

# Innovation without R&D

## The secrets to providing innovative services

*Increased expectations from customers and financial markets, coupled with the rapid erosion of brand loyalty, means that companies in the services industry have to innovate continuously. However, most service companies lack research and development departments—the traditional backbone of innovation—and, in general, have very little to show in terms of innovation capabilities. But service companies have to be innovative. In this paper, we go behind the scenes to unravel the secrets to providing innovative services.*



It pays to be innovative. A.T. Kearney research reveals that innovation leaders achieve almost 70 percent higher earnings over a four-year period than companies without an explicit innovation focus. Other studies support these findings, demonstrating that more innovative companies perform better, not only in terms of sales, but also in achieving a higher return on sales and bottom-line profitability than peers with less developed innovation skills (see figure 1 on the following page).

Traditionally, innovation is the domain of R&D departments, where chief technology officers reign and terms such as the fuzzy front end, technology scouting, throughput efficiency and stage-gate models are common. Surprisingly, we find very little of this vocabulary, let alone the formal structures and processes that go with it, in well-known service companies such as eBay, UBS and American Express. The most obvious explanation for this is that services, unlike products,

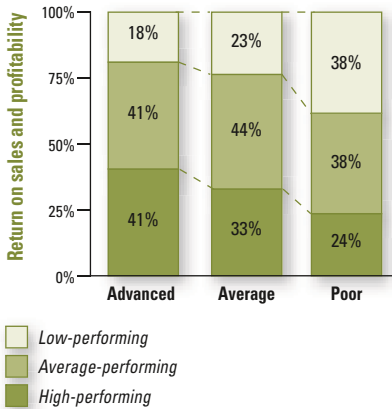
are intangible, making it difficult to quantify innovation performance parameters, as these are judged mainly by the customer.

The traditional product-driven approach to innovation—separating development from the client, dividing it into discrete phases and using testing concepts such as prototyping—is not suitable to formulating new more innovative services. This hierarchical approach, with linear methods to determine who participates in innovation and how it is conducted, does not work. Instead, the core of successful service innovation is a more flexible and iterative approach focused on people contributing knowledge based on their capabilities and reputations.

A.T. Kearney's three-year study of more than 200 European companies in the services sectors (logistics, travel and tourism, communications, financial services, insurance, health and education and training) reveals that innovation leaders differ from their

*In services, the foundation of successful innovation is a more flexible and iterative approach in which people contribute knowledge based on their capabilities and reputations.*

**FIGURE 1: Innovative service companies perform better**



Sources: European Business School; 2006 German Aerospace Center study

peers in three areas: technology, roles and boundaries, and customer involvement (see figure 2).

**Innovation + Technology = Better Service**

Companies are not always aware of the true cost of developing or launching a new and innovative service. The mismatch between assumption and reality can be quite large in product-based companies, and even larger in service-based companies, with ICT (information and communications technology) and advertising as potentially the largest “hidden” costs (often representing more than half of total innovation spending.)<sup>1</sup>

Providing innovative services, to some extent, is a matter of effectively leveraging existing and emerging technologies to reduce costs and improve efficiency, increase convenience and enrich interactions with the customer. These technologies must not only help build an optimal customer value chain, but also address every point up and down the chain where value is delivered, whether it is

delivered to the direct customer or to the end consumer.

Our innovation management approach begins with an analysis of technology trends for all parts of the value chain. We identify cost savings and value-creation opportunities, and assess areas of competitive advantage. The goal is to gauge the intersection of value chain opportunities and capabilities to generate innovation. By quantifying the market potential of providing an innovative service (through a cost-saving perspective) and opportunities to capture value from the service, we develop an ICT innovation roadmap. Figure 3 illustrates the elements of a typical ICT roadmap in the banking industry.

**Flexible Roles, Open Boundaries**

Developing innovative services requires informal, open networks of people who share common values and motivations. Members of these “innovation networks” might include representatives from the company, its suppliers and customers, all focused on delivering value to the customer. These networks are able to overcome hierarchical and functional barriers and organize their innovation activities as virtual networks, where contribution and authority is based on know-how, reputation and intrinsic motivation. To ensure that all innovation activities are aligned with the overall corporate strategy, company executives develop an overarching purpose, which forms the basis of an innovation strategy that links goals and objectives with potential areas for innovation.

An example is the “expert circle” innovation network at one of the world’s premier reinsurance providers.

