Transcript Q&A

Risky Business: Managing Innovation for Growth

Rt Hon Lord Heseltine
Deputy Prime Minister, UK (1995-97); Author, No Stone Unturned: In Pursuit of Growth

Will Hutton
Principal, Hertford College, Oxford; Chair, The Big Innovation Centre, The Work Foundation

Professor Mariana Mazzucato
RM Phillips Chair in Science & Technology Policy, University of Sussex; Author, The Entrepreneurial State: Debunking Public vs Private Sector Myths (Anthem, 2013)

Kathryn Parsons
Co-founder, Decoded

Chair: Sir Richard Sykes
Chair, Imperial College Healthcare NHS Trust

28 October 2013
Question 1:

My question, which is for the entire panel, might seem as another case of somebody putting in the boot to big pharma, but I would point out in relation to Sir Richard’s presence that I’ve worked in the ex-Soviet Union so I think we should fully recognize what he went through and what he did in terms of good governance in relation to ENRC (Eurasian Natural Resources Corporation). But my question is where does the pensions industry, what part does it have to play in innovation, and if that hasn’t been done too well, or indeed if it has, does the blame, if any, lie with that industry or with the tax system or a bit of both? Thank you.

Richard Sykes:

Thank you. Michael, do you want to start that?

Michael Heseltine:

The chancellor has indicated the desire to find a way of bridging the demand for money with the supply of money, within the pension and institutional world, money is there on a scale beyond the wildest dreams. What they cannot find is a vehicle that gives them the security that they’re quite rightly concerned to achieve in what essentially are risk-making projects. My own personal view is that this should be capable of resolution, but nobody has yet resolved it. The chancellor wants to.

Richard Sykes:

Anybody else? Will.

Will Hutton:

I’m not sure about this. I was chatting to somebody at the Department of Business who’s very close to the recent privatisation of the Royal Mail and they were trying to get long-term investing institutions to come into the Royal Mail. That was one of the reasons why the price was pitched at 330p, and actually some institutions that you would think were sitting on this kind of weight of money were simply unwilling to take tranches in the Royal Mail for god’s sake at 330p, and they were looking for returns that were higher even
than the kind of yields and prospects at 330. Now, of course, the shares are
above £5, and you find it continually when you come to infrastructure that
actually, I mean Mariana picked up this point but I think it’s astonishing that
Centrica couldn’t take the risk with EDF Energy of co-building the next
generation of nuclear power plants, instead of which they spent £500 million
in a share buyback. Actually I used to have this argument with Sir Mervyn
King when he was governor, I used to say why is it that actually our finance
institutions are looking for returns north of 15, often as much as 20 per cent
payback at three years. He’d say ah, well it’ll all come down when the nominal
rate, it’s a money illusion, it’ll all come back when actually the inflation rates,
the long period in which inflation rate has been two or three per cent, that
money illusion will - and here we are, we’ve had more than 15 years of
inflation rate and they’re still looking for 20 per cent rates of return, real, and
three year paybacks. There’s a lot of money out there, but the returns they
want are beyond extravagant.

If I was on the board of Centrica I’d have probably had to go along with all the
rest of them and say actually the expectations of our shareholders are so
demanding we can’t do this, and I think it is a really, really big issue and that’s
why I homed in when I talked about business purpose and trying to change
the dynamics of it and trying to get people to kind of lower their expectations. I
think one of the reasons why private equity has turned out to be such a
malevolent force in Britain, and so unconstructive, is actually the rates of
return within these five year periods in which they have the funds under
management are incredible and they become forcing houses for kind of really
silly investment decisions. So I mean I think that we need – I mean the
chancellor’s, I know, well-intentioned on this but the amount of money that the
pension funds, insurance companies come up with is really trivial, sadly.

**Question 2:**

I’ve had 50 years’ experience of an organization called a health service where
on the one hand you’ve got guys like myself who have to sort out chaos and
uncertainty as it’s going forward against the managers who behind us want to
ensure that under no circumstances can they be found to be blamed for
anything that’s gone on, so you have a sort of whole tick-box mentality. I look
in *The Economist* and I see all the business schools which, it seems to me,
are replicating this managerial structure to prove that you can actually do
nothing wrong. You’ve got this totally retrospective approach within those
types of organizations. It does seem to me from what the ladies have said,
and my own view anyway, that one’s got to actually go out into clear blue space and start going forward. But how are we going to nail down not just the managers but, equally, more than managers, the civil servants who want to prove there’s no way they could have possibly have done anything wrong working in Michael’s department when he was a minister? How are we going to deal with this impossible chasm between the retrospective guys on the one hand and the girls and boys, like the people I respect in my job, who are going forward and understand chaos theory and uncertainty?

