

UN seminar on service innovation on 25 March 2010

Session 3: Sector approaches and business perspectives  
“The potential of service innovation to create new markets and to foster innovation in other sectors”

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Slide 1:



Thank you for inviting me to this seminar on services innovation. I am very pleased to see a number of well-known faces as well as also some people I haven't met before. So I hope to take back some new ideas from this seminar, as I wish to enrich the discussion by offering a different perspective on services innovation.

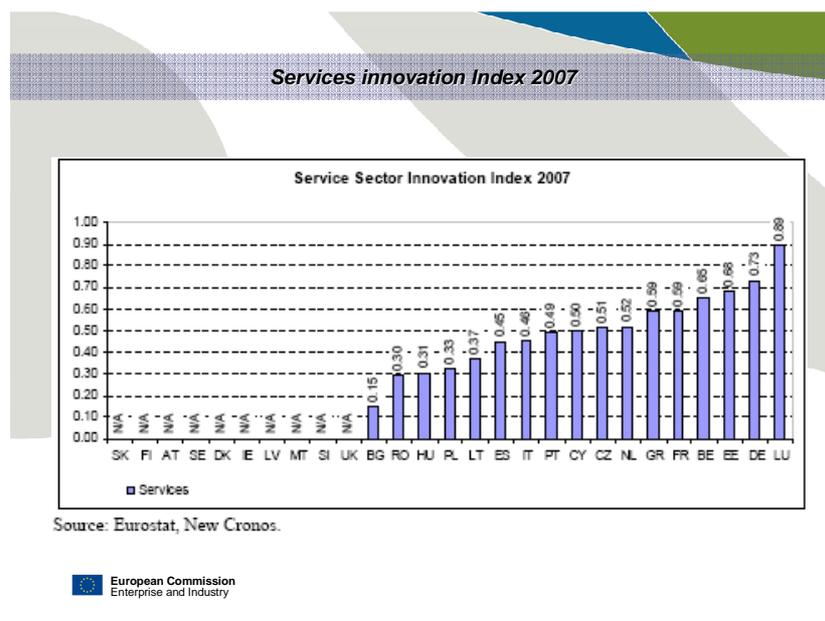
I am involved in the discussions on services innovation only since 2006. It was actually Tiina from Tekes, who spoke earlier today, who urged us to move into this new policy field at European level. I am happy that we did, and that we are still working together with Tiina and her colleagues from Tekes to put services innovation high on the innovation policy agenda in Europe.

When we started looking into services innovation we first asked the question: How to measure services innovation? Many of the participants in today's

seminar were involved in this discussion and still are. For example, Luis Rubalcaba is still working on this subject within the Sectoral Innovation Watch, and Hannes Leo is contributing to a study on services innovation in creative industries that will be published as part of the competitiveness report in 2011. So this discussion on how to better measure services innovation continues. Our INNO-Net on services innovation – EPISIS – which is lead by Tiina, is also looking into this. I look very much forward to the results.

What we learned from this exercise was that services innovation happens, and that it is indeed a real phenomenon. Many service sectors innovate as much as manufacturing, in particular the knowledge intensive services. But we also realised soon that services innovate differently. For example, and as has also been discussed earlier today, the role of R&D is less important in most service sectors than it is for manufacturing. On the other hand, user-centered innovation and employee-driven innovation play a much stronger role, and the “time to market” for innovative solutions is extremely short in services.

Slide 2:



These specificities of services innovation brought us to the idea of a specific “Service Innovation Index” (SII) that aimed at capturing service innovation through a dedicated set of indicators. Although the idea looked appealing, it proved to be a dead end. The results, as they are shown in the slide, were difficult to interpret and far from robust. In 2007, there was still not a lot of relevant data available, and the available results did not really support “conventional wisdom” about who leads in Europe on services innovation. This was mainly due to the fact that there are limits on how to measure and benchmark services innovation at national level. What may be new to the market in some Member States may already be “state of the art” in others.

