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INNOVATION IN EUROPE

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INNOVATION is the principal long-term driver of economic growth. It flourishes when societies create the conditions in which managers and entrepreneurs are encouraged to take risks and hence generate new sources of wealth and work.

It is the activities of entrepreneurs, individual companies and clusters of companies that determine the innovation performance of any national economy. However, governments also have a major role to play in creating a business environment that is supportive of innovation.

This includes the establishment of a stable macro-economic framework that provides managers and entrepreneurs with the predictability needed to support long-term investments in innovation.

UNICE urges Governments to take action to strengthen the enabling conditions for innovation by creating:

- positive attitudes towards risk, enterprise, and new technologies;
- favourable market conditions, including high levels of competitive intensity, demanding customers, and attractive incentives;
- broad development and wide-spread dissemination of new knowledge and ideas;
- ready availability of well-qualified people; and,
- easy access to risk capital of all types.

This paper sets out a small number of policy recommendations which, taken together, will strengthen the enabling conditions for innovation in the European Union.

1. **Raise awareness of the importance of creativity and innovation for the economic and social well-being of all the citizens of Europe.**

   Cultural values of societies and the attitudes of citizens towards risk-taking, enterprise and new technologies are powerful influences on the ability of companies to innovate.

   They influence the willingness of managers and entrepreneurs to take risks, the level of demand for new products and services, technology choices for production processes, and career choices by potential employees.

   European attitudes are generally less supportive of risk-taking, innovation and enterprise than attitudes of individuals in the USA. European citizens are, in general, less able to cope with uncertainty and have a lower competitive drive than citizens in the USA.

   Unless there are changes in such attitudes, it will be difficult to achieve significant improvements in the levels of innovation in Europe and hence sustainable improvements in its competitiveness, growth, and employment.

2. **Demonstrate support for innovative and risk-taking individuals and companies.**

   Government policies and regulatory frameworks influence social attitudes.

   In many European countries, government policies and regulations add to the negative attitudes towards innovation. For example, obstacles are placed in the way of innovators, entrepreneurs and investors because bankruptcy legislation fails to achieve the appropriate balance between providing adequate creditor protection (for investors) and encouraging a climate of risk-taking (for innovators and entrepreneurs). This stigmatises failure and creates unnecessary exit barriers.

   - Attract more innovators to start businesses by reducing the penalties for failure and giving people a second chance.

3. **Remove obstacles to innovation and market entry**

   The incentives and the opportunities available to companies and entrepreneurs and the penalties and obstacles they face in markets are important drivers of innovation. Companies respond to high levels of competition, demanding customers and the presence of new market opportunities.

   Intense competition and the creation of new market opportunities depend on the presence of a regulatory framework and a physical infrastructure that facilitate technical change, the entry of new competitors, and the exit of existing companies.

   Regulations place obstacles in the way of innovation and market entry in many of Europe’s fastest growing markets.

   Regulations that control the approval of new products and services also affect the level of competition and the speed of development of new market opportunities.

Poor regulation and inefficient decision-making processes in Europe increase time-to-market, raise development costs, and create regulatory uncertainty, particularly for new science-based products.

- Remove or reduce regulatory and administrative burden (red tape) on companies (One-Stop-Shop, one single number).

- Deregulate markets for key industrial input, such as telecoms, energy, transport and financial services (more competitive pricing of these inputs will enhance European enterprises' competitiveness and ability to innovate).

- Avoid distortion in competition should be avoided; reduce State aid.

4. Improve the efficiency of spending on R&D.

Innovation depends upon the creation and dissemination of intrinsically new knowledge and ideas, and new concepts based on the fusion of existing knowledge, particularly in science and technology.
For western economies the level of investment in research and development is one of the principal determinants of their ability to generate and commercialise new knowledge and ideas.

As a proportion of its output, the EU invests less of its resources in research and development than the USA. There are, moreover, inefficiencies in spending by the public sector, partly because there are 15 national governments involved in spending decisions with some degree of overlap and duplication. Moreover, procedures for awarding contracts are inefficient in some countries because they are biased in favour of a limited number of research centres.

- Improve the efficiency of public spending on R&D.

- Remove barriers to co-operation between universities and business.

5. Improve the system for commercialising new ideas.

The ability of universities and research institutes to collaborate with business in the commercialisation of new ideas is important for both parties. For academics, it may be a source of additional (institutional) funds and personal (financial) rewards. For business, closer collaboration makes it easier, cheaper and quicker to commercialise academic ideas.

Collaboration can be undertaken directly by universities and research institutes or indirectly through technology transfer organisations. However, a number of regulatory obstacles stand in the way of effective collaboration and commercialisation by universities and research institutes in many European countries, as compared with the USA.
In some countries, regulations make it difficult to exploit government-funded innovations. In many countries it is difficult for a university to benefit from an equity investment in a spin-off company. Finally, it is difficult in some countries for university staff to work for private sector companies.

