This PDF is a selection from a published volume from the National Bureau of Economic Research

Volume Title: Innovation Policy and the Economy, Volume 5

Volume Author/Editor: Adam B. Jaffe, Josh Lerner and Scott Stern, editors

Volume Publisher: The MIT Press

Volume ISBN: 0-262-10109-2

Volume URL: http://www.nber.org/books/jaff05-1

Conference Date: April 13, 2004

Publication Date: January 2005

Title: Education for Innovation: Entrepreneurial Breakthroughs Versus Corporate Incremental Improvements

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URL: http://www.nber.org/chapters/c10806

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Education for Innovation: Entrepreneurial Breakthroughs Versus Corporate Incremental Improvements

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Executive Summary

This paper explores several hypotheses about the appropriate education for entrepreneurship that encourages innovation: (1) breakthrough inventions are contributed disproportionately by independent inventors and entrepreneurs, while large firms focus on cumulative, incremental (and often invaluable) improvements; (2) education for mastery of scientific knowledge and methods is enormously valuable for innovation and growth but can impede heterodox thinking and imagination; (3) large-firm research and development (R&D) requires personnel who are highly educated in extant information and analytic methods, while successful independent entrepreneurs and inventors often lack such preparation; and (4) while procedures for teaching current knowledge and methods in science and engineering are effective, we know little about training for the critical task of breakthrough innovation.

Procter & Gamble has a world class, global research and development organization, with over 7,500 scientists working in 22 research centers in 12 countries around the world. This includes 1,250 Ph.D. scientists. For perspective, this is larger than the combined science faculties at Harvard, Stanford and MIT.... P&G holds more than 24,000 active patents worldwide, and on average, receives about 3,800 more patents per year. This makes P&G among the world's largest holders of U.S. and global patents, putting it on a par with Intel, Lucent and Microsoft.

Procter & Gamble, www.pg.com (accessed February 2004).

Edison, Thomas Alva. Born in Milan, Ohio, he had very little schooling.

Encyclopedia Britannica, *Britannica Ready Reference* (accessed January 2004). Edison's formal schooling ended by age 12.

Steve Wozniak, who built the first Apple computer, "was an undistinguished engineer at Hewlett-Packard." His partner, Steve Jobs, had just "worked part-time at a video game company," and neither had graduated from college. Bill Gates had dropped out *of Harvard in his sophomore year to start Microsoft, and Michael Dell quit the University of Texas in his freshman year to start Dell Computers.*

Bhidé 2000, p. 36.

In established businesses, innovation is mostly shaped through small, incremental steps of additional features to augment basic functionalities. With short product lifecycles, time to recoup R&D investments is limited.... Success is relatively predictable through the execution of well-defined innovation processes and in-depth knowledge of their markets in the respective business units.

A. Huijser, Ph.D., executive vice president and chief technology officer, Royal Phillips Electronics, The Hague, September 2003.

First, I present some preliminary observations on which the hypotheses at the heart of this paper are founded. Not surprisingly, only a tiny proportion of the enterprising founders of business firms actually engage in the innovative activity that is a key element in the extraordinary growth performance of the industrialized free-market economies. In fact, it has been suggested that something on the order of only 5 percent of firm-creating entrepreneurs engage in significant innovation. Rather, most private-sector expenditure on research and development (R&D) is attributable to extremely large corporations. These corporations are prime employers of scientists and engineers, personnel who are characteristically highly educated and technically erudite. Despite this concentration of knowledge, talent, and expenditure in these major enterprises, however, an examination of the list of revolutionary technological breakthroughs since the onset of the industrial revolution suggests that they were contributed in overwhelming proportion by independent inventors and small, newly founded enterprises, not by major firms.[1] Finally (and intriguingly), a review of the biographies of the most celebrated of these innovators shows, in a surprising share of these cases, a most remarkable absence of rigorous technical training and, in many cases, little education at all. The obvious names of yore—Watt, Whitney, Fulton, Morse, Edison, and the Wright brothers—illustrate the point.[2]

The preceding observations would seem to lend support to two surmises: that the concentration of R&D in corporate hands is a gross misallocation of social resources, and that education contributes little and may even be a hindrance to technical progress. Research recently undertaken by several colleagues and myself already indicates that the curious observations just listed are generally consistent with the facts, but that the dubious conclusions that they would appear to imply are incorrect and misleading. Rigorous education does play a critical role in support of technical progress, and R&D expenditure by the giant corporations *together* with the efforts of the independent entrepreneur-innovators provide a crucial contribution to the process. However, the corporate contribution and that of the innovative entrepreneur are characteristically different from one another and play complementary roles. The contribution of the two together is superadditive; that is, the combined result is greater than the sum of their individual contributions.

I. Education As a Help—and a Hindrance—to Innovation

Historical evidence indicates that the design of the educational process has significant consequences for two highly pertinent but very different capabilities of the individuals engaged in innovative activities. On one side, education provides technical competence and mastery of currently available analytic tools to future entrepreneurs and others who will participate in activities related to innovation and growth. On the other side, education can stimulate creativity and imagination and facilitate their utilization. But the following hypothesis is at least tenable: educational methods that are effective in providing one of these benefits may act as an obstacle to the attainment of the other. For example, the student who has mastered a large body of the received mathematical literature, including theorems, proofs, and methods of calculation, may be led to think in conventional ways that can be an obstacle to unorthodox approaches that favor creativity. And our preliminary evidence suggests that a comparable difference exists between the ways of thinking of the personnel of large industrial laboratories who focus on successive, incremental technical advances in product and process design, and those of the innovative entrepreneur (the inventive individual who is responsible for true technological breakthroughs). This finding suggests two companion premises: one related to education, and the other to the complementary activities of invention and incremental innovation. The first premise is that education designed for technical competence and mastery of the available body of analysis and education designed to stimulate originality and heterodox thinking tend to be substitutes more than complements. The second and more complex premise is that technical progress requires both breakthrough ideas and a protracted follow-up process of cumulative incremental improvement of those breakthroughs, with the combined incremental contribution of this second phase often exceeding that of the first. The industrial laboratories of the giant corporations are ill-suited to the provision of the seminal breakthroughs but are well-designed for the subsequent development tasks, which are indispensable for the full achievement of the technological breakthroughs. The study of these ideas promises to provide a deeper understanding of both the nature of education and that of innovative and inventive activity. In addition, it can perhaps suggest ways in which it may be desirable to modify the educational system in general and the preparation of future entrepreneurs in particular.

