

## FACING KNOWLEDGE ECONOMY CHALLENGES THROUGH SERVICE INNOVATION

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### Abstract

*The service industry demands innovation in the coming decades to reach competitiveness and success. Companies' leaders must constantly innovate by redesigning their organizations to adapt to new conditions, while ensuring that the customer is highly satisfied. To face present challenges of knowledge economy, service firms of all types must start defending themselves which is about proactive, far-reaching, often draconian changes, focusing on customer preferences, quality and technological interfaces. Our paper focus on service innovation content and its key potential for the service companies, also discussing present challenges and future trends of innovation in Romania.*

**Keywords:** service innovation, knowledge economy, product innovation, process innovation

**JEL Classification:** M15, O32, M31

### 1. Introduction

Societies advance for many reasons. One of these is the ability to innovate – which simply put means creating new and better ways of solving problems. This is, in fact, the basis of genuine wealth creation. The better the solution, the more likely someone will pay for it. This is most visibly manifest in the industrial world – new tools, machines, methods, techniques, and processes – but also in more abstract endeavors such as the arts and culture.

Our paper reveals the key role of innovation for the service companies' competitiveness and success. The first part of the paper presents the process of service innovation and its four phases; in the second part we come with arguments to support the idea that a service innovation framework is critical for service businesses to stay competitive; the third section of the paper presents some practical issues related to service innovation in Romania.

### 2. Process of service innovation

Innovation, according to experts, is no longer solely the domain of theoreticians or engineers working in isolation in a lab. Innovation now includes the collaboration of creative customers, who find ways to address their own wants and needs in the

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product or service [Brown, Michel and Gallan, (2007)]. *Customers* have power to create value for any number of products and services and innovations will not be successful unless customers co-create value for it. YouTube is a significant example, its users being responsible for making YouTube a global sensation.

Services were long thought to be laggards with regard to innovation – they were assumed to be uninteresting adopters of existing technologies rather than producers of new technology. This perception still exists, and is a major reason why innovation in services remains under-researched. Information and Communication Technologies (ICT) such as the telephone, computer, electronic data transfer and the internet have been fundamental to a whole raft of innovations in the service sectors. Telecommunications and computer software firms are considered services and are of course the primary source of a large proportion of these innovations. However services are also the major consumers and adapters of a range of information technologies.

A service innovation is a service product or service process that is based on some technology or systematic method. In services however, the innovation does not necessarily relate to the novelty of the technology itself but the innovation often lies in the non-technological areas. Service innovations can for instance be new solutions in the customer interface, new distribution methods, and novel application of technology in the service process, new forms of operation with the supply chain or new ways to organize and manage services.

In order to reach success, managers in the service industry have to manage four phases making up the innovation process [Tether, (2005)]:

- 1) Scan and search their environments to pick up and process signals about potential innovation. They represent the bundle of stimuli to which the organization must respond.

- 2) Strategically select from this set of potential triggers for innovation those things which the organization will commit resources to doing.

- 3) Implement the innovation, growing it from an idea through various stages of development to final launch as a new product or service in the external marketplace or a new process or method within the organization.

- 4) Reflect upon the previous phases and review experience of success and failure – in order to learn about how to manage the process better, and to capture relevant knowledge from the experience. Also, we have to mention the generic drivers which are shaping the patterns of innovation across the services sector and are requiring significant management challenges: servicization, increasing customization, and outsourcing of business activities.

Although services represent an increasing share of formal R&D, there still are poor measures of innovative activities in services. The lack of evidence of innovation in services hinders the development of policy towards services and biases attempts to describe the innovation process in the modern firm. Indeed, many of the theoretical

models of innovation remain legacies of a bygone era in manufacturing, although they still dominate research, theory and policy towards innovation.

### **3. Service innovation, as the key to competitiveness**

Specialists consider that, the critical component to being competitive in global markets over the next 20 years is the ability to be innovative. The service industry demands innovation in the coming decades; this innovation will come from companies that foster creativity and communication. Service innovation has many inherent risks from both customers and competitors, but wise management of these risks can lead to increased profits and a stronger long-term position.

Innovations are the key to stay a step or two ahead of competitors. New service delivery models are essentially derived by working closely with customers to co-create innovative and unique solutions best meeting customer inevitably changing needs. According to some specialists, a service innovation framework is critical for service businesses to stay outperform. “The framework can guide the creation of customer value and demand, and the processes and organizations that deliver services successfully - all of it catalyzed by emerging technologies” [Rangaswamy and Pal, (2005)].

The client is often especially critical in services innovation, so questions arise about: a) how to understand and assess the role of clients in innovation processes, to measure the co-production of innovations, the exchange and fusion of knowledge that goes on here? b) how to understand and assess the "impact" of innovation on service firm, client, and the service-client relationship? c) how to understand changing division of labour between the client and provider (as exemplified by self-service and user-driven innovation strategies, and as confronted in make-vs-buy choices)?

Many companies make incremental improvements to their service offerings, but few succeed in creating service innovations that generate new markets or reshape existing ones. To move in that direction, executives must understand the different types of market-creating service innovations. Companies with a restricted view of innovation can miss opportunities.

As we are facing with slow growth, commoditization and global competition, service innovation becomes critical to corporate success. William Ford Jr., chairman and CEO of Ford Motor Co., recently announced that, “from this point onward, innovation will be the compass by which the company sets its direction” and that Ford “will adopt innovation as its core business strategy going forward.”. “Innovation Imperative” means that innovation is central to the success of a company and the only reason to invest in its future [Sawhney, Wolcott and Arroniz, (2006)].

