

Kent and Medway Growth Hub (Capital)

**Business case to support Local Growth Fund investment in the Kent and Medway
Innovation Investment Initiative (i3)**

REVISED VERSION 2

October 2015

Contents

1. Project summary	3
2. Applicant contact details	4
3. Strategic fit	5
3.1. Project objectives	
3.2. Project description	
3.3. Relevance to the Strategic Economic Plan	
3.4. Support for sustainability and equality	
4. Rationale and additionality	10
4.1. The need for the project and evidence of market failure	
4.2. Demand for the project	
4.3. Options analysis	
4.4. Additionality: The need for LGF support	
5. Project schedule and outputs	16
5.1. Project schedule	
5.2. Project deliverables	
6. Costs and funding	18
6.1. Costs	
6.2. Funding	
6.3. Benefit-cost analysis	
7. Governance and project management	20
7.1. Project management and delivery structures	
7.2. Monitoring, reporting and control	
7.3. Risk management	
7.4. Evaluation	
7.5. Exit and legacy/ sustainability	
8. Compliance	27
8.1. State Aid	
8.2. Procurement	
8.3. Publicity	
Annexes	29
Annex 1: Risk assessment	
Annex 2: RGF scheme performance	
Annex 3: Costs and outputs (see attached Excel spreadsheets):	
- Initial costs and funding	
- Recycled capital funds	
- Outputs	
- Benefit-cost analysis	

1. Project summary

The Kent and Medway Growth Hub (Capital) project will fund the establishment of an **Innovation Investment Initiative (i3)**. This will be a recyclable fund offering loan and equity finance to small businesses with the appetite and potential for long-term growth. i3 will invest in projects which enable businesses to create and adopt innovative products, processes and services, improve productivity and deliver sustainable employment over the long term.

The i3 scheme will not replace commercial sources of finance or offer operating subsidies. Rather, it will support projects with strong business cases for which commercial finance is unavailable on viable terms (for example, because the product or technology involved is untested). The scheme will normally only provide finance for up to 50% of project costs, with the balance funded through private sources, including bank lending.

Loans will be generally offered interest-free, although arrangement charges will be levied to pay for administration costs. As the Fund offers a subsidised product, all loans and equity investments will be offered as state aid under the General Block Exemption Regulation and the *de minimis* rule.

The i3 scheme will build on the success of – and the lessons that we have learned from - existing schemes in Kent and Medway funded by the Government’s Regional Growth Fund. It will operate county-wide and will be supplementary to the existing schemes.

Summary details							
Project sound bite	i3 will provide loan and equity investment to small businesses with the appetite and potential for long-term growth. It will support 60 businesses to increase productivity and invest in innovation in the first cycle of funding and will help to create 450 jobs.						
Project location	Kent and Medway						
Project start date	1 November 2015						
Project end date	31 March 2021(defrayal of original LGF grant. Repayments will continue to be recycled beyond this date).						
Project funding summary to 2021							
	LGF	Recycled LGF	Direct private match	Admin contribution		Totals	LGF intervention
				Private	Public		
Capital	6,000,000	3,000,000	9,000,000			18,000,000	33%
Revenue				270,000	305,338	575,338	0%
Totals	6,000,00	3,000,000	9,000,000	270,000	305,338	18,575,338	32.3%
Overall project value						18,575,338	

2. Project applicant

The applicant for this project is **Kent County Council**, acting on behalf of **Kent and Medway Economic Partnership (KMEP)**.

KMEP is the strategic economic partnership for Kent and Medway. It is one of four federated partnerships which comprise the South East Local Enterprise Partnership. It is responsible for developing the strategic economic plan for Kent and Medway, determining priorities for the Local Growth Fund and other funding streams and for agreeing variances to the Growth Deal within the overall LEP decision-making structure. KMEP is governed by a Board chaired by the private sector and with membership drawn from business, local government and further and higher education.

Kent County Council is acting as the accountable body for KMEP for the purposes of this project. All formal authority to spend will therefore be derived from the County Council. However, KMEP will set strategic goals and monitor performance.

Project applicant details	
Address of applicant organisation	Kent County Council Invicta House County Hall Maidstone Kent ME14 1XX
Senior Responsible Officer	David Smith Director of Economic Development David.smith2@kent.gov.uk 03000 417176
Contact Person	Ross Gill Economic Strategy and Policy Manager Ross.gill@kent.gov.uk 03000 417077 or 07837 872705
Type of organisation	Local authority
VAT number	GB 204 2691 91
Website	www.kent.gov.uk www.kmep.org.uk

3. Strategic fit

3.1. Project objectives

The Innovation Investment Initiative aims to support increased employment and productivity within small and medium enterprises in Kent and Medway with the potential for innovation and growth.

Specifically, it aims to achieve the following objectives:

- Objective 1: Greater commercialisation of innovation, by enabling firms to exploit and develop new, often higher risk, technologies, products and services. The success of this objective will be measured by business expenditure on research and development;
- Objective 2: Increased productivity, by enabling firms to invest in new plant, machinery and equipment where this will increase capacity, reduce waste and deliver economies of scale; and by supporting specialised training costs where this will address productivity constraints. The success of this objective will be measured by the number of businesses reporting financial savings as a result of greater efficiency and increased output per worker hour;
- Objective 3: Increased employment, by increasing firms' capacity for innovation and business growth, leading to a rise in employment demand. The success of this objective will be measured by direct job creation within businesses supported through i3 loans.

3.2. Project description

(a) Project overview

The Kent and Medway Growth Hub (Capital) project will fund the delivery of the Kent and Medway Innovation Investment Initiative (i3). The i3 scheme will provide loan finance to small and medium enterprises with the potential for innovation and growth.

Conventionally, funding will take the form of loans for the acquisition of specialist equipment or premises; in some cases, equity investment may be offered, especially in circumstances where the beneficiary is seeking finance for the development of a new or unproven product.

i3 loans will range from a minimum of £10,000 to a maximum of £250,000. Loans will normally be secured where this is viable, and will generally be offered interest-free. Loans will be offered as state aid through the General Block Exemption Regulation and the *de minimis* rule (see Section 8.1). All loans will require matching commercial investment, so conventionally, i3 will only provide finance to a maximum of 50% of project cost.