II. Background Evidence on Inventive Entrepreneurs Versus Incremental Innovators

There are at least three strands of evidence about the differences between inventive entrepreneurs and incremental innovators. The first is related to the types of contributions to economic growth that are characteristic of these two types of innovative enterprise, the second deals with the differences in the educational levels of inventive entrepreneurs and incremental innovators, and the third focuses on the nature of the educational process itself.

Type of Enterprise, Innovation, and Growth

The evidence shows that a rather sharp differentiation exists between the contributions to the economy's technological innovation that are provided by entrepreneurs and those that are offered by the large internal R&D laboratories of established businesses. Large business firms, which account for nearly three-quarters of U.S. expenditure on R&D, have tended to follow relatively routine goals, slanted toward incremental improvements rather than revolutionary ideas. Greater user-friendliness, increased reliability, marginal additions to application, expansions of capacity, flexibility in design—these and many other types of improvement have come out of the industrial R&D facilities, with impressive consistency, year after year, and they are often pre-announced and pre-advertised.

In contrast, the independent innovator and the independent entrepreneur have tended to account for most of the fundamentally novel innovations. In the list of the important innovative breakthroughs of

Table 2.1
Some important innovations by U.S. small firms in the twentieth century

Air conditioning	Heat sensor	Portable computer
Air passenger service	Helicopter	Prestressed concrete
Airplane	High resolution CAT scanner	Prefabricated housing
Articulated tractor chassis	High resolution digital X-ray	Pressure sensitive tape
Cellophane artificial skin	High resolution X-ray microscope	Programmable computer
Assembly line	Human growth hormone	Quick-frozen food
Audio tape recorder	Hydraulic brake	Reading machine
Bakelite	Integrated circuit	Rotary oil drilling bit
Biomagnetic imaging	Kidney stone laser	Safety razor
Biosynthetic insulin	Large computer	Six-axis robot arm
Catalytic petroleum cracking	Link trainer	Soft contact lens
Computerized blood pressure controller	Microprocessor	Solid fuel rocket engine
Continuous casting	Nuclear magnetic resonance scanner	Stereoscopic map scanner
Cotton picker	Optical scanner	Strain gauge
Defibrillator	Oral contraceptives	Strobe lights
DNA fingerprinting	Outboard engine	Supercomputer
Double-knit fabric	Overnight national delivery	Two-armed mobile robot
Electronic spreadsheet	Pacemaker	Vacuum tube
Freewing aircraft	Personal computer	Variable output transformer
FM radio	Photo typesetting	Vascular lesion laser
Front-end loader	Polaroid camera	Xerography
Geodesic dome		X-ray telescope
Gyrocompass		Zipper
Heart valve		

Source: U.S. Small Business Administration, 1995, p. 114.

the twentieth century, a substantial number, if not the majority, turn out to be derived from these sources rather than from the laboratories of giant business enterprises. For example, the U.S. Small Business Administration (1995) provides a list of important twentieth-century innovations for which small firms were responsible, and its menu of inventions spans an astonishing range (see table 2.1). Other studies come to similar conclusions. Thus, it is a plausible observation that perhaps *most* of the revolutionary new ideas of the past two centuries have been, and are likely to continue to be, provided more often by these independent innovators who essentially operate small-business enterprises.

I do not want to suggest that the routine innovative activities have not accomplished a great deal. Their outputs have usually been less dramatic and less spectacular, but if one takes their incremental contributions together and sums their achievements, it becomes clear that the accomplishments of the large corporations have been substantial. A clear example is the airplane. The comfort, speed, and reliability of modern passenger aircraft and complex military flying machines make the Wright brothers' revolutionary device a historical curiosity. Automatic piloting, communication, and location and computing equipment were surely undreamed of in the years following the first flights. And most of the sophistication, speed, and reliability of today's aviation equipment is probably attributable to the combined incremental additions made by routine research activities in corporate facilities. Other careful observers have extended such examples and have concluded that incremental and routinized innovation activities have been responsible for a respectable share of the contribution of innovation to economic growth in the twentieth century.

Educational Attainment of Personnel

All of this information is pertinent to the study of innovation and growth because my communications with several major firms with substantial R&D activities indicate that these enterprises generally employ at least some, and often a profusion of, persons with advanced technical training and higher academic degrees. In contrast, a preliminary sample of successful entrepreneurs and independent inventors indicates that they frequently have had only a basic education and that the core ideas were contributed by the entrepreneurs and inventors themselves (although at least some of them have consulted closely with more extensively trained advisers).

Education for Mastery of Received Knowledge Versus Education for Innovative Ideas

I will end this recapitulation of the preliminary evidence with an observation on a rather different subject, although for purposes of the study of the issues under discussion, it is closely related to the preceding observations, as will be seen below. This observation concerns the contrast between U.S. and foreign educational performance at different levels of education. It has been widely publicized that international comparison tests on subjects such as mathematics, physics, and other technical and scientific disciplines apparently show consistently that the performance of American students at the elementary school and high school levels is markedly inferior to that of some European and Asian countries. Yet the United States is universally considered the superior venue for Ph.D. training, so that the best students from the other countries in question vie for graduate positions in this country. Moreover, it appears that the American graduate students frequently produce the more original and more substantial dissertations. This difference in performance at the two levels of education is a paradox but, like many paradoxes, it may have a straightforward explanation. Maybe the educational approaches that are most effective in providing mastery of the already extant body of intellectual materials actually tend to handicap a student's ability to "think outside the box" and thus discourage unorthodox ideas and breakthrough approaches and results.

