# Key Challenges of Open Innovation: Lessons from Open Source Software

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**Abstract**

"Open innovation" has been suggested as a new paradigm for corporate innovation, in which firms focus on identifying, exploiting and integrating external knowledge into their internal R&D activities. We identify three key challenges to effective open innovation: identifying new and creative ways to exploit internal innovation, incorporating external innovation into company product development, and motivating outsiders to supply an ongoing stream of external innovations.

To illustrate these points, we discuss a specific example of open innovation: open source software. We show how firms use open source to support their innovation strategies in the software browser, operating system, server, and game markets. From this, we identify four approaches — pooled R&D, spinouts, selling complements and attracting donated complements — and discuss how they address the three key challenges. We conclude with suggestions as to how these principles can be applied to other industries, as well as new questions raised by this study.

# Key Challenges of Open Innovation: Lessons from Open Source Software

## 1. Introduction

Models of open innovation offer the promise that firms can achieve a greater return on their innovative activities and their resulting intellectual property (IP). Open innovation models stress the importance of using a broad range of sources for a firm's innovation and invention activities, including customers, rivals, academics, and firms in unrelated industries while simultaneously using creative methods to exploit a firm's resulting IP (Chesbrough, 2003). While the use of external sources of innovation is nothing new, recently the most successful high-tech firms have been those that "free ride" on the basic research of others.

The open innovation paradigm is often contrasted to the traditional vertical integration model where internal R&D activities lead to internally developed products that are then distributed by the firm. However, saying what "open innovation" isn't doesn't tell managers what it is. Here we define open innovation as systematically encouraging and exploring a wide range of internal and external sources for innovation opportunities, consciously integrating that exploration with firm capabilities and resources, and broadly exploiting those opportunities through multiple channels. The open innovation paradigm therefore goes beyond simply the externalization of research and development and is as much a change in the use and management of IP as it is in technical and research driven generation of IP.

Over the past 20 years, an increasingly popular example of open innovation has been open source software, which involves collaboration between firms, suppliers, customers and makers of related products to pool software R&D to produce a shared technology such as the Linux operating system. Here we consider patterns of open source innovation as an exemplar for more general forms of open innovation, and how open source addresses three challenges of open innovation.

## 2. Closed and Open Models of Innovation

The pace of technological advance has often been subdivided into two phases: invention (a scientific breakthrough) and innovation (commercialization of the invention). Nelson & Winter (1982: 263) attribute the distinction to Schumpeter (1934). This split parallels a similar bifurcation between research and development, where inventions come from basic research and innovations from the development group. Many organizations, however, define additional phases between the two extremes, as with Intel's "advanced development" step (Tennenhouse, 2003). Others have attempted to subdivided innovation into "radical" and "incremental", where the former more closely resembles the "invention" concept (e.g. Leifer et al, 2000).

Like Nelson and Winter, we use "innovation" in its broadest sense to refer to the entire process by which technological change is deployed in commercial products. Such innovation may incorporate formally protected intellectual property (such as patents or copyrights) that is difficult to imitate, or it may reflect tacit knowledge that is easily imitated and at best provides a transient competitive advantage.

## 2.1 Proprietary R&D as a Source of Innovation

The source of innovation activities has interested economists for many years (e.g. Schumpeter, 1942). One of the most successful models to emerge was a "proprietary" model where large enterprises internalized their R&D activities. Historical accounts suggest that early R&D activities grew out of the need in many industries to maintain and improve production activities (Chandler, 1990). Because activities were frequently unique for each firm, investments in R&D were firm-specific and thus (as predicted by transaction cost economics) firms internalized their R&D expenditures (Williamson, 1991). From such R&D, firms naturally moved to exploit their accumulated knowledge to develop new products, thereby enhancing their economies of scope; in many industries large scale dedicated R&D functions emerged, providing a barrier to entry through economies of scale (Chandler, 1990).

The managerial approach used for this proprietary model was summed up by Harvard president James Bryant Conant as "picking a man of genius, giving him money, and leaving him alone" (Conant, 2002). Edison's Menlo Park, AT&T's Bell Labs, and Xerox's PARC were exemplars of this type of innovation model and brought about many inventions and innovations during the 20$^{th}$ century. Laboratory researchers in these labs generated IP that engineers could develop into commercial products.

