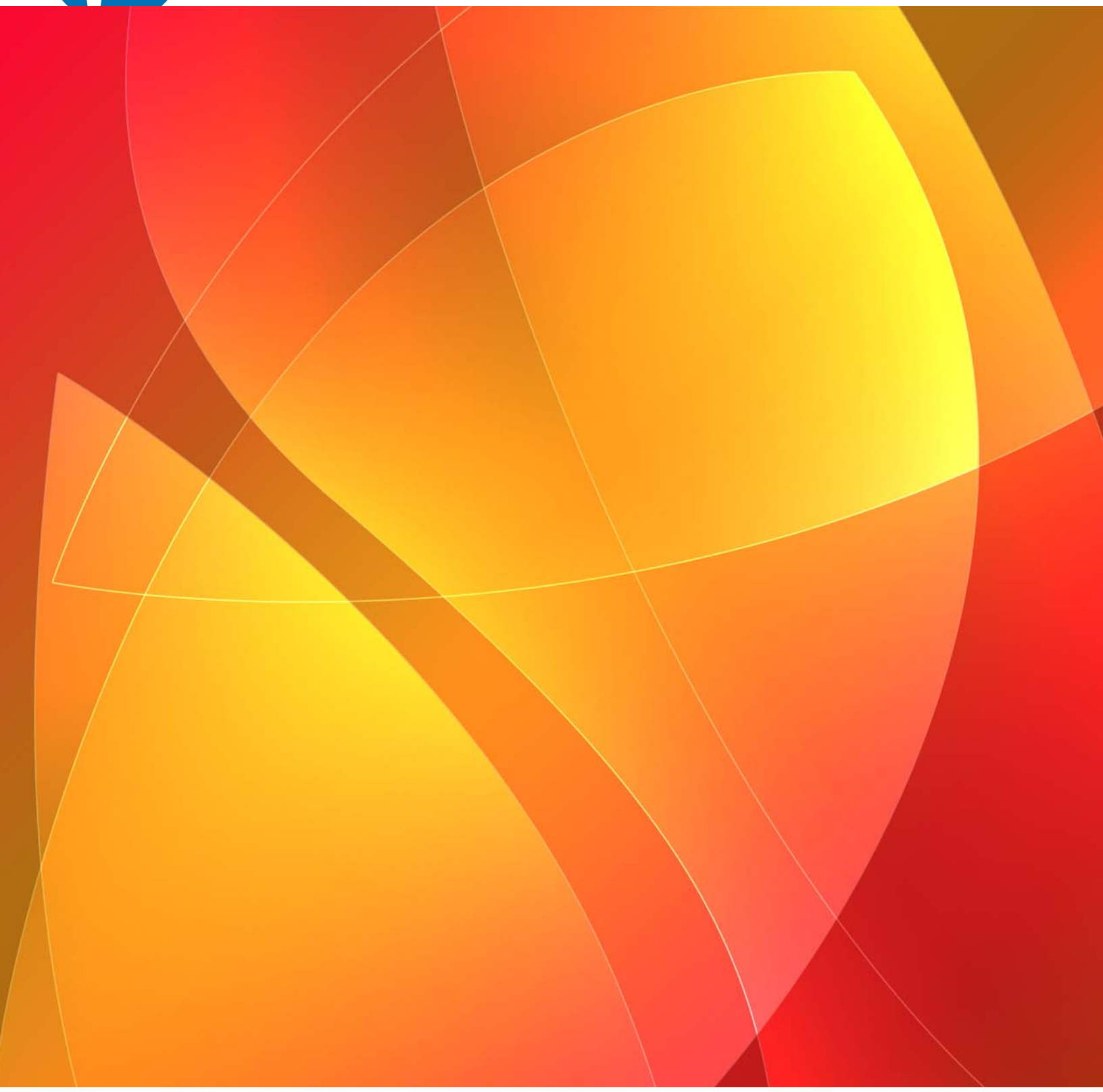
KEY FINDINGS

Innovation and U.S. Competitiveness

Reevaluating the Contributors to Growth



THE CONFERENCE BOARD
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Innovation and U.S. Competitiveness

Reevaluating the Contributors to Growth

Innovation is crucial to growth as traditional inputs of production – physical capital and labor – come under stress.

Innovation: The Lifeblood of Knowledge-Based Economies

The United States has been the global leader in innovation since before World War II. In recent decades, and since the mid-1990s in particular, strong U.S. economic growth has been attributable in large part to gains in productivity that flowed from the diffusion of innovations in information and communications technology.

