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Empirical paper

Relationship between innovation capability, innovation type, and firm performance

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ABSTRACT

Insurers are well versed in the litany of challenging conditions facing the sector. These challenges are economic, political, regulatory, legal, social, and technological. As a result of those pressures, the industry is experiencing increasing competition, muted growth, and an excess of capital. The increased connectivity among household and workplace devices, the development of autonomous vehicle and the rising threat of cyber attacks are transforming the way people live and risk they need to mitigate with insurance products. Insurers need to adopt their business models address the changes which can be threatening to the growth of the industry (Deloitte, 2017). Innovation is widely regarded as pinnacle success factor in highly competitive and global economy. An innovation perspective draws a clear picture of future opportunities that lie ahead. The main purpose of this paper is to explore the relationship among innovations capability, innovation type and on the different aspect of firm performance including innovation, market and financial performance based on an empirical study covering insurance industry in Sri Lanka. The research framework developed in this study was tested 379 senior managers of insurance companies. The empirical verification of assumption of this model has given evidence to confirm the relationship between innovation capabilities; innovation efforts and firm performance are significant and strong. The results of this study could lead effective management of innovation capability which helps to deliver more effective innovations outcomes to generate better performance and it would be benefits for management of the insurance companies.

Introduction

During the past ten years insurance industry faced far border challenges. Demographic shift, financial reforms, emerging market, advancement of communication and information technology and changing customer behavior had a considerable impact to change the efficiency, productivity and the shape the structure of the industry. This would create very competitive threat and recast the whole insurance market. An insurer needs to carefully examine and confront how the various aspect of their business should be sourced to cost reduction, operational efficiency and enhance value. Some would say insurance industry is not known for innovative thinking. Innovation is already creating the significance challenge and pressure to the insurance industry. The potential market for insurance in developing economies significantly demanding for the range of insurance products from health and life; agriculture and property insurance to catastrophe cover. If the industry couldn't respond changes rapidly and successfully, that will become extraneous. The insurance industry cannot maintain their image as a "smart follower". Most academic and industry is widely recognized innovation as pinnacle factor for gaining competitive advantage and sustaining the competitiveness and growth. Awareness of the importance of innovation in the service sector as an engine for the economic growth is the latest phenomenon.

Traditionally insurance products were limited to the standard and stereotypic needs, the whole life endowment or type of life insurance and fire, marine, motor, health in a nonlife segment. There is a need to beyond the traditional products into the realm niches areas that cater to the special needs (Insurance Governance leadership network (IGLN 2015)). Therefore the importance of understanding the innovation competencies for integrated service is necessary and is becoming more relevant as an engine of economic growth under the global change (Ko & Lu, 2010). This concept has been investigated through different approaches ranging from product, process, market and organization (Toivenen & Tuominen, 2009). Growing attention to innovation inclines companies to differentiate the value of existing products and services (Nybakk & Jenssen, 2012).

Innovation is often happened using open technologies and high-quality open resource and relies on a different kind of knowledge

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and information system. Knowledge management is the most important part of the innovation, especially knowledge-intensive industry like insurance. Knowledge is a competitive advantage for underwriting and servicing in insurance companies. In the insurance industry trade secrets, confidential information and valuable ideas are part of the workforce knowledge. Therefore using knowledge management system to capture the internal expert will be crucial to the insurance companies (Plescan & Gavriletea, 2008). The firm's capability to innovate is the most crucial factor for competitive advantage in highly turbulent market condition. Innovation capability leads organization to develop innovations continuously to respond the changing market environment (Slater, Hult, & Olson, 2010) and its embedded with all the strategies, system and structure that support innovation in an organization (Gloet & Samson, 2016).

The insurance landscape in Sri Lanka is behaved as quite steady and confident industry. Due to the economic upturns in country, industry has been going through rough phase and especially increased price competition of motor insurance segment as a result of weakening technical performance which has created threatening competition in between rivals of the industry. On the other hand industry still maintain low insurance market penetration 1.3% of GDP compared with the Asian insurance market such as India 3.4%, Malaysia 4.8%, Thailand 5.8%, and China 3.0%. But Rapid economic development, population growth, and urbanization–combined with rapidly evolving insurance regulation–will lead to increasing insurance penetration. Therefore industry has to believe innovation is the major driver for creating confidence and growth.

