Scandinavian Journal of Management (2012) 28, 321—339

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A capability perspective on service business development in small and medium-sized suppliers

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KEYWORDS
Service business development;
System suppliers;
Dynamic capabilities;
Operational capabilities;
Manufacturing industry;
Supplier—buyer relationship

Summary Existing research suggests three theoretical pathways for service business development. The first pathway involves incremental enhancement of relational value for existing supplier—buyer relationships (Alpha). The second pathway captures financial value-seeking behavior in existing and new supplier—buyer relationships (Beta). The third pathway is a radical leap toward a new value constellation downstream in the value chain (Gamma). Our main research question aims at the exploration of these three pathways with respect to small and medium-sized suppliers. The research design is based on an exploratory study and an in-depth study. The exploratory study was able to replicate these three pathways in the empirical context of small and medium-sized suppliers. The in-depth study explores and describes co-evolvement of the dynamic and operational capabilities of each pathway. The results provide testable propositions that can be used to guide future research. The paper offers a comprehensive framework that will assist researchers in the conceptualization of paths for service business development and in the operationalization of capabilities. For managers, its value lies in a description of the capabilities needed to achieve an incremental enhancement of relational value in existing supplier—buyer relationships (Alpha), financial value-seeking behavior in existing and new supplier—buyer relationships (Beta), and radical leaps into new value constellations downstream in the value chain (Gamma).

Introduction

In today's volatile and rapidly changing markets, manufacturing companies are confronted with competitive challenges such as commoditization tendencies and competitive imitations (Helander & Möller, 2008; Matthyssens & Vandenbempt, 2008). In order to survive, they must constantly (re)gain their competitive advantages. Product and price are presently less significant differentiating factors. Service competencies are becoming core differentiators in business relations (Ulaga & Eggert, 2006). Competing through services creates attractive margins and additional revenues. By becoming a major part of company revenue, services create a positive impact on manufacturers' profit trajectories (Eggert, Hogreve, Ulaga, & Münkhoff, 2011) and enhance a firm's overall value (Fang, Palmatier, & Steenkamp 2008).

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0956-5221/$ — see front matter
http://dx.doi.org/10.1016/j.scaman.2012.07.001

In business practice, companies confront various pathways for service business development. These pathways include basic services for guaranteeing proper product functioning, combinations of products and services for customer-specific solutions, and the position of performance enablers (Davies, 2004; Gebauer, Edvardsson, Gustafsson, & Witell, 2010; Helander & Möller, 2008; Oliva & Kallenberg, 2003). All pathways require significant investments in developing new sets of service capabilities (Baines, Lightfoot, Benedettini, & Kay, 2009; Jacob & Ulaga, 2008; Matthyssens & Vandenbempt, 2008; Storbacka, 2011).

Research has contributed considerably to our understanding of how manufacturing companies can build the necessary new set of capabilities (Kowalkowski, Kindström, Brashear-Alejandro, Brege, & Biggemann, 2012). Interestingly, contributions have emerged in two isolated research fields. The first research field concentrates on the transition from product manufacturing toward service provision. Contributions arise around service strategies and the organizational elements necessary for implementing service strategies (e.g., Oliva & Kallenberg, 2003; Neu & Brown, 2005; Raddats & Easingwood, 2010; Windahl & Lakemond, 2006). Lately, this research field has deepened our understanding of the dynamic and operational capabilities that drive service business development (Baines et al., 2009; Fischer, Gebauer, Ren, Gregory, & Fleisch, 2010; Storbacka, 2011). The second research field elaborates the paths followed by system suppliers toward solutions (Davies, 2004; Helander & Möller, 2008). Similar to recent research on service business development in manufacturing companies, this research field also explores the necessary capabilities (Helander & Möller, 2007, 2008).

Despite the increasing amount of research in both areas, two research gaps still remain. The first can be considered an empirical gap and the second a conceptual gap. The empirical gap arises from the type of companies investigated. Both research fields mainly investigate suppliers of large-scale, complex systems. These systems can worth millions of Euros and they are of high strategic importance for the customer. System suppliers are in the system and solution business (Backhaus & Voeth, 2009). Typical examples are manufacturers of trains, automation equipment, power generation equipment, and water treatment equipment. Such companies have direct access to their own installed base (installed systems). They are in a superior market position for offering services (Wise & Baumgartner, 1999). Nevertheless, little is known about how traditional *suppliers of components* develop their service business. Such suppliers have limited access to the service market because their components are embedded in more complex products. Furthermore, existing case studies often include multinational enterprises (MNEs) (Davies, 2004; Gebauer, Fleisch, & Friedli, 2005; Helander & Möller, 2008; Oliva & Kallenberg, 2003; Salonen, 2011).

Concentrating on small and medium-sized firms is particularly important because they play a vital role in economic growth and employment. In high-income countries, SMEs create about 50% of the GDP (Ayyagari, Beck, & Demirguc-Kunt, 2007). SMEs have been sensitive to the imperatives of globalization. To sustain globalization, managers in SMEs have to acquire new technology or adopt a more proactive approach to product and service innovation (Knight, 2000). The creation of new knowledge often remains a local activity in which SMEs play a vital role in connecting actors with different or complementary knowledge bases. As a result, SMEs expand industry boundaries and open up new business fields (Partanen, Möller, Westerlund, Rajala, & Rajala, 2008).

MNEs can afford to set-up a separate service organization specializing in service provision (Auguste, Harmon, & Pandit, 2006). *Small and medium-sized suppliers* (SMSs) might not reach the critical mass needed for a profitable service business. They might not have the financial resources to cover investment in the service business. A separate service organization adds complexity to the structures of SMEs, creating high coordination costs and limiting flexibility (Gebauer, Paiola, & Edvardsson, 2010).

The second research gap relates to the conceptualization of service business development as a pure modification of operational capabilities. Operational capabilities describe how manufacturing companies can maintain a profitable service business. Investigations of operational capabilities do not cover the dynamic capabilities necessary to sense and seize service opportunities and to reconfigure operational capabilities accordingly. Although there has of course been a considerable amount of research on dynamic capabilities (Di Stefano, Peteraf, & Gianmiaro, 2010), small and medium-sized companies have often been neglected. In our empirical context of small and medium-sized companies the transition from selling products toward providing services or even solutions takes place independently of their business (or value) networks.

Providing solutions means integrating product and service components in a manner which resolves customer-specific business needs (Shepherd & Ahmed, 2000). While the scope of the product and service components necessary to provide solutions might correspond to the competence base of MNEs, it is most probably beyond their organizational boundaries. If SMSs wish to provide complex solutions, they will have to mobilize and orchestrate other companies. They must have the capabilities required to form value networks consisting of various actors that contribute to solutions (Möller, 2006). However, given their size, SMEs tend to integrate with other companies. They rely specifically on their social capital and relationships to mobilize other network actors (Partanen et al., 2008).

To close these two research gaps, we investigate the pathways for service business development in SMSs. Our investigation adopts the organizational capability perspective (Teece, Pisano, & Shuen, 1997) with a corresponding distinction into dynamic and organizational capabilities. The research question guiding the investigation can be formulated as follows: *How does co-evolvement of the dynamic and operational capabilities in small and medium-sized suppliers form pathways for service business development?*

In order to answer this research question, we developed case studies of European SMSs. Through comprehensive data sets, we concentrated on theory-building rather than theory-testing. The remainder of this article is arranged as follows. The next section combines organizational capability perspectives with existing research on service business development in manufacturing companies. It is followed by a description of the research methodology. The article continues with the presentation of results and concludes with a discussion of the theoretical and managerial implications and future research opportunities.