Csaba Makó – Miklós Illéssy- Péter Csizmadia: Some Preliminary Remark on the Organizational Case Studies carried out in the Service Sector

In the case studies to be presented later in this chapter, we analyse the implementation process of a workplace innovation in six different service firms. The aim of this introduction is to present the general context in which the importance of both KIBS and organisational innovation can be understood. Firstly, we intend to analyse the growing importance of the service economy, as measured by its share in employment, economic outputs and productivity growth. The main driver of this global phenomenon will also be presented. Then, we go further by proposing a possible typology of firms operating in this sector. The typology elaborated by Salter and Tether (2006) seems to be particularly useful for the aims of our analysis. Following a short review of the literature on KIBS, we will highlight the most important characteristics of organisational innovations by presenting the definition laid down in the Oslo Manual. Finally we will summarise the most important findings of the organizational case studies according to types of services (e.g. "systems firm", "knowledge intensive business service (KIBS).)

1. A historic shift in the economic structure: the growing importance of the service economy

Since the last decades of the 20th Century, we have witnessed an unprecedented growth of the service sector at the expense of manufacturing and agriculture. In this context, some scholars are labelling this change a 'service sector revolution' (Chesbrough – Shphrer, 2006). In a rather simplistic way, the wealth of nations can be attributed to agriculture two centuries ago, to manufacturing a century ago, and now to the service sector, which produces 70-80 % of GDP in developed economies. In contrast, the service sector's share of GDP in developing countries is 52%, and in the Central and Eastern European Post-Socialist countries it ranges from 58.4% to 62.9%. Another noticeable feature of these changes is the rather different development dynamics in the manufacturing and the service sectors. For example, in the UK, between 1998 and 2004, the KIBS sector experienced a 23.6% productivity growth accompanying a 20.2 % increase in employment. On the other hand, a

28.8% productivity growth and a 22.8 % employment decline were reported in the manufacturing sector (Sako, 2006: 500).

With regard to the unbundling of corporate functions relative to support activities in a firm's infrastructure and administration, globalization of the service sector is a rather new phenomenon driven by the following factors:

(1) *Globalization of the labour market or the Great Doubling* in the international labour market. Unlike in 1989, when the figure was 1.48 billion, now 2.93 people are competing and intensifying wage competition around the globe (Freeman, 2005).

(2) *General use* (due to radical cost reduction) *of ICT* in company practices has accelerated the delocalization (outsourcing/off shoring) not only of the 'primary activities' (e.g., production) in the global value chain (GVC) but also the 'support activities' in the administrative functions (Gospel – Sako, 2008: 2-4).

(3) In the emerging markets, the social and economic actors (governments) are looking for new development strategies (a new path of economic development) aimed at improving their position in GVC in supplying higher-value-added products and services. With the help of this new policy orientation, the CEE countries, including Hungary, intend to get rid of the situation of "locking (...) into economic activities with low-value-added/productivity growth and, thus, undermining future sustainable growth." (Kattel – Reinert – Suurnal, 2009: 2).

(4) The rapid development of 'modularization' or 'networking' via various types of organizational and managerial innovations in global corporations is continuing. This process is driven by both the cost-reduction and the restructuring of the firms (e.g., the focus on the core competences in both the 'primary' and the 'support' activities).[1]

Radical changes in the nature of the global labour market are regarded as a key factor for the great speed of the internationalization of services. As a result of the participation of China, India, and former Soviet-bloc countries in the global labour market, today, 2.93 billion people are in competition, while only 1.46 billion workers were active in the global labour market before these historical changes. Richard B. Freeman (2005) labelled this enormous shift in the global labour market a 'great doubling' with a far-reaching impact on labour in both the developed and developing economies. Before the collapse of the state-socialist

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[1] According to Sako (2009a), in the 'modular corporation,' the labor process in practically every large corporate department can be delocalized (either by outsouring or offshoring) and driven both by cost- and knowledge efficiences, using 'using new locations with a talent pool' (p. 4).

