

Scaling UK Start-ups at Home: The Role of Tax Incentives

Presentation to Canadian Stakeholders
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Other Funders



Who are the ERC?

<https://www.enterpriseresearch.ac.uk/>



- Funded by UK Research and Innovation (UKRI) and the Economic and Social Research Council (ESRC), the ERC has been delivering independent research to inform policy and practice on small and medium enterprises (SMEs) since 2013.
- The ERC is the leading centre of excellence in the UK for research into the growth, innovation and productivity of SMEs and has become the 'go-to' reference point for anyone looking for robust, trusted data and insights on SME performance.
- Our research covers a range of themes with the core research team being based at Warwick Business School; however, we work with a network of researchers based in a range of institutions.
- In addition to core funding, the Centre also receives support from the Department for Business and Trade (DBT), Innovate UK (IUK), Department for Science, Innovation and Technology (DSIT) the British Business Bank (BBB) and the Intellectual Property Office (IPO). The ERC also undertakes commissioned work for a range of other organisations.
- As well as furthering academic knowledge, the ERC's work equips policymakers and practitioners with a better understanding of SME growth and provides insights into many topics critical to economic competitiveness. We communicate our research widely to maximise its policy impact.

Homework Question

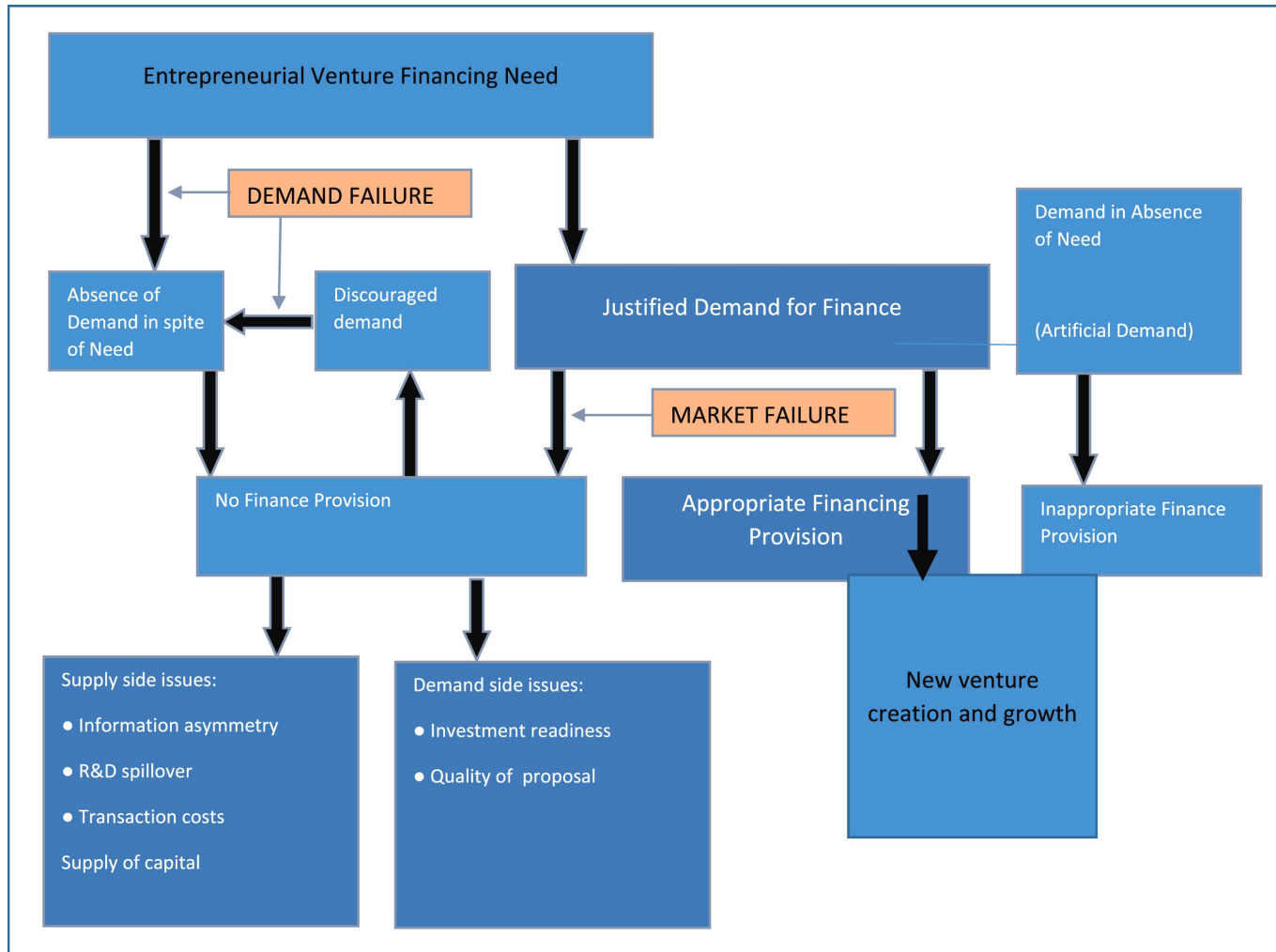


How to ‘reward’ national home-nation equity investment and prevent leakages of equity capital outside the national jurisdiction – what can we learn from the UK?

Market Failure in Early-Stage Finance



- Academic literature consistently identifies a structural “equity gap” affecting:
 - Seed and pre-seed firms
 - Innovative SMEs lacking collateral
 - Firms outside major financial centres
- Early-stage firms face financing gaps due to:
 - High uncertainty and information asymmetry
 - Lack of collateral
 - Thin venture capital markets in developing or smaller economies
- Evidence synthesised by the British Business Bank shows that angel investment and venture capital are often under-supplied without policy support, particularly below £2m deal sizes.
- Note: Market failure is a demand-side as well as supply-side issue (Harrison, 2022).