All projects seeking i3 support will be independently appraised before they are considered by an Investment Advisory Board. The proposed assessment criteria and governance framework for i3 are set out in Section 7.1.

(b) Sources of capital

i3 capital will be funded by the Local Growth Fund through the Kent and Medway Growth Hub (Capital) allocation. This is £6 million over six years (profiled as £1 million per year).

The i3 scheme will be complementary to funding from the European Regional Development Fund. An outline application has been submitted for an access to finance scheme covering the whole South East LEP area. If successful, this would probably start in mid-2016 and will be more generic in scope compared with i3; however as the success of this project is currently unknown, potential ERDF funding has been excluded from this business case.

All funding made available by i3 will be repayable to the scheme. So while there will be no further new capital invested in the scheme beyond 2021, the scheme will continue for several years (although as the i3 is interest-free, it is not intended to be fully recyclable and the available capital will obviously diminish over time). Further details of i3's sustainability and its long-term exit strategy are set out in Section 7.5.

(c) Relationship with the existing Regional Growth Fund schemes

There are two RGF-financed, geographically-focused schemes in Kent and Medway: Expansion East Kent (£35 million initial fund value, due to close to applicants in 2015/16) and TIGER/ Escalate (£20 million, promoted under separate brands for West and North Kent and now closed to new applicants). Kent County Council is the accountable body for both schemes.

Expansion East Kent and TIGER/ Escalate are both recyclable, and repayments are now being received following the initial distribution of loans. It is currently estimated that around £29 million will be repaid by 2021 (see Section 6.2 for further detail).

It is proposed that initially, the existing schemes will remain separate from i3, recognising that they are geographically ring-fenced and (in the case of TIGER/ Escalate) have some coverage beyond Kent and Medway. However, i3 and the existing schemes will be managed together and funding criteria will be complementary (see Annex 1). In due course, there may be a case for merging the existing schemes with i3, although this will be considered in the light of business need.

(d) Management

The i3 scheme will be managed by Kent County Council on behalf of the Kent and Medway Economic Partnership. The Scheme will be managed by the staff who currently administer the existing RGF-financed schemes, yielding economies of scale. Further details of management arrangements are set out in Section 7.1.

The management of i3 will be funded by arrangement and monitoring fees charged to applicants and by local partners. Over the course of the 2015/16 – 2020/21 period, it is forecast that the contribution through arrangement and monitoring fees will rise as a proportion of total management funding. It is not envisaged that the LGF capital allocation will be used to cover management costs.

(e) Business advisory support

It is envisaged that businesses seeking funding from i3 will receive free support on access to finance, regulatory compliance and business development, linked with referrals to other specialist business support where appropriate. This service will partly be delivered through the new Kent and Medway Growth Hub (revenue) service, which has been contracted to Kent Invicta Chamber of Commerce and which will begin operation in autumn 2015. In addition, businesses that are eligible to receive support through the national Business Growth Service will be encouraged to do so.

(f) Geographical scope

The i3 scheme will operate throughout Kent and Medway. Within Kent and Medway, there will be no restrictions on the geographical coverage of the project.

(g) Timing of delivery

i3 will be launched in November 2015. A forecast expenditure profile is set out in Section 5.1. This envisages that the LGF capital grant will be defrayed according to the profile set out in the 2014 South East LEP Growth Deal.

3.3. Relevance to the Strategic Economic Plan and other strategies

(a) The Strategic Economic Plan

The South East LEP's Growth Deal and Strategic Economic Plan (March 2014) highlighted the existence of gaps in equity and loan finance, especially for smaller businesses with innovative – and therefore risky – propositions. This reflects national research, set out in Section 4.1.

In response to this identified need, the SEP stated that a new programme of financial support for innovation should be established in Kent and Medway, focused on “making a long term difference by investing in activities most likely to deliver added value and increase knowledge economy employment” (para. 4.235). The SEP also identified the need to integrate direct financial assistance with the wider innovation support system, linked with the development of the Growth Hub. The establishment of i3 is therefore directly sequential to the priorities identified in the SEP.

(b) National strategy

The Government's Growth Review (2010) set out an intention to prioritise support for small and medium enterprises with the potential for high growth.

Following this, the national Industrial Strategy developed since 2012 seeks to “increase global competitiveness, support innovation and maximise export potential” (*Industrial Strategy Explained*, October 2014). While the Strategy refers to the need to support businesses in all sectors, it prioritises the advancement of eight ‘great technologies’ in which the UK is seen to have competitive advantage. The Strategy specifically refers to facilitating access to finance as a role for Government, highlighting the role of the British Business Bank.

i3 is consistent with the approach set out in the Industrial Strategy. While focused on providing support for businesses with innovative capacity and potential, it is not restricted to specific sectors and it aligns financial support with a wider business support offer. Section 4.1 explains in more detail how i3 is complementary with products offered via the British Business Bank.

(c) Local strategy

In addition to the Strategic Economic Plan, county-wide economic strategy in Kent and Medway is set out in the emerging Unlocking the Potential, the Kent and Medway Growth Plan. This directly informed the priorities for the SEP, including those regarding access to finance. Supporting Unlocking the Potential, Kent’s smart specialisation strategy, Innovation for Growth also sets out the need to support firms with innovation potential.

3.4. Support for sustainability and equality

(a) Environmental sustainability

Supporting the growth of a lower-carbon economy is a priority of the Kent Environment Strategy as well as the SEP. The Innovation Investment Initiative will support this objective by assisting businesses developing or marketing lower carbon technologies and seeking to reduce carbon use through process innovations.

