A New Perspective on Leadership for Achieving Servitization of Business

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Abstract

Servitization is a competitive strategy for product companies to create differentiation advantage by adding services to products. One of the major challenges on implementing the strategy is that the leadership that used to develop a successful product-oriented business now turns into an obstacle in the process of servitization. Leadership is closely related to business field. In the paper, the essence of servitization is interpreted from three levels: service as an intangible product, service as a contextual experience and service as a value co-creating process. Based on an in-depth case study, the research introduces the new concept on leading the transformation towards servitization: vision co-creation with employees. The paper also provides practical implications on conducting various steps of vision co-creation.

Keywords: Vision co-creation, Leadership, Servitization, Corporate transformation

1. Introduction

Service industries have grown significantly through past decades, and have become a dominant concept in today's economy. Many companies are transforming themselves from goods-dominant into service-dominant logic companies, in order to gain an advantage in competitive markets (Vargo and Lusch, 2008). Even for companies still in manufacturing industry, they are adopting servitization strategy to innovate organizational capabilities and processes to better create mutual value through a shift from selling product to selling product-service system (Baines et al., 2009).

However, as Applegate and his colleagues (2006) argued, leadership for product companies no longer works when business is primarily based on service. The leadership of developing a successful product-oriented business now turns into an obstacle in the process of transformation. In service business, employees are encouraged to make more interaction with customers for value co-creation; knowledge workers cannot be supervised or given advice in details as in product-oriented business (Drucker, 1999; Li & Umemoto, 2013; Payne et al., 2008; Prahalad & Ramaswamy, 2004). These leaders are expected to change their leadership to keep employees highly self-motivated for such a successful transformation. Baines and his colleagues (2009) claimed that there is a major gap in the area of how product companies can make the transition to a servitized organizational strategy.

The main purpose of this research is to explore how leaders conduct a successful transformation towards servitization of business and effectively promotes their leadership for knowledge creation in service business. It provides leaders with different lens to re-consider their behaviour and impact, which are indispensable in service-oriented business rather than in product-oriented business.

To fulfil the research objectives, we conducted the research with an in-depth case study. We selected a leading enterprise management software company in China, which was transforming itself from a product company into a service company. We interviewed eight general managers of its regional companies and one vice president in its headquarters.

2. The essence of servitization and its challenge on leadership

2.1 Interpreting 'Service' in servitization

Since it is introduced by Vandermerewe and Rada (1988), servitization has been studied by a range of scholars (Baines, et al., 2007; Oliva & Kallenberg, 2003; Slack, 2005). To catch the essence of servitization, it is indispensable to interpret the meaning of service.

(1) Service as an intangible product

The intuitive understanding of service is gotten by comparing it with the word *product*. Products are physical entities that are manufactured from raw materials. Services are non-physical entities that are the applications of knowledge and skills for the benefit of a party (Vargo and Lusch, 2004). The most famous characteristics of services distinguishing them from products are *intangibility*, *heterogeneity*, *inseparability* and *perishability*, now known as the IHIPs (Gummesson, 2007). The kind of understanding is also consistent with

the definition of servitization that was originally coined. Servitization, the term introduced by Vandermerewe & Rada (1988), is now widely recognised as a shift from selling products to selling an integrated system by adding services to products.

There are a variety of forms of servitization in the current research. Baines and his colleagues (2007) claimed that the concept of a Product-Service System (PSS) is a specific case of servitization. It embraces the service-led competitive strategy rather than simply offers lower priced products. Product firms achieve differentiation through adding services in their offerings since services are more difficult to imitate (Gebauer and Fleisch, 2007; Oliva and Kallenberg, 2003; Vandermerwe and Rada, 1988).

In these discussions, services are viewed as intangible products although they have now been claimed to be obviously distinctive with tangible products. Views mostly are put on the inside of manufactures and the provision of how to provide (produce) additional services to complement their products offering. Tukker (2004) argued that these researches have predominantly explored "function-oriented business models" where services and products are integrated to meet specific customer needs.

(2) Service as a contextual experience

Grove and Fisk (1992) applied the sociological concepts of dramaturgy to services and introduced the model of service experience as theatre. Customers' evolving expectations and continuous interactions provide firms with needed information to guide their behaviour toward a desired outcome. Schmitt (1999) introduced the similar concept of experiential marketing. He argued that customers could not be viewed only as rational decision-makers who care about functional features and benefits. Moreover, as emotional human beings, customers are concerned with achieving pleasurable experiences.

