A guide to the British Innovation Ecosystem

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Introduction

Foreword

The United Kingdom is indisputably one of the top destinations in the world for entrepreneurs and investors who want to make their mark through innovation. As a post-industrial economy, the UK occupies a key role in many global value chains – from semiconductors and processors to pharmaceuticals, from advanced aerospace manufacturing to new materials. It is one of the world leaders in education and science, opening up access to talented and skilled employees and groundbreaking discoveries. As a long-standing member of the EU, the UK has free access to the largest market in the world, reducing costs and regulatory barriers to international trade. Its stable, independent legal and political systems create a highly advantageous investment environment. Government policies encouraging innovation and research create a fertile ground for the establishment and growth of start-ups. However, until now, the sources of information on what to expect when investing into innovation in Britain – as an entrepreneur or a VC – have been disparate and disjointed.

With this in mind, we have produced this *Guide to the British Innovation Ecosystem*. This guide consists of three parts. The first part – The British Innovation Economy – provides a general overview of the advantages and disadvantages of the UK as a destination for entrepreneurs and investors in innovation, the structure of its innovation ecosystem, and its legal system. In the second part, we provide practical guidance to setting up and running a knowledge-intensive business in the UK, describing the taxation system (including the incentives available to innovative businesses and private equity investors), main regulatory pitfalls, the registration and running of businesses, and more. Finally, in the Appendix, we have listed some of the main participants in the innovation ecosystem, whose services and contact details may prove useful to entrepreneurs and potential investors.

The aim of this project was to collect in one place all of the most crucial information necessary when considering an investment in innovation in the UK. Of course, some of the more complex issues remained outside the scope of this guide, but we have tried to provide sufficient guidance to help readers understand when and where they may want to seek out more information. Ultimately, we hope to have demonstrated that the UK is an attractive destination that presents great opportunities to innovators from Russia and other countries as they seek to move into global markets in ICT, biotechnology, high-value manufacturing and other knowledge-intensive industries.

Best wishes,
Alexander Iosad, Senior Analyst
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This guide was prepared on behalf of the OJSC Russian Venture Company by Future Biotech Ventures Ltd, a limited company registered in the UK, reg. no. 08179344.

The Russian Venture Company (RVC) is a government fund of funds and a development institute of the Russian Federation, one of Russia's key tools in building its own national innovation system. RVC was established by the Russian Government on June 7, 2006. Its mission is to encourage Russia's own VC industry and boost capital of VC funds. RVC's role is that of a government fund of venture capital funds channeling public incentives to venture capital and financial support to the hi-tech sector, and of a Russian VC industry development institution.

Future Biotech Ventures Ltd is a privately owned technology consultancy operating in London and within the larger UK innovation ecosystem. It provides market intelligence and technology brokering services to companies in the UK and developing markets and facilitates the exchange of innovation management expertise between British and Russian universities. Our mission is to help bridge the gap between government, academia, and industry to create the right environment for the uninhibited transmission of innovation.

Glossary

- **AIM:** *Alternative Investment Market.* The AIM is a part of the London Stock Exchange that is open to IPOs by smaller companies – it has no market capitalization requirements or trading period limits.
- **CRO:** *Contract Research Organization.* A company that provides R&D services for the pharmaceutical and biotechnology sectors on an outsourcing (contract) basis. Larger *Contract Management Organizations* (**CMOs**) can also produce the developed drugs and devices.
- **FDI:** *Foreign Direct Investment.* The main indicator of foreign economic activity in a country, which measures the total investment from overseas companies and individuals.
- **HMRC:** *Her Majesty's Revenue & Customs.* The government body responsible for the collection of taxes. The electronic system used to calculate and collect income tax and NICs from employers is known as **PAYE** *(Pay As You Earn)*.
- **HVM:** *High value manufacturing.* This is used to describe knowledge- and technology-intensive sectors of the manufacturing industry, such as aerospace and automotive manufacturing. HVM value chains heavily rely on R&D activities.
- **LSE:** *The London Stock Exchange.* The LSE is the largest stock exchange in Europe and fourth-largest in the world, located in the City of London. There are several markets operating under the LSE umbrella, and the FTSE 100 index includes the 100 best-performing UK businesses on the Main Market.
- **SMEs:** *Small and Medium Enterprises.* The standard name used for start-ups in the UK, although the precise definition can vary in different contexts.
- **TTO:** *Technology Transfer Office.* A division within a university that works to develop and license IP from that university.
- **UKTI:** *UK Trade & Investement.* The government office responsible for encouraging investment into the UK and helping British business export their goods and services.

The British Innovation Economy

The investment environment

Summary

The United Kingdom boasts one of the most attractive investment environments in the European Union. Although certain threats and challenges remain, its position as a global financial and trading hub, strong links with the European and US markets, and pro-business government attitudes coupled with a strong, independent legal system secure mean that the UK is the main recipient of foreign direct investment in Europe.

- According to data from the UK government, OECD, and the UN, the UK is the top destination in Europe for FDI. The UK is also among the top investment destinations among the developed economies.
- The UK is popular with investors as a country with a high standard of living, well-developed R&D facilities, relatively low labour costs coupled with a highly flexible workforce, and a transparent legal and political system.
- Some of the best developed sectors in the UK economy are financial services, ICT, and biotechnology. Knowledge-intensive activities and advanced manufacturing are supported by the government through tax credits and other incentive schemes.
- London is widely considered to have the best start-up and innovation ecosystem in the EU. Despite some challenges, particularly with financing, it is likely to see continuing growth in the future.
- Recent years have seen successful IPOs of innovative companies on London's stock markets, making profitable returns on initial investments a real possibility.

General overview

The United Kingdom has traditionally occupied a leading role in Europe and globally and remains a highly attractive destination for investment. It is characterized by an independent and strong judiciary, a stable, pro-business political system, and a well-developed innovation ecosystem with particular strengths in advanced manufacturing, biotechnology and IT. London is a global financial centre with a major stock market and access to world-class services. All of these factors contribute to a health investment climate in the United Kingdom.

Foreign investment

A major indicator of the state of the investment environment is the inward flow of foreign direct investment (FDI) into a country's economy. Naturally, foreign investors are attracted to economies that provide the best conditions for setting up and growing a business, as well as the best potential returns on the investment. Investors will often consider a number of countries before making their choice. This is especially true in the case of European Union member states, since all of the 28 constituent countries provide equal levels of access to the largest market in the world. It is significant, then, that the UK remains the top destination for FDI inflows in the European Union, with 18% of the total FDI project market (2% ahead of the nearest rival, Germany)[1]. According to estimates from the OECD, total FDI inflows into the UK in 2012 were around 62.4 billion USD, more than any other European country and an increase of more than 20% on 2011.[2] Overall, the UK is ranked 6th in the world (after the US, China, Hong Kong, Brazil, and British Virgin Islands) for FDI inflows in 2012 by the United Nations Conference on Trade and Development, which also named the UK as one of top 10 investment prospects for 2013–2015.[3] UNCTAD also estimates the UK's share of global FDI inflows at 4.6%, up from 3.1% in 2011. An important feature of UK FDI inflows is that the country remains the top destination for investment from the USA, thanks to the maturity of the UK market and strong historical links between the two economies.

These data from international organizations and independent analysts are corroborated by the recent *Inward Investment Report* published by the UK Trade & Investment. According to this report, the total value of inward FDI stock in the UK in 2012 is estimated at 1.3 trillion USD, with 204 billion USD (about 25%) alone coming from the US. Significantly, the distribution of FDI stock across sectors reflects traditional UK strengths in financial services, ICT, life sciences, and advanced manufacturing. In 2012, UKTI recorded a total of 787 new

[1] *Ernst & Young's Attractiveness Survey: UK 2013. No room for complacency*. (EY, 2013).

[2] *FDI in Figures*. (OECD, July 2013).

[3] *World Investment Report 2013. Global Value Chains: Investment and Trade for Development*. (UNCTAD, 2013).

projects in knowledge-intensive services and 522 in advanced manufacturing, with R&D projects up by 84% compared to 2011.[4] All of these figures indicate strongly that the UK has a healthy, attractive investment environment, and especially so in innovative, knowledge-intensive areas of the economy.

On the one hand, the high level of foreign investment into the UK is linked to a consistently positive perception of the British economy by investors and entrepreneurs. Different surveys conducted among CEOs of international corporations repeatedly underscore the fact that the UK occupies a strong position in the global market, and especially within the EU. According to the EY *Attractiveness survey 2013*, some of the most important factors include not just the quality of life and use of English (91% of respondents), but also the technology and telecommunications infrastructure (89%), as well as political, legal, and regulatory transparency (84%) and entrepreneurial culture (also 84%).[5] Other studies also suggest the importance of these factors. A 2010 CBI/Ipsos MORI survey showed that 62% of CEOs consider the UK an easy place to invest in, in second place after North America but ahead of Continental Europe among the developed economies.[6] A similar finding was presented by OECD, which suggested that barriers to foreign investment are below average in the UK and placed the UK in the top 10 developed economies for the regulatory environment[7]. Some other UK advantages that both surveys have highlighted are labour force flexibility and costs and a strong R&D and university base.

Policy factors

Much of this positive perception is a result of structural and legislative strengths of the British economy. The World Bank has rated the UK as one of the best places in the world to start up and grow a business (10th out of 185 economies and ahead of most EU countries except Denmark)[8]. The *Doing Business* indicators allow to compare the

[4] *Inward Investment Report 2012/13*. (UK Trade & Investment, 2013).

[5] *Ernst & Young's Attractiveness Survey: UK 2013. No room for complacency*. (EY, 2013). It is worth noting, however, that 52% of participants in the survey named Germany as the top European investment destination for the next 3 years while 33% pointed to the UK.

[6] *CBI Annual Conference Survey 2010. UK as a Place to Invest.* (CBI and Deloitte, 2010).

[7] *OECD Economic Surveys 2013. United Kingdom*. (OECD, February 2013).

[8] *Doing Business 2014. Understanding Regulations for Small and Medium-Size Enterprises*. (World Bank, 2013). UK data available online: <http://www.doingbusiness.org/data/exploreeconomies/united-kingdom>.

regulatory environment between world economies in such categories as registering a new company, dealing with construction and property permits, getting credit, etc. At the same time, the *Doing Business* report does not take into account other features of an economy such as infrastructure, access to large markets, the strength and transparency of the legal system, and so on – areas that UK has a distinct advantage in.

A better representation of these non-regulatory factors is presented in a report comparing the competitiveness of different world economies produced by the World Economic Forum (WEF) in 2013. The report ranks the UK in 10th place, highlighting in particular its labour markets (as a major advantage over other European countries); its innovative, hi-tech businesses; and the size of the market.[9] It is also clear that the ranking would have been higher if not for the continuing threat presented by the UK's exposure to the eurozone and slow recovery from the global financial crisis, with 'Access to financing' seen as the most problematic factor by 20.7% of respondents (see Barriers to investment). Ultimately, Britain is ahead of the WEF benchmark for innovation-driven economies on all counts except the macroeconomic environment. In this survey, too, sectoral strengths of the UK, including the quality of education, research facilities (including university-industry collaboration), and technological readiness play an important role in making the country a highly competitive investment environment.

The high capacity for innovation that the UK demonstrates according to these reports makes it a particularly attractive destination for start-ups in high-growth, knowledge-intensive sectors of the economy: ICT, biotech, life sciences, and so on. According to numerous sources, the UK is one of the top destinations in Europe for innovative early-stage companies. According to one report, in 2011 an estimated 3.4% of working-age Britons were owner-managers of an early-stage business, compared with 1.7% in France and 2.4% in Germany.[10] Another very recent survey, conducted by the World Economic Forum in 2013, shows that British entrepreneurs have the highest opinion of the ecosystem they operate in all European countries (and generally on par with the United States outside the San Francisco Bay Area).[11] This is hardly surprising, given the ready availability of two of the three 'pillars'

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[9] Klaus Schwab (ed.) *The Global Competitiveness Report 2013–2014*. (Geneva: The World Economic Forum, 2013)

[10] Jonathan Levie, Mark Hart. *Global Entrepreneurship Monitor. United Kingdom 2011 Monitoring Report*. (University of Strathclyde and Aston University, 2011)

[11] *Entrepreneurial Ecosystems Around the Globe and Company Growth Dynamics. Report Summary for the Annual Meeting of the New Champions 2013* (Geneva: The World Economic Forum, September 2013)

identified as key to a successful entrepreneurial environment – access to markets and human capital (the third is funding and finance).

The UK's position as a leader of European innovation is reinforced by government policies aimed at encouraging the development of knowledge-intensive SMEs. In addition to a low corporate tax rate (23% currently and set to decrease to 20% in 2015), significant tax breaks exist for companies operating in the innovative economy. Tax credits of up to 225% exist for SMEs on research & development-related expenses; large companies can claim up to 130% of R&D expenses in tax credits. According to UKTI, total typical savings in R&D costs for large companies are 8%, while SMEs can expect to save around 25%.[12] At the same time, the Patent Box scheme lowers the corporate tax rate on profits from patented inventions by 10%. Other schemes such as the Enterprise Investment Scheme exist to encourage investment in early-stage companies and have proven to be quite successful – according to one estimate, between 19 and 34 per cent of investments were made possible by EIS[13]. (See Taxation for a full description of taxation in the UK, including government incentive schemes).

Labour market

The labour market available to employers and investors in the UK consists of the local population, EU citizens, and non-EU workers. By far the easiest to hire are the first two groups, and of course British businesses have the most access to British workers. The population of the UK is estimated to be 63.7 million people; among those between 16 and 64 years of age, **71.8%** (29.95 million people) are employed and the unemployment rate is **7.6%** (2.47 million people). The total EU population is estimated at over 500 million people, most of who are eligible to work in the UK. Finally, British business can sponsor non-EU employees, with an annual cap of just over 20,000 workers. Thus, UK employers have access to an extremely large and fairly well developed labour market, with some of the best universities in the world and opportunities to bring in talent from outside the 500-million strong EU market.

[12] *A Guide to UK Taxation*. (UK Trade & Investment, 2013).

[13] Yannis Pierrakis. *Incentivising the Supply of Finance for Early Stage Business through Tax Schemes: A Preliminary Analysis of the Impact of EIS, VCT and CVS*. (Nesta Working Paper, 2009).

As the UK is part of the European Union, which guarantees freedom of movement for its citizens, all UK employers can hire European citizens with no limitations on the type of work or nationality of employee. (The only exception to this currently is for Bulgarian and Romanian citizens, transitional control over whom are set to be lifted on 1 January, 2014). This is a major point in favour of the UK as an investment destination, as innovative businesses in particular benefit greatly from access to a very large and flexible workforce. However, it is worth noting that there is a major political debate over migration is in progress and is very likely to play an important role in the next parliamentary election in 2015. It is possible that future governments will attempt to re-negotiate the UK's relationship with the EU, which may include the introduction of stricter controls for EU citizens.

London as an investment destination

A major part of investment into the UK flows through London. According to Ernst & Young, the capital's share of FDI projects in 2012 was 45%[14]. Similarly, the British Private Equity and Venture Capital Association (BVCA) reports that 41% of all investments by its members in 2012 were made in London and the South East of England, with the majority of investments in healthcare and consumer services.[15] This pattern is hardly surprising, given that the chief determinant of the location of investment is regional specialisation,[16] and the South East of England has traditional strengths in financial services, healthcare and pharmaceuticals, and other knowledge-intensive sectors. The presence of an active start-up community in the so-called Tech City in East London also makes the UK the best place in Europe in terms of access to venture capital and early-stage funding (though it still lags in comparison with the US). London is the 7th strongest start-up ecosystem in the world according to the *Startup Ecosystem Report 2012*, behind 5 American cities and Tel-Aviv.[17] Significantly, it is ranked 2nd after the Silicon Valley in terms of support for innovative businesses, and it is clear that the UK will continue to develop in this respect in the near future. As noted above, the availability of financing remains a worry, and a funding gap

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[14] *Ernst & Young's Attractiveness Survey: UK 2013. No room for complacency*. (EY, 2013).

[15] *BVCA Private Equity and Venture Capital Report on Investment Activity 2012*. (BVCA, May 2013).

[16] Dimitra Dimitropoulou, Philip McCann & Simon P. Burke. 'The determinants of the location of foreign direct investment in UK regions'. *Applied Economics* (2013), 45:27, pp. 3853-3862.

[17] *Startup Ecosystem Report 2012*. (Startup Genome and Telefonica, 2012).

exists with 81% less capital raised by London entrepreneurs before product-market fit than in the Silicon Valley. At the same time, BVCA notes a steady trend towards an increase in venture capital funding over the past few years, with 53% of investments in 2012 made in venture capital (compared to 44% in 2010).

Finally, London's position as a global financial centre means that a successful start-up can look forward to entering the stock market at a later stage. The London Stock Exchange and its sub-market, AIM, have both seen examples of successful flotations of ICT, biotech, and other innovative companies in recent years. For example, just in 2013 companies such as Cambridge Cognition (biotech, raised 5 million GBP), Outsorcery (cloud computing, 12.7 mln GBP), and Applied Graphene Materials (advanced materials, 11 mln GBP) have held successful IPOs. WANdisco (server software and infrastructure, 15 mln GBP)[18] and Retroscreen Virology Group (life sciences, 15 mln GBP) were some of the most profitable stocks on AIM in 2012[19]. Russian innovative companies, however, have not been particularly active on the London Stock Exchange, with the last flotation in this sector coming in 2010 (Mail.ru). The main market, the London Stock Exchange, has recently introduced a High Growth Segment designed to make it easier for smaller innovation-driven companies to list on the LSE[20]. Thus, good prospects for a return on the initial investment made within the UK also contribute to a healthy investment climate.

