# Preparing for the Next Paradigm: A Series of Perspectives on What Makes the UK an Attractive Investment Environment

September 2019

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# I. Forewords

## a. The Rt. Hon. The Lord Mayor, Alderman Peter Estlin

This year, Sibos – one of the most influential and international conferences on financial and banking services – is taking place in London, and I am delighted to host elements of the conference in the City. Indeed, it is the perfect location, because while London is a historic place, it is also a place of modern enterprise and innovation, especially in financial and professional services. London hosts ten out of the seventeen financial unicorns in the UK, where the 'Fin' and the 'Tech' are only a couple of Tube stops apart, helping make the UK the leading global FinTech hub with a thriving ecosystem and international talent pool spanning the whole country.

By building on our long-standing global business relationships, our flexible and agile approach to regulation and the rich culture and diversity of the UK, we are doing everything possible to ensure this country is where business is done best.

Investment is an important part of this story. In fact, so far 2019 is a record year for venture capital investment into the UK. In the first five months of 2019, venture capital investment into UK technology companies reached over £3.8 billion, which is on track to eclipse 2018 – another record year – in which UK technology companies received £6.3 billion of investment. That's more than any other European country.

The City of London recognises the huge importance of attracting international investment into the UK's FinTech ecosystem, especially from our closest business partners. This report looks specifically at the UK's relationship with the United States, a relationship we in the City of London have helped grow by visiting twice this year with FinTech delegations, and with further plans to visit New York. We will be focusing on working alongside key partners – like Motive Partners and DIT – to look at how we might increase venture capital investment across the UK, not just London.

The work we do in the City of London Corporation is focused on supporting this investment. By building on our long-standing global business relationships, our flexible and agile approach to regulation and the rich culture and diversity of the UK, we are doing everything possible to ensure this country is where business is done best.

This report is not only a testament to that work, but also focuses on the future of this sector and where we need to shift our priorities, backed up with some fascinating research and statistics. I want to thank Motive Partners, and all the participants of the roundtables over the years, who brought their unique insight to this report. I know that if we continue to follow our passion with a focus and dedication, we can not only achieve what is set out in this report, but much, much more.

**Alderman Peter Estlin**
**The Right Honourable The Lord Mayor**

# b. Executive Summary

*By Sam Tidswell-Norrish*

Since 2017, the 690th (Sir Charles Bowman) and 691st (The Rt. Hon. The Lord Mayor, Alderman Peter Estlin) Lord Mayors have led the Digital Skills Working Group – a diverse group of industry leaders from all areas of Financial Services – representing various sub-sectors including Banking, Capital Markets, Asset Management, Insurance, Technology, Trade Associations, Academia and Investment Firms. While discussions were wide-ranging as objectives were set, one of the core pillars centred on how the United Kingdom could further catalyse its own vibrant investment centre, in a similar fashion to Sand Hill Road on the West Coast of the United States.

To assess how the UK could attract more venture investment capital, the Group sought to ask the international investment community itself. Through a survey to over 100 venture capital (“VC”) investment firms (the “Survey”), the Research Project was born.

Following the Survey, a roundtable discussion with investors was hosted during FinTech Week in London. This report is the output of these efforts and includes the findings and clear recommendations to move forward. The wide-ranging contributions to this report have taken considerable time to form, leveraging a broad network of contributors in key areas and adjacencies of the global investment industry.

With great thanks to all those who contributed, we welcome and look forward to feedback on the recommendations and views expressed in this report, each seeking to boost the UK’s VC investment landscape.

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# II. Global Trends & 'State of the Nation'

## a. A Global Perspective: What Makes A Region Attractive to Investors

*Contribution by Hogan Lovells – Richard Diffenthal, Charles Jemmett and Mounir Haddad*

*This article explores what makes a region attractive to investors, including a particular focus on the United Kingdom and the factors that have enabled the UK's venture capital market to flourish.*

**Good Neighbours**

Sand Hill Road has long been held out as the epicentre for venture capital – this has been in no small part due to its location in the heart of Silicon Valley. Silicon Valley became the renowned and dominant centre for innovative technology companies through, amongst other factors, its historic ties to the military-industrial complex (and the research and funding that supported that sector), its proximity to top US universities and the explosive growth of tech companies through the latter half of the twentieth century; all of which mean the region has become a magnet for tech founders and investors. The continual attraction of like-minded entrepreneurs to the area also means it has developed a phenomenal 'business infrastructure' suitable for any aspiring entrepreneur; the location is a cluster of high-quality business connections, funding opportunities and professional support.

Whilst the US continues to lead the way in terms of the size and sophistication of the VC industry, the UK has developed into one of the world's largest markets for VC in terms of both volume and value of deals. The British Private Equity & Venture Capital Association notes that, within its members, Venture Capital fundraising topped £1 billion in 2018 whilst growth capital funds brought in more than £3.5 billion. This growth has been accelerated by the UK's continuing innovation in financial services and technology, which has seen the UK crowned as the undisputed FinTech capital of the world.

**Why is the UK attractive to venture capital investors?**

Whilst London remains a major VC hotspot, out of the 17 UK unicorns (the highest concentration in Europe), seven are located outside of London – this is testament to the depth of talent, innovation, entrepreneurship and grit of founders across the country, which sits alongside a vibrant funding ecosystem and progressive tax and regulatory approaches.

The UK government and regulatory authorities have been highly proactive in offering incentives to both investors and start-up / scale-up entities in the venture capital space. Initiatives such as the Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trust Scheme offer investors access to significant tax reliefs and have led to a boom in early stage funding. Similarly the UK has embraced crowdfunding, being the most active crowdfunding country in Europe;

individuals enjoy the control they have over investment choices and are seeing greater returns than more traditional investment options, whilst entrepreneurs are gaining both an indication on market approval and access to funding to which may be otherwise unavailable. The UK also set up its own innovation agency, Innovate UK, which, according to the UK government, has helped create 70,000 jobs and added £16 billion in value to the UK economy over the last 12 years.