However, sometimes the production-line innovation model broke down when research generated IP that could not be internally commercialized. In some cases, such IP would be licensed to others, but in many other cases it "sat on a shelf" waiting either for internal development or its research proponent to leave the firm and develop it on their own. This led to considerable knowledge spillovers to other firms who were able to capture the benefits of the innovation; the best known contemporary example of such spillovers is Xerox PARC (Smith and Alexander, 1998; Chesbrough & Rosenbloom, 2002).

## 2.2 Absorbing External Knowledge

Considerable knowledge is generated beyond the confines of the firm. Even the proponents of the proprietary model never claimed to explain all innovation activity. In addition to internally generated knowledge, von Hippel (1988) identified four external sources: 1) suppliers and customers; 2) university, government and private laboratories; 3) competitors; and 4) other nations. Firms that fail to exploit such external R&D may be at a severe competitive disadvantage (Rosenberg and Steinmueller, 1998).

Many models have been developed to explain how firms can exploit external knowledge. Perhaps the simplest method is to imitate a competitor: such free riding on the product and market investments of rivals is a common way for firms to overcome a first mover strategy (Lieberman and Montgomery, 1998). Consulting with customers can provide firms ideas about discovering, developing, and refining innovations (von Hippel, 1988). Public sources are also an important source of knowledge, for example government R&D spending was identified almost 50 years ago as an important stimulus for private R&D (David, Hall, and Toole, 2000). Similarly, university research is often explicitly funded to generate external spillovers (Colyvas et al, 2002). The opportunities for firms to benefit from these latter two sources of innovation are aided by the strong professional norms and desires of researchers to publish the results of their work to as wide an audience as possible.

The challenge for firms then is how to find and exploit these external sources of innovation. The nature of the knowledge, including its complexity, explicitness, and similarity to extant knowledge are important considerations (Afuah, 2003). A firm's ability to tap external R&D knowledge frequently seems to depend on its investment in internal R&D capabilities that facilitate the development of "absorptive capacity" (Cohen and Levinthal, 1990). If firms cannot (or don't wish to) develop sufficient absorptive capacity they may utilize strategic alliances in order to gain such knowledge or utilize complementary resources to exploit that knowledge (see Gulati, 1998 for a review of alliances). This alliance or "network" approach is particularly common in technology intensive industries such as biotechnology (Powell, Koput and Smith-Doerr, 1996; Mowery et al 1996). Finally, location has also been shown to result in knowledge spillovers between firms and from university research in many industries, especially high-tech (Porter, 1990; Baptista & Swann, 1998; Kenney, 2000).

The managerial challenges of utilizing external knowledge then center around identifying useful external knowledge, and then integrating that knowledge with the firm. For example, for new products there are significant trade-offs between innovation speed, development costs, and competitive advantage for relying on external rather than internal learning (Kessler, Bierly, and Gopalakrishnan, 2000). Environmental scanning, competitive intelligence, sponsored research, and membership in relevant trade organizations is a way to uncover external knowledge opportunities. Developing absorptive capacity, via *internal* R&D investments appears to be an important prerequisite for converting external knowledge into internal innovation (Cohen and Levinthal, 1990).

## 3. The Open Innovation Paradigm

In contrast to earlier models and "fully integrated innovators" like AT&T (now Lucent) Bell Labs and IBM which do basic research through commercial products, open innovation celebrates success stories like Cisco, Intel and Microsoft, which succeed by leveraging the basic research of others (Chesbrough, 2003). Under this paradigm, firms exploit both internal and external sources of innovation, while maximizing the returns that accrue from both sources (Table 1).

Tactics that embody an open innovation approach include exploiting knowledge spillovers, consulting with venture capitalists, while also using both inbound and outbound licensing of key technologies. Although earlier frameworks acknowledged the role of external knowledge and "accidental" internal discoveries, it is the systematic encouragement and integration of these issues coupled with creative exploitation of IP that distinguishes open innovation from earlier innovation models.

While leveraging the innovations of others might seem the equivalent of "found money," in practice the integration of internal and external innovation faces three challenges:

- *maximization*. Firms should use a wide range of approaches to maximize the returns to internal innovation — not just feeding the company's product pipeline, but also outbound licensing of IP, patent pooling and even giving away technology to stimulate demand for other products.

