

Short term politics should not impact long term investment into R&D

As economic sentiment darkens around the world, with rapidly rising interest rates and double digit inflation, fund allocations are moving towards safety and away from risk. We have seen a number of U-turns on the UK Government's fiscal plans (and prime ministers), but what does this mean for venture capital (VC)?

Thankfully, the policies that were announced in Kwarteng's mini budget to support VC, were not part of Jeremy Hunt's U-turn bonfire. Investment Zones will remain, the amount that companies can raise using the Seed Enterprise Investment Scheme (SEIS) will still rise to £250,000 and the Enterprise Investment Scheme (EIS) sunset clause is still set to be removed.

Rishi Sunak is certainly a "startup-friendly" prime minister, but there is still the real risk that past Government commitments, such as R&D spending to help position the UK as a science superpower, will come under scrutiny as further cuts may need to be found in the near future. This would be a mistake, as short term spending cuts go against the patient capital required for the UK's most innovative sectors, such as deep tech.

Take quantum computing as an example, an area of deeptech that has the

potential to solve some of the world's greatest challenges. From streamlining drug discovery and battery technology, to improving targeting and prediction, trading optimisation, and risk profiling within financial services. The challenge here is that the progress of these companies requires patient capital, not just from private and institutional investors, but R&D spending support from the Government. McKinsey predicts that four key areas will be the first beneficiaries of quantum advantages; pharmaceuticals, chemicals, automotive, and finance and that there is the *potential to capture nearly \$700B in value as early as 2035*. The UK is already a leader in the field of quantum computing (including companies such as Oxford Quantum Circuits, Quantum Motion, Phasecraft) and the continued financial support is evident, given the predictions of how important this segment of the deeptech market will become. These investments are not only important, but recession proof, because their success depends on longer time horizons, which go beyond the boom and bust cycle.

Read also

University spin-outs and the best of UK R&D, a profile of Parkwalk Advisors

In periods of economic difficulty we see retrenchment of consumer and corporate spending and, with lower tax receipts, typically a re-focusing of government spending. VC investments are made across the economic spectrum so, of course, suffer the impact of lower spending. Those VCs which specialise in intellectual property (IP) and research and development (R&D) heavy sectors, often at the cutting edge of technology or even in nascent businesses, face different challenges.

Lower corporate spending is often reflected in a greater focus on efficiency, but this does not necessarily mean those deeptech businesses will see a drop in funding. On the contrary, this plays into the hands of new technology, in particular where emphasis on ESG areas often means reduced power and resource use and where the use of Artificial Intelligence and Machine Learning optimises processes. There is often an accompanying reduction in internal R&D spend so large corporates increasingly look to new businesses to deliver the innovation that they no longer invest in internally. So the value of innovative and disruptive businesses is enhanced, which should lead to an improved M&A market at a later stage.

The Covid pandemic was a very public demonstration of the importance of university research and the deeptech companies that develop and commercialise that breakthrough technology. It also showed that we need to support these companies throughout their journey to commercial success. That requires funding for an extended period of time in many cases, beyond the abilities of EIS investors.

The UK continues to punch above its weight in terms of R&D and IP and the current Government's initiatives are heavily geared to supporting and improving that position. Our universities remain highly ranked globally and are the core of that effort, so the efforts of the technology transfer industry and university accelerators, which help start, select and advise emerging spinout companies, are also key. Whilst the majority of the mini budget's policies that benefited the VC industry have been saved, we must be prepared for previous commitments, such as R&D spending, to stagnate or fall. We must also remember that the deeptech companies of today require patient capital that extends far beyond the near term risk of recession.

Martin Glen is Investment Director at [*Parkwalk Advisors*](#).

Article by MARTIN GLEN