Government Office for
Technology Transfer

The Knowledge Asset
Spinouts Guide

May 2025

Any enquiries regarding this publication should be sent to: **GOTT@dsit.gov.uk**.

Contents

1. Introduction

This guidance is to support organisations in scope with Knowledge Asset (KA) management and, in turn, fulfil their responsibilities as set out in Managing Public Money (MPM), particularly the duty in A4.15.8 to identify, protect, and maximise the value of their KAs.

Whilst the specific approaches set out are not mandatory, it brings together good practice from within and outside of the public sector, to help fulfil the relevant duties within MPM.

Organisations in scope are those headed by an Accounting Officer who is responsible for upholding MPM. These organisations are mainly those classified as central government by the Office for National Statistics, but others will be in scope.

In this guidance these organisations are referred to as public sector bodies (PSBs).

Organisations out of this scope may still find this guidance useful.

The purpose of this guide is to support PSBs to create new 'spinout' companies to commercialise KAs. The primary audience is those responsible for KA management in PSBs, including **Senior Responsible Owners and KA managers**.

It also contains information for other PSB staff involved in KA management and the spinout process, including finance, governance and sponsorship teams. Note, this is overarching guidance and PSBs should always seek specialist functional advice, including legal, when considering developing a spinout.

KAs are intangible assets including intellectual property (IP) such as patents, software, trademarks, know-how, and data. Spinout creation may be a new or infrequent activity for many organisations. However, understanding what is involved, and the rationale for creating spinouts, will help make informed choices around exploitation routes and provide a framework for when a spinout opportunity arises.

Building spinout companies from public sector innovation offers significant social and economic benefits for the UK and can benefit PSBs and their staff through professional development, broadening of networks, increased entrepreneurism and revenue generation.

A spinout may offer the best route to develop the innovation to make new products and services available, enhancing the quality of life for citizens. Spinout creation can generate high-quality jobs, attract significant investment, and stimulate local economies, helping to uphold the UK's competitive edge on the global stage.

It is a valuable activity and within the remit and duties of all organisations in scope of MPM, not solely those with explicit commercial objectives.

This Guide applies to commercialisation where the PSB is taking equity in a spinout and should be read in conjunction with the **Knowledge Asset Commercialisation Guide**.

Both guides have been developed in collaboration with government departments including HM Treasury and Cabinet Office; Arm's Length Bodies including the Intellectual Property Office, The National Archives and National Audit Office; and external experts including investors and leading UK universities.

If you have questions about how to implement this guidance, please contact **GOTT@dsit.gov.uk**.

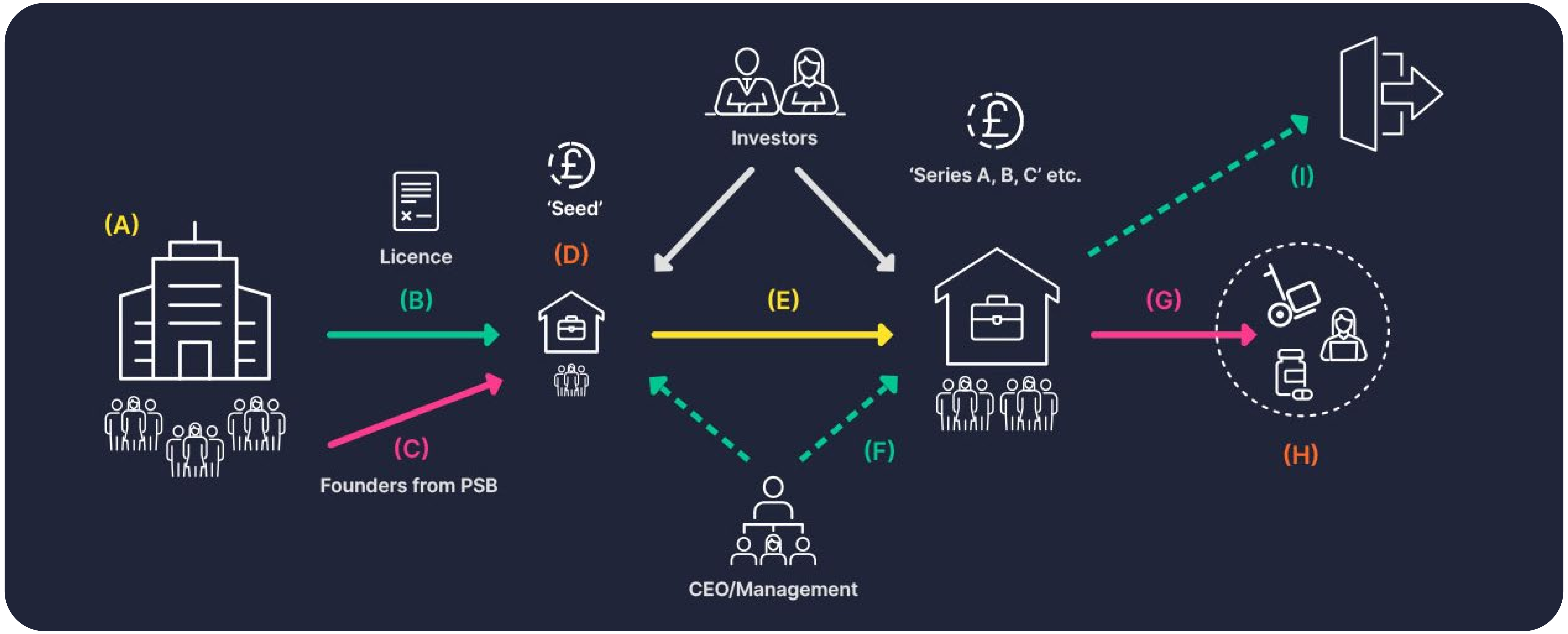
2.

What is a Spinout?

The term 'spinout' typically refers to a situation where an organisation has assets of potential commercial value that are 'spun-out' into a new, typically, private limited liability (Ltd) company. It is conventional for organisations to license assets to a spinout and take shares in the new company.

Note, KAs are typically licensed, not sold (or 'assigned'), so if the spinout fails, the KA reverts back to the PSB, enabling the PSB to make further attempts to realise the KA's potential.

The diagram below (Figure 1) provides an overview of the spinout formation process.



(A) The PSB has assets, which it decides to exploit commercially by creating a spinout company. Companies may be established under existing Companies Act legislation. Founders register the new company with Companies House.

(B) The PSB licenses assets into the spinout company, which gives the spinout the rights to exploit the assets for a specified commercial purpose and takes shares in the company. The licence fees can be structured in a variety of ways to suit the specific circumstances of the spinout.

(C) Staff from the PSB may become associated with the spinout to help build value in the company. These can often be inventors or other staff who have been involved with development of assets (e.g. technology, process or products). How they engage with the spinout is varied. They may be employed directly by the company, be seconded from the PSB, or work for the spinout on a consultancy basis. These people will often be granted shares or share options in the new spinout as an incentive for their continuing participation in the company (E). In making these arrangements regard should be had to the Civil Service code and potential conflicts of interest (visit section 8.5 of the **Commercialisation Guide**).

(D) Investors provide money to the company, typically in exchange for equity shares, in anticipation that the company will grow and increase the value of the shares and therefore their investment. The first investment at the stage of incorporation of the company is referred to as 'Seed funding'. It is likely that the company will be reliant on external investment in the early stage of development since it may take time for the company to generate revenue from products or services. Here, other forms of funding such as grants may provide useful **non-dilutive** sources of investment to help grow the company.

(E) The employees of the company work to develop the underpinning asset (technology or other types of asset) to increase its maturity and build value in the company. If the spinout has been set up to commercialise an already operational service or mature technology, the employees may take on a more operational function, for example in service delivery.

(F) A strong management team is a critical factor for investors. A CEO will develop the company strategy and business plan and based on these, raise funding for the company. The company executives (and potentially other employees) will likely be compensated through a combination of a salary and shares or share options. Shares or share options may also be available to other company employees to reflect risk and as performance incentive.

(G) The spinout is likely to need to raise further investment to grow and attract new employees. The funding 'rounds' following seed stage are known as Series A, B, C etc.

(H) As the company matures it will seek to generate revenue through its products or services, for example by sale direct to customers, to other companies and/or through partnering with an existing company. Alternatively, the company may develop the KA to a point where it can be licensed on (sub-licensed) to another party to bring it to market.

(I) An exit refers to the successful sale, acquisition, or public listing e.g. via Initial Public Offering (IPO) of a company, often resulting in financial gain to the shareholders, including the PSB. The decision to exit will be made by the company. There is no set formula for reaching an exit point. It is not uncommon for a company based on intangible assets, particularly those resulting from science or research activity, to be acquired by a larger company before the spinout is profitable or even has a commercial product or is generating revenue. Investors, who may have board seats, will likely have a desired timeframe to exit by.

2.1. Characteristics of a Spinout Opportunity

Creating a spinout can be exciting and fulfilling, whilst also being complex and a significant undertaking. The spinout will have to adapt and overcome challenges associated with operating within a dynamic and uncertain market environment. The potential rewards and impact need to justify the time and resources that will need to be invested by the PSB and the founders, in setting one up.

Though spinouts differ in their size, mission, business model etc., some common elements that may indicate that a potential spinout opportunity is viable include:

A Committed and Suitably Skilled Team

The team in the spinout can be the single biggest factor for success or failure.

The spinout will need business leadership to develop and drive forward the vision of the company and support effective management of the spinout.

Technical and/or subject matter leadership is also required and at least one credible inventor or staff member with relevant background knowledge of the solution will be expected to join or associate with the company.

Visit section 8. The Founding Team and Attracting Talent for further detail on building and incentivising the team.

A Demonstrable Unmet Need

This should be considered alongside the overall market opportunity, as it will be important that the spinout is solving a problem for customers and users. Spinouts may provide wholly new products or services, or better solutions than those already available.

A Large Market Opportunity

The market size, and the portion of that market that the spinout could address should justify the risk and cost of forming a new company.

For example, the ability to capture the entirety of a £1 million global market is unlikely to justify the effort of spinning out but taking a small portion of a £100 billion market is a more positive indicator of potential impact and future value.

Note, sometimes the market is not large enough to justify or require traditional venture capital funding, but the wider potential impact may be large enough to justify pursuing the opportunity. This type of "social venturing" might include a relatively small business that employs 100 people in sustainable jobs (positive impact, supporting the local economy and the PSB's ecosystem). These ventures would not typically attract venture capital and are not the focus of this guide.