I am led, then, back to my first two premises. The exploration of these premises may, in Benjamin Franklin's words, constitute "useful knowledge" for the design of educational procedures, promotion of entrepreneurship, facilitation of the innovation process, and extension of equality of opportunity in a market economy.[3] Specifically, my colleagues and I are undertaking the study and testing of the following seven hypotheses:

Hypothesis 1. A disproportionate share of breakthrough inventions is contributed by independent inventors, entrepreneurs, and small or startup firms, while the large firms specialize in incremental improvements.

Hypothesis 2. A substantial proportion of startup enterprises involve former employees of large firms who left their former jobs because their large employer was unreceptive to heterodox ideas or offered little financial or other incentives to contributors of valuable inventions.[4]

Hypothesis 3. Training for mastery of currently available scientific and technical methods and materials is of enormous value for innovation and growth. But educational practices that encourage heterodox thinking and the exercise of originality and imagination is evidently also of great importance for society.

Hypothesis 4. The educational approaches best suited for the first of the preceding purposes may be quite different from those that contribute to the second. Indeed, the two approaches may be somewhat inconsistent, with promotion of the one objective tending to impede attainment of the other.

Hypothesis 5. The R&D division of the large firm tends primarily to require personnel who have undergone training for mastery of extant information and analytic methods, while the work of the independent entrepreneur and inventor may prove to be more effectively facilitated by avoidance of that sort of preparation to the extent that it impedes imagination and originality.

Hypothesis 6. Incremental improvement of complex products may require mastery of far more demanding technical information and techniques than was needed for the original ideas that resulted in the invention of those products. The technology needed to improve the design of a Boeing 777 passenger airplane is enormously more complex than that underlying the Wright brothers' first vehicle.

Hypothesis 7. Thus, while the two educational approaches are quite different and to some degree inconsistent, neither can be considered irrelevant or inferior. Each is essential for the process of innovation and growth, and it is important to investigate what educational approach is most appropriate for each task that underlies invention, development, and economic expansion.

Let us now turn to the preliminary evidence and see what it implies about the validity of the hypotheses.

Entrepreneurship and Its Role in the Growth Process

Entrepreneurship has long been valued as a key contributor to the growth of an economy.[5] Indeed, it is widely believed that economies that are abundantly supplied with entrepreneurs will tend to grow far more rapidly than those in which entrepreneurial talent is scarce. Yet Joseph Schumpeter himself, indisputably the twentieth century's prime contributor to the economic analysis of entrepreneurship and innovation, was led to conclude that the day of the entrepreneur was waning, that the expanding role of routinized innovation by big business was threatening to make the entrepreneur obsolete. I will argue here that part of the pertinent mechanism has been correctly discerned both by those who continue to have faith in the individual entrepreneur's critical role in economic growth but also by any who follow Schumpeter in concluding that routinized innovation by giant enterprises is assuming a primary role. But each side here is telling only part of the story and, as a result, overlooks much of the story's essence. The entrepreneur continues to play a critical part in the growth process, and there is no reason to expect that role to disappear. But in the modern economy, the entrepreneur, working alone in the marketplace, cannot carry out the task most effectively. Fortunately, the market mechanism has provided the partners that the entrepreneur needs for the purpose.

Market Pressures for an Enhanced Large-Firm Role in Technical Progress

Free competition—that is, competition not handicapped by severe government regulations or tightly enforced customary rules, like those of the medieval guilds that prevented gloves-off combat among rival firms—has arguably played a critical role in the growth of the capitalist economies. Of particular significance in the arena of innovation is rivalry among oligopolistic firms—those large firms in markets dominated by a small number of sellers. Crucial here is the fact that in today's economy, many rival oligopolistic firms use *innovation* as their main battle weapon. They use innovation to protect themselves from competitors and to beat out those competitors. The result is precisely analogous to an arms race—to the case of two countries, each of which fears that the other will attack it militarily and therefore feels it necessary always at least to match the other country's military spending. Similarly, either of two competing firms will feel it is foolhardy to let its competitor outspend it on the development and acquisition of *its* battle weapons. Each firm is driven to conclude that its very existence depends, at the least, on matching its rivals' efforts and spending on the innovation process. In an economy in which this is so, a constant stream of innovations can be expected to appear because the giant warring firms to whom the story pertains do not dare relax their innovation activities.

At least in the United States, the funding for innovation has been supplied increasingly by large oligopolistic enterprises, hardly the sort of firms that one associates with the entrepreneur. Today, some 70 percent of R&D expenditure in the United States is carried out by private business, and the annual level of real investment by the private sector is growing on a trajectory that seems near-geometric (figure 2.1). Most of this growing outlay is provided by the larger firms. According to

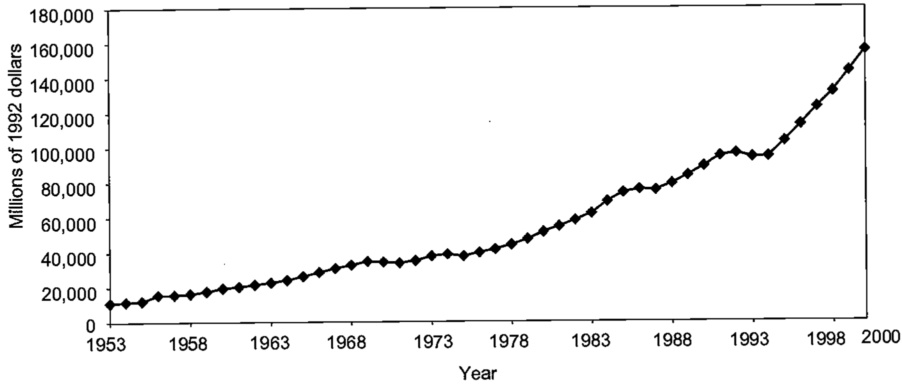

Figure 2.1
Real U.S. private research and development expenditures, 1953–2000.
Source: National Science Board 2002, and *Economic Report of the President 2002*. Expenditures are adjusted for inflation using GDP implicit price deflators.

data gathered by the National Science Foundation (National Science Board 2000, p. 24), in 2000, 46 percent of total U.S. industrial R&D funds was spent by 167 companies, each of which employed 25,000 or more workers; 60 percent of these funds was spent by 366 companies with at least 10,000 employees, and 80 percent was spent by 1,990 firms of 1,000 or more employees. At the other end of the spectrum, about 15 percent of total U.S. industrial R&D funds was spent by 32,000 companies, each of which employed fewer than 500 workers.

