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Fostering Innovation in Services

A Report of the Expert Group on Innovation in Services

BUSINESSEUROPE views and comments on the report are in italics.

Background

In November 2006, the Commission's DG Enterprise asked an expert group for suggestions on how to support innovation in services.¹ The recommendations made by the Expert Group is finalised in a report "*Fostering Innovation in Services*" published in March 2007.

Based on this report, DG Enterprise will prepare a staff working document on innovation in services and will open an official stakeholder consultation.

Chapter 1. Introduction

The main viewpoint in the report is that more research needs to be undertaken to understand the role of innovation in services. At the same time, a much wider and more encompassing definition of innovation is needed that moves beyond technological innovation, to include organisational innovation and innovation in services.

The expert group distinguishes between "**innovation in services**" which is defined as *innovation processes within service industries* (as specified by the NACE and ISIC definitions), whilst "**service innovation**" covers *any innovation activity with service-like attributes that can occur in any part of the economy: manufacturing, agriculture, services or even informal parts of the economy*. The report focuses on both, but emphasises the former in parts of the report.

The Need for a Strategy

The expert group states that the service sector has a dominant role in developed countries, accounting for about two thirds of employment and GDP and gross value added (GVA). According to Eurostat, "services are the only sector of the European economy that has generated jobs in the last decades". Services not only comprise a large part of the economy, but also represent the main engine for growth within advanced industrial economies. "Innovation in services has been largely ignored, in large part because of the artefact, embodied and manufacturing-based paradigms that have remained dominant in innovation studies up until the present day". Despite so

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much of Europe being dependent on services, services have received little or no attention in terms of policy-making. At best, policy formation towards services, and in particular innovation in services, has been piecemeal; at worst it can be summarised as ignorance and neglect.

Thus, the report seeks to define a strategy to promote innovative services in the European Union. There is a need for effective, holistic and integrated set of policies to make innovation in services more effective in terms of enhancing European growth and competitiveness.

*BUSINESSEUROPE is pleased to note that the expert group see innovation related to services in a broad perspective. We certainly agree that **"innovation in services"** and **"service innovation"** that covers any innovation activity with service-like attributes that can occur in any part of the economy should be seen as equally important. The changes in the industrial structure and the deep integration of services in products should be recognised to a much higher degree when talking about innovation in services.*

However, the main weakness of the report and consequently the main objection is that the concept of service is not clearly defined from the beginning. In order to present a framework to enable a better understanding of services innovation, it is first necessary to make clear the concept of services and which areas it covers. We first need to define: "What are services? And which areas and categories does it cover?"

In general the distinction between service and industry has been overstated and does not correspond to recent developments in business. In fact, manufacturing industries are changing to include more and more services. This is partly due to the fact that services are increasingly becoming part of tangible and intangible products. Service packages covering installation, maintenance, updating, training and so on become an integrated part of delivery. In this way - connected to the outsourcing of traditional production to low-cost countries - many European companies concentrate on services and development. In many cases the attached services become the main products.

Another important issue is the question of "Why there is a need for innovation in services?". If the answer is for Europe to become "the most competitive and dynamic knowledge-based economy in the world", we need to take the competition from the rest of the world into account. Services are innovated daily and for some companies their core business is innovation in services. As services are demand driven there is a natural interest for companies to keep up with the market and customize. Competition is the best way to foster innovation.

Chapter 2. Innovation in Services: A Statistical Picture

The expert group notices three trends which are becoming more important:

- *Services are becoming more R&D-intensive: between 1990-2003, service sector R&D increased at an average annual rate of 12% across OECD member countries,*



compared with only 3% for manufacturing sectors. Thus, in 2002 the European Union average for the share of services in business R&D rose to over 15%.

- *Services are increasingly innovative*: the share of business service firms reporting that they were innovative in terms of introducing an innovation between 2002 and 2004 in the EU ranged from around 50% in Germany to less than 20% in Denmark.

- *Innovation in services is usually centred on non-technological, disembodied forms of innovation*: service businesses frequently perceive greater change in non-technological dimensions. This can also be seen in the importance that service firms attach to investing in training for existing staff compared with the importance they attach to investing in new technologies. Technology and skills in relation to innovation is not an either/or decision. The majority of service firms attach equal importance to investing in new technologies and in skills.

BUSINESSEUROPE certainly agrees that non-technological innovation plays an important role in service innovation, but at the same time technology should not be ignored as a critical factor. Further studies in the drivers of innovation in services is needed - both in the technological area (not least the importance of IT technologies) and in the non-technological area (both human resources and other types of non-technological elements like for instance design) - and especially in the interaction between technological and non-technological innovation.