From a regulatory perspective the Financial Conduct Authority ("FCA") has long been seen as one of the most progressive and innovative regulators, having championed initiatives such as:

- Project Innovate - launched in 2014, the project is the FCA's umbrella for all its innovation services, with an emphasis on providing dedicated advice and tailored regulatory support;
- FinTech bridges - the FCA was one of the early pioneers (alongside Singapore) of the FinTech bridge; enabling UK FinTech companies to gain easier access to other markets (and investment from other markets) within the bridge network; and
- the regulatory sandbox - which has recently announced its fifth cohort and has provided an invaluable testing ground for companies to identify and correct flaws and regulatory challenges associated with their business.

Combined with a supportive regulatory environment, the UK has an abundance of talent (founders, employees and investors) which is, in part, reflective of the UK's various highly ranked universities, as well as a technologically savvy and engaged society. According to Statista, the UK currently ranks first in the world by percentage of the population who own a smartphone and fourth in global e-commerce revenue.

**Strength in a sector**

The ability for a location to develop strength in a certain sector is often a catalyst for investment to feed into related sectors – in the UK, the combination of capital, technology, talent and government policy has created an environment where FinTech has thrived. This in turn has led to a sharp focus by corporate venture arms of multinational banks taking a keen interest in the UK FinTech scene - we have advised a number of clients on a wide range of investments in businesses developing open banking apps, algorithm-based investment managers, anti-money laundering software for cryptocurrencies and cutting edge SaaS providers. The deals themselves ranged from early stage seed investments to pre-IPO rounds.

**Where can the UK strengthen?**

Despite strong growth in early stage rounds, there remains a gap in post-Series B rounds, which forms a relatively low percentage of VC deals in the UK. Whilst the government and UK managed funds are taking steps to try and ensure that there is greater capital available for scale-up entities and those who have already undertaken early stage VC rounds (e.g. The British Business Bank (a government-owned business development bank which supports smaller business) launched the British Patient Capital (BPC) in 2018, to enable long-term investment in start-ups and the British Growth Fund) much of the late stage capital in UK FinTechs is coming from international investors, primarily from the US and Asia.

**What challenges lie ahead for UK VC?**

While venture capital has become a key driver of the UK's wider economy, the uncertainty and potential impact of Brexit remains a significant concern for the future; material concerns relate to a potential loss of talent and ability to seamlessly transfer data across the EU as well as passporting rights for those in the financial services sector. UK start-ups may face additional cost barriers as a result of the potential need to set up EU hubs to reduce the impact of EU tariffs. However, the UK, with its world leading financial services and thriving technology environment, has shown itself capable of responding to challenges and will continue to support growth, jobs and investment to ensure that the UK remains a global venture capital powerhouse.

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The UK is the leading global FinTech hub with a thriving ecosystem and international talent pool spanning the whole country. With an increasing number of FinTech firms exporting globally from the UK, we are continuing to set the global standard on the application of technology, and more broadly, innovation in financial services.

The Rt Hon Elizabeth Truss MP - Secretary of State for International Trade and President of the Board of Trade

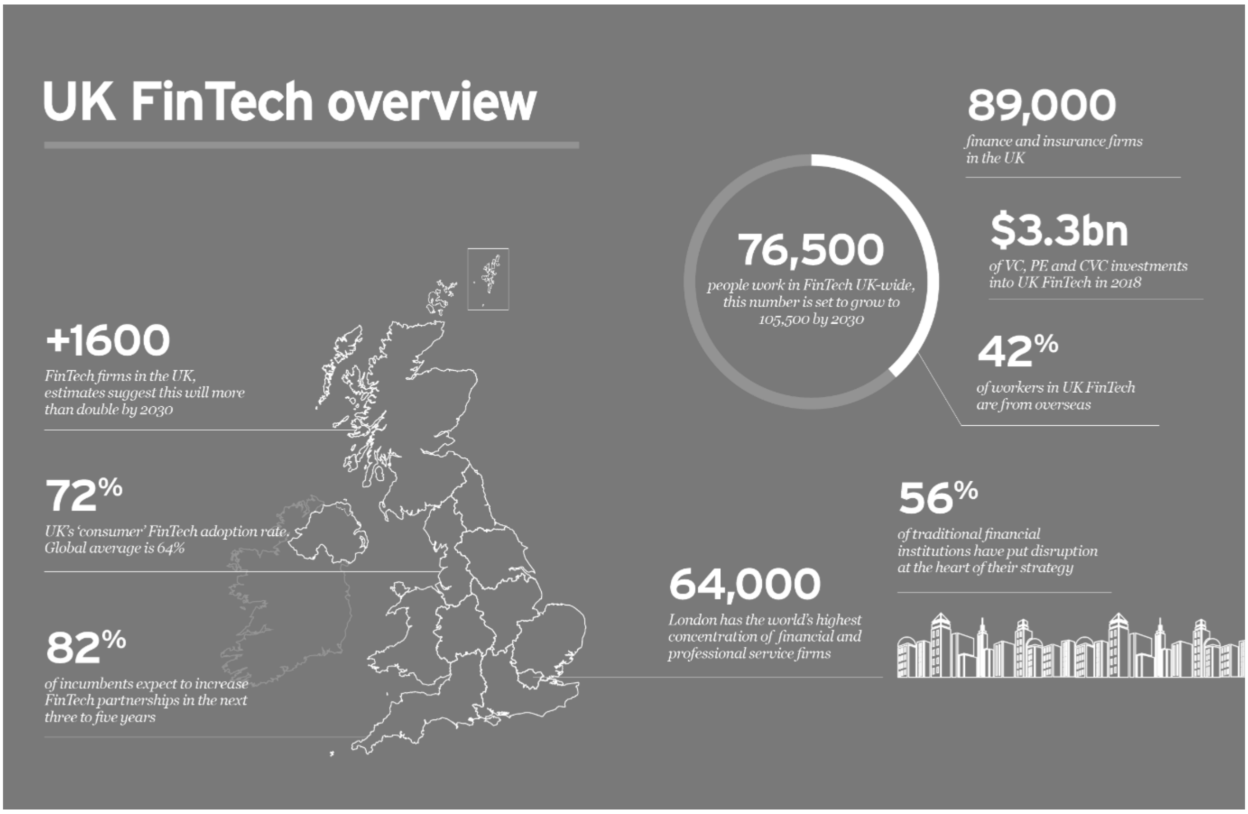
# b. The UK as FinTech Centre of Excellence