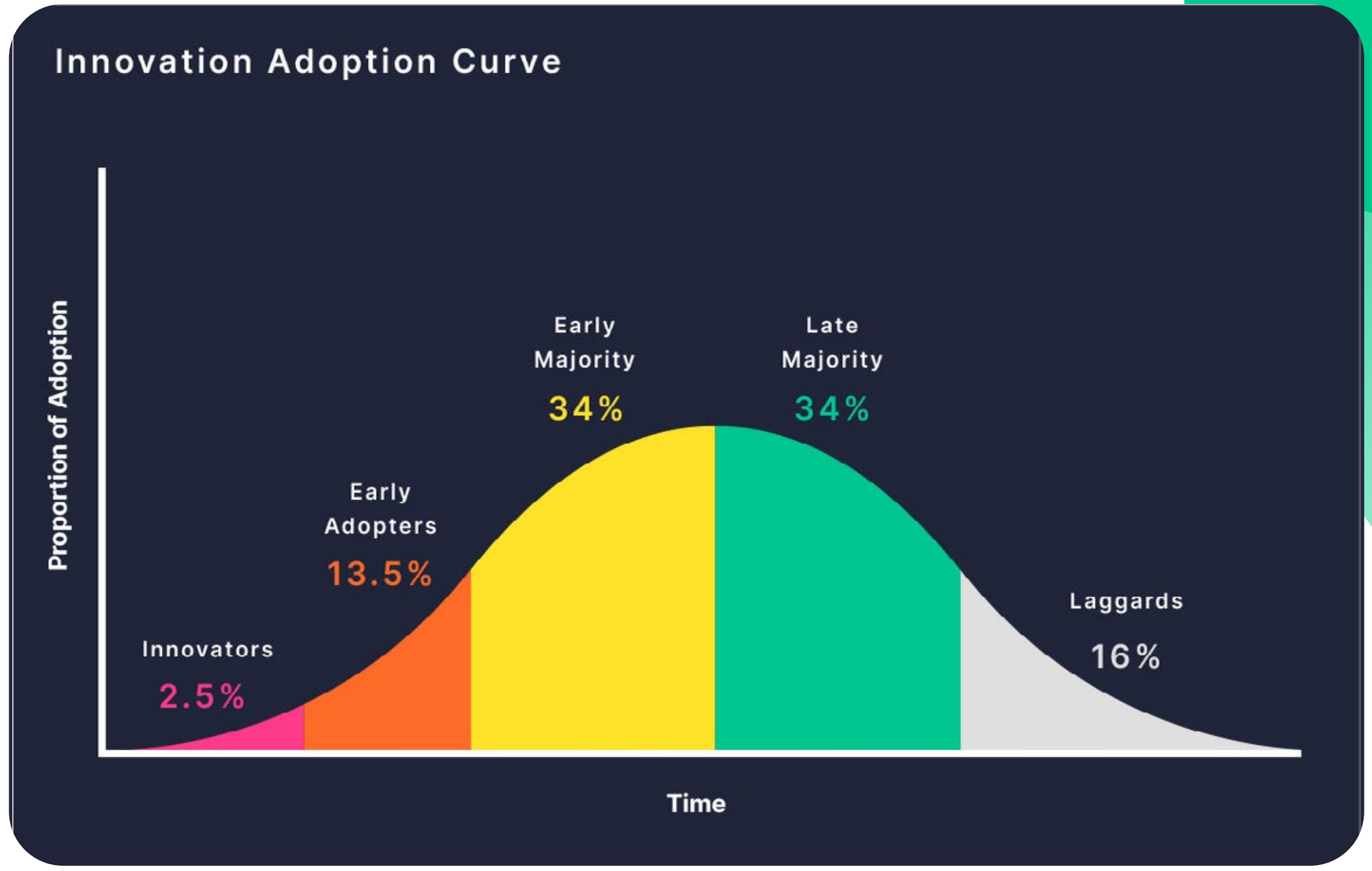
A Platform Opportunity

If the innovation could lead to several distinct products or applications, a spinout might offer a viable option for commercial exploitation. Multiple applications may be an indication of the spinout's market potential. This may be particularly relevant to technology-based inventions.

A Novel Solution

A spinout may be the only route to develop the KA to a point where it can be commercialised. This may be because an existing company is not willing to take a licence and take on the task of further research and development, and commercialisation, or because the opportunity is truly disruptive.

It's worth noting that it is hard for a new company to compete in an established market unless the solution is significantly better than the competing solutions, and even then, the market may not be 'ready' or willing to pay the cost of change to switch and adopt a truly disruptive innovation (the Innovation Adoption Curve, below, for example). Visit section 4. When to Spinout for more information on required research and due diligence.



A Defensible IP Position and IP Strategy

A spinout will often need a strong IP position to give it competitive advantage. Protection will likely be required in the country in which the spin out is located and the major markets in which the company intends to operate, manufacture or commercialise its products. Seeking a range of IP protection can offer commercial advantage.

The types of protection will depend on the type of asset. For technology-based spinouts, patent protection is a typical registerable right. Not all IP will be registerable (e.g. know-how, trade secrets), and the PSB should consider how else it will be protected.

An IP strategy should include the approach to protection including registerable rights, funding required for protection, the approach to IP in commercial agreements, and the active management of IP in-life.

Visit the GOTT guide to Managing IP and Confidentiality for more information.

3.

Why Create a Spinout?

Within the public sector, the primary motivation to create a spinout is to deliver impact. A spinout may offer the best route to develop a government funded KA and make it available.

This can offer new or improved services or products and enhance the quality of life for citizens and benefit the PSB and staff as described above. Spinout creation can boost economic growth, support innovation and healthy competition in the UK, generate high-quality jobs, attract investment, and stimulate local economies.

Creating a spinout company is a strategic business decision that requires consensus across multiple internal stakeholders, informed by meaningful engagement with potential customers and investors.

Creating a spinout company is just one of several ways to deliver impact, or generate additional revenue, from KAs, visit the **Commercialisation Guide**.

Reasons for Choosing the Spinout Route Include:

- The PSB wishes to realise social and economic benefits through bringing new products and services to market, which it cannot do itself. A spinout opens opportunities to scale the adoption and impact of the KA, through attracting investment and resources for further development and endpoint commercialisation, which cannot happen within a PSB.
- Alternative routes to development and exploitation of KAs have been explored and are not suitable e.g. there is no obvious licensee or partner to support commercialisation but there remains a market and unmet need for the KA, which a new company could address.
- The commercialisation of the KAs sits outside of the core business or mission of the PSB. Creation of a separate venture establishes a viable mechanism for the organisation to realise the commercial potential of the assets.
- A new entity can act with greater agility, autonomy, and can access larger sources of capital than the PSB, accelerating the path to market.
- The PSB staff have expressed a desire to create the spinout and this route appears viable. The PSB wishes to support entrepreneurship, which may align with the PSB's strategy to enhance its reputation as a leader in innovation and to increase staff motivation and innovativeness.

4.

When to Spinout

While the process of creating and operating a spinout business happens under conditions of uncertainty, there are key risks that can be addressed and mitigated prior to spinout formation. These can help to give assurance to relevant parties that the opportunity is 'ready' to be spun out.

Broadly these risks can be grouped into Commercial, Technical and Team. Typically, sufficient plans for how all of these will more fully addressed will be required before the spinout can be formed.

Understanding these takes significant time and effort, but this de-risks the opportunity for potential investors and makes it a more attractive proposition. GOTT can provide advice, funding, and access to networks and external expertise to support the commercial, technical and team development required to be ready to spin out.

Contact **GOTT@dsit.gov.uk** to access these and visit the **GOTT funding page** for more information on funding sources. PSBs may also make internal funding available for spinout opportunities.

4.1. Commercial Risks

Market

An understanding of the market into which the spinout will sell products and services. This includes areas of market growth; existing suppliers, including established companies and new entrants; their competing technology or solutions; relevant supply chains; relevant regulations and industry standards.

Where there is market failure, this can favour spinout formation over licensing as they can address market gaps with greater flexibility and innovation.

Customers

There should be an understanding of who the customers are, including whether those are other businesses (as customers or partners) or the end users. This should be informed by engagement with these customers.

The spinout should have confidence that their solution addresses a customer pain point to the extent that customers will pay for the solution.

Providing goods or services to customers in some jurisdictions may require **export controls** approval.

IP

The PSB needs to have undertaken a thorough due diligence (visit the **Commercialisation Guide**) exercise to establish the status of any IP that will be licensed into the spinout.

The due diligence should confirm that the PSB has the necessary rights over IP such that it can be licensed to the spinout and exploited commercially in the field of use relevant to the spinout's business plan. Also consider what rights to 3rd party IP may be required, and relevant restrictions on the use of Crown copyright.

Thought should be given as to who will continue to manage and to pay for IP protection once it has been licensed into the company. For an exclusive licence, the spinout will typically pay for ongoing registration costs, though when those payments are due may vary.

The Intellectual Property Office has a **range of tools** to support IP management, including an introductory course for IP and IP rights in government.

Data

Where data KAs are involved, there may be additional or particularly important considerations such as UK General Data Protection Regulation (GDPR), ethics, public perception, **Re-use of Public Sector Information (RPSI) Regulations**, and the appropriate access model, which will inform the approach to commercialisation.

Initial Business Plan

This should detail how the company plans to generate revenue, its customers, an analysis of the market it will operate in, organisation and management, products and services sold, and financial projections including investment required and cashflow.

Typically a pitch-deck, alongside a financial model is sufficient for securing an offer of investment.

Capital/Investment

If the company requires investment, potential investors interested in the area in which the spinout proposed to operate should be identified.

The timing of conversations with potential investors will need to be judged carefully. Early engagement with some investors in advance of a formal pitch can offer teams valuable feedback that allow them to calibrate their ideas, while pitching (seeking money) too early can put investors off if the proposition is not sufficiently mature, so teams should ensure they are suitably prepared for the type of conversation they wish to have.

PSBs may have existing connections with investors that teams can utilise. GOTT can also provide introductions to investors.

Founders

As part of their decision-making, investors may ask for certain documentation that will typically include:

- Pitch deck – a succinct and compelling summary of what they are being asked to invest in (including a non-confidential version to share without NDAs).
- Capitalisation ('Cap') Table – the breakdown of shareholdings and other ownership elements such as options (rights to shares in the future).
- Business plan – the plan for how the business will operate to deliver a return on investment; a business model canvas or similar can provide sufficient detail.
- Financial forecast – the planned financial growth of the company including investment, costs, revenue, and cash flow.
- Development plan/technology roadmap – how the KA will be developed into products/services.
- Team – who makes up the team and what are their strengths and gaps they are looking to fill.

To ensure all parties can move swiftly when required, it is helpful to secure a non-binding heads of terms for the KA licence. This can be developed into a full agreement alongside negotiation of the corporate documents, to align with the time at which the spinout is incorporated and when the assets are licensed into the company.

Security

The risks to the businesses IP and operations from hostile actors, and the need to comply with relevant security regimes should be considered. Visit section **11.4. Security** for more information.

Exit Strategy

The PSB will want to understand the initial strategy for the company and its short and medium-term funding requirements. The company will need to develop its longer-term exit strategy as investors will want to know when they can expect to see returns on their investment.

In some cases, an exit through acquisition by a larger and better resourced company may be the only way in which a spinout can take products or services to market. Occasionally, an exit by public listing on the stock market (IPO) may be achieved.

In some situations, the spinout may be offering a service that the PSB itself is not able to provide and the aim is to create a self-financing vehicle. This may involve a financial return to the PSB.

4.2. Technical Risk

The product or service needs to have reached a stage of development to give sufficient confidence to investors.

This could include being able to meet viable price points for the market, operate robustly in real world (not just lab) conditions, have sufficient longevity to perform over the full customer lifecycle, be disposable/recyclable, be attractively designed so people enjoy using it, and more.

Demonstrations of these can include: the solution being shown to be reproducible and scalable; it has met certain performance milestones that demonstrate it performs as expected; it has been tested with users and meets their needs; it has been designed to meet or to achieve a particular regulatory requirement.

4.3. Team Risk

The team is crucial for the success of the spinout. Investors are more likely to invest in a strong team with a good opportunity than a very good opportunity with an adequate team.

A strong, cohesive team ensures efficient decision-making and problem-solving, and good mix of technical and commercial skills allows for balanced business strategies and product development. This diverse skill set will attract investors, customers, and new team members, providing confidence in the team's capability to navigate market and technical challenges. Ideally a CEO who will join the spinout will have been identified and involved in seeking investment.

Investors like to see founders from the PSB actively involved, suitably incentivised and taking risk in the spinout, as this provides both critical expertise and shows commitment and confidence. This involvement may be by joining permanently on a full time basis or another arrangement, such as part time employment, a secondment, or on a consulting basis (visit the **Rose Book** Annex E).

It is important to establish who from the PSB will be involved and in what role and when. Founders should be encouraged to take legal and financial advice prior to spinning out to ensure they are fully aware of their obligations, responsibilities and risk. They should also undertake relevant training regarding their duties in their new role ahead of spinning out, for example through their PSB or GOTT.

PSBs will need to ensure that they are able to maintain their core services whilst a founder takes on new responsibilities and ways of working.

4.4. Ready to Spin-out?

The following table can be used to support decision making about whether a spinout opportunity meets a level of maturity at which it could be spun-out.

Table 1: Is the Opportunity Ready to Be Spun-out?

Category	Business Area	Requirements for Spinout
Commercial	**Market**	• Understanding of the market – Market size – Territories – Growth areas – Competitors – Barriers to entry – Supply chains – Regulations – Industry standards
	Customers	• Identify who the customers are for the business • Understanding of customer pain points • Feedback from customers on actual or proposed products or services • First customers identified
	IP	• Due diligence on IP ensuring PSB has freedom to operate and rights to allow licensing (including where Crown copyright and database rights are involved) and spinout for commercial exploitation • Due diligence on compliance with RPSI • Strategy for onward management of IP and other KAs is clear • IP protection filed or granted in relevant territories where applicable • What use of (and rights to develop) the IP the PSB will still require

Category	Business Area	Requirements for Spinout
Commercial	**Initial Business Plan**	• Revenue generation • Customer analysis • Market analysis • Organisational structure • Company management team/CEO • Products and services offered • Financial projections including operating costs
	Capital/Investment	• Investors identified and due diligence completed • Investor readiness – Pitch deck – Cap table – Business plan – Financial forecast – Product/service development plan/technology roadmap • Term sheet • Investment approved subject to contract
	Security	• Security risks understood and mitigations in place/planned as appropriate • Security related regimes are understood
	Exit Strategy	• Longer term strategy understood • Identified commercial milestones for further investment • Considered potential acquirers and direction of the market
Technical	**Performance**	• User testing or Proof of Concept demonstrates good performance • Future performance milestones identified and mapped • Understanding of any regulatory requirements
Team	**Technical and Business Skill Set**	• Technical/founding staff with necessary expertise committed and roles understood • Management e.g. CEO identified and committed
	Team Cohesion	• Team 'gels' and can operate as an effective unit

4.5. Timing of Company Creation

The company needs to exist before it can take in investment and issue shares in return. There are no formal rules as to the timing for company creation. The timing of company creation is usually aligned closely to fund raising i.e. at the point of need.

