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How Public Procurement can stimulate Innovative Services

Report to Nordic Innovation Centre (NICE)

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This report is an account of the study on how public procurement can stimulate innovative services, assigned to *Faugert & Co Utvärdering* (Technopolis Group, Sweden) by the Nordic Innovation Centre (NICe). The report describes a number of initiatives taken in the Nordic countries to promote innovative services through public procurement, as well as some programmes, plans and enterprises carried out elsewhere, in other European countries.

It also contains the results from a number of semi structured interviews, conducted with people experienced in the fields of public procurement and/or innovative services. Results from the interviews are presented and discussed under the headings of a number of themes, which can be regarded as important factors for the possibility to achieve innovative services.

The work in this study has been done by a project group where Jakob Hellman, Monique Rijnders-Nagle, Miriam Terrell and Tomas Åström were included. Peter Stern has been the project leader.

1. Summary and conclusions

The study shows that there seem to be very few initiatives taken where the objective is clearly and explicitly stated as stimulating or creating innovative *services* using the means of public procurement. At least, their visibility is not very high. In most cases public procurement, in general, is viewed and conceived of as useful to achieve innovation, also in general. When there are references to services, it is mostly to public services. Frequently the objectives are also some kind of innovation in terms of procurement procedures rather than innovative services, and sometimes it is not entirely clear in what terms the objectives are actually stated.

There is also a tendency in the countries studied to be quite active on a somewhat abstract policy level, but a bit less active when it comes to specific and detailed programmes and activities directed towards achieving clear and unambiguous objectives or goals. Policy is not equally developed between countries studied.

Differences between procurement of innovation in general as opposed to procurement of innovative services are most often conceived of as differences in the idea of what you are actually buying. In most cases of general innovation procurement, the assumption is that you are procuring R&D, or a prototype or demonstrator. Even if that is not always entirely true, such an assumption characterises a number of procurement approaches (e.g. the European Commission's PCP directives). When thinking about innovative services, the procurement is not of R&D or development, but of the actual service. This constitutes a different mindset. It is sometimes even hard to separate between them.

Perhaps the most significant initiative where actual procurement is currently going on to achieve innovative services to be found so far is the Finnish programme at Tekes, where public procurement units and public utilities can apply for funding for public procurement of innovations. The objectives of this funding instrument are to promote innovation among bidders and enhance diffusion of innovations in the market as well as to promote renewal of public services. Nine months after the launch of the programme, 13 projects had been accepted for funding, mainly focused at developing services, especially in the social and health care sector.

There is apparently not one single way to look upon the importance of factors, conditions and measures to obtain innovative services by the means of public procurement. No clear consensus show among the interviewees in this study.

A general conclusion, however, is that procurement rules are in general not considered to prevent procurement of innovation, but they are not exactly encouraging them either. Procurement of innovation, and innovation services, are possible, but

legislation is not altogether efficacious since it does not specifically take it into account. Rules and regulations mostly tend to make procurers risk averse.

Some sector specific rules and regulations have a restraining effect on innovation in general, as would standardisation in services, which can be considered to reduce the possibilities to procure innovative services.

The use of good examples is also highlighted as a means of developing innovative services. To be able to see how such services can present added value and how to stimulate the process, from real cases is considered valuable. This would also make it possible to develop the guidelines for procurement that exist in some settings.

Several of the critical pitfalls for successful procurement of innovative services seem to be connected with either the issue of rules or incentives on a general level. Budget regulations hold back the procurement of innovations in general, since budgets are annual and itemised and hard to reallocate. Innovation is mostly described as needing more flexible approaches than that. Public actors, including procurers, generally don't gain from innovating. Resources saved from innovative solutions are not automatically allowed to be reinvested for the same purposes.

Management support for developing methods and procedures, as for the individual risk taking, is a critical factor. Procurement must become a strategic activity and an integral part of strategic planning. That way, the skills of being a professional buyer or procurer can be legitimately developed, and procurement become more of a main task in the organisation. A more holistic approach, not entirely focused on the price of services, is needed.

A thorough understanding of the market and how it operates, as well as a clear idea on what you want the service to deliver, is also necessary factors to become successful. Connected with that is also the skills and ability to select the right procurement mechanism, which could be another than the organisation is used to.

Issues associated with intellectual property rights within the service sector still seem to be unclear. Companies need to know if they are able to protect their innovations, or it might not be worth their investment. Moreover, in some sectors and geographical areas service providers are quite few, from which less potential naturally follows. Small municipalities, or other actors in some areas, are usually happy to find service suppliers at all, and that is a situation where it is not realistic to demand innovation.

Information and open communication in the procurement process are stressed. Actors should be able to communicate their needs more rapidly, and before it is too late to think about innovative solutions. The public need must be clearly defined, for the bidder to know what to offer in terms of innovative solutions. There should be clear goals, as well as somewhat elaborate ideas on how to reach them.

The development of approaches for procurement of innovative services needs to be resolved at the highest organisational level, since there are no incentives for procurement units or departments to implement these kinds of changes. They will currently try to minimise both risk and costs, which is not exactly good for development. Procurement also needs to be in very close and constant contact with functional parts of the whole enterprise.

Criteria for selection of innovative services must become clearer, including whether you prioritise price, function, performance or innovation. Processes must start earlier and need involvement of other people, which would take longer time. It must be legitimate to try new solutions, which include a risk of failure. If that is not acceptable, no one will be the first to try. This is, reportedly, what it takes to break with traditionally conservative ways of thinking.

In sum, this study shows that a potential forthcoming project on how public procurement can stimulate innovative services needs to take a number of factors or circumstances into consideration. To successfully establish a practice where such

objectives are likely to be met, attention should probably be given to a number of things at the same time. These include:

- how thorough descriptions of public needs that services are supposed to satisfy might be developed,
- how to make it legitimate to take the risks involved in innovation enterprises and to increase profit for those doing well,
- how to create a good understanding of the market, how it operates and what you want the service to deliver,
- how to reach a well informed decision on which actors to include in the process of procurement of innovative services,
- how to develop and describe good and useful examples,
- how to increase management support and involvement,
- how to conceive of criteria of selection of innovative services (whether, and in what ways, you prioritise price, function, performance or innovation),
- how to expand professional skills of procurers, and
- how to develop and establish information and communication schemes to enhance dialogue between actors in pursuit of innovative services.