*Excerpts from the UK FinTech State of the Nation Report*

The performance of the UK digital tech sector has been world-leading, with British firms attracting more capital than any other European country. Our great strength in technology and innovation, built on the UK's excellence in R&D and creative thinking, is demonstrated by the breadth of tech activity right across the country, and the powerful networks being forged by the next generation of entrepreneurs.

The UK has long been at the forefront of financial services. However, in more recent times, the sector's positive response to the fourth industrial revolution has truly set us apart. The perfect storm caused by growing technology demand, right touch regulation, and customer empowerment in financial services, coupled with the sector's response to the financial crisis, has fuelled FinTech's rapid growth in the UK and its expansion globally.

The UK is the leading global FinTech hub with a thriving ecosystem and international talent pool spanning the whole country. With an increasing number of FinTech firms exporting globally from the UK, we are continuing to set the global standard on the application of technology, and more broadly, innovation in financial services.



### The UK as a Tech Centre of Excellence

Digital tech companies in London are the most connected in Europe, second only to Silicon Valley for international connections. 25% of entrepreneurs across the world report having a significant relationship with two or more entrepreneurs in London, compared to 33% for Silicon Valley.

Tech skills are being used across a diverse range of sectors aside from technology, including financial services, professional services and architecture and engineering. Using LinkedIn data from the UK's 23 million members showed that 2.2 million people claimed to have tech skills in their profile.

Increasing levels of investment into the UK's FinTech industry show that the industry is going from strength to strength. The UK remains Europe's best destination for FinTech investment and the increasing levels of later stage growth capital being deployed suggest the industry is maturing at an unprecedented rate globally. The success of the UK's FinTech sector proves that there is no better place to innovate and invest in the future of financial services.

### Regulation

The regulatory response in the UK to FinTech in some ways has mirrored the journey of start-ups and incumbents – it has been one of experimentation, adaptation and an attempt to align the new world to the old. However, the overarching regulatory commitment to foster market competition has delivered an environment that has supported the UK FinTech success story.

The focus of UK government support for FinTech has been creating a positive regulatory environment for FinTech. The UK's main financial services regulator, the FCA has been given a strong competition objective, which led to them establishing an Innovation hub and Regulatory Sandbox. The

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> Financial services is a key sector of the UK economy and so the government has invested heavily in ensuring that we are also at the forefront of this revolution. This investment has paid off, the UK has been independently assessed as the best place in the world for FinTech, and the government is committed to ensuring that this remains the case.

The Rt Hon John Glen MP - Economic Secretary to the Treasury

### Capital

The UK is the home of European enterprise and investment. We have the most mature and highly developed funding ecosystem in Europe, connecting entrepreneurs and investors along an innovation chain which is supported by strong government backing, world renowned scientific and academic institutions, and a rich support infrastructure. From business angels and crowdfunding, to venture capital and the public markets, the UK is the best and most logical place in Europe to start, run and grow a business.

Innovation hub helps FinTech firms understand the regulatory framework and provides them with assistance when they make an application for authorisation. Since 2013 the Innovation hub has provided support to over 500 businesses. The Regulatory Sandbox creates a safe space for firms to test revolutionary new products, allowing them to serve real customers, while ensuring that risks to both customers and firms are well managed. Since 2016 almost 100 firms have tested products in the sandbox.

The UK is at the forefront of efforts to develop and implement Open Banking. Open Banking allows firms to offer innovative solutions to consumers, from better financial advice, to cheaper loans. The standardisation that sits at the heart of the UK's Open Banking project, and differentiates it from similar activity in other jurisdictions, also makes it easier and cheaper for FinTech firms to build these services and improves the quality of the products they can offer consumers. Open Banking also allows consumers to make payments without needing to use a credit or debit card.

**Talent**

The UK is one of the world's leading FinTech hubs and access to talent has played a critical role in the success of the UK's FinTech sector to date. The UK's traditional strength in both financial services and technology has created a compelling commercial environment for FinTechs and has ensured access to a large pool of skilled people.

There have been a number of key strategic and tactical actions being taken to ensure that FinTechs who choose to set up their businesses here are able to attract the best candidates from within the UK and internationally.

- The UK has a high density of top ranked post-secondary education institutions, with London alone home to four of the top 30 ranked universities in the world.
- The UK is introducing specific FinTech courses, apprenticeships, and sponsored work placements to strengthen the FinTech talent pipeline.
- The UK government has undertaken specific steps towards improving education curricula to align more closely with the needs of industry employers, promoting STEM (Science, Technology, Engineering, and Mathematics) programmes throughout the education system.
- The prominence of FinTech accelerators across major UK cities, has played a significant role in attracting and retaining progressive start-up talent.
- Many larger employers in the UK are offering technical training to upskill their current employees as they future proof their business in the face of digital and technological change. FinTechs will benefit from the pool of skilled talent this creates.
- A number of organisations have developed FinTech related programs and events in order to attract and grow the skills of available talent within the UK FinTech ecosystem.