political-economic system and before the end of their economic isolation, the workforce in the countries noted above (e.g., India) rarely competed directly with those in the developed countries. One of the most important impacts of this historical change on the global labour market is increased wage competition, not only in the low-level blue-collar jobs in the manufacturing sector but also in the best- and worst-paid white-collar jobs, too. Contrary to widespread public belief, these developing (or emerging) economies are increasing their highly skilled labour force relatively rapidly with the future aspiration to improve their present position in the GVC of both manufacturing and services. In this regard, it is important to stress the following: even before the global financial and economic crisis of 2008, China launched various initiatives to increase the share of high-value-added products in total exports and made remarkable progress in R&D (e.g., nanotechnology; more than 750 MNCs created R&D capacity). In addition, by 2010, the number of Chinese PhD students in engineering and natural sciences will outstrip that of similar categories in the U.S.A. Finally, it is noteworthy that, besides China, Indonesia and Brazil had also doubled the number of university graduates between 1980 and 1990.

In relation to future employment trends in the European Union, employment growth will recover gradually in the foreseeable future. There is some good news concerning employment development. According to Cedefop (2011:1-2), the most comprehensive employment forecast, "... there will be job openings for all types of occupations ... most new jobs, projected to be around 8.5 million, will be in knowledge- and skill intensive occupations ... These changes signal a risk of job polarization, with increased demand at the upper and lower ends of occupations, and decreases or stagnation in the middle."

Global competition driven by such elements as the search for cost-efficiency and knowledge efficiency, and enabled by the tools of ICT and modularization (or networking) of business organizations are resulting in the acceleration of the delocalization (outsourcing/off shoring) of services. The dramatic decline in telecommunication costs, the decreasing importance of physical distance (the 'death of distance'), and the extensive use of ICT assist in the geographical redistribution of data storage and processing (e.g., outsourcing the data processing activities of accounting and wage departments, medical diagnosis, and logistical activities). ICT facilitates the standardization of services. This is the process of 'productizing services' in the service sector. However, the infiltration of servicing is also evident in the manufacturing sector. For example, among such globally well-known manufacturers as the American IBM or the German Siemens, the fastest growing share of their turnover is generated from service activities. This process is often called 'servicing products.'

In spite of the fact that the service sector covers a greater variety of activities than manufacturing, at the beginning of the 21st century only 10% of the service sector is involved in international trade, while this proportion is over 50% in the case of manufacturing (UNCTAD, 2004: 97). The smaller share of the service sector in international trade may be explained by the special characteristics of its products. In the majority of cases, it is difficult to store a significant proportion of the service sector's product(s) due to the fact that the production and consumption of services take place simultaneously. This feature of the service sector results in weak tradability; therefore, despite the heavy reliance on the use of ICT, services represented only 1.8 billion USD in traded value, in contrast to the 7.4 billion USD share of the manufacturing sector (WTO, 2005). Despite these difficulties, the share of Foreign Direct Investments (FDI) in service activities increased in the last decades of the 20th century. For example, in the 1970s, the sector represented only 25% of the total inward FDI; by 2002, this share had increased to 60% (UNCTAD, 2004). The role of FDI is especially important in the field of business services (e.g., in such sub-sectors as transportation, telecommunications, real estate, catering, and hotels).

Governments in the emerging markets are designing new development (modernization) strategies aimed at moving up on the GVC and shifting from the 'low-skill' to the 'high-skill' equilibrium growth model in the Central and Eastern European Countries (CEE) countries. The following table accurately illustrates the possible steps involved in moving up in the GVC in the field of business service activities.

Table 1. Moving the value chain of business services

IT Services -→	BPO→	KPO
IT infrastructure Software applications development Hosting Data entry and conversion	Call centres Horizontal back-office processes (e.g., payroll administration, accounts payable) Vertical business process (e.g., claims handling in insurance)	Research & Development Engineering design Data analytics and data mining Advanced processes in legal, medical, biotechnical, and pharmaceutical sectors

Source: Sako, 2009b: 17.

Note: BPO= Business Process Outsourcing, KPO= Knowledge Process Outsourcing

It is quite probable that in spite of the temptation to 'economic nationalism' affecting some countries, the radical changes in the global labour market and the impact of the global financial and economic crisis (2008) may result in only a temporary slowdown and stronger competition and not a reversal of the trend of delocalization of business services. In this context, the organizational innovations and the knowledge development practice in the KIBS firms are playing a key role in improving the competitiveness of the firm by moving up the GVC of business services.

