

The state of the UK Economy

By James Basden

There is undoubted merit in Michael Porter's comments (*Financial Times*, 23 January, 2003) on innovation and the state of the UK economy. From first hand experience it is evident that in many sectors – particularly within Utilities, Financial Services and the Public Sector – the liberalising reforms of the Thatcher era are not bringing the benefits that they once did. The introduction of ten new countries to the EU, all of whom have lower operating costs for manufacturing production, means that the UK, even with its liberal markets, no longer provides a low cost entry point into Europe.

The business environment in the UK is radically different from the one which provided the backdrop to the formative years of many senior managers. Whilst in the 25 years prior to 1992 interest rates averaged 12%, for the last decade the UK has averaged under half that rate and now provides a consistently low inflation environment. With monetary policy now handled by the Bank of England, thus removing the damaging short-term swings brought about by politicians, the UK enjoys a stable business environment – in terms of inflation, interest rates and the value of sterling. Businesses can plan ahead and focus more on international competitiveness.

This is good news, but Porter goes on to highlight the woeful shortfalls in the ability of British business to compete. Whilst the UK provides liberal markets, it lacks the assets, in terms of transport infrastructure, skilled middle management and R&D, of its European rivals. Business investment in new plant, machinery or vehicles and buildings plant has lagged behind our G7 competitors for decades, resulting in lower levels of capital per worker in nearly every sector. Productivity, according to the DTI, remains on average 45% behind that of the US and 18% behind France. If the UK were to match the productivity performance of the US, for example, output per head would be over £6,000 higher.

For too long UK businesses focused on cost reduction and failed to invest in capital equipment and, most importantly, innovation. One of the few areas of innovation has come from larger companies reviewing existing assets bases and recognising possible ways to generate more revenue or even new businesses. There is a consistent track record of greater performance from such spin out operations, thanks primarily to the greater management attention they receive. This activity, often referred to as corporate venturing, builds on current core strengths and has proven to be one of the most successful avenues to growth.

In a recent Corven survey, directors of the UK's largest companies were asked about their focus on innovation. Nearly ninety percent of respondents remained unconvinced that their organisation would successfully commercialise its corporate venturing initiatives and planned to drop their investment in corporate ventures from an average of £18 million per annum to £10 million. Most are fighting shy, and for fairly obvious reasons. Many companies strayed too far from their core business in the dot com boom, sometimes backing internet ventures for the sake of the vibrant image they presented, rather than because of the viability of the ideas themselves. Self serving they looked to discover a latent demand, so latent as to be non-existent. As a consequence, the fear of failure with regard to ventures has generalised to include, for many companies, most new ideas. It is ironic that the unfortunate results of one of the most innovative periods in recent history can now be seen as a brake on innovation.

But, that is not to say that everyone has given in to their fear of failure. Despite the general pessimism in the market and the deteriorating climate for investment, Nokia, Unilever, Diageo and BT are all enhancing their venturing activities. Unilever Technology Ventures, for example, are looking to invest 30 million euros over the next three years specifically in areas that could have a strategic impact on Unilever's business over the long-term, and they have made a conscious effort to avoid the pitfalls that sunk other corporate venturing teams.

State of the UK Economy (Cont'd)

Ensuring a tight focus around innovative business propositions that support but extend beyond existing capabilities over a three to five year timescale is vital to the success of UK corporates and the public sector. The boards of large UK corporates need to see investment and innovative business building as an essential entrepreneurial capability at the core of the company, not as a project initiative. Stronger leadership from government, fund managers and FTSE chief executives to have the confidence to invest in corporate venturing type initiatives will create the kind of innovative solutions that grow businesses and increase productivity. But we need to think beyond three years if innovation and enterprise are to prosper. It will enable the UK to complete its transformation from the sick man of Europe to replace Germany as its economic powerhouse.

James Basden Profile

James is a Founding Director of Corven and leads Corven's Corporate Finance capability and Corven Assets, our portfolio of investee companies. James manages corporate finance transactions on behalf of Corven clients and also manages some of the major consulting relationships with FTSE 100 size clients.

James has more than twelve years consulting experience covering the Utilities, Construction, Banking, Automotive and Retail sectors. His expertise ranges from strategy development to major performance improvement programmes, with a particular focus on managing corporate turnarounds and establishing new business ventures.

Prior to Corven, James helped lead the turnaround of a leading UK sport cars and engineering group. Acting in an interim CEO role for Lotus Cars, James took the company from the verge of bankruptcy to a 95% increase in profits within one year. Further back in his career, James worked in strategy consulting for CSC Index, Andersen Consulting, and Burson-Marsteller.

James has a BA Honours degree in English Literature from Durham University, an MBA from London Business School and is approved by the FSA to carry out investment business.