2. Background

2.1 Public procurement as stimulant of Innovative Services

The use of public procurement in innovation policy is a highly discussed and relevant subject matter in all Nordic countries, as well as in the EU. A large number of initiatives, pilot projects or studies have been launched to look into it. A significant part of the idea behind these initiatives is that (the size of) the public procurement has a potential for new, innovative products and services. The public procurer is thus able to drive innovation from the demand side, by somehow speeding up the process and help companies to reach new markets.

Many of the initiatives so far have been concentrating on procurement of technical products, or the development of standards. There is however an increasing interest in driving innovation in a much broader sense, i.e. in using procurement to stimulate development of products, services, business and social processes and models. Seen this way, innovation is thought of as a prerequisite to competitiveness and the capacity to create new jobs in the current economic crisis, and moreover why the European Commission has placed innovation at the heart of its Europe 2020 Strategy.¹ Innovation is also generally described as the best means of successfully tackling major societal challenges, such as climate change, energy and resource scarcity as well as health and ageing.

A service innovation, in contrast to a technical innovation, can be viewed as a service product or a service process that is based on some technology or systematic method. In other words, a service innovation does not necessarily relate to the novelty of the technology itself, it often rather lies in a non-technological area of such applications. Service innovations are thus new or improved service concepts taken into practice.

¹ Communication from the Commission to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions, Europe 2020 Flagship Initiative, Innovation Union, COM(2010) 546 final, SEC(2010) 1161, Brussels, 6.10.2010.

Focus in this study is on how public procurement can stimulate innovative services, on both national and sub-national levels. The results of the study should be of help to NICE in designing a project on the theme, and to influence the debate on innovation and public procurement.

In somewhat other terms it seems clear that this way we are dealing with an area where other policy considerations, i.e. those of innovative services, are integrated into public procurement. We can regard this as a part of a more general discussion on public procurement of innovative goods, services or works (including initiatives to provide market opportunities for pre-commercial R&D), which will be referred in the next section.

2.2 Public procurement of innovative goods, services or works (processes)

In the last decade, public procurement has increasingly been regarded as a (demand-based) instrument of innovation policy. Buying innovative solutions at public sector level comes along with considerable expectations, such as the creation of lead markets, boosting industrial innovation, better performing government or solving societal problems and so on.

Public procurement of innovation may be defined as the purchase of innovative products, services or processes through public demand with the aim to improve the performance and functionality of public services or to solve important socio-economic challenges. The purchase might include R&D.²

The procurement of innovative solutions to public services needs can contribute to improving the quality and delivery of public services and to assist the public sector in achieving better long-term value for money. In addition, it can stimulate innovation within the economy by enabling the market to respond to current and future public service needs. Innovative solutions may ensure that Governments are able to meet long-term needs, especially in areas where market-ready solutions do not yet exist or are not immediately evident. Procurement of innovative solutions provides signals of Governments' long-term requirements to the market.

Procurement of innovative solutions has potential benefits for public service delivery and for the economy. With regard to public service delivery, it enables better engagement with, and understanding of, the market resulting in more informed, evidence-based decision-making. In turn, this can help Governments to meet their policy commitments and achieve better value for money through higher quality, faster delivery and/or reduced life cycle costs.

With regard to benefits to the economy, the Government can act as a demanding and intelligent customer. By acting as an early adopter of innovative solutions and contracting for them, Governments are able to give industry enough of a market to justify investment in new skills, equipment or R&D, thus improving suppliers' innovativeness and competitiveness in other markets.

In contrast to regular procurement, public procurement of innovation is a full-fledged process whereby the preparation phase is vital for a successful outcome.

In general, three approaches can be distinguished:

- Market sounding, for a more detailed understanding of existing markets and solutions to inform a future policy or procurement strategy. Innovation solutions are sought for longer-term needs, often without a full definition of detailed requirements and with little or no knowledge of potential solutions.

² OMC—PTP, Exploring Public Procurement as a Strategic Innovation Policy Mix Instrument (manual developed within an Open Method of Coordination (OMC) funded by the European Commission within the 6th Framework Programme, www.ome-ntp.eu).

- Market sounding, calling for innovative solutions to inform a future procurement. In cases where more knowledge exists of what the market can provide, the search for innovative solutions can be linked directly with subsequent procurement – using a fair and open tendering process.
- A direct procurement of innovation. Possible approaches include competitive dialogue, pre-commercial procurement (PCP) and forward commitment procurement (FCP).
 - Competitive dialogue allows scope for early discussion with suppliers and innovators to determine how their solution meets the need of the Government and how it can be developed to the point of supply. It is used in the award of complex contracts, where there is a need for contracting authorities to discuss all aspects of the proposed contract with candidates. The competitive dialogue procedure was introduced as a new procedure in the European public sector procurement directive.³ The main features of the new procedure are: dialogue is allowed with selected suppliers to identify and define solutions to meet the needs and requirements of the contracting authority; the award is made only on the most economically advantageous tender criteria; dialogue may be conducted in successive stages, with the aim of reducing the number of solutions/bidders, and there are explicit rules on post-tender discussion.
 - Pre-commercial procurement (PCP) is based on the exclusion of the procurement of R&D services from the EU Procurement Directives (unless the benefits of the R&D are exclusively for the contracting authority and the R&D is fully paid for by the contracting authority). Examples of PCP include the SBIR programme in the Netherlands and the SBRI programme in the UK. PCP requires a clear identification of needs and a call for solutions. Once a number of potential solutions have been found, the contracting authority uses R&D services contracts in discrete phases to progress development to the point at which they can be considered for procurement and supply.
 - Phase 1: feasibility, solution exploration
 - Phase 2: R&D and prototyping
 - Phase 3: R&D for pre-production
 - Phase 4: Production and supply

The first three phases can be progressed without re-competing, and at the end of Phase 3, the procurer enters a commercial procurement procedure. There is no guarantee that any of the suppliers contracted for initial R&D will ultimately supply procured goods or services, but the procurer has the knowledge that potential solutions exist in the market. An advantage of the PCP approach is that it provides incentive for suppliers to share risk and rewards with the procuring organisation.

