

Supporting innovation in services

Executive Summary

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The United Kingdom is often said to have become a “service economy” with services accounting for three quarters of our Gross Domestic Product.

This report is based on a consultation of business in five sectors of the economy¹ to develop a better understanding of what is driving innovation in service sectors, how innovation is developed and managed by leading firms, the barriers to innovation and the role Government might play in improving the UK environment for innovation in services.

It identifies a number of important trends based on the radical changes taking place in global economic value systems and the rapid changes taking place in ICT, particularly the growing capacity of the internet. It highlights three in particular:

- The convergence between manufacturing and service innovation, as manufacturing firms seek to capture greater value added from their knowledge of the products by adding a “service wrapper” and service firms work more closely with their supply chains to respond more quickly to changing customer needs;
- The role and power of consumers/users in the innovation process brought about by developments in the internet and globalisation and, in response, the development of a much more networked approach to developing new services; and
- the growing concerns around sustainability and the environment which are impacting upon a wide range of service sectors and unlocking new opportunities: innovative services have a role to play in the transition to a low carbon, resource efficient economy.

This business-led report follows on from the broader policy frameworks established earlier this year by the “Innovation Nation” White Paper and the Enterprise Strategy, “Enterprise: unlocking the UK’s talent”. It is also one of a trio of studies which Government has commissioned over the past twelve months to ensure that policy is in tune with the needs of the modern economy: the other two are the Public Service Industries report recently published by Dr DeAnne Julius and the forthcoming review of advanced manufacturing, due to be presented in the autumn.

Key Messages from Business

- The more difficult the economic climate, the greater the imperative to have systems which provide the firm with market focus, the ability to differentiate itself from the competition through innovation, and the processes to manage scarce resources.
- There is the opportunity for businesses to respond to the new competitive challenge by looking to innovate in all aspects of their business. While fortune may play an important part in innovation and business success, companies which are successful over time are those which have well developed processes for:
 - identifying customer needs and market trends, including potentially radical shifts in demand or the means of addressing it;
 - creating an environment which is open to new ideas, while sifting rigorously those to pursue against clear commercial objectives;
 - scaling up the most promising quickly and effectively, to exploit the commercial potential to the full, including capturing customer appreciation in the form of brand recognition and loyalty;
 - tailoring their processes to respond to the new demands or even moving to a new business model;
 - benchmarking rigorously their own performance against the competition, and learning from others and their own experience.
- The above processes require strong leadership and a skilled and motivated workforce. They also require investment in systems which allow decision takers, at all levels in the firm, to make decisions on the basis of the best possible management information. However, the prize is that customers will find the overall package distinctive and compelling, and enjoy an excellent experience.

In examining the drivers of change and the barriers to innovation, the report has some clear messages for Government.

Messages for Government

Openness and Flexibility of Markets: Innovation is driven by competition and substantially by new firms bringing new ideas to the market. Government therefore has an important role in ensuring that markets are as open and flexible as possible. Aside from promoting a liberal international trading environment and pursuing an active competition policy, business identified three important levers where, it felt, Government could focus greater effort:

- Where Government is an important actor in the market, as procurer or regulator, strong leadership in the form of clear, consistent, objective oriented policies, and a shared perspective of the policy challenge, gives business the strong market signals it needs to offer innovative and sustainable solutions.
- Information is the raw material of an “Information Society” and business believes that Government has an important duty in making data, which it collects, as accessible as possible
- Markets also require a framework for defining and comparing offerings, and delineating quality and performance over time i.e. a standards framework which is interoperable. This is particularly important for the new models of advanced manufacture and for PFI contracts, where firms are seeking to service assets over a very long period. Given the global nature of value chains, business considers it is important to ensure that the international standards framework provides opportunities for UK firms.