**Report Overview**

The FinTech State of the Nation is a comprehensive summary of the UK's FinTech industry to help inform stakeholders for trade and investment and demonstrate the UK's attractiveness as a FinTech destination. The report convenes knowledge and perspectives from industry leaders across the domestic FinTech ecosystem. This collection of expert views broadly covers the UK's past successes, current state, and future objectives in key areas that include demand, capital, regulation and policy, and talent.

## Key milestones

2008 2009 2010 2011 2012 2013 2014 2015 2016 2017 2018 2019

### Financial Crisis

*Global Financial Crisis created an impetus for numerous regulatory reforms and a shifting public perception towards financial services, creating an opportunity for new, competitive players to join the market with a technology-first approach.*

### FCA's Project Innovate Launch

*The purpose was to help firms tackle regulatory barriers to innovation, be it through clarifying regulatory expectations, examining the FCA's own rules or enacting policy changes. This in turn, provided firms the space to innovate in the interests of consumers.*

### Innovate Finance Launched

*Founded in August 2014, Innovate Finance, an independent membership organisation, formed out of a government consultation to represent the FinTech sector and promote FinTech member companies. The Innovate Finance Global Summit was also launched as a flagship event to convene the global FinTech community to the FinTech capital of the World, London.*

### Launch of FCA Sandbox

### Launch of FinTech North

### First FinTech Bridge

*Singapore was the first FinTech bridge. There are now 5 bridges with Singapore, China, Hong Kong, South Korea and Australia.*

### Retail Banking Market Investigation Order

*The Competition and Market Authority published the Retail Banking Market Investigation Order requiring the nine largest banks in the UK to build standardised systems that allow consumers to safely and securely share their financial information with FinTech firms.*

### Launch of UK Open Banking and PSD2

### British Patient Capital (BPC)

*The British Business Bank announced the launch of British Patient Capital (BPC), a £2.5 billion investment vehicle to help innovative UK startups become world-class leaders through long-term investment by investing in venture and growth capital funds. By investing alongside the private sector, British Patient Capital will support £7.5bn of investment for British businesses.*

### Launch of HMT FinTech Sector Strategy

*The government's first FinTech Sector Strategy, launched in March 2018, set out its plans to maintain and extend the UK's comparative advantage in FinTech.*

### Launch of FinTech Wales

### Launch of FinTech Scotland

# c. The Investment Case for Talent & Diversity

*Contribution by Erevena –*
*Maria Josife and Ben Erskine-Hill*

Early stage venture backed businesses rely heavily on their people to enable success. It is therefore at the centre of thought for many businesses when thinking of where to build headquarters and where to build functional expertise to give best access to talent. From an investor perspective, it is equally as important, knowing their portfolio will be able to achieve scale by hiring from a rich pool of talent. The UK remains the leading European hub for digital talent and has consistently been recognised by many international businesses looking to invest in Europe as the 'land and expand' launchpad from which to build. This is also true of continental European businesses looking to access top talent – in many cases establishing a UK office to attract talent without requiring a relocation.

The ecosystem of talent is what has enabled San Francisco and more broadly the US, to remain at the forefront of top talent. This is in part due to the investment lifecycle and successful exits of multiple businesses which is then reinvested both in the form of capital and as talent into the ecosystem. This circular flow ensures continual development, access to great opportunities and enablement of further success. The level of capital available at all stages of growth is also a major enabler of this success. This ecosystem is certainly developing and growing in the UK with more businesses reaching 'unicorn' status and, in many cases, listing. This is incredibly important to top talent when looking to settle, ensuring they have access to great opportunities and an ecosystem supporting continued growth.

The UK is still able to attract top talent from a global source pool, pulling in the best and most qualified at all levels. Part of this is due to access and company sponsorship, but more could be done to highlight the various visa options that exist for international entrepreneurs and for those moving to the UK from abroad. The UK continues to host many of the best global events within venture and the funds are building a greater international reputation which strengthens views on the market. Larger rounds of funding are starting to take place and more businesses are expanding from the UK to Europe, US and Asia both accessing great talent and advertising the UK's strength.

For the UK to retain its status as the talent hub for Europe, and compete on the world stage, it is important to continually develop the calibre of individual at management level within the most successful European venture-backed businesses. Many searches conducted for UK business at a later stage looking for great top talent are global in nature due to the lack of experienced talent within the UK, compared to North America. Across product, technology and engineering there is still a far larger pool of talent in 'The Bay Area' than in Europe. Executives often also bring deeper experience of developing products for delivery at scale in the US. Recruiting benefits from the network effect, whereby you might hire a single engineer and before you know it, ten people have moved over to join them, are starting to be seen in the UK. However, is still early in genesis versus the US.

To counter this, the UK needs to continue investment in the education and development of talent. This needs to come from schools, through universities and beyond. The available programs in universities across the UK continues to grow and reflect the innovation being seen in business. It is also well catered for foreign students, drawing great international talent to study and ultimately seek employment following graduation in the UK. Attracting top talent globally into senior management and leadership positions in the UK will inspire more junior members of a business.

This, combined with great education, needs to continue to be the case, especially with the looming 'Brexit' there is the additional complexity on drawing nearshore talent to the UK, so we need to rely heavily on what exists here.

There are certainly the foundations in place for the UK to create a Sand Hill Road from a talent perspective. Talent has been a key agenda for many venture and growth funds with a large percentage of tier-1 funds offering this as a service to their portfolios and being a key sell point through a pre-deal process. The UK is following suit with many funds now building talent functions internally both to develop their own portfolio network and enable networking across the portfolio businesses, but also to ensure they build their own pipeline of high calibre talent, which may exist globally.