- Remove the restrictions on exploitation and commercialisation of government-funded R&D results and innovations (equity investment in spin-off companies).

- Promote technology alliances in industry by adapting competition law.

6. Improve the system for obtaining Intellectual Property Rights.

The system for obtaining and protecting intellectual property rights in Europe is less supportive of innovation than that in the USA. Although the quality of patents protection in Europe is similar to that in the USA, costs are greater and the time taken to obtain the patent is longer.

- Improve the system for obtaining intellectual property protection; there is, in particular, a strong need to reduce the costs and time to patent. The Community patent and the patent for software related inventions should be implemented.

7. Improve the level of education and training of individuals in the skills and abilities needed for innovation.

The availability of sufficient numbers of educated and skilled people who are capable of generating new ideas, using new technologies, and adapting to change is a critical input to the innovation process.

It is no longer enough for the basic education system to provide people with simple literary and numeracy skills. People also need more specialist skills to equip them for the future world of work, particularly in mathematics, science and technology.

Europe has not invested sufficiently in the development of key skills in areas such as mathematics, science and technology, including information technology (IT). Europe has also failed to invest sufficiently in more advanced scientific, technical, managerial and learning skills through the higher education system.

- Educate people with effective skills and abilities needed for innovation (e.g. science and maths, computer literacy).

8. Assist each individual to take part in continuous learning programmes, to improve their employability.

The skills and abilities that modern economies need to maintain and improve their competitiveness are changing rapidly over time.

Europe is failing to invest sufficiently in the re-education and re-training needed to ensure greater employability among people of working age, particularly among those sections of society that have lower levels of skills.

- Improve employability of the existing workforce, including the provision of assistance to individuals to take part in continuous learning programmes.

9. Develop more flexibility in the labour market, in areas such as working time, recruitment, dismissal, remuneration, and outsourcing.

Companies need to adopt modern flexible work organisations and performance-related reward structures in order to harness the full creativity of people.

This is important because, in many cases, innovation requires substantial changes within organisations. Re-training can help to achieve some of these changes; others require the recruitment of new people with relevant skills.

Europe's regulatory and fiscal frameworks currently inhibit the development of modern high-performance workplaces. Continued restrictions on temporary and fixed-term contracts, slow down the pace of innovation and the pace at which individuals find new jobs. Moreover, overstrict protection against dismissal discourages start-ups to recruit and longer their development.

- ➢ Enhance flexibility in the labour market; remove restrictions on temporary work.

- ➢ Facilitate employment by start-ups and SMEs; reduce indirect costs on labour for SMEs.

10. Ensure that innovators who receive part of their rewards in the form of stock options are not penalised too heavily.

Companies need to be able to use reward systems that link individual rewards to the performance of the company overall. Many successful companies use share option schemes as a tool for achieving this.

However, there are in Europe significant fiscal obstacles that limit the effectiveness of these schemes. The share of the 'gain' payable in tax by companies and their employees, for example, is much greater in Europe than in the USA.

Some European countries tax share options more punitively than others. In the least generous cases, full social charges (for employers and employees) and highest rates of income tax are charged against any gains.

This slows down the pace of innovation because it prevents companies, especially risk-taking SMEs, from motivating their senior employees most effectively, since they are affected disproportionately by high levels of taxation.

- ➢ Reduce overall taxation on share option schemes to improve risk-taking and employee motivation;

- ➢ Reduce overall taxation on individuals investing personal money in start-ups and early stage businesses.

- ➢ Reduce overall taxation on business to improve the ability of companies to invest in innovation out of their own resources.

11. Improve the availability of seed corn finance for new innovative companies.

Innovation often involves investment in the creation of intangible assets. These provide little in the way of collateral for loan capital. Hence new innovative ventures are normally financed through equity capital, from the savings of families and external investors (business angels and venture capitalists).

The number of adults who have made such investments is lower in the EU than in the USA; and the total sum invested by business angels and venture capitalists in new start-up companies is much lower.

This slows down the pace of innovation because insufficient funds are available for the start-up and early-growth phases of companies.

- Innovative companies need the right type of capital funding at the right time.
- Improve availability of and facilitate access to venture capital to help start-ups and allow financing of intangibles.
- Encourage direct investment in emerging innovative companies by removing obstacles (taxation) to use of stock option schemes.
- Develop access to the equity market (including pension funds) to finance the expansion phase of companies.
- Facilitate the process for a company to go public, by implementing a single quotation passport and harmonising accounting standards.

12. Time for action – the Lisbon Special Summit.

Europe is lagging in the New Economy and urgently needs to make decisions which will help create the framework conditions for innovation and growth. The Lisbon Special Summit will address the cluster of issues which should raise overall European factor productivity in the longer term. Concrete measures need to be taken using the upturn in the economy to put Europe on a fast track for economic growth and jobs.