- *incorporation*. The existence of external knowledge provides no benefits to the firm if the firm cannot identify the relevant knowledge and incorporate it into its innovation activities. This requires scanning, absorption and also the political willingness to incorporate external innovation.
- *motivation*. Open innovation assumes an ongoing stream of external innovation, but such "found money" spillovers require that the stream be replenished.

## 3.1 Maximizing Returns to Internal Innovation

A concern unique to open innovation is how to best use the internal R&D capabilities of the firm to maximum advantage. Those capabilities can be used for

- generating innovations to be internally commercialized (the traditional model);
- building absorptive capacity and using that capacity to identify external innovations;
- generating innovations that generate returns through external commercialization (e.g. licensable patent portfolios); and
- generating IP that does not produce direct economic benefit, but indirectly generates a return through spillovers or sale of related goods and products.

Successful approaches will often combine a variety of these approaches. For example, to identify promising technologies Intel establishes research labs near promising university research groups, with open flows of information in both directions. If an innovation proves promising, Intel recruits the top academic researchers to help commercialize the technology and see it through to production (Tennenhouse, 2003).

This approach can be used cooperatively as well. For example, the GSM patent pool assembled by European telephone makers in the early 1990s. While the patents were often the result of (at times unrelated) basic research, contribution of a patent to the patent pool allowed firms to have favorable access to all of the IPR of the GSM standard, which created a cost advantage for European pool participants over potential Asian rivals (Bekkers et al, 2002).

## 3.2 Incorporating External Innovations

To benefit from external innovations, organizations need to identify such innovations, maintain the absorptive capacity to understand them, and be able to combine such spillovers with firm-specific internal innovation to produce a product tailored to the firm's specific needs.

Even if external innovations are identified, that does not mean they will be incorporated into the firm's product strategies. A firm that was once highly successful at the integrated innovation model will tend to believe its innovations superior to any competing ideas from outsiders. For example, flush from its successful user interface innovations of the 1980s, engineers at Apple Computer rejected external ideas in areas such as handheld computers, adopting the phrase "not invented here" to describe such rejection (Kaplan 1996: 156).

### 3.3 Motivating Spillovers

With external innovation, there is often an unstated assumption that the supply will continue. But what happens if everyone tries to be a "free rider"? Will "innovation benefactors" — such as government and nonprofit research sponsors be as fertile a field (Chesbrough, 2003b)? If commercial firms do not realize a return on their innovative activities, they will tend to under-invest in innovative activities that are either highly risky (e.g. basic research) or that are easily imitated by free-riding competitors. Therefore, we consider the incentives for generating the knowledge spillovers at two levels: the individual and the organizational.

Motivating individuals to generate and contribute their IP in the absence of financial returns is a significant management challenge for an open innovation approach. One of the simplest models of motivation is expectancy theory that posits that individuals are motivated when both valence, the attractiveness of a reward, which can be either intrinsic (e.g. happiness) or extrinsic (e.g. fame or fortune) and instrumentality, the path to that reward, are present (Lawler, 1971). The proprietary innovation model solved this challenge though extrinsic compensation coupled with adherence to traditional professional scientific norms, e.g. freedom. The external model relied upon others, e.g. universities, to partially or wholly provide motivation.

The incentives for organizations to contribute spillovers fall into two categories. In the one case, the innovation benefits the innovator and nothing is reduced by sharing that benefit. Customers often share their innovations with their vendors if it means improved products in the future (von Hippel, 1988). And of course suppliers invest in innovations to sell more products, as when Intel increases the performance of microprocessors that it sells to Dell.

Spillovers to a direct competitor are more problematic, but still are economically rational under conditions of "co-opetition". Firms in the same industry complement each other in creating markets but compete in dividing up markets (Brandenburger & Nalebuff, 1996: 34). So if a firm stands to benefit from an innovation that grows the market, it will accept spillovers if the return from its share of market growth is attractive enough.

## 4. Open Source as Open Innovation

Open source and other collaborative development techniques in the software industry offer examples of how the three key challenges of open innovation can and have been addressed by commercial firms. Open source also offers an approach to address what West (2003) refers to as an "essential tension" in information technology innovation: appropriating the returns from an innovation versus winning adoption of that innovation.

