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Corporate R&D Spending in the Doldrums

For the second year running corporate spending on R&D is in the doldrums. Including Nortel's results, spending on research by Canada's Top 100 Corporate R&D Spenders was down by -5.1% last year. Ignoring Nortel, spending rose by a modest 1.9% despite the fact that revenues were up by 3.2%. This trend is a far cry from the double-digit spending increases in the late 1990s and early part of this decade.

Clearly, the optimistic target that was adopted by the federal government in 2002 - that Canada should move from 15th to 5th position in research spending by 2010 - will not be achieved. Not only is corporate spending not on the right trajectory, but the federal government appears to have dropped its commitment to double its own R&D spending in the same period. University research remains the only bright spot, but that too is dependent on the vagaries of government largesse.

What, if anything, can or should be done about this situation? Corporate R&D spending is the product of 4 intersecting influences: corporate self-interest, economic conditions, public sector incentives, and political factors. Let's examine these influences.

Corporate self-interest is a more-or-less constant force; it relentlessly pushes managers to improve their company's competitive position. R&D for new products or processes, or for cost reduction, is one way to remain competitive. Progressive managers will tailor their R&D to best address their competitive circumstances, but always in light of the prevailing economic and business conditions. When the economy and business are good, managers are more willing to invest in research, and vice versa. So, to some extent moribund R&D performance might be the lingering effect of the economic slowdown that came after the tech "bust".

Public sector incentives, such as the SR&ED tax credit program, clearly influence companies' R&D behaviour. These operate both at a federal and provincial level. Provincial add-ons to federal programs provide a greater incentive for companies to perform research, and there is evidence that they do work to increase the prevalence of corporate research. Public sector initiatives have been rather static for a number of years (in Quebec they are in retreat) and it

would probably be worthwhile to review the suite of incentives and programs to see whether they should be adjusted in light of current trends.

Political factors are harder to pin down, but are nevertheless important. Quebec's success in spurring corporate research in that province is irrefutable. Quebec's rich system of programs and incentives is no doubt the main contributing factor, but political understanding and commitment was the necessary precondition for putting these in place. "Business goes where business feels wanted" is an economic development truism.

Distinguished businessman Douglas Barber recently reported¹ that in interviews with CEOs he and Jeffrey Crelinsten of The Impact Group had found that "Canada's culture of commerce is the weakest in the developed world." One aspect of this is political support for commerce. Discussion of Canada's economic challenges was almost entirely absent from the last federal election campaign, as it was from the last Ontario campaign. Today, politicians are preoccupied with dividing today's economic pie and appear not to be interested in where tomorrow's pie will come from. Small wonder that many business people in Canada feel ignored by political leaders.

On the whole, business managers don't need to be reminded of the need to innovate, whether through R&D or in other ways; that is their job. General economic conditions are largely beyond the control of business and government and will inevitably ebb and flow. Adjusting macro-economic levers such as taxation levels, can have an indirect effect in the medium term. Government programs have proved effective and can be modified at comparatively short notice. Political leadership, on the other hand, is an ethereal commodity. In the short term either politicians "get it" or they don't. That's where industry associations and other groups come in – they can energize the political discussion.

These are 4 factors at play in determining how Canada will address its competitive future. If we believe that increasing corporate R&D is important we'll need to review the factors and see which can be influenced for maximum effect.

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¹H. Douglas Barber. Canada's Culture of Commerce - Our Weakness? RESEARCH Money First Regional Conference, Edmonton, AB, September 21, 2004