

Government loans no remedy for biotech blues

Biotech start-ups need help in getting private funds, not taxpayer handouts, writes Joshua Gans. (*The Age*, 25th April, 2006)

PROFESSOR Mike Vitalie, in Saturday's *Age* (15/4), argued for a HECS-type scheme for biotechs.

The idea is that biotech start-ups would receive a government loan and would repay it as their profits came in.

Basically, it would be a loan that insured the biotech against its own failure. The goal would be to raise the amount of funding to the industry in Victoria.

Of course, that is what venture capitalists do now, except they do this by taking equity in the biotech start-up. For there to be a government-provided substitute, it would have to be that venture capital is suffering from some sort of market failure. Certainly, as Vitalie points out, less venture capital funding goes to Australian biotechs than those in other countries, but that does not mean there is a market failure in terms of a lack of supply of capital to the industry.

Alternatively, the constraint could be on the demand for capital. Not enough funding may be going to Australian biotechs because their profit potential may be lower than elsewhere.

Indeed, this appears to be the constraint on start-ups even in the US.

A few years ago, Professor Scott Stern (Kellogg School of Management) and I studied whether the demand or supply side of the capital market constrained start-up funding. Our thesis was, if the supply side really constrained start-up financing, then, when more money was provided by government, the returns to publicly funded start-ups would be higher in those industries where private financing was relatively low. That is, if it was low because of a lack of capital, then government-funded companies should outperform the market. Instead, if the constraint was on the demand side the opposite would be the case.

Companies in industries with little private financing would still perform poorly if the government helped.

Using data on more than 200 start-ups — privately and publicly funded — we were able to test our thesis.

We concluded that it was the demand side that constrained funding.

Publicly funded start-ups perform better where there is already a lot of private funding.

Thus, the government program was providing more funding but not improving the efficiency of the existing market-based venture capital financing.

This could similarly be the case for Victoria and the biotech industry in Australia. The implication is that, if we are choosing between spending government money on helping start-ups directly or instead helping them with commercialisation, the latter will have a bigger bang for the taxpayer's buck.

It is better to improve the prospects for start-ups to appropriate more of the returns from their intellectual property than to provide them with more capital.

This means it is unlikely biotechs in Australia need a HECS-type scheme. Instead, they need help in accessing commercialisation resources and overseas networks.

This suggests that core infrastructure might be a better way to spend Victorian Government dollars.

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