The term "open source" was coined in 1997 to refer a category of software where the source code is freely distributed. The term is defined to require free redistribution of the software, its source code, or any derived works thereof, while at the same time acknowledging the original author's ownership and contribution (Perens 1999; Raymond 2004). In popular usage, the term "open source" overlaps (and largely subsumes) the "free software" category as launched by Richard Stallman in 1984.[1]

While "open source" is explicitly an IP policy, it typically includes a development methodology where geographically dispersed programmers collaborate in the joint production of a software good through a set of virtual collaboration tools. Such programmers were originally hobbyist users, but increasingly have been professionals paid by employers that either intend to use the software internally or sell related products and services. To be effective, such paid collaborators must internalize the ethos of both their project and the employer (O'Mahony, 2003).

Meanwhile, the widespread dissemination of the necessary tools have both fueled the rise of specific open source projects but also enabled other forms of open innovation in the software industry, such as user scenario development for PC games.

What motivates individuals to contribute to open source projects? Consistent with expectancy theory, empirical researchers (Hars and Ours, 2001; Hertel et al, 2003; Lakhani & von Hippel, 2003) found three general categories of contributor motivations:

- *direct utility,* either to the individual or to one's employer;
- *intrinsic benefit* from the work, such as learning a skill or personal fulfillment;
- *signaling* one's capabilities to gain respect from one's peers or interest from prospective employers.

Thus, open source as an open innovation strategy has two key components: shared rights to use the technology, and collaborative development of that technology. Here we consider four approaches from open source projects (and the non-open source PC games) where firms have both invested in open innovation and benefited from them (Table 2).

### 4.1 Pooled R&D: Linux, Mozilla

A familiar model of open innovation is that of pooled R&D. Two highly visible open source examples are support for the Linux operating system through the Open Source Development Lab, and the Mozilla web browser. For both, firms donate R&D to the open source project while exploiting the pooled R&D of all contributors to facilitate the sale of related products.

A simple example is the Mozilla open source project, a descendant of the Netscape Navigator browser offered for a wide range of systems — Windows, Macintosh, Linux and at least 7 Unix variants. This browser was the first commercial browser product, and held dominant market share from 1994 to 1996 ("Netscape Navigator", 2004). However, Navigator was rapidly eclipsed by Microsoft's Internet Explorer, which gained more than 90% market share due to bundling with Microsoft Windows (Bresnahan & Yin, 2004).

Netscape created the Mozilla open source project in 1998, and in July 2003 terminated all internal development, deferring further work to the open source community. Unix system vendors such as IBM, HP and Sun were left without a browser, which they needed to sell Internet-connected workstations. Thus, each of the major Unix systems vendors assigned software engineers to work with the Mozilla project, both to help keep the project moving forward and to assure that

[1] However, the "free" software contains IP restrictions intended to force sharing of any derivative works, while other forms of "open" software (such as the Apache license) allow private commercialization of related innovations (West 2003).

new releases are compatible with their respective systems (Dotzler, 2004).

The R&D cooperation in the Open Source Development Labs (OSDL) for Linux is more complex. Founded in 2000, the OSDL takes as its mission "To be the recognized center-of-gravity for the Linux industry; a central body dedicated to accelerating the use of Linux for enterprise computing" ("Corporate Overview," 2004). In its first five years, the consortium began work on three projects: data center Linux, carrier grade Linux and desktop Linux.

The founders, sponsors and other members of OSDL and their motivations for supporting OSDL could be grouped into four broad categories: vendors of computer and telecommunications systems, producers of microprocessors, Linux distributors and support organizations, and developers of complementary software products (Table 3).

How do such projects address the three open innovation challenges? For firms participating in Mozilla, the *quid pro quo* is straightforward: systems vendors maximize the returns of their innovation by concentrating on their own needs (such as platform-specific customization), and then incorporated the shared browser technology into their integrated systems. However, the motivation problem is not completely solved, in that the systems vendors assume a pool of individual open source contributors that sustain innovation in the core product.

