

The Significance of Strategic Service Innovation Management in Retailing

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Abstract

Innovation is the key to the creation of a sustainable competitive advantage in most industries. Since costs and cost reductions play an important role in service management, the service innovation process must be discussed from a service operations point of view. An important objective of service, however, is to differentiate the company by creating more value and satisfying the customer better than competitors. According to the service dominant logic – the point of view that customers derive value from the service a product provides them with – much of the value obtained from the retailing experience is co-created by the customer.

Keywords: competitive advantage, profitability, service quality, strategic innovation projects, customer loyalty, repositioning.

Creating an innovative retail organization is of outright strategic importance. Retailers suffer from substantial threats in their industrial environment. Suppliers – such as Unilever, Procter and Gamble, Sara Lee, Nestlé, etc. – are multinational players, concentrated and very powerful. The entry barriers to the retail industry and levels of differentiation are relatively low, while many substitutes – think of e-tailers, outlet stores, and single brand outlets – exist. This situation leads usually to high levels of price competition – negatively affecting average profitability in an industry, which is indeed the case in many retail sectors. At the same time, customers have increasingly become better informed – they use the Information Superhighway, e.g., through apps for their tablets and smartphones, to look for special offers, and compare prices between retailers – and they have become ever more demanding in terms of price and service. Customers are also less and less loyal to specific outlets. This is partially due to the commoditization of products and services: as a result of technological developments, quality differences between products and services are becoming smaller, often even nonexistent.

The retail industry not only suffers from important competitive threats but also goes through a high level of change in the retail environment. Suppliers regularly launch new products and services, in response to customers who continuously develop new needs and wants. Furthermore, retail customers have come to expect fast, cheap, and customized solutions to their individual retailing needs. Finally, competitors compete with evermore sophisticated weapons, often in more than one distribution channel, for example, offering the possibility to order products online and pick them up at the store or at the gas station. To sustainably generate above average profits in such a dynamic and competitive industry is only possible if a firm continuously invests sufficient human and financial resources in exploiting opportunities and neutralizing threats. Innovation allows differentiating the retailing offer by creating advantages that customers really appreciate and value.

Strategic innovation projects must be in line with the strategy of the company and are meant to actually realize or implement the corporate strategy. If the organization adheres to a low-cost strategy, strategic service innovation projects will likely be meant to lead to a further increase of the efficiency and a reduction of the costs of processes, without negatively affecting service quality (e.g., Aldi, Lidl, and Kmart).

If the company adheres to a focus or niche strategy, e.g., by addressing relatively homogeneous segments of customers with specific needs, then service innovation projects will be directed at better satisfying those special needs, e.g., by developing more effective services without increasing the costs (e.g. Giant Food). In the end, competitive advantage makes customers choose and prefer a brand, because it leads to higher levels of satisfaction. Competitive advantage is only sustainable, however, if the service innovation is not easily imitable. If the company differentiates its offer by means of low prices, the innovative cost reductions should by any means be hard to copy for competitors.

Satisfied and loyal customers are of great importance to the retailing business, since customer loyalty is associated with a number of behaviors that lead to lower marketing expenditure, and higher revenue per customer. Loyal customers are considered to develop a preference for the brand they patronize. This implies that when they have to choose between various retail outlets, after the identification of a need or want, they will most probably choose to make their purchases at the retail outlets of the brand of their preference. Satisfied and loyal customers often recommend or speak positively about the brand they patronize (positive word of mouth), repurchase the same or similar goods from their preferred store, and are even prepared to pay a price premium.

Different categories of innovation projects address different strategic needs. Sometimes the environment changes fast – e.g., when a competitor introduces a radically new business model – and retailers need to fundamentally improve their offer to remain competitive. Sometimes slower evolutions occur, and through innovation processes are just kept up to slowly evolving standards – for example, an increase in hygienic standards.

Depending on the relative newness of the innovation, and the relationship between the new service and previously existing versions, we can therefore distinguish between various types and categories of innovations. In the first place, we can make a distinction between incremental and radical service innovations. The relative degree of newness of service innovations can help us to position service innovations on a continuum between incremental or minor changes to an existing service and radical or fundamental innovation. At one extreme of the continuum, we find incremental service innovations. Incremental innovations are minor, particular, changes made to the design of the service or the service process. They have the purpose of either correcting minor faults in the process and improving the service experience (increasing service quality, raising the standards, or adapting the value created by the service), thereby increasing the efficiency (reducing the costs) of the process, or both. An example of an incremental services innovation would be changing the colors used in signalization in a supermarket, using better readable fonts, or a slight change in the design of the furniture.