In addition, there is already a link between the ERDF-funded Low Carbon Plus (LC+) programme, which provides small grants to businesses in the low carbon and environmental goods and services (LGCES) sector and the existing Regional Growth Fund-backed loan schemes. Specifically, applicant data has been shared across the two schemes and applicants are signposted between the two as appropriate. LC+ will close in June 2015; however a successor programme (LOCASE) has recently been submitted for consideration for ERDF funding. It is envisaged that the current close working between LC+ and the RGF schemes will continue into the new programmes.

It is not envisaged that there will be any adverse long term environmental effects as a result of i3. In the short term, there could be minor adverse effects (for example through business miles). These will be mitigated as far as possible by the provision of appropriate business advice.

As a major project, i3 will be integrated into the KCC ISO14001 programme to ensure any negative impacts are mitigated and all positive aspects maximised. It will be subject to the

County's Environment Policy and targets which include carbon, waste, water use and business miles reduction.

(b) Equalities

The project will be run in line with Kent County Council's Equalities Strategy and Policy.

It is not envisaged that i3 will have any negative impacts on any groups in society. However, the programme will have some disproportionate positive impacts. In particular, i3 is designed to benefit SMEs and their employees. Given the focus on support for innovative businesses, it is likely that job outcomes will disproportionately accrue to those with higher-level skills, and that (all other things being equal) beneficiary business owners and directors will reflect the prevailing demographic for that group.

Given these likely impacts, efforts will be made to ensure that the benefits of i3 are widely spread. Specifically, an Equalities Plan will be produced at the start of the project following an equalities impact assessment. Particular principles to be applied will be:

- Efforts will be made to support beneficiary employers in engaging with Jobcentre Plus to fill job vacancies created as a result of i3 support;
- Cross-marketing will take place to ensure that businesses benefiting from i3 loans scheme are aware of and able to access apprenticeships and associated funding;
- Efforts will be made to encourage applications from relatively disadvantaged parts of Kent and Medway (especially in East and North Kent), building on the project pipeline and business connections established by the Regional Growth Fund schemes.

4. Rationale and additionality

4.1. The need for the project and evidence of market failure

(a) The general case for intervention to support innovative firms

There is a strong consensus that long-term economic performance is dependent on the ability to generate and exploit innovation (Cohen, 2010). However, research suggests that the public returns to innovation (for example in the generation of new technologies and products available for wider exploitation and in aggregate employment) are greater than the private returns (Martin, 2012). Government policy therefore seeks to support innovation, as set out in the Industrial Strategy (2012), the Innovation and Research Strategy for Growth (2011) and Smart Specialisation in England (2014), all published by BIS.

A recent review of the links between innovative firms and growth (Coad *et al*, 2014) yields a number of important findings on which the design of the i3 scheme is based:

- First, although innovation supports higher growth in the long run, very fast growth is hard to predict and is generally episodic rather than sustained over time. This highlights the importance of support for firms to develop innovative capacity – which might require levels of initial investment greater than that which would otherwise be available from the market – rather than support for high growth *per se*.
- Second, innovative firms are quite widely distributed. Although it is often assumed that entrepreneurial start-ups are concentrated around particular technology hubs (e.g. as spinouts from universities), their geographical distribution is fairly even and they are multi-sectoral. Effectively exploiting innovation (wherever it may have originated) is also just as important for growth as generating it in the first place. These research findings reflect the practical experience that has been gained through the operation of the RGF schemes in Kent and Medway.

This suggests a need for measures to support innovative companies wherever they are located and whichever sectors they work in – and a focus on commercialisation and exploitation as well as R&D.

- Third, investment in capacity is important. In particular, the growth process appears to start with increased employment, which creates the capacity for product development and leads to future sales. So early stage measures to generate capacity for growth (such as investment in plant and machinery and workforce capacity) are equally or more important than measures to support sales and marketing.

(b) The case for financial assistance

The general case for public sector financial assistance to innovative SMEs is rooted in the fact that:

- Public returns to innovation often outweigh private returns (as highlighted above);
- Innovation is characterised by uncertainty, which impedes the availability of market finance on viable terms.

Consequently, innovative SMEs are more likely to perceive financial barriers as significant impediments to growth than SMEs generally. Indeed, financial obstacles are identified by innovative SMEs as the greatest constraints on innovation, substantially ahead of perceived regulatory and information barriers (Coad *et al*, 2014).

(c) Emerging need since the creation of the RGF-funded schemes

In designing i3, we have reviewed the changes in the economic need for SME finance schemes in Kent since the Regional Growth Fund schemes were established in 2011-13.

Nationally, RGF was partly seen as a counter-recessionary programme, aimed at providing direct finance to business in conditions of general credit constraint. In addition, it sought to provide a local economic stimulus by encouraging the creation of private sector jobs (over the relatively short term) in locations most dependent on public sector employment.

To date, the RGF schemes in Kent and Medway have been successful in achieving these objectives. Business projects receiving finance from Expansion East Kent and TIGER/ Escalate are contracted to create or safeguard 5,548 private sector jobs and have secured £88.2 million in private sector leverage (see Annex 4 for details). Over the next few years, the size of the existing programmes will decrease, as they are reliant on recycled loans, although there will still be around £7 million available for loan across the county in 2016/17.

However, despite the success of the RGF schemes, the ‘macro’ challenges for which they were created remain. In particular, bank lending to SMEs remains constrained compared with pre-recessionary levels, despite improvements in the availability of credit for larger, lower-risk firms (Bank of England, 2015). Our experience of the demand (and quality of demand) for loan finance from the existing RGF schemes also suggests a need for continued targeting towards generally less buoyant areas such as East Kent.

It is therefore proposed that the existing RGF schemes remain in place, open to all businesses with the potential for growth, with local differentiation in the availability of funds and with a stronger orientation to support for small businesses.

However, while the existing schemes will respond to general small business demand, innovative and high-growth companies face the greatest constraints in accessing finance, for the long-standing reasons highlighted above. In particular, small and ‘unproven’ innovative SMEs face the greatest challenges “as the costs of addressing information barriers [i.e. the lack of information that potential lenders or investors have about the future prospects of the firm] are higher as a proportion of the finance being sought for smaller deals” (Elster and Phipps, 2013). The Innovation Investment Initiative seeks to specifically address this gap by providing a county-wide fund operating to regular, targeted calls for projects directly concentrated on innovative SMEs. This will be

complementary to the existing schemes, with shared management ensuring that businesses are appropriately signposted and that duplication is avoided.