[18] *IPO Eye. An overview of Q2 2013*. (EY, 2013).
[19] *IPO Eye. An overview of Q4 2012*. (EY, 2012).
[20] 'London Lowers Barriers to IPO'. *The Wall Street Journal*. (February 13, 2013).

Niches and production chains

Summary

The role of the United Kingdom in global markets has pivoted quite a lot in the past few decades. Whereas prior to 1980s the country was a major industrial power, the growth of affordable outsourcing opportunities in the emerging markets has led to major changes in the structure of the British economy, which underwent a transition to a post-industrial state. Nonetheless, the UK has managed to develop a very strong service sector and to build on its considerable strengths in research and innovation to occupy crucial gaps in global value chains. Essentially, the UK has become the world's R&D lab in a number of high-value, high-cost industries. We identify a number of specific sectoral strengths for the UK and suggest ways in which innovative companies can integrate into these chains at crucial points, creating significant market opportunities, including ICT, the pharmaceutical industry, high-value manufacturing, and more.

Introduction

With all its strengths as an investment destination, the position of the United Kingdom in the global economy is a peculiar one. Having spent the 19th and the first half of the 20th century as the dominant power on the production, financial, and regulatory sides, today it is nonetheless, as some say, a shadow of its former self. As much as it is true geopolitically (after all, the sun finally sets down somewhere in this country), it is hard to overestimate the importance of UK to the economics of the modern world.

Before we go to assess the position UK holds in the worldwide value chains lets define them first. As Michael Porter, who coined the term, puts it in his famous book, "*the idea of the value chain is based on the process view of organisations, the idea of seeing a manufacturing (or service) organisation as a system, made up of subsystems each with inputs, transformation processes and outputs. Inputs, transformation processes, and outputs involve the acquisition and consumption of resources - money, labour, materials, equipment, buildings, land, administration and management. How value chain activities are carried out determines costs and affects profits*".

Nowadays, the traditional supply chains have gone global on a large scale. Most importantly, research, development, design, and manufacturing no longer constitute a single set of expertise that a company can realistically possess; therefore, global chains make countries' economies more stratified, segmenting them into small niches with intense competition. Large corporations mostly function as integrators, providers of strategic investment and market access.

Therefore, anyone wishing to engage in a business within the innovative economy as stratified as the UK one ought to understand the strengths and weaknesses of the local market, the incentives given and the opportunities the market presents. Here we will outline the shape of the UK innovative economy and the primary niches it forms; characterize the incentives provided; and give an insight into potential market niches ripe for taking or recent success stories.

Ever since the Industrial Revolution, the UK has been at the forefront of innovation in manufacturing and services alike. Structural changes in the global economy have meant that the British industrial landscape and its role on the world stage have seen significant transformation over the past few decades. On the one hand, as the British economy became heavily oriented toward service provision (with particular strengths, for example, in finance and insurance), the role of manufacturing declined. This change is reflected in the composition of Gross Domestic Product (GDP), which is currently estimated at 78.2% for services and 21.1% for industry.[21] On the other hand, as traditional low- and mid-tech manufacturing shifted to emerging economies such as China and India, the UK developed a strong base for high-tech, advanced manufacturing in such industries as pharmacology, aerospace, and green tech. Finally, Britain's strengths in research and other knowledge-intensive activities have helped it secure a crucial role in global industrial chains as the 'brains' behind production processes and service provision. Taken together, these factors suggest that a business considering investment in the UK is well advised to look at a number of niches where Britain has a competitive advantage over other economies and consider ways to integrate into these industrial chains.

[21] Index Mundi: <http://www.indexmundi.com/united_kingdom/gdp_composition_by_sector.html>

UK's global advantages

Exports

There are a number of data sources that allow us to pinpoint those areas in which Britain plays a leading role globally. On the one hand, a major indicator of the role the UK plays in the global economy is the composition of its exports – we can make a reasonable assumption that high demand for particular goods and services in foreign markets is linked to the UK's competitive strengths in those sectors. The UK is in the top ten exporters in the world: 10th in goods and 3rd in services. This strength in services is particularly impressive given that 63% of UK exports are manufactured goods. On a more detailed level, we can look at the share of UK exports in the global market and those sectors where it is higher than the UK's overall share (3.4%), suggesting a global advantage. The table below indicates some of the top sectors according to their global share:

UK share of global exports in 2012, selected sectors
(ITC Trade Database)

Sector	Share of global exports, %
Services	
Financial services	17.9
Insurance	12.3
Personal, cultural, recreation services	9.2
Business services	8.0
Manufacturing	
Turbines	18.2
Aircraft, spacecraft, and their parts	7.8
Pharmaceuticals	7.0
Transport	3.8

As this table suggests, the UK has a global advantage in financial and other business services as well as in some areas of high-tech, knowledge-intensive manufacturing. These data are corroborated by trade balance figures across a variety of sectors, which allow us to see where the UK runs a trade surplus (indicating a strong position on the global market). In 2011, the top sectors for trade balances were financial and business services, insurance, air and spacecraft, pharmaceuticals, and ICT[22].

[22] The only way is exports. Renewing the UK's role as a trading nation. (CBI, April

Thanks to its geographical location in the middle of global time zones and a well-developed banking and services infrastructure, the UK has secured for itself a role as a financial and business intermediary on the global stage. At the same time, the data quoted above do not provide any information about the UK manufacturing's place in global supply and value chains. In that respect, a useful measure is the combination of import and export intensities (measured as a percentage of turnover) for the selected sectors. According to CBI calculations, many of the most export-intensive British industries also see a high number of imports. These include pharmaceuticals, computer and electrical equipment, chemicals, aerospace, and other high-value sectors in which the UK has a reputation for global excellence. This suggests that in manufacturing as well as services Great Britain has occupied a position higher up in the supply and value chains, importing raw materials and producing finished goods or assembled parts. (For example, the UK produces 35% of all aircraft engines sold globally and half of all wings for large aircraft)[23].

FDI inflows

Of course, some sectors of the economy cannot be judged on the basis of export figures, since the activities are carried out internally but benefit stakeholders across the world. In particular, this is the case for R&D activities. A useful indicator of the relative strength of Britain's research and development facilities can be found in FDI inflow figures. As foreign investors recognise the UK's pivotal role in the development of new products, they set up new facilities in the country and the result of this work can then be used in global production. UKTI's figures for 2012, for example, indicate that R&D projects were second only to services in the number of new foreign investments. Essentially, this places the UK at the source of many industrial chains, particularly where high-tech manufacturing is involved. At the same time, the sectoral bias of FDI projects shows once again the UK's strengths in advanced manufacturing and knowledge-intensive areas of the economy, with 522 and 787 new projects respectively. Another 46 projects were added in renewable energy, another sector of advanced economy.

2013).

[23] *Inward Investment Report 2012/13.* (UK Trade & Investment, 2013).

The UK's position in global value chains

Ultimately, the data suggest a complex but crucial role for the UK in the global economy. As lower-value manufacturing moves to the emerging economies, the UK's strengths have allowed it to position itself at several important points in global value chains. Firstly, the UK has a major role in global R&D processes and therefore is at the beginning of many industrial chains, particularly in higher-value sectors such as pharmaceuticals and advanced manufacturing. In 2011, for example, 16.98% of R&D in the UK was financed from abroad: a higher proportion of GDP than other large developed economies for which data are available, suggesting that the UK is one of the top destinations for FDI in R&D in the world[24]. At the same time, Britain's relative strengths in such areas as pharmaceuticals and aerospace mean that for such advanced manufacturing processes the country plays an important role in production of either finished goods or complex assembled parts, serving as an intermediate or final link in production (as evidenced by high import and export intensities of these sectors). Finally, the extremely well developed service industry in the UK allows the country to participate in the value chain after production, as well. This extends to manufacturing, as well: research suggests that by 2010 between 15 and 20 of all manufacturing revenues came from the provision of services, and as early as 2005 around 15% of total service exports came from manufacturing[25]. Given that, for example, a third of all manufacturing turnover comes from SMEs, the UK's position in the global value chains offers significant opportunities to entrepreneurs and investors considering entering the British market. In the next section we will take a closer look at some of the sectors that have the highest potential in this respect and the types of support that exist for businesses in these sectors.

UK's industry strategies

The UK's government has recognised a number of sectors as crucial to the future of the British economy and is implementing programmes of support and investment in these areas. There is significant overlap between the industries thus identified and sectors in which the UK has a global advantage, as described above. Some of the industrial strategies developed in the UK include:

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[24] *Annual Innovation Report: Innovation, Research, and Growth.* (BIS, November 2012). The figures are taken from the OECD.StatExtracts database.

[25] BIS Economics Paper No. 10A, Manufacturing in the UK: An economic analysis of the sector (December 2010).

- Life sciences
- Aerospace
- Information technology
- International education
- Professional and business services[26].

Following this, we can identify some of the best niches for integration into the UK innovation ecosystem.

Biotechnology and healthcare

Biotechnology (including pharmaceuticals) and healthcare is one of the leading innovative sectors in the UK economy, with around 4,500 companies boasting an annual turnover of over 50 billion GBP (including around 5 billion in R&D spending) in 2011. This is a sector that has seen strong growth in recent years – between 2000 and 2011, pharmaceutical R&D investment grew by 70%, with 31% of all manufacturing R&D in 2011 coming in this industry[27]. The UK is home to two of the top ten pharmaceutical companies in the world – AstraZeneca and GlaxoSmithKline, with the latter making a 500 million GBP investment in the past year alone.

Another opportunity offered by the British biotech and healthcare ecosystem is the existence of the National Health Service. The presence of a centralised healthcare system presents companies in the market with two significant advantages. On the one hand, the large network of hospitals is well positioned to take up innovations and new discoveries (from drugs to new medical equipment, improvements in procedures, and IT products in, for example, telemedicine), which creates a large and receptive target audience for new biotech and healthcare products. At the same time, the NHS collects a large amount of healthcare data, and many datasets (such as GP prescriptions on the chemical level) are made available to the public. Targeted programmes such as the UK Biobank make it possible to study large populations for healthcare trends, with data accessible to approved applicants on payment of a small (1,750 to 3,250 GBP + VAT) fee.

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[26] The full list of the proposed industry strategies is available online at <https://www.gov.uk/government/policies/using-industrial-strategy-to-help-the-uk-economy-and-business-compete-and-grow/supporting-pages/developing-strategic-partnerships-with-industry>.

[27] Strategy for UK Life Sciences: One Year On (HM Government, 2012).

The implementation of the Life Sciences industrial strategy has made a large amount of funding available to businesses in the biotechnology and healthcare service. Three funds with a total investment of 310 mln GBP have been set up by the government for research in stratified medicine, experimental medicine, and biotechnology. The latter, known as the Biomedical Catalyst, is operated by the Medical Research Council and the Technology Strategy Board and has invested 49 mln GBP in 2012 into 64 projects run by universities and British-based SMEs, with around 25 mln GBP in private investment. A Cell Therapy Catapult project, a 10 mln GBP centre of research excellence, has been set up to collaborate with the NHS, universities, and industry. Other projects, such as a medical research volunteer database BioResource and the Life Sciences Investment Organisation, aim to make the UK a more attractive place to carry out research in biotechnology. As a result, around 1 bln GBP has been raised in new life sciences venture funds in the UK in 2012 alone[28].

Therefore, the potential for international integration into the British biopharma industry is vast and diversified. Many countries have already adopted a collaborative position and are significantly involved; a good example of a niche successfully found and exploited can be made of Finland: half of the country’s CROs and 40% of CMOs have main offices outside the home country in UK and boast British companies as their main clients.

A growing demand for meticulous clinical trials and ever-increasing requirements of the regulators such as FDA and MHRA make larger-than-ever-scale Phase II and III trials a necessity for most of the big and mid-range pharmaceutical companies. The UK itself has a strong advantage in the NHS, which is centralized and adopts a rigorous trial policy; but performing 100% of the trials in UK can often be uneconomic. Hence, another niche arises: countries with a predominantly Caucasian population and a significant amount of qualified doctors and high-quality clinical research centres have started offering outsourcing opportunities for the UK pharma companies. Russia is already a first-tier player and several Russian CROs have moved to market services in UK; the British and international CROs are making a move into Russia, with Quintiles and others opening offices. The mutual trade figure is estimated at £75M a year at end of 2011 and the market niche is by no means saturated yet.

[28] Ibid.

Advanced materials

Another research area in which the UK enjoys a comparative advantage that translates well into industrial competitiveness is advanced materials. The annual turnover of British businesses producing and processing advanced materials in 2010 exceeded 197 billion GBP, which is hardly surprising given the important role that such materials play in high-value manufacturing as well as the development of sustainable energy sources. In addition to new materials like graphene the UK possesses significant strengths in the development and production of 'smart' (for example, self-repairing) materials and composites.

According to estimates by EY, there are around 1500 companies in the composites sector in the UK, with a large number of highly specialised SMEs in addition to market leaders like BAE systems and Bombardier, with a total revenue of around 1.6 billion GBP. A large proportion of produced materials are exported, and the UK itself (given the large number of aerospace, automotive, and wind turbine producers) is a key market for composites. Some of the largest export markets for the UK composites industry include not only the US, but also Asia and South America, with demand for composites forecast to grow by between 3 and 10% by 2020, with demand for carbon fibre in Britain estimated to grow by as much as 17%[29].

The importance of advanced materials for the British economy has been recognised by the Technology Strategy Board, which ran a 'grand challenge' project that raised 10 million GBP of investment from 22 companies, with some participants expecting to record sales of at least 7 million GBP of a new product developed thanks to the project. In 2013–14, the total sum of TSB investments in new and advanced materials is likely to exceed 4.3 million GBP in three separate areas. Research projects funded by, among others, the Engineering and Physical Sciences Research Council include 21 million GBP smart materials collaboration and a 61 million GBP Graphene Institute at the University of Manchester.

We consider Russia with its strong base in material science a prime research & development partner for UK; the oil & gas and aerospace industries of both countries could greatly benefit from joint innovation in this field.

[29] UK Composites Supply Chain Scoping Study. (EY, April 2010).

Engineering and high-value manufacturing

Within the context of the British industrial landscape, biotechnology and advanced materials can be seen as 'enabling technologies' – research-heavy sectors which produce significant spillover effects into other areas such as high-value manufacturing (HVM). As discussed above, advanced manufacturing sectors such as aerospace, turbines, and automotives are a major source of economic benefits to the UK. In 2010, HVM accounted for more than a third of all UK exports, contributing over 150 billion GBP to the UK's balance of payments.[30] In aerospace, for example, the UK is second only to the USA in the global market.

The presence of such a highly-innovative sector in the British economy provides important opportunities for businesses and investors alike. New technologies – whether in materials, chemicals, or life sciences – will have strong domestic demand, and clustering (for example, in semiconductors around Bristol and high-performance cars in the Midlands) creates spaces where manufacturers, engineers, entrepreneurs, and researchers can collaborate on new advances. Ultimately, there are many niches within the value chain – in R&D, the innovation gap, and higher up the production chain – that can be occupied by newcomers into the innovation ecosystem. Government programmes such as the High-Value Manufacturing Catapult exist to improve collaboration between industry (both large corporations and innovative SMEs) and research. In other cases, government funding under such programmes as the Advanced Manufacturing Supply Chain Initiative may be available to companies working on new technologies to be used in production. For example, an Oxford University spin out Oxford BioMedica was recently awarded a 7.1 million grant to develop expertise in advanced therapy medicinal product manufacture, highlighting the potential for cross-over between different sectors of the innovative ecosystem[31].

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[30] High-Value Manufacturing Strategy, 2012–2015. (Technology Strategy Board, 2012).

[31] 'Oxford BioMedica Wins Significant Funding via a Competitive Award from UK Government's Advanced Manufacturing Supply Chain Initiative'. URL: <http://www.oxfordbiomedica.co.uk/press-releases/oxford-biomedica-wins-significant-funding-via-a-competitive-award-from-uk-government-s-advanced-manufacturing-supply-chain-initi/>

ICT

One area with a high potential for market opportunities based on the intersection of different sectors is information and communication technologies, particularly software development. The British software market is the second largest by value in the EU and is estimated at 5% of the global market.[32] At the same time, it enjoys a significant advantage in terms of access to the enormous US market, given historically close economic and cultural links as well as the role of English as a major language in the IT consumer space.

Some of the sectors in which the UK is particularly strong are big data analytics, cyber-security, and e-commerce; Britain also possesses notable super-computing capabilities. Participants in the British market can take advantage of many of these strengths. Some of the most exciting opportunities can arise at the intersection of ICT and leading sectors of the British economy such as financial and business services, healthcare, and energy efficiency. London's role as a financial hub, for example, has led to the creation of a fin-tech hub in the City of London; developers of consumer financial software products can take advantage of both the higher levels of trust that come with regulation by the Financial Conduct Authority and existing financial expertise. The UK's role as a leading provider of higher education, on the other hand, opens up opportunities for the development of Massive Open Online Courses (MOOCs) and other forms of distance learning in a market where demand far exceeds supply at present. The UK's government's commitment to make available large amounts of data collected by its departments (such as the NHS) means that companies developing data analytics solutions (such as Autonomy, an IT developer bought by HP for over 10 billion USD in 2011) have access to large sets of real-life data.

Russian software companies and entrepreneurs integrated well into the UK fintech ecosystem. Several automated trading engines and Forex interfaces started in Russia have seen significant success in UK, Alpari being the leading one. According to estimates by the entrepreneurial community of the Tech City, Russian entrepreneurs based in London and Cambridge run at least 5-7% of the successful fintech consultancies and contract developers.

[32] BIS Economics Paper No. 18, *Industrial Strategy: UK Sector Analysis* (September 2012).

