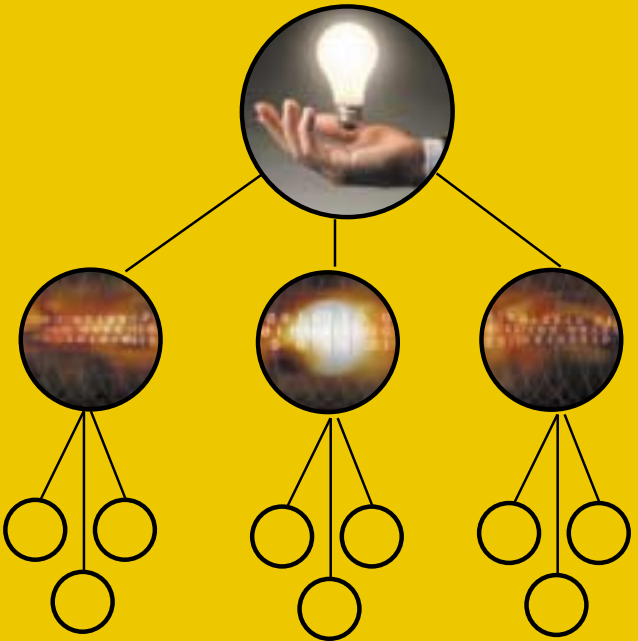


Nurturing suppliers' ideas
in the public sector

Capturing Innovation



Office of Government Commerce

Foreword

To be successful in the global knowledge economy, the UK must encourage the growth of innovative and dynamic businesses, both large and small. Government, with its tremendous purchasing power, can provide a powerful incentive for business to develop innovative products, processes and services, achieving better value for money and driving forward improvements in the quality of public services.

This guidance challenges government procurers to "think innovation" and become intelligent procurers. It demonstrates how procurement professionals across the public sector can procure innovative solutions that will both deliver quality of public service and support innovation in business.



A handwritten signature in black ink, appearing to read 'Patricia Hewitt'.

Rt. Hon. Patricia Hewitt
Secretary of State for Trade and Industry

All public procurement decisions should be based on achieving value for money. Public procurement is generally more effective if it is open to innovative ideas. Supplier innovation has the potential to create better value for money by contributing to better quality public services, reduced costs, and faster achievement of benefits.

This guide builds on work we are already doing to improve public procurement. Its use by public sector organisations will help secure both value for money and an enlightened approach to supplier innovation.



A handwritten signature in black ink, appearing to read 'Paul Boateng'.

Rt. Hon. Paul Boateng
Chief Secretary to the Treasury

Why Innovation

The DTI's 2003 report *Competing in the Global Economy – The Innovation Challenge*ⁱ, called for action across the public sector to boost innovation and to achieve the vision of the UK as a key knowledge hub in the global economy. The report stressed the vital role that public procurement can play as a lever for stimulating and enabling supplier innovation.

As a matter of policy, all public procurement decisions should be based on value for money. Whilst innovation should not be an end in itself, it can add to the value proposition. Public procurement is generally more effective if it is open to ideas from industry. Supplier innovation has the potential to create better value for money in public services, through:

- better quality;
- faster delivery;
- reduced whole life costs.

Achieving the benefits of innovation calls for effective leadership and a professional approach to procurement and project management.

Why Read This Guide

This guide is intended for all those involved in policy development, procurement and commercial activity, project and programme management. The audience includes ministers, officials and professional advisers. The guide seeks to encourage public sector organisations to be intelligent, demanding customers open to new ideas. It contains practical advice on dealing with innovative proposals and propositions; it also offers advice on encouraging suppliers to proffer innovative solutions.

The guide is not a comprehensive text book. For those who need more details on relevant best practice, there is a summary of further reading material.