- Forward commitment procurement (FCP) as a process is still in development. The basic idea is that by giving clear visibility to credible procurement needs, and by making it clear that innovative solutions will be fully encouraged and considered, suppliers' development efforts will be stimulated. The aim of FCP is to build an attractive B2G market for innovative companies. It was originally designed to address market failures in the environmental industry sector. However, the FCP approach can also be applied to pull forward innovation in other sectors. FCP was developed in the UK and the FCP model was designed as a means to enable the public sector to secure the (environmental) technologies and products it needs to achieve its (sustainability) targets, to deliver them in the required timeframe and at an

³ Directive 2004/18/EC, Article 16(f).

affordable price. FCP means that the contracting authority provides the market with advance information about its requirement or 'unmet need'. The requirement is expressed in outcome and technology agonistic terms, and communicated to the supply chain with sufficient time to allow the market to respond. Most importantly the requirement is articulated not in general terms but in the context of an actual procurement opportunity of sufficient scale to stimulate investment to deliver, and an offer of a forward commitment to a solution that is not yet commercially available, subject to performance parameters being met. It differs from PCP, as it does not focus on R&D, but on stimulating the supply chain to invest by creating a visible and credible market and in some cases offers routes to wider markets, for example through engagement with partners with similar needs. In FCP, in contrast to PCP, the contracting authority leaves the development of the solution and potentially new innovation completely to the initiative of the supply chain (who on the basis of a visible market now is in a better position to attract investment). The contracting authority does not enter into any R&D service contract with suppliers. In FCP this is replaced by effectively transferring the risk to the party best suited to handle it – i.e. a large part of the market risk is removed from the supplier and the technology risk made more manageable for the contracting authority.

In this study, steps have been taken in trying to avoid the duplication of recent efforts to review and describe how innovation procurements have been integrated into general public procurement. Our study focuses on good practices as implemented by public authorities.

3. Initiatives in the area of public procurement and innovation

This section of the report contains an account of the visible procurement of innovation initiatives taken on the Nordic level, in the individual Nordic countries, and in a number of countries active in the area is presented. For each country, the properties of the initiative, as well as a list of relevant policy documents are listed. Interviews gave some additional data on initiatives or programmes.

3.1 Nordic level

On the Nordic level, for the Nordic Council of Ministers, a study of Health Innovation in the Nordic Countries – Public Private Collaboration, has been performed. Information is gathered from all Nordic countries about how public-private collaboration and public procurement can result in innovative services and products in healthcare, through survey, interviews and focus groups.

Findings reveal that there is a perception of different type of barriers between the nations. Iceland, being relatively small in size and population, is more internationally targeted than others in their work in this particular area. There are both similarities and differences between the Nordic countries, actors share a common perception of barriers towards each other despite the willingness and need of a common platform for healthcare. Conditions for a common market of services that all five countries can use and make profit from are addressed, and there are some national examples of what has been accomplished in innovative services in healthcare and what kind of initiatives that has been taken.

The main barriers, for public-private collaboration, are depicted as the lack of flexibility in law and regulations for public procurement, user resistance to change and the lack of incentives in projects that includes many partners.

3.2 Finland

During the Finnish Presidency a ministerial meeting was organized, where a paper entitled “Demand as a Driver of Innovation – towards a More Effective European Innovation Policy” was presented (Finland’s Presidency 2006).

The Finnish national innovation funding agency, Tekes, carries out public procurement of innovation to lower risk associated with the development of innovative goods and services. In the first stage, planning of procurement, the government funds between 25% and 75% of total expenses in a single project. In the second stage, procurement or implementation, Tekes provides funding support for the procurer and for suppliers’ R&D and innovation expenses.

The policy objectives of the Tekes funding instrument are to promote innovation among bidders and enhance diffusion of innovations in the market as well as to promote renewal of public services. Public procurement units and public utilities can apply for funding for public procurement of innovations, as mentioned above both for the planning and for the R&D&I stage as part of the procurement. Nine months after the launch of the programme, in July 2010, 13 projects had been accepted for funding. They are mainly focused at developing services, especially in the social and health care sector.

Culminatum Ltd Oy, Helsinki Region Centre of Expertise, is a development company that is owned by a broad base of research institutes, universities, municipalities and companies. Culminatum manages the regional Innovative Public Procurement development programme (2008 – 2010), which aims to deploy new models for the procurement of public services, and to create new types of services for municipal employees and local residents. The programme will promote the creation and implementation of service innovations in terms of procurement procedures and the services to be procured. The practical initiatives of the project include implementing innovative pilot procurements, deepening the procurement process expertise of city managers and experts, and creating a permanent network of key specialists. The cities participating in this programme are Helsinki, Espoo, Kauniainen and Vantaa.

Helsinki Region Centre of Expertise for Knowledge-Intensive Business Services (KIBS) is part of a development program launched by Culminatum, of which the KIBS forum forms the core. The KIBS forum comprises a variety of theme groups, covering service design and innovative public service procurement.

Within the European Regional Development Fund, there are some projects in Finland that have been labelled “innovation procurement”.

3.2.1 Policy documents

The Ministry of Employment and the Economy in Finland has published a “*Demand and User-Driven Innovation Policy*” in 2010, including an Action Plan. This plan formulates different measures in order to promote innovation by means of public procurement:

1. Establish a group of innovative forerunner cities targeting to renew public services through innovations by focusing especially on public – private partnership, user-driven activity and procurement of innovations
2. Development of procurement on public sector to drive innovations
3. Implementation of Government’s procurement strategy aiming to promote innovations
4. Strengthening the role of the organisations that develop public procurement (Hansel, Motiva, HAUS) in order to increase knowledge in public procurement of innovations.
5. Development of incentive models and risk management methods for procurement of innovations

3.3 Sweden

Sweden has a long and successful history of public-sector demand innovation policy in telecommunications, electricity generation and power distribution (Vattenfall/Asea, Televerket/Ericsson etc). However, one current view is that the legislation on public procurement that was introduced in 1994 and the commissioning/ contracting models that became common during the 1990s created a situation in which innovation and technological development rising through procurement by public authorities declined considerably.

No single public programme or policy document in Sweden has so far explicitly listed public procurement of innovative *services* or investigated this subject specifically. Innovation procurement in general includes both goods and services.

The Swedish Energy Agency has over a couple of decades been using the policy measure “technology procurement”, which includes new products, systems or processes in order to stimulate and accelerate the development and introduction of new technologies. This is also the case (although seemingly to less extent) at the former Swedish Road Administration (nowadays the Swedish Transport Administration).

In 2008 VINNOVA introduced a pilot in order to study different forms of innovation procurement. The collected results will hopefully constitute the basis of the public procurement of tomorrow. Up until now only three projects have been funded within the program.