Conclusions

Overall, the market in the UK is complex and powerful; its trade balance is skewed towards exporting innovative industries and imports of raw materials for the high-tech sectors of the economy; it is extremely stratified and saturated with highly specialized SMEs. On the one hand, this guarantees tough competition on any level from running a small fintech consultancy in Shoreditch to managing clinical trials for giants like GlaxoSmithKline or AstraZeneca. On the other, it means that the market is purely meritocratic; anyone who offers the best value to his customer has a chance to succeed against the competition. On the global level, the UK occupies a crucial niche in many highly innovative supply chains, from initial R&D to very knowledge-intensive production processes, making it a wonderful place to invest in innovation with an eye to playing a significant role on the global scale.

Our analysis indicates that some of the most significant strengths of the UK manufacturing, service, and research economies can be mapped onto a matrix of enabling technologies and major innovative sectors, providing some of the most exciting niches in the developed economy. We noted just some of these opportunities – there are many, many more.

With that in mind, we would encourage any entrepreneur or investor looking to enter the British ecosystem not to hesitate in trying to offer innovative solutions to the market in any niche or chain level possible, from basic design to quality control and data assessment, and play to the strengths of the country and its selected strategic areas, where investment and governmental support are easier to obtain and maintain. Among other things, the UK remains a prime market for technological product innovation and maintaining an IP portfolio; with such an amount of innovative companies and corporations, the UK is one of the world’s leading license acquirers.

And finally, last but not the least, remember: any company to market a climate control device enabling the Britons to enjoy more sunny days will own this country.

The UK innovation matrix: sectors (rows) and enabling technologies (columns)

	ICT	Biotech and life sciences	Energy efficiency	Advanced materials	Engineering
High-value manufacturing	Production processes	Industrial biotechnology	• Solar panels • Wind turbines	• Aerospace • Automotive	
Services	• Consumer apps • Fintech • Big data • Cybersecurity				New product design
Healthcare	Telemedicine	Personalised medicine			Medical devices
Pharmaceuticals	• Clinical data systems • Regulatory compliance	Drug discovery and clinical trials		Molecular sieves	
Chemical engineering	3D modelling	• Biofuels • Catalysts	Oil and gas extraction	Chemical sensors	

Barriers to investment

Summary

The UK is one of the most attractive destinations for foreign investment in the world. Falling corporate taxation rates and strong incentives for knowledge-based businesses will continue to attract investment in the future. Areas of concern include economic instability associated with the euro crisis, the restrictive immigration regime, the relatively underdeveloped venture capital market and start-up culture, lower levels of access to credit, and a complex regulatory environment.

- Work permit rules limit the availability of highly-skilled personnel from outside the EU and can prove challenging to navigate for SMEs.
- Growth remains alarmingly slow, affecting consumer confidence and availability of credit to new businesses.
- Relative lack of access to venture capital is mitigated by significant government incentives for innovative businesses, including a 225% R&D tax credit.
- Compliance with regulations can be onerous, but the government is making progress in reducing the regulatory burden.
- Investment in venture funds presents a greater challenge than setting up a business, in terms of regulation, taxation, and the visa regime.

General overview

The United Kingdom has historically played a pivotal role in the development of the global economy, serving as the hub of commercial activity in Europe for several hundred years. In general, the United Kingdom is a highly attractive destination for investment, maintaining its position as the top choice for foreign direct investment in the European Union in 2012.[33] Among its many advantages, the country boasts a long and distinguished legal tradition, a stable political situation and a highly developed financial infrastructure. Nonetheless, a number of barriers to investment inflows and outflows still exist in the UK that need to be taken

[33] According to the quarterly OECD *FDI in Figures* (April 2013), the total volume for UK-inbound FDI in 2012 was around 63 billion USD, fourth in the world. The total number of projects funded by foreign investment in the UK for 2012 stood at 697 (*Ernst & Young's Attractiveness Survey: UK 2013*).

into account. These range from risks to the economy from exposure to the eurozone to a relatively high number of regulatory and legislative limitations on the running of a business, as well as the general culture surrounding venture investment and difficulties related to a restrictive immigration regime. This section aims to give an overview of the various type of barriers to investment on a general level; where appropriate, more information will be provided in the relevant section of the guidebook.

Economic risks

Firstly, while the political and social situations are very stable, the economic risks are relatively high for a developed country. Although the worst of the financial crisis of 2008 has passed, London's role as a major hub of financial services and certain structural features of the British economy meant that the country was deeply affected and the recovery has been very slow. Since 2008, the UK has narrowly avoided a double-dip recession and growth in the first quarter of 2013 remained at the low level of 0.3%. This has resulted in two of the three chief credit agencies – Moody's and Fitch – downgrading the country's credit rating from AAA to AA+[34].

To a certain extent, the slow recovery was due to the UK's proximity to the eurozone. Although membership in the common European market brings significant advantages, the UK is also exposed to the risks associated with the ongoing euro crisis, further damaging investor confidence. According to analysis from Maplecroft, UK is the country most at risk from a potential collapse of the eurozone.[35] Similarly, high levels of public debt have prompted a long-term programme of fiscal austerity from the Coalition government, which is now predicted to last into the 2017/18 financial year,[36] with corresponding negative consequences for consumer demand and the availability of credit. Additional uncertainty is created due to political pressures for a re-negotiation of Britain's relationship with the EU, with a referendum possible after 2015, and the possibility of Scotland opting for independence from the United Kingdom in 2014.

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[34] 'Fitch downgrades UK credit rating to AA+', BBC (19/04/2013): <http://www.bbc.co.uk/news/business-22219382>

[35] 'United Kingdom tops ranking of countries most exposed to Euro crisis - BRICS at "high risk"', Maplecroft Eurozone Exposure Index 2012 (25/07/2012): <http://maplecroft.com/about/news/eurozone-exposure-index.html>

[36] *Living with Austerity.* (PwC, June 2013)

Regulation

The troubling economic situation is compounded by a number of financial and regulatory issues that complicate the process of setting up and growing a new business (for more information, see sections Taxation, Registration of businesses, Filing and auditing, Special regulations, Regulatory harmonization). In terms of regulation, any company headquartered in the United Kingdom has to follow European Union legislation, which tends to impose a greater regulatory burden than, for instance, most states of the USA. The total number of statutory rules and regulations is now estimated to be over 21,000[37], with average time spent on compliance ranging between 60 and 100 man-hours a month according to surveys conducted in 2010-11[38]. All accounting records must be kept for at least three years and reported annually to the Companies House, where they are publicly accessible for a small payment (abbreviated accounts may be submitted by small and medium PLCs). Other regulations of particular note include mandatory compliance with EU data protection (estimated to cost around 190 million GBP for UK businesses overall in 2012-13) [39], competition, and copyright laws. Participation in the single European market also requires compliance with member state regulations, which may vary from one country to another. Such regulations impose a particular burden on small innovative enterprises, generally resulting in higher costs as a proportion of overall turnover than for large corporations; ongoing initiatives within the EU are currently under development to ease this regulatory burden, including excluding start-ups and micro-businesses from the enforcement of EU regulations. Other major challenges to innovative SMEs include costs in legal fees and time for patenting inventions and in particular challenging infringements in court. The costs of protecting intellectual property across the EU can at present reach upwards of £20,000 for a single patent. In general, however, the UK has a progressive attitude towards intellectual property protection: tax deductions are available on profits made from patents and a recent agreement between Britain and the EU will allow British companies to defend their intellectual property in a single London-based European court from 2015 for a single £600 fee[40].

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[37] 'FAQs about the Red Tape Challenge': <http://www.redtapechallenge.cabinetoffice.gov.uk/frequently-asked-questions-faqs/>

[38] Peck, F., Mulvey, G., Jackson, K., Jackson, J. *Business Perceptions of Regulatory Burden.* (Carlisle: Centre for Regional Economic Development, University of Cumbria, 2012).

[39] 'Impact Assessment: Proposal for an EU Data Protection Regulation'. (UK Ministry of Justice, 2012).

[40] 'New patent law will help UK business', *The Independent* (17/02/2013): <http://www.independent.co.uk/news/business/news/new-patent-law-will-help-uk-business-8498245.html>

Additionally, any new regulations introduced by the EU must be complied with by British-based businesses, making the regulatory process less transparent. At present, one of the most significant barriers to innovative SMEs is the EU Distance Selling Directive, which disproportionally affects online sellers and requires them to refund payments for goods even if the buyer has not returned them, as well as levies responsibility for postage costs on the seller. This Directive will be replaced by a new, less burdensome EU Consumer Rights Directive from 2014, which removes these responsibilities[41]. Goods and services exported to EU member states must also be compliant with EU rules, and the creation of a truly borderless digital market within the European Economic Area remains a significant challenge. Additional compliance costs may arise within the UK as the constituent parts of the kingdom (England, Wales, Scotland, and Northern Ireland) can all have different rules, while regulations imposed by local authorities can vary from one region to another.

Access to finance

Financially, one of the key problems is the availability of credit to new companies, especially those in the innovative sectors of the economy. Overall, 52% of UK CEOs are worried about their ability to finance future growth, compared to 31% in the US and 25% in Germany[42]. On the one hand, despite historically low credit rates, the availability of loans, particularly to small and medium enterprises (SMEs), is also low, remaining on the same level as it did in 2010[43]. It is worth noting, however, that the British legal framework for securing credit was rated by the World Bank as the best in the world in 2012[44]. On the other hand, recent consultations by the UK government have demonstrated that the problem is especially acute for knowledge-based business such as those in IT and biotechnology. This is because such businesses tend to rely on intangible assets which British banks are not prepared to accept as collateral for loans and which do not count against accounting evaluations of a company's worth. It is encouraging to see that the government is working to provide alternative sources of finance such as the Enterprise Capital Funds as well as other schemes described in the relevant section

[41] *Removing Red Tape for Challenger Businesses*. (BIS, 2012).

[42] *The 16 Annual CEO Survey: Dealing with Disruption. Adapting to Survive and Thrive.* (PwC, 2013). <http://www.pwc.com/gx/en/ceo-survey/2013/key-findings/index.jhtml>

[43] 'Credit Conditions Survey: Q1 2013'. (Bank of England, 2013)

[44] *Doing Business 2012.* (World Bank, 2013). The UK was rated 7 in the world overall.

of this guidebook[45].

Another major barrier to the growth of innovative SMEs is the relatively underdeveloped state of the venture capital market in the United Kingdom, particularly compared to the USA (for more details, see section The investment environment). In 2012, the total venture investment in the UK was 2.3 billion USD compared to 41 billion in the United States, although still higher as percentage of GDP than other EU countries. In terms of return, UK investments have also lagged behind the US. A recent Nesta report has suggested that the reasons for that include the higher returns on exits in American markets compared to the UK, where the IPO market is less familiar with tech businesses and lacks resources to provide proper analysis; the need to comply with EU-wide regulations; and cultural differences, where the general perception is that UK investors are more risk-averse and therefore less likely to invest in start-ups[46]. On the other hand, a recent survey by PwC has demonstrated that the latter cause may not be as important as the lack of a well-developed community of investors comparable to the Silicon Valley and a poorer awareness of the need for quick scalability on behalf of British entrepreneurs - a difference in priorities between investors and business owners[47]. Nonetheless, reports by PwC, Ernst & Young, and Nesta all highlighted the positive steps the UK government has taken to encourage investment in innovation, in particular the Seed Investment Enterprise Scheme and the R&D tax credit of 225% on research and development activities for SMEs. However, the existence of a large number of diverse tax breaks and funding sources for research-intensive business activity significantly increases the complexity of the British tax code as applied to venture funds and innovating businesses - a shortcoming this guidebook aims to address.

Labour force

Another potential barrier to investment in the UK is the availability of highly skilled labour force. Despite a world-class education system, the UK is likely to suffer from a shortage of tech-savvy employees in the near future; with 129,000 new workers projected to be needed by the innovation economy every year, rates of schoolchildren studying ICT

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[45] *Removing Red Tape for Challenger Businesses.*

[46] *Unchaining Investment. Barriers to US venture investment in UK Internet and digital businesses*. (Nesta, June 2013).

[47] *Fact* or *Fiction - Venture Capital Funding in the UK Tech Sector is Dead. Dispelling the Myths*. (PwC, 2012).

subjects fell between 2002 and 2010[48]. UK-based entrepreneurs are particularly worried about the availability of highly skilled workers in the future, with 65% expressing concern with the situation (compared to 58% globally and 39% in Germany, for instance)[49]. The potential shortage of labour is exacerbated by the restrictive immigration laws which make it significantly harder to hire talented staff from outside the European Union, including the US and Russia (see Hiring non-EU workers). The Coalition government has committed to a net migration rate of below 100,000 people a year and, lacking the ability to control immigration from EU member states, has imposed severe restrictions on migration from outside the EU. An annual quota of 20,700 highly skilled workers has been set, which is spread across the year with a limited number of permits available each month; recent indications are that the quota will be further decreased in the near future. A license to hire non-EU workers must be acquired at significant legal and man-hours costs and compliance with annual reporting of the status of migrant workers is mandatory. Even then, a labour market test must be conducted to demonstrate that no home-based employee could be found to fill the position, and an expensive and lengthy application process follows for each individual employee (waiting times for a Tier 2 visa application submitted in Moscow are currently between 15 and 40 days)[50]. As the Nesta report notes, this means that in addition to the costs associated with hiring a foreign worker the flexibility of the labour force is reduced as a wait of several months can have significant ramifications for IT companies, for instance[51]. The government's anti-immigration policies may also serve to deter talented foreign workers from applying for UK-based job vacancies.

Similar problems exist for potential investors intending to relocate to the United Kingdom. Two routes are available through the so-called Tier 1 of the points-based application system (see Regulation of immigration). One requires an investment of at least 1 million GBP. A separate route exists for potential entrepreneurs, which in most cases requires having at least 200,000 GBP available for investment into a start-up or £50,000 GBP secured in venture funds or government sponsorships. Extra application fees and maintenance requirements apply; the average wait for a Tier 1 (Entrepreneur) visa when applying from Moscow is currently around 40 days. The visa is also liable to be revoked if the

[48] UK Government *Information Economy Strategy,* 2013.

[49] *The 16 Annual CEO Survey: Dealing with Disruption. Adapting to Survive and Thrive.*

[50] According to the numbers provided by the UK Border Agency in its application guidance.

[51] *Unchaining Investment. Barriers to US venture investment in UK Internet and digital businesses*.

business fails, highlighting the cultural differences between the American and British approaches to start-ups and risk. Visa regulations change frequently and more uncertainty is expected in the future as the UK Border Agency is currently being incorporated into the Home Office.

Finally, additional considerations include the relative weakness of the manufacturing sector (including, for example, the scarcity of large-scale industrial facilities in such areas as high-precision engineering and robotics) [52], dependence of the British hi-tech market on one geographical area (London), and occasionally weak links between the industry and some of the leading UK universities, including a lack of 'real-world' training, in contrast to such American models as Stanford University or the University of California at Berkeley.

Conclusion

Overall, however, the UK must be acknowledged to be in a very strong position for attracting foreign investment, and in particular as regards its role as an entry point to the large EU single market. It is true that a number of barriers to investment exist. Among these, perhaps the most significant is the restrictive immigration regime which makes it difficult both to apply for visas to commence investment activity in the UK and to hire the best people on the global labour market - a problem that is most relevant for innovative businesses, particularly SMEs. The regulatory environment presents another barrier that has as much to do with the culture of doing business as with the actual costs of compliance, which are relatively low by European standards. Finally, the venture capital investment market is only starting to develop in the UK, owing to a high degree of legislative restrictions as well as a more risk-averse business culture. While setting up a company to develop a business idea is relatively straightforward, the creation of venture capital funds can present a bigger problem, in terms of regulation as well as the immigration laws. Nonetheless, recent efforts by the British government, including significant cuts in the rate of corporation tax, major incentives for innovative businesses, and efforts to decrease the burdens of regulations on SMEs, dramatically improve the outlook for investment into the United Kingdom. Among other European nations, the UK presents the picture of an investment market with the lowest barriers to entry and some of the best conditions for future success.

[52] 'Bridging the valley of death: improving the commercialization of research. Eighth Report of Session 2012-13'. House of Commons Science and Technology Committee.

Jurisdiction and the legal system

Summary

The British legal system is widely considered to be among the most stable and independent in the world. Its distinctive feature is its reliance on common law, which means that courts are bound by precedent which can only be overturned by a higher court. Statute law (passed by the Parliament) is also a factor, although most laws simply set down the framework for later interpretation by the executive (which interpretations can be challenged in court). European legislation is binding in the UK. Cross-border jurisdiction is possible, although the precise factors determining the jurisdiction can be a complex issue and best practices involve including a jurisdiction clause in contracts. Finally, although the British legal system is typically considered highly advantageous for many kinds of litigation, entrepreneurs and investors should be aware that common law can introduce unexpected difficulties in cases involving innovation.

General overview

The British legal system has the distinction of being among the oldest and most established legal systems in the Western world. The oldest legal statute that is still in force in the UK today dates back to 1267 and establishes the importance of courts for litigation. A major feature of the British law is its reliance on precedent rather than codification, which over time has led to the development of a strong and highly independent judiciary. Although there is no single legal system throughout the UK, the English (also in effect in Wales), Scots, and Northern Irish legal systems share crucial features and are overseen by the same Supreme Court (with the exception of criminal cases in Scotland).

The high reputation of the British legal system means it is often considered among the most trustworthy in the world. This reputation can be particularly advantageous in litigation that involves companies or individuals representing different countries, since it is highly unlikely that a case tried in a British court will be treated with anything other than impartiality. The common law system is also considered by some to have advantages in cases involving contracts and disputes.