When To Act

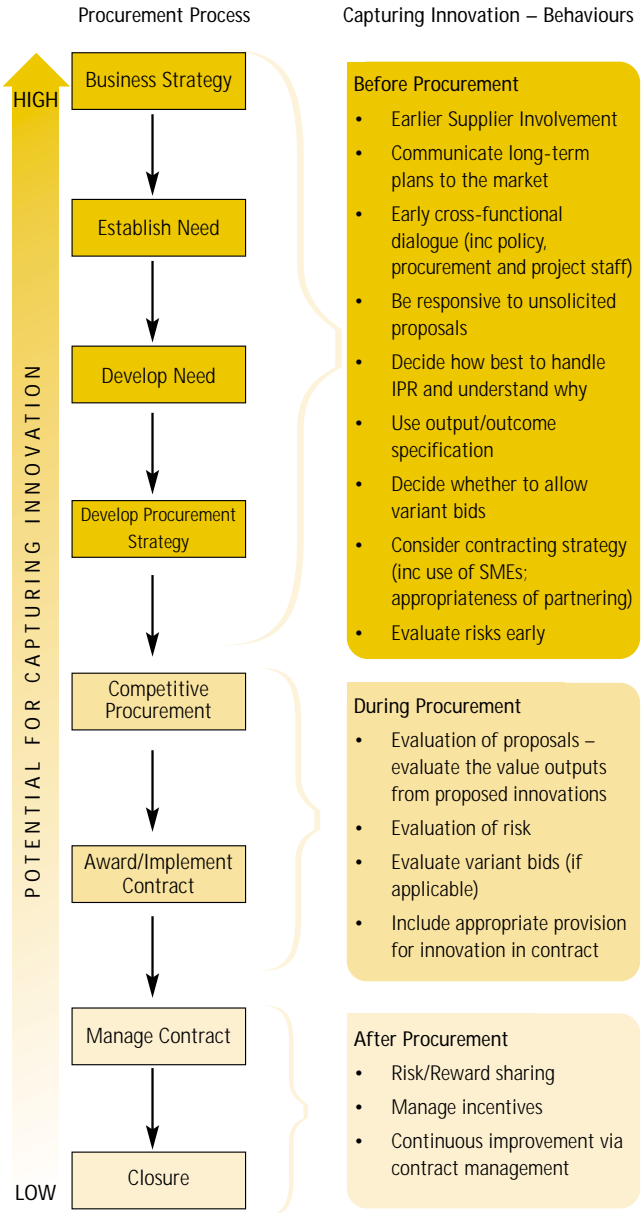
Innovation from suppliers should be encouraged throughout the procurement and contract lifecycle but the greatest potential arises from the earliest stages:

- when policy is being formulated;
- when programmes and projects are being shaped;
- in the formulation of procurement strategy.

That is why this guide emphasises the importance of early supplier involvement. During procurement, the scope to accommodate innovative proposals may be limited by the project's documented requirements; the potential is greatest with a skilful output/outcome-based specification. Once a contract has been let, the scope to accommodate innovation within the contract is governed by the contract itself and the nature of the contractual relationship; the potential is greatest if innovation has been considered during the procurement.

The schematic (overleaf) illustrates the key behaviours and actions for capturing innovation throughout the procurement process.

Schematic: Capturing Innovation through the procurement cycle



Why We Don't Capture Innovation

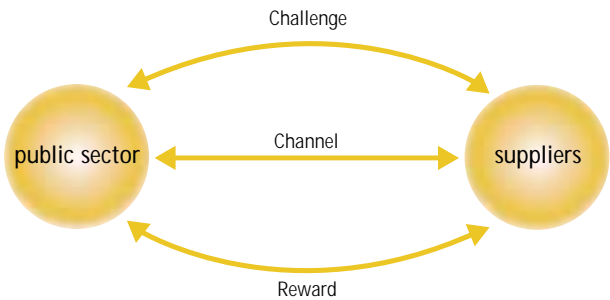
Innovation can take the form of inventions, new technology, new processes and good ideas. Research suggests that the public sector does not always get the best innovation from suppliers, partly as a result of public sector procurement practices and partly as a result of hurdles that suppliers encounter in marketing to the public sector. Some of the key issues contributing to the problem include:

- **Inadequate warning:** The public sector is not always good at communicating long-term plans to the market; as the start of the formal tender process is often the first indication a supplier receives of a complex requirement, the timescales can be too short for innovative solutions to be developed.
- **Risk aversion:** The public sector may seek to stimulate supplier innovation through short-term pilot projects but often does not carry through the ideas into longer term procurements; there is a tendency to opt for low-risk solutions, low-margin players and mature technology – innovation is not routinely welcomed or rewarded.
- **Client capability shortfalls:** Organisations that act as capable clients are better able to harness supplier innovation through effective procurement. Ministers and senior officials need to set the conditions for success, which include: strong leadership; effective planning; and clear, realistic setting of objectives. A professional approach to policy formulation, programme/project management and procurement is essential. There should be consistent application of best practice, including:
 - use of cross-functional teams to ensure policy, project and procurement teams work together in fostering supplier innovation;
 - effective risk managementⁱⁱ, as innovation and risk often go hand in hand;
 - deployment of skilled personnel in key roles concerned with capturing innovation;
 - an organised approach to learning from experience.
- **Regulation:** The UK Regulationsⁱⁱⁱ, which implement the EC public procurement directives, should not be perceived as a barrier to innovation. They allow for the use of output

specifications and variants, which can encourage innovative solutions. The negotiated procedure, which can be used in defined circumstances, provides considerable scope for client/supplier dialogue.

What You Can Do

The guidance that follows is structured around three themes that can stimulate and encourage innovation: Challenge, Channel and Reward. The guidance covers the key Capturing Innovation behaviours shown in the schematic.



Challenge

Organisations gain advantage through their ability to innovate and improve, driven by pressure and challenge from strong rivals, dynamic suppliers and above all from demanding customers. Public sector organisations must therefore be demanding customers – challenging suppliers in new ways and driving new ideas.

The following good practices can help you to be a more challenging customer:

- **Earlier Supplier Involvement (ESI):** It is recognised best practice in procurement for ESI to happen at the design stage if there is one, to capture expertise and inform potential solutions. But the evidence suggests that ESI needs to happen even earlier to realise the full potential of suppliers' ideas, e.g. during policy formulation or at the time of programme or project inception. The watchword should be 'no surprises' to industry.

- To be sure of capturing the potential for innovative solutions to enhance outcomes, the public sector should consult with suppliers and supplier bodies e.g. by means of suppliers' conferences, to enable suppliers to help shape requirements, provide feedback on feasibility and affordability, and gear up to be able to respond to future procurements. Increasingly, the more complex procurements look to supplier alliances and ESI provides an opportunity for suppliers to form those alliances and so improve the competitive prospects.
- One helpful initiative in this respect is Concept Viability^{iv}, a new service from IT industry body Intellect, to help the public sector take early market soundings and to test the practicability of their ideas.
- Opportunities for innovation and barriers to it differ from one market to another. Understanding the market, the environment in which it operates, the companies within it and their capabilities and needs is an important step in encouraging supplier innovation.
- Care is needed with ESI; deal with suppliers on an open and equitable basis in these early engagements: to avoid later accusations of favouritism; to avoid locking in to a particular solution; to maintain healthy competition. However, ESI offers significant payback in deliverability.
- **Procurement strategy:** When the procurement strategy is being developed, consideration should be given to the optimum form of future relationship, taking account of whether an innovative environment will be required after contract award. For example:
 - a partnering relationship may be suitable to create a climate of openness and mutual trust, in which public sector organisations can be more confident about revealing confidential information (e.g. part-formed policy). A partnering arrangement allows the public sector to be challenging in regard to innovation and is more conducive to supplier innovation. Partnering, to be effective, must be used in the right circumstances and in capable hands;
 - the provision of contractual incentives – where supplier and client share the benefits – can encourage innovative solutions to meet changing needs. This is most important

in long-term contracts where suppliers need to be encouraged to seek out advantage from technical developments.