4.2. Demand for the project

There is strong evidence of business demand. Both the TIGER and Escalate schemes have now closed to new applicants, although a pipeline of pre-applications have already been submitted for the two schemes, should a successor programme be established with recycled funds. Expansion East Kent has not yet closed, but over the course of the scheme, demand has substantially exceeded supply, with over 1,000 applicants to the programme to date.

Not all of this potential demand will translate into real demand, and not all of it will be appropriate for the i3 scheme, and efforts will need to be made to drive demand from those businesses with the greatest potential for innovation, but which face challenges in accessing conventional finance. But some of the existing pipeline will form a base of potential demand for the new scheme.

4.3. Options analysis

Four viable options have been considered, including the preferred option.

(a) Option 1: No additional action: Continue existing schemes using recycled funds without the creation of i3

This option involves the retention of the existing Expansion East Kent and TIGER/ Escalate programmes using repayments from those schemes, without the creation of an additional scheme:

Advantages	Disadvantages
<ul style="list-style-type: none"> Existing schemes retained – familiar to business Clarity – no additional schemes or brands to confuse the market 	<ul style="list-style-type: none"> Limits targeted focus on firms with innovative potential Unlikely to enable a suitable vehicle to attract future ERDF funding

(b) Option 2: Deliver additional i3 funding via the existing schemes

This option involves the channelling of additional funds from the LGF into the existing vehicles, effectively ‘topping up’ the RGF programmes.

Advantages	Disadvantages
<ul style="list-style-type: none"> Existing schemes retained – familiar to business No additional schemes or brands to confuse the market 	<ul style="list-style-type: none"> Practically difficult due to local ringfencing of existing schemes – a scheme targeted at a limited number of innovative businesses will be hard to deliver county-wide when the availability of funds varies substantially across the

	county <ul style="list-style-type: none"> • Potentially destabilises existing schemes, which already work well
--	---

(c) Option 3: Preferred option

The preferred option is that outlined in this business case. This involves the creation of a new Innovation Investment Initiative, alongside the retention of the existing RGF schemes.

Advantages	Disadvantages
<ul style="list-style-type: none"> • Clearly targets firms with innovative potential • Provides a vehicle suitable for further funding from ERDF or other sources • Complementary to RGF-funded schemes, but avoids destabilising existing arrangements 	<ul style="list-style-type: none"> • Some additional administration (although significantly mitigated by the use of joint management team).

(d) Option 4: Preferred option, but covering a wider geographical area

This option is the same as Option 3, but would extend the coverage of i3 to include the rest of the LEP and perhaps a wider area.

Advantages	Disadvantages
<ul style="list-style-type: none"> • As Option 3, plus: • Potentially stronger pipeline • Potentially more attractive as a vehicle for future ERDF funding 	<ul style="list-style-type: none"> • Limited funding in first instance: unlikely to be sufficient to cover a wider area • Diseconomy of scale, as management team and market knowledge focused on Kent • Potentially confusing if scheme duplicates locally-backed initiatives in other areas

Merger of all existing schemes into a single fund, with the addition of LGF funding was also considered. While potentially attractive, commitment to local ringfences make this impractical at this stage, so this option is considered unviable.

At present, Option 3 is the preferred option. However, Option 4 may be an attractive option in the future, as the i3 scheme becomes established and if further funding allows.

4.4. **Additionality: The need for LGF support**

(a) Scheme additionality

The i3 proposition is complementary to several schemes:

- The RGF-funded schemes, as set out earlier. Section 4.1(c) explains how i3 is complementary to Expansion East Kent and TIGER/ Escalate. Specifically, i3 will target funding directly towards businesses with potential for innovation through a programme of specified calls for projects. The RGF schemes will maintain a broader focus, supporting growth and employment in the wider economy.
- Small-scale loan schemes exist in Medway (Partners for Growth, funded by Medway Council) and the Romney Marsh. These provide small loans (usually below £10k), on an interest-free basis within specific geographical boundaries. The funding provided by these schemes will generally be smaller than that provided by i3 and mostly focuses on generic SME support. However, Partners for Growth in particular will help to drive demand for the larger scheme.
- Grants for innovation, provided by Innovate UK. There are several products offered by Innovate UK, which seek to promote investment in R&D and its commercialisation. A full list is set out at www.gov.uk/innovation.

The i3 scheme complements the Innovate UK offer. Whereas Innovate UK is 'technology-led' (i.e. focusing on specific technologies and research that will support growth), i3 is 'firm-led' (i.e. investing in capacity – physical or human – within firms that will enable them to effectively exploit innovation). This reflects the need to support investment in capacity identified in section 4.1(a), as well as the relative strengths of Innovate UK in understanding technology drivers and KMEP in understanding local business capacity.

- University support, including business incubator facilities and access to university research expertise (such as via innovation vouchers). This support does not generally take the form of direct loan finance; however, premises and advisory support will complement i3 support in strengthening business survival prospects.
- Government-backed equity schemes. There are several equity schemes supported by the Government, including the Enterprise Capital Funds programme and the Business Angel Co-investment Fund. Both operate nationally, although funding is relatively limited. A smaller equity fund has also been established focused on businesses at Discovery Park Enterprise Zone in East Kent. The i3 loan fund is complementary to these equity funds and businesses will be signposted as appropriate.
- The Business Finance Partnership. The BFP invests Government funding in fund managers and non-traditional lenders (such as peer-to-peer lending), who then make funding available to SMEs on a co-financed basis. BFP backed loans could be attractive to some i3 target businesses; however unlike i3, BFP lends on fully commercial terms. But for some businesses with unproven products or markets, fully commercial terms will be unviable.