Nonetheless, investors should be aware that the British jurisdiction has its disadvantages when it comes to cases involving innovation (for example, patent litigation). The common law system means that the courts rely on precedent to a great degree. However, many cases involving innovative companies deal with entirely new concepts, which makes decisions much harder to plan for than in more basic situations, while the interpretation of existing case law is far from straightforward. This is in addition to the fact that the VC and financial industry in general are tightly regulated and can run afoul of the law. Finally, once a ruling has been made all other courts of the same level *have to* follow it until it is overturned, meaning that landmark legal decisions in cases involving innovation may prove to be disadvantageous to participants in the innovation ecosystem. While it is possible to overturn such decisions through the appeals process, it can be both lengthy and costly.

Common law

The bulk of British legislation belongs to the so-called common law, or law established by precedent rather than legislation. Typically, the courts follow the rulings issued in previous, similar (like-for-like) cases until a higher court overturns those rulings. There are two types of precedents – *binding* (rulings issued by a higher court on a case argued on the same legal point) and *persuasive* (other rulings considered relevant to the case at hand, with those issued by higher courts considered more persuasive than others). An important feature of the legal system that allows common law to be followed efficiently is a rigid structure, which consists of County, Magistrates', and Crown courts at the bottom, the High Court and Court of Appeals in the middle, and the Supreme Court at the top of the system. Within this hierarchy, decisions made by lower courts cease to be precedents if overturned by one of the higher courts; decisions made by the higher courts are in turn binding on all lower courts. This creates a fairly transparent and flexible system, which does not rely exclusively on national legislation.

Statute law

At the same time, the common law in the UK is complemented by statute law – the legislation passed by both Houses of Parliament. With the exception of EU-wide law (see below), the Parliament is presumed to be sovereign – that is, the Acts of Parliament cannot be overturned by courts and are binding on them. They can, however, be repealed by successive Parliaments. There exist two types of statute law: *primary* and *secondary*.

Primary legislation consists of laws passed by the Parliament and often provides a framework for the development of secondary law, which is made by the executive branch. For example, an Act of Parliament may set out the broad outlines for a particular law and delegate the authority to provide the details of implementation to a branch of the Cabinet or a local authority. Typically, a much larger number of secondary legislation is passed every year (in 2012, 44 and 4,150 pieces of primary and secondary laws, respectively, were passed). Secondary laws have the same standing as primary, but unlike Acts of Parliament, these can be struck down by the Supreme Court of the court decides the executive exceeded the authority granted by the relevant Act.

It is also worth noting that the legislative process in the UK is highly transparent: each bill goes through three readings each in both Houses of Parliament; most bills are typically precede by a prolonged public consultation, during which members of the public and organisations can express their opinions of the proposed changes; the government routinely publishes responses to these consultations, outlining their intended course of action in advance. This means that individuals and businesses, as a rule, have notice of proposed changes and can plan accordingly.

European legislation in the UK

As a full member of the European Union, the United Kingdom is subject to all EU legislation. European laws have supremacy over all local legislation, including Acts of Parliament, to the extent that the Supreme Court may strike down such an Act if found to be in breach of EU legislation. This means that all UK-based companies and all individuals within the jurisdiction of English, Scottish, and Northern Irish courts are also subject to EU legislation. This may change in the future, should the UK decide to withdraw from full EU membership.

British jurisdiction over cross-border cases

Where the defendant in a case is based overseas, the jurisdiction under which the case will be tried depends on a number of factors. Typically, the chief factor is the domicile of the *defendant,* but other facts of the case can have an effect. These situations can be very complicated and professional legal advice should be sought. Generally, the following scenarios will establish a British jurisdiction:

- Where both parties agree to try the case in a British court – for example, when this is specified by a clause in a contract.
- If the claim is served to the defendant when they are in Britain. This also applies to non-EU companies that have a UK branch registered with the Companies House. Cases against EU companies and citizens will generally be tried in the courts of the relevant EU country.
- If a British court decides it has jurisdiction over the case, taking into account its particular facts (domicile of parties, the place of performance of contract, which jurisdiction is more convenient for the trail, the location and interests of witnesses, and many other).

Similar issues exist for cases between Scottish and English/Welsh parties. There may also be international conventions or agreements between the UK and other countries that dictate the jurisdiction in a particular case.

Doing Innovative Business in the UK

Taxation

Summary

Although the UK has relatively high levels of personal and corporate taxation compared to many countries, it has one of the most competitive taxation regimes among the developed economies. The government has also made available a number of very tax-effective schemes, which are particularly suitable for innovative businesses carrying out R&D investors willing to invest into smaller, higher-risk companies.

- The personal *income tax* rate is **20%** at the basic rate (taxable income under £32,010 *p.a.)*, **40%** at the higher rate, and **45%** (taxable income over £150,000 *p.a.*). The first **£9,440** earned in a year are not taxable for most people. *Dividends* are effectively tax-free at the basic rate and taxed at **25% and 30.56% for the higher and additional rates respectively.** *Capital gains* are taxed at **18%** at the basic and **28%** at the higher/additional rates. The first **£10,900 in capital gains are non-taxable for most people.**
- Employees pay **12%** in *national insurance contributions* on all income up to £41,450 *p.a.* and 2% on everything above. Employers pay another **13,8%** on top. Most self-employed people pay a little over **9%**.
- The corporation tax rate is **20%** for small companies (<£300,000 *p.a.*) and **23%** (**21%** from April 2014) for large companies (>£1.5 million *p.a.*). The rate is adjusted for profits between these thresholds. From April 2015, all companies will pay 20% in corporation tax. Value-added tax is currently at **20%**.
- Capital expenditure can be claimed against taxation. R&D expenditure (including salaries) provides up to **225%** in tax relief. Profits from patents (currently 60%, to rise to 100%) are also exempt from taxation. Among other schemes, **30%** of investment (up to an annual limit) in unlisted SMEs and **50%** of investment in small start-ups is exempt from income and capital gains tax.

General overview

In the past decade, the United Kingdom has made great strides in making its corporate and personal income taxation regimes competitive on the global scale. If in 2008 the UK's corporate tax main rate (then at 30%) was the sixth-highest in the European Union and above the EU average, a recent report by the World Bank and PwC that looked at a combination of total tax rates, compliance costs, and complexity of the system gave the country an overall 14th place in the world[53]. According to this report, the UK is the third best country in the EU for corporate taxation – after Ireland (6th) and Denmark (12th) – and performs significantly above averages for the G8, G20, OECD, and EU/EFTA taxation regimes on all metrics[54]. Similarly, a survey conducted by KPMG among top British executives showed that the UK is generally seen as having the most attractive tax regime among its competitors, including Ireland and Switzerland, with 65% of respondents naming it as a top choice[55]. Much of this good will has been earned in recent years by the current Conservative/LibDem coalition, which has committed to a transparent road map of tax reforms that makes it possible for businesses to plan ahead. The stability of the British political and legal system is a major advantage for businesses planning to conduct operations in the UK.

'One of the most attractive aspects of any tax system for international investors is stability. The approach of [the UK] government in laying out its corporate tax road map for reform has helped in this respect, as has the model adopted by the UK tax authorities, Her Majesty's Revenue and Customs, (HMRC) and its risk based approach to dealing with taxpayer issues'[56].

Similarly, despite relatively high levels of personal taxation (with a basic rate of 20% and a top one of 45%), the UK actually compares well with the rest of the OECD, especially when social insurance contributions are taken into account (see inset). Overall, the UK has embarked on a programme of tax reform that has helped it become one of the most attractive among the developed economies, and the current government

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[53] Paying Taxes 2014: The global picture. A comparison of tax systems in 189 economies worldwide. (PwC and World Bank, 2013). URL: <www.pwc.com/payingtaxes>

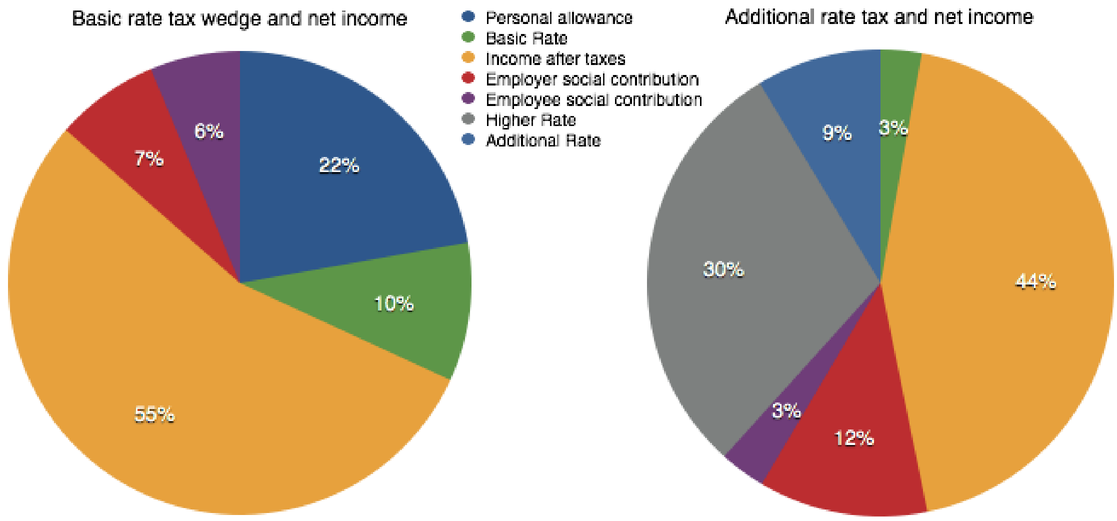
[54] The UK currently has a higher headline rate for taxes on corporate profits, but this is both offset by much lower social security contributions and will decrease in the near future (see the rest of this guide).

[55] KPMG Annual Survey of Tax Competitiveness 2013 (KPMG, December 2013). URL: <http://www.kpmg.com/uk/en/issuesandinsights/articlespublications/pages/tax-competitiveness-survey-2013.aspx>

[56] Paying Taxes 2014, p. 109.

has repeatedly demonstrated its commitment to reducing the burden of taxation on UK-based businesses.

The 'tax wedge' is calculated as a percentage of total wage income that is paid in taxes and other contributions to the government – whether by the employee or their employer. The average tax wedge among OECD countries for 2013 is 35,6%, with the UK (at 32,3%) below that average. The highest tax wedges are in countries like Belgium (56%), France (50,2%), and Germany (49.7%), meaning that the costs of employment and levels of income taxation in these economies are much higher than in the UK[57].



Income tax

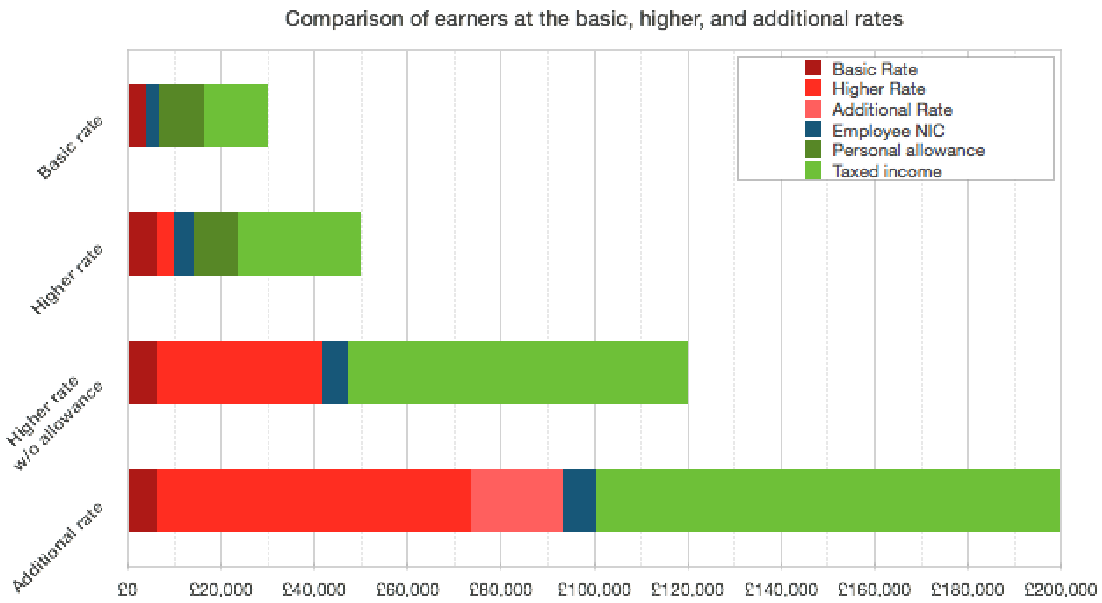
Tax on earnings

The UK has a progressive tax regime, meaning that higher earners are taxed at higher rates. At the same time, most people working in the UK receive an automatic tax-free allowance of **£9,440** (to be raised to **£10,000** from April 2014 and likely to be indexed to inflation from then on)[58]. There are three tax rate brackets:

[57] Taxing Wages 2013. (OECD, 2013). URL: <http://www.oecd.org/ctp/tax-policy/taxing-wages.htm>

[58] While we aim to make this section as comprehensive as possible, there are a number of exceptions and special cases that cannot be covered here in sufficient length. Full guidance is available at the HMRC website (<http://www.hmrc.gov.uk>).

- **20% (basic):** applies to all taxable income (*i.e.* above the personal allowance) of up to **£32,010** (£31,865 from 2014/15).
- **40% (higher):** applies to all taxable earnings above the basic bracket and up to **£150,000**.
- **45% (additional):** all taxable earnings **above £150,000**.



This means that, in 2014/15, people earning up to £41,865 (basic threshold plus personal allowance) a year will pay 20% income tax on all earnings above £10,000. When earnings in a year exceed £41,865, all additional income is taxed at 40%. Personal allowances still apply to everyone earning less than £100,000 *p.a.* At that stage, the personal allowance is reduced by £2 for every £1 of *adjusted net income* (that is, excluding allowances such as for charitable donations) above the £100,000 threshold (see inset and Example 3). In effect, anyone earning enough to reach the additional rate will not have a personal allowance and all income after the threshold is reached will be taxed at 45%.

People earning over £120,000 *p.a.* in 2014/15 will not have a personal allowance and will be liable for 20% of £31,865 (*i.e.,* £6,373) and 40% of the remaining £88,135 (*i.e.,* £35,254) in income tax (or a total of £41,627).

The income tax is typically deducted from an employee's salary through the electronic PAYE system, which automatically calculates the amount payable in any given month and takes into account the personal living allowance and other applicable deductions. Self-employed workers and company directors need to register with the HMRC and fill in a self-assessment form (available online), regardless of whether their taxes are already deducted via PAYE. The deadline for the online return is **January 31** for the previous fiscal year (*e.g.*, 31/01/2014 for the 2012/13 fiscal year).

There are a number of benefits (mostly conditional on age) and deductions (on charitable donations, business expenses, etc.) available. Full information is available on the HMRC web-site.

Example 1: Basic rates of income tax and NICs

For an employee with a gross salary of **£30,000** in 2013/14:

- Income tax of *20%* on £20,560 (total earnings minus personal allowance), *i.e.* **£4,112** (deducted monthly from gross salary via PAYE).
- A primary National Insurance Contribution of *12%* on everything above £7,755 a year, *i.e.* **£2,670.24** (deducted monthly from gross salary via PAYE).
- Total tax deducted from the gross salary in 2013/14 will be **£6,782.24**, leaving the employee with **£23,217.76**.
- The employer will also need to add their own (secondary) National Insurance Contribution on top of what was deducted from the gross salary at *13.8%* for everything earned by that employee above £7,696 a year, which in our example will come to **£3,077.95**. This is also calculated automatically by the PAYE system.

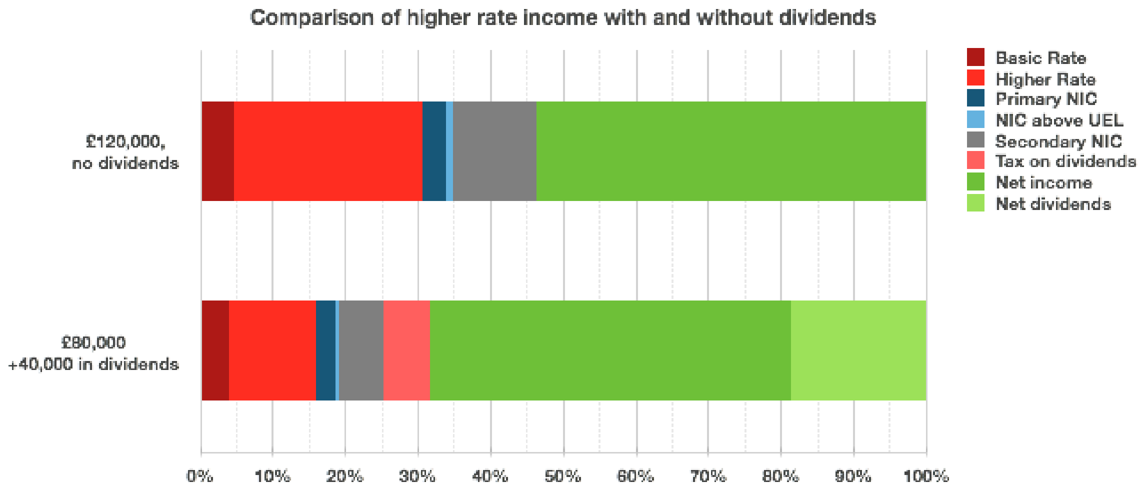
Tax on dividends

Income from UK dividends is taxed at different levels depending on the total taxable income, using the same thresholds (£32,010 and £150,000). The dividend income (like savings income) is treated as 'the top slice' – that is, other earnings are taken into account before the appropriate rate is calculated. Because the dividends are paid from company profits that are assumed to have been taxed, all dividends come with a 10% 'tax credit' (typically automatically deducted before the payment of dividends). The rates of taxation for UK dividends are:

- **Basic:** 10%. Because of the tax credit, all dividend payments under the taxable basic rate threshold (*i.e.*, when total taxable income including dividends is less than £32,010 for 2013/14) have effectively been taxed prior to payment and the shareholder does not need to pay any further taxes.