In an analogous situation, investors used to working with university spinouts don't necessarily expect to 'see' a company formed in advance of investment, subject to assurances, such as the institution confirming that the spinout will have the option to license the assets if it is able to raise investment.

Reasons to set-up a company significantly in advance of first investment may be where:

- The company is able to generate revenue immediately such as through a service-based model ("boot strapping"). Often external venture capital (VC) or Angel investment comes much further down the line when the business model is proven and/or there is a requirement for significant capital.
- Creation of a company enables access to necessary business support programmes. For example, to be eligible for a particular grant funding scheme. It's worth noting that criteria for such schemes are varied but usually include a low ceiling for the percentage ownership by the founding institution. They also often do not cover 100% of costs and pay in arrears (so the company will require operating capital and to cover any remaining or non-eligible expenses).

If a company is formed prior to investment (other than when boot strapping), it is a shell company i.e. it has no assets and is not trading. It doesn't require a complicated board structure. The company director(s) will need to assure themselves that company formalities, such as filing annual returns, will be undertaken.

It is usual for the founders to register the company themselves via **Companies House** or instruct a lawyer to undertake this for them.

There are also potential tax implications of founders taking founding equity, which may inform timing, visit section **11.5. Tax**.

National Security & Investment Act notification requirements (where relevant) can also affect timings, visit section **11.4. Security**.

5. Quick Start Guide

The table below sets out actions to undertake in preparation for and in support of spinout formation. It assumes that a PSB has already identified and evaluated the suitability of an opportunity for spinout creation (visit Table 1).

Detailed guidance for each of these sections is discussed later in this guide.

The Quick Start Guide identifies specific actions for PSBs and founders.

Topic	Description	Responsible/Involved		
		PSB	Innovators/Founders	Other
PSB Policy framework These should form part of a PSB's **Knowledge Asset Management Strategy** (KAMS)				
Rewards to Innovators policy	Describe: • How innovators will benefit from returns from licensing • Circumstances in which innovators may receive equity in a spinout and the conditions that apply (including any requirements to waive rights to other forms of revenue share) • How the PSB will benefit and manage returns from licensing and sale of its equity in spinouts	✔ (Relevant PSB Official)		
Spinout policy	This policy may be part of the PSB's Commercialisation Policy Describe the decision-making process for **spinout approval** and **equity share** including the approach that the PSB will take to distributing equity between the parties. This may be a set value or an agreed upon approach for deciding the split. Confirm that the PSB has appropriate vires as delegated by Parliament to establish and take equity in a spinout.	✔ (Relevant PSB Official)		
PSB Employees: Secondment policies or 'principles' for founders	Document the ways in which **PSB staff** can associate with a spinout.	✔ (Relevant PSB Official)		

Topic	Description	Responsible/Involved		
		PSB	Innovators/Founders	Other
Conflict of Interest management procedures	Document how PSB will manage and minimise actual or perceived conflicts of interest for the organisation and its officers in relation to the spinout including: • Involvement with spinout governance e.g. as board observers or non-exec directors • Use of facilities or equipment by the spinout • PSB staff or close friends or families as consultants or shareholders • Joint R&D projects Procurement of products or services from the spinout and any consultancy arrangements, access to labs, equipment, databases etc. (these must comply with the **procurement regulations**).	✔ (Relevant PSB Official)		
Complete IP Due Diligence Visit: **Management of Intellectual Property**				
Confirm staff contributions to creation of relevant KA	Document the percentage contributions of inventors. This will help to inform revenue shares from licensing to staff.	✔ (Relevant PSB Official/ Legal adviser)		
Obtain Confirmatory Assignment of KA from inventors	Legal document to confirm that employer owns rights to KA to be licensed to the spinout.	✔ (Relevant PSB Official)	✔	
Ensure that PSB has the right to license the KA	Assess whether there are any 3rd party ownership rights. If so, this needs to be first resolved to permit the PSB to license the KA to the spinout.	✔ (Relevant PSB Official/ Legal adviser)		
Ensure rights are appropriately registered where applicable	Confirm all registrations are correct and any upcoming deadlines identified, including scope for registration in relevant territories.	✔ (Relevant PSB Official)		

Topic	Description	Responsible/Involved		
		PSB	Innovators/Founders	Other
Agree Starting Equity Share Visit: Shareholdings				
Agree equity share with founders	Document the pre-money (before investment) equity split between the PSB and the PSB founders, rationale for equity split, and how it aligns with the PSB equity policy. If an externally sourced CEO is involved with the company prior to investment, they may be considered as part of the founding team. They could receive a proportion of the PSB founder(s) equity.	✔ (Relevant PSB Official)	✔	
Collect waiver letters from PSB staff who are taking shares, where applicable	Individuals taking equity in the spinout may be expected to waive rights to other forms of revenue share the PSB receives from the spinout. The approach taken will be in accordance with the PSB's Rewards to Innovators policy. It is worth considering that revenue share is in respect of the KA licence and equity will be in respect of contribution to the spinout. Therefore, a Rewards to Innovators policy may allow for an innovator to receive both shares and a share of licence revenue.	✔ (Relevant PSB Official)	✔	
Identify Investment Visit: Financing Spinouts				
Initial engagement with investors to understand suitable sources of investment for the spinout	Aim to engage investors before the formal pitch. Talk to GOTT and approach UKI2S, the public sector seed fund. Seek referrals from other PSBs and external Technology Transfer Offices who have set up spinouts.	✔ (Relevant PSB Official)	✔	
Prepare for investment	Get 'investment ready' and prepare: • Pitch deck • Capitalisation (Cap) table • Business plan, including IP Strategy • Financial forecast • Development plan/technology roadmap • PSB staff roles	✔ (Relevant PSB Official)	✔	

Topic	Description	Responsible/Involved		
		PSB	Innovators/Founders	Other
Undertake diligence on investors to assess suitability	Investors should bring added value beyond investment, such as commercial experience, links to partners such as manufacturers etc. Speak with other companies in investor's portfolio and founders who have exited if possible. Engage with other PSBs or University TTOs for testimonials. Assess any restrictions under **the National Security and Investment Act 2021**. Consider reputational risks. A greater level of due diligence is recommended if the investors aren't well known. Talk to GOTT.	✔ (Relevant PSB Official)		
Governance Visit: **Approval Process**				
Designate Senior Responsible Owner (SRO) for spinout in PSB	Identify the individual at senior level within the PSB who will provide institutional sign-off and consider spinout business cases. Note, a PSB may have appointed an **organisational SRO**, responsible for leading the PSB's **KAMS**, who can support this. They may or may not be the SRO for the commercialisation activity.	✔ (Relevant PSB Official/ SRO or ExCo)		
Revenue retention	If the PSB expects to generate income from royalties, share sales, or dividends at the point of spinout or at any point in the future, these activities should be included in PSB's **ambit** as a designated activity.	✔ (Relevant PSB Official)		✔ HM Treasury Spending Team Sponsor Dept (where applicable)
PSB role on the Board	Agree how PSB wants to be involved in the in-life **governance** of the spinout and who within the PSB will take on that role, noting a director acts in the spinout's interest, not as a PSB representative. Consider: directors' duties; conflicts of interest; director vs observer role; liabilities, how governance measures may influence any **classification** decision. A PSB may wish to choose and appoint a director to the board who is not a member of the PSB.	✔ (Relevant PSB Official/ SRO or ExCo)		

Topic	Description	Responsible/Involved		
		PSB	Innovators/Founders	Other
Approval Process Visit: **Approval Process**				
Early functional engagement	Creating a spinout is a cross-functional endeavour and the PSB should ensure that all relevant functions include legal, finance, commercial and HR as engaged early to inform the approach.	✔ (Relevant PSB Official and functional leads)		
Early engagement with SRO	Gain approval **in principle** from executive committee or SRO. Prepare an executive summary of the opportunity to facilitate discussion, detail: • Commercial opportunity (use Table 1 as a guide) • Why a spinout is recommended and other commercialisation options considered • How this aligns with the PSB's responsibilities under **MPM** (primarily section A4.15.8) Where information is involved, how this aligns with the PSB's responsibilities under RPSI and MPM (annex 6.2) • What investment is being sought, from whom, and stage of discussions • What approvals have been provided to date • Roles of PSB staff in the spinout and how conflicts of interest will be managed • Proposed equity split • Proposed licence terms	✔ (Relevant PSB Official/ SRO or ExCo)		
Engage with PSB's Departmental sponsor organisation, where applicable	Where the PSB is a sponsored body, this will be required at least for the first spinout (novel or contentious), and it is recommended that PSBs propose delegation of decision making for future spinouts and agree an appropriate approach to future governance. Use the executive summary, as above.	✔ (Relevant PSB Official/SRO)		✔ Sponsor Dept (where applicable)
Engage with relevant HM Treasury spending team (via Departmental sponsor, where applicable)	Typically required for the first spinout (novel or contentious) and it is recommended that PSBs propose delegation of decision making for future spinouts and agree an appropriate approach to future governance. Use executive summary, as above.	✔ (Relevant PSB Official/SRO)		✔ HM Treasury Spending Team Sponsor Dept (where applicable)
Delegation of Authority from The National Archives	If the PSB intends to license Crown copyright materials to the spinout, it will need a **delegation of authority** from The National Archives.	✔ (Relevant PSB Official/SRO)		✔ The National Archives

1. Introduction
2. What is a Spinout?
3. Why Create a Spinout?
4. When to Spinout
5. Quick Start Guide
6. Shareholdings
7. Financing Spinouts
8. The Founding Team and Attracting Talent
9. Approval Process
10. Company Formation: Practicalities
11. Company Operations

Topic	Description	Responsible/Involved		
		PSB	Innovators/Founders	Other
Approval from PSB executive or appointed SRO to form a spinout company	Gain formal approval from executive committee or SRO. Prepare a more detailed summary of the opportunity for approval, building on the initial, **in principle**, paper. Provide more detail of: • Investor terms • What diligence has been undertaken on investors • How conflicts of interest will be managed	✔ (Relevant PSB Official/ SRO or ExCo)		
Approvals from Secretary of State (as relevant)	Identify appropriate approach between PSB, departmental sponsor, and Secretary of State private office, where applicable. GOTT can provide support engaging with sponsor departments where desired.	✔ (Relevant PSB Official/SRO)		✔ Sponsor Dept (where applicable)
Security	Ensure appropriate security risks to the company and PSB have been assessed and suitable mitigations are in place/ will be put in place by the company as appropriate. Assess the relevant security regimes. Visit section **11.4. Security** for more information.	✔ (Relevant PSB Official)	✔	
Company Incorporation Visit: **Company Formation**				
Agree approach to company name and other PSB reputational KAs	Spinouts will often want to associate themselves with the PSB for credibility and brand recognition. Therefore, agreeing the extent to which naming and other material can and cannot refer to the PSB, including use of PSB branding is required. Use of KAs such as logos should be captured in the licence agreement.	✔ (Relevant PSB Official)	✔ (Founder, or spinout CEO, if relevant)	
Purchase domain names for company website	Use domain name checker to see availability for preferred name. Try combinations if the preferred option is taken. Do this early (before registering on Companies House ideally) to avoid 3rd parties buying up relevant domains. Consider purchase of multiple domains to prevent confusion and enable redirections from similarly spelt domains.		✔ (Founder, or spinout CEO, if relevant)	
Register new company at Companies House	Register company at the point where investment is likely. Can be done in advance of investment if a company structure is required to be eligible for certain grant schemes. The company will need a registered address which may be that of the company lawyer or accountant at the stage of incorporation. At stage of incorporation the first director will be appointed.		✔ (Founder, or spinout CEO, if relevant, with lawyer if required)	