Overall, there is no direct duplicate of the Innovation Investment Initiative. The nearest similar products are the RGF-funded schemes, but these will be managed to ensure clear scheme differentiation.

(b) LGF additionality

The Local Growth Fund will be enabling the delivery of a new fund to support innovative businesses. This is additional to the support currently provided through the RGF schemes and other Government-financed products, as outlined above.

5. Project schedule and outputs

5.1. Project schedule

(a) Assumptions

The Innovation Investment Initiative will be managed through a series of regular, open competitions. These competitions will set the criteria against which businesses can come forward with eligible proposals for loan funding and will be time-limited.

At this stage, the project schedule and deliverables have been set on the assumption that the Local Growth Fund is the only source of capital for the Fund, and that the Fund has £1 million per year (plus any repaid loans). However, additional funds may be sought from other sources.

Competition dates assume that funding is available. However, should very strong applications come forward, the Investment Advisory Board may decide to make funds available in an earlier round and reduce availability later.

No recruitment processes are required as management staff are already in place.

(b) Schedule

Action	Completion target
Scheme setup	
Detailed scheme design developed	October 2015
Scheme approved by KMEP	November 2016
Investment Advisory Board recruitment process	November 2015
Investment Advisory Board approved (KMEP/ KCC)	December 2015
Competition criteria determined	December 2015
Delivery	
Competition 1 launched	December 2015
Competition 1 closes	January 2016
Competition 1 funding decisions	February 2016
Competition 2 launched	March 2016
Competition 2 closes	April 2016
Competition 2 funding decisions	June 2016
Competition 3 launched	July 2016
Competition 3 closes	August 2016
Competition 3 funding decisions	October 2016
Competition 4 launched	November 2016
Competition 4 closes	December 2016
Competition 4 funding decisions	February 2017
<i>[then all future competitions on 6-month cycle]</i>	
Review and evaluation	
Regular Scheme Review	After each competition round
Mid-term evaluation	2017
Final evaluation	2021

5.2. Outputs

Output	Target	Measured by	Rationale
Businesses directly assisted	60	Number of businesses securing i3 loan finance	Assumed average loan value of £100k. This is lower than the average loan value across the RGF schemes, but in line with Escalate, the most similar of the RGF schemes to i3 in targeting smaller, innovative businesses.
Businesses surviving after 3 years	54	Number of businesses directly assisted still trading independently or acquired	Assumed failure rate of 10%. This is higher than the actual failure rate for the RGF schemes (currently 5% for Expansion East Kent), but reflects the higher risk profile of target businesses.
Jobs created or safeguarded	450	Number of FTE jobs created or safeguarded as a result of i3 support (assuming 1 FTE = 30 hours/ week+)	Assumed cost per job of £20,000. This is considerably higher than the cost per job achieved on the RGF schemes (£8,920), but reflects the likely higher value of jobs supported and the lower labour intensity of likely activity.
Private leverage	£9m	Private sector funding to projects supported by i3	Assumed i3 contribution of 50% of project costs (both on the initial RGF capital and recycled funds within the period to 2021)

It is also anticipated that i3 will contribute to increased business collaboration with the higher education sector (e.g. through the take-up of innovation vouchers) or with other businesses.

Outputs are set out linked with funding flows across the Scheme in Annex 3.

6. Costs and funding

6.1. The i3 Loan Fund

(a) Loan Fund initial capital

The i3 loan fund will be financed by LGF grant of £1 million per year. All LGF funds will go directly into the i3 loan fund to be disbursed to business.

(b) Loan Fund repayments

All loan repayments will be reinvested in the fund. In order to estimate the level of funds that will be available, it has been assumed that:

- All loans are interest-free;
- Provision is made for bad debt at 10% of all loans. This is higher than the bad debt currently incurred on the Expansion East Kent and TIGER/ Escalate schemes, but reflects the higher risk associated with innovative businesses and products;
- All loans are repaid over five years, with repayments starting in the financial year following the commitment of the loan.

(c) Private sector leverage

All projects will be required to demonstrate private sector leverage to a ratio of at least 1:1. It is assumed that all i3 funds will therefore be matched pound for pound.

Based on the above assumptions, total Fund availability is estimated as:

	15/16	16/17	17/18	18/19	19/20	20/21
i3 (initial funds)	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
i3 (repayments)			500,000	500,000	1,000,000	1,000,000
i3 (total)		1,000,000	1,500,000	1,500,000	2,000,000	2,000,000
Private match	1,000,000	1,000,000	1,500,000	1,500,000	2,000,000	2,000,000
Total programme value	2,000,000	2,000,000	2,500,000	2,500,000	3,000,000	3,000,000

This is set out in greater detail in the spreadsheets in Annex 3.

6.2. Management costs

The i3 scheme will be managed alongside the existing RGF programmes and will be funded in the same way, through:

- Initial administration charges of 3% of loan value; and
- Local authority contributions

Work is currently underway to identify savings in overall management costs; however, the following table illustrates management costs and funding:

Annual operating costs						
	15/16	16/17	17/18	18/19	19/20	20/21
	49,913	102,192	111,808	104,808	104,808	101,808
Financed by						
Arrangement fees	30,000	30,000	45,000	45,000	60,000	60,000
Local authority contribution	19,313	72,192	66,808	59,808	44,808	41,808

6.3. Benefit-cost analysis

A benefit-cost analysis of the Scheme has been carried out, based on a central scenario reflecting the estimates set out in this document and an adjusted (pessimistic) scenario. Both scenarios consider the benefits and costs of the Scheme over a 15 year period to 2029/30, taking into account funds recycled during this time.