- **Higher:** 32.5%. Because of the tax credit and thanks to the fact that the credit is taken at source, any actual dividend payments that fall above the basic threshold are effectively taxed at **25%.**
- **Additional:** 37.5%. The application of the tax credit means that the actual dividends paid to a taxpayer in the additional rate bracket are taxed at **30.56%.**

Where the dividend income is split between two brackets (*e.g.* £1,000 before the threshold is reached and £800 after), the two parts are taxed accordingly (*e.g.,* **0%** and **25%** on the basic and higher rates respectively). Dividend earnings are exempt from NICs (but the payments are subject to corporation tax, unlike salaries and bonuses).



National Insurance Contributions

In addition to income tax, most earners in the UK need to make a regular social security contribution (NIC). For employees, the contribution is split between themselves (so-called primary contribution) and their employer (secondary contribution). The primary contribution is deducted from the gross salary, whereas the secondary is paid on top of it. The NIC is only paid on earned income (wages and salaries), but not savings or dividends.

The size of the contributions depends on the employee’s salary:

- For people earning less £641 a month (or £7,696 *p.a.* – Secondary Threshold) no contribution is required;

- For all earnings between £646 per month (or ££7,755 *p.a.*)[59], and up to £3,454 per month (£41,450 *p.a.*), the primary contribution is typically *12%* and the employer contribution is *13,8%*.
- Earnings between £641 and £646 per month are subject only to secondary (employer) contributions at *13.8%*.
- £41,450 **p.a.** is known as the Upper Earnings Limit (UEL). All earnings above the UEL are subject to only *2%* in primary contributions, but a full *13.8%* in employer contributions.

Example 2: Higher rate of income tax and NIC above the upper earnings limit

For an employee with a gross salary of £50,000 in 2013/14:

- Income tax of *20%* on £32,010 (total earnings minus personal allowance), *i.e.* **£6,402** – maximum amount possible under the basic rate (deducted monthly from gross salary via PAYE).
- Income tax of *40%* on £7,990 (total earnings minus personal allowance and the £32,010 already taxed at the basic rate), *i.e.* **£3,420** (deducted monthly from gross salary via PAYE).
- A primary National Insurance Contribution of *12%* on everything between £7,755 and £41,450 a year, *i.e.* **£4043.4** plus a contribution of 2% on the difference between gross salary and £41,450 a year, *i.e.* £171. Total employee NIC is **£4,214.64** (deducted monthly from gross salary via PAYE).
- Total tax deducted from the gross salary in 2013/14 will be **£14,036.64**, leaving the employee with **£35,963.36**.
- The secondary contribution by the employer is *13,8%* on all earnings above £7,696 with no upper limits, *i.e.* **£5,837.95**.

Self-employed people (but not company directors) pay a different rate of NIC, known as Class 2: a flat rate of £2.70 a week, paid by direct debit. People earning less than £5,725 a year can apply for an exception. Self-employed people earning between £7,755 and £41,450 a year pay an additional 9% on annual profits (calculated automatically with the annual tax return), and 2% on any income above £41,450.

It is important to remember that the secondary contribution comes on top of gross salary, and labour costs are therefore 13.8% higher than the salary itself. However, the government has recently announced that

[59] This is known as the Primary Threshold and serves essentially as a personal allowance for NICs.

from April 2014 every employer in the country will have an **'employment allowance' of £2,000** on Class 1 contributions, meaning that the first £2,000 of all NIC in a year do not need to be paid. This enables businesses to pay up to £22,400 a year in salaries without making a Class 1 contribution. This is particularly helpful for start-ups, where the financial barrier to hiring a first employee is significantly reduced.

Capital gains tax

Gains on the disposal of capital assets (property, shares, business and overseas assets) are subject to a capital gains tax. [60] The 'gains' are defined as the difference between the value of the asset when it came into your possession and its value when you disposed of it – regardless of whether you received any compensation for the disposal (gifts are therefore also subject to CGT). Most UK tax residents receive an Annual Exempt Amount and all gains under it are not taxable. The amount for 2013/14 is **£10,900** (or £5,450 for most trustees). You will have to pay CGT on all gains above that level.

The rate of tax depends on your overall taxable income. Taxable gains (total gains minus Annual Exempt Amount) are added to your total taxable income. Everything below the basic rate threshold (see above) is taxed at **18%**; everything above at **28%**. There are tax reliefs available, such as the Entrepreneurs' Relief (see 2.a) and gains on certain kinds of shares (see 3.a).

Taxation of overseas residents

For UK tax residents who are not 'domiciled' in the country (*i.e.,* not born in the country or intending to reside their permanently), there are two options for the taxation of foreign income. One is the **arising basis** of taxation, which is the same system that is used for all UK-domiciled taxpayers: income and other taxes are paid in the same manner on foreign as on domestic income, as described above. Essentially, all income is declared and subject to UK taxes. If that income had already been taxed in the country where it was received, you can claim for double taxation relief to reduce your tax liability in the UK by the amount you had already paid in another country.

[60] Certain kinds of assets – personal cars, main home, certain kinds of shares – are exempt from the CGT.

The other option is the so-called **remittance basis** of taxation. In this case, only income brought into the UK (whether by bank transfer, in cash, or if used for purchases) is taxed, as long as the non-remitted income is taxed in the country where it was earned. (Foreign income brought into the UK for investment purposes can be exempt from UK taxation – see 3.a). However, people who have over £2,000 p.a. in untaxed income and claim the remittance basis are not entitled to the personal allowance for income tax and the annual exempt account on CGT. That means that they will have to pay taxes on *all* remitted income.[61] There is also an annual remittance basis charge of either £30,000 or £50,000 *p.a.* for long-term residents (7 and 12 years respectively) who choose not to pay tax on the arising basis.

Corporation tax

The rate of corporation tax depends on the size of the company. The government is in the process of decreasing corporation tax to 20% from 2015 for all types of companies, but current rates are **20%** for companies with 'small profits' of £300,000 *p.a.* and **23%** (21% from 1 April 2014) for companies with profits of over £1.5 million. Companies with profits in between these two figures are eligible for marginal rate relief, where the corporation tax rate rises gradually from the lower to the higher rate depending on the profits posted by the company.[62] The 20% rate also applies to unit trusts and open-ended investment companies.

The financial year for the corporation tax runs from 1 April to 31 March. Registered companies (excluding partnerships, which are transparent for tax purposes) are liable for corporation tax, including overseas companies with UK establishments (but in that case only profits arising from UK activities are taxable), and need to file tax returns within 12 months from the end of the accounting period and pay the corporation tax within 9 months and 1 day from the end of the accounting period. The corporation tax is paid on trading profits as well as capital gains incurred by the company.[63] If a company makes a trading loss, it is possible to

[61] There is an exemption in place for UK residents who are employed in the UK and pay income tax through the PAYE system (rather than self-assessment) if their foreign employment income is less than £10,000 p.a.

[62] It is possible to calculate the company's marginal rate by using the calculator provided by HMRC: <http://www.hmrc.gov.uk/calcs/mrr.htm>.

[63] This is known as a chargeable gain and can take into account additional expenses since coming into possession of an asset, as well as inflation. A detailed description is available online: <http://www.hmrc.gov.uk/ct/managing/company-tax-return/returns/chargeable-gain.htm>.

carry it forward, in which case the taxable profits in the following year will be reduced by the appropriate amount. There are also a number of allowances and relief schemes available that can significantly decrease the amount of tax innovative companies have to pay (see 2.a).

Controlled Foreign Companies

Companies controlled by UK residents but located outside the UK and subject to significantly lower levels of taxation in their country of operation may be subject to a lower rate in the UK. This is a complicated issue and professional legal and accounting advice should be engaged.

VAT and other taxes

The Value-Added Tax in the UK is a consumer tax on certain types of services and goods. The cost of VAT (which is currently at **20%**) is included into the price of goods and services, and all VAT collected by a company will need to be paid to HMRC. However, for companies that both produce and consume goods and services, the amount of VAT owed to HMRC is a balance of VAT paid and charged. For example, a business that collected £5,000 in VAT and paid £4,000 in VAT over a year will only need to pay £1,000 to HMRC. Similarly, a business that *paid* more in VAT than it collected can ask for a refund from HMRC, which is typically paid within 10 working days. Companies **must** register for VAT if their VAT-taxable turnover exceeds £79,000 in a year.

VAT issues can become complicated when trading across borders. From 1 January 2015, for example, providers of electronic services will need to pay VAT according to the location of their customer in the EU, rather than in their place of business. However, EU countries are planning to role VAT Mini One Stop Shops (MOSS), which will allow EU businesses to make all VAT declarations to one organisation.

Other relevant taxes include stamp duty tax (0.5% paid on all share purchases over £1,000 in value) and business rates (small taxes on the premises occupied by the company, set by the local authorities according to the value of the premises and rarely exceeding 3 to 5%).

Relief schemes for businesses and employees

Capital allowances

There are a number of allowances that businesses can claim for capital expenditure (‘plant and machinery’, but generally including most necessary business equipment, including *e.g.* laptops) against their taxable profit. Capital expenditure is generally available for purchases with a useful life of 2 years or more and should exclude the VAT if the claimant is registered for VAT (see 1.b). The sum of the allowance can then be deducted from the total taxable profit before calculating the amount of corporation tax (or income tax for partnerships and self-employed persons).

- *First-year Allowance:* businesses can claim a 100% of the cost of ‘green’ equipment – water-efficient or energy-saving technologies, as well as low-emissions vehicles. The claim can be made in the same year that the equipment was purchased.
- *Annual Investment Allowance (AIA):* each business can claim up to a certain amount of money for purchased equipment every year. This means the taxable profit can be decreased by the amount of capital expenditure up to the relevant limit. The total size of the allowance depends on when the equipment was purchased. Currently, the AIA is **£250,000** for equipment purchased after 1 January 2013. This is expected to change in 2015.
- *Writing-down Allowance:* In addition to the AIA, each business can claim up to **18%** of expenditure on a piece of equipment in one year.[64] The balance of that expenditure is then carried over to the next financial year, when the WDA can be claimed again on the ‘unrelieved expenditure’. For example, a £10,000 purchase made in 2012 will allow the business to claim £1,800 in FY2012/13, with £8,200 carried over. In FY2013/14, the business can then claim 18% of that (£1,476), and so on, until the expenditure is completely written-down.
- *Research and Development Allowance:* Capital expenditure for purposes of research and development can qualify for relief of 100% of the cost of asset.

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[64] 8% on some cars, integral building features, and assets with an expected useful life of over 25 years.

Small business rates relief

Companies occupying just one property with a rateable value of less than £12,000 can claim an exemption to business rates of up to 100%. The rate of relief gradually decreases from 100% to 0% for properties with a rateable value of over £6,000. Small businesses also get a discount on the business rate for properties with a rateable value of less than £18,000.

Enterprise Management Incentives (EMI)

Independent companies with less than 250 full-time employees and gross assets under £30 million can grant up to £3 million in share options to its employees (up to £250,000 per employee) and these shares will not be subject to taxation when the option is realised. This is intended to make it easier to attract and retain high-quality employees for small innovative SMEs and start-ups (this excludes most financial services companies, but includes R&D). The value of the shares is determined either according to market value (if the company is listed on a stock exchange) or the company's valuation (which may be subject to an HMRC audit) [65].

Employee shareholders

There is a separate incentive in place for 'employee shareholders' that exempts gains made from the disposal of shares acquired under an employee shareholder agreement from CGT and provides a personal allowance of £2,000 for income tax and NICs on such shares (meaning that the first £2,000 in such shares are exempt from taxation).

Incentives for innovative start-ups and venture capital investors

The types of incentives that are particularly helpful to innovative companies in the UK can be categorized into two areas: taxation relief for knowledge-intensive companies and highly tax-effective schemes for investors that make it significantly easier to raise early-stage funding.

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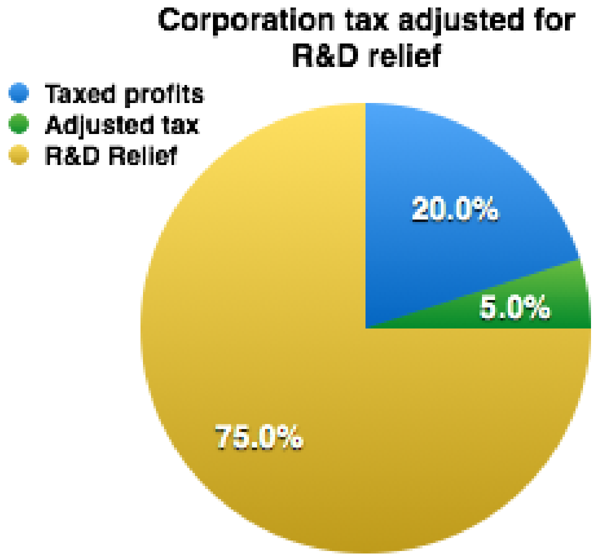
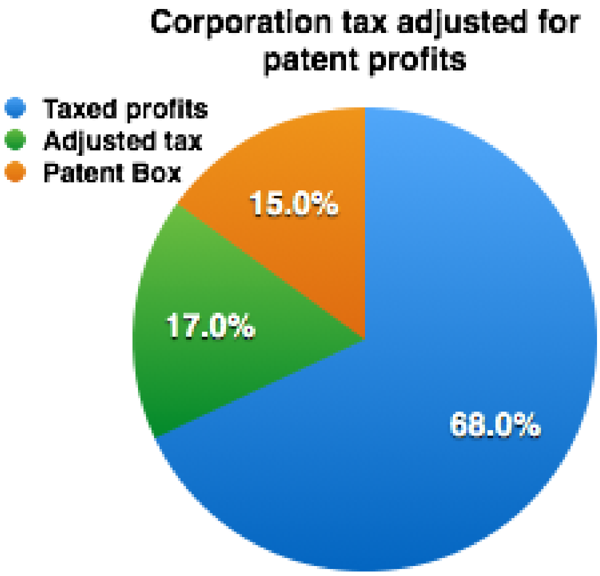
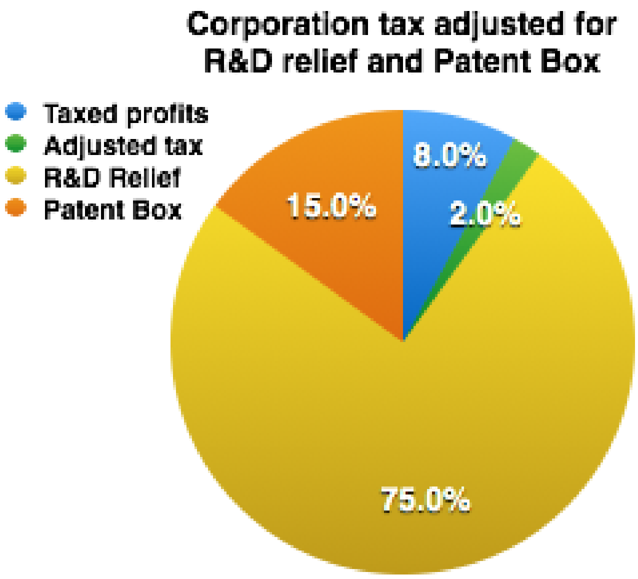
[65] There is a number of conditions applied to shares under the EMI scheme and the shares may become taxable in a number of situations. Full guidance is available online: <http://www.hmrc.gov.uk/shareschemes/emi-new-guidance.htm>.

R&D Relief and the Patent Box in Four Charts







In the charts above, a hypothetical company pays **20%** of Corporation Tax on an annual profit of **£300,000**. If half of these profits come from qualifying patents, its tax liability is decreased by 3% to **17%**. If it spends £100,000 p.a. on qualifying R&D, it can pay only **5%** in tax. A combination of R&D relief and Patent Box under these conditions gives a tax liability of **2%**. Thus, a highly-innovative company that has patented its inventions and invests relatively heavily in further research and development can, under these circumstances, pay 10 times less tax than an SME that does not take advantage of these schemes.

R&D Relief

Expenditure on research and development[66] is highly tax-efficient. An innovative SME, defined as a company with fewer than 500 employees and either a turnover of less than €100 million or balance sheet of less than €86 million may claim up to **225%** on revenue expenditure related to R&D activities. That includes employee costs, materials, payments to volunteers, utilities, software, and subcontracted expenditure. Thus, a company with qualifying R&D expenditures of **£100,000** can reduce its taxable income by **£225,000**. This rate is only available to registered companies paying Corporation Tax (not partnerships). The R&D relief can also be carried forward to the next financial year if the company suffers a trading loss. However, if a company received a grant or subsidy for the R&D project in question, the expenditure on which relief can be claimed is reduced by the sum of the grant (if the grant qualifies as State Aid under EC conditions, no relief can be claimed at all).

A *Large Company* rate also exists, which provide relief of 130% to companies that do not qualify as SMEs.

Patent box

Companies that own patents or exclusive licenses to patents registered by the UK Intellectual Property Office, the European Patent Office, or many of the EEA patent offices can receive tax relief on profits originating from these patents. To qualify, the profits must come from selling patented products (including products incorporating the patented invention), licensing or selling patent rights, as well as infringement income and other compensation related to patent rights. The patent in question must have been developed or commercialized by the company in order to qualify for the Patent Box scheme.

