

Presentation Brussels Economic Forum 18/5/2000

1.

Research & Development and Innovation: Ensuring a Competitive Edge

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Ladies and gentlemen, common wisdom has it that by increasing R&D efforts, innovation is stimulated. The patent system plays a crucial role in enticing investment in R&D by providing the protection that is required for adequate financial returns. It is further assumed that these protected innovations are brought to the market by competitive, small and nimble companies, the engines of economic growth.

2.

Different perspectives on

Innovation

The patent system

The respective roles of small and large companies

Identifying

EU potential

Beneficial shifts in policy

Over the next 20 minutes I will offer an alternative view on innovation, the crux of the matter, which will cast the patent system and the role of small and large companies in a different light.

In turn, this will help to identify considerable potential for EU economic development and finally I will make a few recommendations that should help to bring the desired future closer

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3.

Examples of innovation

Let me start out by identifying three kinds of innovation among many that do justice to the fact that 70% or more of EU GDP consists of services

Blends of designer products and services, co produced with customers

The perfect example is the I pod. Apple used its brand, its experience in outsourcing production, a set of proven technologies, its marketing expertise and distribution channels to bring a well-designed seemingly conventional product to the market. The outrageous success came because customers had to download their preferred music and radio programs themselves. The ultimate product became a co production and created far more value where it counts: in the eyes of the customer.

We also see the explosion of Internet banking, interactive gaming, educational theme parks, and patient self-monitoring.

Improvement of production processes

At no occasion can construction companies effort to tender on the basis of the calculated cost of the project. They have to put their trust in their engineers and workforce to come up with improvements in design and execution during the construction process to bring cost down and improving the end result. Only tried and tested technologies can be used if only for reasons of safety and the environmental protection. The name of the game is blending the specific requirements of the work, practical experience and technology

Generating new services

JC Decaux has brought public transport companies, municipal authorities and advertisers together and provides and maintains well designed bus and tram shelters that provide unique opportunities for sophisticated companies to launch new products. One Dutch company is world leader in temporary shelter another in providing industrial pallets throughout Europe in a by definition highly decentralised organisation held together by ICT and a strong culture.

All these ventures expand, generate more and more economic value and contribute to the economic growth that Europe needs.

4.

In all instances economic value is created by:

Teams of professionals, composed, guided and supported by managers

Commercial talent and consultants with very different backgrounds are required. Managers become entrepreneurs by developing the business concepts, helping and protecting the teams and securing the financial and other resources for the business.

that use combinations of tested technologies

Given the many interconnections and the risks associated with the scale of the efforts the innovators could ill afford to have any weak links. R&D does play a decisive role.

and design new rules of engagement between employees, customers and partners

The days of the value chain are over. The trick is to create value constellations that consist of numerous partners who link up in new ways to capture opportunities that cannot be realized otherwise.

Protection against the competition is not derived from patents, but from the uniqueness of the concept, an original combination of technologies and the creation of a social and legal structure, all features that, taken together, are very difficult to emulate.

Entrepreneurial success is based on a broad view of potential partners, of potentially interesting technologies, of partners that master a particular technology.

5.

The function of the patent system needs to change

We should stop emphasizing the commercial exploitation of legal definitions of newness. A more important function is the provision of access to what the world has learned at reasonable expense. The real success of the patent system is not measured by the extraordinary returns on a limited number of findings, but by the thousands of small and large licensing deals that are closed year after year after year. I am, for example, not aware of any new step in the world of biotechnology that does not depend on a string of platforms, procedures and

products developed in the past. It is still the case that in this industry no company, large or small, will refuse licenses for serious purposes.

6.

The patent system should become the cornerstone of open innovation

The question is how entrepreneurs gain access to the 4 000 000 patents in the world and the 800 000 patent applications that are annually added to the pool. Europe is well placed to enforce the original function of the patent system by:

Removing the constitutional barriers

We know the problems. Lack of a community wide patent and no single patent court

Seeking connections between all forms of intellectual property

With European design leading the world and good brand protection, combinations with tested technology should be facilitated

Facilitating licensing and cooperation throughout the EU

Anything to open up the internal market for intellectual property. The innovation exchange networks sponsored by the European Patent Office deserve more attention and support. All this goes to the core of the internal market. Any progress will far outweigh the impact of increases of R&D expenditure.

Stimulating European export and import of intellectual property to and from other regions of the world

European companies file more patents in the US and Japan than vice versa. The 60 billion or so that is presently exchanged between the regions in royalties and licence fees is already impressive but could be built on. A multilingual Europe could be the world's honest broker both on line and in bringing the best and the brightest together in top conference facilities in the most attractive places.

Adding applications in real life settings to patent information

The majority of patents is a long way away from reliable new technologies. It is therefore important, within the constraints of commercial conditions of exclusivity and confidentiality, to make information about applications available.