**Mariana Mazzucato:**

Well I think that’s a really important point and I think what it highlights is that, if you look at some of the most important areas within strategic management, it’s actually been applied precisely to the problem you raise but in the private sector, so when you have a mature corporation how do we revitalize it and actually get it to welcome failure and to create revolutions from within? But by dismissing the role of the public sector, right, as at best again fixing market failures and not being a lead creator and shaper of markets. We haven’t applied those lessons within the state. And if you look at the state agencies, because when I talk about the state I’m actually talking about a decentralized network of different agencies within all these countries that I’ve been looking at. But in the US, so in the Silicon Valley part of the world, if you look at what DARPA (Defense Advanced Research Projects Agency) did, but also ARPA-E (Advanced Research Projects Agency-Energy) today which is trying to do what DARPA did for the internet but in renewables, these are agencies that have very explicitly said if we want to do innovation and fund it we have to be innovation from within. We actually have to understand that we will fail and we have to welcome failure.

The problem is, however, that unless you also then have the population understanding what these agencies doing – and there’s no understanding of that, so even the whole Obamacare thing, you know, the state is meddling in your healthcare choices, how many Americans know that again 75 per cent of radical new drugs are coming out of NIH (National Institutes of Health) public funds, right, so if they knew that that whole debate would have at least been different, and so you’ve just raised an extremely important point because there is nothing in the DNA of the public sector that’s going to make it less innovative and less able to welcome failure, but you need a framework through which to understand that. And again, even in Singapore, or take BNDES (Banco Nacional de Desenvolvimento Economico e Social) which in
Brazil is one of the lead innovation agencies, it’s their state investment bank, they’re thinking very clearly about this. They’re saying if we’re going to be funding innovation we have to completely do different types of risk analysis. We have to be able to differentiate the risk that comes from actually investing in these really scary areas from the kind of risk just because a company is not a very good investment, and banks actually don’t know how to do that.

So we did a study with an Italian bank and actually looked at their credit scores, and we found that they had an equal probability of giving a bad credit score to very productive companies and very non-productive companies and then we asked ourselves why and that’s because the very productive ones are actually investing in these really difficult areas and those are high risk, and the banks don’t know how to differentiate that. So these are related topics on how to get places like BIS and the TSB (Technology Strategy Board) to also be innovative within and not just through is a huge challenge.

Kathryn Parsons:

I’ve seen incredible innovation being embraced, and innovation for a lot of people at the moment is really kind of overlapping with digital and transformation because they’re seeing that affect their business. From a senior level I’ve actually been really overwhelmingly impressed, and there’s a lot of young innovation happening. But then, funnily enough, with the bigger businesses what happens is they then look at their kind of middle layer, which I suppose you could call like it’s the biggest part of their business, and they see incredibly traditional skill sets and it’s quite a scary realization when you think well can I hire from the outside? No, that’s not going to change things. How do I change from the inside? The answer is you need different skill sets and actually those hybrid skillsets maybe need a lot less of those skill sets, so that’s quite a scary thing. But yeah, no, I do love this culture of embracing failures and testing but as long as the ambition isn’t to fail.

Mariana Mazzucato:

Can I just give one really important example in the UK which to me just says everything, so Government Digital Service was going to make this new website so people actually didn’t go to Google but went to a government website to do searches, and initially they were like oh, that’s going to require all these kind of Silicon Valley skills and we can’t do it, we don’t know how to do that, so they outsourced it, to whom? Serco, and Serco charged them 25
million to make a completely crap website that was very static, not dynamic, and then someone from within government said why don’t we just hire within government top coders and software designers, and they spoke to someone in the BBC - because the BBC did iPlayer from within, that’s completely anti-tendency where we outsource that kind of things, right, in a public agency, the BBC as a state agency. And they did that, they brought in all these geeky guys in government, civil servants, and now they’ve just won this really important design prize, so YouGov, and it’s costing government 10 times less than what Serco is charging them. But that requires us to hire within government these top skills, and can we do that with all this pressure on the budgets?