The Patent Box works by decreasing the Corporation Tax rate on qualifying profits by 10%. The proportion of patent income that qualifies for relief is currently at **60%** and is being increased by 10% every accounting year:

- 1 April 2013 to 31 March 2014: **60%**
- 1 April 2014 to 31 March 2015: **70%**
- 1 April 2015 to 31 March 2016: **80%**

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[66] HMRC provides a guide to what constitutes research and development: <http://www.hmrc.gov.uk/manuals/cirdmanual/cird81900.htm>.

- 1 April 2016 to 31 March 2017: **90%**
- From 1 April 2017: **100%**

The amount of income to be deducted from taxable profits is calculated by multiplying the qualifying profits (*e.g.* £6,000 out of £10,000) by the formula 'Main rate minus 10 per cent divided by the main rate:

$6{,}000 \times ((20-10) \div 20) = 3{,}000$

The Patent Box sum is then deducted from total profits (the £10,000) to arrive at the taxable income (£700). Thus, a company claiming the Patent Box deduction will pay £1,400 in Corporation Tax instead of £2,000.

Venture Capital Schemes

There is a number of incentive programmes in place to encourage investment in small unquoted companies in the UK, known as the Venture Capital Schemes.[67] Companies are not allowed to raise more than £5 mln in any 12-months period from Venture Capital Schemes, including investments that qualify as Risk Capital Investments under EU State Aid rules.

Enterprise Investment Scheme

The Enterprise Investment Scheme (EIS) allows investors to claim significant reduction on their income tax and capital gains tax if they invest into small British businesses. The EIS entitles investors purchasing up to £1 mln in full-risk ordinary, non-redeemable shares of companies not listed on the LSE (although AIM-listed companies qualify).

The company in question must not have gross assets exceeding £15 million before the investment in question, should not be controlled by other companies, must not have subsidiaries in which it controls less than 90%, and should have fewer than 250 employees. The investor must not control more than 30% of the company (or be entitled to as much if the company winds up), should not have voting rights, and should not be its employee or director. (There is a 'business angel' exception for directors who are not entitled to renumeration). The purchase shares need to be

[67] Guidance on VCMs can be found online: <http://www.hmrc.gov.uk/manuals/vcmmanual/>. As usual, these schemes may be quite complicated and we aim to only give a general overview.

held by the investor for at least 3 years and the invested funds can only be used for the purposes of carrying out the company's trade (this excludes purchase of shares in most cases).

If all conditions are satisfied, the investor is eligible for income tax relief amounting to **30%** of the investment (*i.e.,* a reduction in taxable income of up to £300,000 in any one year). The gains from disposing of such shares after holding them for the requisite period are also exempt from the Capital Gains Tax. Loss relief may be available on shares disposed of for a loss. Finally, EIS investments can be used to defer capital gains tax payments while the gain is invested (the gain needs to be made one year before or within three years from the purchase of shares).

These kinds of investments can also be made through approved EIS funds, with the income tax relief on the value of shares on the date of fund closing rather than share purchase.

Seed Enterprise Investment Scheme

The Seed Enterprise Investment Scheme (SEIS) is a similar scheme, intended to encourage early-stage investment. The company in question must have been trading for less than 2 years, have under £200,000 in gross assets, fewer than 25 employees, and not be listed on the LSE or other recognized stock exchanges (excluding AIM and most PLUS Markets). The company must also not have received any investment from VCTs (see below) or issued shares eligible for EIS and it cannot raise more than £150,000 in SEIS funds (including State Aid grants, see above). It must not be a member of a partnership, must not be controlled by other companies, or have subsidiaries in which it owns less than 50% or which are controlled by other companies.

The investor must not be connected to the company for HMRC purposes (although they may be a director). For qualifying investments, the relief available is **50%** of up to £100,000 in investment annually (*i.e.,* up to £50,000 a year). If held for three years, capital gains from the disposal of such shares are also exempt from CGT. Any company that receives a SEIS investment cannot issue EIS shares until it has spent 70% of that investment.

Venture Capital Trusts

Investors in Venture Capital Trusts (VCTs) are eligible for certain tax reliefs. VCTs are companies admitted to trading on regulated markets (according to EU definitions) and are essentially investment trusts specializing in high-risk, early-stage investment. VCTs must be registered by HMRC, but are exempt from Corporation Tax on gains arising from the disposal of their investments.

Investors in VCTs are exempt from income tax on VCT dividends and are eligible for tax relief of **30%** of the value of *new ordinary shares* issued by VCTs (but not on second-shares) up to a maximum of £200,000 in one tax year (*i.e.,* relief up to £60,000). Individuals are also eligible to not pay CGT on gains from the disposal of VCT shares if the VCT is still in operation at the time of disposal.

The conditions under which a trust may register as a VCT are described in detail on the HMRC website. The general rule is that at least 70 per cent of a trust's investments over the preceding year must have been in ordinary shares of unquoted companies with gross assets under £15 million[68].

Share Loss Relief

Under certain conditions, capital losses from investment in shares can be used for relief from income tax (for individuals) or corporation tax (for companies). The shares must have been subscribed to by the company/individual in question (with the exception of EIS shares purchased-second hand by individuals).

Corporate Venturing Scheme

The Corporate Venturing Scheme (CVS) operates in a manner similar to EIS, but exists as an incentive for corporate investment into small British companies. The qualifications for companies issuing shares under CVS are:

- The company must be unquoted
- Its gross assets must not exceed £7 million prior to issuing shares (and £8 million immediately after)
- It must not be a member of a group of companies or controlled by

[68] Available here: <http://www.hmrc.gov.uk/guidance/vct.htm#3>

other companies (but it can be parent company of a group that carries out qualifying trades)

- Not more than 80% of the company's shares can be held by employees (including directors) of the investing company or any other connected companies.

Similarly, the investing company must not own more than 30% of the issuing company throughout three years following the purchase of shares. Qualifying CVS investments allow the investing company to claim up to **20%** of the amount of investment against their taxable profits for Corporation Tax. There are no limits on the amount of investment annually, but the conditions on the total gross assets and the 30% limit described above present natural restrictions to the amount invested in any one company. Corporation tax on gains from the disposal of CVS shares can also be deferred as long as the gain is re-invested in another company under the CVS; the deferral period ends when the investment stops qualifying for investment relief. Under the same condition, capital loss from disposal of qualifying shares can be claimed for relief against the company's taxable profits.

Investment exemptions for remittances

As a rule, taxpayers who are non-domiciled or not ordinarily resident in the UK who claim the *remittance basis* of taxation have to pay taxes to HMRC on any income remitted to the UK (see Taxation of overseas residents). However, an exemption exists for foreign income brought into the UK for investment in a British company or start-up. This is known as Business Investment Relief. Any funds invested in this manner will not be treated as *remitted* for the purposes of taxation. In order to qualify, the investment needs to be:

- Made by an investor (or 'relevant person') who is **already claiming the remittance basis in the UK** in the tax year in which the invested funds were made
- The investment (purchase of newly issued shares or a loan, secured or unsecured) is made within 45 day of the income being brought into the UK
- The investment is in a **private limited company** that either:
  - carries out a *qualifying commercial trade* (including R&D) or intends to do so within 2 years from the investment (the *start-up rule*), or
  - is a *stakeholder company* that is established with the sole

purpose of investing in qualifying trading companies and makes at least one such investment within 2 years, or

- is *a holding company* that has (or is expected to have within 2 years) a 51% subsidiary which qualifies as a qualifying trading company. The trading group to which the holding company belongs must consist only of private limited companies and the group's primary activity must be a qualifying commercial trade (including R&D). The holding company itself must not be a 51% subsidiary of any other company.

In addition, the investment must not lead to or be expected to lead to a benefit (monetary or otherwise) that would not have been obtained without the investment or available to other people in the same position as the investor ('extraction of value'). This excludes, for obvious reasons, commercial returns. That is, dividends paid out of profits or a director's salary do not disqualify the investment from relief, since these would be available to any other shareholder or director; but a service provided at a discounted rate may be. Essentially, this provision exists to ensure that the investment is not made as a result of or in anticipation of a bribe of any kind.

The qualifying investments are treated as not remitted to the UK and therefore exempt from income tax; any gains arising from such investments are also not subject to the capital gains tax. However, the investment may become liable for taxation if:

- The investment is disposed of (*i.e.*, shares sold or loan fully or partially repaid), or
- The target company no longer qualifies for investment under the rules outlined above, or
- The target company does not become active within 2 years or stops its activities at any point after the end of the two-year period, or
- The 'extraction of value' rule is breached.

If any of the above events occurs, the investment will be liable to taxation, unless the investor either moves the proceeds out of the UK or re-invests them into another eligible company within 45 days of disposal (and has 90 days to dispose of the holding in the latter three cases).

Registration of businesses

Summary

Entrepreneurs in the UK have a choice of a number of legal entities for their companies, most of which need to be registered at the Companies House. The most frequently adopted legal entity is the private limited company, where the founders' liability is limited to their investment. When using model articles of association, these companies can be registered online. Other types include different partnerships, public limited companies (which can sell shares to the general public), and subsidiaries of overseas companies. Registration with the Companies House is followed by a number of other procedures, such as registration for taxation, purchase of compulsory insurance, and opening a bank account. Total time to open a company is on average around 12 days, although some procedures like VAT registration may take up to a month.

Introduction

The registration of new businesses in the UK is governed primarily by the Companies Act 2006, the full text of which is available online.[69] Other relevant acts include those regulating the payment of taxes (see 1.b) and licensing (see 1.d). The body responsible for the registration of new limited companies in England, Wales, Northern Ireland, and Scotland is the Companies House (an executive branch of the Department for Business, Innovation, and Skills). The full regulations related to the registration and running of a business are relatively complex, but this guide provides the basic information necessary to set up a new business in the UK. The procedure for the registration depends on the type of company.

Private limited company (Ltd)

This is the most common type of business in the United Kingdom. The liability of shareholders in a private limited company can be limited either by shares (to the amount of capital invested into the company) or by guarantee (to the amount agreed by the shareholders in the statement of guarantee – mostly used for non-profit organizations). The shares of a

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[69] URL: <http://www.legislation.gov.uk/ukpga/2006/46/contents>

private limited company cannot be sold to the public.

Documents required

To register a private limited company, its founders must submit to the Companies House the following documents:

- The application to register, including
  - The company name, which must be unique and avoid the use of 'sensitive' words[70].
  - The registered office address. This will be the address used for all communications by post in connection with the business, including by HMRC, and cannot be a PO box.
  - Director name and details. The company must have at least one director who is over 16 years of age. You may also name a secretary for the company. The following details are needed:
    - Full name
    - Residence address
    - Service address, which can be the same as the company's registered office
    - Country of residence
    - Nationality
    - Occupation
    - Date of birth and former names (if used for business in the past 20 years)
    - Signature (or 3 items of personal information if filing online).
  - Statement of capital and initial shareholders (for companies limited by shares) or a statement of guarantee (see above).
- The memorandum of association, confirming the intention of forming a company and, in the case of companies limited by shares, the members' agreement to purchase at least one share.
- The articles of association, outlining the rules of running the company. Most companies adopt model articles of association,[71] although they can also be amended or written from scratch as long as the rules do not violate existing laws. Any changes in the articles will need to be sent to the Companies House.

Limited companies must display include 'Limited' or 'Ltd.' in their

[70] Full list available here: <http://www.companieshouse.gov.uk/about/gbhtml/gp1.shtml#appA>

[71] Available, for example, here: <https://www.gov.uk/limited-company-formation/articles-of-association>.

name, but an application for an exemption from this rule can be made under certain circumstances.[72]

Registration process

The documents can be submitted to the Companies House in three ways:

- **Online**[73]**.** This is the easiest way, available to private companies limited by shares that use the model articles of association and a name that does not include 'sensitive' words. The payment for this is £15 and the processing time is around 48 hours.
- **By post.** A filled in application form IN01[74] and a memorandum of association, as well as a cheque payable to 'Companies House' need to be sent by post to the relevant Companies House office. If the model articles of association are used, they do not need to be sent with the application. The fee is £40 (8-10 days to process) or £100 for same-day processing (if received before 3pm).
- **Formation agents.** A new company can also be registered electronically using the services of a formation agent.[75] These applications are typically processed within 24 hours for a fee of £13 (£30 for processing on the same business day), but the agents will normally charge their own fee on top of that.

After the Companies House processes and approves the application, it will issue a Certificate of Incorporation and send it to the registered office address. It is important to note that the incorporation does not take place until the application is approved and the certificate is issued. After this, there a number of steps a company must take to operate legally.

HMRC will be informed by the Companies House of the newly registered company. At this stage, it will send a Unique Taxpayer Reference to the registered office address. You must contact HMRC **within three months** of starting business activity (trading, advertising, managing investments, or employing people). This can be done either

[72] Typically for a non-profit – more details available here: <http://www.companieshouse.gov.uk/about/gbhtml/gp1.shtml#ch6>.
[73] The Web Incorporation Service: <https://ewf.companieshouse.gov.uk//runpage?page=welcome>
[74] Available online: <http://www.companieshouse.gov.uk/forms/formsContinuation.shtml#IN01>
[75] A list of approved agents is available on the Companies House website: <http://www.companieshouse.gov.uk/toolsToHelp/formationAgents.shtml>

concurrently with the Web Incorporation Service or through the HMRC online registration service[76]. You will then need to consider which HMRC services you need to enrol for:

- **Corporation Tax Online:** You will receive a PIN-code by post within **7 days** of registering online. The letter will also inform you of the relevant deadlines for corporation tax online payments and records filing. Note that if you informed HMRC of the start of business activity through the Companies House system, you must still register for Corporation Tax Online separately[77].
- **PAYE:** You need to register for the PAYE (Pay As You Earn) system for income tax and NICs payments in advance of the first pay day. This can be done online simultaneously with registering for Corporation Tax,[78] but keep in mind that the PIN-code will take up to **7 days** to arrive by post before you can set up the PAYE system. Note also that company directors need to fill in individual Self-Assessment tax return forms even if they have no sources of income other than their salary.
- **VAT:** You must register for VAT if your turnover in the next 30 days is anticipated to exceed the VAT limit (currently at £79,000). This, too, can be done online through the HMRC system. You do not need to wait for a PIN code to apply, but it may take HMRC **up to a month** to process the application[79]. You will not be able to claim VAT until you receive your VAT registration number.

If a business has more than one employee (a single director), including part-time and temporary workers, it must purchase Employers' Liability insurance, which covers a business in the event an employee is injured or becomes ill in the course of work. Any vehicles used by the business must also be covered by Third Party Motor insurance.

There are a number of industries where specific permits and licenses can be required prior to commencing operations (see 1.d).

[76] https://online.hmrc.gov.uk/registration/newbusiness/introduction

[77] https://online.hmrc.gov.uk/registration>

[78] The exception is when a director was not issued with a National Insurance Number (for example, if they do not qualify for one through their visa) and a few special cases. In these cases, you may need to register by email or by phone: see <http://www.hmrc.gov.uk/payerti/getting-started/register.htm>.

[79] See more here: <http://www.hmrc.gov.uk/vat/start/register/waiting.htm>.

Ordinary partnership

Ordinary partnerships do not require a special registration procedure. The partners may choose to set up a deed of partnership; otherwise, the partnership will be governed by the Partnership Act of 1890. *However,* all partnerships need to be registered with HMRC by one of the partners and all partners must also register for Self Assessment. This can be done through the online system.[80] They will then pay income tax on any earnings from the partnership (or corporation tax is the partner is a company). The partnership must also register for appropriate taxes (VAT, income tax, NICs, etc.) where necessary.

Limited partnership

A limited partnership (*i.e.*, one that has at least one General Partner responsible for day-to-day business and at least one Limited Partner, whose liability is limited to the size of their investment) must be registered with the Companies House. To register a limited partnership, the partners need to send the appropriate form (LP5)[81] to the Companies House office in the appropriate constituent part of the UK. The registration fee is £20 (or £100 for same-day registration). As other partnerships, LPs are subject to registration with HMRC (see above).

Limited Liability Partnership (LLP)

A limited liability partnership has no general partners and all partners in an LLP have limited liability. LLPs must be incorporated at the Companies House and are essentially a private company that is organized and taxed as a partnership. There are two ways to incorporate a LLP:

- **By post.** A filled in application form[82] must be sent to the relevant Companies House office. The fee registration fee is £20 (£100 for same-day registration) The form contains the following details:
  - Partnership name
  - Registered office address
  - Details of proposed members

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[80] https://online.hmrc.gov.uk/registration
[81] http://www.companieshouse.gov.uk/forms/generalForms/LP5_Application_for_Registration_of_a_Limited_Partnership_and_Statement_of_particulars_and_of_the.pdf
[82] http://www.companieshouse.gov.uk/forms/formsContinuation.shtml#LLIN01

   - Whether all or only some of the members are to be treated as 'designated'
   - Statement of compliance
- **Formation agents.** These applications are typically processed within 24 hours for a fee of £13 (£30 for processing on the same business day), but the agents will normally charge their own fee on top of that.

LLPs must have at least two partners and all changes in partnership must be notified to the Companies House. An LLP must also have at least two *designated* partners who carry extra responsibilities for the partnership (such preparing the annual return).

Public limited company (plc)

A public limited company can be set up as a new company, or a private limited company can be converted into a public one. Public limited companies can offer their shares to the public (for example, by listing on the Stock Exchange), but are subject to stricter filing and auditing rules and must have at least £50,000 in share capital, of which at least £12,500 must be paid up. In addition, PLCs *must* have a qualified secretary and at least *two* directors. The registration process is the same as for a private limited company (see above), except that Web Filing Online cannot be used. Existing private limited companies will need to submit a different application form to re-register as a public company.[83] This requires a prior audit.