One of the main problems is that services innovation happens in both service sectors and manufacturing. We and others have worked to achieve some improvements over the last years to measure services innovation as such, and there will now be more statistical information available through the next Community Innovation Survey (CIS) on where services innovation takes place. But there are still limits that are difficult to overcome, as such surveys must remain rather short to receive results, they are very expensive, and the distinction between innovation in services and in goods is not always easy to understand by those who shall provide such information. Many services innovations are not recognised as such as they are part of new or improved package solutions. Nevertheless, we will continue our efforts to better measure services innovation as such. The question is however, how much must we know about the nature and relevance of services innovation in order to draw meaningful policy conclusions?

From a policy point of view the question is not: What is services innovation, and where does it happen? But it is: How to economically (or politically) exploit it! We, as policy makers are not interested in services innovation as such, but in

competitiveness, growth and jobs or in better addressing societal challenges. The new Europe 2020 strategy does not make any explicit reference to services innovation, but new or better services can help achieving many of its goals. The question is how services innovation can contribute to this policy agenda, not how to promote services innovation for its own sake. Services innovation is from a policy point of view per se neither good nor bad: Either it helps to better achieve our policy goals – and then we - policy makers are interested in fully exploiting its potential – or it does not. In this case, policy makers remain either neutral – or they may even take action against service innovation that is considered to be harmful.

This is a completely different approach, and the CIS offers only limited information about what hampers services innovation and what makes it specifically beneficial for the economy or the society. For policy makers interested in industrial competitiveness, like DG Enterprise and Industry, it is not enough just to understand where services innovation happens and what drives it. More importantly, we need to know how to impact services innovation and why, either by removing practical barriers or by offering specific incentives. For this, we need different information, starting with concrete hints on existing market and systemic failures. But this kind of information is even more difficult to get than capturing services innovation in general. And yet another kind of information is needed if we want to demonstrate how services innovation can contribute to other societal challenges, like a low carbon economy. What do we really know about the ecological footprints that new Internet services, like Google or Facebook, leave? And if we knew how to improve eco-efficiency through services innovation, would we know whether this needs to be supported politically and if, how?

Slide 3:

### Barriers for services innovation: An overview

<b>Market failures</b>
<b>Imperfect competition</b>
<b>Immobility of resources</b>
<b>Information asymmetry</b>
<b>Externalities</b>
<b>Property rights</b>
<b>Systemic Failures</b>
<b>Structural deficiencies</b>
<b>Institutional deficiencies</b>
<b>Regulatory deficiencies</b>

Source: Van Cruysen, A. Hollanders, H. (2008), PRO INNO Europe INNO-Metrics



As you can see from the slide, many potential market or systemic failures exist that may hamper services innovation. In the Commission Staff Working Document “Challenges for EU support to innovation in services – fostering growth and jobs through service innovation”, which was published last September, we summarised the available wisdom on market and systemic failures in the field of services innovation. This analysis showed that the empirical evidence on barriers to services innovation is rather poor. We can think of many market and systemic failures that potentially hamper services innovation and would justify policy intervention, but most of them are hard to prove. It is therefore nearly impossible to base any meaningful policy conclusions on the available information on market or systemic failures, which is much too general and far from complete. This is why many policy recommendations on services innovation stay at the level of generalities. We all agree that services innovation matters, but when it comes to specific actions in support of services innovation, the discussion remains rather generic and refers back to supporting services innovation in general, that is to say at activity level through research projects and at market level through the further completion of the Internal market for services and other measures improving the overall

framework conditions for innovation. It does not require so much to propose this.

In the Staff Working Document on services innovation we therefore presented in addition another route of argumentation: the sectoral approach. We know that services innovation takes place in all sectors – manufacturing and services. But we also know that such services innovation finds its expression, sooner or later, in businesses that are specialised in services. It is safe to assume that services innovation currently taking place in manufacturing will sooner or later be outsourced and further professionalised, thereby creating new businesses, new markets and sometimes entirely new sectors. Services innovation is a catalyst for industrial change and entrepreneurship, resulting quite often in new enterprises, sectors and markets. You will certainly understand that we in DG Enterprise and Industry are very much interested in this aspect of services innovation as a driver of industrial change and entrepreneurial rejuvenation. I just want to point out that this is not a question of right or wrong, but of where to put the emphasis.