The program “Environmentally driven markets”, run by the Swedish Agency for Economic and Regional Growth includes coordination and support for SMEs to become better at winning large deals through innovation procurement.

The working group named “Public innovation procurement” within the project “Innovation for growth”, run by The Royal Swedish Academy of Engineering Sciences, has (2010) published a set of proposals to the steering group. These include (among other ones) the creation of a “delegation for innovation procurement” which explicitly would have to address the issues of service procurement.

The Legal, Financial, and Administrative Services Agency (Kammarkollegiet) is, as of 2009, responsible for a national function for procurement assistance and development, and should develop methods partly aimed at encouraging other authorities to use public innovation procurement.

The Swedish Environmental Management Council (SEMCo, Miljöstyrningsrådet) assists contracting authorities and entities by developing relevant environmental criteria for procurement. The council launched the report “*Technology procurement – tools to stimulate innovations and new environmental technology*” in 2008, funded by Nutek (Swedish Agency for Economic and Regional Growth). The Jegrelius Institute for Applied Green Chemistry, who also participated, has the aim to utilise purchasing power in procurement to demand new cleantech.

The Innovation Procurement Inquiry was commissioned by the Swedish government 2009, to investigate the conditions for public innovation procurement in Sweden and put forward proposals for measures to increase the application of innovation procurement. This was done in august 2010, SOU 2010:56.

3.3.1 Policy documents

The Strategy of the Swedish Competition Authority and its *Direction for Procurement Issues* from 2007 addresses the issue of innovation procurement and in 2006, the Swedish government commissioned Nutek and VINNOVA, in consultation with the Swedish National Board for Public Procurement (Nämnden för offentlig upphandling, NOU), to examine how public procurement can contribute to developing innovation and creative renewal. This was to include investigation as to how procurements may

be structured in such a way that, to a greater extent, they drive forward technological development and business opportunities.

The national council for architecture form and design (dissolved in 2008) published the report “*Quality of public procurement*” in 2008, which partly discussed innovation procurement.

Sweden does not have a national innovation or innovation procurement policy in the health care field. However, VINNOVA commissioned a consultancy to write the report “*Can public procurement spur innovations in health care?*” as a part of the background material for the conference Public Procurement of Innovation – A Driver for Future Health in Europe, organised by VINNOVA in October 2009.

3.4 Norway

For the Norwegian government, effective use of society's resources is a central element in policy. Competition is an important instrument in order to reach the goal of obtaining a well functioning and reasonably priced production of goods and services in the private as well as the public sector, to the benefit of the consumers.

The Minister of government administration and reform has the overall responsibility for the sector crossing instruments in the government's competition policy. This includes competition law and regulations for businesses, regulations on public support and regulations on public procurement. *The Competition Authority* reports to the Ministry and continuously oversees the competition in the various markets based on the regulations in the Competition Law.

The Research Council Norway (RCN) has launched an overall initiative to promote innovation in the public. As a part of this initiative the thematic research programme on Value-adding Innovation in the Public Sector (VIOS) was established. Three years later VIOS was incorporated into the existing Programme on Research for Innovation and Renewal in the Public Sector (FIFOS). Among its objectives is to establish a better knowledge base for innovation and renewal, with no specific reference to services other than e-services and health and care services, and no specific mentioning of procurement.

On the procurement side, one of the current initiatives is the Environmental and Social Responsibility in Public Procurement Action Plan, where the government wants the public sector to lead the way as a responsible consumer and demand environmentally sound products and services which have been manufactured in accordance with high ethical and social standards. Among the objectives we find: to contribute to a competitive business sector by encouraging a market which promotes innovation and the development of environmental technology and environmentally sound products. Hence, there is a reference to innovation, but not innovative services specifically.

During the period 2010-2014 there will be a joint national programme on the development of suppliers in Norway, with participation from over 15 public and private actors involved one way or another in public procurement, or its development. The objectives in the programme are to promote competition, industry development and innovation, through:

- active use of public procurement,
- understanding, competence and knowledge about public procurement, and
- carrying out of additional innovative procurement.

We see that also in the case of the programme on the development of suppliers, the emphasis is on the innovative procurement as such to promote, among other things, innovation in general, not innovative services specifically.

3.5 Iceland

In Iceland it is recognised that innovation is concentrated to a limited number of firms and that policy should aim to broaden the innovation base by encouraging innovation in the smallest of firms and supporting entrepreneurship. Thus funding for developing new knowledge should be supplemented by policies to stimulate diffusion of knowledge and good practice among a broad set of firms in a diverse set of manufacturing and service industries.

Since 2005, Iceland has synchronised with the new public sector EU procurement directives, and worked on new legislation. In 2001 the Icelandic Parliament passed the first comprehensive act on public procurement and with the new legislation, four directives on public procurement were put together as one piece of legislation. Before that (1994-2001) the main principles of the European legislation had been incorporated into a number of regulations issued by the Ministry of Finance. The directives dated back to 1992 and 1993, and concerned the awarding of *products*, *services*, *public works* contracts and *utilities* such as procurement of public institutions serving in the energy and water supply sectors, telecommunications and public broadcasting.

No programme or initiative where public procurement is connected with innovative services has been visible.

3.6 Denmark

In the area of public innovation procurement, Denmark seems to be relatively late in taking specific policy initiatives. Also in Denmark many of the most recent initiatives relate to green procurement.

However, the Danish Agency for Science, Technology and Innovation has initiated a process where Danish actors revise what is happening inside service companies when they innovate, the drivers of service innovation and what hinders service companies from innovating. Among a number of other things, the analysis shows that knowledge and expertise matter. It is recommended that procurement officers' skills to make procurement of more creative and innovative solutions should be improved. Also, public and private actors across levels and sectors should work together to create new and make use of existing best practice tools and guidelines for innovative procurement in state organisations, regional authorities, and municipalities.

The recommendations also include the establishment of a Centre for Public-Private Service Innovation, which has been set up in Region Syddanmark (Region South Denmark) focused on welfare and service. In addition to this, the Danish government has established a new fund, Fornyelsefonden (Renewal fund), with a focus on public-private partnership and public procurement. There are no other ministerial policies or initiatives particularly visible in Denmark.