2. The heterogeneous character of services and innovation

Characterizing the service activities in general, Korczynski (2002) (cited by Flecker-Holtgrewe-Schönauer-Dunkel-Meil, 2008: 103) identifies the following basic features of services:

- 'intangibility' – the product of service work is not, or is only partly, of a tangible nature,
- 'perishability' – the product is 'temporary' and, thus, cannot be stored,
- 'variability' – the product is not homogeneous, for it can vary according to the individuals involved (for instance, through the perception of the services on the part of a customer),
- 'simultaneous production and consumption' – the product is produced and consumed in one and the same situation ('uno-actu' principle),
- 'inseparability' – the product is produced by both a service provider and a receiver (co-production).

Due to the great variety in the form and content of services, it is extremely difficult to identify and assess innovations in the field of service activities. To overcome the problems related with the heterogeneity of the service sector, Salter and Tether (2006: 9-17), instead of using a universally accepted definition of a service, made a distinction among the following main clusters of services:

- Traditional services
- Systems firms
- Knowledge-intensive business service (KIBS) firms

2.1 Traditional services

According to Selter and Tether (2006: 9 -11), these types of services ' ... occupy the 'top and bottom' of the knowledge economy – the best and the worst jobs in services, and the growth of services, has been characterised by growing inequalities in advanced economies ... Because of their nature, many services ... are provided locally. This local-provisions to serve local-needs has arguably led to a form of low-quality lock-in, which Finegold-Soskice (1988: 22) identified as the 'low-skill equilibrium' – in which the majority of enterprises staffed by poorly trained managers and workers produce low quality goods and services.'

Small traditional service firms dominate the modern economy, and the following statement is generally accepted among experts dealing with service innovation: '... Few of these firms employ professional staff, and, therefore, they often lack the absorption capacity necessary for successful innovation' (Selter-Tether, 2006: 9). However, it is not only the necessary professional-technical skills as social preconditions of innovation which are missing in small traditional service firms but also the necessary social skills (e.g., ability to perform teamwork, capacity to solve workplace conflicts, and communication skills).

To overcome the problems related to knowledge shortages in small traditional service firms, it is necessary to draw attention to the role of the franchise and company networking in speeding up knowledge transfer and development. The 'franchise contracts' may enlarge the available knowledge pool and speed up the diffusion of the new working practices as well as help identify the conditions of brand use, including the methods and routines of the new firm establishment. Another important facilitator of knowledge transfer is networking or company group membership. Organizations operating as a company group member (e.g., convenience store chains) may disseminate knowledge faster and improve their innovation performance better than a single firm operating alone (Nielsen – Lundvall, 2007: 74).

According to the review of the relevant Community Innovation Survey (CIS) (Makó-Illéssy-Csizmadia, 2012), the innovation performance of micro- and small firms lags behind that of medium-sized and, especially, large companies. In this sense, it is necessary to report that we have rather modest systematic knowledge on the social innovation performance of the micro- and small firms operating in the traditional service sector. An overwhelming majority of innovation research focuses on the growth potential of start-ups in the high-tech sectors (e.g., software development and bio-technology). Few scholars are interested in better understanding the innovation activities of the low-tech ('technology users') small firms in the traditional service sector.

To better understand the complexity of the innovation process, since 2008, the European Innovation Scoreboard (EIS) survey has focused on the particular social segment of firms labelled as *'neglected innovators.'* According to the EIS (2009) report, R&D is not the only method of innovating. Other methods include technology adaptation, incremental changes, imitation, and combining existing knowledge in new ways. With the possible exception of technology adoption, all of these methods require creative efforts on the part of a firm's employees and, consequently, lead to a better development of the firm's in-house innovative capabilities (EIS, 2009: 23). In comparison to a firm's in-house R&D, a higher proportion of non-R&D innovators use fewer than 50 employees and operate in a low-technology service sector and '... are located in European countries with below average innovative performance' (op. cit., p. 23).

In spite of the difficulties raised above regarding the low innovation capacity of traditional service firms, some of them are able to create a new path of development and break with the practice of low-cost and low-quality service ('low quality lock-in'). For such firms, the benefit margin of innovation activities could be quite high.