The company identified 12 potential areas of innovation, based on an analysis of available competencies and market and technology trends. For each area, an acknowledged expert was appointed gatekeeper. For each network, an intranet site outlined the topics and people involved, supported by a toolbox of tactics and knowledge pieces, including market reports, technology studies, risk analysis and concept validation techniques. Not only were employees from all functions and regions encouraged to participate, but also customers, business partners and academic and government thought leaders. Identifying the appropriate expert for a specific innovation topic was just a click away in an online skills inventory. No innovation activity was pre-structured, but rather invited, stimulated and nurtured—making the

**FIGURE 2: Characteristics of innovation leaders versus followers**

	Innovation leaders	Innovation followers
<b>Technology</b>	<ul style="list-style-type: none"> <li>• Use technology to drive innovation</li> <li>• View mid- and long-term trends</li> <li>• Focus on costs and differentiation</li> </ul>	<ul style="list-style-type: none"> <li>• Do not use technology or adopt tools too late</li> <li>• View mid-term trends only</li> <li>• Focus only on costs</li> </ul>
<b>Roles and boundaries</b>	<ul style="list-style-type: none"> <li>• Have flexible structure and allow employees to be creative</li> <li>• Engage suppliers, customers and employees in innovation activities</li> </ul>	<ul style="list-style-type: none"> <li>• Have a hierarchical structure and confine employees to specific job descriptions</li> <li>• Engage employees only in innovation activities</li> </ul>
<b>Customer involvement</b>	<ul style="list-style-type: none"> <li>• Involve customers early</li> <li>• Identify customers’ value perceptions and purchasing decisions</li> <li>• Build brand loyalty</li> </ul>	<ul style="list-style-type: none"> <li>• Involve customers at the end of development (if at all)</li> <li>• Create services without considering customer value</li> </ul>

Source: A.T. Kearney Best Innovator study 2003-2008

<sup>1</sup> A.T. Kearney European IT Growth Study, 2007.

process flexible and open to customers to define what represents true value to them.

### Involve Customers Early

A related challenge is knowing when to involve customers in the innovation process, and which customers to involve. Companies typically engage customers at the end of development, through focus groups or customer trials of largely finished services, selecting the overall average based on the opinions of a sample group. With customer value so illusive, we believe that the earlier customers are involved, the better. And we make sure “lead” customers—opinion leaders, power users and a company’s most demanding customers—are integrated at the beginning of the development process so their ideas can be captured first. More companies today are also including custom-

ers who do not belong to their existing customer base. In this way, they ensure the service is applicable to a broader audience of potential customers. For example, the anti-lock braking system (ABS) was first developed for aircraft in 1929, but Dunlop saw a broader use for ABS and later commercialized the system for cars.

### The Perception of Value

Despite all market research efforts, it is vital to understand what customers consider real value to be, but rarely addressed systematically. Determining what customers value in products is easier as value is often defined in absolute terms such as memory capacity (computer) or fuel consumption (car). For services, however, value is subjective and relative to the customer’s perception. What counts is customer-perceived value in relation to the service.

This customer perception is all the more important as people often act as ambassadors through word of mouth and influence other prospective customers.

Southwest Airlines, well aware of the importance of customer perception, does not consider other airlines as main competitors, but rather cars. Airlines traditionally segment their market by economy and business class and short- versus long-haul flights. Customers, however, are less concerned about these segments than with getting from one place to another; making it to their final destination as quickly, cost-effectively and comfortably as possible. Therefore, customers’ travel considerations might include different airlines and other options such as trains or car rentals. A value-driver analysis will help determine what customers value the most (see figure 4). As Southwest knows, it pays to view travel through the customer’s eyes by:

- Placing the customer at the center of the innovation equation
- Focusing on the reasons for choosing one mode of travel over another instead of the act of purchasing a ticket
- Considering the customer’s perspective on value and quality