The Centre for Public-Private Innovation and Welfare Technology is national and partly funded by all five Danish regions and the European Union structural funds. Its aim is to further public-private innovation in relation to the development of both technologies and better services. This is done through illustrative examples and by focusing and overcoming legal, cultural and financial barriers for successful co-operation between private companies and the public sector.

3.7 United Kingdom

In the United Kingdom there are quite a lot of activities going on in the area of Innovation Procurement Policy as well as Services Innovation Policy. However, the two seem to be less connected.

The Department for Business, Innovation and Skills (BIS) is responsible for UK policy on innovation procurement. An important commitment in the Innovation Nation White Paper, (March 2008) was for each Government Department to publish an Innovation Procurement Plan (IPP) as part of its commercial strategy, setting out how

Departments will embed innovation at the heart of procurement practices and will ensure that they engage with UK businesses at an early stage. No initiative of this kind is visible in any of the plans.

The position in the UK is that they do a lot of work on the procurement of innovation, and have two main mechanisms for doing this:

- the Small Business Research Initiative (SBRI), which has been utilised for products rather than services, although some ICT products has had support, which blur the line between the two; and
- Forward Commitment Procurement (FCP).

SBRI is, more specifically, a mechanism to enable innovation in goods and services through the public procurement of R&D. It provides innovative solutions to Public Sector Challenges, a route to market for new ideas, and new business opportunities for Technology Companies.

FCP, on the other hand, is a practical supply chain management tool that creates the conditions needed to deliver innovative, cost effective products and services. It provides a framework for purchasers to seek solutions to unmet needs, rather than specify required outputs, involves early engagement with business in order to identify potential ways of meeting the need, and seeks to go beyond the customary supply chain.

Another important goal for BIS is to support services innovation. Public procurement is one of five drivers for services innovation. However, no specific initiative is connected to this point. They conceive of recommendations for how public procurement processes need to be changed/conditions that need to be met by the procurement processes to boost services innovation, and also refer to the Innovation Platforms with their focus on solutions to major policy and societal challenges such as climate change and an ageing population. These challenges are used as the stimulus for procurement action having to be taken by the relevant Government Department. Procurement is thus *part* of Innovation Platforms. There is no specific platform for Services Innovation.

In sum, there is a lot of information on the approach to innovation procurement in the UK, and the BIS Business Sectors policies, focusing on Services, but practically nothing referring to a UK project/programme/committee focusing on the cross section between the two policy areas Innovation Procurement Policy and Services Innovation Policy specifically.

3.8 Others

The starting point for searching for initiatives in other countries has been to look into some European and international networks on Innovation Procurement and Services Innovation to determine which countries seem to be most active in this regard, assuming these would be the countries to start looking for initiatives where the two policy areas meet. These networks are:

- OMC-PTP (see www.ec.europa.eu/invest-in-research/coordination/short_summary_project_en.htm)
- EPISIS (see www.proinno-europe.eu/episis)
- Expert Panel on Services Innovation (see www.ec.europa.eu/enterprise/newsroom/cf/itemshortdetail.cfm?item_id=4004)
- European Public Procurement Network (see www.linkedin.com/groups/European-Public-Procurement-Network-35283)
- International Public Procurement Conference (see <http://www.ippa.ws/>)
- STEPPIN (see <http://standards.eu-innova.org/Pages/Steppin/default.aspx>)

- PRECO (see ftp://ftp.cordis.europa.eu/pub/fp7/ict/docs/pcp/preco-brochure-final_en.pdf)
- EUROPROC (see <http://www.europroc.eu/>)
- Report on Demand-side policies in the different European countries (Trendchart, 2009)

The countries that seem to be the most active in these contexts are the Netherlands, Germany and Ireland:

- **Netherlands;** have had major initiatives in both Public Procurement and Services Innovation, but again no combined initiatives have been found. After the recent government reorganisation, Innovation Procurement falls under a new department in a new ministry and no information is available on the government website. Technopolis Group is also doing an ex ante evaluation of the Dutch Innovation Program on Services & ICT and no initiatives on public procurement are included/connected there.
- **Germany;** The Ministry of Science and Research has an “Innovation with Services” programme and there is supposed to be a joint initiative with at least 5 ministries concerning innovation procurement. No policy document is visible, however, as is the case with any links to procurement in the “Innovation with Services” programme.
- **Ireland;** has dedicated groups/committees/organisations for Public Procurement and Services Innovation respectively. The “Services Strategy Group” has recommended using public procurement to stimulate services innovation, but no further evidence or information on specific initiatives are visible.

4. Interview study

In addition to the above descriptions of initiatives taken in the Nordic countries to promote innovative services through public procurement, as well as some programmes, plans and enterprises carried out elsewhere, in other European countries, 16 interviews have been conducted. Findings from interviews are presented and discussed under the headings of a number of themes, which can be regarded as important factors for the possibility to achieve innovative services.

The interviewees were chosen in dialogue with NICE, in their capacity of experienced and knowledgeable in the fields of public procurement and/or innovative services. They are not to be seen as representatives of any organisation or body, or expressing the official views or opinions of such an organisation or body.

4.1 Rules and regulations that need to be adjusted, changed, removed or added

Answers to the question if there are any specific rules and regulations that need to be adjusted, changed, removed or added vary from the laconic “No, I’m not aware of any” to a somewhat lengthy description of how to understand their development the last ten years.

The main picture, however, is that procurement rules are in general not considered to prevent procurement of innovation, but they are not exactly encouraging them either. Procurement of innovation, and innovation services, are possible, but legislation is not altogether efficacious since it does not specifically take it into account. Rules and regulations mostly tend to make procurers risk averse.

There are clearly some sector specific rules and regulations that have a restraining effect on innovation in general. An example which is pointed at is the health sector, where people work with several kinds of rather strict protocols. The suggested solution to this tends to be to co-operate with organisations or companies in the sector, to

obtain solutions that have impact on several organisations and thus makes it more interesting to invest in. Also, the example of data protection, including rules regarding handling and protection of personal information, challenges innovative information systems solutions. Standards in services can also be considered to reduce the possibilities to procure innovative services.

Another potential problem for companies that participate in some form of public-private partnership could be that private actors' insight from helping out in developing solutions could exclude them from being invited to tender or having their products purchased because they are regarded to possess knowledge that their competitors lack, which would be against procurement rules.