2.2 System firms

Previously, we insisted that many services are dominated by micro- and small firms which satisfy the needs of the local market and belong to a class of firms called 'neglected innovators.' However, 'system firms' operating in the service sector are using both high-tech and advanced organizational and managerial practices. As Selter-Tether (2006: 13) reported, 'These services include banking and insurance, super market-retailing and airlines ... these industries typically involve very highly developed division of labor, sophisticated technologies including ICT and complex organizational forms.' System firms represent two bureaucratic forms of organization. Both are characterized by varying degrees of innovation and learning capacity. Mintzberg (1979, 1983) labelled these forms of organization a 'mechanistic' and a 'professional bureaucracy.' According to the latest survey data comparing the models of work organization in Europe, work in a 'mechanistic' bureaucracy is standardized through the use of formal job descriptions and rules imposed by management. The labour process is characterized by a higher degree of centralization and limited autonomy for employees to decide how to carry out their tasks and the pace of their work. On the other hand, in the case of a 'professional' bureaucracy, centralization is lower '... and behavior is regulated and standardized through the acquisition of standardized skills and the internalization of professional norms and standards of conduct. As a result, operating procedures are rather stable and routine, in spite of the considerable autonomy in the work' (Valeyre et al., 2009: 9).

2.3 Professional service firms or knowledge-intensive business service firms (KIBS)

KIBS service firms are playing a key role in developing innovation and knowledge at the national, regional, and firm (or firm network) levels. This type of service is the core focus of our analysis and the great majority of the organizational case studies were carried out in this sector. According to Toivonen (2006: 5),[2] professional service firms can improve innovation activities and have a so-called "bridge function" role in developing and transferring knowledge in the following ways:

- 'direct transfer of expert knowledge, i.e., the traditional model of consulting practice, experience sharing, and carrying experiences and ideas from one context to another,
- benchmarking, where the process of identifying and focusing on 'good practice' can be established through an intermediary,
- brokering, putting different sources and users in contact with each other,
- diagnosis and problem clarification, helping users articulate and define the particular needs in innovation in such a way that external resources and opportunities can be used effectively,
- change agency, where organizational development can be undertaken with help from a neutral outside perspective.'

Besides this, the key role of the rapid development of information and communication technologies (ICT) has tremendously improved knowledge management in general (e.g., the handling, storing, and transferring of information did not question the importance of the 'proximity syndrome'). In this context, Toivonen reported the following: 'The empirical studies made until now indicate that even though there is growing potential for the electronic delivery of graphic, numerical, and text-based information, no part of the KIBS transactions can be carried out without local presence of face-to-face contact' (op. cit.: 9).

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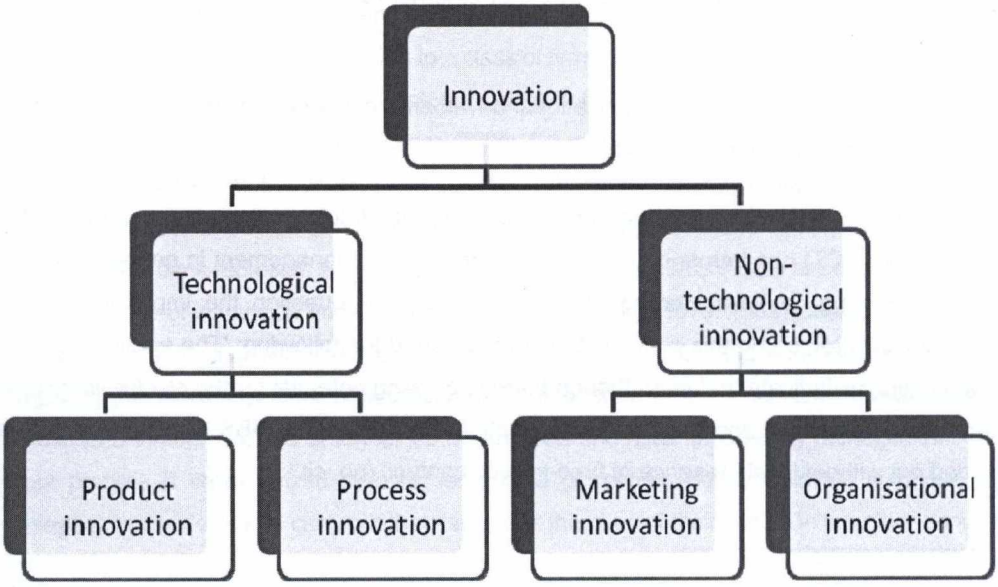
[2] According to Salther and Tether (2006), the fundamental characteristics of innovation activities in the knowledge-intensive and professional service firms are as follows: '(1) the role of highly skilled labor in the creation and exploitation of new solutions; (2) the importance of new organizational practices, such as the use of knowledge management systems (KM) in supporting the realization of new innovative opportunities; (3) the 'generative dance' between clients and producers as new solutions are negotiated and co-produced between different actors; (4) the key role of social networks in generating and supporting knowledge creation and exchange through brokerage and closure; (5) the '*ad hoc*' or 'informal' organizational form of most knowledge-intensive service firms.' (Salther-Tether, 2006: 17)