- **Involve SMEs^{vi}:** Small innovative firms can be excluded from contracts owing to a lack of capacity on their part, meaning innovation can be lost. Breaking the requirement into smaller chunks may create opportunity for smaller firms to participate. Alternatively, public procurers can encourage larger suppliers to form alliances with smaller, creative partners.
- **Output/outcome specifications:** A well-constructed output specification identifies the outputs from, rather than the inputs to, a requirement. An outcome specification takes this one step further and specifies the end result to be achieved. It is equivalent to specifying the problem and inviting solutions. The use of output and more particularly outcome specifications challenges the supply base to generate ideas. In allowing suppliers freedom to submit innovative bids, procurers should specify compliance with standards where appropriate, for example to ensure compatibility.
- **Acceptance of variants^{vii}:** Innovative responses can be encouraged by allowing bidders to submit variants to the core or standard specification. However, any such approach should be in line with the scope of the project and with the EC directives where applicable. Advice should always be sought from procurement experts.
- **Contract management^{viii}:** Contract managers can challenge suppliers to be innovative. Techniques include the use of continuous improvement drivers and supplier suggestion schemes. Many public sector organisations operate staff suggestion schemes but rarely extend them to their suppliers! Provision needs to be built into the contract from day one, for innovation over the life of the contract.

Channel

The public sector must ensure that the channels are in place for it to interact with industry over time; not just during the procurement phase, but also beforehand and over the life of the contract. Information on dealing with the public sector, and on the public sector's current and future requirements, must be

communicated to suppliers. Internally, best commercial practice needs to be deployed to ensure the public sector is ready to interact with suppliers in the right way and at the right time.

The following good practices apply:

- **Communicate long term plans to the Market:** To give industry confidence to invest in meeting the public sector's long-term needs, the 2003 OGC report *Increasing Competition and Improving Long-Term Capacity Planning* calls on public sector organisations to improve two-way communications with industry on future needs. It states that suppliers' needs should be taken into account in public organisations' business and procurement planning. To communicate future needs with industry, use can be made of existing channels, such as DTI's innovators club, or specific targeted events. See Early Supplier Involvement above.
- **Unsolicited proposals:** The "cold call" can be the most difficult case to handle for public procurers. The proposer may have identified or be trying to create a potential need for their product or service. The proposal may be "half-baked" or fully developed, perhaps seeking support funding or sponsorship. In some cases, it may be just a wild idea. The public sector may not recognise any demand or priority. There may be no funding stream; the client cost of implementing the idea may be prohibitive. In a hundred such unsolicited proposals, ninety-nine could be totally impractical, but the hundredth could lead to improved services, reduced costs, creation of useful employment and prosperity-enhancing export opportunities. The UK public sector needs to improve its conversion rate on the really creative proposals; to be more 'open for business'; and to challenge perceptions that it is unreceptive to 'cold-calling'. When the more interesting proposals have been identified there are still issues about handling. Professional advice should always be sought but the following points offer some leads:
 - treat the proposal as an integral part of Early Supplier Involvement, to inform the developing requirement; but make it clear to the supplier that the UK Regulations dictate that all potential solutions be investigated;
 - invite the supplier to participate in an early design contest (see below);

- advertise the requirement, making sure you don't jeopardise the proposer's intellectual property in doing so, and encourage the unsolicited proposer to bid. By running a competition, you should be better able to judge whether the cold caller has the solution that best meets your needs;
- it may be appropriate to use the negotiated procedure without call for competition i.e. single tender action. However, this procedure is strictly controlled by the UK Regulations – the procurer must first establish that the proposal is unique and that relevant conditions permitting use of the negotiated procedure are applicable;
- the proposer may be too small or under-resourced to bid for a substantial contract. Solutions could include:
 - securing licensing rights or a share in IPR so that other suppliers can be engaged;
 - with the supplier's agreement advertising two separate requirements: i) to procure a creative partner to work alongside and support ii) a larger contractor for the main contract.
- if an unsolicited proposal is relevant to an existing contract, the client can encourage its prime contractor to consider subcontracting to the proposer. The public sector organisation and the prime contractor would want to be satisfied that the proposal represented value for money.
- **Early design contests and IPR:** Where the public sector is seeking a new design, it can run an early design contest, with the ability to hold or share intellectual property rights (IPR) and the right to license manufacture / build, to ensure it does not get locked into a monopoly supplier. In some cases it will be appropriate to pay for several or all contest outputs, to enable all the good ideas to be used. The prize for the design contest could even be the award of a service contract to develop further the winning design. Public procurers must declare upfront if they intend to buy IPR, to give suppliers that are unwilling to yield their IPR the chance not to participate. Design contests are subject to the UK Regulations.