**Question 3:**

I think several of the speakers suggested there may be a role for Europe in all of this, and innovation is certainly a word that gets used a lot in Europe and increasingly has not insignificant funding linked to it available to both the public and private sectors. My question is how damaging is the current attitude within Britain towards the EU or within government towards the EU in terms of fostering that relationship? Does Britain need to be looking outwards as well as inwards in order to support innovation?

**Michael Heseltine:**

Well, of course, you’ve only got to look at the last thousand years to realize that there’s always been something of a controversy to our views about Europe, and that hasn’t changed and I doubt if it will. But if you ask a specific question, is it doing as harm? Of course it is, because the UK isolationist party is peddling a world which doesn’t exist. The idea that we can be independent of Europe, we never have been independent of Europe. It is on our doorstep, it is our marketplace, it is just there and if you think you’re going to be outside it, very well, they’ll fix the rules as 60, 40, 50 per cent of our trade goes there, the conditions upon which the products can go will be determined by them and not us. And it’s called the common agricultural policy of 60 years ago when we said no, and so the farmers of France fixed a deal with the industrialists of Germany that suited them and not us, and we’ve been complaining ever since.

We have this extraordinary view in this country that we’re so much cleverer than everybody else. It makes me weak, frankly. The only real role for this
country is to be a pacesetter in Europe, is to have an agenda about investment, innovation, wealth creation, prosperity, human rights, all these things, and create our own impact on one of the world’s great groupings of power. And if you want to see the world of today, it is about great groupings of power. We are a midget in that context on our own. In Europe we can be a pacemaker and historically that has been a traditional British view. I don’t see a reason for changing it.

**Question 4:**

In particular, I wanted to look at how we could potentially cultivate the City’s already existing positioning amongst ultra-high net worths, family offices and its position now, it’s obviously a hub for wealth preservation. Now I’m taking a view more from ultra-high net worth, family offices, etcetera, that are viewed or worked with abroad, giving Mumbai India as an example. They may be investors but they’re also very, very astute in business and entrepreneurship, and the culture seems to be promoting of that. For example, an ultra-high net worth family they’ll put the children through university but then they’ll work in the business and develop business skills, whereas I come across to Europe and look at the American model of this ultra-high net worth segment and it’s really more of an investment, a preservation type of strategy. Now because the City, for example, over has 6,000 ultra-high net worths with 30 million or more and leading into the billionaires and it’s a trusted wealth preservation destination, how do you think we can utilize that more effectively to cultivate wealth creation amongst the innovators in this generation of entrepreneurs? Because we’re good for private equity, but look at the difference between VC in Silicon Valley and London. Thank you.

**Kathryn Parsons:**

I actually wonder where that culture came about from and where was the money created? I mean I do see a huge culture on the West Coast of entrepreneurs who are high net worth individuals reinvesting their money back into entrepreneurship. So maybe the kind of key is let’s create some more entrepreneurs, really successful entrepreneurs in the UK and that culture of they love business. They didn’t just do it, because it kind of landed on their doorstep, they will invest in other businesses because it’s part of their culture.
Will Hutton:

I agree with that in part. I do think that too much money in the city has been made through what I loosely call this kind of rentier world. I mean I do think the asset management business with its very high charges and so much of investment banking and impropriety trading is about knowing, because you make a market and you’re also an agent, you’re conflicted, you’re both sides of the bargain in a sense. I mean so much of what goes on in the city isn’t, in my view, about genuine wealth generation, or I think I would exempt some of Lloyds and some of what goes on in insurance industry when it was genuine risk taking, but a lot of it is about making money from money and charging fees in a very opaque way, and so when you actually end up being rather rich and having 50 million or 100 million, or whatever it might be, or more, you don’t actually know this world that Kathryn lives in. I mean you just don’t know it. What you know about is actually how to kind of play that game. And I think, and I’ve thought this kind of all my working life, I began my career in the City, I mean I know it’s better to have it than not to have it but I think actually we pay a very high price for it. Things may be just changing in the proximity of tech city to the City.