Topic	Description	Responsible/Involved		
		PSB	Innovators/Founders	Other
Agree split of shares between PSB and founder(s) and issue shares	Agree this split. Shareholders' agreement agreed will then be negotiated with investors, unless the company is bootstrapping itself. This details shares to be issued to founders and the PSB and how these will be managed. Shareholders' agreement can be developed with legal advice (internal or externally sourced). Founders should take their own legal advice prior to signature, as the PSB cannot provide this, given it is a separate party involved in any negotiations.	✔ (PSB official, legal adviser)	✔ (First Company Director with legal advice)	
Open company bank account	Guidance can be found through the **British Business Bank**.		✔ (First Company Director)	
Complete Articles of Association	It is simple to register Model Articles of Association without a bespoke shareholders' agreement pre-investment (unless the company is being financed through bootstrapping). More detailed Articles of Association and Shareholder Agreement will need to be negotiated with the incoming investors, with legal advice.	✔ (PSB official, legal adviser)	✔ (First Company Director with legal advice)	
Legal advice	Ensure founders and PSB both have independent legal representation to represent their separate (and, in cases, competing) interests. PSBs should establish a policy for providing funding towards founders' legal fees, typically this will be to a capped amount. Legal representation must be commissioned by the founder and cannot be done on their behalf. A portion of the legal fees incurred by founders for the spinout transaction may be charged to the spinout and paid for from first investment, in agreement with the investors.	✔ (PSB official, legal adviser)	✔ (Founders, with legal advice)	
Tax advice	Founders and the PSB should each take independent tax advice. Visit section **11.5. Tax**.	✔ (PSB official, legal adviser)	✔ (Founders, with tax advice)	
Licence Agreement				
Execute Licence Option Agreement or Letter of Intent to license from PSB to Spinout	Option or Letter of Intent can provide comfort that the spinout will be able to take a licence, on terms to be agreed, should it complete its fundraising. The licence agreement will be negotiated between the PSB and the company. Where external investors are involved, this will be in parallel with the investment agreements and the investors are likely to be involved in the negotiation.	✔ (PSB official, legal adviser)	✔ (First Company Director with legal advice)	

Please contact **GOTT@dsit.gov.uk** if you have or are developing a spinouts policy (or supporting policies, such as Rewards to Innovators), for support and to enable GOTT to understand and help advance public sector spinout capability.

6.

Shareholdings

6.1. Ownership, Control and Classifications

Why Classification Matters

The rationale for establishing a spinout from the public sector is to create a new company to act independently of the PSB, for the purpose of commercialising assets.

The Office for National Statistics (ONS) is responsible for classifying bodies to the public or private sector for statistical purposes. There are a number of practical consequences of ONS classification, for both the PSB and the spinout. If classified as 'public sector', this will likely impact the ability of a spinout to act as a private sector entity and attract appropriate investment. It may also put specific management and accounting requirements on the PSB.

Therefore, the PSB must consider the statistical classification of spinouts. For guidance, PSBs should contact GOTT, their sponsor department (where applicable) and their HM Treasury Spending Team who can liaise with HM Treasury's Classification team. The Classification team can provide advice on classification issues and give indicative classifications until the ONS can formally **classify a body**.

Classification Process

Section 3.1.1 of the ONS's **classification process guidance** provides the criteria for determining whether an entity will be classified to the public or private sector. The fundamental question is "does government exercise control over the general corporate policy of the unit?", and this ONS **article** provides further explanation of what control means in this context.

Some criteria (e.g. shareholdings of 50% or more) will constitute 'control' in isolation, but the ONS will also take a holistic view and whilst no single aspect might constitute 'control', it is possible for the cumulative effect of public sector powers over the spinout body to result in public sector classification of the spinout.

The ONS will look at the entirety of the relationship between the public sector and the body in question when assessing whether control exists, considering all potential sources of public sector influence or power.

Terms that accompany licensing agreements could be viewed by the ONS as control if they are restrictive enough to allow the public sector control over the wider policy of the spinout e.g. if the public sector has sign off over the spinout's business plan. This is seen as a powerful control as it allows the public sector to influence general policy of the body or how the entity decides to deliver its outputs.

The Implications if Classified as Public Sector – Sub-Classification

If an entity is classified as public sector, it will then be sub-classified as either:

- Central government
- Local government
- A public non-financial corporation

The Public Bodies Handbook: part one contains further information.

The Implications if Classified as Public Sector – Records

If a spinout is classified as being in the public sector, it is likely subject to the Code of Practice on the management of records issued under section 46 of FOIA[1] and the PSB should be mindful of the transfer of records, information and knowledge guidance in Cabinet Office's machinery of government guidance (Annex 2). PSBs should consult The National Archives.

6.2. Who Receives Shares and Why?

There is no set formula for share distribution in a spinout company, however, it is usual that the recipients of shares on investment will be:

- Founders from the PSB
- Investors
- The PSB
- Innovators that do not join the spinout (but have made a significant contribution to establishing the company, to be agreed on a case-by-case basis)
- Managers from outside of the PSB (e.g. CEO)

Additionally, spinouts usually establish an 'option pool', which is used to incentivise employees by providing them with share options.

Founders From the PSB

These founders are the people from the PSB who both start and join (in some capacity) the company at the outset.

The PSB will typically agree a share of equity in the spin out with the founding team prior to investment.

Distribution of shares to founders serves two primary purposes:

1. **Recognising the risk that founders take** in committing their time to a company with an uncertain future and likely forgoing alternative sources of income and career development
2. **Incentivising founder participation** in developing the company proposition, supporting successful fundraising and sustaining long-term growth

Different types of founder engagement with the spinout (e.g. joining permanently, joining on secondment, visit section 8.1. Joining the Spinout: Founders for more details) carry different types of personal risk.

The allocation of founder equity also signals to potential investors that the founders have an incentive to see the business succeed. This is especially important where the success of the spinout, at least initially, is reliant on access to tacit knowledge and know-how from founders.

Spinouts described in this guidance are based on nascent KAs, and so shares are one element of recognising the risk individuals take on in founding a company and the importance of the individuals' expertise. These factors, and therefore the approach to shares, may well be different in the case of privatising mature, existing services (which this guidance does not cover).

Equity is one way in which innovators can be incentivised in a PSB. More detailed guidance of incentives for innovators will be published by GOTT.

Innovators That Do Not Join the Spinout

In some situations, the PSB revenue share policy may permit innovators who are not joining the company (full or part-time) to be allocated equity to recognise the effort they have put in to helping the company get off the ground. Where this creates a large number of shareholders, including some of whom will not have any other ongoing relationship with the company, this is often not favoured by investors.

One approach to manage this situation could be for the PSB to hold equity on behalf of PSB staff and distribute proceeds accordingly when those shares are sold. Share allocation to innovators not joining the company should be considered on a case-by-case basis as there may be good reasons for granting such shareholding.

Employees of the Spinout

Shareholders may agree a percentage of equity to be allocated for an option pool for employees (visit section 8.2. Hiring a Management Team and Share Options for more details). Where an employee option pool is created, employee shares are for the company to allocate.

Employees, like founders, can be incentivised to help the company become successful by having 'skin-in-the-game' through share options that may increase in value. This can also enable the spinout to attract talent whilst providing lower salaries than without equity, reducing the cash cost of employees.

In the early stages of the company, they may expend significant time and energy to ensure the spinout is on course to deliver on its mission and raise further investment and/or revenue. They may have to sacrifice benefits or the offer of a higher salary elsewhere for the potential to benefit financially if the company is successful.

Share option pools can be set up within the spinout to incentivise new employees to join the company and are typically between 10-20% of total equity after investment. This will be a consideration for the spinout as it looks to recruit a management team and new employees and may be a condition for investment for some investors.

Investors

Investors put capital at risk when they invest in a company. They receive shares in return for their investment in proportion to the amount they invest divided by the price per share.

1 Freedom of Information Act 2000. Section 3 of the Act provides a definition of public authorities, and section 6 deals with the status of publicly owned companies.

Some investors will ask for 'preference' shares. In the event of liquidation, preference shareholders are repaid **before** ordinary shareholders (often founders and PSB), but after creditors. PSBs and founders typically both take ordinary shares.

Depending on the size of their investment, investors may appoint a board director or observer.

The PSB

The primary objective for a PSB in creating a spinout company is to deliver impact and unlock value creation. However, it is appropriate that public sector organisations seek a return should the company prove successful.

Read the following section for more details.

Appropriate delegation of in-life decision making, including on financial risks and liabilities, between the PSB as shareholder and any sponsor department should be agreed when the spinout is established.

Managers From Outside of the PSB

Where a potential CEO (or other manager joining at foundation) has been identified, it is likely they will have been involved in developing the business plan and pitching for investment. They may be granted equity, typically at the time of investment. The relative split will be agreed in principle ahead of the investment and form part of the overall negotiation with the investors.

If equity split is agreed pre-money, it would be usual for these shares to be part of the allocation to individual shareholders, not the PSB. If at the time of investment, this will be negotiated as part of the overall investment negotiation process. Recognising that a spinout may change CEO multiple times, consideration should be given to how these shares will vest and how they will be handled if the CEO leaves.

Alternatively, an option pool can be used in place of providing shares at the outset. Visit section **8.2. Hiring a Management Team and Share Options**.

6.3. PSBs and Founders as Shareholders and Approaches to Determining Appropriate Equity Split

Shares are typically taken in consideration for the PSB's contribution in supporting the development of the company including but not limited to support for development of the KA, to the founders, for business development activities, access to PSB connections, brand leverage etc.

The KA (or IP) will be licensed separately into the company. However, equity and the licence agreement are viewed together as one package and there may be some trade off to reach a balanced deal of equity and licence terms.

It is recommended that a PSB seeking to create spinouts adopt a consistent approach for determining the pre-money equity distribution between the PSB and founders (before investment is received), as outlined below, where possible and makes this available on their intranet.

6.3.1. Approaches to PSB Equity

The PSB will take its shares prior to investment when equity will usually be held by the PSB and the PSB founders. When investment is made, the shares will be further split to include e.g. the investors, likely an employee option pool and others who the company wishes to incentivise. Non-dilutable shares are not recommended as they add complexity.

The relative pre-money shareholding for the PSB should be such that it incentivises founders and is attractive to investors, while considering the contributions made by the PSB to date. Visit the following section for detailed guidance.

Once the spinout is formed, there is often still a lot of work to do for the company and its employees before the spinout can monetise its assets. Employees will need to be incentivised to build value in the company and investors will need to see that these incentives for employees are meaningful to have confidence in investing. Investors will also want to see the potential for revenue return to their fund.

To arrive at an appropriate pre-money shareholding for a PSB, the temptation may be to place emphasis on the perceived monetary value of the KAs licensed to the company or the sunk costs involved in an KA's development. This is not the primary determining factor. Instead, visit the principles below.

Return for PSB's investment in developing KAs should be handled through the licence agreement, which allows for a more nuanced approach to sharing risk and reward, than focussing only on a percentage equity split between the PSB and founders.

The licence will account for the stage of commercial readiness of the assets to be licensed into the company and allow the PSB to share in the spinout's success if these are commercialised successfully. Revenue return to the PSB from licensing may include royalties, milestones, and/or success payments.

6.3.2. Equity Distribution: Principles for PSBs

1. **Recognise the State's Contribution to Spinout Creation:** PSBs should take shares in spinouts they create in exchange for the PSBs contributions to the environment for developing KAs, underpinning ecosystem and supporting the spinout to form.
2. **Incentivise Founders and Employees to Attract Investment:** The pre-money shareholding distribution between a PSB and founder(s) should be designed to incentivise founders and employees to build value in the company and attract private investment.

3. **Enable Long Term Value Creation:** PSBs should take a long-term view on holding spinout equity, which recognises that the PSB percentage equity holding will likely decrease over time but that as the spinout attracts investment and becomes more valuable, the price per share will likely also increase in value.

The following subsection provides guidance on how to implement these principles.

6.3.3. Equity Split Guidance

UK universities have accrued a significant depth of expertise in spinout creation across a range of disciplines, which is curated and shared by communities of practice such as **Knowledge Exchange UK** and **TenU**.

The **Independent review of university spin-out companies** recommends that universities use the equity splits identified in the TenU **USIT Guide**, which was developed by leading universities with the investment community. These are:

- Where the spinout is based on foundational technology, university equity is 10-25% before external investment ('pre-money') with exact terms varying depending on the wider commercial deal
- For software, the **USIT Software Guide** recommends a university equity share of 5-10%

The equity splits described here are all dilutable.

These recommended ranges balance the interests of all interested parties and have been developed to give spinouts the best chance of delivering both impact and returns on investment.

The majority of UK universities have adjusted their equity share policies to reflect the USIT guidelines and, in practice, are now seeking equity at the lower end of the ranges.