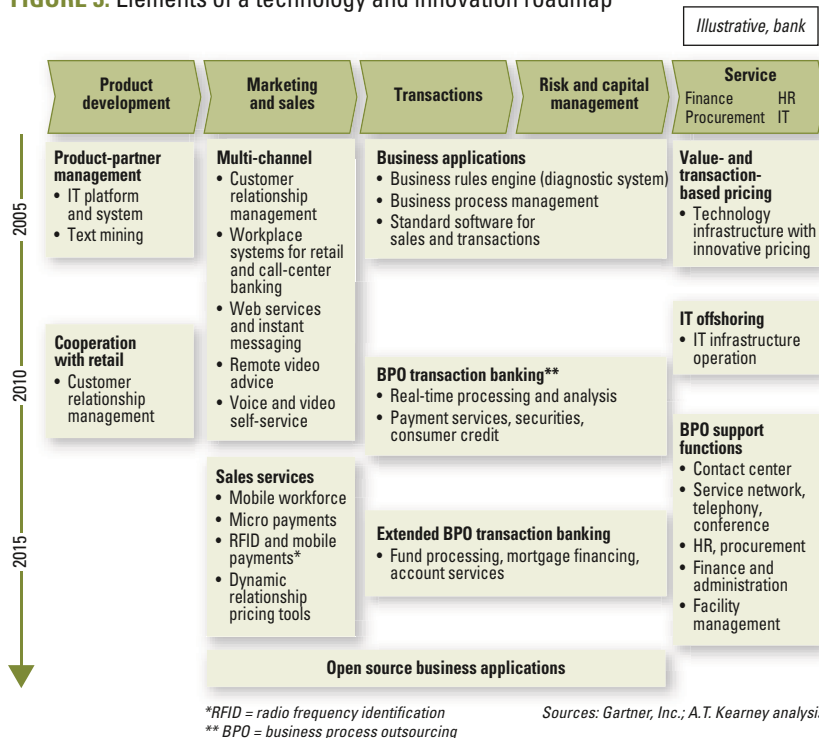
Companies that fail to understand customers’ perspectives often create new services that customers are not willing to pay for, which is the most common cause of a failed market launch.

### The Organizational Implications

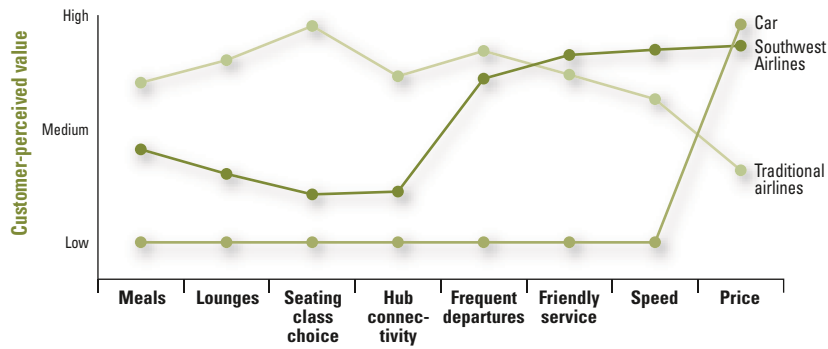
The organizational implications of exploring and offering more innovative services are different depending on the business context.

In service companies, for example, innovation is about combining brand, message and interactions to generate

**FIGURE 3:** Elements of a technology and innovation roadmap



**FIGURE 4:** What do travelers value most?



Sources: W. Chan Kim and Renée Mauborgne, Blue Ocean Strategy: How to Create Uncontested Market Space and Make Competition Irrelevant; A.T. Kearney analysis

a positive and distinct customer experience. In this context, convenience is important so technology becomes an enabler. In the business-to-business arena, customers are more interested in reducing costs or improving return-on-assets, so companies often use information and communications technologies to help cut costs and improve returns.

Product-based companies, especially those that want to deliver value-added services, typically turn to cross-selling. Convenience, such as home

delivery and in-home installation, plays an integral role, and pricing depends not on peer comparisons but on available substitutes. For instance, do-it-yourself home repair is cheap, but risky if the customer is not handy with tools; hiring an independent contractor is safer, but often expensive and not very convenient. One of the biggest challenges for product-based companies is to shift from a product-orientation mindset to an intangible service mindset where a continuous and consistent level of service is often

more important than having the highest-quality offering.

### The Way Ahead

Companies that successfully develop and launch innovative new services are those with well-formulated values, objectives and innovation goals. They understand that the building blocks of innovation are to define and map the opportunities, set the direction and get the idea to market quickly. They also understand that the ultimate goals are to improve customer experience, increase returns and gain a competitive edge.

Some or all of these elements exist in many of today's services companies. But the best and most innovative firms go a step further to build a culture and environment that motivates and empowers employees to work with customers and suppliers to create faster and cheaper ways to please customers. Exploiting their full value-creation potential, these companies are fast becoming the innovation leaders of their industries.

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