



State of the nation

Regional policy is far from easy. Directing too much money into disadvantaged regions can be as bad as investing too little, warns **Jon Moulton**

Disruption is what venture capitalists seek to do. Good disruption that is. Investing in early-stage companies, creating jobs, backing innovation and technologies that can move a country, or perhaps a region of a country, forward.

But there's a catch: economic displacement. This happens when policy intervention that boosts economic activity in one location has the effect of bringing about some degree of reduction in economic activity elsewhere. And it's something that is happening more and more in regional venture capital.

You might think that this simply means that some action taken in rural Scotland to generate enterprises, jobs and prosperity could have an equal and opposite effect in, say, Cambridge.

Regrettably, though, the effect can be worse than that – and, therefore, be bad for the country as a whole.

Businesses tend to prosper when they concentrate in areas of advantage. Engineering, back when the sun never set on the Empire, prospered in many areas of Britain. In the Black Country in the Midlands, for instance, where there was coal, iron ore, rail and canal links, and local skilled workforces, concentration on engineering made economic sense.

Provision of employment aside, workers didn't necessarily reap the benefits of these flourishing industries, of course, but that's an argument for another day. Economics almost never has a gentle nature.

People power

Today, concentration is driven by different factors. Skilled workers are more critical to business success, and they are attracted to places that are pleasant to live in, with good transport, health facilities, education and housing.

Other businesses still need good old-fashioned natural advantage. You don't build a windfarm where there's no wind. But you also need to bear in mind proximity to expensive National Grid connections.

Politics has a huge bearing on where money is invested in democracies. Any government that throws money into a high-unemployment area, for example, should boost its popularity. Logic here says that votes (should) follow.

But the crude arithmetic of business says that putting £100m into a region with weak economics will generally be less attractive than putting that money into an area where the elements of business are already well established. There are exceptions – an area might already be concentrated to a level where it cannot sensibly absorb more money, for example – but those scenarios are rare.

The reality is that regional policy is actually pretty difficult. If you pour money into weak businesses then not much good emerges. Perhaps you fund a business for half a dozen years and then it goes bust with heavy job losses. In the meantime, good people and good assets elsewhere go underfunded when they could be generating serious money for the country.

The worst case is that good people are pulled out of potentially decent businesses to waste their skill and time at lesser organisations.

It really is not a zero-sum game. To be honest, nothing much is. Money allocated to less prosperous areas may do less good – or even damage those regions – while already-stronger regions could put it to better use. Reinforcing success at a stronger location is far more likely to generate greater benefit to the nation.

Greater workforce mobility would help, of course. The cost of bricks and mortar and moving is clearly a huge obstacle to development in less prosperous areas.

In the UK venture capital world, there is a lot of government money now being funnelled into multiple regions and devolved administrations. The managers are measured on volume of money out of the door in some restricted geographies, rather than carefully working to improve the sparser good businesses. Indeed, returns – if there are any – rarely get much coverage at all.

It's not a new problem. Regional venture capital funds have been trying to boost development for 40 years or so, but I know of no such funds that have been noticeably successful long-term in generating investment returns. Perhaps they exist, but if this were the case I suspect we would be busy attempting to replicate them across the nation.

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