

Session 8

The Private Sector Response to Economic Challenges Facing Canada

CHATTER

A. Sulzenko OK, I'm going to – Ladies and Gentlemen, we're going to start the session now. I'm Andrei Sulzenko. I'm chairing this session called The Private Sector Response to Economic Challenges Facing Canada. We've heard a lot over the last day and a half about the challenges facing the country and now it's time to focus our debate on how we're going to react to the challenges and act to seize the opportunities. This session looks at possible responses from the private sector. The session following this one will be from the public sector. I'm pleased today to have Professor Randall Morek, right here to my immediate left, of the University of Alberta, who will be presenting his paper done with a colleague professor, Bernard Young of the University of Michigan entitled The Corporate Response Innovation in the Information Age. Let me as well introduce the 3 panelists who will comment on the paper. From, and my immediate left, Jim Frank, the Vice-President and Chief Economist at the Conference Board of Canada. To his left, Roger Martin, Dean of the Joseph L. Rotman School of Management at the University of Toronto. And to my far left, Bob Baldwin, Director of Technical Services at the Canadian Labour Congress. We'll now turn the floor over to Professor Morck for his presentation.

Prof. Morck **INSTRUCTED NOT TO TRANSCRIBE**

APPLAUSE

A. Sulzenko Thanks Randall for that provocative talk. I don't know what kind of set up it is for our, our panelists and I'll let them decide. And I think we'll, we'll start with, with Jim Frank. And I've asked the panelists to try to limit their remarks to about 10 minutes and that'll still leave us about 10 for question and answer.

J. Frank Thank you Andre. I should identify myself for some of you who don't know who I am and what I do. I'm one of those people that has spent a goodly part of my professional life trying to forecast with econometric models. And when I started to read this paper, I wasn't quite sure whether it was going to be a piece that would spend 50 pages attacking the veracity of forecasting in general, or just exactly what it was going to do.

So, when the paper starts out by pointing out that just about all forecasts are wrong I felt a little nervous because we forecast quarterly and we

actually put numbers on our forecasts. And, I thought, if he's going to take this position, why would I carry on reading. After all, anything that he writes which would have a considerable forecast tinge to it, given the premise of the piece, would obviously be wrong.

In any event he wasn't terribly deterred in making his own forecasts despite his initial position. I went through the piece and counted 28 predictions! Now none of them – Randall – have any numbers in them. So they're particularly good predictions and I'd only like to read one here for you because I think it's especially good. It's the classic if/then prediction. It says, "If high income taxes push innovators out of Canada and/or lower the countries innovation rate by reducing the returns to innovators, there could be heavy costs to bear in the longer term." Now either it is a problem or it is not a problem. So I don't know what to think.

I just want to editorialize a few more moments before I become more serious. I felt very much like I was back in my student days when I read this because it's an excellent primer on the Austrian school of economics and the assumptions, values and concepts that underpin this line of thought. First, the basic ideas that people are driven by greed and risk aversion seem to me to be perhaps an extreme statement, but nevertheless there's some truth to it, as pointed out in the piece. And incentives obviously make a difference in what we choose to do in life and business. I must confess that a lot of the points and ideas in the document are ones that I share.

So with this in mind, I would like to make these few points about innovation from the point of view of the Conference Board of Canada and some of the work that we've been involved in over the last number of years. We'll be publishing our 4th annual report on Canada's *Performance and Potential* and we are spending a lot of time on the issues of productivity, brain drain, income distribution, quality of life and, of course, innovation. And I guess the perspective that I could offer to you in response to what Randall has presented here today is reflected in our *Performance and Potential* work.

All of us I think understand what we mean when we talk about innovation. It has something to do with finding new ways to do things or new things to do that other people haven't thought of. It's in that sense both a process and an outcome. And it's very hard to quantify this concept for any kind of serious research.

And in fact Randall doesn't even define innovation! Now we don't either, with any degree of precision, except that we say it's an effort to squeeze more useful "stuff" or economic value, out of the knowledge that we have as a society.

But there are virtually no measures of innovation itself. So it's a great topic to talk about and to forecast and make predictions about because of course if you can't measure it how will you ever know if you've got it or don't have it!

Now, in truth there are indirect measures and we heard some this morning about our patents issued and so on. And it is our view also, at the Conference Board that Canada, that our country has a serious innovation shortfall. It's related to a lot of things, our industrial structure, ownership structure and what I would argue is a long-term tradition of protectionism in this country.

We also think that just because only 4 or 5 per cent of Canadian companies do any serious R&D, that we can't argue that they are the only ones that might be innovative. If you talk to business people, they will all say they innovate. They innovate in small ways, and in big ways; they try to find a leg up on their competition and so on. But it's a moving target because it means different things to different people. In mining or in high tech, innovation has different meanings and so we have to measure and research it differently.

We believe that innovation is about ways of doing more than just cutting prices. In fact the goal of most businesses that I deal with is to try to get an innovation that does in fact allow you to raise prices. To earn what economists would call monopoly rents. And those profits supposedly move on into employment gains and hopefully successful long-term employers of lots of people.

Profits in innovative firms have to reflect the ability of those managers to outperform their competitors. And that ability to out-innovate or outperform has to be rewarded with higher rates of return, somewhere in the system. You have to reward people for their risk taking and the dedication and the hard work that goes with innovation, particularly if you're talking of smaller or start-up organizations. Randall makes this point I believe quite correctly.