Actors involved in research and pre-commercial procurement tend to conclude that no changes of rules are necessary, or in some case even that they include too many possibilities. Instead, the lack of information and knowledge about the workings of the rules is pointed out as the important factor. A need to disseminate information and develop the competence of procurers of how the rules work and how they can be used to reach innovative solutions is pointed out.

The idea of good examples is also expressed in the interviews. To be able to see how innovative services can present added value and how to stimulate the process, from real cases is considered valuable. This would also make it possible to develop the guidelines for procurement that exist in some settings.

4.2 Apparent critical pitfalls for a successful innovation services procurement approach

A number of critical pitfalls for a successful procurement of innovative services approach seem to exist, and at different levels as well. Looking at the answers from the interviews, it becomes clear that many of them are, again, connected with the issue of rules and regulations that may need to be developed or adjusted one way or the other. It also seems to be connected with incentives on a general level. Consequently, at an agency level, budget regulations hold back the procurement of innovations, by budgets being annual while contract periods are often several years. Budgets are also itemised, seldom with the possibility to reallocate, with investments and operations conceptually separated. Public actors, including procurers, generally don't gain from innovating. Resources saved from innovative solutions are not automatically allowed to be reinvested for the same purposes.

As far as the private sector is new territory for procurers, there is also a need to develop similar language and conceptions of the field. A thorough understanding of the market and how it operates, as well as a clear idea on what you want the service to deliver, is necessary. Connected with that is also the skills and ability to select the right procurement mechanism, which could be another than the organisation is used to. An example would be using competitive dialogue as a method instead of a single (call for) tender. Practice will probably also need more of exploring and outreaching elements.

Within the organisation, management support for developing the methods and procedures, as for the individual risk taking, is a critical factor. Procurement must become a strategic activity and an integral part of strategic planning. That way, the skills of being a professional buyer or procurer can be legitimately developed, and procurement become more of a main task in the organisation. A more holistic approach, not entirely focused on the price of services, is needed.

In the interviews, it is also argued that in the case of service innovation the entire organisation with the whole of its organisational processes is turned upside down. Procurers and companies need to be patient. Procurers need to understand that these initiatives can't be taken lightly, and that companies have limited resources. Companies need to understand that procuring organisations may frustrate if innovation demands are too high. Transaction costs are high and a lot of money is needed, especially in intense first, explorative, pre-tender phases.

Reasonable expectations from policy makers and when deciding on funding of innovative services, commitment from both boards and top management and a clear eye of the balance between investment and operating costs in a life cycle perspective are all factors that can be extracted from interviews as being of great importance.

Furthermore, issues connected with intellectual property rights within the service sector still seem to be unclear. Companies need to know if they are able to protect their innovations, or it might not be worth their investment. There also seems to be a trend of standardisation of services, which is seen as preventing the open and innovative character of procurement needed to obtain innovation. Service innovation is moreover often characterised as multidimensional, more like process innovation and thus difficult to define.

In some sectors and geographical areas service providers are quite few, from which less potential naturally follows. Small municipalities or other actors are in some fields usually happy to find service suppliers at all, and that is a situation where it is not realistic to demand innovation. Some public actors have development divisions of their own, who will prevail over smaller companies in competition. Evaluation of competing services in the procurement process is also described as a weak point, with a lack of common criteria.

Again, information and open communication in the procurement process are stressed. Actors should be able to communicate their needs more rapidly, and before it is too late to think about innovative solutions. The public need must be clearly defined, for the bidder to know what to offer in terms of innovative solutions. There should be clear goals, as well as somewhat elaborate ideas on how to reach them.

4.3 Problems connected with processes of tenders

The views on this matter are somewhat conflicting among the interviewees in this study. On the one hand the opinion is that tender specifications must be much more open than today. Instead of procuring for instance health insurance for 200 employees, the specification could be 20% fewer sick days per year. On the other hand there is another opinion that it is a mistake to think that a very general functional specification will make everything fine. A vague description will not challenge people to come up with something new or innovative. However, both sides share the notion that the tender in itself is only a part of procurement, and that proper planning makes the process as such much easier.

The opportunity for developing innovative solutions is early in the process, often even in some kind of pre-project. The use of more pre-competitive tenders can be increased or extended. Time and cost for developing tenders must be allowed or accepted. Narrow ways of thinking follow from time limitations. Tenders should contain more of descriptions on how to satisfy the customer, rather than what product or service is needed. A general lack of competence in these areas needs to be addressed. Risk aversion follows from fear of making mistakes. People automatically act as they always have or in a way that has worked before. A set of good examples is needed to show the possibilities of reaching innovation in services. And again, how tenders are formed is affected by the extent to which the management is using procurement as a strategic instrument.

Procuring innovation also often means dealing with new potential suppliers, that you must be able to evaluate more of qualitative aspects and also put them in contracts, which does not make it simpler. Selection solely by lowest price does not lead to the most innovative solution. Even big suppliers feel insecure by this kind of procurement, and there is a risk that procurers will see no tenders. The market needs to adjust to this, which is not done rapidly.

These questions need to be solved at the highest organisational level, since there are no incentives for procurement units or departments to implement these kinds of changes. They will currently try to minimise both risk and costs, which is not exactly

good for development. Procurement also needs to be in very close and constant contact with functional parts of the whole enterprise.

4.4 Differences between services in general and product based services

The answers to these questions range from “No specific difference” and “I don’t know, haven’t thought about it” to the opinion that innovation of services are user driven while innovation of goods are technology and science driven. The user experiences are the criteria for success in services, as opposed to in goods where it has to do with if specifications or functions are met.

Knowledge of innovation is often limited in the traditional service sector. There is a resistance towards change, and in many cases it follows from conservative thinking. A focus on good examples is therefore of vital importance. Public procurers are generally good at buying services in general, but innovative services are harder. You must think more about the outcome, and how to get there.

Functional sales is in many instances the goal, and that means that the companies need to think along new and different lines. Dealing with functional sales ideally entails more awareness of the innovation dimension throughout the process.

A balancing view is that there are differences between services in general and product based services, but that they are not important. What matters is always understanding what goods or services, or blend of them, is likely to be needed to fulfill the requirement. A very early, close co-operation between purchasing partner and service provider is important, even before the tender. Big manufacturing or industrial companies are most likely to be involved in functional sales, and therefore the steps of development are likely to be smaller but the smaller, knowledge intensive companies are, on the other hand, often continuously innovative.