Reward

Suppliers need to be incentivised into working innovatively with the public sector. Key points to note in considering suppliers' rewards include:

- **Cost and value for money:** Value for money should not be seen as a barrier to innovative solutions. Procurement decisions should not be made based on lowest cost but on value for money, which is defined as 'the optimum combination of whole life costs and quality to meet the user requirement'. The best value for money can come from an innovative solution. Innovation can enable you to do new things or provide you with a step change in effectiveness or efficiency. At the start of procurement, the requirements specification can reflect the need for innovative solutions, subject to normal rules on cost-effectiveness of public expenditure. At the award stage, the value accruing from innovative aspects of the bid can also be relevant to the evaluation of 'whole life cost and quality'.
- **Incentives:** Research shows that the contract structure and incentives can have a major impact on suppliers' motivation to innovate. Joint funding of investments and the award of longer-term contracts are powerful incentives.
- **Risk and reward sharing:** Risks need to be sensibly apportioned, and joint benefits should be pursued. Sharing of cost-savings identified by suppliers is an incentive that could be used more widely. Similarly the reward from any suggestions schemes in operation is a factor. Care should be taken not to over-compensate suppliers through reward-sharing initiatives, as doing so could be construed as a State Aid. Organisations with concerns about the levels of their reward scheme should discuss them with DTI's State Aid Branch.
- **Payment is not the only reward:** Acknowledgement, kudos and good press can be important motivators for suppliers, particularly in markets where fierce rivalry exists.
- **Ownership of intellectual property^{ix}:** This should not always be assigned to the buyer. Recent OGC guidance recommends that intellectual property rights should ultimately rest with the party who is best able to exploit it. As against that, assignment of IPR to suppliers can serve as a dampener to competition. See Early Design Contests above. In any event,

public sector organisations must take care not to 'leak' suppliers' IPR that has not been bought by the public sector to other companies, as that is wrong in principle and discourages future innovation. To safeguard confidentiality, care is needed with internal handling.

Further Information

The Successful Delivery Toolkit (for guidance on all procurement, project and programme issues)

<http://www.ogc.gov.uk/sdtoolkit/>

ⁱ **Competing in the global economy: the innovation challenge**
<http://www.innovation.gov.uk>

ⁱⁱ **Risk Management**
<http://www.ogc.gov.uk/sdtoolkit/workbooks/risk/index.html>

Management of Risk: Guidance for Practitioners
http://www.ogc.gov.uk/sdtoolkit/reference/ogc_library/partner_guidance/risk/index.html

ⁱⁱⁱ **Introduction to the EC rules**
http://www.ogc.gov.uk/sdtoolkit/reference/ogc_library/procurement/ECProcurementRules.pdf

^{iv} **Concept Viability**
<http://www.intellectuk.org>

^v **Effective Partnering**
<http://www.ogc.gov.uk/sdtoolkit/keyissues/effectpart/index.html>

^{vi} **Smaller Supplier...Better Value?**
http://www.ogc.gov.uk/embedded_object.asp?docid=2077

Government's response to the BRTF report
<http://www.brtf.gov.uk/taskforce/responses%20new/smallbusinessresponse.htm>

^{vii} **Variant bids**
http://www.ogc.gov.uk/sdtoolkit/workbooks/procurement/8_bidevaluation.htm

^{viii} **Contract Management**
<http://www.ogc.gov.uk/sdtoolkit/workbooks/contracts/index.html>

^{ix} **Ownership of Intellectual Property**
http://www.ogc.gov.uk/sdtoolkit/reference/ogc_library/procurement/owner_ipr.html

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