



Levels of innovation

Jon Moulton reflects on his vast experience of investing in innovation and in regionally-focused funds

An observed fact over most of my 40-plus-year career is that 'regional' funds have underperformed private equity in terms of return terms by a significant amount.

Even the most fervent of capitalists – and I associate myself with that cohort – would acknowledge that there are other legitimate objectives to financial returns for mostly government-funded, regional venture capital and buy-out funds: the creation of employment in areas of higher unemployment; supporting financial and scientific activity outside London and Cambridge areas; seeding skills and facilities that might, perhaps decades later, generate important new businesses, are among those cited.

A less economic and more political set of objectives includes government-led schemes addressing diversity and equality agendas, and regional funds can obviously insist on them.

In 2010 when the coalition government set up the Regional Growth Fund, I joined the board. I can assure you that politicians see throwing money at areas important to electoral success as great PR, with the advantage that the costs trail some years behind. That fund disbursed around £3bn to very little effect. "More money for high-paying local jobs in areas of exciting technology" is a really good basis for a speech on a politician's day trip by helicopter to somewhere outside of the south east of England.

Return to returns

But for those of us from the 'simplistic' return maximisation game, what explains the lower returns? The possible answers are not popular for reasons all too apparent as I go through the causes.

Perhaps regional fund managers are too civil-service-like without the necessary commercial experience and know-how to enhance businesses' value. Is there a difference between the average quality of publicly funded fund managers and private funds? Certainly, they have somewhat differing objectives and my interactions in this area show widely different apparent capabilities in those publicly funded managers.

Is it poor selection of investments? Perhaps driven by short time-frame targets for the investment of funds or by service-level agreements of the number of investments in a given year? It certainly was the

case in an early-stage fund I was engaged with some years ago in Northern Ireland – December was always our peak investment month and returns were dire.

It has been put forward that publicly funded investees are more likely to get rescue financing with expensively funded failures arriving later – I have not seen much evidence to back that hypothesis up, though.

Is there too much money for the available pool of good transactions? This is pretty obviously plain to see. Such excess money being pushed into a regional private equity market will inevitably be likely to do harm – possibly even serious harm.

The pool of high-quality, experienced staff, especially senior management, is finite and too much money attracts good managers into mediocre or poor businesses. Good businesses prosper less well and bad businesses attract the money. Returns of both types of business slump. A lack of specialised assets, (such as labs), or infrastructure inadequacies can also constrain market size.

If there is too much money chasing deals, non-government funded funds get priced out – and over time can lose interest in the regions. I think that too much fund capital is a considerable component of underperformance and is probably the main component.

So, how do you improve the supply of good deals in an area? It is a very difficult problem. And most of the fixes are long term and so politically uninteresting. I think better business-focused education would eventually help, but you need to retain people in the region after finishing education to make significant improvement.

Stronger academic and technical universities and colleges with more of a focus towards business, including some adult education, would certainly help and should be encouraged. Labs, equipment and other facilities in academic use can help some younger businesses to have a better start. Tax and regulatory benefits for a region should help attract people from established businesses or academia into earlier stage businesses. Proper planning can make this work.

Generating clusters of similar businesses is superficially attractive and is popular, but I think the jury is out on their effectiveness. Whether allowing greater concentration of business activity in the currently most prosperous areas of the country makes for a better national economy than levelling up is a political decision. That will be up to them.

'Too much money attracts good managers into poor businesses'