UK Government Response



- UK Government initially concerned with incentivising innovation through tax incentives by encouraging higher levels of informal and formal equity investment.
- This, it was believed, would allow experienced business angels and venture capitalists to target innovative SMEs with the highest growth potential and channel 'patient' capital to them.
- The end policy goal in this context was more innovation and indirectly more jobs and higher levels of productivity through the creation of more new technology-based firms (NTBFs) and the growth of existing new technology-based firms.
- Need policies to address this through risk-sharing with private investors via tax reliefs.

Tax Schemes

<https://www.saffery.com/insights/articles/eis-seis-vct-and-uk-investment-tax-reliefs-explained/>



- The UK tax system offers various tax reliefs intended to address the ‘equity gap’ by encouraging investment in UK businesses through innovative tax schemes:
 - Enterprise Investment Scheme (EIS),
 - Seed Enterprise Investment Scheme (SEIS) and Venture Capital Trusts (VCTs) – in existence since the mid-1990s
- EIS and SEIS address this gap by:
 - Reducing downside risk for investors
 - Increasing post-tax returns
 - Encouraging new entrants into angel investing
- Differentiation Between SEIS and EIS:
 - SEIS: Targets very early-stage firms; higher relief to compensate for higher risk
 - EIS: Targets scaling firms; lower relief but larger investment limits

Overview of the UK Model



Enterprise Investment Scheme (EIS)

Key features:

- Income tax relief (typically 30%)
- Capital gains tax deferral and exemption
- Loss relief against income

Target: growth-stage SMEs requiring scale-up capital

Seed Enterprise Investment Scheme (SEIS)

Key features:

- Higher income tax relief (typically 50%)
- Lower investment caps
- Designed for very early-stage firms

Target: high-risk, pre-revenue or early-revenue businesses

VCT (Fund-Based Model)

Key features:

- Listed investment vehicles pooling capital
- Diversified portfolios of SMEs
- Dividend tax relief for investors

Target: Broader investor base and later-stage early growth

April 2026 – updates

EIS - For shares issued on or after 6 April 2026, the annual amount a company can raise is £10m (£5m before 6 April 2026), or £20m for knowledge-intensive companies (£10m before 6 April 2026).