In the large enterprises, innovative activities are carefully designed to prevent unwelcome surprises and to keep risks to a minimum. As a result, there is little of the free-wheeling, imaginative, and risk-taking approach that characterizes the entrepreneur. Instead, the large firm's top management often keeps a tight rein on the activities of the company's laboratories, with budgets determined by the upper strata of control within the firm, which may also determine how many persons and what sort of specialists at what levels will be employed on R&D endeavors. It is not even unusual for management to determine what new products and processes the laboratories should next seek to discover. Large firms sometimes try to unleash their employees engaged in innovative activity by organizing a subsidiary operation that is more inviting to the free exercise of entrepreneurship, but often without much success.

The natural incentive system for a bureaucratically governed enterprise is to run R&D according to bureaucratic rules and procedures, which leads to the conjecture, voiced by Schumpeter, that the work responsibilities the economy assigns to the entrepreneur are narrowing and are destined to shrink even further. One can easily surmise what prompted Schumpeter to foresee a limited future for the entrepreneur where industry and its innovation processes are widely characterized in the manner just described. Yet I will argue next that this conjecture is a fundamental mischaracterization. Rather than being condemned to obsolescence, independent entrepreneurs continue to play a vital role.

Revolutionary Breakthroughs: A Small-Firm Specialty

It is convenient here, if patently inaccurate, to divide inventions into two polar categories: revolutionary breakthroughs and cumulative incremental improvements. Of course, many new products and processes fall into neither extreme category but are somewhere in between. Still, it will become clear that the distinction is useful. Many examples clearly fit into one category or the other quite easily. For instance, the electric light, alternating electric current, the internal combustion engine, and a host of other advances must surely be deemed revolutionary, while successive models of washing machines and refrigerators—with each new model a bit longer-lasting, a bit less susceptible to breakdown, and a bit easier to use—arguably constitute a sequence of incremental improvements.

The relevance of the distinction should be evident, given what has been said about the working and organization of R&D in the large business organization. The inherent conservatism of the process naturally leads to the expectation that these firms will tend to avoid the risks of the unknown that the revolutionary breakthrough entails. The latter, rather, is left most often to the small or newly founded enterprise, guided by its enterprising entrepreneur. Though that distinction is to be expected, the degree of asymmetry in the apportionment of this specialized activity between large and small firms in reality is striking. Earlier studies, such as those by Jewkes, Sawers, and Stillerman (1969); Scherer (1980); and Acs and Audretsch (1988), have provided evidence pertinent to this conclusion. Acs and Audretsch conclude that, "While some of the appropriability measures such as market concentration and unionization are negatively related to innovative activity, the extent to which an industry is composed of large firms is positively related to the total number of innovations" (p. 679). They go on to write that, while their results, "do not support an unequivocal conclusion regarding the exact differences in innovation behavior between large and small firms" (p. 688), the data suggest, "that, *ceteris paribus*, the greater the extent to which an industry is composed of large firms, the greater will be the innovative activity, but that increased innovative activity will tend to emanate more from the small firms than from the large firms" (p. 687). Scherer remarks in a similar vein that "the most favorable industrial environment for rapid technological progress would appear to be a firm-size distribution that includes a predominance of companies with sales below $500 million, pressed on one side by a horde of small, technically oriented enterprises bubbling over with bright new ideas and on the other by a few larger corporations with the capacity to undertake exceptionally ambitious developments" (p. 422, as quoted in Acs and Audretsch).

My hypothesis here goes a little beyond these conclusions, surmising on the basis of only preliminary evidence that small enterprises tend to produce a disproportionate share of inventions that are the heterodox breakthroughs. Table 2.1 is a list, made up by the U.S. Small Business Administration (also the source of the Acs and Audretsch data), of small-firm innovations in the last century. Its menu of inventions literally spans the range from A to Z, from air conditioning to the zipper. This remarkable list includes a strikingly substantial share of the technical breakthroughs of the twentieth century, including FM radio, the helicopter, the personal computer, and the pacemaker, among a host of others, many of enormous significance for our economy.

Two recent studies, also sponsored by the U.S. Small Business Administration (CHI Research 2002, 2004), provide powerful and more systematic evidence to similar effect.[6] These reports examine technical change through patenting and define *small firms* as "businesses with fewer than 500 employees." Perhaps most notably, the first of these studies finds that "a small firm patent is more likely than a large firm patent to be among the top 1 percent of most frequently cited patents." Among other conclusions, in the words of its authors, this study reports that "[s]mall firms represent one-third of the most prolific patenting companies that have 15 or more U.S. patents.... Small firms are more effective in producing high-value innovations—the citation index for small firm patents averaged 1.53 compared to 1.19 for large firms.... A small firm patent is at least twice as likely to be found among the top 1 percent of highest-impact patents as a patent from a large firm" (CHI Research 2002, p. 2). The more recent study found that "[t]he technological influence of small firms is increasing. The percentage of highly innovative U.S. firms (those with more than 15 U.S. patents in the last five years) that are defined as small firms increased from 33 percent in the 2000 database to 40 percent in the 2002 database." In addition, "[s]mall companies represent 65 percent of the new companies in the list of most highly innovative companies in 2002" (CHI Research 2004, p. ii).