A performing management of innovation requires finding answers to the following questions:

- How do service organisations (of different types) manage innovation processes in practice?
- How do these organisations capture intelligence on innovation so as to make it more reproducible (this may be referred to as "knowledge management") and why is this apparently often lacking? How can matters be improved?
- What is the role in services of traditional innovation activities (R&D, design, sourcing information from professional networks and from contract research and universities, acquiring equipment and software, training)? What other mechanisms and practices are involved?
- How are these activities planned, implemented, monitored, evaluated? Are there roles for better policy support, better metrics, etc?

In the 1990s, innovation was about technology and control of quality and cost. Today innovation is more about reinventing business processes, collaborating and integrating within the firm, and creating entirely new markets to meet various customer needs. Increasing globalization, the growth of the Internet, and more demanding customers are forcing marketers to find innovative ways of conducting service business. Understanding the connectedness of the external environment is vital to enhanced innovation in all domains.

In fact, a service company can innovate along any of 12 different dimensions with respect to its: offerings, platform, solutions, customers, customer experience, value capture, processes, organization, supply chain, presence, networking, and brand. Together the 12 dimensions of innovation can be displayed in a new framework called the "innovation radar," which companies can use to manage the increasingly complex business systems through which they add value.

#### **4. Dynamics of service innovation in Romania**

According to a recent innovation survey done by the Economist Intelligence Unit, Romania ranks 53 in the expected innovation performance for the next 5 years. EIU uses a proprietary instrument to measure innovation potential, taking into consideration a blend of several factors. The main drivers quoted by the EIU in assessing a country's capacity to innovate are the following: government policies and government R&D spending; education systems; proximity to high-tech clusters; IT and communications infrastructure and broadband penetration.

In recent years policy makers have begun to consider the potential for promoting services innovation as part of their economic development strategies. Such consideration has, in part, been driven by the growing contribution that services activities make to national and regional economies. It also reflects the emerging recognition that traditional policy measures such as R&D grants and technology transfer supports have been developed from a manufacturing perspective of the innovation process.

Although it's placed among the states with lower scores for the ability to innovate, Romania is rapidly approaching the EU average in this area. Better results are recorded, in particular, in terms of number of companies that introduce innovations in their activity and about the economics effects of innovation, and applying them successfully in the area of human resources, sales and exports. The European study Innovation Scoreboard 2008, conducted by the Institute of Maastricht and the European Commission, indicates progress regarding innovation of new member states, especially Romania, Bulgaria and Cyprus. On the other hand, Romania has problems regarding the availability of financing and support of authorities for innovation activities and related to intellectual property rights arising from such initiatives.

In Romania, big companies are more innovative than SME. Two big companies and only one SME out of five are innovative. Considering activity as criteria, industry is more innovative than services sector. Both in the industry and in services sectors, the highest level of innovation expense is made for purchasing of machines, equipments and software. Companies in the services sector spend more money for research and development than those in the industry sector.

Companies in Romania usually innovate new products for companies, and not for the market. Big companies are co-operating much better, in comparison with the SMEs. Only 17,3% from the total number of innovative companies have co-operation agreements for implementing innovation activities. Co-operation intensity for innovating is strong related with the size of the company. Even it is low in comparison with the European average, the innovation potential in Romania is keeping a positive trend in the last six years. The future perspectives of innovation in Romania are highly associated with the National Strategy for Research, Development and Innovation (RDI) for the period 2007-2013 which is based on the Romanian society's vision referring to the role of science, technology and innovation for the development of knowledge society in Romania, and for the economical and social progress. RDI strategy provides also the coherence in the main specific political documents at the European Union level.

The main action points for the Romanian innovation sector, according to the National Strategy for Research, Development and Innovation (RDI) for the period 2007-2013 are:

- 1) Supporting companies' pre-competitive research initiatives, through financial instruments and adequate assistance;
- 2) Stimulating public universities and RD entities to create and develop interaction units with the private sector;
- 3) Increasing the collaboration of public and private innovating entities, by developing innovation networks;
- 4) Supporting entrepreneurship based on innovation by developing services in innovation incubators, improving the access to the risk capital and by providing training in the innovation management sector;

5) Improving SMEs' access to information about the research results, and financing and collaboration opportunities through dedicated support services.

RDI system will represent the engine in the knowledge society development in Romania, being capable to support the performance through innovation in all sectors that contribute to the citizens' wellbeing and, at the same time, to reach scientific excellency internationally recognized.

European Year of creativity and innovation in 2009 was officially launched with the slogan "Imagine. Create. Innovate". This initiative emphasizes the importance of creativity and innovation contribution to economic prosperity and social and individual welfare. European Year of creativity and innovation wants to highlight the importance of creativity and innovation in personal, social and economic development. It also aims to promote human talents, creativity and innovative approaches in different sectors such as education, culture, social and regional policy, research, energy, transportation, and environment and information society. European Year of creativity and innovation in 2009 is held in the context of the Lisbon strategy that aims for the EU to become, by 2010, the most competitive economy in the world, based on knowledge.

## 5. Conclusion

Taking into consideration the crucial role of innovation within the framework of services organizations management, we can say that, *innovation in services must offer to consumers, confidence, being perceived as unique*, and must find enough customers willing to pay the costs, producing a plus of economic ideas, and of course profitability.

In their attempt to link with customers directly, service firms must overhaul their offerings, cost structures, and competitive platforms to align with the shortened information chain and with the changing demands and behavior of their customers. Specifically, companies have to rewire their strategies to find new value from existing sources; deintegrate and radically assemble their operational processes; and restructure the organization to accommodate new kinds of work and needed skills.

It is not easy to achieve this performance of innovation: it is necessary to identify the goals, to clearly define the target customers and therefore, it is required a marketing strategy that considers the existence of innovating organizational culture, on the background of permanent innovation process improvement.

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