For the OSDL, firms contributed their specialized knowledge (e.g. in telecommunications operations or microprocessor architecture) to build a common platform. OSDL resembles other self -supporting industrial research consortia, where firms pool interests towards a common goal, and assume they can both cooperate in supporting that goal and compete in selling their respective products.

However, both Mozilla and OSDL differ from typical consortia in two ways:

- *Spillovers are not controllable.* Many consortia incent membership by limiting access to the consortium's research output to member-participants. Open source licenses make this difficult if not impossible, allowing non-members to accrue many of the same benefits as members.
- *Contributions from non-participants.* The engineering contributions to these open source projects extend beyond the sponsoring companies to include user organizations, academics, individual hobbyists and other interested parties. Unless the corporate contributions eventually dwarf the individual ones, the projects must continue to motivate such contributions to survive.

Given these factors, an open source innovation model is inherently more "open" than a typical R&D consortium, both in terms of exploiting information from outside the consortium, and sharing that information back out to non-member organizations and individuals.

### 4.2 Spinouts: Jikes, Eclipse, Beehive

Open innovation can release the potential of technologies within the firm that are not creating value. In some cases, the technologies are no longer strategic, as with AOL Time Warner's decision to spinoff Mozilla into a stand-alone open source project after firing its Netscape development team (Hansen, 2003).

But in addition to spinoff (and, frequently, abandonment), firms also have opportunities to release more value from their technologies by situating them outside the firm, but at the same time maintaining an ongoing corporate involvement. Here we use the term "spinout" to refer to all cases where firms transform internal development projects to externally visible open source projects.

If a firm gives away its IP, how can such spinouts create value? One way is that the donated IP generates demand for other products and services that the donor continues to sell. Two examples of this come from IBM and its efforts to promote the Java programming language developed by Sun Microsystems, that was widely embraced by firms competing with Microsoft in web-based technologies. In such a Java-centric world, IBM would still generate revenue from sales of hardware and supporting services.

IBM's first open source spinout came from a pre-production R&D project. In response to IBM's growing interest in Java, in early 1996 two IBM researchers began work on an experimental Java compiler, which they named "Jikes". They quickly developed a prototype that was more efficient than Sun's industry standard compiler. After customer requests for a better Java compiler, in December 1998 IBM announced the release of Jikes in open source form to allow external programmers to extend and improve the compiler. IBM continues to host the project website, but since 2000 development has been led by non-IBM engineers (Gonsalves & Coffee, 1998; Shields, 2004). Jikes has been widely adopted, and is now bundled with several distributions of open source operating systems.

A second IBM spinout came with Java development tools. In 1996, IBM purchased a Canadian software company that created such tools for its WebSphere application server product; IBM released much of this technology in open source form when it founded the Eclipse project in 2001 (Brody, 2001). IBM was joined by other software companies involved in web application development, including Borland, Red Hat, SAP and SuSE, and well as hardware makers HP, Fujitsu and Intel; in 2004, the project became an independent non-profit corporation ("Eclipse Forms Independent Organization," 2004), although IBM engineers retained technical leadership of key projects. As an IBM executive later explained, "It is not that we are looking to make more money off the platform. It is just that we are looking to accelerate the adoption of Java and the building up of it for all of us" (Southwick, 2004).

But despite this openness, Java rivals BEA and Sun chose not to join IBM's coalition, instead promoting the rival Java Tools Community (Taft, 2003). Meanwhile, in May 2004 BEA announced plans to create a "Beehive" open source project, in which key application libraries from its WebLogic product family could be used with Sun's NetBeans, Eclipse, or other development systems.

The spinout thus makes sense for technologies that either are not yet commercialized (as with Jikes), or that will eventually become commoditized and thus of limited commercial value (as many predicted for Java development tools).

Both IBM and BEA donated internal innovations to create open source projects, which were intended to fuel adoption of the innovations. As with other organizations that sponsor open source projects, the benefits included:

- helping establish their technology as *de facto* standards, which, at a minimum, reduces the likelihood of having to re-implement their technology to conform to competing standards;

- attracting improvements and complements that make the technology more attractive;
- together, the innovation and complements enable the sale of related products (such as other components of WebSphere and WebLogic); and
- generating mindshare and goodwill with the same audience that includes the potential customers for these related products.