As we will see next, however, large firms have made equally important contributions to technological progress. Though the small enterprises have specialized in the breakthroughs, they are not alone in making critical contributions to innovation and growth.

Revolutionary Consequences of Aggregated **Incremental** *Improvements*

The type of innovation in which the giant enterprises tend to specialize is primarily devoted to product improvement, increased reliability, enhanced user-friendliness of products, and the finding of new uses for those products. The approach tends to be conservative, seeking results whose applicability is clear and whose markets are relatively low in risk. As already noted, the bureaucratic control typical of innovative activity in the large firm serves to ensure that the resulting changes will be modest, predictable, and incremental. These firms are not predisposed to welcome the romantic flights of the imagination, the entrepreneurial leaps of faith, and the plunges into the unknown that often lead only to disaster but that alone are likely to open up new worlds.

Having recognized the critical role of the smaller enterprises, however, one should not go to the other extreme and undervalue the incremental contribution of the routine activity that at least sometimes adds even more to growth than do the more revolutionary prototype innovations. Though each such small improvement may be relatively unspectacular, added together, they can become significant indeed.

Table 2.1 provided a set of extreme examples of the contributions of the small, entrepreneurial firms. But one can easily obtain equally startling examples of the magnitude of the innovative contributions of the large companies, whose incremental contributions can add up to results of enormous magnitude. One such illustration is the progress in computer chip manufacture by Intel Corporation, which is the leading manufacturer of these devices and has brought to market successive generations of chips and transistors, on which the performance of computers is so heavily dependent. According to a recent report, over the period 1971–2003, the clock speed of Intel's microprocessor chips—that is, the number of instructions each chip can carry out per second—has increased by some *3 million percent*, reaching about 3 billion computations per second today.[7] During the period 1968–2003, the number of transistors embedded in a single chip has expanded more than *10 million percent*, and the number of transistors that can be purchased for a dollar has grown by *five billion percent*. These contributions are not minor. Added together, they surely contribute far more computing capacity than was provided by the original revolutionary breakthrough of the invention of the electronic computer. Of course, that initial invention was an indispensable necessity for all of the later improvements. But only the combined work of the two made possible the powerful and inexpensive apparatus that serves us so effectively today. Yet we must not ignore a caveat here. The 2004 CHI Research study reports that in their large sample, the 5.3 percent of all patent citations by large firms that entailed patents owned by small firms was substantially smaller that the small firm's ownership share (6.1 percent) of patents owned. "This suggests that large firms build upon the patents of small firms at a rate 14 percent lower than expected given the number of patents owned by small firms" (p. 11).[8]

III. Some Suggestive Intercountry Comparisons

Having set the background, I can return now to the central issue of this paper and its hypotheses: the role of educational orientation in affecting the amount and type of innovation, here distinguishing once more between breakthrough and incremental innovations. Because dividing innovations between these two categories is not easy, one cannot expect to find any systematic body of data that permits any formal test of the hypotheses. However, one can glean some suggestive observations from the available statistics on patenting, patent license revenues, and R&D spending and personnel.

Recall that one of the conjectures at least implicit in my earlier discussion is that the U.S. educational system is less effectively designed than that of most other industrialized countries to inculcate full mastery of currently available bodies of scientific and technological knowledge, but that this country's educational process is better adapted to stimulation of heterodox and imaginative thinking. The implication is that the U.S. system is better suited to the creation of breakthrough in-

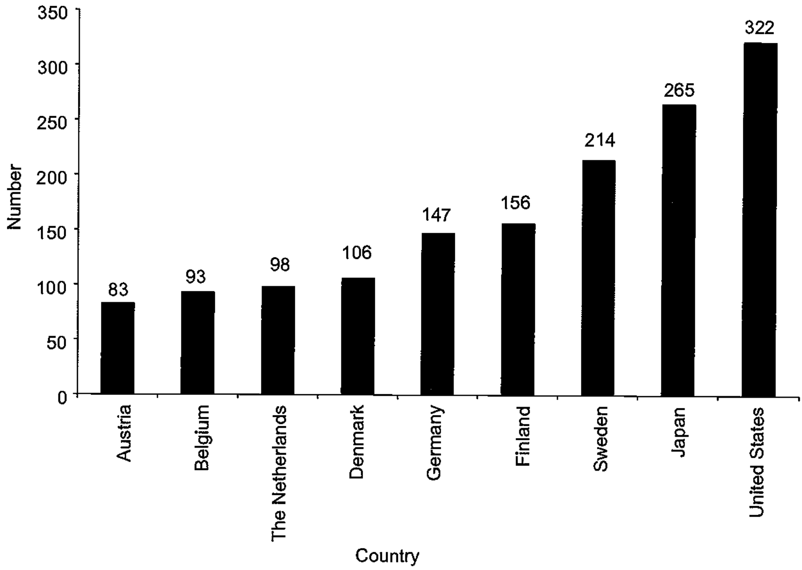

Figure 2.2
Number of patents granted per million inhabitants by U.S. Patent and Trademark Office, 2001.
Source: European Commission 2004.

novation but less well adapted to incremental innovation. Let us see what the data suggest about these conjectures.

Figures 2.2 through 2.5 include the nine countries that are the highest performers in whatever measure is at issue in each graph. Where the data are available, the graphs also include the Russian Federation, for a reason that will be brought out presently, though that country is generally far from the top performer in terms of each variable studied.[9] Figure 2.2 shows the number of patents per million inhabitants granted by the U.S. Patent and Trademark Office in 2001. It is clear that the United States itself is in the leading position.