Slide 4:

*How to support services innovation?*

<b>Activity level</b>	<ul style="list-style-type: none"> <li>- Services innovation metrics</li> <li>- Innovation projects &amp; new business models</li> <li>- Facilitation of knowledge transfer</li> </ul>
<b>Firm level</b>	<ul style="list-style-type: none"> <li>- Business incubation &amp; growth facilitation</li> <li>- Innovation management training, design &amp; IP support</li> <li>- Access to finance &amp; investment readiness</li> </ul>
<b>Sector level</b>	<ul style="list-style-type: none"> <li>- Services sectors metrics</li> <li>- Infrastructure &amp; institutional support, e.g. design</li> <li>- Specific cluster policies &amp; infrastructure</li> </ul>
<b>Market level</b>	<ul style="list-style-type: none"> <li>- Service markets foresight</li> <li>- Quality standards &amp; certification</li> <li>- Legal &amp; regulatory framework for innovative services</li> </ul>

Let me explain our approach to services innovation in some more detail. As is illustrated by the new slide, services innovation may be supported at different levels: (1) at activity level for example through research projects and financial support for the development of new business models; (2) at firm level by enhancing the capacity of service companies to innovate faster and better, for example by supporting start-up's, improving the innovation management of firms or facilitating access to finance; (3) at sectoral level by creating a favourable business environment for services innovation, such as through clusters; and (4) at market level through the liberalisation of service markets, effective consumer protection or standards that support the trust and interoperability into innovative services.

The difference between supporting services innovation at activity level and at firm level is that in the first case the development of specific new business models is supported, whereas in the second case the innovation capacity of a service firm is targeted in general, irrespectively of the type of services innovation. Supporting services innovation through cluster initiatives at sectoral level goes even a step further, by improving more generally the business environment in which service firms operate and innovate. With other words, supporting services innovation at activity level results in projects. Supporting services innovation at firm level means in most cases subsidizing companies to innovate more and faster. And supporting services innovation at sectoral level requires strategic choices and dedicated efforts to improve the business environment for service companies more fundamentally.

All these approaches are complementary to each other, and in order to have a real impact on services innovation a combined approach should ideally be followed. But not necessarily by everybody, everywhere and at the same time. We have to accept that policy agendas are different across the Member States

and so are the actors supporting services innovation – and from different angels. What is perhaps least understood at the moment, is that services innovation does not happen everywhere with the same likelihood. It is not enough just to promote new service concepts or to unlock the innovation potential of services by creating favourable framework conditions for new services markets. Innovation also depends on a strong entrepreneurial spirit and the right business environment that help shaping new industries.

Slide 5:

High clustering	Low clustering
Transportation	Retailing
Financial services	Public services
Publishing	Healthcare

Source: European Cluster Observatory 2009

It may be difficult to measure and benchmark services innovation at national level, like we tried with the “Service Innovation Index” (SII). A more promising approach is to identify where and in which sectors services innovation actually happens, and this brings us to cluster mapping at sectoral level. Also service industries “cluster” their activities as they benefit from regional proximity of partners and technology providers. The European Cluster Observatory provides ample statistical evidence of this. Some services sectors, like transportation and logistics, financial services and publishing lend very much towards clustering, whereas other services, like retail, public services or healthcare, can be found practically everywhere.

Some service innovations can therefore not only be supported through research and business support, but also through cluster policies. This requires however looking closer at how and within which sectors services cluster. Here we have at least two problems: One is that the current NACE classification does not really translate into the service sectors as we see them in reality. The different layers as defined by NACE are often too thin to show the real importance of services as a driver of innovation and competitiveness.

Take for example the creative industries. Each of them may not be important, but together they are as important as financial services. Only when looking at the whole of the creative industries - they attract also the political interest they deserve. And once it is understood that a sector like “creative industries” exists, it is much easier to define ambitious policy initiatives that support services innovation in this sector in a more targeted and strategic manner.

By aggregating different service activities, it becomes quite often possible to capture their economic importance and to define a more strategic approach towards services innovation. In the case of creative industries, we feel confident making this step. Not only are creative industries an important sector in itself that contributes to growth and job creation, but there are also many positive spill over effects from this sector into other sectors that stimulate innovation. This makes the sector also of strategic importance. And this we are able to prove. But this approach can not be easily followed everywhere. Because there is a second challenge we are faced with when trying to define relevant services sectors: Services innovation often leads to new types of services that may happen at the same time in different sectors, such as this is the case for services enabled by space technologies.