Once a PLC has been incorporated and received its Certificate of Incorporation, it needs to apply for permission to trade (form SH50)[84] before it can commence business activities. The form exists to demonstrate to the Companies House that the correct minimum allotted capital is available.

[83] Available online: <http://www.companieshouse.gov.uk/forms/generalForms/RR01_application_by_a_private_company_for_reregisration_as_public_company.pdf>.

[84] Available online: <http://www.companieshouse.gov.uk/forms/generalForms/SH50_application_for_trading_certificate_for_a_public_company.pdf>.

UK establishments of overseas companies

An overseas company may also wish to establish a presence in the UK that is more closely connected to its corporate structure. The registration of a UK establishment is a requirement for any company that physical presence (for example, an office or a branch). This does not apply to independent contractors acting on behalf of an overseas company.

The registration of an overseas company involves the submission of an application form[85] to the Companies House **within 1 month** of establishment, which includes the following details:

- The name of the overseas company and its country of incorporation.
- The registered address (both for the UK establishment and its overseas parent)
- Details of:
  - Directors and secretaries
  - The persons authorised to accept services or represent the company in the UK, including the extent of these rights.

In addition to this, when an overseas company registers its first UK establishment, it need to submit a certified copy and certified translation into English of its constitutional documents. If the company is legally required to submit its audited accounts under parent law, it must do so **within 3 months** of establishment, accompanied by the form OS AA01[86]. As the process of registering a UK establishment can be fairly complicated, we would advise to seek professional advice prior to creating such as establishment.

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[85] Available online: <http://www.companieshouse.gov.uk/forms/forms Continuation.shtml#OSIN01>.

[86] Available online: <http://www.companieshouse.gov.uk/forms/generalForms/ OS_AA01_statement_of_details_of_parent_law_and_other_information_for_an_overseas_ company.pdf>.

Filing and auditing

Summary

A requirement for yearly filing of reports is in place for all UK-based companies. Depeding on the size of the company, this may involved a full audit and submission of extensive accouting information or simply abbreviated accounts for small or inactive companies. Certain changes (such as changes of address, directors, or shareholders) need to be reported to the Companies House, which then uses the yearly filing records to make sure that all changes are recorded correctly.

Company records

All companies must keep certain records, which should be available for inspection by the authorities for at least 6 years after the end of the relevant company financial year. The following information should be kept (for most, scanned PDF files are sufficient):

- Company information:
  - Details of directors, shareholders, and secretaries
  - Records of all shareholder votes and resolutions
  - Details of debentures and indemnities
  - Records of share transfer
  - Loans (including mortgages) where company property was used as security
- Accounting records:
  - Entries for all money spent and received by the company
  - Details of assets owned by the company and any debt either owed by the company or owed to it
  - If the company trades in goods, then records of inventory as well as purchases and sales of goods
- Employee records:
  - Personal details and employment history with the company
  - Salaries and tax deductions, as well as expenses and benefits provided to them, holidays, sick leave, and statutory pay (such as maternity leave)
  - Absences, disciplinary measures, and so on
- Health and safety records – a record of all accidents and employee injuries for companies with more than 5 employees. It

may also be helpful to keep records of all major risk assessments.

Annual return

All UK-registered companies must file an annual return to the Companies House. The annual return includes up-to-date information about the company, including:

- The name of the company and its registered number
- The 'made-up date' (the latest date at which corrections to the record are possible)
- The principal business activities of the company – up to 4 SIC codes for the activities carried out by the company[87]
- The type of company: private or public
- The address of the registered office and, if company records are not kept there, the address where the records are held (known as the single alternate inspection location, or SAIL)
- Name and details of the company secretary
- Names and details of all directors
- *For companies with share capital:* statement of the amount of share capital, total number and value of shares and their classes (including attached voting rights), a list of shareholders (past and present).[88] For companies whose shares have been admitted to trading on a 'relevant market'[89] only shareholders with more than 5% of shares need to be reported[90].

The Companies House will send an annual reminder that the return is due soon to the registered office address of the company, and the return can be filed online for a fee of £13.[91] The online filing system has an additional advantage of flagging all 'inconsistencies' with the records

[87] The full list of relevant SIC codes is available online: <http://www.companieshouse.gov.uk/infoAndGuide/sic/sic2007.shtml>

[88] A full list of all shareholders must be provided with the first annual return and every third year after that; for interim returns, only changes to the shareholders' list and details of share transfer need to be reported.

[89] Full list available online: <http://www.fsa.gov.uk/register/exchanges.do>

[90] Unless the company is subject to Vote Holder and Issuer Notification Rules contained in Chapter 5 of the Disclosure and Transparency Rules source book issued by the Financial Conduct Authority, since major shareholder details need to be reported separately for these companies.

[91] You may need to register for WebFiling before supplying the accounts, and the PIN code will be sent by post. The registration form is available online: <https://ewf.companieshouse.gov.uk/runpage?page=webfilingRegister&signUpPage.lang=en>.

already held and therefore reducing the chances of the return being rejected by the Companies House.

Annual accounts

Depending on the size of the company, different kinds of accounts need to be submitted to the Companies House. However, it is important to note that **all** companies must submit account annually, even when they are dormant. The accounts should be prepared annually, within 9 months from the made-up date of the annual return for private and 6 months for public companies (or 21 months from incorporation for private and 18 months for public companies for the first submission). These accounts will be available to the public for a small fee.

Every company must prepare annual statutory accounts for all its members and shareholders, as well as HMRC (as part of the company Tax Return). These include:

- A balance sheet including the value of everything owned by and owed to the company
- A profit and loss account
- Any notes about the accounts
- A director's report
- An auditor's report (where necessary – see below)
- The director's name and signature.

The Companies House must receive a copy of the accounts every year. However, smaller companies (annual turnover under £6.5 million, balance sheet total under £3.26 million, fewer than 50 employees) have the option of submitting abbreviated accounts, which do not need to contain a profit and loss account or a director's report. When a company chooses to use abbreviated accounts, it only needs to submit its balance sheet to the Companies House. You can use the Joint Filing feature of the online Web filing system to submit full audit-exempt accounts to HMRC and abbreviated accounts to the Companies House at the same time, but this is not available to LLPs or limited-by-guarantee companies.

The level of detail for accounting requirements depends on the size of the company and its main business (many financial services, for example, are subject to stricter reporting rules). As a rule, the larger the company, the more detailed its accounts must be, both as issued to shareholders and as submitted to the Companies House. (All public companies **must** submit full accounts). From December 1, 2013, a simplified form of account reporting is also available for micro-entities (balance sheet under £316,000, net turnover under £632,000, and/or fewer than 10 employees)[92]. The annual accounts return can be carried out online for audit-exempt abbreviated accounts and dormant companies; all other companies must file accounts by post to the relevant Companies House office.

Reporting of changes

It is important to keep in mind that **the purpose of the annual return is not to report changes to company information, but rather to provide a regular snapshot of how things stand**. Most changes have to be reported separately as they happen, which can be done online as well. Changes to the following information have to be reported:

- Registered office address (as soon as possible, since the change will not take place until registered by the Companies House)
- Appointing, terminating an appointment, or changing personal details of directors and secretaries (within 14 days)
- SAIL (the address where company records are kept) (within 14 days)
- Issues of new shares (within 30 days) and certain other capital changes[93]
- Some changes (such as the change of company name, removal of a director, change of constitution, change of company type e.g. from private to public) need to be first passed by a resolution, which must then be reported to the Companies House.

Auditing

In principle, all UK companies are supposed to submit their accounts to an audit. However, certain types of companies can receive an exemption. In particular, small companies that satisfy two out of three (annual turnover of not more than £6.5 million, balance sheet total of not more than £3.26 million, average number of employees under 51) can claim an exemption from the auditing requirement. Certain types of activities exclude the company from being able to claim the exception (for

[92] Excluding limited partnerships and LLPs, PLCs, overseas and charitable companies, as well as some other types of legal entity.

[93] You can consult the full guidance here: <http://www.companieshouse.gov.uk/about/gbhtml/gp3.shtml#ch7>

example, many types of financial and insurance companies).

All other companies must appoint an auditor, whose report must be included with the annual accounts return. The auditor's report will state whether the accounts were prepared in compliance with a particular reporting framework, the Companies Act 2006, whether the director's report is consistent with the accounts, whether adequate accounting reports were kept, etc. Foreign companies with a UK establishment must file copies of their overseas reports and include a statement of how (if at all) these accounts were audited.

Special regulations

Summary

UK companies are subject to regulations enacted by the UK Parliament and the European Union alike. The precise nature of these regulations will vary from sector to sector and businesses need to make sure they are aware of all necessary licenses before commencing trading. Some of the general regulations include the minimum wage of £6.31 an hour, compulsory insurance and pension schemes, health and safety regulations, and visa regulations for overseas workers. Non-EU citizens also need to be aware of visa regulations regarding their own presence in the UK. There are separate bodies established for the regulation of specific industries that are relevant to knowledge-intensive enterprises such as venture capital and the pharmaceutical industry, and it is necessary to familiarize yourself with all relevant regulations and procedures.

General overview

The UK has over 20,000 different regulations. Many of these are specific to particular industries and it is advisable to consult appropriate sources to see which regulations may apply to a particular business.[94] In general, we would advise most businesses to familiarize themselves with regulations in the following areas:

- *Health and safety:* employers must have insurance against injuries in the workplace, keep records of all work-related accidents and injuries, display a health & safety poster publicly, and, for companies of over five employees, have a written policy for dealing with health and safety issues.[95]
- *Data protection:* there are rules regulating the collection of personal data that may be particularly relevant to businesses in the pharmaceutical and ICT sectors. In particular, special permission to collect and store personal data may be required. However, new EU-wide legislation is slated to come into force in

[94] A very useful tool is the UK government's License Finder, which allows users to choose the industry and activities of their business and see which licences may apply. The tool is available here: <https://www.gov.uk/licence-finder>.

[95] The Health and Safety Executive provides guidance on these issues. You can consult their guide online: <http://www.hse.gov.uk/simple-health-safety/index.htm>

2015, which will inevitably lead to changes in current UK laws.

- *Anti-trust law (EU and UK):* there are rules forbidding certain kinds of agreements that may inhibit competition and these are enforced across the EU. Regulators may also need to approve mergers and joint ventures, and State Aid grants may be awarded to smaller companies, which may distort competition.
- *Money laundering regulations:* businesses working in the financial sector may have to comply money laundering regulations, including carrying out additional checks.

Labour regulations

The UK has a number of regulations in the area of employment. UK employers must pay their workers a minimum wage of **£6.31 per hour** (there are different rates for employees under 21 years of age (£5.03), 16-17 year olds (£3.72), and apprentices (£2.68)).[96] All employers must have Employers' Liability insurance (see Registration of businesses). Employers must also keep track of the employees' immigration status and may have to carry out security checks in certain occupations. In most sectors, workers do not have to work more than 48 hours a week unless they choose to do so and working weekends or nights needs to be agreed to in the employment contract.

When a business starts employing staff, it must register as an employer with HMRC and may have to set up the PAYE system that is used to pay income taxes and NICs on behalf of the employee (see 1.b). This can be done up to 4 weeks before the first pay day. After employing a worker for more than 1 month, the employer must also provide them with a written statement of employment, which includes details of the job position and description, the conditions of payment, holiday entitlement, hours and place of work. It should also include information about contract dates, notice period, pensions, and the general procedure for resolving grievances. Labour disputes can normally be resolved through employment tribunals and employers must respond to tribunal claims within 28 days. Pension schemes must be provided for employees earning over £7,475 *p.a.*

[96] The minimum wage does not apply to some occupations, for example company directors or volunteers.

Regulation of immigration

The UK government is pursuing a policy of limiting the net migration figure to less than 100,000 a year. As a result, a number of laws passed in recent years have made it more difficult for non-EU citizens to enter the UK to set up their own businesses. The main route available to prospective entrepreneurs is the Tier 1 (Entrepreneur) visa, which is conditional on the availability of funding for your start-up idea.

Tier 1 (Entrepreneur) visa

The following criteria need to be satisfied in order to apply for an entrepreneur visa:

- *Access to investment funds:* more than **£200,000** or more than **£50,000** from UK-based VCs, seed funding competitions, or governmental departments. The funds need to be held at a regulated financial institution
- *English language skills:* the applicant must be a national of a majority English-speaking country, hold a university degree that was taught in English, or pass an approved test (*e.g.* IELTS) with a high enough result
- *Maintenance funds:* **£3,100** in personal savings (for applications from outside the UK) held for **90** consecutive days (and not as part of the investment funds above).
- The immigration authorities may also contact applicants to ask for additional information, such as business plans and evidence of market research.

The application fee is **£840** from outside the UK. The same investment funds can be used as proof of access to funding by 2 individuals (an entrepreneurial team) who plan to go into business together. The current waiting times for a Tier 1 visa application made in Moscow are between 10 days (18% of applications) and 60 days.

Conditions of stay

The maximum period of stay under a single Tier 1 (Entrepreneur) visa is **3 years and 4 months**. Entrepreneurs have no access to public fund and must register with the police. They cannot work at any company other than the one they have established, joined, or taken over and they must register as self-employed with HMRC (see Taxation), register a company in which they are a director (see Registration of businesses), or join another company as a director within 6 months of the date specified in their visa. They must also continue to have access to all funds that they have not yet invested in the running of the business.

After three years, entrepreneurs may wish to apply for an extension of their visa. To do so, they must provide evidence of the following:

- *Investment in UK business:* they must have invested not less than the £200,000 (£50,000) in cash from the investment funds that they had access to on initial application, in one or more businesses located in the UK.
- *Registration with HMRC:* they must be registered with HMRC as self-employed or a director of a company. The registration must have taken place within 6 months of entering the UK.
- *Current business activity:* they must still be registered with HMRC in one of the above capacities and be engaged in a highly-skilled activity according to the National Qualifications Framework
- *Job creation:* they must have established or taken over a business that has created the equivalent of at least 2 full-time jobs for people eligible to work in the UK
- *Maintenance:* same as above.

Tier 1 (Investor) visa

Like the Tier 1 (Entrepreneur) visa, this is based on the ability of the applicant to invest in the UK economy. However, for prospective investors the sum of the investment is £1 million. Applicants who are able to demonstrate that they are in possession of at least £1 million, show the source of funding, and prove that it can be transferred to the UK freely can receive a visa for the duration of **3 years 4 months**. (Alternatively, an individual with a net worth of over £2 million can provide a letter from an authorized, UK-regulated financial institution that at least £1 million in a loan is available to them). There are no conditions placed on maintenance funds or English-language skills. The application fee is **£840**.

Conditions of stay

People living in the UK on the Tier 1 (Investor) have no access to public funds and must register with the police. In order to qualify for an extension of the visa, they must demonstrate that:

- They still have at least £1 million under their control in the UK (including any investments)

- They had invested at £750,000 in the UK (*e.g.*, in British businesses) within 3 months of entering the UK.

Hiring non-EU workers

Although EU citizens can for the most part work for any UK-based company, there is a limit to the amount of non-EU workers that can immigrate into the UK. UK employers must also apply for a permit to employ non-EU citizens before they are able to sponsor such prospective employees and hiring such workers increases the regulatory burden on companies.

Permit to hire

In order to hire people from outside the EU, employers need to be placed on a register of sponsors and receive a sponsor licence. The exact list of documents for the application varies according to company type (start-ups, public companies, and partnerships, for example, all have different requirements),[97] but the general idea of these documents is to prove to immigration authorities that the company operates as a legitimate business and can afford to hire highly-skilled workers for significant periods of time (so they may include company accounts).

A company that receives a license undertakes a number of responsibilities as far compliance is concerned, which includes keeping up-to-date records on non-EU employees, reporting certain events such as unauthorised absences or changes in company details, and allows inspections from immigration officials.

Tier 2 (Skilled)

In order to hire a worker under Tier 2 of the points-based system, a company needs to carry out a number of operations. Depending on the position you wish to fill, you may have to conduct a resident market labour test by advertising the vacancy in the UK prior to hiring a foreign worker.[98] Nearly all workers sponsored under Tier 2 will not be able to receive a visa unless they are paid **£20,300 *p.a.*** or more, and they also need to pass an English language test and have sufficient funds for a

[97] A comprehensive guide to documents is available here: <http://www.ukba.homeoffice.gov.uk/sitecontent/documents/employersandsponsors/pbsguidance/guidancefrom31mar09/appendix-a.pdf?view=Binary>.

[98] The test requirement is waived for occupations on the shortage list, available: <http://www.ukba.homeoffice.gov.uk/sitecontent/documents/workingintheuk/shortageoccupationlistnov11.pdf>.

month's residence in the UK. The Tier 2 visa is issued for a maximum of 3 years, with the possibility of extension for another 2. (After 5 years, workers can apply for permanent residence). The average waiting time for a Tier 2 application made in Moscow is currently 15 (88%) to 40 days.

Tier 4 (General and Doctoral Extension)

Non-EU citizens who are currently studying at UK universities can work part-time (no more than 20 hours a week) in term time and full-time during vacations. It is also possible to hire non-EU citizens who graduate from UK universities. Although in the past it was possible for such students to receive an extension to their visa to help them find jobs in the UK, this scheme is currently only available to graduates with a PhD degree. Postgraduate students who receive a PhD degree from an accredited British university are eligible to work in the UK with no restrictions for 1 year after receiving their diploma. However, after that year they will still need to be sponsored for a Tier 2 visa if their employer would like them to continue working for the company. This means that innovative companies can have access to very highly skilled professionals (either in the laboratory or in other positions) within weeks from graduation.