Factors that influence the exact share **within the range** include:

- If a spinout wants to avoid early licence fees (e.g. upfront payments, annual fees), and would prefer reduced royalties or milestone payments, the PSB's equity would be at the higher end of the of range to compensate.
- If all the inventors are founders and they waive their rights to other returns (e.g. licensing royalty shares), this can enable PSB equity to be reduced.
- If the PSB-derived KA is critical to founding the spin-out, this would normally result in PSB equity at the higher end of the range; if the PSB-derived KA is additive but not foundational KA this may result the PSB having equity at the lower end of the range.
- If there are 3rd party funders of the research, they may contractually require equity share, and this often results in equity being at the higher end of the range.

Whilst the exact terms and equity split in the public sector may vary depending on the organisation and commercial environment, it is recommended that public sector organisations use the USIT recommended equity shares and consider agreeing an equity position at the lower end of the scales.

Public Sector Equity Share Guides

Pre-investment:

For spinouts based on foundational KAs licensed from a PSB, typically PSB equity will be 10-25%.

For software and similar KAs, which may be less resource-intensive to develop, and/or may not have registerable IP rights (e.g. not patentable), and/or have a shorter time-to-market, typically the PSB equity will be 5-10%.

With consideration given to PSB equity shares at the lower end of the scales.

Where a PSB has collaborated with another PSB (or a university) leading to the spinout creation, this does not by default increase the total equity taken by those PSBs/universities, and their relative contributions to the KAs being licensed and the factors above should be considered in their individual shares.

Founders

6.3.4. Equity Split Among Founders

It is common that founders split equity in the company based on these determining factors:

- Commitment and Risk – the amount of time, effort, and personal/professional risk that each founder will contribute to making the new company successful.
- Previous Contributions – the relative contribution of each founder to innovation and creating underlying value in the spinout, which might include named inventors on patents.
- Domain Expertise – the technical, business, and other professional expertise of the founders, and how critical these are for the future success of the spinout.

Typically, a Rewards to Innovators policy won't prescribe how equity should be split between founding members joining from a PSB. This is often delegated to the local business area and those involved to agree. It is important that all founders agree with the split to avoid future issues.

Note, the relative seniority and relationships between founders within the PSB should not themselves be a factor in the split (though it may influence the roles individuals take in the spinout, and therefore the split).

6.3.5. Licensing and Royalties

Equity is just one part of the commercial deal when licensing KAs into spinouts. Others can include upfront payments, annual fees, development milestones, sales milestones, and royalty rates.

It is recommended that public sector organisations use the USIT suggested royalty rate guidelines that have been included to facilitate negotiations:

- For know-how only or very early-stage KAs a typical royalty rate is between 0.5% and 2%
- For KAs that are more progressed a typical royalty rate is between 2% and 5%
- For advanced KAs the royalty window may exceed 5%

It will often be beneficial for all parties to focus on ensuring the licensing and royalty terms are structured to help the spinout company to preserve early cashflow and to spend investment on progressing the technology development. This can be done by back-weighting costs to the spinout in the licensing deal i.e. only smaller payments due in the first years, larger payments due in future years through royalties or milestone payments.

It should be noted that in some circumstances, in the case of early-stage software spinouts for example, the application of royalties may not be the most suitable way to structure licence fees, and alternative fee structures for generating returns to the PSB should be considered.

GOTT plans to publish detailed licensing guidance in due course. Visit the **Commercialisation Guide** for common considerations across multiple commercialisation routes.

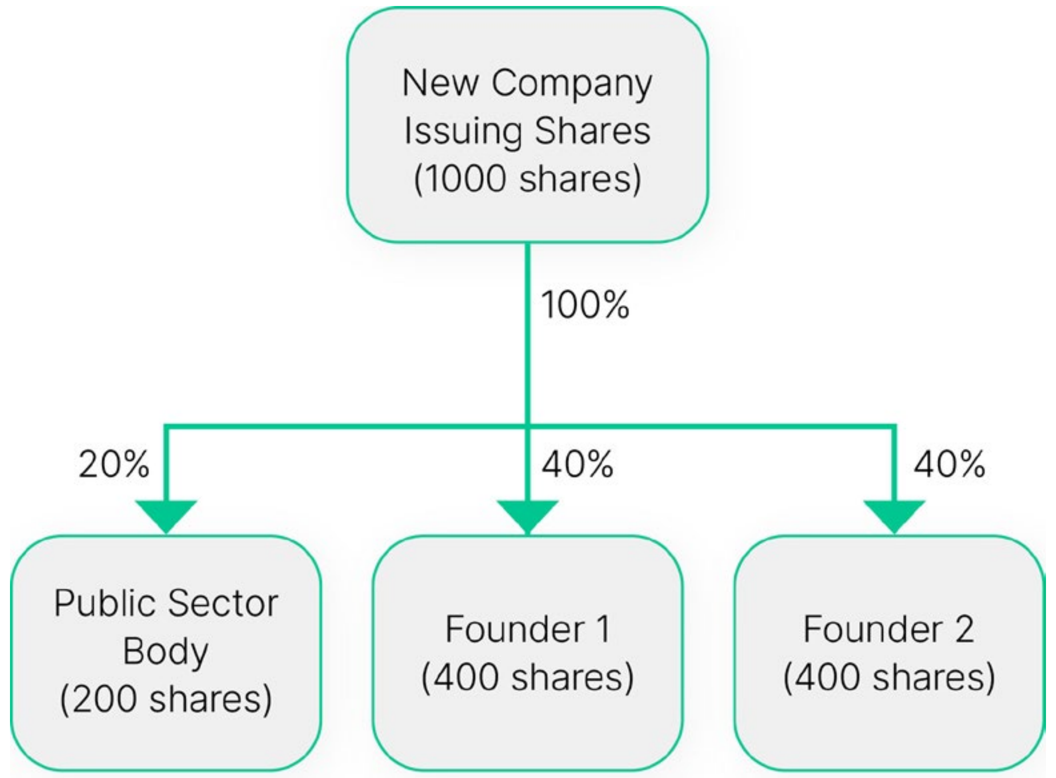
Visit the **USIT Guide** for more detailed discussion of structuring deals in an academic context.

6.4. Issuing Shares on Incorporation

Having agreed the relative equity share before investment, only when the company is incorporated will these be issued. When issued, shares can be bought and sold, dependent on the terms and conditions of the share option, share awarded etc.

In anticipation that founding shares will be split between the founder(s) and the PSB, the new company may wish to issue a large number of shares e.g. 1000 x £0.001 shares, which can be divided up between the parties in proportion to the amount of founding equity being taken by each.

When a company issues new shares to shareholders or to raise capital, it must complete and submit an SH01[2] form to Companies House. This form includes details about the shares being issued, such as the class of shares, the number of shares allocated, their nominal value, the names and addresses of shareholders receiving these shares, and any payments made for these shares. An example is provided in the below diagram:



Shareholdings and Public Sector Control

This guide recommends that PSBs take between a 5-25% shareholding in the spinout, depending on the KAs being licensed and factors to consider in 6.3.5. Licensing and royalties.

Note, if 50% or above of shares in a company are owned by the public sector (this includes both the originating PSB and any other public sector investors, such as the British Business Bank or Local Government Pension Schemes), then the entity will be classified by the Office for National Statistics (ONS) as being public sector.

Also note:

- If the PSB (or any other individual or entity) owns more than a 25%, they will be classified as a **person with significant control** and need to register specific information on Companies House
- A PSB holding more 25% or more equity may impact the spinout's eligibility for certain funding schemes (e.g. grants) and have tax implications for investors using relief schemes

There may be a temptation at incorporation stage for the PSB to take 50-100% equity with the intention is to reduce this subsequently. This should be avoided as this will result in creation of a public sector entity, when the expected intention is to create a private sector spinout.

6.5. Issuing New Shares When the Company Raises Investment

On investment, the company will issue investors with newly created shares.

The number of shares issued will depend on the **Pre-money valuation** of the company i.e. the valuation of the company before investment is received, and the post money valuation, which is equal to the pre-money valuation plus the value of the investment. This can be calculated using the formulas in the box, below.

The SH02[3] form provides Companies House with details of the split, such as the original number of shares, the new number of shares resulting from the split, the classes of shares affected, and any adjustments made to the company's share capital because of this action.

Calculating the Number of Newly Issued Shares and Valuations

Investment = Price per share × Newly Issued Shares
Pre-money Valuation = Price per share × Existing Shares
Post-money Valuation = Price per share × (Existing Shares + Newly Issued Shares)

2 SH01 form is a document used for notifying Companies House about changes in a company's share capital, specifically related to the allotment of shares.

3 The SH02 form is used when a company executes a stock split or subdivision of shares, which involves dividing existing shares into a larger number of shares.

6.6. Dilution

Dilution refers to a reduction in the ownership percentage of existing shareholders in a company. This typically occurs when a company issues additional shares, either through a new round of funding, employee share options, or convertible securities.

As new shares are issued, the ownership stake of existing shareholders is proportionally decreased. The value, however, may be increased with investment.

As the company raises investment, the ownership stake of existing shareholders (including that of the PSB) becomes diluted unless they invest further (visit **7.4. Financial Investment Into a Spinout by a PSB**). This applies to both the founders' and the PSB's equity.

It is usual for PSBs and founders to receive 'ordinary', dilutable shares. There are other **types of shares**, such as preference shares. PSBs should seek expert advice if considering these.

6.7. In-life Governance

Generally, management decisions of the spinout post-formation will be taken by the spinout company itself, without direct consultation with the PSB, as the PSB's relationship with the founders and KA becomes one of shareholder and licensor with the spinout.

This is a significant change in control over the commercialisation process and care should be taken to ensure that stakeholders understand and are comfortable with this.

The PSB will want to manage potential risks including financial and reputational. A suitably trained and qualified Non-Executive Director (NEDs) or Board Observer appointed by the PSB is an appropriate mechanism to consider for oversight of the spinout by the PSB. Typically, PSBs will have a right to a NED or observer, which they may or may not choose to take up depending on the other mechanisms for sharing information that are put in place. These are usually in place until the PSB shareholding drops below 5-15%. Directors must act in the best interests of the spinout company. Visit section **11.1. Company Directors** for more information.

Note, for the purposes of classification, ONS will view appointments made by PSBs as public sector appointments, so any powers that these roles have will be viewed as public sector powers. Therefore, the same principles as when considering other mechanisms of potential public sector control should be applied e.g. any veto over appointment of board members would likely constitute control and lead to public sector classification.

The PSB's finance team and the National Audit Office may also need to consider whether the PSB is, in practice, directing the strategy of the spinout as this could have implications for the PSB's financial reporting requirements.

Specifying sectors that the KA licence does not include is another mechanism for managing reputational risks, by excluding those that might bring reputational harm to the PSB.

Decisions that would come to shareholders, for example if the PSB has a say regarding the sale of PSB equity, should be referred to the PSB's approval board rather than made by any appointed director. No further approval should be required by HM Treasury or a parent body unless there are additionally novel, contentious or repercussive matters. Suitable delegation for such decision making should be confirmed in the approvals to establish the spinout, to enable timely in-life decision making.

Changes to the KA licence agreement with the spinout would be handled in the same way as changes to any other licence.

For non-shareholder interactions between the PSB and the spinout (including collaborations, sales and procurement) the company should be treated in the same way as other companies, taking care to exclude interested parties from PSB decision-making to avoid actual and perceived conflicts of interest.

When a spinout is given access to space, facilities, equipment, administrative support etc. from the PSB, this should be in return for a fair return, such as an increased equity stake, to avoid breach of the Subsidy Control regime.

7. Financing Spinouts

Often, a spinout company will need to raise funding to support its operations. For spinouts developing new, unproven assets substantial investment may be required to make them commercially viable and generate revenue.

Large investments over multiple funding rounds are common in capital-intensive companies like life sciences or biotechnology spinouts. These companies require long incubation periods for their technology to pass quality, safety, and efficacy hurdles to obtain regulatory approval and reach market adoption. Consequently, they often seek investment from a combination of sources.

The way in which a company is financed in its early stages has important implications for its ability to raise funding in the future, and its chances of reaching financial sustainability over the long term.

Three common sources of funding for a spinout company are:

- **Debt:** The company can take a loan.
- **Equity Financing:** The company can sell shares to investors.
- **Grants:** The company can apply for grants from charities or the government.

Some spinouts are also able to use initial revenues to invest in further development and growth (most applicable in consultancy or some software companies), this is known as 'bootstrapping'.