When I was in Boston recently, there was a kind of fantastic thing happening, I thought it was fantastic anyway, I really liked it, there were a couple of squares in Boston where all the postdocs from MIT were showing their latest inventions, and there were lots of stalls and it was like going around kind of a boot sale in a field in Wiltshire except it wasn’t that at all. Each stall had this extraordinary kind of innovative thing happening in it, and there were angel investors stalking and examining, hoping to get ahead of Kickstarter, and it was just a kind of, the whole thing as just, and I just thought to myself if in Oxford’s Broad Street there could be such a fair what a breakthrough that would be. You do a bit of that in Imperial don’t you?

Richard Sykes:

Yes.

Will Hutton:

But it’s so small. But it’s growing, and I think some of the people, they are high wealth individuals and they could actually take these risks and they could be persuaded that actually they could even lose 10 per cent of 100 million or
200 million and it wouldn't actually matter. But if enough of them did it the kind of paybacks in terms of actually getting a presence in a sector might be huge.

**Richard Sykes:**

Marianna, last word.

**Mariana Mazzucato:**

Yeah, so first of all I think one of the problems here in the UK is they don't even differentiate private equity in VC for say the capital gains treatment, the PAXs, and it was actually the Labour party that in 2002 reduced the time that private equity has to be invested from 10 years to two years, so actually made now VC, because it's the same thing, even more short-termist than it was. But this whole Silicon Valley thing, and I guess I should just almost just focus on that point because I kind of feel like it's getting repeated here, the whole myth; Tesla Motors, Elon Musk is now the big new Silicon Valley hero. 500 million guaranteed loan from Obama, right? So it's just not true that these guys are somehow there, they're welcoming all this failure, they're almost all state-backed, including the big companies like Compaq, Intel, Apple, they all got massive state money in the beginning, and unless you talk about that then you get into a major dysfunctional thing which Silicon Valley has today, which is the public school system. It has gone completely down the drain. Now how wrong is that? An area of the US that got massive state funding, the money has not come back to the taxpayers that funded it and we need to talk about that, otherwise just mythologizing all these entrepreneurs as if they sort of come out of nowhere.

**Will Hutton:**

It's true, you know, I've only spent days there and not weeks, but I mean when I'm there I mean you find an acknowledgement of that. I mean that's why the semiconductor industry's there. It was the Berkeley nuclear semiconductor Stanford, and you're right, they do say that, they do acknowledge that in fairness to them. I mean I spend time with some of the...

**Mariana Mazzucato:**

Sorry, who acknowledges it?
Will Hutton:

They acknowledge it. I mean the entrepreneurs, the venture capitalists.

Mariana Mazzucato:

Maybe the secessionist movement, they want to go into the coast, because they want to play… [inaudible]

Will Hutton:

Well it depends who you talk to but I don’t think there’s a – I mean I think we should talk about it but I think to accuse them of not talking about it misrepresents them. Some of them may not, of course, but I mean it is part of the discourse. I mean there’s also a recognition that actually the role played by the two universities too actually in fairness. I mean they don’t think they’ve all done it by themselves.

Michael Heseltine:

Can I just make one point, which is hopefully an optimistic point. The United States basically has had no interruption in its capitalist system for well over a century, and in this country the ravages of punitive taxation, 98p in the pound in the 1940s, nationalization of commanding heights of the economy, rapid periods of inflation have actually created a serious period in my lifetime in which the accumulation of private wealth was not possible and in which there was every incentive if you had a business to sell it for shares to the quoted companies of City of London as opposed to your friends who had cash, if they did, in the cities in which the businesses were occupied. It is in my view hopeful and incalculable the extent to which Nigel Lawson’s budget of 1986 began to change that process when tax rates came down at a top rate of 40 per cent, it was possible for the capitalist system to begin to regenerate itself. Since then there has been a massive increase in the number of small businesses. Now I don’t disagree with practically all the things that have been said about the City and its financial institutions and all that sort of stuff, but underneath there is a growth in the entrepreneurial opportunity of a very much larger number of companies, and if we can continue that to give the
certainty and the time, it is very possible that we will see a different approach in this country.

Mariana Mazzucato:

But the top rate under Eisenhower was 90 per cent.

Richard Sykes:

We finish on an optimistic note.

Mariana Mazzucato:

Ninety per cent under Eisenhower, top rate...

Richard Sykes:

Thank you very much. Thank you to all the panel, and thank you to you.