These discussions extend attentions from product companies' capabilities for adding services offering to the concern of customers' experience and feelings. While customers are involved, sensory, emotional, cognitive, behavioural and relational values replace functional value (Schimitt, 1999).

(3) Service as a value co-creating process

With the proposal of service-dominant logic (Vargo and Lusch, 2004) provided a new perspective to observe the economic phenomenon. Two propositions become prominent: first, the fundamental source of competitive advantage is not operand resources (e.g. materials and equipment) but operant resources (knowledge and skills); second, the customer becomes a co-creator of value who determines the value of service.

Prahalad and Ramaswamy (2004) explained that customers could be a source of competence. Companies have to find ways to process what they learn from customers so they can encourage the dialogue forward and make customers actively involved. Customers' involvement instead of treating customers as passive consumer generates meaningful experiences that will satisfy their ideas and they are willing to reward. In the process, customers contribute their knowledge, especially tacit knowledge that is hard to convey and

know by others (Chesbrough, 2010; Gebauer & Fleisch, 2007; Kolter et al., 2010; Payne et al., 2008). Kosaka (2012) argued the role of service field to service value is consistent with that of the electromagnetic field in physics. The service field model can be specified as (Service value) = (Service) × (Service field). The identical service might generate very different value as the service field changes. The value of service a provider delivers depends on the situation such as customer knowledge, needs, place, time and the like. A high service value for the customer is generated when the services are provided in the high potential service field.

The above interpretations of service lead to different focus on servitization. Product-oriented companies implement function-oriented business model and regard customers as consumers at the end of the value chain. They manufacture their products or deliver their services based on their research, where it is assumed they know their customer well. But, much of the knowledge involved in service field is tacit that customers gain from experience. The best way towards servitization is to become integrators of both internal and external knowledge. Co-creation can bring greater value to customers and greater competitive advantage for the firm (Chesbrough, 2010). Nie et al., (2013) also argued that the company that can attract the most numbers of co-creators would be the king in service business.

2.2 The Challenges of servitization on leadership

Servitization is a competitive strategy for product companies to create differentiation advantage. Meanwhile, implementing such a transforming strategy challenges these companies. Mathieu (2001) points out that service management principles are often at odds with traditional manufacturing practices. As the CEO of IBM Palmisano (2004) claimed if three-fifths of business is manufacturing, management is basically supervisory, but that no longer works when business is primarily based on service. For one thing, people-rather than products- become the company's brand. In product-centric business, work is broken down into smaller units and different people are assigned to execute each procedure correctly, value is produced inside the company. In this condition, customers have little or no role in value creation. Leaders can control almost all the factors of the production inside the company. But in service-oriented business, customers become a co-creator of value. So employees are encouraged to make active dialogue with customers, effectively manage customer diversity and co-create personalized experiences (Prahalad, & Ramaswamy, 2004).

Obviously, this brings challenges on leadership. The process of value creation extends from inside production to outside co-creation. Employees instead of products become the main touch point with customers. The employees cannot be supervised closely or given advices in detail as usual when they make close interaction with customers. Stronger self-motivation by employees and more creative behaviours are needed. Nie and his colleagues (2013) discussed the following seven commensurate shifts of leadership when a company transforms its business from product-oriented to service-oriented: followership, value source, communication, goal setting, influential power, corporate climate and decision-making tools. Miles (1997) discussed that corporate transformation challenges confront executive leaders. They have to find the solutions of how to side-step complacency and energize employees to

redirect their efforts. These leaders have to help people develop a new agenda to lead them through the next phase of servitization.

3. Theoretical basis

3.1 Transformational leadership

The concept of transformational leadership was introduced by Burns (1979) and developed by Bass (1985, 1990). Burns distinguished the two concepts of between transactional leadership and transformational leadership. Transactional leaders exchanged tangible rewards for the engagement of employees. Transformational leaders engage with employees, inspire and satisfy intrinsic needs.

The big difference compared with transactional leadership is that transformational leadership provides vision and sense of mission, instills pride, gains respect and trust (Bass, 1991, p.20). These leaders can create visions that give workers the feeling of being at the active centres of the social order. Transformational leaders are expected to intellectually stimulate their followers and thus may activate the followers' creativity potential (House & PodsakoV, 1994; Yukl, 1994, 2013).