Figure 2.3 shows receipts of royalties and license fees in U.S. dollars per person in 2001. First, we observe that, in this case, Japan ranks third from the bottom, indicating either a marked unwillingness to license or instead that its large number of patents have relatively little market value, a possibility consistent with its first-to-file patent system, which promotes rapid filing of a large number of patent applications that can be prepared quickly, are narrow in scope, and often represent incremental advances. We see that the United States is not the leader

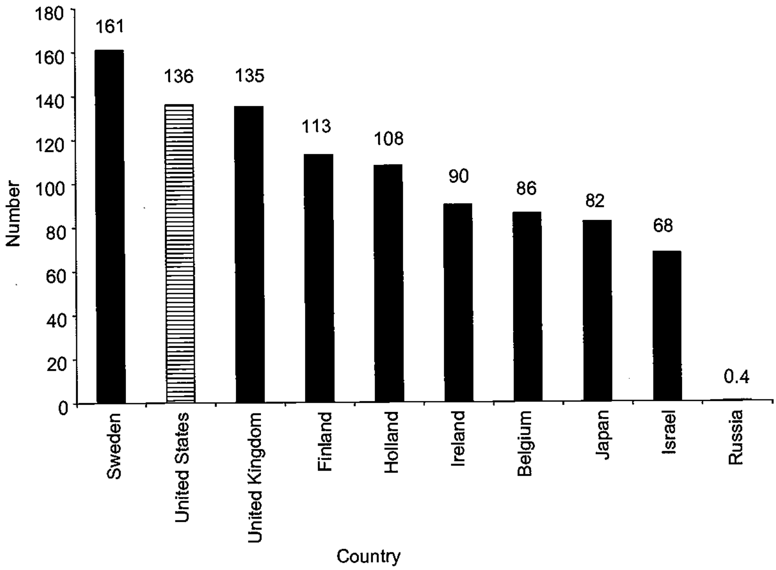

Figure 2.3
License royalties, dollars per person, 2001.
Source: United Nations Development Programme 2003.

in terms of license royalties per capita, but it is second only to Sweden. In contrast, as shown in figure 2.4, the United States is in the middle in terms of its R&D spending as a percentage of gross domestic product (GDP) (1996–2000), as well as in the number of scientists and engineers in R&D per million people (Figure 2.5).[10]

While nothing can be inferred categorically from this set of observations, they do at least appear to be consistent with the conjecture that superior performance in the number and economic significance of the inventions produced in the United States place it in or near the lead, despite the relatively mediocre levels of its per-capita expenditure on R&D and the number of persons with advanced formal education who are employed in this area. This lead surely is consistent with our conjectures on U.S. education, though one cannot claim any more than that.

A word should be added about the performance of the Russian Federation, which is close to the other end of the spectrum, at least in the number of scientists and engineers devoted to R&D, compared to its near-zero licensing royalties. It is suggestive here that technical training in the sciences and engineering in Russia has for many years been

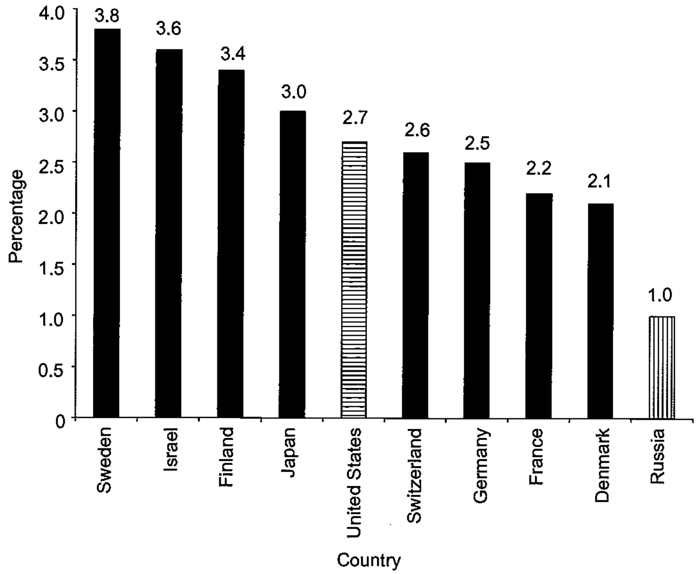

Figure 2.4
Research and development as a percentage of GDP, 1996–2000.
Source: United Nations Development Programme 2003.

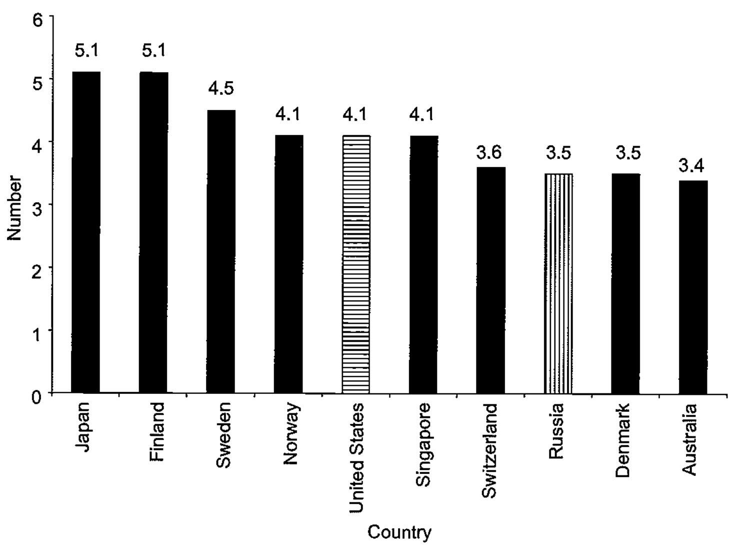

Figure 2.5
Number of research and development scientists and engineers per million population, 1996–2000.
Source: United Nations Development Programme 2003.

quite rigorous, satisfying exceedingly high standards. But the Russian data are even more to the point for an issue I have discussed elsewhere (see Baumol 2002, p. 67). I have argued that the former Soviet Union's poor performance in terms of innovation (including putting inventions to actual use), despite its fine body of scientists and engineers, was ascribable in large part to the absence of incentives for rapid and effective utilization like those provided in the free-market economies. The data described above seem to confirm that the Russian economy still has a long way to go before it achieves the full free-market stimulus to innovation and growth.

