

The future depends on innovation

According to Government, innovation is the key to sustained growth. Not only can it take a business to new heights, it could also help pull the UK out of the economic quagmire. In this article Adrian Price, of Menzies LLP, considers what it takes to be an innovator.

The Government places a lot of faith in innovation. In his foreword to the Department for Business, Innovation and Skills' - Annual Innovation Report 2010, the Universities and Science Minister (David Willetts) described innovation as a key driver of economic growth. It is central to the Government's economic policy objective of achieving strong, sustainable and balanced growth across the country.

Yet according to the report, investment in innovation in the UK lags behind that in many other major developed economies. Between 2008 and 2009 business investment in research and development in the UK fell by 2.5% to £15.5 billion, while Government investment in research and development was valued at more than £9.4 billion in 2008/09. So what should the Government be doing to encourage the UK's 4.8 million small and medium-sized enterprises to be more innovative, and what are the necessary ingredients for success?

A small advantage

According to the Federation of Small Businesses (FSB), 64% of commercial innovations come from small firms. This is partly because of the decision making speed and smaller firms have a streamlined command chain, so things can happen quicker. The same can be true of medium-sized businesses, but structure and having to answer to shareholders can make large organisations less innovative. SMEs definitely have an advantage.

The success of many SMEs has been fuelled by innovation. It begins with having knowledge and talent, which means having the right people within your organisation. It is also about desire; you have got to want to innovate. If you recognise the benefits it can bring, you are more likely to commit the necessary time, effort and money. That commitment needs to be part of the organisation's culture and management must take a lead. Genuine passion is a key driver.

Innovation comes in many varieties and if you want to grow your business you either do more of what you do, do what you do but do it differently or you do different things. In most cases, innovation involves adapting an existing product or service to create something superior, otherwise there is no point.

Know your market

Innovation is not for everyone. Some businesses carry on doing more or less the same thing for years, but you risk getting left behind if a competitor launches something more attractive in your market. You have to assess regularly where you are in your market and ask whether developing something new could bring you greater success.

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If the answer is yes, you have to fully understand your market, otherwise you risk developing something your customers will not buy. Why develop something that offers your customers A and B if what they really want is C and D?

The importance of safeguarding your intellectual property (IP) cannot be overstated and it is recommended that you use a solicitor with direct experience of your type of business and innovation. Once your IP is fully protected you must consider whether you are best placed to maximise the market potential of your creation. Developing and knowing how to make a widget is only part of it, you might be best to leave bringing it to market to someone else, especially if you want to operate in new markets overseas. You might decide to sell licences or possibly franchise your idea.

Funding and taxation

Wanting to be an innovator is one thing, affording it is another, especially at a time when all costs must be tightly controlled. Often businesses do not have the funding, and bank loans and overdraft extensions are not easy to access. Shared costs via joint venture could be an alternative option, but only with a firm legal agreement in place.

For those who choose to do it alone, the Enterprise Finance Guarantee (EFG) scheme could provide a solution. It is described by the Government's support service Business Link as a guarantee facility for small businesses, intended primarily to improve availability of working capital through term loans and the consolidation of overdrafts. It will also support lending for business growth and development when a sound proposition may otherwise be declined due to a lack of security. EFG is available for sums up to £1 million to businesses in most sectors with a turnover of up to £41 million.

For large sums, private equity (venture capital) could be a possibility, while there are some innovation grants available. In the past, local education partnerships have started to take over from smart grants for technology and feeder grants.

Before seeking external funding, businesses need to work out how much money they require. Do you just need seed capital to test your idea, or significantly more money to develop, manufacture and market your product? Would you be better off leaving the manufacturing to someone else with lower costs, greater experience or possibly the distribution and sales channels you need? If so, you will need less money.

Research and development tax credits can ease some of the financial pressure. They function in two key ways. You can enhance your expenditure, so, for example, if you spend £100,000, you might get a tax write-off of £225,000, which can enable you to pay less tax by reducing your profit. If you are not making profit, you can cash in those R&D credits and get an 11% tax refund.

Incentives

Innovation can not be taken for granted and must be encouraged, particularly, but not solely, by the Government. UK tax rates are still too high and there should be more incentives. For example, the UK Patent Box scheme significantly reduces corporation tax on income derived from patents. Also, universities and research facilities have to be adequately funded, so the innovators and businesses of tomorrow can be produced.

We have some large industry left in this country, but the decline has been huge in recent decades. Great Britain PLC is now driven by SMEs that is where the wealth is being created. There is creativity and desire among such businesses, but they need to be encouraged if Britain is to become a centre for technological innovation. We can not all work in the services sector, can we?

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