The full BCA is set out in the spreadsheet in Annex 3. In summary:

Central case		Adjusted case	
<u>Assumptions:</u>		<u>Assumptions:</u>	
Cost per job	£20k	Cost per job	£25k
Failure rate	10%	Failure rate	20%
Deadweight	20%	Deadweight	40%
Displacement	15%	Displacement	30%
Indirect effects multiplier	1.3	Indirect effects multiplier	1.1
Arrangement fees	3% of loan value	Arrangement fees	Reduced by 50%
Inflation	2%	Inflation	3%
<u>Outcomes</u>		<u>Outcomes</u>	
Discounted benefits	£78,412,312	Discounted benefits	£10,454,476
Discounted costs	£6,273,297	Discounted costs	£6,273,297
<u>BCR</u>	<u>12.50</u>	<u>BCR</u>	<u>1.67</u>

The BCR for the adjusted case is substantially lower than for the central case. However, allowing for 'worst-case' scenarios in cost per job, business failure rates and additionality, the project remains value for money on the adjusted case.

7. Governance and project management

7.1. Project management and delivery structures

(d) Governance

The accountable body for this project will be Kent County Council (KCC). All loan agreements and contracts arising from the project will be issued by KCC.

If this project is approved, KCC will take a Cabinet Member Decision to establish an Innovation Investment Initiative and to create a mechanism to make loan finance available to business, consistent with any provisions set out by Government as the funding provider or by Essex County Council as the accountable body for the Local Growth Fund.

The mechanism to make i3 funding available to business will involve:

- Consultation with Kent and Medway Economic Partnership on the design of the scheme (as well as regular reporting to KMEP Board on scheme performance); and
- The establishment of an Investment Advisory Board (IAB). The IAB will consider competition specifications and all applications for funding following appraisal and will make recommendations to KCC. The IAB will be made up of 6-8 representatives from the public sector and from industry.

(e) Delivery strategy overview

As the accountable body for the project, KCC will employ the Management Team. The Management Team will be the existing management resource employed to deliver the Expansion East Kent and TIGER/ Escalate schemes – so there will be no additional management cost to the public sector as a result of i3. The i3 scheme will also use the CRM, application and monitoring arrangements that we already have in place.

KCC will contract with an external organisation to provide appraisal support. KCC will also contract additional business support to beneficiary businesses and prospective applicants, via separate Growth Hub revenue funding.

(f) Project management

Overall management of i3 will be carried out by the Regional Growth Fund Manager, reporting to the Head of Economic Development and Business Engagement within KCC.

Day-to-day management of the Fund will be carried out by one of two Programme Managers currently reporting to the RGF Manager. The team also includes contracts and monitoring and administrative support.

(g) Decision-making process and criteria

The Investment Advisory Board will be responsible for recommending to Kent County Council whether or not an application for i3 funding should be approved, and any conditions that should be applied.

At its first meeting, the IAB will consider a draft Delivery Plan, which will set out criteria for funding and the objectives of each competitive funding round. The Delivery Plan will be updated every six months in advance of each round. It is anticipated that criteria for loan approval will include:

Eligibility criteria

To be eligible, businesses must:

- Be considered small or medium enterprises (i.e. employ fewer than 250 people, or have an annual turnover not exceeding €50 million or a balance sheet not exceeding €43 million);
- Spend the full value of the i3 loan on a project taking place within Kent or Medway;
- Secure at least 50% of the costs of the project in cash from private sector sources before the loan agreement is concluded;
- Be able to demonstrate that funding cannot be secured from private sector sources
- Not be engaged in a restricted sector according to the state aid regulations (including primary agricultural production).

Projects must:

- Demonstrate how they will lead to the development or commercialisation of a new product or service, or how they will deliver a process innovation that will yield higher productivity;
- Demonstrably lead to business growth and/ or sustainable job creation;
- Demonstrate how they contribute to sustainable growth and the development of a low carbon economy;
- Meet the sectoral or technology criteria associated with the specific competition round.

Eligible expenditure

i3 loan funding may be used for:

- Commercial premises: costs of deposit, moving and improvement of premises, including construction and improvement works (although not premises or land purchase)
- Plant and machinery: costs of re-tooling and installation of machinery and hardware and training required to operate it
- Intangible assets: including costs of purchasing patents, IT, software and licences
- Consultancy costs (e.g. marketing, business planning)
- Wage costs of new employees
- Gap funding: funding required to cover gaps in working capital where commercial funding sources (e.g. overdrafts and invoice finance) cannot provide the full

requirement. In such cases, the business will need to demonstrate why there is a funding gap, and that all other sources have been explored.

i3 loan funding may not be used for working capital (other than within the definition of gap funding above), the acquisition of real estate or the acquisition of motor vehicles.

The state aid basis for the Fund is set out in Section 8.1.

The competitions process

Applications to the Innovation Investment Initiative will be sought through a series of competitions. It is envisaged that these will focus primarily on specific technologies and applications related to key areas of growth within the local economy (for example agritech or life sciences). However, recognising that innovation occurs in all sectors and often in areas that policymakers are unable to predict, competitions will also be open to wider applications.

Appraisal criteria

All applications for i3 funding will be appraised before they are considered by the Investment Advisory Board. Appraisal will generally be undertaken by independent advisors, using relevant industry expertise where appropriate. Criteria for appraisal will include:

- The viability of the applicant's business plan and their ability to generate sustainable growth;
- The likelihood of the project driving product or process innovation that will support the innovative capacity of the business;
- Jobs created or safeguarded as a result of the project;
- The contribution of the project to wider economic growth (through for example supply chain impacts or wider productivity gains); and
- Private sector leverage

Approval

Appraised projects will be considered by the Investment Advisory Board, which shall decide whether or not to recommend approval. Kent County Council as the accountable body will then formally make final investment decisions.

Post-approval decisions

Following KCC's Cabinet Member decision described in 5.2(a), authority will be delegated to the Director of Economic Development to enter into loan agreements with beneficiaries and to authorise expenditure.

The Director of Economic Development will also have the authority to stop payments or claw funds back in the event of a failure of a project to deliver, or in the event of

irregularities in the original application. However, the Programme Management and team will work to ensure that any performance issues are resolved in good time.

(h) Customer journey

The following paragraphs describe how i3 will work from the perspective of beneficiary businesses.

According to the timetable in Section 5.1(b), applications will be invited via time-bound competitions. A prospectus for each competition will be published when the competition is launched.

