Chancellor of the Exchequer Rt Hon Rachel Reeves MP
HM Treasury
1 Horse Guards Road
London, SW1A 2HQ

2 August 2024

Subject: Leveraging the UK's Healthcare & Life Science Sector to drive growth in the UK economy

Dear Chancellor of the Exchequer,

Cc: Secretary of State for Business and Trade Jonathan Reynolds, Secretary of State for Health and Social Care, Wes Streeting, Minister for Science, Sir Patrick Vallance, Financial Secretary to the Treasury, Lord Livermore, Chief Secretary to the Treasury, Darren Jones, Parliamentary Under-Secretary of State for Public Health and Prevention, Andrew Gwynne

This is a joint letter from UK Equity Research Healthcare and Life Sciences Analysts ahead of the upcoming first budget and to inform Government thinking as it develops the industrial strategy which life sciences will be a key part of.

We are a group of professionals that have spent our careers working in, and alongside, the UK's Healthcare & Life Sciences sectors: from bench science and Biopharma to company operations and the NHS. In our current roles, as Equity Research Analysts in the UK's most active small / mid cap investment banks, we sit at the intersection between UK Capital Markets, UK Growth Companies and UK Fund Managers, and collectively we speak to hundreds of company boards/management teams and thousands of institutional investors each year.

Whilst we have various affiliations, and much of what we write is applicable to UK markets more generally, our motivation in writing this letter is to lend our unified voice to the challenges that we have seen on the UK's Healthcare & Life Sciences landscape.

Furthermore, we propose six working themes that should directly help the UK Government deliver on its ambitions to be a life sciences superpower while supporting business growth and the wider economy. These include:

- **Improve capital flows, bridging the divide between private and large, listed companies**
    - A strong investment ecosystem will result in companies that are more likely to remain in the UK and list on the UK market driving further investment into UK life sciences and growth companies
- **Embrace innovation and change within the NHS**
    - The pandemic demonstrated the power of the NHS which when working collaboratively with the private sector, generated world leading insights and improved patient outcomes
- **Go further with R&D tax relief**
    - Every £1 spent on R&D tax relief, £1.53-£2.35 of additional investment follows from UK companies
- **Retaining talent, in academia and industry**
    - Talented individuals trained in the UK should be encouraged to stay with appropriate visa rules. In addition, company management should be incentivised

with internationally competitive pay awards without excessive headwinds from proxy advisors.

- **Push UK entrepreneurialism harder**
    - Equitably share university IP with scientists to encourage innovation and 'biotech business building'
- **Be bold & be quick**
    - Changes made now will pay back quickly

We expand upon these topics and why this issue is so important in the attached appendix, as well as describe critical challenges to the sector and propose potential solutions. We note that several of the issues we point to are much-discussed structural issues which afflict wider UK markets but we believe high-growth sectors, such as Healthcare & Life Sciences, will benefit disproportionally from their resolution.

In addition, as a collective group we want to urge the new government to truly **make Healthcare & Life Sciences a core pillar in the UK's Industrial Strategy.**

The UK has Healthcare & Life Sciences capabilities that are the envy of many a developed nation, and this new Government could reinvigorate these sectors and improve the NHS, all whilst benefitting the economy, at relatively minimal investment from the exchequer. We encourage the early narrative from new Government ministers on 'boosting growth' and the evolving remit for The Department for Science, Innovation and Technology and look forward to this groundswell translating into policy. However, we would advocate for doing more, and making Life Sciences a core pillar in a new fit-for-purpose industrial strategy for the UK. This is about unleashing the potential of the UK's strengths: Capital Markets & Finances, Life Sciences & Healthcare and the NHS to deliver on Labour's decade of renewal, improved care outcomes for patients and higher economic growth.

We would welcome an opportunity to arrange a roundtable discussion, during which we could provide you with more first-hand information about the challenges we see companies face from a funding, operational and regulatory standpoint, as well as the opportunity we see if the sector is harnessed in the right way.

Yours sincerely,

Cavendish

Chris Donnellan, **Cavendish**

PANMURE LIBERUM

Julie Simmonds and Seb Jantet, **Panmure Liberum**

PEEL HUNT

Miles Dixon, **Peel Hunt**

SCM SHORE CAPITAL CAPITAL MARKETS

Sean Conroy and Brian White, **Shore Capital**

STIFEL

Christian Glennie, **Stifel**

5654 & Company has helped coordinate the content of the letter across the signatories.

