

Financing strategy

A financing strategy helps you decide on the best opportunities and instruments to deploy for an innovation project and what risks you are willing to take in this regard.

1. When is this instrument useful?

This instrument is useful if you are trying to identify how you want or are able to finance innovation procurement. Based on the budget available for such a purchase, you choose from existing financing options and instruments. It may be that you yourself invest in the innovation – solely or with others. Or it may be that you expect other parties to be willing to invest in the project. Or there is no budget, or the available budget is insufficient. In a case such as this you should investigate whether you can obtain part or all of the finance from external sources. You could, for example, cooperate with another government body facing the same problem or seek assistance from a European or other fund or a market party.

2. Step-by-step plan

You can translate an innovation request from within your organisation into a financing strategy for an innovation project in the following three steps:

Step 1: Identify the options with regard to finance

You should first ascertain the maximum available budget. It may be that there is no available budget at all, or that the budget is already fixed. In most cases, however, the budget depends on the project and you will have to make a considered choice. Questions that are important in determining the financial scope are:

1. Does your organisation attach sufficient value to the renewal/innovation project to make funds available for this purpose?
2. What chance is there to share the costs with any external parties?
3. Do you expect the market to contribute all or some of the investment and are you prepared to then reward them for this?
4. Are you prepared to invest in an innovation project yourself with the aim of subsequently recouping that investment? It is always more risky to invest yourself than it is to leave the investing to the market.

Tip: Other government bodies may perhaps be facing similar problems/projects and looking for a solution at the same time as you. It is also possible that other government bodies have already gained experience – both positive and negative - with comparable innovations.

Step 2: Choose one of the financing options

Following step 1, you know your available budget. One of the following three situations applies to your innovation project. We have explored any financing options relevant to these three situations below. On the basis of these you can further develop and determine your financing strategy.

Situation 1: There is no budget or only a limited number of additional funds for innovation.

To encourage an innovation project in this situation you could, for example, use the innovation funds that are available. Or you could offer market parties the prospect of sharing in the returns from the innovation.

Using available funds

There are various funds for research and development that can help government bodies encourage innovation:

- [Horizon2020](#) is a European fund that encourages innovation at an international level. The Netherlands Enterprise Agency helps Dutch parties wishing to submit a tender. Horizon2020 also makes funds available to government bodies wishing to procure innovation.
- [INTERREG](#) is a European fund for innovative projects that promote the competitive power of Europe.
- [European Structural and Investment Funds](#): The European Commission (EC) makes funds available for the development and strengthening of the economy.

Use of performance contracts

By entering into a performance contract with a market party for an innovation project, you make payment dependent on the performance of the solution. A market party will be paid less if the performance agreed in advance is not achieved. A market party may in some cases also choose to invest or partially invest in advance. But it will want to receive income in return in the event of a good performance. Performance contracts include:

- ESCOs
An ESCO is an Energy Service Company. A market party (energy company) invests via an ESCO in energy-saving measures that reduce the energy costs of the contracting authority. The market party earns back these investments by virtue of receiving the revenue generated by these measures for a predetermined number of years. At the end of the contract the ESCO is wound up and the contracting authority benefits entirely from the energy-saving measures. There are variants of this in which the contracting authority guarantees the ESCO finance. You can agree terms in this regard when you issue the tender, for example by entering into a performance contract under which the supplier receives a lesser payment if it fails to meet the pre-agreed performance standards.
- Lease
You can also encourage innovation by entering into a lease. Under a lease the contracting authority does not become the owner, but pays an agreed sum for the use of the products or services. This can be a fixed or variable sum. For example, these days you can purchase lighting under a subscription. Payment is based on the lumens of light produced instead of on the purchase and use of light sources. In this way it is beneficial for the market party to adapt new innovations along the way. The contracting authority only pays for the consumption. The risk of adverse maintenance costs usually lies with the market party.

Other instruments

- An innovation agenda indicates the direction in which the organisation's work will head in the coming years. If you report the purchase of an innovation in this agenda, then economic operators and investors can respond to this through their research and innovative energy.
- Making a trial purchase for a part of the organisation will lessen the consequences if a solution proves not to work in practice.
- A design contest is a way of using the creativity of the market. In most cases the supplier itself will invest fully in the tender it submits.

- A project with a small risk of failure and for which a large investment is needed is often the product of natural market mechanisms. No additional efforts on the part of the government body are required. This is not a form of finance, but in some cases it is an option worth considering. In fact, you simply wait for the market itself to take advantage of the opportunity. It is important here, however, that you communicate your need for innovation to the market via, for example, the innovation agenda.

Situation 2: There is an available budget, but you expect the market to make the biggest investment.

In this situation the market itself bears the risk for an innovation. However, as the contracting authority you must, of course, offer sufficient prospects of reward.

Innovation request

If the selected solution is a long way towards development and most likely several suppliers will be involved, a tendering process can give that extra nudge to bring about the innovation. You can take account of the requirement for innovation in the tendering process by having regard to the following matters:

- Sufficient time for development
- The possibility of failure
- Proper supervision

Choosing a form of integrated contract

You can also choose a form of contract in which you share the savings or returns with the market party or supplier. Innovation can especially benefit from longer projects or projects in which the supplier has a bigger responsibility. [DBFMO](#) contracts and constructions such as [ESCOs](#) assign a large part of the risks to the supplier in exchange for a continuous income stream. See also [this](#) PIANOo publication.

Situation 3: There is a budget available and you are willing to invest - solely or with others.

In this situation you invest more than you would in a normal procurement. This can be done in ways including the following two examples. You can also earn back your investment if the solution works well.

Joint investment and return of some or all of the investment

If you develop an innovation together with a market party/supplier, you can earn money back through intellectual property rights or the granting of third-party user rights. An example of this is the [Codemo scheme](#) of the Dutch Ministry of Defence. Research and development contracts have specific rules for the sharing of intellectual property. If you fail to honour these rules, this may constitute state aid (see in this regard [Article 2.3](#)). An effective handling of intellectual property issues is an art in itself.

Invest with other government bodies trying to resolve the same problem

Will an innovation require greater investment than your own funds can cover? If so, you could consider setting up an innovation fund. You could set up such a fund to enable other parties such as government bodies to work together to encourage innovation in a particular direction and then to finance such innovation. There are also funds which you can subscribe to yourself, as the Rijkswaterstaat did. It may be that your organisation already subscribes to a fund.

Step 3: Monitor progress and share in successes

If you have drawn up a financing strategy on the basis of your available budget and launched an innovation project it is important to manage the risks, since as the initiator or promoter of the innovation you always bear some degree of risk: the innovation will not always meet your requirements. Monitoring progress limits these risks. Tools to help you in this include a risk analysis to provide you with more information about estimating the risks and obtaining a clear picture of savings made (for example, using TCO calculations) via budget reports or procurement accounting.

Does a particular approach yield results for the procurement of innovation? If so, this is information that is worth communicating. A report about a successful innovation is energising and creates support for any future investment in innovation.

3. Further information

[Pro-EE](#): Article about the various forms of energy performance contracts.

4. Source

This information was taken from the “Innovation Procurement for Contracting Authorities” document that was prepared by [PIANOo](#) in 2017.