# III. Survey Research Findings & Analysis

*By Emma Glyn and Alistair Lyons*

London is on the path to becoming the innovation capital of the world. The city's global connectedness, its cultural richness and diversity and its attractive tax incentive schemes are key factors that have elevated the UK's early stage investment community to global player status. Yet there is still a journey ahead in building our own Sand Hill Road in London. In response to the Survey, VCs called for a centre of innovation and investment in the city (a single convening point for investors, incumbents and entrepreneurs). Some VCs alluded to a lack of cohesion in the investment community as many strive to differentiate themselves in a competitive environment. There was also a call for more regulatory certainty post-Brexit to ensure the UK remains an attractive and accessible destination for top talent from around the world.

2019 has been a record year for venture capital investment into the UK, with London receiving the lion's share of investment, and has raised the UK's status as an investment and innovation powerhouse on the global stage. In the first five months of 2019, venture capital investment into UK technology companies defied expectations amidst the turbulent political and economic climate by reaching over £3.8 billion ($4.8 billion). This is on track to eclipse 2018, another record year, in which UK technology companies received £6.3 billion ($8.0 billion) of venture capital investment, more than any other European country.

London's **global connectedness** has played a vital role in supporting the health of the UK's investment landscape and has bolstered its attractiveness for top talent as a place to live and work. The rise in digital technologies has enabled people and companies to stay connected across different time zones and locations, unlocking new remote and flexible working patterns. However, the power and importance of face-to-face communication should not be underestimated. Most VCs in the Survey highlighted London's convenient time zone, accessible location and proximity to Europe and potential investment opportunities as primary reasons for setting up shop in the United Kingdom.

Alongside its global connectedness, London's **cultural connectedness** is another feather in the city's cap that has enabled it to attract leading talent. Key to successful innovation is diversity and London is truly a city of the world. With over 200 languages spoken on its streets, London is home to one of the most ethnically diverse populations in the world. The city beats with a sense of self and resilience, largely as a result of its 2,000-year history, its world-class academic, legal and financial institutions and its highly educated workforce. This unique fusion of legacy and homegrown innovation and talent with the city's great dynamism and openness, has created London's cultural richness and has been a key reason for VC funds to set up shop in the United Kingdom.

London's status as the world's leading global financial hub is also supported by a rich history of financial innovation and openness. Most notably, Margaret Thatcher's "Big Bang" in 1986 and the resultant deregulation of financial markets created a meteoric boost in economic growth and job creation and paved the way to the city's open and global approach to financial services. London has since become synonymous with free market principles, supportive regulation and innovation and has benefited from an influx of global talent and a proliferation of new products and technologies. This **progressive regulatory environment** has been a key driver of venture capital investment into the UK. Most of the VCs that participated in the Survey highlighted the tax advantages and incentives associated with the UK's venture capital schemes (most notably, Seed

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London is on the path to becoming the innovation capital of the world. The city’s global connectedness, its cultural richness and diversity and its attractive tax incentive schemes are key factors that have elevated the UK’s early stage investment community to global player status.

Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS)) as huge drawcards for investment into the UK.

Yet there is still way to pave in building our own Sand Hill Road. The Survey revealed areas in which London is lagging its global peers (notably Silicon Valley and New York). Whilst known for its supportive regulatory and policy framework (particularly relating to tax incentives when investing in start-ups), VCs flagged the need for policy and tax incentives to **encourage fund investment from local LPs**. The availability of capital from UK-based LPs remains a challenge and the origin of a VC's LP base has significant influence on the regions in which it invests, and the time spent on assessing investment opportunities. Creating a channel for seamless and efficient investment by UK-based LPs is therefore an imperative.

Inevitably, a common thread in responses to the Survey highlighted Brexit uncertainty as a key factor that is influencing decisions to invest in the UK. Political uncertainty and the resultant regulatory implications for **talent and employment policy post-Brexit** is a significant concern for VCs. In particular, the UK's immigration and visa policy for financial professionals and entrepreneurs alike remains unclear to VCs and is a major impediment to setting up shop in the UK. Analysis by the Entrepreneurs Network, a think-tank, showed that 49% of the 100 fastest-growing companies in the UK have a founder born overseas. Furthermore, the Global Entrepreneurship Monitor found that 12.9% of immigrants were early-stage entrepreneurs, compared with just 8.2% of UK-born citizens. These figures highlight the importance of policy certainty when it comes to skilled migration and access to talent in building our own Sand Hill Road.

Finally, the UK needs to do more to foster **innovation-driven entrepreneurship**. Several VCs highlighted a lack of entrepreneurial spirit and appetite for risk in the city, relative to other global technology hubs, as well as a need for physical infrastructure developments (such as a city innovation hub or a central start-up facility) to drive this entrepreneurial mindset and foster innovation. VCs noted that, relative to other global innovation hubs, start-ups and entrepreneurs struggle to gain the exposure, talent, contacts and, most importantly, the investment required when working in isolation. Furthermore, there is a lack of productive partnerships and a spirit of collaboration between incumbents and rising start-ups. According to VCs, these factors and the absence of a single innovation centre hinder the ability for London start-ups to commercialise and scale in comparison to their counterparts in the United States. This, in turn, limits the availability and quality of larger early-stage investment opportunities (post-series B stage).

# IV. USA – Our Special Relationship

## a. Foreword by DIT Consul General & HM Trade Commissioner for North America, Antony Phillipson

In recent years the UK has worked hard to set what many regard as the gold standard in FinTech, rooted in a strong partnership between industry, trade associations, government and regulators.

We are determined to ensure that the UK remains the most diverse and vibrant investment location for FinTechs. I hope that companies across the US will let me or the DIT team in their region know how we can help them realise their growth ambitions.

