatest returns may lie in the future.



... thank you



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