### 4.3 Selling Complements: Apache, KHTML, Darwin

Many goods in computers and electronics fall into what Katz & Shapiro (1985) term the "hardware-software paradigm". As Teece (1986) notes, the base innovation ("hardware") requires an investment into producing complementary goods ("software") specialized for that innovation, in order to make the entire system useful. In many cases, these complements are more valuable than the core innovation. For example, makers of videogame consoles deliberately lose money or break even on the hardware so that they can make money from software royalties (Gallagher & Park, 2002).

In other cases, a system architecture will consist of various components. Some mature (or highly competitive) components may be highly commoditized, while other pieces are more rapidly changing or otherwise difficult to imitate and thus offer opportunities for capturing economic value.

Two open source examples are the Apache web server and the KHTML web browser engine.

Customers access IBM's WebSphere e-commerce software using standard web browsers, so IBM originally developed a proprietary httpd (web page) server. IBM later abandoned its server for the Apache httpd server, recognizing that it would be wasting resources trying to catch up to the better quality and larger market share enjoyed by Apache (West, 2003). Today, IBM engineers are involved in the ongoing Apache innovation, both for the httpd server and also related projects hosted by the Apache Software Foundation (Apache.org website).

Similarly, in 2002 Apple Computer decided to build a new web browser called Safari, to guarantee one would be available for buyers of its computer systems. Instead of Mozilla, it incorporated the KHTML open source libraries, which in turn were developed to support the KDE desktop interface for Linux users (Searls, 2003). The move paralleled Apple's earlier use of BSD Unix as a foundation for its OS X operating system, in which it created a new open source project (Darwin) to share all modifications of the BSD code (West, 2003). For both Safari and OS X, Apple used open source and contributed back its changes, but the company did not release the remainder of the proprietary code for its browser and OS, respectively (Brockmeier, 2003).

In the case of the Apache, KHTML and Darwin open source projects, the firms adopting open source components had four common characteristics:

- there was pre-existing open source code being developed without the intervention of the focal firms;
- the "buy vs. build" decision to use external innovation was

made easier because the code was "free"[2];
- the firms were willing to contribute back to the existing projects on an ongoing basis, both to assure that the technology continued to meet their respective needs and to maintain absorptive capacity;
- the firms could continue to yield returns for internal innovation by combining the internal and external technologies to make a product offering that was not directly available through open source.

### 4.4 Donated Complements: PC Game "Mods"

In other cases, firms make their money off of the core innovation but seek donated labor for valuable complements. Although not an example of open source software, the solicitation of "mods" for PC video games demonstrates this principle.

The PC gaming industry competes with lower priced dedicated gaming platforms such as Sony's PlayStation2 or Microsoft's Xbox. The commercial publishers of PC games thus have decided to exploit the one key advantage they have versus the consoles: the ability for PC users to update and modify their games. To do this, publishers release editing tools for their games to encourage user mods that create different environments, scenarios, or even total rebuilds of the game; the users then freely distribute these mods on the Internet.

While mods do not directly generate publisher revenues, the novelty of the mods extends the relatively short demand period (measured in weeks or months) for most computer games. Meanwhile, the mods keep the name of the game in front of consumers for additional months, while the publishers need years to prepare follow-on products. This external innovation keeps the product current without tying up internal innovation resources.

As with open source, a key issue for mods is motivating the contributors. The motivations parallel those for open source: direct utility, intrinsic reward or external signaling. Individuals (or virtual teams) contribute mods because of their creative nature, love of either the computer game they modified or the milieu they recreated via their mod (Todd, 2004). Students are also frequent contributors, increasing their enjoyment of a favorite game (direct utility) as well as signaling their value to potential employers.

The computer game industry highlights two key ideas for attracting external innovation that similar to those for open source:

- *creating an infrastructure* that encourages participation and collaboration. For open source, this is a project website and e-mail lists, but for mods this would be a distribution site that highlights the mods. Modern technologies make the cost of such infrastructure quite low.
- *recognition for contributors,* including added visibility for the most popular creators. For example, since 2002 Apple has given annual awards for the best use of open source related to its OS X operating system.