This is, at a minimum very much in the interest of the licensor in his quest for more licensees. There are many examples of technologies that crossed sector boundaries such as pneumatics, pumps, and particular computer soft and hardware.

The second important consequence of my view on innovation is that:

7.

Large companies play a crucial role

Source of funds

Providers of continuity

Masters of Marketing

Controllers of sales and distribution channels

Managers of teams

Managers of partnerships

Partners for governments

Only large companies have the financial resources to invest in large-scale ventures. They provide the continuity that is required for persistent step-by-step improvements. They are the masters of marketing and they own the sales and distribution channels. They can field any teams of specialists. They have the experience in managing networks of companies and institutions. They dominate world trade and the transfer of technology. They are partners in designing industry regulation that protect social and environmental interests.

8.

Unfortunately, their performance leaves a lot to be desired. The majority fails:

To introduce new products

Productivity of the world's largest pharmaceutical companies is for example extraordinary low. With industry expenditure of US 75 billion only 27 new drugs reached the market in 2005 which was an improvement over the 24 that

were introduced in the course of 24. Only now, with the pipelines empty large pharmaceutical companies start to look elsewhere.

To grow existing products

A recent and extensive survey shows that 80% of companies that try to grow fail. Unilever is one company out of many.

To invest

I only have to mention the oil industry.

To consummate acquisitions and mergers

80% of all mergers destroy economic value

To realising their ambitions to cut cost

The cost of cost cutting goes up all the time. In lost know how and embedded knowledge, in beneficial informal relationships, both inside the company and with partners, and in business opportunities,

To retain young professionals

Large companies are incapable to meet the very reasonable expectations of their recruits. Within one year 50 percent of them try their luck elsewhere

All this being the case we would be well advised to stimulate large companies to fulfil their crucial economic role. Again we have our work cut out for us, albeit of a more defensive nature. Prevailing westerly winds bring us the shareholder corporate model as a result of which:

9.

Too many large companies

Focus on shareholder return on investment

Simply defined as the increase in the price of the stock over the shortest period of time

It is assumed that the market capitalisation of the company is a proper reflection of its value. At best this only holds in the long run. This assumption has a

number of unintended consequences and unaccounted cost. For example, the convention to arrange governance and management control on the basis of the market capitalisation of merging partners are very harmful. AOL and Time Warner and British Steel and Hoogovens come to mind

Assume that persistent increases in profit per share produce higher share prices.

The Boston Consultant Group has concluded that no such link exists. This is very disturbing because it implies that even companies that take the long view waste resources by optimising this ratio.

Appoint managers for short tenures

Over the past 15 years the average tenure has come down from 10 to 4 years

Link remuneration to improvement in profit per share

With the variable part of the package exceeding by a factor 2 to 5 for the management and with tight management controls based on financial and operational targets, sticks and carrots, for the rank and file.

The combination of these features trigger policies and management practices that are harmful to innovation and economic value.

Only measures with an immediate impact on profit per share count such as share buy backs, cost reduction and acquisitions to cut more cost. As indicated, many of these measures are taken at the expense of long-term cash flows i.e. economic value or shareholder value. It must be one of the great ironies of our times that shareholder value is being sacrificed in the interest of shareholder return on investment.

Investments in plant and equipment, in market development and in the building of partnerships, that all dent profitability in the short term, are treated with suspicion. As a result less economic value is being created than possible. Value that is not being created is lost forever, but is of course nowhere recorded.

10.

The defence of Europe's competitive advantages

There is ample reason to challenge large companies to improve their performance. They are the recipients of impressive tax facilities and benefit disproportionately from government investments in infrastructure and education and from subsidies and grants, particularly in the field of innovation.

Furthermore, Europe should defend its position. It is the

Home of very different competitive ways to conduct business

European entrepreneurs still employ a range of models from family owned companies in many sizes, shapes and forms, to co-operatives and from co-operatives to foundations. Only 25 percent of capital requirements of European companies is met by stock markets. As a result many companies escape the web of expectations that bankers, analysts, strategy consultants and journalists spin around listed companies. Europe would be well advised to facilitate the free flow of money for investments bypassing the stock exchanges.

Cradle for new enterprise models

Public/ private partnerships tailor made in pursuit of combinations of private and public partnerships are just in their infancy. In addition, more and more countries allow the use of legal entities rooted in other member states. Organisational economics is a new field that deserves to be supported as do European business schools that break away from the curriculum of their American counterparts.

10.

In conclusion

In the interest of innovation and economic growth, there is ample reason to put the spotlight on the role of the patent system and the functioning of large companies.

Kenaupark 3, 2011 MP Haarlem, the Netherlands, May 24th 2006

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