Remember that change always implies loss and Randall is quite correct when he talks about the Schumpeterian idea of creative destruction. I'm always conscious as a manager of the difficulty in making change occur. It's because people instinctively worry about the disinvestment in what they are already doing. Thus it is a real challenge to make change occur and it relates of course to ideas of incentives needed to support change.

Second point. Innovation is supported by all of the factors of production including management and leadership. And this isn't just the leadership of

the CEO, it's leadership at all levels in the organization. We think, at the Conference Board, that management and leadership is probably the most scarce resource we have in our organizations.

Now it's hard to prove that. But certainly when you observe how some firms are so successful in the same types of business as other firms, you do have to come to things like leadership, organizational culture and so on. We call this doing the softer, but harder, things better by being innovative in organizational processes, as opposed simply to adding more technology or more M&E investment. Thus we talk an awful lot in our organization, about finding ways to innovate in organizational structures, processes and so on.

What are we trying to do here? We're trying to get people to take risk. We're trying to reward them for taking risk. And we're trying to ensure that when they fail, which they will do most of the time, that they aren't penalized. And that's a very tricky business.

When we did our analysis on the Free Trade Agreement 10 years ago at the Conference Board, we thought we would see manufacturing productivity just take off in this country—economies of scale, access to bigger markets, all the usual drill. And yet we have not seen that. And we've been banging on that little drummer on manufacturing productivity for some time. It is my considered opinion, after having worked in the productivity area for the better part of 25 years, that a central issue goes around management, ingenuity, entrepreneurship and drive in Canadian organizations versus their competitors. And I think that's where we come up short.

Third point. We don't believe that R&D alone or technological innovation alone is where we have to look for successful innovation. Innovation is not an end in itself. Innovation is a competitive weapon as far as we can tell, or at least that's the way we see it. So what we're looking for here is innovations that help us get ahead of the next guy. And that means we have to be nimble, we have to be able to take risk, to change quickly and so on and we need incentive systems that allow us to do that.

We also think that diffusion of discoveries or new ways of doing things by other organizations is a key determinate for Canadian firms because of the low level of R&D that we do here and the nature of our markets. We all know about the better mouse trap that didn't get sold because marketing was poor or people didn't have the capacity to market and make the sale. Marketing abilities are one of those softer but harder things to measure.

And I would only say to you that if you believe the skill shortages in Canada are not just for carpenters at the moment, but are for

entrepreneurial talent that can really take ideas and operationalize them into successful products and services, then we have a serious issue around incentives. I'm reminded in this regard, about the Japanese. As you know, their management and operational prowess have fallen in and out of fashion over the last decade, but they have been able to innovate in some areas very, very effectively. I would draw your attention to the auto sector. Cadillac and Lincoln were around a long time before Lexus, Infinity or Acura were even thought of. Ladies and gentlemen, the Japanese niched that high-end market with a more innovative product than what we were producing in North America and they have changed the industry.

Now, my last point. On the public policy front I can only leave you with a simple message. It's a difficult one for governments because I think that what they have to do is ensure that the legal and policy framework is supportive and conducive of *change* and particularly *rapid change*.

And this is where the challenge arises because firms and people, who lose from change as I said earlier, are obviously going to look everywhere, and especially to governments, for help. And this of course is something that Randall points out. This naturally impedes change and innovation. So the less that governments do to stop or manage change I would say the better.

But this is a tall order in a society, and I'm going to say something perhaps you won't like to hear. I believe that Canadian culture is predominantly risk averse, egalitarian and entitlement oriented. In this regard the level of taxes on individuals and businesses are a central deterrent that gets in the way of innovation.

We know that startups and spin-offs require individuals to take significant risk and pay the personal price of doing this. And the vast majority fail. For those who succeed it usually takes several tries and years of sacrifice. Then, when they start making significant returns Her Majesty takes half of them. It doesn't take too long for folks to decide that perhaps they will look elsewhere to do their business.

I don't think Canada is going to change in this regard very quickly. And as a result I think we're going to lose out. And that's because there is truth to the idea that knowledge is central to organizational success and that services that are knowledge intensive can be supplied from various parts of the world.

My final reflection goes back again to a bit more lighthearted, I suppose, comment here. And that is that when Denis Gauthier called you, Randall, and offered you money to challenge directly some of the issues around looking into the long-term, it amazed me to see in your report that there was such a strong discussion around the motives of business and of course

public servants. So I thought to myself, now Denis, why would you ever hire somebody that is going to be challenging some of these points to the degree to which Randall has done.

I want to draw your attention if I could very quickly to page 25 where you say, “the Austrian perspective on public sector economics has led to a number of insights, among them public choice theory, which stresses lobbyists’ influence and the dynamics of politicians and bureaucrats’ self interest. In a nutshell, the idea is that politicians, bureaucrats and lobbyists all have the same human nature as everyone else and that government should be designed with this end in mind.” I was greatly relieved to see on the front cover that it says the views expressed in these papers do not necessarily reflect the views of Industry Canada or the Federal Government.

I enjoyed reading the document, it was fun. I think it’s by and large on the right track and I want to congratulate you for having the courage at least to put forward those ideas so aggressively. Thank you.

APPLAUSE