This is backed up by the data. Investment in FinTech experienced record-high levels in the UK last year. In fact, the UK accounted for over half of the total global investment in this sector, reaching close to $26 billion, according to a recent report by KPMG. And the UK was home to 25% of the global “unicorns,” including giants like Revolut, Monzo, and TransferWise.

The bottom line, which is what really matters, is that venture capital investors across the globe know that the UK FinTech ecosystem is rich with opportunity. Four of Europe’s top ten deals of 2018 happened in the UK. This momentum continued into 2019 with OakNorth’s $440 Million in fundraising, led by SoftBank Investment Advisers, setting the record as the largest UK FinTech startup round. Innovate Finance reported a growth of 18% in VC and private equity investment into UK FinTech firms last year, reaching a record high of $3.3 billion, a record we expect to surpass in 2019.

US companies have played their part, heading to the UK market to take advantage of an industry now contributing £6.6 million to the UK economy. Many of the top US FinTech companies and VC investors have recently established new bases of operation in the UK. There are now over 76,500 people employed in FinTech in the UK, buoyed by our supportive regulatory environment and demand for innovation, placing the UK ahead of the pack.

Here in the US, the UK Department for International Trade’s Financial Services team is focused on helping firms of all sizes seize the opportunities in the UK market. We do this by creating bespoke trade missions anchored around industry-specific conferences, curating high-level roundtables with US and UK regulatory stakeholders, managing relationships with the VC and capital markets communities in both countries, and engaging closely with strategic FinTech community hubs and associations across the US. Additionally, American venture capital firms that are keen to diversify their investments in the UK can work with the DIT Capital Investment team to learn more about how they can support fundraising for UK growth capital companies via direct investment or co-investment with UK funds.

We are determined to ensure that the UK remains the most diverse and vibrant investment location for FinTechs. I hope that companies across the US will let me or the DIT team in their region know how we can help them realise their growth ambitions.

## b. QED Investors: ‘Why We Opened Shop in the UK?’

*Contribution by Yusuf Özdalga,*
*QED Investors (London)*

This summer marks the second anniversary since I joined QED Investors to open our London office. In those two years we have already created or invested in six UK companies that are all growing rapidly. Those of you on top of current events will have noticed that our decision must have been made after the by now infamous 2016 Brexit vote (and, yes, I was able to hold on until the third sentence of this article to mention the B-word).

So why did one of the leading FinTech funds in the US and Lat Am, having invested in six out of the top ten fintech unicorns in America, choose to open an office in the UK in the midst of all the Brexit noise and drama? While answers to questions such as this are always subjective and open to interpretation, as the head of our UK office, my view is that there is a set of obvious answers that are underpinned by more fundamental reasons.

In terms of the more obvious answers, first and foremost, London is geographically connected to the rest of the world in a unique manner. Sitting in London, one is simultaneously a manageable flight away from Mumbai, San Francisco, and Sao Paolo. More importantly, it is possible to have a video conference call with any of the aforementioned cities within the span of the same business day. This is the classic time zone advantage that is often attributed to London.

Moreover, London is also culturally connected: From sports (think football or tennis) to literature (Shakespeare!), the UK is connected to the rest of the world in a number of complex and subtle manners. One just has to walk the streets of Soho, Piccadilly, or Mayfair to witness this. On any given street corner, you can find people from Argentina to Zimbabwe talking to each other about and exchanging ideas in English, the Lingua Franca of the modern world.

Secondly, from a VC perspective, the crucial ingredients that a venture capital ecosystem needs are all present in London in spades: Access to ideas, capital, talent, and markets and are all available more so than any other European capital. All these classic reasons that make London a natural destination is also supported by economic facts. More venture capital was deployed in the UK than in any other European country in 2018, London is the largest foreign exchange trading market in the world, etc.

However, beyond these more traditional answers there are more fundamental reasons that have catapulted London to the position it occupies today. After all, from the perspective of Marcus Aurelius close to two millennia ago, London would hardly have seemed a central and connected place as he was travelling from Rome to Cairo to meet Cleopatra. So, what are the reasons that made London so central to the modern world over the subsequent centuries, and how do they relate to venture capital?

While I am no historian, I did receive a Master’s degree from the University of Chicago, and in my own humble view, the first fundamental factor that set (and continues to set) the UK apart is the value it places on individual freedom and enterprise. This has resulted in a legal and regulatory system that is market friendly, while valuing intellectual property and innovation as well as free speech and thought. It is also closely intertwined with a long history of stability: The United Kingdom is one of the few countries in the world that have had continuous democratic governance over several centuries.

The second, and equally important reason is tolerance. This is in part driven by the centuries of experience the UK has in successfully integrating diverse cultures and has yielded big dividends today in terms of diversity and a society that values mutual respect. While I have witnessed successful and well-educated expat friends of mine living in other European capitals facing difficulties renting accommodation on account of what appears to have been nothing other than their names (incidentally Shakespeare’s Juliet has an appropriate quote about this), the tolerance and acceptance of London has stood out in contrast. And tolerance in the UK extends to everyone, including the non-digitally native workers that feel frustrated at having been left behind a rapidly evolving world. The UK clearly realizes that to have a well-functioning society, the needs and constraints of everybody have to be represented and balanced, which is a complex and ongoing process.

The third fundamental reason is that, the combination of tolerance and individual freedom has consequently resulted in the UK being able to attract and nurture creative communities in areas as diverse as technology, art, science, and media. Balancing creativity in areas as diverse as arts and Artificial Intelligence is not easy. And of course, it is this creativity that makes London and the UK fundamentally attractive for venture capital. It attracts the right kind of people and capital from across the globe, resulting a vibrant ecosystem.