Innovation is dependent on human creativity, entrepreneurship, and technical know-how. It flourishes in a competitive market environment that rewards the development of new products, services, and ways of doing business. The United States has enjoyed a fertile environment that effectively combines a talented and educated population with capital, investments in R&D and organizational innovations, and protection of intellectual property.

That successful mix, and the resulting competitiveness of the United States, is under threat. It is critical that short-term cost cutting and the dynamics of the economy do not divert attention from the long-term threats to U.S. competitiveness that are already present.

The U.S. Economy Is Losing Its Innovation Edge

Innovation is both endless and relentless. To maintain a competitive edge, a knowledge-based economy needs to produce a continuous pipeline of innovative new products, services, and processes to replace those that are maturing – a particularly difficult challenge in a down economy. But knowledge and innovation know no national boundaries. Other knowledge-based economies are becoming increasingly competitive. At the same time, the vast U.S. market, which has been a major source of innovative efforts, is being supplanted by the growing power and expectations of emerging markets. These trends, while doubtless beneficial globally, may rob the United States of its role as the leading knowledge economy, unless it can find ways to make innovation self-perpetuating.

Changes in Education Needed

Educational attainment drove the early stages of the U.S. technology boom, but the rate at which Americans are earning college degrees is slowing. More important, the educational content of curricula will have to change to catch the next innovation wave. Continued innovation requires creativity, critical thinking, and problem-solving entrepreneurship. Companies are complaining about a shortage of skilled technicians and managers even as demand for those talents is exploding in other countries. There are benefits from increasing flows of high-skilled immigrants, but the numbers are too small for immigration to be a silver bullet. Unless these problems are overcome, the United States faces an extended period of more than a few quarters of slower growth and reduced competitive capacity.

Innovation Spending: CEOs Can't Get No Satisfaction

While CEOs rank innovation as the most important factor for long-term growth and profitability, large numbers report that their companies are weak at fostering innovation. In several surveys, many CEOs have said that they did not have or were not sure if they had the right organizational structure to spur innovation. CEOs also report little satisfaction with the results of their spending on innovation. Confidence in the ability to turn innovation into profits is waning. One of the most significant long-term challenges confronting companies trying to innovate is the lack of technical and management expertise.

Stop Treating "Intangible" Inputs As Costs – They Are Investments

Businesses are struggling to understand the process of innovation. There is no coherent analytical framework to measure and evaluate the impact of innovation on economic growth. Standard accounting systems treat inputs that produce innovation – research and development, marketing, human resource development, improved management capability, and strategic planning – as expenses rather than investments. These "intangible" inputs to innovation must be recognized for what they are and measured appropriately. This is not just an academic exercise. It is a critical part of taking the necessary steps to stimulate innovation within firms and society as a whole. Moreover, it will only be when investments in intangibles are adequately measured that markets will recognize the value of investments in intangibles and reward the companies and industries that are undertaking the necessary investments. Innovation must also be understood as not just breakthrough discoveries, but also as incremental improvements in the usefulness and efficiency of existing products and processes.

What we found ....

Innovation is crucial to growth as traditional production inputs plateau.

The U.S. competitive edge in innovation is eroding.

To catch the next innovation wave, U.S. educational curricula must change now.

High-skilled immigrants contribute, but immigration is not a silver bullet.

CEOs rank innovation as critical, but are unsatisfied with the results of their investments in it.

Standard accounting systems must stop treating "intangible inputs" to innovation as costs and regard them as investments.

Innovation depends on an active, cooperative effort between government and business.

Restoring Innovation and U.S. Competitiveness

A favorable environment for innovation requires a cooperative effort between government and business aimed at developing the increasingly critical intangible inputs to innovation. Educational institutions and the business community need to put much more emphasis on creativity, critical thinking, and entrepreneurial problem solving. The benefits from the global migration of skilled labor need to be captured, but they cannot fully resolve the shortages the United States will face in the long term. There is also a need to find the right balance of intellectual property policies to ensure that innovation is encouraged and rewarded while promoting incremental gains in the utility of products, services, and processes. Finally, there is a need for accounting and analytical approaches that better allow a measure of both the inputs to innovation and the economic growth that results from them. Only by understanding innovation's economic value and harnessing its power will America be able to act on it and maintain its competitiveness in the future.

To order the research report *Innovation and U.S. Competitiveness* (R-1441-09-RR) or more copies of the Key Findings, visit www.conference-board.org or call 212 339 0345.

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Funding for this project was generously provided by the Microsoft Corporation.

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