3.2 The role of shared vision in leadership building

Miles (1997) explained the term of vision became salient in the United States in the early 1980s, when many large American corporations decided to make corporate transformation under the pressure of global competition. The best way they could do was to build a broad vision of what the desired future they looked like in future. Collins & Porras (1996) defined that a well-conceived vision consisted of two major components: core ideology and envisioned future (Figure 1). Core ideology means what the firm stands for and why it exists. The envisioned future is what the firm aspire to become.

Nanus (1992) maintains that the "right vision" has five characteristics: attract commitment and energizes employees; create meaning in employees' lives; establish a standard of excellence; bridge the present to the future, and transcend the status quo. A vision not only helps a company transform itself, but also enables the enterprise to transform its competitive situation (Miles, 1997). Hord (1997) argued the importance of employees' involvement in building a share vision and making decisions in lines with the vision. Shared vision can be created only when leaders listen very, very closely to employees, appreciate their hopes, and attend to their needs (Kouzes & Posner, 2009). Senge(1997) emphasized that a shared vision is a vision many people are truly committed to, because it reflects their personal vision.
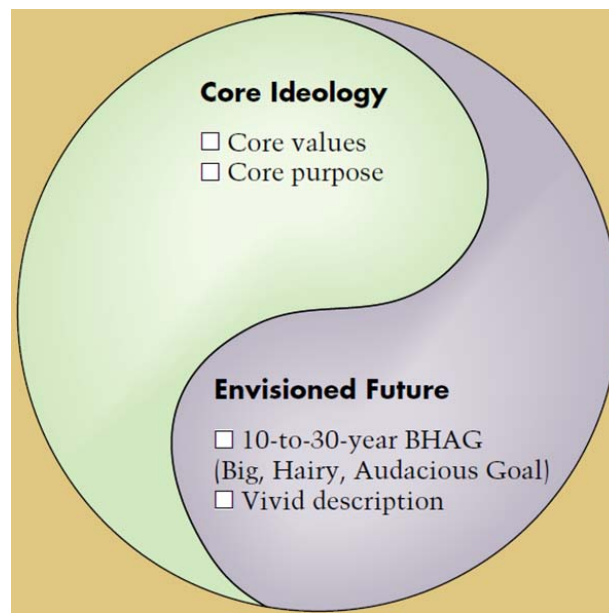
Figure 1. Articulating a vision

(Source: Collins & Porras, 1996, p.67)

3.3 Summary

The leadership theories in product-oriented business strive to solve problems and promote management effectiveness mainly based on individual leaders or the relationship between superior and subordinate. In service business, the process of value creation extends from inside production to outside co-creation. Employees' creativity and self-motivation are needed. To inspire them, those leaders who are conducing the process of servitization should value the role of vision to build their transformational leadership.

4. An analysis of a representative case on servitization

4.1 Case company

We selected Kingdee International Software Group Company Limited (Hereinafter referred to as 'Kingdee') as a representative case company. Kingdee was founded in 1993 with the headquarters in Shenzhen, China. Kingdee is a leading enterprise management software group in China and a listed company on the Main Board of the Hong Kong Stock Exchange (Stock Code: 00268). Kingdee has three software parks respectively in Shenzhen, Beijing and Shanghai. Its major products include financial software, ERP software, human resource management software, and so on.

From 2007, its development strategy is transforming from a software company to a service company that provides the total IT solution and consulting service for the customer. Kingdee achieved a successful servitization of business. Services percentage in total revenue increased from 29% in 2007 to 42.2% in 2010 while the total revenue turned from ￥767 million to ￥1,436 million in that period. We conducted an in-depth interview with 8

general managers of its regional companies who are in charge of 80 to 200 employees and 1 vice president who is in charge of marketing of Kingdee.

4.2 Analysis and discussion

- *Why did Kingdee implement the strategy of servitization?*

Why did Kingdee decide to transform itself from a product company to a service company? Toffler (1985) agued in his book of The Adaptive Corporation that a company decided to make a significant change, there must be three conditions: "*First, there must be enormous external pressures. Second, there must be people inside who are strongly dissatisfied with the existing order. And third, there must be a coherent alternative embodied in a plan, a model, or a vision*" (p.14). For Kingdee, the three conditions were all there around 2006. Kingdee faced external pressures from customers and rivals. Large customers had industry-tailored demands in management and IT solutions. Meanwhile, the competition with Chinese and foreign competitors was increasing fiercely in the market. UFIDA, another Chinese software company, as the top competitor to Kingdee, provided the extremely similar products in the market. Kingdee endeavored to go beyond homogeneous competition. Foreign rivals like SAP and Oracle had competitive advantage in the high-end markets. Kingdee also felt frustrated when it provided their solutions for big customers because only the software solutions could not meet their demand. Its mission-Enable customers' success also strongly pushed it to challenge these conditions.