Further information in addition to the overview provided below on business finance support can be found on GOV.UK and through the British Business Bank.

7.1. Debt

A loan is a form of credit where one party lends money in exchange for an agreement to repay the principal amount in the future, often with added interest. As with an individual borrowing money from their bank, a company can take out a loan.

Sometimes a lender will seek additional assurances from a company before lending money, such as the company providing certain capital assets or equipment as collateral. Equipment loans, for example, help companies purchase capital items, spreading the cost while providing added security for the lender.

Debt can be a flexible way of financing a company but there are some potential pitfalls, set out in the box below.

Spinouts and Debt

While debt can be a flexible way of financing a business, there are several reasons why spinouts, and particularly spinouts based on scientific research or new technologies, can be less well suited to debt financing.

Some important considerations:

Risk Profile

Spinouts are generally considered high-risk investments compared to established businesses. They often lack a proven track record, steady cash flow, or collateral, making it harder for banks to assess their creditworthiness. As a result, banks might perceive spinouts as higher-risk borrowers and high street lenders will often not loan money to spinouts or startups.

Uncertainty and Failure Rate

Spinouts operate in an uncertain environment. Market shifts, competition, regulatory challenges, technology development hurdles, or other unforeseen obstacles can impact their ability to generate revenue and repay loans. Banks are often more comfortable with businesses that have a predictable income stream and stable operations.

Raising Funding from Other Sources

Taking a business loan can make it harder for a company to raise money from other investors such as venture capital organisations because the later investors may be reluctant to invest in a company only to see their investment servicing the payments on the company's debt with the original lenders.

Notwithstanding these challenges, some loans have been developed with small, high growth potential companies in mind e.g. Innovate UK's **Innovation Loans**.

7.2. Equity

7.2.1 What is Equity Investment?

Equity investing is where a sum of money is given to a company in exchange for a portion of the company – shares.

Investors who provide capital to a spinout do so in anticipation that the company will use the investment to increase the company's value and that the shares can be sold for a profit.

The return to investors is typically achieved when the company is acquired by another company, or the company lists on public markets through an Initial Public Offering (IPO), or less commonly, through a direct listing. These liquidation events are referred to as an 'exit' because the investors exit from the company and receive money for their shares.

Funding though equity investment commonly happens through a series of funding rounds, with the first investment known as the 'Series Seed' (or "seed round" or "seed funding"), then increasing in value through rounds named alphabetically, 'Series A', 'Series B', etc.

Table 2: Investment rounds and typical investment ranges

Venture Capital Investment Round	Summary	Typical Investment Range*
Series Seed	Initial funding for proof of concept or product development.	£100,000 – £2 million
Series A	Funding to help companies scale operations, expand, and reach new markets.	£1.5 million – £12 million
Series B	Investment for further scaling, market expansion, and product development.	£10 million – £35 million
Series C	Financing for significant growth, global expansion, and market dominance.	£20 million – £110 million+

*Note, these are illustrative figures only. Funding round ranges can vary greatly by sector e.g. life sciences and biotechnology can be significantly higher.

Equity investors may also offer other types of security, often referred to as a **convertible note** or **convertible bond**.

This form of investment is often provided to companies when the valuation of a company is hard to determine, typically in the early stages, or between funding rounds to help the company achieve a critical milestone before raising more investment at a subsequent priced round.

Here, a convertible note can be used to finance a company in exchange for shares at a later date at which time the convertible note is converted into shares.

This conversion often happens at a priced fundraising round when the company receives a valuation and the investor will often receive a discount on the share price in consideration for having invested at an earlier, higher risk, stage.

In the US and Canada, a common alternative to the convertible note has been the SAFE (Simple Agreement for Future Equity).

Such agreements can vary in complexity and sophistication. It is important that the spinout has access to legal advice on terms and agreements offered by investors.

7.2.2. Who are Equity Investors?

An overview of some categories of early-stage investors are provided below. For more information about equity investment, visit the British Business Bank's guide to equity finance.

Some investors use tax incentive schemes such as Enterprise Investment Scheme (EIS) and Seed Enterprise Investment Scheme (SEIS). It is important to be aware of the eligibility requirements for these schemes as some investors will only invest in qualifying companies and advice should be taken.

Due diligence should be done on investors and an assessment of whether notification under the National Security and Investment Act 2021 is required (visit section 11.4. Security for more information).

Angel Investors

High Net Worth Individuals (HNWIs) who invest their own money into companies are often referred to as **Angel Investors**. Angel investors can act alone, but they sometimes join networks to invest alongside, or '**syndicate**', with other investors. Angel investors typically invest at series Seed or Series A rounds.

There are several groups and networks that bring together Angel investors, including the UK Business Angels Association.

Experienced Angels sometimes offer additional support or mentorship to companies through their sector expertise or network, in addition to capital.

Family Offices

Family offices manage the financial affairs and investments of high-net-worth families or individuals. Some private offices choose to provide direct investment into private companies, but they are more often investors in larger funds managed by other professional investors.

Venture Capital

Professional investors who invest in early-stage companies are known as venture capital (VC) investors. VCs raise money from other investors with the goal of investing in companies to generate a return. This will be when the VC exits the company, which is typically when the company is acquired or shares are publicly listed on a stock exchange (Initial Public Offering, IPO). In a more mature company, shareholders may also enjoy a return through dividends.

Given the probability of any individual company becoming successful and making a large return for an investor being low, VCs typically look to invest in a portfolio of companies, which could each return a large multiple (at least five to fifteen times) on their original investment, over a period of five to ten years.

As shareholders, VCs will typically wish to appoint a director or observer to sit on the company's board. This ensures that the investors perspectives are represented in key decisions taken by the company, such as financial and strategic including appointing a CEO or other executives, deciding on executive compensation, product development, commercialisation and fundraising strategies.

VCs also like to syndicate with other investors to share the risk of each individual investment and to bring additive value to the company beyond capital.

To be attractive to VCs, companies will often need to have access to management expertise and business networks. GOTT can provide advice.

UKI2S

The UK Innovation & Science Seed Fund (UKI2S) is a national seed investment fund that nurtures innovative businesses to leverage private investment and grow jobs, recycling profits from the realisation of its investments into the next generation of impactful UK companies. The fund invests in innovations emerging from the UK's publicly funded science and knowledge base.

The fund is backed by public bodies including the Department of Science, Innovation and Technology (DSIT). The Knowledge Assets Seed Fund is a sub-fund created to invest in new ventures arising from public sector KAs.

UKI2S is independently managed by Future Planet Capital (Ventures) Ltd.

Venture Builders, Accelerators and Incubators

These organisations take a business idea and work with a team to create, launch and scale high-growth businesses. They typically use their own resources and networks and may offer shared services. They seek to bring in capital, often taking the lead. They operate a variety of business models and some may take equity, but not all.

7.3. Grant Funding

Innovation grant funding serves as financial support to companies provided by funders including governments and charities aiming to support the development and implementation of new technology, products, or services.

Grant funding is non-dilutionary and can be a good way of leveraging investment from other sources.

Grants are typically awarded through a competitive application process, where applicants are required to complete a proforma, which is submitted for review by a panel comprised of experts in relevant sectors of industry.

Grants can have long application cycles and require the submission of a detailed workplan. Typically, applicants to innovation funding schemes are required to outline the milestones or deliverables which will be achieved over the course of the project.

This can make some grant funding schemes well suited for technical development of products or services, but less suitable for day-to-day operating expenditure of a company.

It is important to consider the eligible costs of grant funding schemes and whether each meets the needs of the spinout at its stage of development since some costs, particularly for large capital items, may not be covered, and often only a proportion of eligible costs are covered, and paid in arrears.

Innovate UK provides comprehensive information on grant and other funding sources for companies.

7.4. Financial Investment Into a Spinout by a PSB

It would be unusual for a PSB to provide investment (capital) into a spinout. Spinout ventures are inherently risky, and public investment into an individual spinout will likely fall outside of the PSB's approved uses of public funds. Such payments would fall into the category of transactions that "set precedents, are novel, contentious or could cause repercussions elsewhere in the public sector"[4].

Importantly, when a PSB forms a spinout, a key 'market test' for the future viability of a spinout can be the spinout's ability to raise investment from external sources. Investment in a spinout by its PSB may mask this early critical litmus test of market need, especially in cases where private investors have not indicated an intention to back the company.

To provide funding to the spinout, PSBs must have appropriate spending authority ('vires') compatible with the purposes of the company.

Where a PSB is intending to provide funding to a spinout, HM Treasury consent will need to be sought.

Note, this refers specifically to a PSB investing directly in its own spinout. This is separate from a spinout seeking funding through public startup or innovation grant funding schemes, where funding is awarded through a competitive process.

In the absence of further investment from the PSB, it is expected that, as the spinout raises investment from external sources, the percentage ownership stake of the PSB – the proportion of shares the PSB owns relative to the number of shares issued – will be diluted.

4 2.3.4 Treasury Consents, Managing Public Money

8.

The Founding Team and Attracting Talent

Talented and motivated employees are critical to the success and viability of a spinout. At Seed funding and Series A funding stages, a small and high-functioning team can be sufficient to drive the vision forward and develop the company's reputation.

This team will need to combine technical expertise and commercial acumen.

Technical staff from the PSB will often be critical to the development and commercialisation of assets licensed into the company. This is because the inventors or developers of KAs will know their innovation inside out.

It is very likely that these experts have tacit knowledge or know-how about the invention or innovation, which needs to be transferred into the company to build a product or service.

Management and product development expertise is required to help develop the innovation into a commercial proposition and the spinout into a viable business.

Note that the management team, particularly the CEO, may change several times over the lifetime of a spinout, especially in the early stages, as each stage can require very different skills.

8.1. Joining the Spinout: Founders

A PSB may consider providing staff with a range of options in relation to associating with or joining the spinout.

Typically, the options available are:

1. Leave employment with the PSB to join the spinout full time
2. Stay employed with the PSB part time and join the spinout part time. This might be through a secondment or through a dedicated mobility scheme. Visit Annex E of the **Rose Book** for more information on routes and considerations, including conflicts of interest. This may be remunerated and/or in return for equity
3. Stay full- or part-time employed with the PSB and provide services to the company, part time or ad hoc, as a consultant. They may be remunerated and/or in return for equity
4. Stay in employment full time with the PSB and provide initial sharing of tacit knowledge to support transfer of the innovation into the company. The innovator may be awarded founding equity in the spinout which will likely be less than the founding equity taken by someone joining the company full time. This reflects the balance of risk and incentives given to founders who remain in employment or join the spinout

The decision to engage in entrepreneurship is a personal decision and each prospective founder will need to carefully weigh-up available options in relation to their own personal circumstance, aspirations, and motivation for joining or not joining the spinout company.

It is important here that the PSB does not unduly influence the decision of an individual one way or another, but a PSB can facilitate this decision-making process for a founder by providing clear information about the acceptability of each of the scenarios presented above. Providing training and information on what it is like to work in a spinout will be valuable if an individual is considering joining the spinout in some form.

Founders

Founders who cease their PSB employment to join a spinout (rather than engaging e.g. through a secondment or consultancy role) will likely want to align timing of this with investment into the company to give them sufficient confidence in the spinout's viability for the immediate 1-2 years.

8.2. Hiring a Management Team and Share Options

It is possible that a founding team has a complete complement of technical, commercial, and management expertise, but often the spinout will need to bring in additional business experience to support technical founders. A CEO can be a good first external recruit to set the business on the right course, build an advisory board and lead fund raising. A Chair is likely to be sought at an early stage in the company's development.

It is not recommended for the PSB to hire the future CEO or other spinout management. If the PSB wants to engage external management expertise in advance of establishing the spinout, they should be hired to deliver a clearly defined task, such as developing the business plan and securing investment. This individual may or may not subsequently be hired by the spinout as a CEO.

Company management can be incentivised to join a spinout through a combination of equity and salary. The offer of equity in some form can be an acceptable substitute for a high salary, which can be needed to attract high calibre executives, but may be unaffordable for a spinout, which may not have sufficient cash in the early days.

With any compensation package, the goal for the company will be to ensure the executive stays to lead the company to grow and increase in value. Offering shares to executives outright when they join the spinout can place the spinout in a precarious position – consider, what happens if the executive leaves the spinout and takes their shares with them?

To address this issue, the following strategies can help ensure that the new management is both incentivised and compensated while protecting the company's interests.

Issuing Share Options to Employees

Management and other employees may be granted share options as part of their employment. These typically total between 10-20% of total equity in the spinout post-money.

