

**Report to:** West Yorkshire Combined Authority

**Date:** 16 March 2023

**Subject:** **Regional Investment Vehicles for Innovation Finance**

**Director:** Phil Witcherley, Interim Director Inclusive Economy, Skills & Culture

**Author:** Mitchell McCombe, Interim Head of Innovation & Digital Policy

Is this a key decision?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Is the decision eligible for call-in by Scrutiny?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No
Does the report contain confidential or exempt information or appendices?	<input type="checkbox"/> Yes <input checked="" type="checkbox"/> No
If relevant, state paragraph number of Schedule 12A, Local Government Act 1972, Part 1:	
Are there implications for equality and diversity?	<input checked="" type="checkbox"/> Yes <input type="checkbox"/> No

## 1. Purpose of this Report

- 1.1 To give the Combined Authority an overview of Northern Gritstone Ltd, an investment company aiming to raise up to £500m to provide much needed investment in high-growth university spinouts, as well as other SME startups across West Yorkshire, South Yorkshire and Greater Manchester.
- 1.2 To approve, following appropriate assurance and due diligence, a £1.5m contribution from the Combined Authority towards the Northern Gritstone investment company from the Single Investment Fund.

## 2. Information

### Context & Background

- 2.1 Innovation finance is a crucial component to support high-growth startups to grow and scale. However, the landscape is well-evidenced as being rigorously competitive, concentrated in certain geographic locations and disproportionately allocated to individuals from particular backgrounds.
- 2.2 The West Yorkshire Innovation Framework was adopted by the Combined Authority in 2021. It sets out 12 priority areas to drive up innovation activity in the region and address a number of challenges. This includes a series of priority areas relating to innovation finance including:

- P1 Inclusive Innovation: creating a more diverse, inclusive and open innovation ecosystem.
- P5 Innovation Finance Availability: develop innovation finance provision from pre-start to scale-up.

### **Northern Gritstone**

- 2.3 Northern Gritstone Ltd is an investment vehicle founded in 2020 by the Universities of Leeds, Manchester and Sheffield that supports the commercialisation of intellectual property-rich and innovation-driven science and technology businesses from across the North of England.
- 2.4 The company secured £215m at the first rounds of investment calls which were completed in May 2022. They are now targeting a second close this Spring.
- 2.5 A total raise of up to £500m is being targeted, at least £250m of which is to be allocated for follow on investment. It is anticipated that these investments would achieve net returns in excess of a 20% internal rate of return over the next decade.
- 2.6 Investment into this scheme will provide much needed venture capital finance to university spinouts and startups from across the region that are focused in high-growth sectors.
- 2.7 Investing in Northern Gritstone's Round 2 would directly support delivery of the Mayor's pledge focused on supporting local businesses and championing the local economy. Specifically, it supports the sub-pledge relating to closure of the R&D spending gap between West Yorkshire and London. In addition, this project will also:
- Support the creation of new jobs which are likely to be high-skilled. Northern Gritstone supports a particular set of spinouts and startups which tend to be high-growth oriented (such as clean growth, biotech and AI).
  - Support the ideation, prototyping, development and commercialisation of new products, services and technology to market. Northern Gritstone provides venture capital to support the growth of businesses who are innovating.
- 2.8 The investment would indirectly support delivery of Mayoral Pledges 1 and 2 through investment decisions made by Northern Gritstone. For instance, providing venture capital to a clean-tech business could result on the creation of new green-jobs or development of new products, services or technology to tackle the climate emergency.

- 2.9 Northern Gritstone has already started to invest in West Yorkshire businesses. For example, £1.5m was invested in Leeds-based Slingshot Simulations (£3 million including co-investment from other funders). In addition to this, 26 West Yorkshire businesses are currently active in the Northern Gritstone investment pipeline. Of the 26, 11 businesses are in the technology sector and 8 are in the life sciences sector.
- 2.10 There is now an opportunity for the Combined Authority to invest in Northern Gritstone. This contribution will seek to:
- Deploy £100m into the West Yorkshire region over a 5-year timeframe.
  - Attract £300m of co-investment into the West Yorkshire region over a 5-year timeframe.
  - Invest in 30 companies in West Yorkshire in the next 5 years (of which 18 would be university spinouts).
  - Generate c.450 additional skilled jobs in West Yorkshire across the next 5 years.
  - Generate a 4x return on investment for shareholders over a 10 year timeframe.
- 2.11 This would ultimately support more high-growth spinouts and startups in West Yorkshire to increase their innovation activity, increase the provision of venture capital in the region, and showcase the region as a place for high-growth businesses to scale-up.
- 2.12 Unlike a traditional venture capital fund, the Northern Gritstone structure is a company that employs the investment management staff itself, rather than a special purpose vehicle managed by a third-party fund manager. This structure appears to better align interests as unlike a fund structure, realisations are maintained within the company for further investment.
- 2.13 Northern Gritstone will make investments in early-stage businesses as patient capital and whilst it is expected that those businesses will increase in value during their research and development cycle, it will make a return when those businesses are exited in the long term.
- 2.14 The Combined Authority's contribution also has a secondary benefit of return on its investment. The targeted return of the Company is an annualised return in excess of 20%. If this is achieved, the Combined Authority's investment is expected to grow from £1.5m to over £6m in the first 10 years and would be worth in excess of £40m after 20 years. There is potential for these returns to then be reinvested to further the region's ambitions.
- 2.15 In addition to the value of the Combined Authority's shareholding, discussions with Northern Gritstone indicate dividends may be paid to shareholders after 5 years.
- 2.16 To mitigate risk, Northern Gritstone seeks to invest as a part of a larger syndicate of investors, usually other VCs or large organisations.