- *What problems did Kingdee encounter on leadership?*

However, when Kingdee started to implement the strategy of servitization, the first challenge its leaders faced was uneasy to adjust the traditional mindset of the staff. Many employees actually did not realize the magnitude of the coming competition. They were satisfied with the working model, skillful knowledge on products and even their salary. For example, they were familiar with workflows on software products such as research, development and promotion. They were not so positive for the internal training courses on new business. It meant that they were not willing to change themselves to challenge the new situation.

The second common problem was employees felt the new corporate vision for servitization was not so closely related to their own value. Hence, the corporate vision could not stimulate their active involvement. Because of the gap between vision and reality, many employees were easily frustrated and thought the new vision was unrealistic. Especially at the beginning, their companies had inadequate capacity for servitization and they worried the strategy would lead the company to a wrong direction. Some employees also were confused with future uncertain markets.

- *What changes did Kingdee make to promote its leadership?*

In order to achieve successful servitization business, these leaders realized that employees should be engaged with higher self-motivation, commitment and shared responsibility. Kingdee should provide customers with impressive experience, get a close collaboration from customers, and make customers satisfied beyond their expectations. Then it had the

opportunities to co-create greater value with customers and win the competitive advantage. However, in service business, it was employees that conducted instant interaction with customers. Employees mostly determined customers' satisfaction, which was fulfilled mostly by software functions in the past success. Employees who worked with customers were enduring more psychological strain than workers who worked with computer or colleagues inside the company. They were asked to have higher decision-making ability to provide better and faster response to customers' demands. Their tasks were making active dialogue with customers, managing customer diversity effectively, and co-creating personalize experiences with customers.

Employees with high following and low commitment are not competent to fulfill the above tasks. How could leaders get so highly motivated employees? Traditional management methods, like management rules, PDCA and incentive system, HR development and corporate culture building, were still indispensable but not enough to inspire employees to unleash their creativity for service innovation.
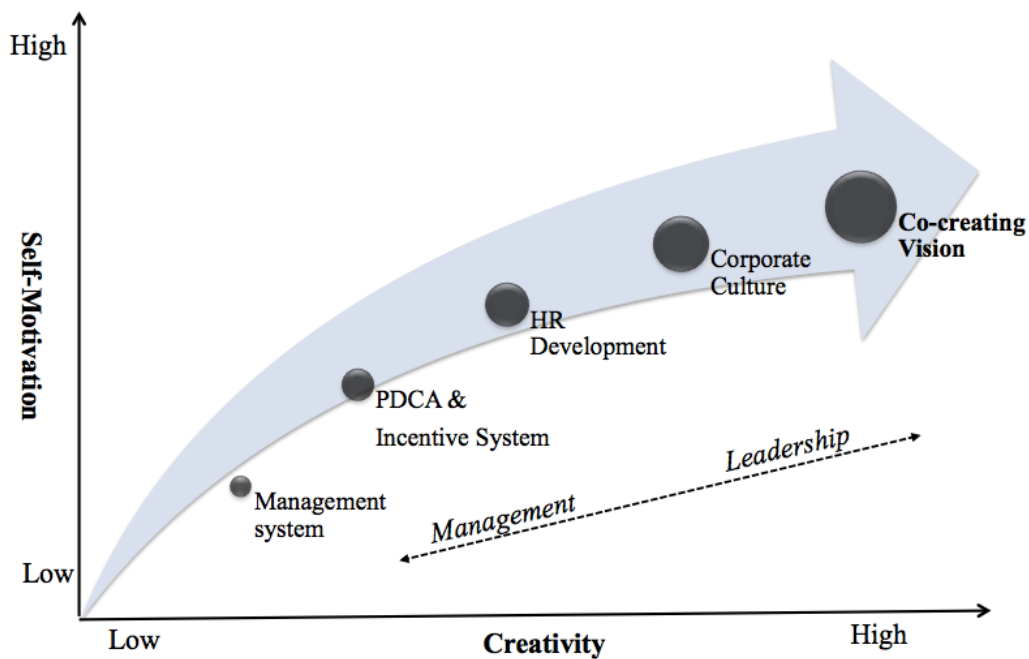

Figure 2. The relationship between leadership and employees' commitment

There are several common aspects that all the interviewees took to win the challenge. They would like to listen closely to what their employees were thinking and feeling. These leaders thought the discussion with employees about the problems they were worrying about and their different thinking was a golden opportunities to know each other well. Comparing with telling-leading-style of the past (e.g., how to conduct the research and development of software, or how to introduce software to their customers), these leaders would like to enhance mutual communication through various activities.