The expert group recommends revisions of the definitions of R&D activity to include more service-oriented research activity and to highlight their closer relationship with related creative, technical and design activities. Further, the expert group recommends making innovative service companies aware that many of their activities are indeed "R&D" and innovation-based, in order to energise and enable these to feel part of and be active in the wider European innovation community. Encourage key stakeholder (member states and statistical agencies) to develop a better understanding and measurement of the innovation process in relation to services and, lastly, to support the research and statistical community in developing new and robust indicators that can better articulate and measure what service innovation is actually about.

BUSINESSEUROPE supports the above viewpoints. We strongly agree with the expert group's statement that "we need a much better understanding and measurement of the innovation process in relation to services" (p. 15).

BUSINESSEUROPE also strongly agrees that the present NACE and statistical base is not up-to-date with recent developments and trends within business. Therefore, more effort should be taken to amend this and more studies on the recent trends on service development within business are needed.

We strongly support the viewpoint that "there appears to be a growing consensus that acknowledges the increasing complex and multidimensional character of innovation not only in services but also in manufacturing. This includes the increasing "encapsulation" or bundling of services and manufactured goods into "solutions"... The shift away from "manufacturing" versus "service" companies, towards organisations focused on the



realisation of value. This has moved the focus away from...individual firms towards understanding value chain or networks, locating service and manufacturing in a set of interrelated activities". (p. 15). BUSINESSEUROPE thinks that this is indeed an important acknowledgment on which further initiatives on innovation in services should be based.

Chapter 3. Horizontal Framework Policies

In order to support innovation in services/service innovation the expert group makes the following suggestions:

Legal and regulatory frameworks for service innovations should be improved by:

- provide guidance to regulators to offer more proactive support in the development of new services and business models,
- support a regulatory regime which would provide a positive driver for generating new service offerings, for example in environmental services.
- encourage full recognition of professional qualifications across all key service sectors, both public and private, to enable the movement of key knowledge works between Member States.

BUSINESSEUROPE strongly warns against using legal and regulatory frameworks in order to support service innovation. Especially since - as stated by the expert group itself - innovation in services is a fairly complex matter and the innovation process is not yet properly understood, the EU should not set up further legal or regulatory initiatives that might in the worst case be counterproductive. Therefore the EU should not engage in any legal or regulatory "experiments", and neither should it encourage the member states to do so.

In order **to support intellectual property rights (IPR)** for service innovation the expert group suggests that the Commission develops policy instruments which systematically increase awareness on the various options that IPR can provide for innovative service companies, especially SMEs. And further support services for SMEs in the handling of their own intellectual property.

BUSINESSEUROPE supports initiatives to increase awareness on IPR, in particular to the benefit of SMEs. Optimising the use of existing network for IP education and IP awareness raising purposes is a positive step forward.

It is also important to improve the European patent system in terms of costs and legal certainty. A Community Patent that fully meets the needs of users is also of great value. Administrative burdens and barriers linked to obtaining IPR protection should be eliminated.

Concerning **servicing the research needs of services** the expert group invites



the Commission to

- involve service industries more actively when drawing up research agendas'
- encourage more socio-economic research associated with service innovation, which could provide a basic research platform for services activities.
- establish a "Service R&D Challenge Call" whereby R&D and innovation programmes encourage service, "hybrid" and manufacturing firms to systematically develop new service products and related support services.
- integrate a wider range of services to be more closely aligned to certain thematic research networks and programmes. For example biotechnology, nanotechnology, new generations of ICT and converging technologies. But also genomics, neurosciences and ambient intelligence and technologies will have many applications in services (as well as stimulation of new services).

BUSINESSEUROPE warmly supports the above-mentioned suggestions and regards them as probably the most important measures to create new "generations" of service products and to develop new paradigms for services innovation. BUSINESSEUROPE urges the Commission to implement these ideas in the CIP and 7th Framework Programme, for example by setting up more technology platforms aimed at innovation in services/service innovation and also a bigger focus on service innovation within the already established technology platforms.

In order to **support better innovation networking links for services** the expert group invites the Commission to introduce and diffuse the successful innovation voucher scheme (providing a small amount of money) operated in the Netherlands to a wider European scale and specifically aimed at service firms.

BUSINESSEUROPE recommends the EU Commission to be cautious about applying an innovation scheme specifically aiming at SME service firms - considering the complex nature of service innovation. Instead BUSINESSEUROPE recommends that the EU Commission and member states pay more attention to innovation in services/service innovation within existing programmes for SMEs, etc.