However, the mods also help address one problem that's very different from those of business-oriented source projects. As with other entertainment products,

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[2] Both Apache and BSD packages were open without restriction in the typology of West (2003), while KDE contained the compulsory sharing restrictions of the GPL.

novelty-seeking consumers eventually grow bored with a PC game; by combining the core game engine with new externally generated game scenarios, the external innovation extends the life of the core (internally developed) innovation.

## 5. Implications for Open Innovation

The goals and broad principles of open innovation are attractive, but to have practical value, managers need specific guidelines about how such innovation can be implemented.

We suggest that what is distinct about open innovation is the systematic exploitation of external and internal innovation. We identify three key challenges central to its success: maximizing returns to internal innovation, incorporating external innovation into internal development, and motivating an ongoing stream of external innovation. And we identify four patterns of open innovation in software that suggest approaches that address these challenges (Table 4).

### 5.1 Implications for Other Industries

The four patterns of combining internal and external innovation in open source could be applied to more general forms of open innovation:

- *Pooled R&D.* This has been used in many industries, but the open source examples offer new insights for coordination and governance of collaboration to support competing interests.
- *Spinouts.* Since spinouts are valuable for technologies locked in the laboratory, they are most relevant to the largest firms, which tend to both have the largest innovation budgets and also the largest bureaucracies that can defeat commercialization. While Xerox PARC is the poster child for such obstacles, Chesbrough and Rosenbloom (2002) note that in some cases Xerox was able to spinout the technology and participate financially in its commercialization.
- *Selling complements.* Firms have long sold support services around public goods. However, open innovation requires overcoming the "not invented here" bias of in-house R&D to maximize reuse by designing external innovations into internally developed products.
- *Donated complements.* These fit the category of what von Hippel and Katz (2002) refer to as "user toolkits," where general purpose technologies are sold to users capable of generating their own modifications and improvements. Such strategies are most feasible when selling to technically proficient buyers, whether corporate engineers or hobbyist-programmers.

Open source software as part of corporate open innovation strategies is still a comparatively recent phenomenon, and there are some unresolved issues. Open source built on a confluence of ideology, professional norms and enthusiasm; some question the long-term sustainability of such motivations. Also, many projects have been created as challenges to an entrenched incumbent (e.g. Microsoft), and if such challenges are largely unsuccessful, vendor interest in sponsoring future open source efforts could wane.

Also, open source has yet to fully resolve the IP issues of accepting donations from a wide community of unknown contributors. Contributors to Linux have been accused by SCO of stealing copyrighted or trade secret-protected source code from SCO's proprietary Unix implementation. While such potential infringement has been attributed to ignorance, others have suggested that infringing "stealth" IP could be deliberately donated to projects to sabotage their success (Cargill & Bolin, 2004).

## 5.2 Further Research

In considering what "open innovation" means, there is a huge gap between the free-riding on basic research (e.g. Chesbrough, 2003b) and this study of the partitioning of software development between firms and open source projects.

From our own study, we suggest that future research should consider whether these characteristics of open source are prerequisites for other forms of open innovation:

- *feasibility of virtual teams* as a way to organize innovation, enabling pooled R&D and other collaboration between organizations;
- *a culture of open innovation* throughout such teams that spans organizations;
- *modularization* of technologies and products, to allow the external production of components or complements; and
- *formal IP mechanisms* that encourage collaboration.

Our attempts to define open innovation uncovered questions beyond those specific to software. Two relate to the availability of external spillovers:

- *commercialization of public research.* Universities have increasingly sought to profit from their research spillovers, a trend encouraged in the U.S. by the Bayh-Dole Act (Colyvas et al, 2002). Will this restrict the flow of external innovations or provide an ongoing incentive for greater supply?
- *increasing conflict over patents.* The increasing scope and commercial value of patents has spawned various concerns that patents will inhibit traditional closed innovation (e.g. Jaffe & Lerner, 2004); the threat to external spillovers is likely greater.

Other questions relate to potential patterns for leveraging external knowledge:

- *role of process innovations.* Companies like Dell combine external product innovations with internal process innovations. Is the process of open innovation fundamentally different when it incorporates process innovations?
- *low R&D intensity firms.* Many firms have low R&D intensity, either due to size (e.g. small businesses) or industry characteristics (low tech). Are they pursuing "external innovation," "open innovation," or (as commonly assumed) "no innovation" strategies?