While those are the reasons that have made London an attractive destination, last but certainly not least, one should also mention that the founder of QED, Nigel Morris is a Londoner (I know, I probably should have mentioned this at the beginning). While he moved to the US thirty-five years ago and co-founded Capital One which is now a top-ten publicly listed US bank, he still maintains a pied-a-terre in London as well as season tickets to Tottenham Hotspur (and he was willing to share said tickets with yours truly until I professed my support for a rival club in SW6).

So, I suppose in the end, determining why QED came to London is a classic example of historical analysis: big historical forces juxtaposed with the vision and values of individual actors. All I can say is that I am happy to be where I am, and excited about the future, both for London and the community of creators that call it home.

## c. What Made Silicon Valley the Legendary Hotbed of Investment and Innovation?

*Contribution by Jacob Whitish, Department for International Trade (San Francisco)*

**A Legacy of Entrepreneurs**

In the early 20th century, Stanford University built a 660-acre industrial park and gave long term leases to high tech companies. Stanford spinout, Hewlett-Packard (HP), was one of those first tenants to occupy the space and begin experimenting with new ways to build electronic test equipment. While generating income for Stanford, this move would also put into motion the events that began to concentrate tech talent around the Northern California university. Then, in 1957, Fairchild Semiconductor was founded by ex-employees of HP in nearby San Jose, California to start manufacturing silicon circuits - leading the charge to help give the area its now-world-famous moniker: Silicon Valley. These early forebears of the technical industry would inspire generation after generation of wealth and talent to create the innovation and entrepreneurial ecosystem that Silicon Valley would become. Among this next generation of entrepreneurs was also the storied venture capital firm, Kleiner Perkins, which pioneered the current model of venture investing at all company stages and would fuel the tremendous growth that would later be the signature hallmark of Valley companies.

One of the often-overlooked factors that initially spurred the valley to tech prominence was the role that the space race and the US Department of Defence played in that initial development. In no small stroke of luck, Sputnik was launched just three days after Fairchild was incorporated. The resulting flood of technical research required to catch up with the Russians was overwhelmingly financed by the DoD, and Fairchild along with the other young tech companies of the Valley were the lucky recipients. As time passed and the Cold War took root, the US government again funnelled resources into the Valley as a means of retaining technological superiority. While government funding of research was not new, the method used to disburse these funds was. Contracts were issued via a privatized, decentralized system that benefitted, in particular, the kinds of small start-ups that thrived in the shadow of Stanford University. It didn’t stop there: a generous tax break implemented in late 1958; abolition of non-compete clauses in California contracts; and a subtle change in the laws which allowed pension funds to allocate money to venture firms, all led to the creation of a unique and flourishing ecosystem.

**The Mindset**

Just having the right laws, talent, and incentives in place wasn’t enough on its own - the Silicon Valley mindset is what set it apart: the conviction that through technology you could change the world; the instinct to share lessons learned; and a culture of embracing and learning from failure. And that uniquely Silicon Valley mindset can be traced back to the spirit of the Bay Area in the 1960s.

It’s 1964. The Beatles just released ‘All my Loving’, the USA goes to war in Vietnam, the Civil Rights Act is signed by President Johnson, and the little university town of Berkeley, California becomes the centre of the Free Speech Movement. In tracing the elements of what makes Silicon Valley, Silicon Valley, one would have a tough time not recognizing the pivotal role that this era played in shaping the minds and ethos of the tech ecosystem. The Human Potential Movement and the research undertaken at the Esalen Institute just outside of San Francisco would open society to new ways of thinking and integrate psychedelic research into the mainstream. Counterculture groups would start to destigmatize alternative lifestyles. People in the Bay started to put less stock in the traditional belief that there was a script about how life ‘should’ go. These lateral lines of thinking started to infiltrate the technical and hacker culture of the era as well, manifesting in (then radical) ideas that technology could be used for good, and that failure didn’t mean the end of a career, just a new beginning. This idealistic language still persists in today’s tech world. Just listen to a pitch at any start-up demo day to hear hopeful candidates profess to be changing the world through their app.

The Valley’s vibrant hacker culture eschewed traditional status symbols such as degrees, and embraced youth over the wisdom of age. Instead, natural intelligence and a resume of building interesting products became the indication of someone’s worth. Of course, when a group of rogues who reject traditional rules get together to build things, other philosophies will also begin to emerge: asking for forgiveness rather than permission, freedom to learn outside of academia, an idealistic notion that anyone who is able to improve upon a thing should be allowed to do so. These game changing philosophies of the 60s can be seen in today’s headlines, with Uber creating a new form of multi-modal transport without permits, Udacity and Coursera bringing education to the masses, and in Facebook’s ill-fated motto, Move Fast and Break Things. Steven Levy sums it up perfectly in his book Hackers, Heroes of the Computer Revolution: “In a perfect hacker world, anyone pissed off enough to open up a control box near a traffic light and take it apart to make it work better should be perfectly welcome to make the attempt.”. In short, bureaucracy and inefficiency became the new enemy.

**Experience and Capital**

The final component that turbo charged the Bay Area to become ‘The Valley’, was ready access to an abundance of resources: talent, experience, capital, and infrastructure all combine to create an incubator for extraordinary tech companies. Silicon Valley entrepreneurs were thinking more boldly and in new dimensions, and at a much bigger scale, than anyone else in the world.

One trait of the valley that isn’t often found elsewhere is an abundance of experienced founders and employees who have successfully built, scaled, and exited tech enterprises. While successful founders wouldn’t be faulted for taking their hard earned reward and sailing into the sunset, Valley founders tend to stick around in the ecosystem and join other enterprises, advise the next generation of founders, or start another company of their own and do it all over again. Whether due to the unique incentives, abundance of resources, or simply because they enjoyed the culture of building new things; this has caused an abundance of ‘generational’ experience in knowing how to scale a company to a late stage exit that many other ecosystems do not have. These same individuals also tend to be more accessible than their non-valley counterparts, continuing to attend and speak at events, mentor the next wave of founders, and create a more collaborative atmosphere than is found in many other start-up environments.