Share options give the employee the right to buy shares in the company at a fixed point in the future at a set price. This can happen upon the fulfilment of certain conditions, such as a successful fund raise, an exit event, completion of a specified tenure with the company, or meeting performance targets.

Options align the employee's interests with the company's long-term success. As the company's value increases, so does the value of the options, motivating employees to drive growth and boost shareholder value. Options encourage staff to stay with the company to achieve these potential gains, creating continuity in leadership while conserving immediate financial resources for the company.

The Enterprise Management Incentives (EMI) Scheme

This is a UK Government initiative designed to assist small and medium-sized enterprises (SMEs) in attracting and retaining key employees by offering them tax-advantaged share options. **EMIs** allow an employee to receive share options on which they will not need to pay income tax.

The scheme was introduced in 2000 and is overseen by HMRC.

Attaching a Vesting Schedule to Shares

A vesting schedule outlines a timeline over which the employee can earn shares or share options. Typically, ownership accrues gradually over a specified period to incentivise retention and align the interests of the executive with company's success. More information is provided in Vesting Example, below.

Ensuring That Executive Compensation Is Linked to the Company Hitting Certain Milestone

The company may enter into an agreement with the executive that their salary or other benefits will increase once certain technological or commercial targets are met. This can help to align the incentives of executive to the long-term strategic aims of the company.

Vesting Example

A **four-year vesting schedule** with a **one-year cliff** means that an employee or executive of the spinout must work for the company for one year before they can take any portion of their shares or share options.

After the 1-year cliff period, employees receive 25% of their shares vested for the 4-year period. The remaining 75% of their shared vest gradually over the following three years, typically on a monthly or quarterly basis, until full vesting is achieved at the end of the four-year period.

If the employee or executive leaves the company before the first year has finished, they will receive none of the benefits set out in the vesting schedule (hence, the 'cliff').

9.

Approval Process

A PSB intending to create one or more spinout companies needs to have in place suitable approval processes and procedures. This is designed to provide oversight to spinout opportunities from the point of identification of a KA with spinout potential, throughout the spinout process. These should align with the governance structure and risk appetite of the PSB.

Processes should be written down and accessible to employees of the PSB to provide clarity about the PSBs approach to spinout formation. This will provide a fair, consistent, and transparent approach to creating spinout companies, which can help to align the relevant parties and prevent disputes arising.

Importantly, appropriate policy, processes, oversight and governance, along with appropriate PSB guiderails for spinout creation will reduce the PSB's exposure to risk associated with creating new companies by reducing opportunities to miss important steps or leave out important stakeholders.

Where necessary, a PSB should be prepared to regularly review its policies and processes. Spinouts happen in a dynamic environment and a PSB should be ready to take account of emerging best practices, and its own lessons learned from spinout creation.

The following general approach should inform engagement with governance structures:

- Involve innovators and relevant expert officials where available (e.g. technology transfer or commercialisation experts) in initial deliberations about the optimal exploitation route for potential commercial opportunities. Contact GOTT for advice on exploitation routes and engaging key stakeholders and experts.
- Ensure clear expectations of the spinout structure and roles for those involved early on, including manager(s) and division/directorate of the innovator, to ensure that they support the time and effort that will be needed to develop the spinout.
- Explore spinout formation with relevant internal senior stakeholders at an early stage.
- Seek early and iterative input from internal and external stakeholders as the spinout proposition is developed. Consider where any additional **confidentiality** measures are required.
- Before seeking formal approval, it is important to ensure that the spinout proposal has internal buy-in, and all the necessary due diligence has been completed.
- Ensure that any potential conflicts of interest are identified and that processes to manage conflicts of interest are in place.
- Identify risks to successfully delivering impact through a spinout and management approaches.

9.1. Internal Governance Structures

Although each spinout will be different and precisely the same governance approach is unlikely to apply to each, agreeing a standard process helps teams plan resourcing; the individuals involved in approvals to understand their responsibilities (and limits); and internal and external stakeholders (including investors) estimate timelines.

Typically, the executive committee and board of the PSB will formally approve and sign off on the spinout creation. In many cases, the board, or members of, will already have considered the spinout opportunity at earlier stages, for example by approving the activity to pursue the spinout route in the first place or at other internal governance forums.

This final approval board may also include external members with commercialisation and entrepreneurial experience. In the case of agencies and arm's length bodies (ALBs), a representative from the PSB's parent body may be a member, which may help facilitate delegation of approvals to within the agency or ALB, where appropriate.

Before the final approval board, relevant stakeholders should be consulted and necessary approvals gained informally. Formal governance structures may include IP committees, corporate development committees, finance committees or commercial committees. Relevant heads of internal departments may be involved and HR too, when staff movement, such as secondments, are planned.

It will be important for a PSB to strike a balance between consulting relevant expertise and enabling timeliness and agility for the spinout. Complexity will significantly delay approvals and may disincentivise spinout creation.

For ministerial departments, the Secretary of State will be the ultimate approver by default. Ministerial approval timelines can be significantly longer than those required by commercial partners and investors. Therefore, the Secretary of State should be engaged early and, where possible, approval should be delegated to officials (individuals or committee). If Secretary of State approval is required for the first spinout, approval should concurrently be sought for delegation to officials for future spinouts.

Visit section **11. Company Operations** for information on in-life PSB governance and management of spinouts.

Documentation

Ensure governance processes are documented and communicated throughout the organisation.

The following documents would typically be expected to be developed and approved. Some may be reviewed or approved by other committees before or on behalf of the final approval board.

- A business case – this may be an investment pitch or a Green Book-style business case (particularly for spinouts primarily offering services back to government), depending on the nature of the spinout opportunity.
- Details of the heads of terms, shareholder agreement including proposed distribution of spinout equity, any licence agreement, and proposed investors.
- Declarations of potential and perceived conflict of interest and how they will be managed, including, but not limited to:
  - Agreements on staff involvement in spinout.
  - Provision of facilities or equipment to the spinout.
  - Ongoing contractual relationships, such as PSB provision of further research, or provision of services by the spinout to the PSB.
- The final spinout team structure and management.
- PSB representation on the board of the spinout (visit section **11. Company Operations**).
- An exit strategy, if appropriate.

9.2. External Governance – Parent Bodies

For PSBs that are ALBs, approval may be required from the parent body. This can depend on factors including the partnership agreements between the PSBs and the founding documentation including legislation of the agency or ALB.

Wherever possible, decision making should be wholly within the organisation, to enable the timely and effective decision making required for spinout development. Therefore, this should be delegated to the agency or ALB where there is a parent body.

A representative from the parent body being part of a decision-making committee can provide a suitable level of visibility and input, but that individual should be empowered by their organisation to make decisions without seeking further approvals in the parent organisation.

Parent bodies should appoint an individual whose responsibility it is to champion spinout activity within their organisation and across their agencies and ALBs.

Some agencies and ALBs' partnership agreements or founding documentation may require approval by the Secretary of State of their parent body. As above, if this is deemed necessary, approval should concurrently be sought for delegation of future decision making.

The following steps can help ensure a shared understanding of the process between the PSBs and timeliness of decision making:

- Agree a template of information to be provided, areas of concern and potential risk to be considered, and timelines for decision-making
- Provide a summary of the internal approval board's deliberations and governance processes that have been followed to the parent body
- Agree a specific individual within the parent body with responsibility to manage any parts of the approval process they are involved in
- If expecting to develop more than one spinout, formally agreeing the set of requirements and criteria against which the parent body will assess spinout proposals can help standardise and streamline the process for subsequent spinouts

9.3. External Governance – HM Treasury

Creation of a PSB's first spinout is likely to be considered 'novel' by HM Treasury. PSBs should engage their applicable HM Treasury spending team to confirm and seek approval where required. If the PSB has a parent organisation, this engagement will likely require their involvement. Contact GOTT for support if you are engaging HM Treasury.

Where possible, approval of this first spinout and the overarching governance approach should seek agreement that future spinouts will not be considered novel and therefore not require further HM Treasury approvals (unless there is a contentious, repercussive or materially novel aspect of a future spinout, such as creating a spinout that has a risk of being classified to the public sector by the ONS). HM Treasury may still wish to review future spinout propositions, but all parties should endeavour to minimise this to ensure spinout activity is not stifled given its time-sensitive nature.

HM Treasury classifications team, via the relevant spending team, should be approached wherever there is a risk that spinouts could be classified by the ONS to the public sector.

9.4. Other Government Stakeholders

Cabinet Office's **Public Bodies Team** provide advice on the sub-classification of central government bodies – specifically Non-Departmental Public Bodies (NDPBs), Non-Ministerial Departments (NMDs) and Executive Agencies (EAs) – and the implications of these three **classifications**. When setting up spinouts as private sector entities, these will not be classified as a central government body (including any of these three types), therefore, there is no required role for Cabinet Office in approving spinouts.

The National Audit Office (NAO), in the course of their audit and assurance activities, may review the PSB's development and in-life management of spinouts. It will not have a role in the company's decision making.

The NAO will need to form a view about the accuracy and completeness of information about the spinout which is included in PSB's Annual Reports & Accounts. In order to do so, the NAO may need to request additional information (for example, about a PSB's valuation of equity it owns) from the PSB's finance team, which in turn may need to request additional information from the spinout.

It is important that the PSB has in place suitable arrangements to ensure it can obtain the information it requires in a timely manner. Failure to do so could delay certification of its accounts or result in the NAO issuing a qualified opinion.

Where Crown copyright or Crown database right material is to be involved in a spinout, The National Archives must be consulted to ensure that any necessary delegation of authority to license Crown information is in place, and that the intended licensing approach is in line with Government policy (currently set out in the **Open Data White Paper** and Annex 6.2 of **Managing Public Money**). Customer organisations within government should be engaged where service-oriented spinouts plan to provide services back to government.

9.5. Receiving and Retaining Revenue: Limits and Flexibilities

Receiving Revenue – Ambit

If a PSB is listed in the **Main Supply Estimates**, (these are typically central government departments), then to receive revenue from commercialisation of KAs including from licensing, dividends, equity investment etc., the activity will need to be included within the scope of the PSB's ambit.

This can be found under the 'Income arising from' section of the relevant organisation (or parent department as applicable) in the Main Supply Estimates. Wording is not typically standard, so finance teams and legal advisors will be best placed to advise if the scope is sufficient. If it is not, organisations can work with their HM Treasury spending teams to amend their ambit.

This can be done at Main or Supplementary estimates. Further information is available in the **Supply Estimates Guidance Manual**. It is advised to ensure this is in place when the spinout is formed or licence signed, or shortly after, to avoid it being forgotten or delayed.

Retaining Revenue

In order to retain revenue (whether as a central government department or other PSB), for example to reinvest in the development of the business function, organisations will need to comply with the flexibilities in the 'Retention rules' section of HM Treasury's Consolidated Budgeting Guidance (**2024-25 edition**, check for latest version).

Paragraphs 4.70 and 4.71 contain KA-specific flexibilities, either to spend in year, or, separately, to carry between financial years. If considering using these, please contact GOTT to support any engagement with HM Treasury.

9.6. Parliamentary Powers

PSBs require explicit permission from Parliament to take equity in private sector entities, including spinouts.

This legal permission, referred to as 'vires', can likely be found in a range of existing Acts of Parliament. PSBs should engage their legal team early to confirm the appropriate vires.

Note, the Act might either give the PSB explicit power to support companies in general (e.g. by taking equity and royalties in exchange for a KA licence) or might give them the power to engage companies in support of their wider objectives.

10.

Company Formation: Practicalities

Founders

10.1. Company Registration

Company registration is simple and cheap and is usually be done by the spinout founder(s), or the spinout CEO.

Registration involves deciding on a registered office for the spinout, appointing directors, and allotting shares. The spinout will also need to open a business bank account.

All companies registered in the UK are required to file a **confirmation statement** (previously known as an 'annual return') to Companies House. This must be done within a month of the date the company was incorporated, or the date of the last confirmation statement, and must be completed even if the company is not trading or there have been no changes. The confirmation statement provides an updated record of the company's registered address, persons of significant control, shareholders, and other information.

A step-by-step guide for setting up a Ltd company is available on **GOV.UK**.

Private Limited Companies

A private limited company (Ltd) is a business structure that offers limited liability to its shareholders and is a separate legal entity from its shareholders. The Ltd is the most common structure for spinout based on KAs and offers several advantages compared to other types of company structures, including:

- **Limited Liability:** Shareholders' liability is limited to the amount unpaid on their shares. This means their personal assets are generally protected from the company's debts or liabilities.
- **Attracting Investment and Funding:** The structure is considered appealing to potential investors and lenders due to the ability to own and transfer shares, as well as the limited liability feature. This can facilitate raising capital for growth and expansion.
- **Employee Incentives:** The ability to issue shares can help the company to attract and retain employees, such as through share options or share schemes, which can incentivise employees to stay with and build value in the business.