IV. Trends in the Required Education of the Entrepreneur

I have argued earlier that, by the nature of his or her task, the entrepreneur-innovator has required less advanced education than the industrial scientist and engineer who focus on cumulative incremental improvement. I have also suggested that such *limited* education has been helpful to the former, and indeed almost essential, as a way of liberation from the rigidities and standardized ways of thinking that current practice in higher education is apt to impose. Yet it is arguable that the advantages of limited education may be subject to diminishing returns. As time passes, the cumulative character of technological information makes it increasingly complex, and this complexity imposes an ever-more-severe handicap on relatively unaided intuition. Even ill-educated entrepreneurs, with Steve Wozniak and Bill Gates apparently prime examples, cannot usually get along without at least some limited knowledge of physics, chemistry, computer technology, or some other body of analysis and information. This complicates to some degree our hypothesis about the ideal education of the innovative entrepreneur. That hypothesis must apparently be modified to assert that while overly rigorous education is an impediment to exercise of the imagination (which is an entrepreneur's prime professional instrument), the minimum educational attainment characteristically needed for the task is nevertheless growing. No carpenter such as John Harrison (who solved the longitude problem) no mere bicycle repairperson such as the Wright brothers, can any longer hope to contribute, for example, today's mind-boggling medical breakthroughs. Two illustrations are the already extant and workable equipment that makes it possible for surgery to be carried out by computer-guided robots, with immediate and automatic restocking (without reordering or human intervention) of surgical equipment and medication (which is partly already in use); and remote surgery in which the operating surgeon, who controls the computer, may be thousands of miles from the patient during the procedure, which has already been done successfully (American Philosophical Society 2003).

V. The University's Role in Innovator Education

So far, I have omitted two other key players in the innovation process: the universities and the pertinent government agencies, which have also made major contributions to technological progress. I do not mean to undervalue their role—one need only mention once again the development of the electronic computer or the creation of the internet to illustrate their important contributions. But these institutions have also tended to carry out a rather specialized and different function from those discussed above. We must look primarily to these not-for-profit players for the results provided by *basic* research as distinguished from *applied* research.

The reasons for this division of labor with private industry are well understood, so that only a few words (but taking a viewpoint that is not quite standard) need be said on the subject here. I have argued earlier that the market mechanism is a powerful enforcer of corporate innovative effort, making mandatory its growing participation in applied innovative research. But the same market mechanism also inhibits investment in basic research, that mainstay of long-run innovative output. From the point of view of the unthinking market mechanism, investment in basic research is largely a wasteful expenditure because the outlay offers no dependable promise of addition to the profits of the firm.[11] By its very nature, it is nearly impossible to predict whether basic research will yield any financial benefit at all and, if it does, who will ultimately be the beneficiary. Certainly, it need not be the enterprise that was so improvident as to have carried it out. That unpredictability is why governments and universities have had to step in if truly basic research of any magnitude is to be carried out in the market economies.

The importance for technological progress of this contribution of academia and the public sector need hardly be argued. The focus here is not on innovation itself, however, but on the education of the innovator. Obviously, the institutions of higher education are at the heart of this process. And university *research activity* is directly pertinent to this subject. As the universities themselves frequently point out, one of the major purposes of research in the academy is the training of the researchers of the future. The participation of graduate students in the investigations of senior faculty members, as well as the research the students carry out themselves under faculty supervision, is clearly an effective way, perhaps even the most effective way, to equip the next generation to carry on the tasks of discovery and innovation.

Though their work at institutions of higher learning leans toward basic research, many of these students will, of course, go on to jobs in the industrial laboratories of private enterprise, swelling the number of employees with advanced academic degrees. Such research activity of the postgraduate students can help to prepare them for participation in either camp. It can offer them both types of education that have been stressed here: mastery of the currently available body of analysis that arguably is of primary importance in the industrial laboratories, and more free-wheeling exercise of the imagination in the unorthodox directions from which the technical breakthroughs are more likely to emerge. But there is also a danger here. As in any activity, many university teachers understandably succumb to the temptation of directing students to follow all too closely in their own footsteps, thereby leading to mastery of the already available research paths but weakening their ability to proceed in unexplored directions. There is no obvious way of eliminating this arguably widespread problem, but it may at least be possible to contain it to some degree if the evidence supports the educational hypotheses that have been offered here and the results are appropriately disseminated.

VI. Appropriate Educational Programs for Innovative Entrepreneurship

I have already argued that at least some limited amount of technical training, presumably at the university level, is growing increasingly indispensable even for the most independent of innovating entrepreneurs. Though a marked difference presumably remains between this sort of education and that needed for cumulatively incremental product development, the implication is that it is increasingly appropriate for universities to provide a place for these prospective entrepreneurs but to design for them a program that avoids the inculcation of standardized and unimaginative ways of thinking. Providing that kind of education, in essence, is the difficult—but critical—assignment facing anyone who wants to provide a better program for educating the *innovating* entrepreneur of the future. It is not something that need concern significantly the training of prospective entrepreneurs as defined in a broader sense, in other words, the process of equipping those who hope to create new firms that are likely to be of some standard type, with products and procedures that are largely conventional and replicative. But it is an issue that pertains to the education of the entrepreneur with innovative propensities.

