Jon Moulton's Diary

Should governments have policies aimed at picking regional winners?

Veteran financier Jon Moulton has been involved in buyouts, turnarounds and venture capital since 1979 with firms such as CVC, Permira, Apax, Alchemy and, most recently, Better Capital, where he has been the chair since 2009

I write this with trepidation. Here are a few views about government intervention in the venture capital world.

Take R&D tax credits – much loved by recipients for obvious reasons but they are given out equally to companies good and bad. Much of this support is definitely wasted with creative effort being focused on classifying all kinds of expenditure as R&D. I have seen claims where the underlying spending was actually filling in a spreadsheet – hopefully not the leading edge of UK technology!

Have a look at regional early-stage funds in the UK — it is difficult to get private sector funds to invest into UK early-stage investments because experience shows that returns are not great. If there was a real shortage of early-stage funding then those brave enough to invest would be expected, from the basic economics of a market, to get good returns more often.

Understandable reasons

The problem is that successive governments, for understandable reasons, want to demonstrate that they are investing "in the disadvantaged regions" and/or to ignite growth. Too much money going into the early-stage deals means that weak to terrible businesses and managements (and doubtless a few good ones) are being funded by government agencies or their subcontracted fund managers in order to meet the politically-driven investment targets quickly. And of course, increased fund size means more management fees so the managers are always keen on growth.

The key objective of the state-funded investors is thus getting the money out of the door – with larger management fees...

And the dead hand of the civil service is all too apparent. Labour for days on a great pitch and at least one of the subcontract managers greets you on their website as follows: "Please forward your materials to the website to begin the process. Please note there is no need to contact us further. We will review your information and contact you directly if your business meets our criteria."

Don't ring us...

Getty Images

Despite politicians backing schemes that offer good publicity, HMG often fails to manage projects well

There are obvious downsides to biting the hand that feeds you.

Expressing opinions in this area publicly might stop flows of capital or make things tricky for portfolio companies. But in private there is much complaining about an over-heavy public sector, no response on Fridays, micro-level of due diligence, interminable lawyering, timescales, process pace and lack of commercial skills. I attended an event recently where five university heads startlingly shared their low opinion of some of the government-funded early-stage investors.

Failing initiatives

The ability to survive the form filling and lawyer-controlled due diligence is an important criterion for getting investment from government entities. But we really should not be selecting investments with public money on the basis of process endurance qualities.

The history of the UK in setting industrial strategy is not a cheering read. Most initiatives fail – there is little doubt that markets do far better at allocating capital than the civil service.

A real problem is simply that governments last a lot less time that it takes for early-stage businesses to demonstrate success, even for investments made in the early months of a Parliament. So, the investments will inevitably show little to attract votes at the time of an election.

Politicians see benefits from the ephemeral popularity of announcing schemes and investments – preferably the more telegenic ones featuring photogenic CEOs to provide some TV content. They don't want failure or job losses.

The government could be very helpful to some areas of the economy – the high capital demands and complexity of nuclear fusion has been matched by about £3bn of government funding – and this seems reasonably sensible – so far! But generally, HMG is rubbish at industrial strategy and cannot execute projects well – expect overruns!

Venture capital is something better left to markets. Government can help the sector, and the economy generally, by generating good conditions (tax, regulation, legal framework...) for all businesses.

'Politicians see benefits from the ephemeral popularity of announcing schemes and investments – preferably the more telegenic ones'