Universities UK’s response to HM Treasury’s consultation ‘Financing Growth in Innovative Firms’

Introduction

Universities UK (UUK) is pleased to respond to HM Treasury’s consultation ‘Financing growth in innovative firms’. We support the review’s goal to catalyse patient capital as an asset class that offers attractive risk adjusted returns to investors, and welcome its recognition of the importance of university spinouts.

Our response focusses on the problems confronted by university spinouts in raising finance, and how best to support investment into these companies. This draws on evidence and views gathered from UUK members, and from a UUK-HM Treasury roundtable event bringing together spinout investors and universities¹, held on 13 September.

On the problem

Do you think there are problems raising financing for spinouts? If so what do you think causes these problems in raising finance? (covers questions 1-6 of the consultation document)

There are problems raising financing for spinouts. These are caused by the following key factors:

Availability of early stage capital

Spinouts are a relatively immature and risky prospect for venture capital investors. The risk-return profile of spinouts, the timescales required for investors to realise positive returns on them (typically 10-15 years from incorporation) and the prospect of share dilution all encourage migration towards later stage investment, leaving a significant gap in finance at the proof of concept, pre-seed and seed stages.

Business angels help mitigate this gap. However, their role is limited by their lack of visibility/connectivity outside London and the South East and variable expertise in assessing deep technology opportunities (which sometimes results in unrealistic evaluations).

Low investor capability / understanding of complex propositions

There are few investors in the UK with the specialist expertise required to evaluate deep technology spinout opportunities, particularly compared with the US where investment specialisation is more common.

Recruiting experienced management teams to run spinouts is also a challenge because academics often lack the necessary set of skills and connections to grow a business successfully. Further, it is difficult for universities to attract experienced CEOs, CTOs and consultants with adequate reward packages.

Volume and quality of investible propositions

Spinouts are particularly risky propositions for investors but also expensive to de-risk for universities. Therefore both parties can only back a limited number of spinout

¹ Some UUK members are also members of PraxisUnico/AURIL’s network.
propositions at a time. This problem is most acute in areas outside of London and the South East, some of which lack critical mass of both equity capital and investment opportunities. Investment through HEFCE’s new Connecting Capability Fund may enable universities to improve their knowledge transfer capabilities but not necessarily to invest in spinout development at scale (particularly relative to research activity).

**Speed of access to scale-up finance**

The current UK equity market does not entirely recognise the importance of being first to market and moving fast for technology businesses. Difficulties or delays in securing development funds for R&D, product implementation or expansion needs can substantially slow down the growth of these businesses, or lead to an “early sale” of the company before its economic impact (in terms of sales, job creation, exports) is realised.

**‘Lumpiness’ of investment**

UK investors prefer to invest equity in modest ‘lumps’ and/or to gradually draw down their commitments (possibly to ensure they can exit bad investments before these get too expensive). This means many start-ups must spend considerable time on fund-raising rounds in their first 2-3 years, when their focus should be on developing the business in this critical initial phase.

As recognised by the consultation document, securing follow-on investment can be challenging, particularly when the business has a large number of shareholders (as in the case of spinouts supported by business angel syndicates).

**On the suggested solutions**

*Are existing schemes and interventions (investment programmes, tax reliefs and tax-incentivized investment schemes) effective at supporting investment in innovative companies and spinouts? (covers question 7 of the consultation document)*

We agree with the government’s view that a mixture of tax relief and publicly-supported investment programmes is appropriate to support early stage investment in innovative companies.

Spinouts, in particular, benefit enormously from investment attracted through the UK Government [Seed Enterprise Investment Scheme](https://www.gov.uk/government/publications/seed-enterprise-investment-scheme) (SEIS) and / or the [Enterprise Investment Scheme](https://www.gov.uk/government/publications/enterprise-investment-scheme) (EIS). Our consultations suggest that EIS and SEIS are helping universities raise significantly more investment in commercialisation from alumni and business angel investors than would otherwise be possible.

Other programmes reported as effective include:

- Innovate UK’s [Biomedical Catalyst](https://www.gov.uk/government/publications/biomedical-catalyst), which provides grants to support early stage companies’ progress towards a range of exit strategies and commercial production/sale of a product or service.

- [Confidence in concept](https://www.gov.uk/government/publications/confidence-in-concept) (CiC), a joint scheme between MRC and Innovate UK that provides pump priming funding to move projects to a position where additional investment can be sought from external investors.

- The British Business Bank (BBB) which is beginning to provide co-investments into [Enterprise Capital Funds](https://www.gov.uk/government/publications/enterprise-capital-funds) created around specific university
spinouts. This is helping mitigate the gap in early stage equity finance for spinouts requiring investments of up to £2m.

- Innovate UK’s Investment accelerator pilot which supports early stage commercialisation projects through a combination of grant funding and venture capital investment. This is an attractive support model because it allows innovative companies to access early stage investment and experienced advice and support at scale.

- Innovate UK’s ‘Aid for Start-ups’ programme. This provides up front grants to spinouts emerging from ICURe (see a description of ICURe below) that have been ranked to have high success potential as start-up companies. The programme is already showing success in quickly moving these early spinouts to being investible by focusing on attacking key technological risks and attracting experienced entrepreneurs into the management teams.