At the other extreme of the continuum we find radical service innovations. Radical or fundamental service innovation is often complex, and touches many aspects of the service at once. The so-called architectural innovations change the connection of parts of the process, the structure of the service (e.g., the order of activities, the distribution channel, etc.). In the case of radical service innovation, the new service is radically different, either in the perception of the customer (e.g., changing the interface of an electronic service) or with respect to operational aspects (e.g., changing the distribution of products). Radical innovation may also offer an entirely new bundle of benefits to both the company and the customer.

Advantages and Disadvantages of Radical Innovation

Radical innovations are more complex, more costly, and riskier and generally take much more time to develop and to realize. The advantage of radical service innovations is that generally the firm will create a more substantial competitive advantage – when the innovation is

successful. Radical, complex innovations are often also more difficult to imitate, which makes the competitive advantages they create more sustainable. When customers do not perceive the changes as an improvement, or do not seek or value the new benefits the service may offer, or when costs have not been reduced, the innovation must be considered unsuccessful and a waste of resources. The more complex, the more radical a retail service innovation, the higher the potential return, and also the higher the risk of unsuccessfulness.

Imitability of Service Innovation

However, since most service innovations are fairly easy to copy, the duration of the competitive advantage will be limited in time. Only few mechanisms exist to protect intellectual property in service innovation. Patents do not exist, although they can be used for tangible aspects of the innovation. The more complex the service innovation is, the more difficult it will be for competitors to understand the service and to copy it. Incremental service innovations are generally less costly, and often require smaller investments to implement them than radical innovations.

To make optimum use of available resources, and to limit the risks of failure, most companies try to balance incremental and radical service innovations. They try to constitute a portfolio of innovation projects that distributes risk and return over a limited number of projects. Retail innovation can, for example, focus on innovating the core services and introducing or developing complementary services. While designing a competitive strategy and a portfolio of service innovation projects, senior management must take into account the developments in a number of dimensions of the general business environment and the retail industry in particular. In general, changes take place in the political, economic, social, technical, ecological, and legal dimensions of the retailing environment.

In the economic dimension, competitors exert an important influence. Competing retailers continuously make strategic decisions about repositioning their activities, refocusing their service offers, relocating or expanding their networks, etc. These are all aspects that need to be taken into account when designing a strategic portfolio of innovation projects. In many cases, retail service innovations are used to reduce or neutralize strategic threats. For example, while some supermarket chains – in an attempt to maximize economies of scale – have focused on the creation of mega-markets on the outskirts of towns, other supermarket chains have (re-) opened small city-stores, offering a basic assortment near populated areas, or areas where office buildings are located. By focusing on specific needs, although being more expensive in their operation, and therefore higher priced, they compete successfully with the mega-markets. In other cases, opportunities may be created as a result of strategic activities of competing retail chains. In that case, retail service innovation projects may be designed to capitalize on these opportunities.

Important changes are taking place in the domain of retail customer behavior. Customers increasingly value their time, are less and less willing to wait for service, and, as a result, have increasing preferences for fast self-service. Self-service has therefore taken an important position in retailing. Several aspects of the retailing service experience can be automated or create some sort of potential for self-service. Examples are selecting fruit, vegetables, cheese, meat and fish products. Another service is the return of empty and cautioned packaging, such as bottles or crates. Finally, activities such as pick-up of (mail- or Internet) ordered products and the automation of the checkout are often part of self-service initiatives.

Retailing services are unique in the sense that customers use them almost on a daily basis, and, therefore, notice changes (and faults) in the service system very rapidly. Some consumers consider shopping a necessary evil, while often being under time pressure. Since they use retailing services so frequently, small service failures can easily lead to irritations, complaints,

and dissatisfaction, which makes it very important to keep a close eye on the customer experience.

An important source of creativity and ideas for innovation in retailing services is the customer. Customer feedback can serve as a relatively inexpensive source of inspiration, especially in cases where customers complain about service quality. Nowadays, this feedback can often be found on the Internet, on social media platforms such as Facebook or Twitter. Equally important is to anticipate customer complaints, by doing research. Research can be done in a structured way, guided by research questions, or in a more unstructured way by observation, or by organizing focus groups. Staff involved in service provision can also serve as an important source of feedback about efficiency and effectiveness of existing service processes.

Conclusion

Retailing is a very dynamic and competitive industry. To survive and sustainably generate above-average profits in this industry, companies need to continuously improve and innovate their offerings: through creative thinking they can offer more and better value to their customers. They can do this by developing a portfolio of core and complementary service innovation and new service projects, and carefully manage these projects – thus mitigating the risk of failure. Equally important as the development and launch of the service innovations are the evaluation and control of the results.

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