The objective of this study is to investigate the relationship between innovation capability innovation strategies and innovation performance. Due to the lack of research related to the innovation and innovation performance of insurance industry in literature, there is a gap between factors affects innovation and influence to the overall performance of the insurance companies. Therefore the purpose of this paper is to fill the gap by developing a model to understand the factors which influence the innovation performance among the insurance companies in developing countries. Although there are numerous conceptual studies have been tested in extant literature studies are limited with numbers and depth of the analysis. Most of the studies have investigated the relationship between innovations typologies, innovation performance mainly linked with the manufacturing sector (Gunday, Ulusoy, Kilic, & Alpkan, 2011; Jin, Hewitt-Dundas, & Thompson, 2004; Kalay & Lynn, 2015; Rosil & Sidek, 2013). The studies related to the service sector have made the investigation linked with the company business strategies with the perspective of innovation (Lilly & Juma, 2014; Akman & Yilmaz, 2008). Especially innovation capability far less concerned and under-examined within the service sector. On the other hand, most of the research dealt with innovation capability and firm performance or innovation capability with innovation typologies (Huhtala, Sihvonen, Frösén, Jaakkola, & Tikkanen, 2014; Chang, Yen, Ng, & Chang, 2012; Taherparvar, Esmaeilpour, & Dostar, 2014). There are no studies intimately studies the relationship between innovation capability, innovation typologies and firm performances in the literature. Therefore the purpose of this paper is to establish more balance and empirically grounded picture of the innovation activities in service sector in developing country perspective, especially in insurance industry, that haven't been fully tested in the literature.

Literature review

Research background and hypothesis

Innovation literature claims that innovation is the most fundamental source for firm's success and survival (Abbing, 2010; Cho & Pucik, 2005) in such a competitive complex and intellectual environment. But the innovation in the service sector received relatively little attention. Research in the specific features and issues in the insurance sector is quite limited and untested until recently especially compared to the banking sector. A service business is often unique and it is widely regarded as services are not same to one another which cannot apply the same strategy when developing new product or services process or business model. For an example, they can be differentiated in terms of nature of service or act and on the degree of interaction between the service organization and the customers (Johne & Storey, 1998). A new way of business thinking which generate and reform unconventional and flexible operations (Kuo, Kuo, & Ho, 2014) that changes in the process of existing line as a example in insurance industry improvement in the risk assessment through changes of new policy conditions or new classification of existing risk in marketing and organization as well as primary product innovation (PPP) can be define as new product for new risks which together sometimes constitute new branches of the insurance industry in the way that fit instance employer liability and railway accident insurance formed branches of accident insurance (Pearson, 1997).

Many researchers agreed that innovation in service sectors different characteristic than the manufacturing sectors (Drejer, 2004) and often seen as non-technological (De Jong, Bruins, Dolfsma, & Meijaaed, 2003). Innovation in service sector generally considered two factors which are an introduction of a completely new product or service to the company or individuals and reconfiguration or improvement of existing services (Miles, 2008) either in a radical or incremental way. According to Veugelers (2008) in the manufacturing sector, this can be changed in the things such as products or goods which a company offers and changes the way which they created and deliver and he interpreted this as product and process innovation. But in services distinction between product and process tend to draw a quite unclear picture. Because of the in-service product and process innovation happens coincidently. However it depends on the industry which you are involved, some industries in service sector can apply this approach but this might be totally or slightly irrelevant for others (Bitran & Pedrosa, 1998), for an instance in insurance industry company can introduce new product with additional covers including extra bonus or some extra benefits such as foreign tours this can be called product innovation and on the other hand company can develop internal process of claim handling, underwriting and call center to speed up the delivery process. This can be justified as process innovation.

Innovation can only happen if the company has the capacity to innovate (Laforet, 2011). Innovation capability is considered as the valuable assets for the firms to provide and sustaining competitive advantage and in the implementation of the entire strategy. It is composed through the main process within the firm (Lawson & Samson, 2001) and cannot separate from the other practices. It is tacit and non-modifiable and closely correlated with the experimental acquirement and interior experiences (Guan & Ma, 2003). The capability of innovation facilitates firms to introduce new product quickly and adopt new systems rather it is important to factor for feeding the ongoing competition. Innovation performance can be explained as combination of assets and resources. Therefore it requires wide variety of resources, assets, and capabilities (Sen & Egelhoff, 2000) to drive through success in rapidly changing environment. According to the Adler and Shenbar (1990) innovation capability is defined as (1) the capacity of developing new products satisfying market needs; (2) the capacity of applying appropriate process technologies to produce these new products; (3) the capacity of developing and adopting new products and processing technologies to satisfy future needs; (4) and the capacity to respond