Appendix

Why is this important?

- **The UK is a leader in Healthcare & Life Sciences** – Life Sciences is also one of the UK's most successful sectors and the NHS is unrivalled in its scale and capability.
  - **The UK's Life Sciences sector delivers an enormous bang for its buck –** It was worth over £94bn to the UK economy in 2021 (a 9% year-on-year growth), and it employs nearly 300,000 people. It punches far above its weight internationally, being a beacon for excellence for UK endeavour, producing nearly 12% of the world's citations and c.16% when considering the most highly-cited academic papers (despite the UK making up less than 1% of the global population). The UK currently ranks fourth in the Global Innovation Index (2023).
  - **The NHS as an exemplar of our Healthcare sector** – The NHS budget comprises 11.3% of our annual GDP (c.£283bn in 2022) and it is the largest employer in Europe (1.3m employees). Its ethos of cradle to grave care, free at the point of delivery, remains a cornerstone of UK culture. We welcome any ambition to harness the power of the NHS further, believing that Life Sciences and Technology is key to creating a fit-for-future NHS.
- **Building a growth economy** – Small and medium sized companies are the key engine of growth, as are the Life Sciences & Healthcare sectors. If the UK wants to deliver on GDP growth above inflation, we need to curate a vibrant ecosystem of well-funded, high-growth companies, particularly in subsectors identified by the UK's previous Industrial Strategies. Demonstrating the significance of the UK Capital Markets in fuelling the economy, we note that UK-listed companies contribute a combined £3.1tn of revenues – approximately 50% bigger than the UK economy.
- **Financial services is a UK strength but we could do much more** – The Labour Party's own plan for 'Financing Growth' recognises the strength of the UK financial services sector, collectively contributing over 8% to GDP and tens of billions in tax revenue each year to UK GDP.
- **Tax, employment, investment & innovation** – Companies listed in the UK make tangible contributions to our economy, not least through employment and taxes: direct taxes (corporation tax, VAT etc), collected taxes (PAYE) and indirect taxes (dividend income, CGT etc). PWC's survey of the 100 Group of listed companies shows that this group alone paid c.£8.3bn of corporation tax in 2021/22 (13% of combined UK take) with total tax contributions, from the group, of £82bn (including rates, employer NIC, VAT etc). The 100 Group also reveals the contribution that listed companies make to capital investment and innovation with the group making £25.8bn of investment in tangible fixed assets (12.3% of UK's combined business investment) and £10.9bn in R&D (driven by the Biopharma industry). We note that the most likely way to become a large UK-listed company is to be a small one first.

What is the primary problem affecting UK Healthcare & Life Sciences companies?

- **UK outflows** – UK funds have seen an unprecedented level of outflows, with c.36 consecutive months seeing net outflows, and where more than £110bn (across both retail and institutional investors) have moved away from UK assets in the last 2 years. This dwarfs the challenges seen during the Global Financial Crisis (where inflows stalled but largely stayed positive).