4.5 Incentives for innovation in services integrated in the public procurement process

Also in this area there is a palette of answers. Several of them are of a financial kind. Keep part of the profits in the procuring organisation! Reward and celebrate success, and refuse to tolerate renewal of existing contracts or the procurement of similar services. Give points in the tendering process for quality and the innovative services component. In contracts, innovation means greater risk and it is not always clear who will be responsible for the costs of unexpected risk. Staff may for instance need unanticipated training. Profits for the procurer can be enormous in services innovation, and it has to be determined who gets them.

Imposing requirements for both procurers and policy makers to deliver improvements is another theme – financial, emission reduction, energy saving, user outcomes etc. It might be a good idea to start with the big budgets, the large cities. They can constitute best practice, and develop further. However, it is also important to include SMEs, who have the potential to grow.

Again, risk reduction is seen as important. It could be reduced by the means of pre-projects, pre-competitive tenders and innovation funding. In the description of the procurement the offerings from the innovation agency can be described. Administrative and political directives are very important. More substantial action plans, co-operations and use of existing knowledge about procurement and innovation are all regarded important areas to help formulate incentives. As is good examples and to be able to show good examples and documented evidence of benefits and profits of aspiring innovation in service.

4.6 Changes needed in current procurement processes in order to stimulate innovative services

One significant view on the issue of change is that none is needed. It is more about culture and capability in public sector organisations, than in changes to rules and

processes. On the other hand, another interviewee points to the need of stringently targeted measures with explicit focus on services. The problem is that we do not yet have sufficient understanding to design such initiatives. More research and study is needed.

The criteria for selection must become clearer, whether you prioritise price, function, performance or innovation. There should be a focus on procurement in innovation processes, as well as on innovation in procurement processes. Processes must start earlier and need involvement of other people, which would take longer time. It must be legitimate to try new solutions, which include a risk of failure. If that is not acceptable, no one will be the first to try. This is what it takes to break with traditionally conservative ways of thinking.

Dialogue between procurers, potential suppliers or service providers and the scientific community, and to establish functional forms for it, is vital. Public procurers do not always know exactly what they want or need. A deeper dialogue with different bidders enables a better procuring process and a better product in the end that can fulfil their specific needs. However, current rules make it difficult to know how much you can talk before if you want to bid on the purchase.

Changes in procurement processes must also be a component of long term strategic management and top management involvement, otherwise not much will happen. A “bank of experience” is lacking, following from a decentralized or even shattered public procurement structure. The procuring actor definitely needs to be large enough to achieve these things.

4.7 Pro-innovative dialogues with service providers supported and translated into operative activities

Long term, strategic planning is regarded a good way to lay the grounds for interaction with the market prior to the tendering process. Procurement clinics can be a way to establish the arena or meeting grounds that also provide professional procurement services to the buyer. The clinic runs the entire process for their customer, who gets access to professional expertise that also involves potential bidders. Neutrality is ensured through openness where everyone (all potential bidders) may participate. This allows focus on the real values of the buyer and it is considered a successful and good experience.

Arenas can have different forms and names or labels, but serve the same purposes. Consequently we see some centres for user driven innovation, some laboratories for public-private partnerships and some web portals on the Internet for online collection of ideas and documents.

Another way is to establish a process of supplier engagement, which takes place before the start of the procurement, rather than early in the process. By such an approach there are no rules to impede dialogue. This way, a number of important actors can participate; suppliers, technical/academic experts, service (end) users and procurers.

Pre-procurement projects is another possibility, that can be commissioned to explore opportunities, when innovation is expected to lead to big change and risk is high. That way consultants involved can get in contact with all relevant types of actors, which will help to increase the possibilities of success since several people are behind the ideas. Test beds or pilot environments where companies can show themselves and their competence and skills are important. As is experimental sites where innovation can be verified.

In the view of some interviewees exhibitions and talking to others are not enough. Pre-commercial procurement enables discussions and invitation of suppliers to use and analyze their competence. This type of procurement may take longer time, a year or more, and may better suit analysis of a long-term need.

In other circumstances mini seminars attended by public procurers, suppliers, users, experts and innovation agencies have been conducted. If there is an interest from

other sectors and actors, there are consequently some examples of how to establish dialogue in a structured way. Pro-innovative dialogues are described as “under-used”. However, the rules must allow companies to bid also after having been invited to or involved in the dialogue.

4.8 Inclusion of external experts evaluating public proposals of procurement in the dialogues to enhance the knowledge on innovation

There are programmes where such consultancies can be purchased, and otherwise several ways to do it. It can be announced that a panel of experts will assist. They can be invited, and either have a formal, contracted or informal advisory role. It can be important, however, to remember and make sure that they are not the same people who are subsequently evaluating proposals, and that they have sufficient knowledge from the field in question.

It is pointed out that it is regarded too late to include experts when evaluating proposals, which may be no problem since evaluators are seldom innovators. External or internal experts can be used to describe the state of the art and trends. Experts should be included in the formulation of proposals. Experts, researchers and consultants with deeper knowledge about qualities and problems in the innovation area are regarded as very important.

However, there is some hesitation regarding the use of external experts in the dialogue. The view is that they can be of help in sorting out the market and find out which would be the good thing to do in some long term general way instead.

5. References

The factual information in this study is retrieved and compiled from public sources, web sites and official documents, and from interviews. Appendix A lists the people interviewed in the study, and Appendix B contains the interview guide, including the specific questions, used. In this section, a listing of the remaining sources is presented, according to country (and the Nordic level).

Nordic level

Health Innovation in the Nordic Countries, Nordic Council of Ministers
<http://www.norden.org/en/publications/publications/2010-765>

Finland

Case study Finland: Funding for procurement of innovations in the public sector, Kirsti Vilén, Teija Palko, Innovation Department, Ministry of Employment and the Economy, Finland, 2010, (preco.share2solve.org/main/.../Case-study-Finland-revised-07-20101.doc).

Action programme for demand and user-driven innovation policy, Innovation Department, Ministry of Employment and the Economy, Finland, 2010.

Vaso social housing - Procuring passive housing in Finland.

(http://ec.europa.eu/environment/gpp/pdf/news_alert/Issue7_Example20_Finland_Housing.pdf).