It may therefore be difficult to decide which sectors need to be targeted in order to stimulate services innovation that is powered by satellites. Many new businesses are being built around GNSS systems like Galileo, nevertheless it is still unclear what the dynamics of the sectors involved are and this makes it also difficult to define specific policies in support of this type of services innovation. Here, it may only be possible to support services innovation in a horizontal manner at activity or market level. But we have not yet arrived at this conclusion. We are still trying to find out whether also a more targeted approach is possible to support services innovations powered by satellites. Taking into account the huge investments made into Galileo, you will certainly understand that the Commission, and DG Enterprise and Industry in particular, has a strong interest in getting the most out taxpayer's money. We are organising a seminar in Stuttgart on 17-18 May to define further this approach. The programme will soon be available on the Europe INNOVA website. You are all very welcome to participate. Just let me know.

This dilemma from space shows that there is also another challenge with a sectoral approach. As we are often in the field of emerging industries, the classical market and systemic failure analysis does not apply. The concept of market failure presumes that there is already a market. However, for Galileo, such service markets still need to be created. Therefore, we talk in this case about "emerging industries". Emerging industries are, as the term suggests, only emerging, and the question is more how to shape new industries rather than how to remove specific obstacles that hamper service firms from bringing their innovations to the market. We need much more information about future trends and market foresights. We still look too much at the past and not enough at the future. This is also where the limits of a strictly sectoral approach lie. Innovation happens most often at the cross-road of different technologies and markets, resulting in new business models, enterprises, sectors and markets. We are

aware of these limitations, when applying a sectoral approach and trying to identify the most promising areas of services innovation that may deserve our political attention and support.

Lastly, I would like to come back to an issue which is frequently discussed (and also today): How does all this fit with an “evidence based approach” to policy making? It does – and it does not! It does in the sense that we should base our strategic choices regarding which sectors to target on clear economic evidence and statistical analysis. Strategic sectors must be of strategic importance, and this question will be answered differently from Member State to Member State. As we have heard today, the Netherlands have for example just adopted a new programme on services innovation that targets specifically ICT, logistics, financial services and creative industries; in Finland creative industries together with wellness and forestry are priority sectors. For the UK, different choices have just been made last week. What matters is where growth and job creation are expected to be best stimulated through services innovation. And if cluster policies are used to create a more favourable business environment for specific service sectors, it should be clearly understood that successful clusters are difficult to build from scratch. Again, a good sectoral analysis is needed of existing strengths that can be further strengthened, and this calls for an evidence based approach.

But the past is not always the best guide for the future. Regions and countries will have to develop their own visions about where they would like to position themselves in the coming years in the global competition. Most often, they still bet on technological leadership in specific sectors, such as ICT, biotechnology or nanotechnology. Some regions have however in the meanwhile well understood that services may be the future for them. Services innovation can, in theory, happen everywhere, but certainly not with the same probability. They

require their own “eco-system” that supports creativity and openness towards new solutions. The sector approach, as I have tried to present it today, reminds us that creating generally favourable framework conditions for services innovation is not enough. Different services flourish best under different conditions, and many of them are determined by sectoral boundaries in which companies operate and innovate. This may offer some food for thought for further discussion.

Slide 6:



Thank you for your attention!

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I am happy to see that this discussion does not only take place here and today, but is also followed-up in a more institutional manner at EU level through the EPISIS project. Many of you participate also in this discussion so we will certainly meet again on this subject. The next big event on services innovation is the EPISIS Conference in Copenhagen in June. I hope to see you all there.

What I have presented today is our methodological approach towards services innovation. I have not talked much about the policy actions that we build upon this approach to boost services innovation in the EU. This would be another speech. For today, thank you listening. I look forward to further discussing these

methodological issues with you now and later! For any further questions on our activities in this important policy field, please don't hesitate to look for more information, either by directly contacting us or by visiting the websites of PRO INNO Europe and Europe INNOVA, where you will find all relevant information about what we are doing and discussing at the moment in support of services innovation.