- **'Risk assets' and active funds are being eschewed** – The funds that have experienced the worst of these outflows are active funds and the companies exposed the most are those in the small to mid-cap space, particularly those that are considered 'high growth' and often used synonymously with 'high risk' (Healthcare and Life Sciences sectors are notable exemplars and are being impacted disproportionately).
- **There is a negative feedback loop –** Many high-growth UK-listed companies have been starved of capital courtesy of a marked downward shift in risk appetite, particularly in the last two years. As the sector shrinks, so does the pool of specialists that work within it (both on the Buy and Sell side), which makes the sector even less accessible/investable for UK Funds.
- **Capital has moved into overseas funds and/or to lower risk assets** – UK pension funds alone have 'exported' c.£1tn of assets, moving aggressively towards bonds and global assets at the expense of UK equites (having fallen from making up c.53% of the average portfolio in 1995 to just 6% in 2023).
- **The net result is de-equitisation of the UK Small- and Mid-Cap market**
  - **Companies that are starved of investment see valuations and liquidity fall** – This leads, ultimately, to market exits; either through companies delisting (seeking private pools of capital) or via M&A (typically from overseas acquirers attracted by depressed valuations). The number of UK companies on the FTSE small cap reduced from 160 in 2018 to 114 in 2023, with the combined market cap falling from c.£50bn to £25bn. In contrast, the US Nasdaq has added c.600 companies over the last four years.
  - **The hopper is not refilling fast enough** – Private high-growth companies with ambitions for IPO see these market trends and are seeking alternative options. These typically include: staying private for longer (using PE funding, where UK Retail and Pension Fund investors typically do not benefit from valuation uplifts) or are seeking to IPO in other regions where risk-appetite is more supportive (notably the US but also the Eurozone). Most high-growth UK management teams will have, as part of their strategy, considered a 'route to Nasdaq.'
- **It is not enough to simply direct capital towards private/illiquid companies** – The Mansion House reforms and the LIFT (Long-term Investment for Technology and Science) initiative are a great start, but the capital should not be directed exclusively towards venture capital and illiquid assets, otherwise we merely create a deeper register of companies with ambitions to list elsewhere or be acquired by international companies.

The Solutions: What can be done to revitalise the UK's Healthcare & Life Sciences sector?

- **Be bold & be quick** – Too often decisions on what's good for our ecosystem are made too late into a Government's tenure. This means that near-term economics tend to trump medium-term benefits; particularly as it seems to be easier to calculate losses to the exchequer than it is to forecast returns from any newly implemented policy.
- **We need to bridge the divide between private and large, listed companies** – The UK has made significant strides in the last decade in spinning out ideas from Academia (something historically we underperformed at), but having created and funded these companies, many seek listings in overseas markets where valuations are superior. We need to ensure that we are not merely a 'feeder market' for other overseas venues, by encouraging investment 'down' into the Small- and Mid-Cap universe too, as well as 'up' from 'Private /illiquid' companies via the LIFT/VC route or the successful EIS/VCT schemes. Encouraging consolidation of funds should drive greater risk appetite, allowing capital to

flow further down the market cap scale. The French 'Tibi' is also a very good example of how funds can be directed to both listed and non-listed companies building a whole ecosystem around a sector, and a Sovereign Wealth fund here in the UK could have more agency to invest up and down the scale.

- **Require DC funds to disclose UK positions sooner** – 2027 is too late, this should be accelerated by a new government. Whilst we understand that an individual might want to pursue returns with little regard for the local/national economy, it is damaging if all institutional investors do so too. Importantly, there should be direction as to what 'good looks like' in terms of capital allocation to high growth assets.
- **Improve financial literacy** – We need to change the current status quo whereby financial literacy in the UK is poor. Financial literacy is closely related to a 'competitive performance culture' amongst UK Funds. Far too many people are unaware of where their pensions and savings are invested, what the performance is, and how to weigh up risk and returns. This should encourage UK funds to move towards higher-return assets in order to outperform the index.
- **Encourage allocation into UK assets from retail investors** – An element of the UK's Retail investor base does demonstrate an appetite to support high growth listed companies, and this should be encouraged – in a responsible manner. There are a number of ways this can be enhanced: through choice via workplace schemes, tax breaks for UK investments, dividend tax relief, full SIPP tax benefits with mandated levels of UK exposure, the UK ISA and the Tell Sid/NatWest offering.
- **Regulatory red tape should not discourage UK listing** – The UK is rightly proud of its governance around public markets but we need to ensure we don't go too far and stifle growth. The UK listing regime has proposed wide-ranging reforms for July 2024, and we should continue to review the hurdles that companies encounter en route to a UK listing.
- **Regulation of the industry should encourage growth and investment and not be a barrier** – Similarly, the current complexity of the planning system can discourage larger Life Sciences companies from selecting the UK as a site for manufacturing or R&D. Lastly, the UK's MHRA (the Medicines & Healthcare Regulatory Agency) has committed to faster approval for cutting edge therapies and this should be applauded. Amongst a backdrop of increasing regulatory complexity elsewhere (eg US Inflation Reduction Act and EU regulation reform), this provides an opportunity for the UK to get ahead. We should not lose the pace of progress, nor let regulation reviews disrupt (eg the scheduled medical device regulation review in 2025) or frustrate BioPharma (such as the voluntary pricing scheme from 2023).
- **Abolish stamp duty on UK equities** – The UK has a disproportionally high-rate vs US and EU counterparts and stamp duty impacts upon liquidity. Whilst the 0.5% rate (for UK shares) may not seem onerous to occasional traders, larger market participants prioritise regions (eg France 0.3%, Hong Kong 0.3%, US 0%) or instruments (eg CFDs) with low(er)/no costs. Whilst the removal of the stamp duty on AIM companies has had limited impact, we think this is more to do with the weak-economic performance, and the headwinds to 'growth stocks' created by other market dynamics (eg the trend for exporting capital during the same period).

