



The Rt. Hon. George Osborne MP
Chancellor of the Exchequer
HM Treasury
Horse Guards Road
London
SW1A 2HQ

2nd December 2013

Dear Chancellor,

As the UK economy begins to recover, we at the Big Innovation Centre see great opportunities to sustain the recovery through more support for innovation. Currently, 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 opposite of how a financial system should allocate resources.

We believe that new types of banking business models can help overcome structural barriers in our economy. Business accelerator initiatives are offering new ways to build truly supportive environments for small innovative companies and new opportunities for collective action between public and private organisations will build the markets of the future.

The Big Innovation Centre's research has identified three opportunities that are not only crucial to unlocking innovation and developing the major disruptive forces of our time, but will also lock-in and sustain our current recovery.

1. Financial solutions to support innovators

We warmly welcome the latest steps taken by the Business Secretary, Vince Cable, to boost small business lending. The recent announcement of a £45 million funding allocation from the British Business Bank's investment programme to start lending to firms early next year is definitely a move in the right direction.¹ However, the government must do more if it wants to have a substantial impact on access to finance for SMEs.

Our research 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 crisis². Traditional banking business models are failing to accurately value the intangible assets (such as computerised information, innovative and intellectual

¹ <http://news.bis.gov.uk/Press-Releases/Investment-and-campaign-to-help-small-firms-grow-6958c.aspx>

² Lee, N., Sameen, H. & Martin, L. (2013) "Credit and the crisis: Access to finance for innovation small firms since the recession", Big Innovation Centre



property, etc) which drive growth and job creation in new startups and young SMEs. This is unsustainable. We believe that the services offered by banks can evolve to ensure that they better support our economy.

We therefore call for three policy interventions to address this problem:

- **Greater emphasis should be placed on facilitating access to angel investors and seed funds to those at the bottom end of the funding escalator.** A substantial gap exists here, and as equity financing is better at valuing innovation and intangibles it can promote access to finance for high growth and innovative firms.
- **Support new and better ways of valuing innovative and knowledge-based businesses.** High levels of intangible assets are correlated with firms being high-growth, but also with a difficulty of accessing finance.
- **Use the British Business Bank to facilitate alternative financial technologies.** The Business Bank must be used to increase competition in the financial sector, by providing alternative finance and developing new banking business models.

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

Accelerator schemes, such as initiatives 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 skills³. Accelerators can offer targeted support over the long haul and help companies overcome these hurdles that might otherwise cut their growth short. For example, it is challenging to build a customer base in new markets – even when the product and its business plan are well developed. Accelerators that cultivate strong regional and international networks are well positioned to facilitate different market linkages over time, and help the firm scale-up quickly. These introductions can initially help young and growing companies land critical customers and deals, then propel continued growth.

³ Lee, N. (2012) "Free to grow? Assessing the obstacles faced by actual and potential high growth firms", Big Innovation Centre



We recommend that:

- **Government should test and explore new ways of using its convening power to encourage cross-industry collaboration to build accelerators.** Accelerators also offer opportunities to de-risk investments in innovation, and unleash the growth potential of innovative SMEs.
- **Government should use co-investment models where de-risking is necessary.** To further promote home-grown and international investment in UK innovation, the government could use initiatives like the Regional Growth Fund to match private investment in areas where it has not been forthcoming.

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.

Entirely new goods and services, business models and industrial processes create new types of economic relationships, which must be supported by new markets. These new markets are central to the economic benefits of innovation. However, in practice, markets are highly complex entities and their development is no easy task. 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 behaviours, 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. If we are to unlock innovation and growth, then we need to fully commit to structural reforms and to place the development of innovative markets, networks and places at the heart of policy making and commercial practice.

Big spending decisions and major investments have too often lost sight of what unlocks growth and innovation in our economy. This will mean more targeted spending to remove structural problems and ensuring that we exploit the opportunities presented by new



general purpose technologies. Success will depend on: investment in research, technologies, new infrastructure and institutions. However, these basic conditions for economic growth are not enough. To successfully deliver sustainable growth, the UK will require leadership, collective action and open innovation in order to exploit the opportunities presented by new general purpose technologies.

Our research identifies two recommendations to build the markets of the future through collective action:

- **Government should not solely invest in technology foresight, but also in business insight.** Government should seek to understand the needs and challenges faced by businesses by focussing on new markets and business applications of future technologies and ideas, particularly those that meet current or potential economic needs.
- **Policy should also focus on supporting markets rather than trying to create them from scratch.** Government should not try to second-guess the private sector, instead it should focus on supporting entrepreneurs who are experimenting with new technologies and business models, but are facing legal and regulatory constraints.

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

Yours sincerely,

Birgitte Andersen
Director

Will Hutton
Chair