



The Global Outlook

Drivers for Europe's Recovery

By Mark Spelman

*Will Europe become a marginal continent or is there a way back? In this second article of the series, **Accenture's Mark Spelman** focuses on the Global Outlook with particular reference to Europe and looks in more detail at innovation as a key driver for recovery in Europe.*

2010 has seen the Asian economies continue to power along with average GDP growth rates of 5-10 per cent per annum, whilst the developed economies have stuttered back into growth. The US economy has recovered on the back of significant productivity gains but Europe seems to have stumbled with a range of structural deficits epitomised by 'the Greek tragedy.' The challenges of public sector deficits, low growth and high youth unemployment in Europe have made the continent look vulnerable and less relevant on the global stage.

Fiscal consolidation has become the latest phrase to dominate the economics vocabulary over the past three months. The premise is that countries need clear budget deficit reduction plans in order to persuade fickle bond markets not to change sovereign debt ratings and push up the costs of financing the debt even further. Yet this argument has had to be balanced with the fear that reducing government

spending too fast could choke off a weak recovery. This is still a major concern in Europe given the low projected growth rates of 1-1.5 per cent over the next two years.

The reality is more complex. Europe itself is recovering at multiple speeds and in different ways. Countries like Poland have escaped the worst of the crisis - the economy grew in 2009 and its GDP forecast is for positive growth of 2.6-3.1 per cent in 2010-11. Poland has demonstrated that you can run an economy with both export led demand and domestic consumption growth.

Germany continues to remain the powerhouse of the continent - employment has been growing over the past two months, the balance of payments remains in significant surplus, the fruits of strict wage controls are coming through and the economy has fewer of the structural challenges that inhibit many other European countries. However, Germany remains

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over-dependent on an export-led growth model that is not sustainable in a context of weak global demand; it needs to do more to stimulate domestic consumption if it is to generate a robust recovery.

The overall picture is mixed but with Germany and Poland remaining relatively strong, there is some comfort to moderate the gloom surrounding Greece and to a lesser extent Ireland, Portugal, Spain and the UK.

STRUCTURAL ECONOMIC REFORM KEY TO RESTORING GROWTH

The European hope is that the process of fiscal consolidation will trigger further reforms that will make Europe more competitive on the global stage. The key issue behind all the reforms is growth - political leaders know that without growth, the economic and social models in Europe become more and more unsustainable, especially with a rapidly ageing population. Yet there is a clear risk that the entitlement mindset is alive and well, and that after

the pain of public sector cuts there may be some temptation to return to old ways. The evidence of the pace of change, especially in Asia, is that a backward-looking view will only condemn Europe to lower growth and increased marginalisation.

The big question is: Can Europe use the current crisis to stimulate structural economic reforms that will accelerate competitiveness and better equip the continent to win against the fast growing tigers from the emerging markets? The early signs have some promise - Spain is looking at greater labour market flexibility, France is discussing pension reform and the UK is examining the range and scale of welfare payments, especially to middle class families.

THE CENTRAL ROLE OF INNOVATION

Of all the areas on the structural reform agenda, innovation will be uppermost in the minds of European political leaders as they look for new ways to kick-start the European economy. But the global innovation

landscape is changing fast; innovation is becoming more footloose, fragmented and geographically dispersed. Emerging markets have closed the innovation gap with more developed countries; it is no longer high-tech in the West and low-tech in the East. The rise of nanotechnologies and biotech in Beijing, digital media and genomics in Seoul and biofuels in Brazil are three examples of how emerging economies are learning the importance of specialisation and developing clear niches.

Innovation in Europe has broad scope and multiple dimensions - e-skills, super clusters, 3 per cent of GDP on R&D being just three phrases used in the debates on innovation. Product innovation is one core component leveraging research facilities and European leadership in high-tech manufacturing to create the potential to develop new high value products in the green technologies. For example in Northern Italy, Europe has the world leader in the manufacturing of vertical lathes used to hollow out the casings of turbines and jet engines. Close

ties with the EU's aerospace industry has created a platform for capturing a 60 per cent share of the world market. There is evidence that Formula 1 is also proving to be a successful source of innovation as companies like McLaren begin to apply their sensor technology from the racetrack to new applications such as smart buildings and remote diagnostic healthcare solutions.

Innovation extends beyond products to include services, where demand for new solutions to help cities with smart urban planning will grow as cities compete to lead in the low carbon economy. Process improvement is a further source of innovation as companies use new technologies to access ideas from customers and other stakeholders.

The danger for Europe is that the need for more explicit focus on innovation is met by weak and fragmented approaches. Policy instruments do need to have a demand focus as well as a supply side orientation and the metrics need to be both input and output centred. Europe has a number of distinct strengths to focus on: over 140,000 high-tech manufacturing companies, leadership in many clean tech sectors and a large and expanding Information and Communication

from the business world on what they are looking for out of new recruits to retain and develop future competitiveness.

Innovation covers the whole lifecycle from product to process to service to new business models. It works best when companies have a structured and disciplined approach. Many companies talk the story of innovation but have practised cost reduction for the past 18 months - with the result that words of innovation are drowned out by the pressures to reduce costs.

Innovation is more than a company approach - leading companies like Nokia and Procter & Gamble see it as a way of leveraging other stakeholders in their value chain. The new world of innovation involves customers, suppliers, other stakeholders in an open innovation ecosystem. In emerging markets where understanding local needs and tastes can be critical in tailoring globally configured products, key distributors can play a significant role in product and service innovation. For example, a mobile phone company in India grew its market share in rural communities by developing specific applications for farmers providing price information on agricultural products at main agricultural centres.

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Technologies (ICT) sector. Even the twin challenges of ageing can be turned into an opportunity with new e-health solutions and more remote diagnostics. Government spending in Europe is at 16 per cent of GDP - the sheer size and scale of this spend provides significant opportunities to find new ways of supporting new technologies and smaller to medium size companies.

On the supply side, innovation requires more focus on skills - both the hard skills related to science, technology, engineering, and mathematics (STEM) and the softer emotional intelligence skills which underpin collaboration and teamwork. Increasing the number of students with STEM skills is vital in a world which will be e-enabled. Europe already struggles with a skills mismatch - over 20 million unemployed but yet four million open vacancies today. Skills gaps need to be plugged with guidance

CONCLUSION: EUROPE NEEDS A MORE SYSTEMATIC APPROACH TO INNOVATION

For European countries and businesses that want to grow and be relevant on the global stage, the pace and scale of innovation are going to be critical success factors to better understand changing customer needs and improve the customer experience. The words need to be turned into reality - it is the output and results that count. Governments for too long have set targets - 3 per cent of GDP on R&D - which they then fail to attain and which fail to deliver the relevant results. Many businesses lack systematic approaches to innovation and fail to get the appropriate returns from their investments. Innovation is macro and micro - it is about being part of dynamic global innovation nodes which are industry relevant but it is also about attention to detail - disciplined approaches

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that will allow good ideas to scale and flourish and can stop the poorer ideas from sucking up valuable time and resources.

A focus on growth sectors combined with a clear skills agenda are two principles that could help Europe rediscover its innovation engine. More is required - Europe has too many small innovation clusters which are insufficiently linked into global innovation nodes. With product lifecycles getting shorter, more specialisation in innovation clusters and pressure on costs, it is even more important that countries and businesses are clear about which clusters they want to develop and be part of.

Governments can create the macro policies for more innovation but it is the entrepreneurial spirit and a structured approach in businesses that will determine which companies are able to translate innovation into tangible results that re-ignite the engines for growth in Europe.

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