These are but some of the questions about how open innovation can be applied to a wide range of industries and contexts.

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## 7. FIGURES AND TABLES

| Innovation Model | Management Challenges | Resulting Management Techniques |
|---|---|---|
| Proprietary (or internal or "closed") | 1. Attracting "best & brightest"<br>2. Moving research results to development | 1. Provide excellent compensation, resources, and freedom.<br>2. Provide dedicated development functions to exploit research and link it to market knowledge. |
| External | 1. Exploring a wide range of sources for innovation.<br>2. Integrate external knowledge with firm resources & capabilities | 1. Careful environmental scanning<br>2. Developing absorptive capacity, and/or using alliances, networks, and related consortia. |
| Open | 1. Motivating the generation & contribution of external knowledge<br>2. Integrating those sources with firm resources & capabilities<br>3. Diversifying the exploitation of IP resources | 1. Provide intrinsic rewards (e.g. recognition) and structure (instrumentality) for contributions.<br>2. As above.<br>3. Share or give away IP to maximize returns from entire innovation portfolio. |

*Table 1: Models of Innovation and Resulting Managerial Issues*

| Project | Product Category | Approach |
|---|---|---|
| Apache | web server | shared R&D |
| Darwin | operating system | selling complements |
| Eclipse | programming environment | spinout |
| Jikes | Java compiler | spinout |
| Linux | operating system | shared R&D |
| Mozilla | web browser | shared R&D, spinout |
| MySQL | database | selling complements |
| OpenOffice | business productivity | selling complements |
| Sendmail | mail router | selling complements |

*Table 2: Open source projects as examples of open innovation*

| Category | Companies | Motivation |
|---|---|---|
| Computer systems vendor | Dell<br>Fujitsu<br>**Hitachi**<br>**HP**<br>**IBM**<br>**NEC**<br>Sun | These vendors spent the late 1980s and 1990s fighting the "Unix wars" with mutually incompatible Unix implementations for their workstations and servers. In the late 1990s, they began shifting resources from their proprietary Unix implementations towards adapting and extended a shared implementation of Linux. |
| Telecommunications vendor | Alcatel<br>Cisco<br>Ericsson<br>NEC<br>Nokia<br>NTT<br>Toshiba | These vendors used Unix to run their switching systems but began shifting to Linux. As with systems vendors, interested in assuring that Linux evolved to work with their respective hardware and customers. |
| Microprocessor producer | AMD<br>**Intel**<br>Transmeta | Makers of Intel-compatible processors wanted to speed the shift of enterprise applications from proprietary RISC processors to their commodity processors. |
| Linux distributor (server and desktop) | Miracle Linux<br>NEC Soft<br>Novell<br>Red Hat<br>SuSE<br>Turbolinux | Distributors have a clear interest both in free riding off the work of others in developing Linux, and making sure that the software met the specific needs of their customers. |
| Embedded Linux distributor | LynuxWorks<br>MontaVista<br>TimeSys<br>Wind River | Similar to motivations of desktop and server Linux distributors, but need to support more heterogeneous customer needs for use with custom system configurations. |
| Linux support company | VA Software<br>Linuxcare<br>LynuxWorks | Without development capabilities, the firms both want to leverage the work of others and understand how it met customer needs. |
| Software developers | Computer Associates<br>Trolltech | Want to make the operating system more reliable for running their specific applications and libraries. |

Founding member in **bold**
Source: "OSDL Members," OSDL and company websites (as of May 2004)

*Table 3: Members of the Open Source Development Labs*

| Open Source Strategy | Maximizing Returns of Internal Innovation | Role of External Innovation | Motivating External Innovation |
|---|---|---|---|
| Pooled R&D | Participants jointly contribute to shared effort | Pooled contributions available to all | Ongoing institutions establish legitimacy and continuity |
| Spinouts | Seed non-commercial technology to support other goals | Supplants internal innovation as basis of ongoing innovation | Free access to valuable technology |
| Selling Complements | Target highest value part of whole product solution | External components provide basis for internal development | Firms coordinate ongoing supply of components |
| Donated Complements | Provide an extensible platform for external contributors | Adding variety and novelty to established products | Recognition and other non-monetary rewards |

*Table 4: How open source addresses open innovation challenges*