

## 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?

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

- [Public procurement \(see Innovation procurement schemes \[1\] and Public procurement for innovation \[2\]\)](#) can stimulate innovation in 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 set up the regulations for markets and industries, and these regulations [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 a general, 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 (Lacey, 2007). In contexts 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.

Policy instrument	Objective of the policy	Condition/Node	Rationale	
Public procurement tenders for innovative entrepreneurs	Reduce the barriers for innovative entrepreneurs accessing public procurement	Public procurement for innovation (see <a href="#">Public procurement for innovation</a> [2])  • Innovation procurement schemes (see <a href="#">Innovation procurement schemes</a> [1])	<b>Institutional failure</b> (potential bias in public procurement) against SMEs	
Proportionate qualification levels and financial requirements	Reduce the barriers for SMEs accessing public procurement	Public procurement for innovation (see <a href="#">Public procurement for innovation</a> [2])  • Innovation procurement schemes (see <a href="#">Innovation procurement schemes</a> [1])	<b>Institutional failure</b> (potential bias in public procurement) against SMEs	
Cost-reimbursement contracts	Reduce the technological risks associated with the risks of non-completion owing to technical features of the procured good or service.	Public procurement for innovation (see <a href="#">Public procurement for innovation</a> [6])  • Innovation procurement schemes (see <a href="#">Innovation procurement schemes</a> [1])	<b>Market failure</b> due to uncertainty	
Guidance, tools and support for innovation-oriented public procurement (including examples of best practice, sample documents)	Stimulate innovation-oriented public procurement within public agencies	Public procurement for innovation (see <a href="#">Public procurement for innovation</a> [2])  • Innovation procurement schemes (see <a href="#">Innovation procurement schemes</a> [1])	<b>Capability failures</b>	
Creation of incentives to stimulate private demand (e.g. through guaranteed tariffs for innovative products or services)	Develop lead markets to help innovating firms achieve critical mass and competitiveness, bring prices down and encourage further diffusion and adoption of innovations.	Markets, Competition and Standards (see <a href="#">Markets, Competition and Standards</a> [3])	<b>Market failure</b>	

Creation of standards	Reduces risks for consumers, and foster, thereby, diffusion of innovation	Markets, Competition and Standards (see <a href="#">Markets, Competition and Standards</a> [3])  Standards and certification (see <a href="#">Standards and certification</a> [4])	Market failure	
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 <a href="#">Markets, Competition and Standards</a> [3])	Capability failures	

Source: OECD (2011), Demand-side Innovation Policies, OECD Publishing. doi: 10.1787/9789264098886-en

**Contributor:** OECD

## References

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