Of course, more humdrum educational activities can also be helpful both to the nascent innovating entrepreneur and the prospective entrepreneur in the more general sense. As we know, it has generally proven convenient, if not essential, even for innovating entrepreneurs to establish new business firms as their vehicle for economic exploitation of their ideas. But the inexperienced founder of any new company is apt to be handicapped, sometimes fatally, by lack of rather elementary knowledge that is particularly critical for successful and innovative firms. This knowledge includes information like guidance on the different sources of funding and their relative advantages and perils. It can also encompass steps for reducing the dangers raised by the financing process, pitfalls stemming from the tax system, safety requirements to protect the labor force, and environmental regulations. Inventors need guidance through the morass of patent laws and the complications that threaten inventive activities, as well as the difficulties that can be introduced by institutions dealing with patents, such as patent pools and standard-setting organizations. The founders of new enterprises need help in dealing with regulations, from the tax laws to the fire laws, to avoid difficulties entailed in construction of their facilities, in the requirements of record keeping, and so on. It follows that nothing said in this paper should be taken as an effort to induce prospective entrepreneurs to avoid education. Rather, the purpose here is to suggest what differences in the contents of the entrepreneur's education are most promising.

VII. Conclusion

This paper offers two relatively novel observations that may contribute to our understanding of the growth process. The first asserts that our economy derives its innovations from two sources: from the routine activities of giant firms and from independent inventors and their entrepreneur partners. The second observation is that the education best adapted to the requirements of one of these activities is quite different from that most suitable for the other.

These two types of inventive effort are not as inherently substitutable, one for the other, as they may appear to be. Rather, there has been a predictable tendency toward specialization, with the entrepreneurs providing the more heterodox, breakthrough innovations, and the R&D establishments of the larger firms creating the enhancements to those breakthroughs that contribute considerably to their usefulness. These Goliath innovators have not eliminated the role of the entrepreneurial Davids. Instead, the two have tended to specialize and, together, they have enhanced the process beyond what either type of innovator might have been able to achieve by him- or herself. Thus, a critical complementarity exists between the roles of the two types of innovating enterprise, and growth is arguably enhanced by this division of their labor.

Routine innovation processes—those guided by standard business decision principles—are of great and probably of growing importance. But the entrepreneurial independent innovator in his or her small-business enterprise continues to play a critical role. Revolutionary breakthroughs continue to be provided to a considerable degree by small enterprises that can avoid the conservative propensities of the giant firm. Without their revolutionary entrepreneurial contributions, much less would be available for the large firms to develop.

It is fortunate for the U.S. economy that its institutions and arrangements facilitate and stimulate profuse formation of small firms and encourage their more radical innovative contributions. And the American educational system seems to be less rigid and demanding than those in the other industrialized countries, thereby enabling it to serve more effectively the needs of innovative entrepreneurship. If further investigation indicates that these two observations are valid, they can perhaps offer some useful guidance for the design of better-adapted educational procedures, particularly those intended as preparation for entrepreneurship.

Notes

This paper is an early report on a research project at New York University and is made possible by the generous support of the Ewing Marion Kauffman Foundation. I am also grateful to Joshua Lerner and Scott Stern for their encouraging and helpful comments on an earlier draft of this paper, and to my colleagues Melissa A. Schilling, Edward N. Wolff, and Sue Anne Batey Blackman for their contributions to the research and to this paper. Many of the ideas in this paper are based on Baumol (2002).

1. Significant exceptions exist, notably the invention of the transistor at Bell Laboratories. But in that particular case, the parent firm was in a special situation that was arguably highly relevant. At that time, AT&T was a regulated monopoly protected from competitors who might otherwise have benefited from the spillovers generated by the innovative breakthrough, and regulation almost guaranteed AT&T recoupment of the R&D outlays that other, less-protected firms might have considered a wild gamble on a harebrained project.

2. Samuel Morse did attend Yale but, like Fulton, was trained as an artist. More recently, the jet airplane engine was invented by Frank Whittle, who came up with the idea while he was a pilot in the Royal Air Force, years before he attended Cambridge University.

3. On May 14, 1743, Franklin wrote "A Proposal for Promoting Useful Knowledge among the British Plantations in America," a document that led to the establishment of the American Philosophical Society for Promoting Useful Knowledge, America's first scientific society.

4. If the firm offers little or no added reward to successful employee inventors but provides all R&D staff members with wages sufficiently above market levels, this hypothesis can be interpreted simply as a transfer of the risk of the invention process from the employee to the firm. But note that it reduces the prospective incremental payoff for successful contribution to the individual employees and can thereby reduce the effort they devote to the process.

5. Here, I will emphasize Joseph Schumpeter's conception of the entrepreneur as a partner of the inventor—as a businessperson who recognizes the value of an invention, determines how to adapt it to the preferences of prospective users, brings the invention to market, and promotes its utilization.

6. Quoting the press release describing the study, "A total of 1,071 firms with 15 or more patents issued between 1996 and 2000 were examined. A total of 193,976 patents were analyzed. CHI [the firm that carried out the study] created a data-base of these firms and their patents. This list excluded foreign-owned firms, universities, government laboratories, and nonprofit institutions" (p. 2). The 2004 study expanded the sample to 1,270 firms and dealt with the period 1995–1999, and a total of 177,899 patents.

7. John Markoff, "Technology; Is There Life After Silicon Valley's Fast Lane?" *New York Times*, Business/Financial Desk, Section C, April 9, 2003, p. 1.

8. However, "[t]here are a number of individual industries in which large firms cite a higher than expected number of small firm patents, suggesting that they are building extensively on small firms' technology. These industries include high-tech areas such as biotechnology, medical electronics, semiconductors and telecommunications" (CHI Research 2004, p. iii).

9. I have omitted Luxemburg and Iceland from the graphs; they are special cases that limit their interest for the discussion here.

10. Here, it should be observed that, because of the absolute size of its economy, the total figures for the United States tell a different story. The United States accounts for 44 percent of total R&D expenditures in all Organization for Economic Cooperation and Development (OECD) countries combined. And U.S. R&D investments outdistance, by 150 percent, the R&D investments made by the second largest R&D performer, Japan. Thus, the fact that Sweden spends 3.8 percent of its GDP as opposed to the United States spending 2.5 percent pales somewhat in light of these numbers.

11. For a broader discussion of the market's propensity to interpret various socially beneficial investments as wasteful, see Baumol and Blackman (1991).

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