Managing Innovation in the Service Sector

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Traditionally, most of the discussion of the management of innovation has been based on manufacturing industry. This is not surprising because manufacturers have tangible products, the development of which normally follows a well defined process. However, the service sector is now of major importance in many countries of the world. For instance, in 1998 it was responsible for 47% of GDP in the UK and 50% in Germany. Interestingly in the United States in 1998, 25% of all industrial R&D was undertaken by companies in the service sector – a big increase over the previous 10 years. Therefore, an emerging key question is how companies in service sector can improve their innovation performance. In spite of the increasing importance of the service sector, the issue of how to stimulate and manage innovation in the sector remains a conundrum. The reasons for this include:

The Nature of Service Products
Managing innovation is difficult in service companies due to the complex nature of service products, which are mostly intangible. While manufactured products may be offered with or without customer service elements, nearly all service products involve close interaction with customers. The implication of this is that service suppliers must design the interaction with customers in addition to developing the service product itself. Therefore, innovation in service companies is not only about “what” is being offered but also about “how” it is being offered. Service products are predominantly processes rather than objects. Thus, the development of a new service is often more complex than that for a new manufactured product.

Lack of Processes
Just as service products are often intangible, so are the processes by which they are developed in many companies. For example, a major international bank, which came to Cranfield for advice in 2000, did not have a clear new product development process. This had resulted in product managers finding it difficult to learn the steps required for managing innovation (it only existed as company folklore) and key steps being forgotten. Now the bank has a documented process, which is actively being used.

Lack of Tradition In Innovation
Perhaps the main issue facing service companies is their lack of innovation legacy. For instance, in the financial services sector, companies are often bureaucratic. The banking industry is traditionally not known for innovation. Companies in this industry make money and stay in business by controlling risk, procedures and processes, not by innovating. However, this is changing fast as leading companies in the banking industry have now recognised the need to be more innovative.
In view of the challenges to managing innovation outlined here, service companies need a more strategic focus on new service development. To achieve this they need to develop competencies and appropriate organisational structures that foster creativity and innovation. Leading companies are now moving in this direction and the authors know of several companies, which have made innovation their top priority.
Lessons from Manufacturing – the ‘Innovation Pentathlon’
Cranfield School of Management has carried out extensive research on innovation in the manufacturing sector. This showed that innovation management requires good performance in five areas described below:
A challenge for service companies is to explore how this model can be applied in their organisations.

Innovation strategy
Management needs to develop the strategy and communicate the role of innovation within a company, decide how to use technology and drive performance improvements through the use of appropriate performance indicators.

Creativity and Ideas Management
Stimulating good ideas, which address customer requirements, is crucial. The scope for ideas is wide and therefore all employees should be involved and close contacts with customers should be cultivated.

Portfolio Management
Once ideas have been generated, an efficient means is needed to select the best ones for implementation.

Implementation
The capability to quickly turn ideas into new products is fundamental. The best service companies manage New Product Development like a manufacturing process, for example by looking at how they can avoid bottlenecks.

Human Resource Management
Underlying all efforts of innovation management is the need to create a culture in which employees are motivated to contribute to innovation. Often companies fail to create reward and recognition mechanisms, which promote innovation thinking. Leading manufacturing companies recognise that being good in one of the areas above is not enough. Just like in the sporting analogy, good performance in all five areas is more important than exceptional performance in one area. Therefore, the Innovation Pentathlon can be used as a diagnostic framework to spot which of the five areas improvement initiatives need to be focused on. Service companies have already used it, and managers have found it an effective tool for improving innovation performance.

AXA Ireland
AXA is the leading Motor and Household insurer in the Irish Market. It distributes its products through a network of branch offices, insurance brokers and telesales operations. Formerly part of the Guardian Insurance Group, the company was acquired in 1999 by AXA, the largest insurance company in the world. Says Catherine Whelan, “The take-over, along with the world-wide emphasis that AXA place on innovation and the appointment of a new Chief Executive Officer were the key drivers in relation to the innovation activity currently taking place within our business”. Catherine was appointed into the position of Innovation Manager in January 2000. Her responsibility is to raise the innovation capability of the organisation through staff involvement and shared knowledge.
Many companies struggle with the meaning of innovation making it very difficult to develop and implement innovation improvement programmes. AXA developed what they refer to as the “Innovation Quadrant” which explains the meaning of innovation in their business. The quadrant forms part of the company’s communication strategy and helps to promote the understanding of the meaning of innovation among staff. The four elements of the quadrant are:

- Create new customer-focused opportunities
- Improve existing products, services and processes
- Eliminate non-value adding activities
- Re-use AXA Global success stories

One of the key approaches chosen by AXA Ireland to enhance its innovation performance is the “MadHouse” programme. This is a team-based innovation programme that brings seven employees together from across different grades and functions for a period of two months. Their objective is to brainstorm, select and develop two customer-focused innovation proposals. They carry out this activity in an environment that is both fun and challenging. The programme incorporates a challenging idea assessment process that walks participants through a critical evaluation of their own ideas - enabling filtering. The final output is produced using a comprehensive business case framework unique to the programme. The teams present their proposals to the Director team at the end of the two-month period and each team member is expected to actively contribute to the presentation. The Directors provide the necessary feedback including the strengths and weaknesses of the proposals submitted and decide which ideas move to implementation. Key members of the MadHouse team are included on the project team responsible for the implementation of the selected ideas. This is to ensure continued learning and development as well as ownership and sense of achievement for the teams concerned.

To enable the employees understand and identify with the MadHouse programme, the company branded the programme as the “AXA Baby” to represent new beginnings, questioning of the environment, awareness and sensitivity to changes, new ways of looking at things, mastering new skills rapidly and a sense that nothing is insurmountable.

MadHouse is a very successful innovation programme generating, within a year, over 200 business improvement ideas, 20 of which have been implemented with a further 20 being implemented. Many of the ideas generated are substantial customer-focused business projects. The interesting thing about the programme is that it also encourages staff to develop programmes and solutions for the staff of the organisation. An example is the “TaskMasters” programme which is designed to empower and encourage each employee, at every level in the organisation, and to engage in innovation and continuous improvement on a daily basis and within their daily jobs. The focus is on addressing small problems/issues or introducing improvements that can be implemented in the short term and at minimal cost.

The brand is structured to provide alignment between the company goals and objectives (improved customer service and profitability) and individual goals and objectives (continued learning and development, reward and recognition). Innovation in AXA is seen as a continuous process. Their innovative programmes are structured around creating ‘Innovation Champions’ or ‘Role Models’ whose stories are communicated organisation-wide to encourage others to do the same.
Conclusion
So what advice can we offer to managers in the service sector?

- Identify the process behind innovations within your company. This may be a challenging task because of the intangible nature of services but it is worthwhile.
- Use the “Pentathlon Model” as a diagnostic framework. This helps to identify where innovation management needs to be improved.
- Get the commitment of top management to support improvement initiatives. Because of the lack of innovation legacy in service companies, improving innovation in these companies generally requires more weight than would be required in the manufacturing sector. For instance, good communication strategy and the role of the CEO have been vital in improving innovation capability in highly innovative service companies.

The dictionary definition of innovation is simple – introducing something new - but managing innovation is far from easy. However, leading service companies are already rising to the challenge of competing in the innovation pentathlon.

The Innovation Research Unit at Cranfield is carrying out further research into the management of innovation in service companies. If you are interested in more details about this research or would like to participate, please contact:
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