



Competitive advantage through service differentiation by manufacturing companies

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ABSTRACT

This paper examines the relationship among the complexity of customer needs, customer centricity, innovativeness, service differentiation, and business performance within the context of companies that have made a service transition from pure goods providers to service providers. A survey of 332 manufacturing companies provides the basis for the empirical investigation. One key finding is that a strong emphasis on service differentiation can lead to a manufacturing firm's strategies for customer centricity being less sensitive to increasingly complex customer needs, which can increase a firm's payoff for customer centricity. In contrast, the payoff from innovativeness appears to be higher if the firm focuses its resources on either product or service innovation; that is, a dual focus does not work well. This paper discusses the implications of these findings for researchers and managers.

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1. Introduction

Markets have become highly competitive and turbulent and are constantly changing. Market conditions move from being simple to complex, from stable to dynamic, and from tame to hostile (Neu and Brown, 2005). In response to changing market conditions, manufacturing companies have traditionally become more customer-centric and innovative, in a way that customers receive products that better fit their needs (Deshpande et al., 1993; Drucker, 1954; Johnson and Selnes, 2004; Narver and Slater, 1990; Treacy and Wiersma, 1993). In addition, manufacturing companies have started adding more services to their total offerings as part of a differentiation strategy (Gebauer et al., 2010; Neu and Brown, 2005; Oliva and Kallenberg, 2003). Companies with greater reliance on the service part of their business reportedly achieve better return on sales and improve their value (Fang et al., 2008).

Manufacturing companies are redirecting their efforts towards customer centricity and innovativeness, and also from goods to services. Instead of only innovating products, companies are investing in service differentiation. Consequently, instead of services being add-ons to the product, they become the center of the total offering, with products as add-ons to the services. Various terms describe this service differentiation in manufacturing firms, including service business development, servitization, service infusion, high-value solutions, and transition from products to services (Davies, 2004; Gustafsson et al., 2010; Oliva and Kallenberg, 2003; Vandermerwe

and Rada, 1988). A common rationale involves using service differentiation to take advantage of strategic, financial, and marketing opportunities. The fact that services are less visible and more labor-dependent makes them a strategic opportunity and a sustainable source of competitive advantage (Heskett et al., 1997). Services lead to co-creation of value based on the competencies of the company and the customer (Matthyssens et al., 2006; Vargo and Lusch, 2008), which leads to resources that are unique and hard to imitate (Wernerfelt, 1984). Financial opportunities include additional service revenues throughout the product life cycle (Potts, 1988; Wise and Baumgartner, 1999). Marketing opportunities involve using services to augment the product offering and increasing the quality of the customer interaction (Mathieu, 2001).

However, most researchers study the phenomenon of service differentiation in isolation from other firm activities (Homburg et al., 2003; Neu and Brown, 2005). In so doing, they neglect the interaction of service differentiation with other antecedents that may affect success, such as customer centricity and innovativeness. Combining service differentiation with factors such as innovativeness and customer centricity, versus service differentiation alone, can sustain above-industry average performance. Only the combination of service differentiation with other factors can translate into valuable resources that are neither perfectly imitable nor easily substitutable (Hoopes et al., 2003).

With few exceptions, the general approach to studying the service differentiation phenomenon involves case studies. This approach allows in-depth exploration of mechanisms related to service differentiation, which makes the method appropriate for exploring emerging trends. The disadvantage of the method stems from the difficulty in judging the effect of service differentiation for

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manufacturing firms in general. A few studies have taken a large-scale study approach (Fang et al., 2008; Gebauer, 2008), but none of them has investigated service differentiation in relation to other firm activities.

In order to fill this research void, the present study examines the interaction of service differentiation with customer centricity and innovativeness through a cross-sectional study of manufacturing companies. To this end, the study builds on established relationships among complexity of customer needs, customer centricity, innovativeness, and business performance. The study integrates service differentiation as a moderator into these relationships, and the moderator analysis explores the weakening (negative) and strengthening (positive) effects that service differentiation has on those relationships. The study covers 332 European-based manufacturing companies from a variety of industries.

This research makes several contributions to the literature. Firstly, the research expands the existing literature by studying service differentiation with an emphasis on the interaction of service differentiation with customer centricity and innovativeness, rather than in isolation from the strategic orientation of manufacturing companies. This perspective on service differentiation fits more closely with how manufacturing firms work with service. Secondly, the study provides some insights into the effects of service differentiation and how a company achieves them.