- Within Scotland, the Scottish Investment Bank supports a “shared risk” approach (on an equal basis with private investors) to investing in high growth SME companies – through initiatives such as the High-Growth Spinout Programme, which offers bespoke business mentoring and advice, funding and ongoing entrepreneurship training to academic entrepreneurs.

- Within Wales, the AgorIP scheme provides assessment, proof-of-concept, and investment-readiness support for open innovation projects, using a co-investment approach. Projects can be followed up by Swansea University with internal seed funding matched with independent co-investment.

Schemes focussing on entrepreneurial talent and skills are also an essential complement to investment programmes. For example, SETSquared’s ICURe pilot (co-funded by HEFCE and Innovate UK), is a 3-month programme offering teams of university researchers with commercially-promising ideas up to £50k to ‘get out of the lab’ and validate their ideas in the marketplace. ICURe shows promising results, with 78 teams supported since 2015, resulting in the launch of 28 new companies.

**What should the government do to support more effective investment in university spinouts? (covers questions 15, 17, 25)**

The government should consider a mixed approach including:

- additional speculative grant funding for universities to strengthen the pipeline of investment-ready spinout opportunities across the UK;
- more risk capital and enhanced tax relief to improve incentives for patient early stage investment;
- regionally-focused initiatives to help build thicker capital markets outside London and the South East.

These objectives could be achieved through a combination of the following measures.

**Grant funding for Intellectual Property (IP) commercialisation**

1. Increase the Higher Education Innovation Fund in England and provide it over a longer period, with a fraction earmarked for IP commercialisation (including proof of concept-market activity). This would enable universities to strengthen the pipeline of investment-ready spinout opportunities.
**Risk Capital**

2. Support initiatives that enable universities and private partners to invest in innovative company development at scale, building on promising co-investment models such as Innovate UK’s [Investment accelerator](#) and the [AgorIP](#) scheme.

3. Provide a domestic replacement for the European Investment Fund, which matches current levels of EIF investment.

4. Open up the BBB’s mandate to fund University Technology Transfer Offices, and to promote collaboration and sharing of best practice across TTOs when there is a strong case for it.

5. Support the creation of a fund of funds via the BBB to encourage investment specialisation and diversification of strategies across the UK. The government should ensure that any additional investment is targeted so that funds reach sufficient critical mass to make an impact and become sustainable in the long-term.

**Tax relief**

6. Create standard form investment documents to help streamline the process for setting up EIS/SEIS-backed funds and reduce its cost.

7. Match tax credits available to retail investors with institutional incentives, such as providing tax credits to pensions / institutional funds to be used against their non-risk capital investment dividend streams (pound for pound, risk to non-risk investment) to help anchor later stage growth investment at the very early stages.

8. Revise the £20m EIS cap for knowledge-intensive companies and the annual limit for EIS/SEIS, to attract more venture capital investment.

9. Support tax-efficient replacement capital deals to strengthen the incentive for experienced management teams to engage with spinouts, for example by making them not count against EIS relief. This could also be achieved by ensuring EIS is accessible to the spinout company directors, regardless of when they invested.

10. Complement extensions to EIS relief with properly incentivised tax advantages for patient investment (> 5 years).

11. Explore opportunities for new Venture Capital Trusts (VCTs), which are already a vehicle for patient, long-term permanent capital, to be pivoted towards very early stage investment into university commercialisation - building on the success of VCT as successful later stage growth funders, which are often managed by investment managers who also invest other earlier stage funds in university start-ups (eg the [UCL Technology Fund](#))

12. Enhance R&D tax credits to sharpen incentives to conduct R&D in the UK and to encourage greater corporate investment in early-stage spin-outs, for example by:

   - extending their coverage to include investment in early-stage university spin-outs (these spin-outs are effectively being used as “outsourced R&D” by corporates)
   - increasing rates of relief for clinical trials conducted in the UK (as currently done in Australia)
New university spinout tax incentive programs for EIS, SEIS, and VCTs could also have longer holding periods, as most spinouts take longer to show profitability and market growth.

**Availability of capital outside London and the South East**

13. Support programmes that encourage the regionalisation of funds, such as Nottingham’s NTech fund. These should help anchor investors to areas with thin capital markets and encourage diversity in investment strategies, without duplicating the infrastructure already existing in London and the South East. If tied to criteria around local job creation, these would also help ensure the benefits of commercialisations accrue to local areas.

14. See 5.

15. Provide additional resources for the BBB to invest in developing regional business angel networks outside London and the South East, so that the Angel CoFund can further its impact.

16. Support programmes that help inventors gain entrepreneurship skills and connect with the local investment and management communities, such as ICURe.

17. Develop a clearer view of venture capital investment vehicles available from local bodies (eg Local Enterprise Partnerships, local authorities), including their modus operandi. This would help improve signposting and identification of gaps in venture and patient capital investment, and could be used as a basis for sharing best practice and encouraging others to consider successful approaches as part of their portfolio.