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Killing the zombies and raising the innovators

Three opportunities to unlock innovation in the UK

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The 2013 party conference season coincides with the fifth anniversary of the height of the credit crunch and the collapse of Lehman Brothers. Half a decade on, the UK economy is still struggling to create sustainable jobs and growth. We can do more to innovate together.

We see huge opportunities to improve how we support innovation in the UK. Unproductive firms are being kept alive by low interest rates and tolerant lenders, while too many firms with high potential are struggling to find the help they need to grow. This is the very opposite of how a financial system should allocate resources.

We have articulated a vision of 2025 in which disruptive technologies, business models and approaches to R&D are transforming health delivery, domestic energy, and finance. The Big Innovation Centre is co-creating this future via Open Innovation, Big Data and the Internet of Things. Through open innovation, multinational corporations and our partners engage with networks of SMEs, research facilities, entrepreneurs and an enterprising state to deliver this positive vision of the future.

We believe that new types of banking business models can help to overcome structural barriers in our economy. New, open approaches to collaboration are driving new ways of innovating. Business accelerator initiatives are offering new ways to build truly supportive environments around small innovative companies and there are new

opportunities for collective action between public and private organisations to build the markets of the future.

The Big Innovation Centre's party conference events will focus on how the UK can exploit these opportunities to unlock innovation and build around the major disruptive forces of our time.

1. Financial solutions to unleash the innovators

Our research on finance has identified that as little as one per cent of the capital raised in the UK is invested in innovation. SMEs are a vital part of our economy, but our research shows that innovative SMEs find it harder to access finance than other firms, and this has worsened since the financial crisis. Traditional banking business models are failing to accurately value the intangible assets (such as specific knowledge, brands, human and organisational capital and intellectual property) which drive growth and job creation in modern, and particularly young, SMEs. This is unsustainable. We believe that the services offered by banks can evolve to ensure that they better support our economy.

The long-term solution will lie in the evolution of how banks make money. Banking business models must/are respond/ing to the reality of a modern intangible asset based economy. In a data-driven economy, banks are increasingly positioning as knowledge-intensive service providers. Information is becoming increasingly valuable and banks could use this opportunity to expand their role in the financial ecosystem by becoming a value-added information broker to grow lending to fast growing innovative firms and sectors. This would require finding new ways to value innovative business models based

on intangible assets, and new alternative financial platforms and instruments to finance these business models. Alternative lending instruments such as peer-to-peer lending and new financial products tailored for young and growing SMEs could be the disruptive technologies to drive this change in banking business models.

Our research identifies three potential policy prescriptions to address this problem:

- New and better ways of valuing innovative and knowledge-based businesses to grant them access to finance – Big Data will play a decisive role here
- More angel and seed funds towards the bottom end of the funding escalator, as equity financing is better at valuing innovation and intangibles
- Innovating banking business models, and alternative financial technologies, such as new platforms-as-a-service business models for finance, to foster innovation and growth

2. Using accelerators to get the most out of our businesses

Accelerator schemes, such as the initiative currently being conceived by the Big Innovation Centre, offer an exciting alternative approach to tackling structural issues in our economy. They link small and large companies, universities, banks and training or business support groups together in new ways. Accelerators also offer opportunities to de-risk investments in innovation, and unleash the potential of innovative SMEs.

Our evidence shows that high growth firms typically face a wide range of obstacles stunting their growth such as the cost of premises, managerial skills, access to finance and markets, recruiting staff and a general shortage of skills. Accelerators can offer targeted support over the long haul and help companies overcome these roadblocks that might otherwise stunt their growth. For example, it is challenging to build a customer base in foreign markets – even when the product and business plan are well developed. Accelerators that cultivate strong international networks are well positioned to facilitate different market linkages over time. These introductions can help young companies land critical first customers and deals, then propel continued growth.

Examples of firms that have experienced rapid growth through the help of an accelerator/incubator include Scribd, Dropbox and Airbnb at the US based accelerator Y Combinator. In the UK, ARM Holdings and Autonomy Corporation are examples of businesses benefiting from the Cambridge Science Park accelerator.

3. Collective action to build the markets of the future

Our economic prosperity will depend on our ability to make new markets that exploit emerging disruptive technologies such as nanotechnology, big data, 3D printing, the internet of things, smart grids etc. Incremental improvements in products and services can be handled within existing markets, but radical innovations often don't fit in existing frameworks.

Totally new goods and services, new business models and new industrial processes create new types of economic relationships, which must be underpinned by new markets. These new markets are central to the economic dividend from innovation. However, in practice, markets are highly complex entities and their development can be prone to failure. They do not always form instantly, even with an existing potential supply and demand for a product. New market development depends on key building blocks: specific technologies, infrastructures, standards, consumer behaviors, supply chains, regulations and enabling legal rights systems.

However, history shows us that market formation can be supported and de-risked through sophisticated collaborations between public and private groups. It is widely accepted that strategic policy from the US government has resulted in many new innovations, such as the microchip, the internet and, more recently, nanotechnology and biotechnology. Each was funded by public agencies such as DARPA, the NSF and the NIH.¹

¹ Mazzucato, M. (2013) *The Entrepreneurial State*, Anthem: London.

The innovation challenge

Politicians from all parties are accepting that traditional routes to growth are simply not available in 2013. If we are to unlock innovation and growth, then we need a full commitment to structural reforms and to root the building of innovative markets, networks and places at the heart of policy making and commercial practice.

This will mean targeted spending to remove structural problems in our economy to ensure that we exploit the opportunities presented by new general purpose technologies. Success will depend on: investment in research, technologies, new infrastructure and institutions. But these basic conditions for economic growth are not enough. Success will also require leadership, collective action and open innovation to exploit the opportunities presented by new general purpose technologies.

If we are to secure a lasting recovery, then it is essential that all parties place this innovation-led vision at the centre of their strategy to support our economy.

The Big Innovation Centre

The Big Innovation Centre is a distinctive and unique initiative of Lancaster University and The Work Foundation, co-designing research with businesses. As a much-welcomed player to the policy scene, we punch above our weight as we work with our partners to propose and deliver practical reforms to make the UK a global, open innovation and investment hub.

We learn from evidence-based research, practice, trial testing, and through business and policy forums. We are also testing evolving ideas in real time with leading companies whilst incubating open innovation experiments and test beds.