On **education, learning and skills for an innovative service economy** the expert group urges the Commission to

- identify new educational needs and establishing a "European Services Industrial Training Roundtable" to help articulate what knowledge and skills base modern service workers should aspire to.
- develop a range of schemes, including, identification of "best practice" courses; investment in dual "workplace" learning programmes where adults combine learning from traditional educational establishments with workplace-based training in service firms; encouraging the creation of courses and professional exchanges based on service R&D and services innovation management; and supporting the emergence of multi-disciplinary "service engineering" or "service science" training and learning initiatives.



- explore the extension of tax credits to support investments in R&D and associating tax credits for training with innovation.

Supporting access to finance for service innovation:

- support for better intellectual property (IP) valuations
- support for due diligence
- support for financial and business plan preparation
- establish an "Train the Trainer Initiative", where selected venture capitalists, incubators, other investors (such as "business angels") and legal professionals could be trained to provide more tailored support to innovative service companies.

On **clusters and innovation in services** the expert group suggests:

- European cluster mapping, impact assessment and "tool box": Eurostat and the European Commission to launch an action programme to ensure that regional data on a broad set of indicators and practitioner training courses that the EU could organise.
- European service cluster alliance for best practices: the EU Commission to provide workshops for practitioners to help share best practice experiences.
- network of service clusters, with the EU helping to provide an environment that makes it easier for regional clusters to develop such linkages.

Concerning all the above-mentioned suggestions on education, learning and skills for an innovative service economy, access to finance for service innovation and clusters and innovation in services, BUSINESSEUROPE believes that it should be left up to the Member States to decide which measures and initiatives are needed.

Instead the EU Commission should focus on creating better business environment for the service sector in broad by realising the services directive and making it easier for service companies in the Internal Market. Such initiatives would have much more impact and encourage the development of new services. At the same time lighter administrative burdens and a generally better business climate in the EU and the member states would be much better for supporting innovation in services.

The Role of Demand in Stimulating Innovation in Services

- foster more experimentation in developing more *demand-driven* R&D programmes.
- governments need to develop schemes that could encourage purchasers of services to be more innovative in their purchasing patterns, via: a) Develop the use of more ambitious *standards* to stimulate more innovative service products and performance levels within services. b) Improve *market transparency* for services by helping to ensure consumers and intermediate users are better informed on available service offerings (i.e. dealing with typical market failures, such as information asymmetry and market transparency).
- governments are also consumers in their own right and should seek ways to become more innovative procurers for services. As such, governments are in a unique position to support service innovation by acting as *lead customers* with



ambitious requirements when procuring services. Governments should be encouraged to develop and share experiences of innovative procurement policies.

BUSINESSEUROPE endorses the opinion that public procurement can be a driver for business investment in innovation. Private suppliers of services react and interact with their customers and their demands on a daily basis regardless of the customer being a public purchaser or a private business. BUSINESSEUROPE, however, holds a strong view on procurement of services and goods. Competition for the most economically advantageous bid must remain the yardstick for public procurement.

The exception of R&D services to the public procurement directives and the recent published guidelines from the Commission on state aid for innovation both allow for Member States to launch R&D programmes to enhance innovation. BUSINESSEUROPE supports that Member States stimulate these programmes in becoming more demand-driven. Furthermore that some of these programmes are used for the development of standards and improved market transparency. However, there must be a clear distinction between procurement of services and procurement of R&D services. The services covered by the procurement directives should be procured in a competitive way.

BUSINESSEUROPE supports that Member States are encouraged to develop and share experiences of innovative procurement policies. Innovative procurement policies should be based on the principles described in the recent communication by the Commission: "Guide to dealing with innovative solutions in public procurement - 10 elements of good practice", 2. March 2007. There are several ways of procuring more innovative which still comply with the procurement directives. To foster innovation through procurement involves a strong effort in securing the enforcement of the procurement directives.

BUSINESSEUROPE strongly opposes any introduction of any new procurement procedure, which will hollow out the scope of the procurement directives. A procedure for procuring R&D services may be misused for protectionist behaviour by Member States.

BUSINESSEUROPE has previously provided the Commission with the following suggestions on how to foster innovation through procurement:

The EU should in particular:

- *enforce the application of the legislative procurement package in Member States*
- *do more, within existing rules, to facilitate access of innovative SMEs to procurement contracts and ensure that decisions are taken based on reasons of value, not to simply meet targets;*
- *promote the introduction of advanced education and training in public procurement for civil servants of contracting authorities and suppliers;*
- *address the problem of risk aversion. Innovation may be considered in pilot or short-term projects, but often this is not followed through into longer-term projects, instead low-risk solutions are sought;*



