Innovate More by Doing Less

By Henrich Greve , INSEAD

R&D departments could be better utilised to look for alliances that may provide robust innovations

The pharmaceutical firm, Merck & Co., has a famous research and development (R&D) unit with successes that include first-ever vaccines and cholesterol control drugs, all developed fully in-house from discovery to final development and approval. But the fame is fading these days, because their last successes were drugs approved in 2006, which means that they have had a long dry run and will soon be holding a portfolio of drugs with fewer and fewer patents. That means more competition and lower profits.

Their solution is to do less research. They will sell many of the drug development projects they are doing, reduce the size of their R&D unit, and instead create a set of innovation hubs that are intended to look out for research done by others. These hubs are rumoured to be planned for Boston, the San Francisco Bay area, London, and Shanghai. This probably seems like a strange idea. Can a firm improve its research record by doing less research? Is a hub that plans to look for research done by others really an innovation hub or an imitation hub? What exactly is going on here?

The explanation is that Merck is finally starting to do what other pharmaceutical firms are doing. The pharmaceutical industry has increasingly lost its advantage in doing research relative to biotechnology firms and universities, and now it is common for pharmaceutical firms to look out for promising research done nearby, with an eye to create an alliance with the biotech firm or get a license for its product once it looks promising. Such arrangements are useful for two purposes. The first purpose is to do the research in an economical place. Biotech firms have two advantages over pharmaceutical firms in doing research. One is that they do it very well; the other is that they either succeed or go broke, which means that the cost of failures is borne by their founders and investors, not by any pharmaceutical firm.

The second purpose is to grab research results from firms that usually cannot commercialise them. There are very few biotech firms that have the capabilities and resources needed to get a new drug approved for use, but pharmaceutical firms are experts in doing that. This means that the biotech firms can't get the full value out of their research, they need to sell it at a "discount." That discount, of course, becomes profits for the pharmaceutical firms.

Researchers have followed this change to innovation and commercialisation through a network of firms for a while, with the best-known articles involving Walter Powell and collaborators. The advantages of this system were pretty established in 1996, so Merck is a few years behind the curve in changing to it. The advantages of combining proximity to firms that do research with a central position in alliances is something that was documented in research by **Whittington, Owen-Smith, and Powell**, and it suggests that Merck not only needs to be in the right place, it also needs to have the right connections – the right alliances.

Getting the right portfolio of alliances actually takes longer to do than building an innovation center, so there is no guarantee that Merck's new strategy will work soon enough for them. And if it took them many years to start following what researchers and other firms saw as the good way to locate research centers, it is hard to tell when they will start following advice on how to build alliances. I know where they could get it, though, having recently finished writing a **book with Tim Rowley and Andrew Shipilov on how to get a Network Advantage through alliances**.

Loftus, Peter and Rockoff, Jonathan D. 2013. Merck Plans Radical Overhaul of Drug R&D Unit. Wall Street Journal, Dec. 27 2013.

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