Pre-Commercial Public Procurement policies in Finland, Suzan Ikävälko, Culminatum Innovation Ltd Oy, 2010. (<http://preco.share2solve.org/main/files/2010/10/PCP-policies-in-Finland-2010.pdf>)

Mapping Innovation Policy in Services: Country report – Finland, Jari Kuusisto, Soile Kotala. (www.proinno-europe.eu/doc/finland.pdf)

Innovating service-concepts for a new city: Marja-Vantaa Service Architecture Competition 2011, Department of Health and Social Welfare, City of Vantaa.

OSUMA - Participatory Innovation Model for Wellbeing Services.

Sweden

Innovation för tillväxt – Förslag från arbetsgruppen ”Offentlig innovationsupphandling”, IVA, 2010.

(<http://iva.se/PageFiles/11453/Beslutsunderlag%202010-06-24.pdf>)

Can public procurement spur innovations in health care? VINNOVA, 2009. (<http://www.vinnova.se/sv/Publikationer/Produkter/Can-Public-Procurement-spur-Innovations-in-Health-Care/>)

Offentlig upphandling som drivkraft för innovation och förnyelse, VINNOVA, 2008. (<http://www.vinnova.se/sv/Publikationer/Produkter/Offentlig-upphandling-som-drivkraft-for-innovation-och-fornyelse/>)

Innovationsupphandling, SOU 2010:56, 2010.

(<http://www.regeringen.se/sb/d/12565/a/150990>)

Norway

www.forskningsradet.no, Division for innovation, Innovation in public sector (FIFOS): (<http://www.forskningsradet.no/servlet/Satellite?c=Page&pagename=fifos%2FHovedsidemal&cid=1226994341629>)

Innovation and Renewal of Public Sector (VIOS): (<http://www.forskningsradet.no/servlet/Satellite?c=Informasjonstekst&cid=1232443089099&lang=no&pagename=fifos%2FHovedsidemal>)

<http://www.innovasjon norge.no/default.aspx>

Innovasjons og kommersialisering helse sør-øst, (<http://www.helse-sorost.no/fagfolk/forskning/Documents/Innovasjon/Kortnotat%20-%20innovasjons%20og%20kommersialisering%20%28endelig%20oversjon%29%5B1%5D.pdf>)

<http://www.nho.no/leverandorutvikling/>

<http://www.anskaffelser.no/tema/innovasjon>

Environmental and Social Responsibility in Public Procurement, The Norwegian Action Plan 2007-2010, Norwegian Ministry of the Environment, Norwegian Ministry of Government Administration and Reform, Norwegian Ministry of Children and Equality, (http://www.regjeringen.no/Upload/MD/Vedlegg/Planer/T-1467_eng.pdf)

An Innovative and sustainable Norway, Norwegian Ministry of Trade and Industry, (http://www.regjeringen.no/upload/NHD/Vedlegg/brosjyrer_2008/innomeld_kortv_eng.pdf)

Denmark

Danish Agency for Science technology and Innovation, (<http://en.fi.dk/publications/publications-2007/innovation-denmark-2007-2010/2746001.pdf>)

Erhvervs- og Byggestyrelsen, (http://www.ebst.dk/innovation_og_bdi)

United Kingdom

SBRI,

(<http://www.innovateuk.org/deliveringinnovation/smallbusinessresearchinitiative.aspx>)

technopolis_[group]

FCP, (<http://www.bis.gov.uk/policies/innovation/procurement/forward-commitment>)

Others

Buying Innovation: How Public Procurement Can Spur Innovation, The Information Technology & Innovation Foundations, (<http://www.itif.org/publications/buying-innovation-how-public-procurement-can-spur-innovation>)

Appendix A - Interviewees in the study

Håkan Alm, Näringsdepartementet, Sweden

Christian Bruhn Rieper, Business Innovation Fund, Danish Enterprise and Construction Authority, Denmark

Ann-Mari Fineman, Swedish Agency of Innovation Systems, VINNOVA, Sweden

Bjørn Grønli, Helse Sør-Øst RHF, Norway

Fergus Harradence, Innovation Policy at Department for Business, Innovation and Skills, United Kingdom

Hans Jeppson, Innovationsupphandlingsutredningen (Procurement Committee), Sweden

Trond Knudsen, The Research Council of Norway, Norway

Jeppe Kristensen, Regional Development Agency Southern Denmark, Denmark

Eivind Lorentzen, Ministry of Trade and Industry, Norway

Marie Louise Løvengreen Rasmussen, Dansk Erhverv, Denmark

Tor Mühlbradt, Innovation Norway, Norway

Marieke van Putten, Ministry of Economic Affairs and Agriculture, Netherlands

Frederikke Saabye, Fornyelsefondens sekretariat, Denmark

Cecilia Sjöberg, Swedish Agency of Innovation Systems, VINNOVA, Sweden

Sini Uuttu, Finnish Funding Agency for Technology and Innovation, Tekes, Finland

Ville Valovirta, VTT, Finland

Kirsti Vilén, Ministry of Employment and the Economy, Innovation Department/Demand-based innovations, Finland

Note: Interviewees have been chosen in their individual capacity of knowledgeable and experienced in the field of public procurement and or innovation/innovative services. They do not express the official views of any organisation.

Appendix B - Interview guide used in the study

The desk research of this study shows that there seem to be very few initiatives taken where the objective is clearly and explicitly stated as stimulating or creating innovative *services* using the means of public procurement. At least, their visibility is not very high.

There are programmes or initiatives for public procurement, or even for making it innovative. There are also programmes or initiatives for innovation, more seldom for innovative services. There are very few, if any, programmes or initiatives connecting the two – on how to use public procurement to achieve innovative services.

Interview questions:

To achieve the goal of obtaining innovative services through public procurement;

1. Are there any specific rules and regulations that need to be adjusted, changed, removed or added? Which ones? Why?
2. Are there any apparent critical pitfalls for a successful innovation services procurement approach? Which ones?
3. Are there any problems connected with processes of tenders? How they are collected and evaluated? What competence the staff has? How risk averse they are? Are there administrative problems?
4. Are there differences between services in general, in what is sometimes labelled the traditional service sector, and product based services, or what could be described as the functional sales part of the manufacturing sector?
5. How can incentives for innovation in services be integrated in the public procurement process?
6. What changes are needed in current procurement processes in order to stimulate innovative services?
7. How can pro-innovative dialogues with service providers be supported and translated into operative activities?
8. How can external experts evaluating public proposals of procurement be included in the dialogues to enhance the knowledge on innovation?
9. Is there any written material about any initiative with these objectives available for us to study?

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