- **Encourage the NHS to embrace innovation –** Without change and innovation, the NHS will be stuck in its currently overwhelmed state. The solution is not 'more funding', 'operational efficiency' or 'reinstated targets' alone, but rather it requires transformative change and innovation. Whilst funding for innovation does exist (eg NHIR / Innovate grants), it could go further, and the challenges in driving innovations into the day-to-day process within the NHS remain, and limit change and company engagement. Whilst the NHS has extraordinary staff, services, and assets (notably the unrivalled datasets), key to achieving the necessary innovation will be enabling more independent companies to work collaboratively and effectively within the NHS from research through to commercialising products. If we are in any doubt as to the power of the possible, we need not look beyond the pandemic, when extraordinary change and flexibility was embraced.
- **Going further with R&D tax relief –** The previous Government committed to increasing investment in R&D to 2.4% of GDP by 2027 but we still lag behind our global peers (US at 3.46%, Germany at c3.13%). Going further here will yield a thriving environment in the UK and HMRC have previously estimated that for every £1 spent on R&D tax relief, £1.53-£2.35 of additional investment follows from UK companies.
- **Talent retention needs to be addressed** – This applies from the bottom to the top of Life Sciences & Healthcare organisations. Management is almost always critical to a company's long-term success (alongside technology/assets and capital). The underwhelming recent track record of some UK-listed emerging life sciences companies reflects, to some extent, the experience of management teams. We need to ensure that any perception that the UK 'is poorer' in comparison to other regions, is broken.
    - UK listing criteria and/or greater use of US style cross-over rounds ahead of any UK IPO (which can lead to management change) could act as natural checkpoint for investors, advisors and regulators to assess management teams and upskill/support where necessary.
    - At the executive level, proxy advisors that recommend how shareholders vote on pay are hurting our ability to hire and retain the highest-performing leaders which are best equipped to run larger, successful companies. This is particularly unwarranted when the pay awards are linked to shareholder returns. Many executives subsequently choose to pursue alternative venues / regions or stay / go private where there is less sensitivity to higher pay packets.
    - Talented individuals that choose (and qualify) to study here in the UK (eg doctors, nurses, scientists), should be encouraged to stay and leverage their hard-won training from our world-leading universities. For instance, newer visa rules (on minimum earnings) make it harder for matriculating international post-graduate students to find roles in the UK after completing their course. PhD work for instance (typically 3-4 years cutting-edge training) should contribute to indefinite leave to remain in order to encourage these skilled professionals to remain.
- **Regulation of the industry should encourage growth and investment and not be a barrier** – The UK's MHRA (the Medicines & Healthcare Regulatory Agency) has committed to faster approval for cutting edge therapies and this should be applauded. Amongst a backdrop of increasing regulatory complexity elsewhere (eg US Inflation Reduction Act and EU regulation reform), this provides an opportunity for the UK to get ahead. We should not lose the pace of progress, nor let regulation reviews disrupt (eg the scheduled medical device regulation review in 2025) or frustrate BioPharma (such as the voluntary pricing scheme from 2023). Similarly, the current complexity of the planning system can

discourage larger Life Sciences companies from selecting the UK as a site for manufacturing or R&D.

- **Push UK entrepreneurialism harder** - Universities retain essentially all IP related to PhD and post-doc work and most students tend not to think about 'Biotech business building' until much later in their careers. More should be done to share IP with young scientists and encourage them to exploit it. For instance, the individual is far more motivated to leverage an idea (if in possession of the IP) vs an institution, which often doesn't know what IP it has.