VCTs - From 6 April 2026, an investor can obtain income tax relief for investments in the fund at 20% on up to £200,000 investment a year (30% before 6 April 2026). This relief is withdrawn where the investor doesn't hold the VCT shares for at least five years. Dividends paid out by the VCT on investments within the £200,000 annual limit are received free of income tax, and the subsequent sale of VCT shares is free of CGT.

<https://www.saffery.com/insights/articles/eis-seis-vct-and-uk-investment-tax-reliefs-explained/>

British Business Bank

<https://www.british-business-bank.co.uk/>



- The British Business Bank (BBB) supports early-stage UK companies by investing in, and alongside, funds that utilise the Seed Enterprise Investment Scheme (SEIS) and Enterprise Investment Scheme (EIS).
- Through its Regional Angels Programme, the BBB commits capital to partner with angel networks, boosting funding capacity for companies raising under SEIS/EIS.

What does the evidence say?

- Analysis by the British Business Bank and others highlights that:
 - These schemes play a central role in the UK’s angel investment market development.
 - EIS/SEIS effectively target **sub-£2m financing gaps**
 - A significant proportion of EIS/SEIS investors report they would not have invested without the schemes (**strong “additionality”**).
 - EIS-supported firms show **positive growth trajectories**, especially when combined with follow-on funding.
 - Have improved **survival rates and access to follow-on finance**
 - Effects are strongest for young firms and innovation-intensive sectors
 - High behavioural additionality: investors would not invest otherwise, or would invest less or later – so these schemes expand markets rather than simply subsidising existing activity

Wider Ecosystem Effects

- Academic and policy research highlights that EIS/SEIS succeed because they operate within a broader system including:
 - Venture capital funds
 - Angel networks
 - Public co-investment programmes
- The British Business Bank stresses that co-investment models and tax incentives are complementary, not substitutes.

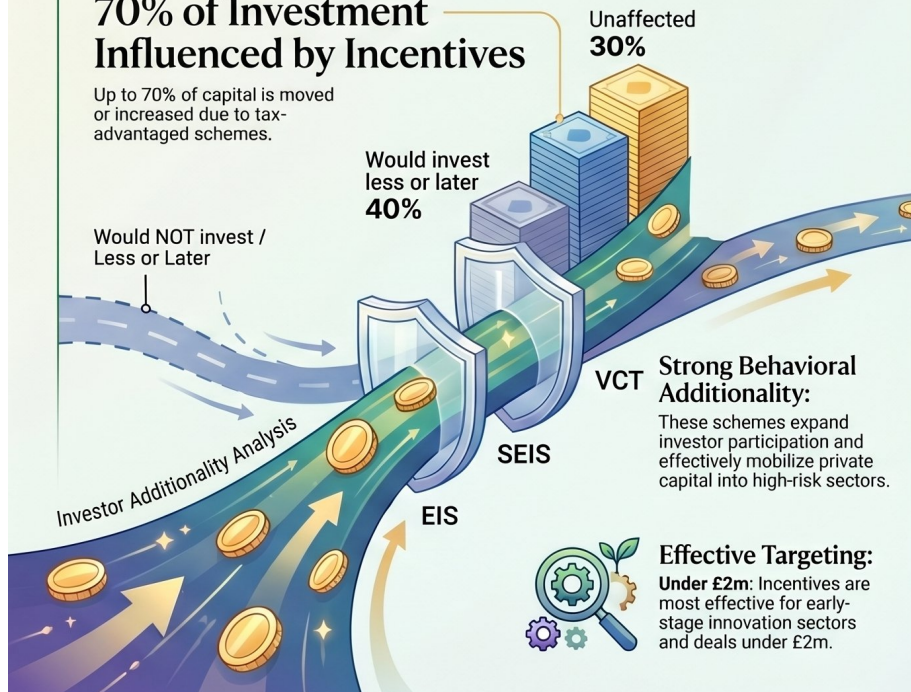
The Tax Incentive Edge: Catalyzing Investment and Growth

Demonstrating how tax-advantaged equity schemes (EIS, SEIS, and VCT) influence investor behavior and measurably improve the performance of early-stage firms.

