

Report to: Business, Economy & Innovation Committee

Date: 29 March 2023

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

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|---|---|
| Is this a key decision? | <input type="checkbox"/> Yes <input checked="" 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 provide the Committee with an overview of innovation finance policy development and outline proposals relating to Northern Gritstone.

2. Information

Innovation Finance Policy Development

- 2.1. Innovation finance is a fundamental tool to support high-potential and IP-rich businesses to grow and scale.
- 2.2. Traditionally, SMEs have access to three forms of finance to grow their companies:
- **Debt:** where businesses receive a loan from a bank and repay that loan with additional interest rates on top of the borrowing.
 - **Grants:** where businesses can apply for competitive funding and receive either match-funding or unmatched funding to develop an idea or business proposal.
 - **Equity:** where individuals or venture-capital firms invest money into an SME using their own funding. In return, they receive a stake of ownership

in the firm and some decision-making powers (such as being a non-executive director).

2.3. In West Yorkshire, businesses have access to a range of these finance options for their companies, but there are a number of setbacks with each option:

| Mechanism | Challenges |
|-----------|--|
| Debt | Start-ups and spinouts are less likely to secure debt as banks view them as risky investments at such an early stage of the business development cycle. |
| Grant | Grants are highly competitive and tend to be lower value in nature (<£100,000). In some cases, businesses will also be required to match the grant-funding awarded. |
| Equity | Venture capital and angel investment are highly competitive. The US Venture Capital Association estimates that for every 100 business plan submissions, 10 are assessed and only 1 receives funding ¹ . In the UK, venture capital and angel investment are heavily concentrated in London and the Greater South East. |

2.4. In particular, there is a relatively strong gap in the provision of equity finance that is available to businesses – particularly those which have high-growth potential and are IP-rich. We know the following:

- The British Business Bank² estimates that London also secured almost half of all equity deals (1,286), Yorkshire and the Humber secured only 86.
- A recent report from Harvard University on Tackling the UK's *Regional Economic Inequalities* found that there is a statistically significant difference in the likelihood of receiving funding for SMEs in other regions – particularly the Yorkshire and Humber. SMEs in the Yorkshire and Humber were only 50% as likely to receive equity funding compared to equivalent firms in London³.
- Aggregated data from Beauhurst also suggests that total deal investment across West Yorkshire equalled around £269 million in 2022. In comparison to other regions, Greater Manchester in the same period secured £625 million and London taking over £18.8 billion.
- Further Beauhurst data also shows that West Yorkshire has 0.41 spinouts per 1,000 businesses compared to 0.56 in London, 0.76 in Greater Manchester and 0.99 in South Yorkshire.

¹ [New-Approaches-SME-full-report.pdf \(oecd.org\)](#)

² [Nations and Regions Tracker Infographic 2022 - British Business Bank \(british-business-bank.co.uk\)](#)

³ [Tackling the UK's regional economic inequality: Binding constraints and avenues for policy intervention | Harvard Kennedy School](#)

- 2.5. To resolve this challenge, the West Yorkshire Innovation Framework, approved by the Combined Authority in 2021, outlined a priority around innovation finance availability. This identified a priority that focuses on exploring new ways to address the investment gap attracting more choice in equity investment including angel investment and venture capital to the region.
- 2.6. Developing policy interventions around seedcorn financing was one of the investment priorities the Committee previously agreed at a meeting in Autumn 2022 and options for future Combined Authority-led schemes are in the early stages of development.
- 2.7. Work will continue to explore the potential opportunities relating to the delivery of interventions that address the seedcorn finance gap. In addition to this, the Combined Authority will also explore the need for developing a series of investment principles that align with our position on tackling the climate emergency, delivering inclusive growth and promoting equality, diversity and inclusion.

Northern Gritstone

Overview

- 2.8. Aligning to the ongoing policy development, the Combined Authority has been approached by Northern Gritstone Ltd.
- 2.9. Northern Gritstone was founded in 2020 by the Universities of Leeds, Manchester and Sheffield. Its purpose is to support the commercialisation of intellectual property-rich and innovation-driven science and technology businesses from across the North of England.
- 2.10. Northern Gritstone operates as an investment company that invests its own capital directly in the investee businesses rather than a fund managed by a third party. This has the benefit that any profits will be retained in the business rather than paid as a carried interest to the fund manager, which should afford greater growth potential for any investments. Unlike other funds, it is a true evergreen structure as there is not an investment and realisation period.
- 2.11. The organisation is aiming to raise over £500 million, of which £250 million will be allocated for follow on investment.
- 2.12. In its first investment round which closed in May 2022, Northern Gritstone secured £215 million. The company is now targeting to close a second round in Spring 2023. They will provide much needed venture capital finance to university spinouts and startups from across the region that are focused in high-growth sectors.

2.13. Since the first round, Northern Gritstone has invested in a number of companies across the north of England. This includes local spinouts such as Slingshot Simulations.

Investment Opportunity

2.14. Northern Gritstone have approached the Combined Authority for contributing to the latest round of investment calls. It is proposed that the Combined Authority would invest £1.5 million into Northern Gritstone.

2.15. Our investment is in addition to investment that will be made by other northern Mayoral Combined Authorities, public sector pension fund organisations as well as further investment leveraged from the private sector.

2.16. 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.

2.17. Investment in Northern Gritstone would contribute to supporting around 30 companies over the next 5 years (18 of which are university spinouts). The companies receiving investment have the potential to grow significantly and could provide a significant return to shareholders. In addition to this it is anticipated that the investments would create 450 additional skilled jobs.

2.18. Investment is anticipated to achieve an Internal Rate of Return of up to 20%. This means that from an initial £1.5 million of investment, within 10 years, this would be worth £6 million, and within 20 years would be worth £40 million.

2.19. The Combined Authority met on 16 March 2023 and considered a report that included a recommendation to progress investing £1.5 million into Northern Gritstone. This is subject to further due diligence checks which will be taken through internal decision-making bodies. The report to the Combined Authority can be found as a link at the end of this report.

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 identifies “clean tech” as one of the growth sectors which the company will focus on. 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 Northern Gritstone is very modest (£1.5m of a £500m investment call), so - in the first instance - we may not be able to stipulate targets around EDI. However, with the Combined Authority being represented on the Steering Group, it is planned that we will

be able to influence the targeting of startups and spinouts able to access support through Northern Gritstone, 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. The Combined Authority met on 16 March 2023 and agreed, subject to appropriate due diligence, to invest £1.5 million into Northern Gritstone.

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. That the Business, Economy and Innovation Committee:
 - a) Notes the progress on the policy development relating to innovation finance; and
 - b) Note the decision made by the Combined Authority to invest £1.5 million into Northern Gritstone.

11. Background Documents

[Report](#) to Combined Authority Meeting – 16 March 2023

12. Appendices

There are no background appendices referenced in this report.