Demand-side policy instruments for innovation in firms

The objective of demand-side policies is to increase demand for innovation so as to create bigger incentives for innovation, to improve conditions for the uptake of innovations, and to speed up the diffusion of new technologies. The rationale for demand-side innovation policies is often related to the need to stimulate innovation in areas where societal needs are pressing and where government action can complement market mechanisms with, ideally, minimal financial outlays. In most OECD countries, governments have paid an increased attention to demand-side innovation policies in recent years.

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What are demand-side policy instruments for innovation in firms?

The objective of demand-side policies is to increase demand for innovation so as to create bigger incentives for innovation, to improve conditions for the uptake of innovations, and to speed up the diffusion of new technologies (Edler, 2007). Demand-side innovation policies are often used to boost innovation performance in areas of strong societal demand such as health, population ageing and the environment. They have also received increasing attention as they might help improve the efficiency of public spending through innovation. Increasing attention as they might help improve the efficiency of public spending through innovation. Increasing attention as they might help improve the efficiency of public spending through innovation.

Demand-side policies may include different policy domains and support innovation in various ways:

- **Public procurement of innovation** by private firms when the government acts as a lead user of new technologies.
- Governments can stimulate private demand by offering subsidies and tax incentives to consumers that purchase new products resulting from innovation.
- Governments may set up the regulations for markets and industries, and these regulations influence the articulation of demand for innovation (see Markets, Competition and Standards[3], Standards and Certification[4], Environmental and safety regulations[5]).

In most OECD countries, governments have paid an increased attention to demand-side innovation policies in recent years. This evolution can be explained by a greater awareness of the importance of feedback linkages between supply and demand in the innovation process and a general perception that traditional supply-side policies have not been able to bring the desired outcomes. Furthermore, pressures on public spending create incentives to explore how demand-side policies might boost innovation without new programme spending.

What are the rationales for demand-side policy instruments in support to innovation in firms?

Demand-side innovation policies respond to situations in which barriers affect the expression of societal needs - which can lead to technological path dependencies and high entry costs.

The rationale for demand-side innovation policies is linked in general terms to the need to stimulate innovation in areas where societal needs are pressing (e.g. health, environment) and where government action can complement market mechanisms with, ideally, minimal financial outlays. But specific rationales pertain to individual demand-side instruments. For example, procurement...
processes can help accelerate the emergence of technologies for which there is an urgent time bound societal need. Innovation-oriented public procurement can also be designed to help counter gaps in the supply of risk finance for small early stage ventures. By contrast, the rationale for government action in the area of technical standards is somewhat different, corresponding to public-good characteristics possessed by such standards. The development of standards is likely to experience some degree of market failure. By itself, the market may provide too few standards. Creating standards entails fixed costs, while the gains may not be appropriable by the individual firm.

Examples of demand-side policy instruments for innovation in firms.

The table below provides a set of examples of demand-side policy instruments in support of innovation in firms:

<table>
<thead>
<tr>
<th>Policy instrument</th>
<th>Objective of the policy</th>
<th>Condition/Node</th>
<th>Rationale</th>
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<tbody>
<tr>
<td>Public procurement tenders for innovative entrepreneurs</td>
<td>Reduce the barriers for innovative entrepreneurs accessing public procurement</td>
<td>Public procurement for innovation (see <a href="#">Public procurement for innovation</a>)</td>
<td>Institutional failure (potential biases against SMEs in public procurement)</td>
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<tr>
<td>Proportionate qualification levels and financial requirements</td>
<td>Reduce the barriers for SMEs accessing public procurement</td>
<td>Public procurement for innovation (see <a href="#">Public procurement for innovation</a>)</td>
<td>Institutional failure (potential biases against SMEs in public procurement)</td>
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<td>Cost-reimbursement contracts</td>
<td>Reduce the technological risks associated with the risks of non-completion owing to technical features of the procured good or service.</td>
<td>Public procurement for innovation (see <a href="#">Public procurement for innovation</a>)</td>
<td>Market failure due to uncertainty</td>
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<tr>
<td>Guidance, tools and support for innovation-oriented public procurement (including examples of best practice, sample documents)</td>
<td>Stimulate innovation-oriented public procurement within public agencies</td>
<td>Public procurement for innovation (see <a href="#">Public procurement for innovation</a>)</td>
<td>Capability failures</td>
</tr>
<tr>
<td>Creation of incentives to stimulate private demand (e.g. through guaranteed tariffs for innovative products or services)</td>
<td>Develop lead markets to help innovating firms achieve critical mass and competitiveness, bringing prices down and encouraging further diffusion and adoption of innovations.</td>
<td>Markets, Competition and Standards (see <a href="#">Markets, Competition and Standards</a>)</td>
<td>Market failure</td>
</tr>
</tbody>
</table>
Creation of standards

- Reduces risks for consumers, and fosters, thereby, diffusion of innovation
- Markets, Competition and Standards (see Markets, Competition and Standards [3])
  - Standards and certification (see Standards and certification [4])

Consumer policy and education to enhance user-led innovation

- Promote innovation in key innovative markets, ensure that confident consumers make informed choices, and counter inertia and scepticism towards new goods and services
- Markets, Competition and Standards (see Markets, Competition and Standards [3])


Contributor: OECD

References


Related Link: Public budgets for innovation
Strategy and policy coherence
Public procurement for innovation
Policy instruments
Public Policy and Governance

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