- 2.17 As a shareholder in Northern Gritstone, the Combined Authority would also have an influence on how the Company's funds are invested and its priorities.
- 2.18 Northern Gritstone view investment by the Combined Authority as being key to unlocking investment from other investors, who see local support for the initiative as critical before they invest themselves.
- 2.19 Not proceeding with this option would mean that the Combined Authority would not be able to invest in Northern Gritstone until 2026 or later when a future investment round is held.
- 2.20 West Yorkshire Pension Fund has also already made the decision to invest in Northern Gritstone.

### **Next Steps**

- 2.21 The Combined Authority could invest in an immediate opportunity provided by Northern Gritstone this Spring. The Combined Authority would invest money into the company and become a minority partner, alongside other Mayoral Combined Authorities, pension funds, and the private sector. This investment would:
  - Be used to provide venture capital to university spinouts (60-70% of funds) as well as high-growth startups outside of universities (30-40% of funds) across the West Yorkshire, Greater Manchester and South Yorkshire regions.
  - Focus on a series of high-growth sectors such as clean tech; software, digital and AI; electronics, materials and manufacturing; and life sciences and biosciences.

## **3. Tackling the Climate Emergency Implications**

- 3.1 Northern Gritstone is a signatory to the Net Zero Asset Managers Initiative and is committed to being a carbon neutral business both in its own operations and across its subsidiaries and other investee companies.
- 3.2 Northern Gritstone as a venture capital firm have outlined clean tech businesses as a key sector for investment, and each investment is aligned to the UN Sustainable Development Goals. This means that interventions should not have a negative effect on our regional ambitions to tackle the climate emergency.
- 3.3 Northern Gritstone's Round 2 Investment identifies "clean tech" as one of the growth sectors which the Company will focus on supporting. This contributes to our regional climate emergency ambitions and the West Yorkshire Climate & Environment Plan (in particular CC06: Innovation for Net-Zero, Nature Recovery and Climate-Ready) by encouraging the creation of new products, services and technology that could support the transition to a low carbon economy.

## **4. Inclusive Growth Implications**

- 4.1 Northern Gritstone was founded with the philosophy of Profit with Purpose, combining attractive returns for shareholders with wider positive, societal and economic impact, including supporting Levelling Up and high-skilled job creation in the North of England.
- 4.2 Our regional Innovation Framework outlines priorities to deliver inclusive innovation. Investment decisions undertaken by Northern Gritstone are mapped against the UN Sustainable Development Goals. Previous investments have been mapped to:
- SDG5: Achieve gender equality and empower all women and girls.
  - SDG9: Building resilient infrastructure, promoting inclusive and sustainable industrialisation and fostering innovation.
  - SDG10: Reduce inequality within and among countries.
  - SDG11: Make cities and human settlements inclusive, safe, resilient and sustainable.
- 4.3 In addition to this, Northern Gritstone are also signatories of the UN's Principles for Responsible Investing Code.
- 4.4 The project also supports the West Yorkshire Economic Recovery Plan by delivering on the "supporting local businesses" chapter and directly contributes to support the action to "ensure the right finance is in place to support innovators from a range of backgrounds".

## **5. Equality and Diversity Implications**

- 5.1 Northern Gritstone is explicit in its commitment to Environmental, Societal and Governance (ESG) standards. Their philosophy supports Profit with Purpose, combining attractive returns for shareholders with wider positive, societal and economic impact, including supporting Levelling Up and high-skilled job creation in the North of England. The company is a signatory to the Investing in Women Code.
- 5.2 The Combined Authority's financial contribution to the Company is very modest (£1.5m of £500m investable funds), so - in the first instance - we may not be able to stipulate targets around EDI. However, with the Combined Authority being represented, we will be able to influence the targeting of startups and spinouts able to access support through the Company, aligning this with our EDI targets for business support services.
- 5.3 By leveraging the support and values of our local universities, it is anticipated that targeting a diverse range of startups/spinouts will be a focus.

## **6. Financial Implications**

- 6.1 Investment in Northern Gritstone's Round 2 call will require a payment of £1.5 million.
- 6.2 The targeted return of the Company is an annualised return in excess of 20%, meaning that the Combined Authority's investment is expected to grow from £1.5m to over £6m in the first ten years and would be worth in excess of £40m after twenty years, based on the targeted annualised return of the Company being over 20%. From discussions with Northern Gritstone, it is expected that dividends may be paid from the shareholding after five years.
- 6.3 If the Combined Authority would seek to monetise their investment, they would be able to sell their shareholding (or part thereof) to a third-party investor, subject to satisfactory approvals and consents.

## **7. Legal Implications**

- 7.1 There are no legal implications directly arising from this report.

## **8. Staffing Implications**

- 8.1 There are no staffing implications directly arising from this report.

## **9. External Consultees**

- 9.1 No external consultations have been undertaken.

## **10. Recommendations**

- 10.1. The Combined Authority approves that delegated authority be granted to the Chief Executive Officer to approve £1.5 million investment to Northern Gritstone. This delegation is requested to allow time for further due diligence and application of the Combined Authority assurance processes before the deadline for investment.

## **11. Background Documents**

There are no background documents referenced in this report.

## **12. Appendices**

None.