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COMMENTARY

Europe Needs A New Playbook For Growth

By ISAAC GETZ

Tomorrow, Tony Blair, Jacques Chirac, and Gerhard Schroeder will meet to discuss how to promote innovation and economic growth in Europe. If they want to do more than pay lip service to the "innovation gap" with the U.S., they should take this opportunity to revamp Europe's whole approach to the problem, which now rests essentially on two pillars -- pouring money into research & development and encouraging the filing of patent applications.

Consider the following analogy: Suppose the EU Basketball Team decides to enter and win the NBA title. Then, to achieve this goal, the team decides to maximize two things: the players' total salary and the number of passes during the games. Is this a good strategy?

For the last two years, the New York Knicks had the largest payroll in the NBA, but they failed even to reach the play-offs. At the other end of the spectrum, the two key players of the current NBA champion San Antonio Spurs, the Caribbean Tim Duncan and the French Tony Parker, didn't cost much to the team because they were hired as rookies. The passes measure is even more ridiculous, as any basketball fan knows that passing the ball around is not an end in itself. What counts are the assists -- passes that allow the receiving player to score points.

But when it comes to the European economy, a similar strategy for overtaking the U.S. seems to have gained credibility. A recent report by the European Commission argues that the innovative-capacity gap needs to be narrowed in order to compete with the U.S. How? Among other things by increasing research and development and the number of patent applications. This is the economic equivalent of the "salary and passes" strategy.

Regarding R&D, it is widely believed that its increase leads to more innovation -- new products and services successful in the marketplace. But the facts contradict this belief. There are plenty of examples of "Knicks" -- companies with expensive and intense R&D -- that consistently perform poorly. There are equally many organizations that have been high performers without doing that.

How did Lucent Technologies, which owns Bell Laboratories, perhaps the leading generator of inventions in the world, end up in so much trouble? How did Xerox -- which invented the

laser printer, ethernet networking, and the point-and-click interface -- perform so poorly over the last decade? DuPont, inventor of Nylon and Lycra, has failed to produce any major innovation since 1986 even though the company poured \$1.6 billion annually into R&D.

Cisco, on the other hand, did just fine, despite the bursting of the dot-com and telecom bubbles. When we asked one executive from Cisco, which recently became the world largest telecommunication infrastructure supplier -- and unlike Lucent is hugely profitable -- how it manages innovation, his reply was: "We just buy it."

And witness the latest data from the industry in the U.S. that spends most heavily on R&D -- the pharmaceutical industry. Several studies based on data from the Food and Drug Administration and other sources explored the relationship between this industry's R&D investment and its innovation -- the number of new drugs put on the market. One key finding is that between 1991 and 2001 R&D spending rose to \$30.3 billion from \$9.7 billion while the number of new drugs introduced each year dropped to 24 from 30. Similar data are found in many other industries.

Now consider the economic equivalent of "basketball passes" -- patent applications. A cross-industry study estimated that out of every 300 initial experiments and/or patent filings, only 125 advance into full-fledged projects, and from these only 1.7 products are launched, with only one finally succeeding in the market. The same study also found that only 5%-10% of U.S. patents have any market relevance and only 1% of them actually bring any profit. In fact, patents themselves are a protective instrument. It is the number of patent citations ("assists") by other inventors ("players who score") that has been shown by economists as the best indicator of patents' relevance for profits. Witness IBM, which owns the world's largest patent portfolio. In terms of patent citations by other inventors it falls far short of the array of start-ups acquired by Cisco or even of a relatively small company like Micron Technology in recent years.

In fact, things are not all bleak; light may come from the best European practices in innovation management. These companies, in an array of industries, are gradually replacing the "closed" and "elitist" approach to innovation that calls for them to maximize internal R&D and the number of patents sought. They are not against R&D, but by espousing a new paradigm of "open" and "participatory" innovation, they put in place processes to involve company partners and all company employees into the corporate innovation effort. And the data supports them -- in companies that successfully involve their front-line employees in the innovation effort, the latter initiate 80% of innovative projects and those projects are also the most commercially successful.

So what can be done? The European Commission can promote best practices halting the current national R&D budget-based innovation rankings (like that of the British Department of Trade and Industry). Instead, it can implement a European ranking based on "open" innovation and make known the best practices in innovation management, thus encouraging other companies to implement them. And political leaders such as Messrs. Chirac, Blair and

Schroeder can put the emphasis back where it belongs -- on results, not on spending or patent applications.

There are excellent European basketball players -- Dirk Nowitzki, Tony Parker, Pau Gasol -- but they play in the U.S. NBA teams. Why? Because many NBA teams have an "open" approach, looking everywhere for talent. Unless Europe's economic team abandons the belief that more spending and more protection bring performance, it may never compete on the U.S. level. If the Knicks, a team in the most European U.S. city, New York, could do it (they have started to innovate thanks to their new manager, Isiah Thomas) there is hope for everyone.

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