These leaders valued the involvement of staff. These leaders invited the staff (at least the key employees) to discuss the corporate vision and speak out their personal idea. In the process, employees' personal values and visions were paid more attention to. They were keen to make a shared vision that was comprised of individual visions; even the objective was difficult to reach. The vision building in every company we interviewed was not an easy process, but these leaders realized it was employees' creativity and organizational innovation that decided the competitiveness in the knowledge economy era. Vision co-creation between leaders and employees was a must, not an option. As we analyzed before, they could choose to continue to depend completely on the traditional management systems to fight for the organizational goal. However, these still indispensable systems could not lead employees effectively to challenge the competitive service markets. Leadership based on vision co-creation became more effective (Figure 2).

Kingdee judged commitment from self-motivation and creativity. These two aspects are both high for employees with the shared vision as shown in Figure 2. This is in line with the findings of Senge (1997) who found that building shared vision must be a central element of the daily work of leader. And so are the findings of Kotler and his colleagues (2010) who thought leaders must go back to basics and realize that the future vision will determine the performance of the company.   In the book of marketing 3.0, the similar view was also been verified: shared vision can attract and retain talent, and it makes back-office productivity and front-office quality. Moreover, it integrates and empowers differences.

From the interviews, we summarize the working state into six levels: not-engaged, expectation, satisfaction, engaged, loyalty and creativity. Gallup (2013) defined engaged employees as people working with passion and feel a profound connection to their company. Not-engaged employees are putting time but not energy or passion into their work. In the process of vision co-creation, the level of employee involvement is going up step by step. The connection between the shared vision and employee involvement is summarized in table 1.

Table 1. Different focuses in the process of vision co-creation

Phase	Issues	Employee Engagement	Focus
Proposing a vision	Worried, thinking the new vision unacceptable or unrealistic	Not-engaged	Share and face-to-face communicate
Gradually understanding the vision	The study of practical and theoretical feasibility for the vision	Expectation	Share sufficient cases and knowledge to verify the new vision is a must for greater business opportunities and individual career development
Seeing opportunities of the vision	Relationship between employees' career development plan and the corporate vision	Satisfaction	Building the connection between corporate vision and individual one
Merging with individual visions	Company vision and individual visions are one or can go hand in hand	Engaged	Developing individual and organizational capability for corporate transformation under the new vision
Believing the new vision	The close connection between organizational behaviours and the new vision	Loyalty	Based on the evaluation of what the vision want, building the corresponding management system
High engaged	Self-actualization of employees	Creativity	Honours and substantial rewards, giving concerns to the whole family of the employee

5. Conclusions

Although some attempts have recently been made to explore the major challenges on servitization such as service design, organizational strategy and corporate transformation, there are almost no tools or techniques available on how to overcome these challenges (Baineset al., 2009). This study responds to that void in the literature by proposing a new concept for leading the process of servitization: vision co-creation with employees. The research represents the essence of servitization with interpreting service from three levels: service as an intangible product, service as a contextual experience and service as a value co-creating process. In the process of servitization, employees cannot be supervised closely or given advices in detail as usual since they create value through making close interaction

with customers. The process of value creation extends from inside production to outside co-creation. Employees instead of products become the main touch point with customers. In these conditions, traditional management systems are still indispensible but not enough to inspire employees to fulfill these transforming tasks. Vision co-creating leadership becomes more effective for this kind of transformation. Vision co-creating leadership is defined as:

- A process of creating a shared vision among the staff by merging employees' personal visions with corporate vision

- A process of two-way communication rather than top-down and one-way announcement of vision dominated by leaders

- A process of energizing each other by appreciative interaction between leaders and employees

Based on the findings on the relationship between employees' engagement and vision co-creation, the research also provides practical implications on leading employees from not-engaged, expectation, to satisfaction, engaged, loyalty and to creativity.

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