The Government has recognised the force of these arguments and is addressing them:

- **it announced in Innovation Nation a strategic review of standards for the service sector, to be conducted by the BSI, which will feed in to the discussions of the EU Services Directive and the International Standards Office (ISO) as part of UK policy to liberalise trade in services and provide an objective framework for assessing the impact of supply chains on the carbon footprint;**
- **It has also announced that it is undertaking an assessment of the Trading Funds to be carried out by the Shareholder Executive which will give a particular focus to the role that information, collected by the Trading Funds, should play in the wider economy.**
- **In following up this report, BERR, together with Defra, DfT, DIUS and the Technology Strategy Board will co-ordinate policies to strengthen innovation in the fields of waste and resource management and logistics. The upshot will be a clearer, more consistent policy environment aligned in each of these two areas to the development of new technologies, skills and standards which will enable innovative firms to develop new value added services.**

The Importance of ICT: Innovation in services is being driven by rapid developments in ICT, specifically the ability to capture, store, analyse/manage and exchange massive quantities of data. Knowledge based services need early access to knowledge based tools and an ICT infrastructure which can handle media rich services. To remain competitive, UK firms have to be able to tap into the technology and talent which will drive the next wave of internet development.

- **Government is committed to providing an ICT infrastructure which benefits a modern economy and is working with Ofcom to this end. BERR has launched an independent review by Francesco Caio, looking at barriers to private sector investment in next generation broadband networks in the UK, complementing Ofcom's work in this area.**
- **In developing its strategy, the Technology Strategy Board is giving a particular focus to the needs of knowledge intensive services and the technology which underpins them. It also recognises the importance of disseminating knowledge about new technology and applications to as wide a business audience as possible, including firms in the service sector.**
- **In this context, the Knowledge Transfer Networks of the Technology Strategy Board and the business clusters supported by Regional Development Agencies provide a valuable starting point for companies looking to improve their knowledge of technology developments and identify new business opportunities.**

Leadership and Management Skills: The development and delivery of complex services, and the ability to respond to the rapid evolution of service markets, places a considerable premium on leadership and management skills. Leading UK service firms consider the UK to be a source of such talent but that there is no room for complacency: service firms will migrate to locations where young professionals have the requisite all round skills.

DIUS's "Train to Gain" programme, targeted at improving the leadership and management skills of SMEs, has been expanded from £4 million pa to £30 million pa. The Knowledge Transfer Partnership (KTP) programme, which provides support to firms to transform their businesses and, in so doing, develops a cadre of young executives with a range of project management skills, will be doubled. BERR and DIUS will work with the Regional Development Agencies to strengthen business engagement with provision of learning opportunities and best practice. In the light of this report:

- **BERR is considering a pilot in the West Midlands, to transform business processes through the innovative application of information and communications technology, in order to identify the benefits to SME performance, the barriers to wider uptake, and the case for developing a wider network of expertise.**

- **BERR and DIUS will also work with the Advanced Institute of Management to disseminate more effectively, to a much wider audience, the outputs from its network of research in leading schools of management.**

The aim is to raise the profile of management skills and ensure that firms, with the ambition and capability to grow, have access to the knowledge which lies in the UK's leading management schools; and that they develop the business processes and exploit ICT to maximum effect.

Access to Finance: Access to finance remains difficult for some innovative, high growth service businesses.

- **BERR will lead implementation of the Enterprise Strategy, which aims to be a catalyst for helping small businesses to access the finance they need. BERR is working with a wide range of public and private stakeholders to improve access to finance for business. BERR is collaborating with NESTA and the Regional Development Agencies to establish a "Framework for Investment Readiness" and continues to support private sector investment in high growth early stage businesses through Enterprise Capital Funds.**

The proposed action programme to address these key messages is set out in more detail in Chapter 9 of the report, and will be delivered alongside the Government's Business Support Simplification Programme.

But perhaps the most important response to the business message is that the Government is aware of the strong interest in service innovation in competitor countries. It is firm in its commitment to strengthen the environment for innovation in the UK to make the UK an attractive place for firms to locate, not least to capitalise on its world class capability in knowledge intensive services. To this end:

- **The Government will seek to ensure that the implementation of the EU Services Directive opens up opportunities for innovative UK firms, and will play a full part in promoting the competitiveness of services in Europe after 2010 (the "Lisbon2" agenda);**
- **BERR/UKTI will survey firms with a global perspective to benchmark UK performance in terms of the quality of knowledge intensive services and the attractiveness of the service environment; and**
- **BERR/DIUS, working with stakeholders, will tackle any identified weaknesses.**