Mid and late-stage venture funding is another resource that separates the Valley from many other regions. Start-up hotspots like London are teeming with angel and early-stage investors ready to jump on the next hot company. Many countries have developed great investment programmes that have been an incredible benefit in terms of helping budding firms access smaller sums of funding when first starting out, but when those same companies grow to a larger scale and start seeking out mid and later-stage capital, they often find that options are lacking. A defining characteristic of tech companies is their ability to quickly scale, this also means that to be successful and remain in their home jurisdiction, they need access to experienced investors at all stages of business. Fortunately, this is an opportunity that can be capitalized on and encouraged to develop through both public and private means.

**Can it be Replicated?**

Recreating the ineffable blend of ingredients that met in a confluence of technology, mindset, and revolutionary history may not be replicable in its exact form, but perhaps a new community with its own special traits, characteristics, and ethos could be developed. Technologists of the Valley constantly live five years in the future, imagining and designing the world of tomorrow without concern of failure and a code of constant and never-ending improvement. The clusters of deep expertise and seemingly endless supplies of investable capital fuel growth at every stage, at a rate that often astounds onlookers. The great part? Much of this can be developed and engineered. Demonstrating to foreign investors that excellent companies exist at each stage of the venture investing lifecycle will encourage further foreign investment at later stages. Incentives can be created to keep founders and talent in market. Each tech hub will inevitably have its own flavour and its own character developed from the regions and history that they spring out of; this should be seen as an advantage rather than a failure and be encouraged to develop. Perhaps the more difficult part will be to normalize and accept failure by the greater community each hub exists within. Once that stigma is erased, however, and the other components mentioned are in place, a formidable tech community will begin to rise that challenges even the great Silicon Valley.

# V. Recommendation Framework – Forging Our Own Sand Hill Road

The findings of the Survey and the contributions made to this report provide a broad path to building our own Sand Hill Road. There are three main pillars that support the Recommendation Framework of this report: Regulation & Policy; Talent; and Infrastructure.

**Regulation & Policy – Encouraging Investment & Innovation**

The UK has made significant progress in promoting retail investment in start-ups through tax incentive schemes such as EIS and SEIS. Through its Industrial Strategy, the UK Government has also made advances in encouraging investment in research and development (R&D) and innovation, particularly through measures such as the R&D Tax credits scheme. The regulatory foundations are set. However, further work is to be done to support and encourage innovation and entrepreneurialism whilst promoting investment by UK-based investors and incumbents. A defining characteristic of successful companies is their ability to scale at pace and to do so, access to local and international investors and strategic partners at all stages of business is an imperative. The availability of capital from UK-based LPs remains a challenge for VCs and has significant influence on a fund's ability to invest in UK companies. We need to build on our current incentive schemes and initiatives (such as the British Patient Capital and British Growth Fund) to provide additional incentives for local investors and LPs to invest in innovative companies (at all stages), directly and indirectly through VC funds. We must also encourage corporate partnership and corporates to invest in external innovation. Can similar types of incentives for retail investors be applied to corporates to encourage this?

**Talent – Celebrating our Founders**

The UK needs to promote London as open for business post-Brexit, particularly for highly skilled professionals and entrepreneurs. To develop our own global innovation ecosystem, the UK needs to celebrate and make heroes of its founders and investors, both homegrown and from abroad, by telling their stories around the world and developing a talent program that encompasses simplified and clear visa policies. This could include the ability for entrepreneurs and investors to fast-track the visa process. It could also include the ability for recent college graduates to work in the UK for a finite period of time after leaving education in the hope of encouraging young entrepreneurs to start and keep their businesses in the UK.

**Infrastructure – Driving Entrepreneurial Spirit**

There is a need for cohesion and a convening voice for the entire investment ecosystem, from entrepreneurs to investors, under one roof in order to centralise talent, ideas, opportunity and funding. Forming an innovation and investment hub in the heart of London, as the obvious meeting point for entrepreneurs, domestic investors, international investors and incumbents, would drive an entrepreneurial mindset city-wide, support productive industry partnerships and unlock channels for start-up growth. This could be built in collaboration with UK universities, VCs, incumbents and entrepreneurs to ensure it is a centre for all players in the ecosystem and a catalyst for investment in ideas and opportunities in the UK.

**Conclusion**

London is on the path to becoming the innovation centre of the world and is paving its way to its own Sand Hill Road that encompasses London's character and flavour. To truly succeed, the City needs to leverage its strengths and build on its current infrastructure. London's global and cultural connectedness and its progressive regulatory stance stand out to top global talent, from investors to creators.

The ability to meaningfully draw on this unique and diverse set of perspectives, skills and talent in London will set the city apart in building an innovation and investment hub not only for London, but for the world.

# Next Steps

The detailed path to implementation of the Recommendation Framework of this report will be discussed at an Industry Workshop. The objective of the Workshop is to devise an Implementation Plan to **build the UK's own Sand Hill Road**. The Implementation Plan will include a detailed set of recommendations to the UK Government under each of the three pillars of the Recommendation Framework.

Participants of the Workshop will include representatives from the UK Government; Investors (primarily Venture Capital Firms); Early-Stage Companies; and Corporates. Focus will be placed on ensuring participants represent a broad array of industries, functions, regions and cultures in order to ensure the Implementation Plan is a convening voice for London.

If you would like to find out more about the Workshop or provide input, ideas or feedback on what you believe is required to position the UK as the world's leading innovation and investment hub, please contact:

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