2. Theoretical framework

The theoretical framework of this study builds on customer centricity and innovativeness in relation to market orientation, which represents one of the various strategic orientations of manufacturing companies. Other strategic orientations include technological and entrepreneurial orientations. Technology orientation advocates a commitment to R&D, the acquisition of new technologies, and the application of the latest technology, while entrepreneurial orientation pursues new market opportunities or the renewal of existing areas of operation (Zhou et al., 2005). Whereas customer centricity and innovativeness, as parts of market orientation, are likely to interact with the service differentiation of a manufacturing company, the acquisition of state-of-the-art technology or the renewal of existing markets might be more independent of the service differentiation. Entrepreneurial orientation promotes the proactive exploitation of market opportunities, tolerates risk, and is receptive to innovations, but it does not necessarily result from higher complexity of customer needs. Although market orientation and technological orientation both promote openness to new ideas, technological orientation prefers those companies that employ state-of-the-art technologies. Customer centricity and innovativeness embed in market orientation favors ideas that more accurately satisfy the increasing complexity of customer needs. Therefore, the conceptual model in this paper concentrates on customer centricity and innovativeness and how these factors relate to service differentiation.

There has been a wide range of research contributions that examine the relationships among innovativeness, customer centricity, and business performance (e.g., Hult et al., 2004; Jaworski and Kohli, 1993; Narver and Slater, 1990). Narver and Slater (1990, 2000) test and retest the positive relationship between market orientation and business profitability, providing strong support for the importance and generalizability of the market orientation–profitability relationship. Hult et al. (2004) examine a general model of the direct relationship between innovativeness and business performance, which reveals the significant effects of innovativeness and market orientation on business performance. Strong support exists for the relationships among market orientation, innovativeness, and business performance across varying environmental contexts.

The literature review also shows that authors often consider market turbulence rather than directly assessing the complexity of

customer needs. Jaworski and Kohli's (1993) association of market orientation with business performance appears to be robust across environmental contexts that are characterized by varying degrees of market turbulence, competitive intensity, and technological turbulence. Hult et al. (2004) reveal that the effect of innovativeness and market orientation on business performance does not differ greatly during periods of low and high market turbulence. In contrast, a significant relationship does exist between market orientation and innovativeness under high market turbulence, but not under low market turbulence.

Service differentiation represents an alternative business logic for manufacturing companies. Emphasizing service differentiation can lead to a company transitioning from being a pure goods provider to a service provider (Oliva and Kallenberg, 2003). For a pure goods provider, the product dominates the total offering, and the service component only includes customer service (Vandermerwe and Rada, 1988). Customer service only augments product offerings and improves the quality of customer interaction (Mathieu, 2001). Products remain the main source of profits and revenue, while customer service only makes a marginal contribution (Oliva and Kallenberg, 2003). The strategic priority for a pure goods provider is the facilitation of product differentiation through customer centricity and innovativeness.

In contrast, service providers in this context do not restrict their offerings to customer service. They offer a comprehensive set of services including services for the installed products, design and construction services, high-value solutions, system integration services, or outsourcing services (Davies, 2004; Gebauer, 2008; Oliva and Kallenberg, 2003). A company can combine these services with product components in a manner that provides a solution to a customer's specific business needs. Services or solutions evolve to the main market offering and start to dominate the total offering of service providers (Vandermerwe and Rada, 1988). Accordingly, revenue and profits are mostly attributable to the services; products only become an add-on to the services (Oliva and Kallenberg, 2003). For a service provider, service differentiation represents the main strategic priority, built on the company's customer centricity and innovativeness.

The next part of the paper introduces the basic model, including complexity of customer needs, customer centricity, innovativeness, and business performance. These concepts and their relationships are seen as a basis for the strategic orientation of manufacturing companies. The paper develops four hypotheses regarding these concepts and then introduces four additional hypotheses related to the concept of service differentiation and its role as moderator in the relationships between complexity of customer needs, customer centricity, innovativeness, and business performance.

2.1. Basic model

2.1.1. Complexity of customer needs, customer centricity and innovativeness

The complexity of customer needs is part of a company's external environment (Neu and Brown, 2005). Dess and Beard (1984) distinguish between three factors that characterize the external environment: munificence, complexity, and dynamism. Munificence refers to the scarcity of environmental resources that support a firm's growth within a given industry, while environmental complexity refers to the heterogeneity and concentration of environmental elements. Finally, environmental dynamism refers to the rate of change and the instability of the environment. Rapid change, short product life-cycles, and processes of creative destruction are all typical characteristics of a dynamic environment, which make current products and services obsolete and require the development of new competences (Dess and Beard, 1984). Jaworski and Kohli (1993) use the term 'competitive intensity', which reflects the behavior,

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