- *secure a level playing field for public suppliers (municipalities and municipality-owned enterprises) and private suppliers by opening up the public service sector;*
- *clarify and elaborate further on the relationship between the state aid and public procurement rules;*
- *clarify the situation regarding the possible use of variants by public authorities as a possible tool for encouraging and promoting innovation, and;*
- *ensure effective protection and confidentiality of information so that companies are protected against the "cherry picking" of ideas by competitors and by contracting authorities. Without this there is no incentive for companies to develop and propose innovative solutions.*

Member States for their part should:

- *can support innovation by acting as and early adopter of new ideas. Early adoption of ideas can have a major impact on supply-side business. Providing firms with their first significant customer for a new innovation can form the platform of respectability from which further sales and long-term growth can be achieved;*
- *use procurement more strategically to stimulate innovative firms. For example they could promote the use, by public purchasers, of innovative criteria in the award of contracts;*
- *put forwards legislation that will encourage public purchasers to make procurement policies and to share these plans with the private suppliers. Early supplier involvement in the procurement process is critical if innovation is to be captured, and;*
- *promote advanced education and training in public procurement for civil servants of contracting authorities and suppliers.*



Chapter 4. Specific Policy Actions

The expert group suggests:

- implement the **European Innovation Platform for Knowledge Intensive Services as a pilot scheme** which should act as a network for experts from different fields.

The network could aim to develop, test and validate pooled service packages for potential high growth Knowledge Intensive Service (KIS) ventures, assessing research needs, offering KIS ventures specialised on coaching and training and facilitating access to clusters.

- establish **European Institute for Service Innovation** where future service needs could be identified, concepts "proofed" and innovative pilot projects in service innovation could be tested.

- **Innovation Service Exchange Network** by establishing a specific peer-to-peer knowledge community on services R&D and highlight and diffuse best practices by establishing an industry-academic network in service innovation.

- **High Risk, Innovative service Product Support Initiatives** by offering financial support to market testing, marketing and overseas expansion of new innovative service products and support overseas launching of innovative service products.

BUSINESSEUROPE does not support the establishment of new bodies or organisations specially focused on innovation in services/service innovation. BUSINESSEUROPE does not believe that such permanent bodies and activities on a European level might actually be able support and control the development of services. Instead creations of special "service bodies" tend to deepen the gap between service and other business. BUSINESSEUROPE is of the opinion that the EU Commission should strive to attract much more focus on service innovation and innovation in services in already existing programmes and schemes. For instance to integrate service innovation and innovation in services in the activities in the new European Institute of Technology (EIT) and to focus more on service in the Knowledge Intensive Communities (KIC) and also to support service development within the 7th Framework Programme.

Furthermore, BUSINESSEUROPE strongly believes that innovation in services is better supported by a healthy development of the free market and implementation of the services directive.

Such special bodies for services would isolate service innovation from other kinds of business activity, which would not be a healthy development.

By creating a body which should serve the companies with specialised coaching and training in market and investment readiness, there is a risk of undermining the market for services companies offering services in this area. If there is a need for such kind of services, companies should be let fill the gap on a commercial basis.



The Commission should foster the innovations demanded by the market, not create new needs for funding. The latter will only foster new services to help applying for funds and not encourage competitive services in a global competition.

CONCLUDING REMARKS

BUSINESSEUROPE supports the EU Commission's initiative to draw more attention to service innovation and innovation in services since this is considered to be one of the most important features for the future of European economy. In addition, BUSINESSEUROPE is happy that the expert group places a balanced and broad view on the concept of services. However, it is still needed to further investigate what we want to include in the concept of services.

The expert group states in one place: "services are simply too big a "sector" to study in any meaningful or coherent form" (p. 14). But the expert group still tends to do so by making several suggestions that tend to place services in a special category and depart services from other kind of business.

BUSINESSEUROPE is of the opinion that services are giving the best conditions for development by creating an Internal Market, implementing the services directive and diminishing the barriers and administrative burdens as much as possible.

BUSINESSEUROPE recommend the EU Commission not to establish new schemes or bodies to focus especially on the "service sector" but instead to encourage innovation in services and service innovation in the already existing initiatives and schemes, most notably the CIP and 7th Framework Programme.

Finally, we would like to strongly underline that increased competition is the best tool to foster innovation, and that the main task for the Commission is to ensure that there is open and free competition in the services sector - free from both technical and administrative barriers. When services can move smoothly across borders there will be increased competition and thus more innovation.

Innovation in services also requires public incentives that place the innovative company in charge of the innovation process. Public innovation programmes with a narrow scope and definition of innovation favours traditional R&D and innovation in manufacturing companies. Tax incentive schemes for investments in R&D and innovation is an example of more "open" policy measures where service companies find room for their type of innovation processes, even though these schemes are usually not targeted specifically towards the services industries.