10.2. Company Documents

Note, bespoke articles of association and a shareholders' agreement will need to be agreed with investors. At company registration stage, model articles of association can be used.

Articles of Association

This is a legal document that outlines the rules governing the operation of a company. It is an essential part of a company's constitution and is filed with Companies House on incorporating a company. The **articles**, along with the memorandum of association, form the company's constitution and are legally binding upon the company, its shareholders, and its officers.

Memorandum of Association

This is a legal statement signed by all initial shareholders agreeing to form the company.

Shareholders' Agreement

A shareholders' agreement is a contract among the shareholders of a company that outlines their rights, responsibilities, obligations, and protections. Unlike the Articles of Association, which govern the overall structure and operations of the company, a shareholders' agreement is more specific to the relationship between the shareholders themselves.

It is not typically registered with an authority and remains a private document among the shareholders. It is not necessarily required at company registration stage.

10.3. Important Supporting Documents

Licence Agreement and Option Agreement

The licence agreement provides the spinout with rights to use KAs owned by the PSB. Visit the **Commercialisation Guide** for a detailed description.

It is not necessary to have a licence agreement in place at the point of spinout formation, instead, the spinout may have an option to license at the point of spinout or commitment from the PSB in some form. The licence to the spinout from the PSB can be triggered at a certain event, such as investment being received by the spinout, although there may be **tax implications** on founding shares if the licence to IP is significantly later than founders taking shares.

Secondment Agreement

A secondment agreement outlines the terms of a temporary assignment of an employee from the PSB to the spinout for a specified period of time. The purpose of a secondment is to facilitate knowledge transfer between the PSB and the spinout. This is not required if there is no secondment.

Letters of Appointment of Directors

Letters of appointment for directors are formal documents that outline the terms and conditions of a director's appointment to a company's board. They clarify the role, responsibilities, and expectations, ensuring legal compliance and formalising the appointment process.

These letters typically include details about the director's duties, term of appointment, remuneration, confidentiality clauses, and available support. They are usually issued by the board of directors and signed by the company's chair or CEO.

Non-Disclosure Agreement

A non-disclosure agreement (NDA), also referred to as a confidential disclosure agreement (CDA) may be relevant to share confidential information between the PSB and the spinout.

Consideration should be given to whether using an NDA will be a proportionate and realistic way to manage confidentiality. For example, the spinout may need to share certain information with potential investors or professional advisors. The licence agreement may provide suitable confidentiality provisions between the spinout and PSB, without the need for a separate NDA between those parties.

Visit **Managing IP and Confidentiality** for more information.

11.

Company Operations

11.1. Company Directors

A company's directors oversee strategic decision-making, ensuring alignment with the organisation's goals and shareholder interests. They bear legal responsibilities for corporate governance, compliance, and financial performance.

Directors also appoint executives and set executive pay. Ultimately, directors have responsibility for safeguarding the company's reputation and long-term viability. In the early phases on a spinout, their focus will be on generating growth and value creation while upholding legal and ethical standards.

A good rule of thumb is to have a board comprising an odd number of directors, which gives a natural majority to company decisions which will be passed by the board. An even number of directors can lead to split votes which can leave the company unable to execute decisions.

Once initial investment is secured, directors on the spinout board will consist of:

i. the founder(s) (to be agreed pre-investment),

ii. investor(s) (to be agreed as part of the investment negotiation, minority investors may not require/be given a board position),

iii. and likely an independent director whose appointment has been mutually agreed upon by the founders and investors.

It is often beneficial if the independent director has expertise in the spinout's area of operations through relevant experience that can help to guide the company through important decisions and introduce the company's management to useful business contacts.

It is usual to have the right for the PSB to appoint a director in the shareholders agreement. It is at the discretion of the PSB whether it takes up this right. If it does, it is important that the individual acts on behalf of the company when wearing their 'director hat' and not on behalf of the PSB. Conflicts of interest need to be managed.

The PSB should consider internal decision-making governance related to the spinout within the PSB to manage potential conflicts of interest. Decisions should not be made on behalf of the PSB by those who have an interest in the company, whether by way of equity or a board role, or by those who report to them where the perception may be that the PSB shareholder or director could exercise control.

A PSB may decide to appoint an observer to the Board. Care must be taken that PSB observers and directors understand the scope of their role, visit section **11.2. Shadow Directors**.

Company Chair

The company Chair plays an important role in the governance of a company, as they act as the leader of the board of directors. They are responsible for ensuring that the board operates effectively and makes decisions in the best interests of the company.

The Chair also has an important role in leading the process of overseeing the performance of the CEO. For spinouts, an experienced Chair can play a vital role in coaching, mentoring, and developing a less experienced but high potential CEO.

It is important that a Chair has board-level experience, good leadership, and strategic thinking skills. It's often important that the Chair has good industry knowledge and experience specific to the spinout's area of work.

Director's Duties

Under the Companies Act 2006, directors have a set of general duties that outline their responsibilities towards the company. These duties are legally binding and encompass various aspects of their role. The general duties of directors as per the **Companies Act 2006** are summarised below (visit the Act for full detail):

1. **Duty to Act Within Powers:** Directors must act in accordance with the company's constitution and exercise their powers for the purposes intended. They should act within the company's powers as outlined in its articles of association.
2. **Duty to Promote the Success of the Company:** Directors must act in a way that promotes the success of the company for the benefit of its shareholders. They should consider long-term consequences, the interests of employees, relationships with customers and suppliers, the impact on the community and environment, and the company's reputation.
3. **Duty to Exercise Independent Judgment:** Directors must exercise their own independent judgment and avoid situations where they may have a conflict of interest between personal interests and the company's interests. They should not follow the instructions of others if it goes against the company's best interests.
4. **Duty to Exercise Reasonable Care, Skill, and Diligence:** Directors should use the care, skill, and diligence that would be expected of a reasonably diligent person with their knowledge and experience. They must apply themselves to the role and make informed decisions.
5. **Duty to Avoid Conflicts of Interest:** Directors must avoid situations where their personal interests conflict with the interests of the company. If such conflicts arise, they must declare their interests and abstain from participating in relevant discussions or decisions.
6. **Duty Not to Accept Benefits From 3rd Parties:** Directors should not accept benefits from 3rd parties that are conferred because of their position or because of actions taken as directors. There are exceptions, such as normal company benefits or permitted benefits under the Articles of Association.
7. **Duty to Declare Interests in Proposed Transactions or Arrangements:** Directors must declare any interest in proposed transactions or arrangements with the company. This declaration must be made as soon as practicable and recorded appropriately.

These duties are meant to ensure directors act in the best interests of the company, exercise care and diligence, and maintain transparency and accountability in their actions.

Failure to fulfil these duties can result in legal consequences and liabilities for directors, therefore, it is critical that spinout directors are aware of their obligations to the company from the outset.

In the case of employees of a PSB becoming company directors, either as founders, or as independents, it recommended for new directors to familiarise themselves with the duties of directors. It is also beneficial to attend directors' duties training, which can help them to understand their obligations to the company.

Individuals should understand their duties and legal responsibilities before deciding to become a company director. The **Institute of Directors** is a useful source of support, advice and training available for spinouts and startups.

11.2. Shadow Directors

A **shadow director** is "a person in accordance with whose directions or instructions the directors of the company are accustomed to act". In essence, a shadow director is an individual who may not have a formal appointment as a director in a company but still exercises significant influence and control over the company's board or management.

By law, a shadow director has the same responsibilities and liabilities as an appointed director. It is an issue that observers to the board should be aware of.

A PSB, itself could be acting as a shadow director of a company if one of its representatives acting in an official capacity provides direction to the company.

It is important that the relationship between the spinout and the PSB, and its representatives are clear and that the PSB is not providing direction to the spinout. A PSB acting as a shadow director could expose the PSB to unnecessary risk and hamper the spinout's ability to make independent decisions in its interest.

11.3. Insurance

Directors and Officers Insurance (D&O insurance) is a type of liability insurance designed to protect directors and officers of a company from personal losses incurred as a result of legal actions brought against them in their capacity as company executives.

This insurance typically covers legal costs, damages, and settlements that may arise from claims of negligence, breach of duty, errors in judgment, misleading statements, or other wrongful acts.

The scope of coverage provided by D&O insurance can vary depending on the policy and the specific needs of the company. It may include protection for legal expenses associated with investigations, regulatory proceedings, shareholder actions, or employment disputes brought against directors and officers.

D&O insurance is an important and necessary feature to attract executives to join the spinout and is usually purchased by the company.

Depending on the nature of the spinout's activities, other types of insurance will likely be required.

11.4. Security

Spinouts are attractive targets for state actors looking to steal technology, competitors seeking commercial advantage, and criminals looking to profit from companies with weak security. Many businesses remain vulnerable through failing to implement basic security measures.

Good security practices can protect the spinout (and PSB's) information, people and competitive advantage, making the spinout more attractive to investors and customers. This requires proactive consideration and mitigation of security risks at the start and can save time and money as the spinout grows.

These include, but are not limited to, understanding where investment comes from, who the spinout partners with, and identifying the critical assets which are crucial to the existence and success of the spinout and ensuring these are protected.

The National Protective Security Authority (NPSA) and National Cyber Security Centre (NCSC)'s Secure Innovation campaign provides free security guidance and resources specifically for emerging businesses.

Spinouts are strongly encouraged to complete the **Secure Innovation Personalised Action Plan**. This tool takes 5-10 minutes to complete and produces a tailored report of suggested actions, to implement better security measures quickly and simply.

Spinouts should also refer to the measures set out by NPSA and the NCSC in **Core Security Measures for Early-Stage Technology Businesses**.

More detailed advice is available on the **Secure Innovation** website, including **Secure Innovation guidance for investors** which, whilst targeted at investors, contains information that can be useful for those establishing a spinout and seeking investment.

The National Cyber Security Centre (NCSC) recommends **Cyber Essentials** as the minimum standard of cyber security for all organisations. Cyber Essentials is an effective, Government backed scheme that implements 5 cyber security controls that prevent the most common types of cyber-attack. Further cyber security guidance, and hands-on support to implement the Cyber Essentials controls is available from the NCSCs **network of assured Cyber Advisors**.

In addition to the above, spinouts must determine whether **export controls** and the **National Security and Investment Act 2021** are applicable to their business.

11.5. Tax

It is important that founders, employees of the spinout, or other individuals who take shares or share options in the spinout are aware of the tax implications of owning and transferring ownership of such securities.

Tax implications may arise due to an individuals' shareholding in the spinout company likely arising as a result of their employment. The transfer of a KA into the spinout is likely to have some value to the spinout (even if there is no up-front payment). Individuals, effectively, then own shares of value as a result of their employment. This can create a tax liability for the individual.

The provisions for researchers in 'Research Institutions' as set out in **HMRC's ERSM100000 – University spin-outs** may apply to some PSBs and individuals. Visit the **legislation** for full details.

PSBs and individuals should each seek tax advice.

11.6. Valuation

The PSB will need to value its interest in the spinout in its accounts appropriately. The PSB's finance team will need to establish a suitable approach to valuing the PSB's equity (and any other interests) in spinouts, and will need to revisit the valuation regularly, at least annually.

It is recommended that the PSB's finance team is consulted at the earliest opportunity and an agreed approach to what information will be needed for the financial reporting and wider PSB financial management processes is agreed for the full life cycle of the spinout.

A PSB should seek to take a consistent approach for all spinouts it has an interest in and consider what information it will need from spinout companies in order to appropriately value the PSB's interests, and ensure it is able to obtain this information. It may wish to consult with the relevant NAO audit team in order to understand what information the NAO is likely to require in order to appropriately challenge the finance team's judgments as part of the annual audit of the PSB's accounts.

Founders

11.7. Running the Business

Whilst this guide focusses primarily on the roles of the PSB and founders in helping to establish the spinout and the PSB's in-life responsibilities, the spinout will also need to consider the day-to-day operations of the business including payroll, HR, accounting etc. as and when applicable.

Visit **guidance** on running a limited company from Companies House for an introduction.

Government Office for
Technology Transfer

This publication is available from: **https://www.gov.uk/government/organisations/government-office-for-technology-transfer** If you need a version of this document in a more accessible format, please email **alt.formats@dsit.gov.uk**. Please tell us what format you need. It will help us if you say what assistive technology you use.