



journal homepage: www.elsevier.com/locate/emj

Towards a service-based business model – Key aspects for future competitive advantage

Daniel Kindström *

Linköping University, SE-581 83 Linköping, Sweden

KEYWORDS

Service;
Service innovation;
New service development;
Business model;
Strategy

Summary Many product-based companies are seeking to increase their competitiveness by moving towards a service-based business model. This research is based on a multiple case study of seven manufacturing companies and by using the business model concept it links managerial activities to a service innovation framework to emphasise how companies can best take advantage of a new service-based business model. Findings indicate that companies need to focus on all areas of their business models in a holistic fashion, and not just change isolated elements. Among other challenges, companies must develop their abilities to build relationships with customers, to visualize the intangible value of their service offerings, and to advance a dynamic service offering portfolio that is adaptive to changing customer needs.

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Introduction

Driven both by competition and by new customer demands, many product-based companies find themselves moving – willingly or unwillingly – from their traditional business models based on product sales towards models based on services, and thus needing to increase their focus on services, and on solutions that encompass both service and product areas (see e.g. Gebauer et al., 2005; Oliva and Kallenberg, 2003). This article discusses how managers can approach and understand this change to their business models, and also how their organization can become more service oriented in order to take advantage of the emergent opportunities inherent in this shift.

Competition in their traditional product sectors, including from low-cost actors, together with decreased sales margins due to commoditisation, are driving companies to extend their businesses with new offerings that include a relatively high degree of service content (see e.g. Matthysens and Vandenbempt, 2008; Reinartz and Ulaga, 2008). With traditional product markets fast becoming saturated, moving into service offerings also offers them the possibility of extending their market scope. This so-called ‘servitization’ (Vandermerwe and Rada, 1988) of many industries means that companies are not only augmenting their product offering with services, but also developing new offerings where products are no longer necessarily at the centre of the company’s value proposition, or even of its business model. For example, instead of concentrating on selling warehouse trucks, truck manufacturers such as Toyota

* Tel.: +46 (0)13 28 24 96.

E-mail address: daniel.kindstrom@liu.se

Materials Handling are turning to new revenue models based on various forms of rental agreements, which require them to invest in both service and maintenance activities and in financing.

While companies are acknowledging this shift, top managers still struggle to understand how they should best address and manage it, as it often involves a new strategic direction, which requires the development of new, service-based, business models. Business success in this setting depends as much on such organizational rearrangements (including business model redesign) as it does on the creation of particular services and increased focus on new service development (NSD) and service innovation¹ (see e.g. Gebauer et al., 2008). Main challenges involved in changing from being product-centric to being customer-centric – which often is seen as vital to offering more advanced services and combined product/service solutions – relate to internal organisational issues (Shah et al., 2006). Furthermore, shifting the mindset to that of providing services is also forwarded as a challenge for product-based companies (see e.g. Neely, 2008). The implications of this shift are that services – and an increased focus on NSD – should not be limited to just those processes by which the firm's value proposition is 'created': the transition will also modify other areas of the business model.

Although previous studies have addressed certain areas of the product-to-services shift, few have focused on what constitutes a successful business model in this new context. Some delve into specific aspects to identify various issues – such as the needs for a clear service development process (Gebauer, 2008), the formation of a separate in-house service organization (Oliva and Kallenberg, 2003), and the reshaping of certain organizational arrangements (Neu and Brown, 2008) – but few look at the problems from the inherently holistic perspective a business model approach offers.

This article aims to identify the key aspects of a service-based business model as companies address the challenge of shifting towards an increased focus on service offerings. More specifically, it begins by adopting a general business model framework. By linking NSD and service innovation literature with the business model concept this research seeks to synthesize key concepts to form a logic to underpin the design of a successful service-based business model, and offer managers a more holistic perspective from which to approach NSD and service innovation. The methodology is presented first, and then the research data is considered and analysed (based on this synthesised framework) to identify key service-based business model aspects and their links to NSD. Finally, implications for managers and researchers are presented and discussed. The empirical context comes from in-depth case studies of seven market-leading manufacturing companies.

¹ Service innovation and new service development are often used interchangeably and in this paper the terms are to be seen as such. The term new service development (NSD) is preferred here except for in some theoretical discussions where service innovation is used to better resonate with terminology in previous research (as in e.g. Bessant and Davies, 2007) Furthermore, new service development was the term used by the respondents.

This study should be of particular interest to top managers, since the constant erosion of their traditional product-based competitive advantage is very real in many industries, and many managers find it difficult to know how to innovate services systematically (Malleret, 2006). Its findings offer guidance as to how they can succeed in increasing their businesses' service orientation, which has often been associated with higher levels of financial performance (Lytle and Timmerman, 2006).

Service innovation as a starting point

Services are often seen as a key growth area by many companies, not only in the service sector but also in manufacturing (Jacob and Ulaga, 2008), where many companies are changing their traditional business models as they begin to offer more services (cf. Wise and Baumgartner, 1999). But previous studies have pointed to a number of problems for companies whose established corporate cultures and organizational structures may stand in the way of service development (cf. Mathieu, 2001b; Gebauer et al., 2005; Neely, 2008), and who lack a service innovation strategy to guide their NSD efforts (Bessant and Davies, 2007). Companies who find themselves increasingly pressured to realign their business models towards services will need to invest in NSD urgently if they are to create sustainable competitive advantage in this area (see e.g. Martin and Horne, 1992), the more so since service innovations are considered easier to imitate than product innovations (Gebauer et al., 2008). However, companies typically invest significantly less in R&D for services than they do for products – partly because product R&D traditionally requires higher capital investments in assets, while service innovation (in contrast) requires increased investments in human resources and other 'soft' elements to lead to better performance (Homburg et al., 2003).

Service innovation and NSD are interactive, coupling processes (Vargo et al., 2008) that can take several forms. Bessant and Davies (2007) proposes a generic framework made up of four types of service innovations (creating together what could be termed a 'service innovation space') that can be used to understand the underpinnings of service innovation: (1) service offering innovation – changes in the actual offering or value proposition; (2) process innovation – changes how services are created and delivered; (3) position innovation – changes in the context of the service; and (4) paradigm innovation – holistic change in the mental models underlying the business. (Here the first three elements of this framework are adopted as one constituent of the analysis in this paper. The fourth dimension paradigm innovation and its holistic character encompasses the other three and is instead seen in the business model concept.) This idea is echoed by other research: Tidd et al. (2005) propose a similar innovation classification in three types – Technological, Organizational and Market – with service innovations needing to occur in all three types to be successful, while Edvardsson and Olsson (1996) suggest the three dimensions of service concept, service system and service process in their analysis framework. Although it has been argued that innovation in services should take several dimensions into account (de Jong and Vermeulen,

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