Following the launch of the competition, applicant businesses will complete the following steps

- Step 1: Businesses considering applying to i3 will complete a 'pre-application' form on the Kent County Council website (www.kent.gov.uk/business). This will be open for a defined period (usually 4-6 weeks) and will allow the programme team to check for basic eligibility using the eligibility criteria set out in Section 7.1(d) above.
- Step 2: If the business is eligible, it will be sent the full application form and advised of appropriate sources of advice. The business will have a fixed period in which to submit its application.
- Step 3: The business submits its i3 application to Kent County Council. Once checked for completeness, the application will be appraised and considered by the Investment Advisory Board.
- Step 4: If the application is approved, a loan agreement will be entered into between the business and Kent County Council, subject to the resolution of any conditions advised by the IAB or by KCC. When the loan agreement is concluded, an arrangement fee will be charged by KCC to cover management and administration costs (see Section 6).
- Step 5: The business will draw down loan funding in accordance with the profile set out in the loan agreement. Conventionally, this will be linked with funding need.
- Step 6: Loan repayments will be made in accordance with the profile set out in the loan agreement. Once the first loan payment has been drawn down, businesses will be monitored by the Management Team for up to three years from the final repayment date.

7.2. Monitoring, reporting and control

(a) Control

The Programme Manager will have overall responsibility for the successful delivery of the project, ensuring that it links to other relevant programmes and reporting to the Director of Economic Development. The Programme Manager will ensure that project is managed in line with the Funding Agreement taking into consideration the views of the Investment Advisory Board.

(b) Monitoring state aid

State aid will be monitored on the KCC's Customer Relations Management (CRM) system and will be collected once a business registers with the project. Before support is provided, the Management Team will ensure that the business and the project are compliant with state aid rules.

(c) Monitoring finance

The Management Team will be responsible for collating and retaining all documentation relating to finance including grant applications, grant agreements, invoices and timesheets.

(d) Verification and audits

The Management Team will coordinate all monitoring or audit visits. Any issues/irregularities raised at these visits will be managed by the Management Team and logged on the Project Issues log. Any issues which cannot be resolved will be raised to the Programme Manager and the IAB as applicable.

(e) Record keeping

The Management Team will maintain all project records including all LGF related documentation, correspondence from/to DCLG, quarterly claims, evidence of businesses assisted, etc. All documents will be retained until 3 years after the closure of the programme.

(f) Project monitoring

The Monitoring and Contracts Officer will monitor progress against outputs and targets monthly, reporting to the Programme Manager. Any issues/barriers will be raised to the Programme Manager or the IAB.

(g) Claims

Claims will be made quarterly in advance, and will be accompanied by monitoring returns as required by Government or the LEP Accountable Body

7.3. Risk assessment

A risk assessment is set out in Annex 1.

7.4. Evaluation

A mid-project and end-project evaluation will be carried out.

The mid-project evaluation will take place in July 2017, and the end-project evaluation will take place in 2020.

The evaluation will consider:

- Impacts on business performance (including productivity and product development);
- Employment impacts and benefits of the project (including direct jobs created and safeguarded);
- Environmental impacts and benefits (including resource efficiency);
- Distributional effects (including the geographical distribution of benefit across Kent and Medway and equalities impacts);
- Achievement of actual against anticipated outputs;
- Integration with other loan, grant and business support programmes available in Kent and Medway;
- Risk management;
- Lessons learned from i3 and how they can inform future projects.

The evaluation will also seek to measure:

- The extent to which the scheme supports the commercialisation of innovation, including R&D spend and new capital and revenue investment by the firm;
- Productivity gain, evidenced through sales increases and cost savings;
- Indirect employment effects, for example through benefits to suppliers.

Kent County Council has recently entered an agreement with the University of Essex's Big Data Centre, through which the University will offer support in developing a more consistent framework for project evaluation. It is envisaged that the University will be engaged in the ongoing evaluation of the i3 project, including at mid-project and end-project review stage.

7.5. Exit and legacy/sustainability

(a) Exit strategy at the beneficiary level

All i3 loan applications will be carefully appraised to ensure that all finance is used to cover the costs of specific projects which will deliver business growth, and is not used to support working capital. The viability of the applicant business and its ability to generate sustainable growth without further public support will be a key criterion in the appraisal process, and businesses will need to secure at least 50% of project costs through private

sector sources. It is therefore intended that i3 will fund specific investments in innovative firms, rather than provide ongoing support.

(b) Exit strategy at the fund level

As set out in Section 4.1, the difficulties experienced by smaller, innovative companies in accessing finance are well documented, and there is frequently a role for the public sector in making finance available on sub-market terms, recognising that the economic gains from innovation are greater than the private returns. There is therefore likely to be an ongoing requirement for public sector support for a scheme such as i3 beyond the end of the funding period in 2021. This ongoing demand will be partly met through the reinvestment of repaid loans (although the balance of the fund will diminish over time unless interest payments are introduced) and partly through other funding sources, in particular ERDF.

However, while there is likely to be a requirement for public sector assistance, the mid-term and final evaluations will inform whether or not this requirement should continue to be met through i3, taking into account other products supported by Government.

(c) Assets

It is not intended that there will be any assets acquired by Kent County Council with LGF funding for this project. However, KCC will take security against assets where appropriate when entering into loan agreements. Where KCC disposes of assets acquired as a result of the bankruptcy of a beneficiary business, receipts will be returned to the i3 loan fund, minus costs.

(d) Monitoring and reporting

Monitoring and reporting requirements beyond 2021 will be covered by Kent County Council.