Investor Behavior & Additionality

70% of Investment Influenced by Incentives

Up to 70% of capital is moved or increased due to tax-advantaged schemes.



Strong Behavioral Additionality:
These schemes expand investor participation and effectively mobilize private capital into high-risk sectors.

Measurable Firm Impact



+12%
Turnover Growth Uplift

Firms supported by EIS show significantly higher turnover compared to matched firms without support.



+10%
Employment Growth

Tax-advantaged support leads to measurable increases in hiring and headcount.



Better Survival & Funding Odds

Incentivized firms experience higher survival rates and increased success in securing follow-on funding.

Integration into Canada?

- Canada already supports innovation through:
 - Generous **R&D tax credits (SR&ED)**
 - Public VC via:
 - Business Development Bank of Canada
 - Provincial funds
- These reduce **innovation costs**, but comparatively weaker **retail and angel investment mobilisation tools** – i.e., lower levels of **angel investment participation** compared to the UK
- A Canadian EIS/SEIS/VCT hybrid **could** significantly expand early-stage equity finance if carefully integrated into the tax system – e.g., Federal tax incentives with Provincial ‘top-ups’.

Lessons for Canada

- Research on early intervention systems shows:
 - Uptake depends on whether stakeholders perceive the system as supportive rather than punitive
- Studies emphasise that effectiveness depends on:
 - Clear eligibility criteria (e.g. firm age, size, sector)
 - Limits on investment to prevent abuse
 - Alignment with innovation and productivity goals
- Evidence suggests that targeted schemes outperform broad-based tax reliefs.
- Implication for EIS/SEIS equivalents:
 - Tax authorities must be well-resourced to aid rapid processing times
 - Clear guidance and administrative simplicity are essential

Overall Assessment

Risk	Evidence	Mitigation
Deadweight loss	Some investments would occur anyway	Tight eligibility and caps
Market distortion	Over-subsidisation of certain sectors	Sector-neutral but innovation-focused design
Regional imbalance	Concentration in major cities	Regional targeting mechanisms
Complexity	Reduces participation	Simplified rules and guidance

Strategic Recommendations

- **Adopt but adapt:** Use EIS/SEIS as a template, not a blueprint.
- **Prioritise simplicity:** Administrative ease is critical to uptake.
- **Ensure additionality:** Target genuinely underserved firms.
- **Embed in ecosystem:** Align with venture capital and innovation policy.
- **Commit to evaluation:** Continuous evidence generation improves outcomes.

Further Reading

- Colahan, M et al., (2026) “The use and impact of venture capital schemes”, HMRC Research Report 355, February 2026. <https://www.gov.uk/government/publications/the-use-and-impact-of-venture-capital-schemes>
- Harrison, RT (2022) “Pennies from heaven”? Market failure, circuits of capital and policy support for business angels: The case of cross-border angel investment, Journal of Business Venture Insights, Vol. 17, June 2022 <https://doi.org/10.1016/j.jbvi.2022.e00311>
- Marc Cowling, Bates, P., Jagger, N., & Murray, G.(2015) Study of the impact of Enterprise Investment Scheme (EIS) and Venture Capital Trusts (VCT) on company performance (HMRC Research Report 44)
- Marc Cowling, Liu, W., Ledger, A.(2017) The UK equity gap and the role of government-supported equity finance schemes (ERC Report)
- Marc Cowling et al.(2018) Evaluating the impact of EIS on firm performance (ERC report)

Contact us



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