Financial regulation

Before April 1, 2013, all financial regulation in the UK was carried out by the Financial Services Authority. However, that organization has now been abolished and replaced by two separate regulators – the **Prudential Regulation Authority** (PRA), which is part of the Bank of England and ensures the financial stability of banks, building societies, credit unions, insurers and large investment firms. The behavioural regulation has been delegated to the newly established **Financial Conduct Authority**, which undertakes the regulation and enforcement duties in the financial sector. This includes anti-fraud measures, anti-money laundering regulations, and continuous assessment of firms with the heaviest burden of regulation placed on the largest of the 26,000 financial companies under the FCA's authority. The participants in the financial market are paced in four categories, with the firms in the top one continuously assessed over two-year rolling periods and firms in category four inspected at least once in a four yea period. If your plans for investment in the UK include operating in the financial markets, we strongly advise engaging professional legal advice to ensure compliance with all necessary regulations.

Pharmaceutical regulation

The body responsible for the regulation of the pharmaceutical industry in the UK is the **Medicines and Healthcare Products Regulatory Agency (MHRA)**. The organisation consists of the main regulatory body, the Clinical Practice Research Datalink (which looks to make the most of the wealth of data collected through the NHS), and the National Institute for Biological Standards and Control (which produces over 90% of international standards in biological medicine quality assurance). The MHRA approves both medicines and medical devices – the former directly, the latter through private-sector 'notified bodies', which are audited by the MHRA. Manufacturers and distributors of medicines also need to be licensed by the MHRA. In regulating the market for medicines, the MHRA is governed by EU-wide directives and in particular *Directive 2001/83/EC*. All new products under development also need an authorisation from the MHRA before clinical trials can begin. Within the regulatory agency, there is an Innovation Office that assists companies with navigating the regulatory process for innovative medicines.

MHRA licences only cover the UK market. Thus, in most cases, pharmaceutical companies apply for medicine licenses to the **European Medicines Agency (EMA)**, located in London, which has the power to recommend single marketing authorization to medicines for the entire European Union (and also Iceland, Lichtenstein, and Norway). On application, the EMA carries out an evaluation of up to 210 days, at the end of which it produces a report for the European Commission. (The ultimate power to grant marketing authorization lies with the EC). In the absence of an EMA-recommended license, drugs can only be sold in individual countries where they are approved, significantly raising the cost of regulatory harmonization. Nonetheless, even EMA-approved drugs ned to go through the MHRA if they are to be recommended for prescription within the NHS.

Regulatory harmonization

Summary

Regulatory harmonization is a key element in cutting costs associated with regulatory compliance when exporting goods from one country to another. This can play a particularly important role in such knowledge-intensive areas of the economy as pharmaceuticals, advanced manufacturing, and other major sectors of the British economy. Businesses based in the United Kingdom enjoy the advantages of operating within the framework of EU-wide legislation that sets technical requirements and safety standards for a vast majority of all goods.

- Although EU regulations on the whole can be more burdensome than in other parts of the world, the existence of common technical requirements means that goods produced in the United Kingdom do not need to separately comply with rules set by other EEA countries, significantly cutting the costs of compliance.
- Goods for which no EU-wide regulations exist, known as non-harmonized, can still circulate freely within the EEA under the principle of mutual recognition as long as they comply with British legislation.
- Services are governed by the Services Directive of 2006, which removed many of the existing barriers to cross-border provision. The directive has so far been unevenly applied and exporters of services occasionally still have to deal with differing national regulations. However, the European Commission is currently developing laws that create a single digital market well-suited to the needs of innovative small businesses.
- Outside the EU, standard procedures for regulatory compliance apply and businesses need to make sure they fulfill national technical requirements. In certain sectors, such as pharmaceuticals, this can be mitigated by following standards suggested by international organizations, which are frequently adopted by developed economies.
- The UK government provides support to businesses based in Britain, advising them on differing national regulations both within the EEA and outside it through UK Trade & Investment.

Overview

As a member state of the European Union, the United Kingdom has access to a wide, well-developed market of 30 (27 EU and 3 EEA) additional economies with virtually no restrictions on the free flow of goods across borders. It is also subject to free trade agreements ratified by the EU, which often include clauses on regulatory harmonization and lifting of technical barriers to trade in addition to lowering tariffs. (Currently, the EU has FTAs with Chile, Mexico, South Africa, and South Korea).[99] In practice, this means that although the level of regulation in the UK is relatively high, compliance with local legislation guarantees free access to the largest consumer market in the world. At the same time, the importance of trade to the British economy means that, as a rule, UK regulations are aligned with best international practices (such as the standards published by the ISO).

Regulatory harmonization of goods within the EU

The chief effect of the European single market on regulatory harmonization is that the vast majority of products and services crossing international borders within the EEA are subject to the same standards and regulations. These types of goods are known as harmonized and are covered by EU-wide directives that are accepted by other members of the market. These cover a wide range of manufactured goods and exist to ensure compliance with safety requirements, technical specifications, etc. As a result, goods produced in the UK (including pharmaceuticals) can be freely exported within the single market as long as they comply with British legislation, with little additional expense on compliance with regulations in other EU countries. (Some small costs may be associated with product labelling, which often needs to be in the language of the country the product is been exported to). The one disadvantage of the system of harmonized goods, however, is that since these directives are written, debated, and adopted by the European Commission and the European Parliament, the legislative process is less transparent than with national laws and there may be fewer opportunities for participation in the consultation process. Some difficulties may also arise when a member state is slow to enact a directive into national law, although as of February 2013 only 0.6% of directives have not been transposed on time.[100]

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[99] 'Free Trade Agreements', European Commission: Enterprise and Industry. URL: <http://ec.europa.eu/enterprise/policies/international/facilitating-trade/free-trade/index_en.htm>

[100] *Internal Market Scoreboard 26*. (European Commission, February 2013).

A few categories of goods (including, for example, bicycles and ladders) are not covered by EU directives and are regulated instead by national legal codes. However, in such cases the free movement of goods across borders within the EU is guaranteed by the principle of mutual recognition, which states that all goods produced legally in one EU country must not be rejected by other countries except on the grounds of public morality, public policy, security, protection of health, property, or national treasures.[101]. This threat, as a rule, must be demonstrated in court and in practice non-harmonized goods can be freely exported within the EU and EEA in most circumstances.

Regulatory harmonization of services within the EU

While EU-wide regulations can be seen as necessary for the production of industrial goods where technical specification exist to ensure that the final product is safe, the establishment of a single market in services requires solutions to a different set of problems. The Services Directive of 2006 provides the general framework for the regulation of services across the EU. The directive removed a significant proportion of potential barriers to entry, simplifying, for example, national authorisation or licensing procedures. A major consequence of the directive is that services can now be easily provided across borders and an organisation established in the UK is not under any obligation to establish a subsidiary in Germany in order to conduct business operations there. However, the implementation of the Services Directive remains uneven. This can be problematic for small- and medium-size businesses that may not necessarily have the resources to overcome existing barriers.

In particular, the ideal of a single digital market has not yet been realized. Different national regulations exist in such diverse areas as consumer rights and personal data protection, distance selling, online payment and identification, net neutrality, and intellectual property, all of which are important for businesses operating in the ICT sector. One survey has identified around 100 separate issues, with some of the most numerous ones concerning privacy and copyright.[102] According to the UK-based Federation of Small Businesses, another significant problem is the difference between levels of Value-Added Taxes (VATs) across different

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[101] *Treaty on the Functioning of the European Union*, Article 36.

[102] *The Economic Impact of a European Digital Single Market*. (European Policy Centre, March 2012).

EU member states, with 30% of respondents claiming harmonised VAT rules across the single market would be a significant improvement.[103]

However, the EU is currently working on resolving a significant part of these problems. As part of its Europe 2020 initiative 'Digital Agenda for Europe', large-scale consultations are currently under way to deal with all of the issues mentioned above. In addition to this, work is in progress on setting EU-wide standards for ICT interoperability that should also significantly reduce regulatory barriers to information technology businesses within the EU.

Regulatory harmonization outside the EU

Although exports to EU countries constitute about half of British overseas trade (47.5% in 2012),[104] trade with the rest of the world is playing an increasingly important role. This implies the need for an awareness of regulations in countries outside the EU. As mentioned above, the UK is subject to FTAs ratified by the European Union, which include, for instance, South Korea and Canada. Other countries are currently negotiating with the EU, including, significantly, such major markets as India and the USA. (The US is already responsible for 16.2% of British exports). Membership of the European Union can be seen as a significant advantage, since the large size of the European market arguably gives the EU more diplomatic clout than the UK would have on its own.

Nonetheless, Britain-based businesses intending to export outside the EU need to comply with the relevant regulations in target countries. This is especially important given that many of the sectors that the UK excels in (such as pharmaceuticals and advanced manufacturing, which are the two most export-intensive industries in the British economy)[105] may be subject to greater national regulation. There are a number of ways to reduce potential costs associated with compliance. In certain areas, such as pharmaceuticals, international organizations (for example, the International Conference on Harmonisation of Technical Requirements for Registration of Pharmaceuticals for Human Use) work to develop international standards; when these standards are adopted by both

[103] Sietske de Groot. *Small Businesses and Online Trading*. (Federation of Small Businesses, 2011).

[104] *The Only Way is Exports. Renewing the UK's Role as a Trading Nation*. (CBI, April 2013).

[105] *The Only Way is Exports. Renewing the UK's Role as a Trading Nation*. (CBI, April 2013).

trading parties, regulatory barriers are significantly lowered. (The EU also has its own set of standards, which are not obligatory but can help a business prove that its products comply with EU legislation). At the same time, the UK government provides support to businesses based in Britain through UK Trade & Investment, which can advise companies (including SMEs) on how to best prepare their products and services for compliance with international regulations; the UKTI has expertise in various sectors of the economy and across all international markets.

Conclusion

The UK is a relatively highly regulated environment, both in its own legislation and thanks to its membership of the European Union. At times, the regulatory burden can create problems for businesses based in Britain, particularly SMEs. (See Barriers to investment). Nonetheless, Britain's membership of the European Union creates significant economic advantages, and one of the most important areas where this is the case is regulatory harmonization. The majority of goods produced within the EEA are regulated by EU-wide directives, which means that goods produced in one European country comply with regulations across the single market. For a small proportion of products not covered by these directives, known as non-harmonized goods, a principle of mutual recognition ensures that in the majority of cases these can also freely circulate within the EEA. Although the situation is more complex and regulation more fragmented for services, including digital products, the European Commission is actively working on creating a truly single digital market. Outside the EU, regulatory harmonization may at times require effort and compliance costs on the part of the exporter; however, new treaties currently under negotiation may expand the market within which national regulations match more closely, and organizations such as the World Health Organization are working to establish international standards for such important British exports as pharmaceuticals. Finally, the UK government provides significant advisory support to businesses wishing to export (both to EU and the rest of the world) through UK Trade & Investment.

Services

Given the high degree to which the British economy relies on the service industry, it is only natural that companies operating in the UK have ready access to a wealth of business services. Many of these are available through the private sector, although a number of government agencies also provide very useful services for knowledge-intensive businesses and foreign investors. For example, London, as a world capital of finance, is home not only to many investment funds, but also ancillary services – legal, financial, insurance, and many others. Similarly, areas specializing in the production of innovative goods and services tend to attract providers of appropriate services like rapid prototyping. In this section, we we provide a brief overview of the kinds of services these businesses can find particularly useful.

Private-sector

- **Financial services and banking:** the UK, and particularly London, are home to a large number of highly efficient financial services firms, with over £2 million people working in the financial services industry. This means that businesses in the UK can access finance at different stages of growth more easily than in most other European countries, seek financial advice, and manage their risks by engaging the services of firms in the financial sector. The City of London is the largest and best known concentration of financial services in the country. London is also home to the London Stock Exchange, including the Alternative Investments Market, which provide IPO and exit opportunities for successful businesses and investors alike.
- **Accounting and audit:** although it is possible to run the accounting side of a small company without professional help, thanks to electronic filing systems like PAYE, you may find it much easier to outsource this part of your business. This is a widely available service. There is no legal requirement for a specific license to operate as an accountant, but the term Chartered Accountant can only be used by members of the *Institutes of Chartered Accountants*, the *Chartered Institute of Management Accountants*, or the *Association of Certified Chartered Accountants* (ACCA). We would advise choosing an accountant who is a member of one of these bodies; it may also be helpful to negotiate a fixed fee for their services. The audit requirements (see Filing and auditing) for auditing of limited companies mean that many businesses also require auditing services. These can be provided by members of appropriate supervisory bodies.[106]

[106] The list of these is available online: <http://www.auditregister.org.uk/Forms/RSBList.aspx>

- **Legal services and insurance:** the UK has a long tradition of legal and insurance services on a global scale and is among world leaders in legal services exports. Two of the top five global law firms by revenue are based in the UK.[107] In the UK, a distinction is made between solicitors (lawyers working in an office, typically within a law firm) and barristers (who appear in court to argue cases). Solicitors are regulated by the Law Society, whereas barristers are approved and regulated by the Bar Council. Patent attorneys are licensed by the Chartered Institute of Patent Attorneys. Insurance services are also easily available, with some insurance (such as Employers' Liability) mandatory by law for many companies.
- **Consulting:** a wide range of consulting services is available in the UK, from professional services provided by large multinational corporations (two of the Big Four consultancies – PwC and EY – are headquartered in London, and the other two have multiple offices) to specialized consulting services in such areas as HR, management, and technology.
- **Technology consulting:** one area in which the UK has a global advantage is technology consulting. Technology and product development consultants act as technology brokers and help connect start-ups and inventors with potential investors. They also provide advice and practical help in developing new products, from initial assessment to manufacturing processes. Many of the largest technology consultancies in the UK (such as Cambridge Consultants and PA Consulting Group) are located in close proximity to leading universities and play important roles in the development of university clusters. Technology consultants can also specialize in particular sectors.
- **Prototyping:** technology consultants and engineering centres around the country can also provide prototyping services that allow inventors to test their ideas and work out the best product design. Prototyping services vary from mock-ups to pre-production demonstration units and can help create a proof-of-concept that attracts investors and makes it possible to avoid many costly mistakes before production begins.
- **Incubators and clusters:** there is a large number of incubators for start-ups in the UK, based at universities and different technology clusters like Tech City. The incubators provide flexible working spaces, mentoring, and networking opportunities at affordable costs. Some accelerators (like Tech Stars) are highly

[107] Key Facts about UK Financial and Professional Services. (TheCityUK, January 2013).

exclusive and prestigious programmes that help their residents connect with some of the most successful entrepreneurs and investors in the technology world. In addition to that, business parks can serve as clusters with a high concentration of companies in a particular industry (for example, the Cambridge Cluster in biotechnology) and as a rule have relationships with other providers of relevant services in the area, helping to cut the costs of finding experienced professionals.

- **Portfolio management:** about one third of assets managed across the UK (£5.1 trillion at the end of 2011) are managed on behalf of overseas clients, making this one of the largest export industries in the UK. At the same time, the UK is a leader in private equity and VC management, with total assets of over £140 billion.

Government programmes

Enterprise Zones

There are 24 special Enterprise Zones in England, 4 in Scotland, and 7 in Wales. These areas offer a number of incentives to businesses located within them:

- *Business Rate Relief:* companies located within the zones are exempt from paying business rates to local councils
- *Simplified planning permissions:* local councils will automatically grant approval to certain types of development, such as building new industrial facilities, significantly cutting down the cost of development and compliance
- *'Soft landing packages':* businesses planning to relocate to an Enterprise Zone can benefit from pre-agreed deals with local service providers, such as developers, accountants, and estate agents
- *Infrastructure advantages:* the Enterprise Zones are similar to business parks in that much of the necessary infrastructure, like very high-speed broadband, is already available.
- Some Enterprise Zones specialise in particular industries and businesses there can benefit from local specialization. These industries include advanced manufacturing, aerospace, ICT, biotechnology, and many others (see Niches and production chains). A full list of such zones by sector is available online[108]. The

[108] <http://enterprisezones.communities.gov.uk/enterprise-zones-by-sector/>

government has also recently announced the development of specific university enterprise zones that will rely on local universities for local expertise in innovation.

Financial assistance

The UK government can provide assistance to British start-ups in securing a loan, for example, by providing a guarantee to a bank or a loan for investment, including for R&D. To qualify, a business must be based in Britain and have a turnover of less than £41 mln; the scheme allows for the provision of finance between £1,000 and £1 mln and qualifies as State Aid under EC rules (which means, for example, that such a business would not be eligible for R&D tax relief)[109]. There is also a start-up loan programme available that has funded over 11,000 businesses and provides mentoring and other support in addition to financing[110].

UK Trade & Investment (UKTI)

UK Trade & Investment is a division of the governmental Department for Business, Innovation, and Skills that is charged with attracting foreign entrepreneurs and investors into the UK and helping British businesses export. UKTI provides expert, country- and sector-specific advice on the best way to approach your goals in investing into the UK. Once a start-up has been established, UKTI can help brings its products and services to the global market. They are one of the main partners in the development of Tech City, an ICT cluster in East London, having set up the Tech City Investment Organisation. UKTI also runs a Global Entrepreneur Programme, which provides tailored assistance to foreign entrepreneurs who plan to set up a business in the UK[111], and the Sirius Programme, a competition for a 12-month start-up package that includes help with access to finance and visa sponsorship[112].

[109] More information is available online: <https://www.gov.uk/understanding-the-enterprise-finance-guarantee>.
[110] <http://www.startuploans.co.uk>.
[111] <http://www.ukti.gov.uk/investintheuk/globalentrepreneursprogramme.htm
[112]<http://www.siriusprogramme.com>