8. Compliance

8.1. State aid

The Innovation Investment Initiative will offer state aid. This is because loan funding will be offered interest-free – so the interest forgone is essentially grant. The grant equivalent will be calculated according to the EU reference rate and will be made available as one of the following forms of legal state aid:

(a) Aid provided through the General Block Exemption Regulation

In most circumstances, aid will be provided through the GBER, through the following exemptions:

- a) Investment Aid to SMEs (Art. 17 of Commission Regulation (EU) 651/2014). This provides that aid of up to 20% of project cost may be provided to small enterprises for the purpose of investment in tangible or intangible assets. We anticipate that the majority of loan funding will be offered as Investment Aid to SMEs, and that all funding for the acquisition of plant and machinery will be offered under this measure;
- b) Innovation Aid for SMEs (Art. 28 of Commission Regulation (EU) 651/2014). This provides that aid of up to 50% of project costs may be provided for the purpose of obtaining, validating and defending patents, other intangible assets, costs of secondments of highly qualified personnel and advisory and support services;
- c) Aid for Start-ups (Art. 22 of Commission Regulation (EU) 651/2014). This provides that aid of up to €800k may be provided to small innovative enterprises less than five years old.

(b) Aid provided under the *de minimis* rule

Where it is not possible to offer assistance via the GBER, support may be offered under the *de minimis* rule. This provides that businesses in non-restricted sectors may obtain up to €200,000 in *de minimis* aid in any three year period.

Applicant businesses will need to demonstrate that they are compliant with the *de minimis* rule. This includes demonstrating that they have not previously received *de minimis* aid (or other forms of aid which cumulate with *de minimis* aid within the state aid rules) to the extent that they would exceed the *de minimis* ceiling as a result of i3 support. A standard notification will be used to inform businesses that they are obtaining state aid under the *de minimis* rule.

3.1. Procurement

KCC has a full procurement policy and will follow this, unless the Government requires more as a condition of grant. A full copy of KCC's procurement policy can be found at:

<https://shareweb.kent.gov.uk/Documents/business/procurement/spending-councils-money.pdf>

The main item for procurement will be project appraisal support. It is envisaged that this will be competitively tendered together with support for Expansion East Kent and TIGER/ Escalate when these are due to be retendered in 2015. No expenditure has already been procured.

3.2. Publicity

A Publicity and Communications Plan will be produced during the set-up phase. This will determine the initial marketing materials to be used and a programme of events and workshops to promote i3.

It is anticipated that business intermediary organisations, such as Chambers of Commerce, local business forums, the Federation of Small Businesses and private sector advisors (such as accountants, banks and financial advisors) will be important channels of communication about i3, as will the other local authorities in Kent and Medway. KCC already has good networks with these bodies, associated with our current management of the Regional Growth Fund product range.

KCC's business-facing website at www.kent.gov.uk/business will be used as the gateway to i3 support. However, the [Kent and Medway Growth Hub](#) website will also contain information about i3 (and other sources of funding and support), and Growth Hub advisors will be fully informed about the Scheme's availability and criteria.

In all publicity, Government support will be fully acknowledged, consistent with any publicity requirements.

Annex 1: Risk assessment

Risk	Inherent risk (1-5)			Mitigation	Residual risk (1-5)		
	Probability	Impact	Rating (P*R)		Probability	Impact	Rating (P*R)
Duplication of existing schemes, leading to confusion of market	3	4	12	<ul style="list-style-type: none"> • Clear scheme criteria • Management alongside RGF schemes to ensure coordination/ avoid duplication 	1	4	4
Poor marketing and awareness leading to weak demand	3	2	6	<ul style="list-style-type: none"> • Use of intermediary networks (Chamber of Commerce, districts, etc) • Joint marketing alongside RGF schemes • Strong existing marketing 	1	1	1
Insufficient funding to satisfy demand	4	3	12	<ul style="list-style-type: none"> • Clear scheme criteria and process for selecting successful projects 	3	2	6
Poor quality applications leading to high rejection rate	3	4	12	<ul style="list-style-type: none"> • Clear published criteria • Established support networks in place supplemented with Growth Hub 	2	3	6
Poor project selection leading to failure to achieve outputs	4	5	20	<ul style="list-style-type: none"> • External appraisal • Clear decision-making process via IAB • Effective project monitoring 	2	2	4
Failure to comply with state aid rules	2	5	10	<ul style="list-style-type: none"> • Clear scheme criteria linked with state aid rules • Consideration at appraisal, 	1	3	3

Risk	Inherent risk (1-5)			Mitigation	Residual risk (1-5)		
	Probability	Impact	Rating (P*R)		Probability	Impact	Rating (P*R)
				<ul style="list-style-type: none"> contracting and claim • Effective project monitoring 			
Failure to secure private sector match	2	4	8	<ul style="list-style-type: none"> • Match requirements linked to scheme criteria • Promotion to banks and intermediaries 	1	3	3
Lack of additionality as businesses could have secured funds through other sources	4	4	16	<ul style="list-style-type: none"> • Evidence of additionality required as part of appraisal process • Clear targeting in competitions 	2	4	8
Failure to achieve anticipated outcomes	3	4	12	<ul style="list-style-type: none"> • Effective monitoring • Access to additional business support via Growth Hub and existing providers 	2	4	8
Bad debt	4	4	16	<ul style="list-style-type: none"> • Robust appraisal processes • Effective monitoring • Flexible approach to rescheduling of debt/ payment holidays to maximise potential for business success • Security where appropriate <p>However, i3 by definition will be supporting higher risk projects.</p>	3	3	9

Annex 2: RGF scheme performance

The table below provides details of the performance to date of the two Regional Growth Fund schemes in Kent and Medway at January 2015:

Expansion East Kent

RGF grant:	£35 million
Funding committed:	£30.9 million (+£5m allocated to equity fund)
Private investment:	£57.3 million
Companies supported:	119

Contracted jobs

Jobs created:	2,744
Jobs safeguarded:	656
<u>Total:</u>	<u>3,400</u>

TIGER/ Escalate

RGF grant:	£20 million
Funding committed:	£20.0 million
Private investment:	£30.9 million
Companies supported:	91

Contracted jobs

Jobs created:	1,366
Jobs safeguarded:	782
<u>Total:</u>	<u>2,148</u>

<u>Total jobs (all schemes)</u>	<u>5,548</u>
---------------------------------	--------------