3. The concept and definition of organisational innovation and its importance

In this study we use the definition of innovation developed in the Oslo Manual[3]. This manual, compiled jointly by the OECD and Eurostat, serves as a common reference point for all researchers investigating any forms of innovation. The manual was first published in 1992 and the third and latest edition came out in 2005. The manual defines innovation as 'the implementation of a new or significantly improved product (good or service) or process, a new marketing method, or a new organisational method in business practices, workplace organisation or external relations' (ibid. p. 46). The manual distinguishes 4 types of innovation: product, process, marketing and organisational innovations. Product and process innovations belong to the category of technological innovation, in contrast to marketing and organisational innovations which belong to the category of non-technological innovation. The following figure presents this classification.

Figure 1: Classification of innovations



[3] OECD – Eurostat (2005)

The Oslo Manual defines the different subcategories of innovation as follows:

1) Product innovation is 'the introduction of a good or service that is new or significantly improved with respect to its characteristics or intended issues. This includes significant improvements in technical specifications, components and materials, incorporated software, user friendliness or other functional characteristics' (ibid. p. 48).

(2) Process innovation is 'the implementation of a new or significantly improved production or delivery method. This includes significant changes in techniques, equipment and/or software' (ibid. p. 49).

3) Marketing innovation is 'the implementation of a new marketing method involving significant changes in product design or packaging, product placement, product promotion or pricing' (ibid. p. 49).

4) Organisational innovation is 'the implementation of a new organisational method in the firm's business practices, workplace organisation or external relations' (ibid. p. 50).

The Manual defines organizational innovation

4.1 in business practice as 'the implementation of new methods for organising routines and procedures for the conduct of work' (ibid. p. 51);

4.2 in workplace organisation as 'the implementation of new methods for distributing responsibilities and decision making among employees for the division of work within and between firm activities (and organisational units), as well as new concepts for the structuring of activities, such as the integration of different business activities' (ibid. p. 52);

4.3 in firms' external relations as the implementation of new ways of organising relations with other firms or public institutions, such as the establishment of new types of collaborations with research organisations or customers, new methods of integration with suppliers, and the outsourcing or subcontracting for the first time of business activities in production, procuring, distribution, recruiting and ancillary services' (ibid. p. 52).

Organisational innovations have received a great deal of attention from both academic researchers and business practitioners in recent years. Both quantitative and qualitative empirical data show that organisational innovations play a crucial role in various aspects of organisational performance. Organisational innovation can contribute to productivity growth, can improve the quality of working life at individual (employee) level, can help to use the

advantages of technological innovation and can strengthen the learning and innovation capacity at both individual and organisational level. Briefly, organisational innovation represents a key source of economic competitiveness.

As the so-called Dortmund/Brussels Position Paper rightly put it, although it is hard to find directly measurable indicators of the economic return of investments on organisational innovation, recent empirical data show that these "investments influence up to some ten percent of economic growth (Corradó et al., 2005). Consistent with earlier results of the Erasmus Competition and Innovation Monitor (2009), technological innovation, by means of R&D and ICT investments, determines 25% of innovation success, whereas social innovation (management, organisation and work aspects) determines 75% (Volberda et al., 2011)".[4] The authors therefore conclude that one of the main challenges for the new European Framework programme (Horizon 2020) is to give more weight to this issue in various dimensions (fund, research, dissemination, etc.) and incorporate it in all policy programmes at European, national and regional levels.

4. Main Characteristics of the Organizational Case Studies

In presenting the organizational case studies, the following characteristics related to the organizational changes were distinguished:

1. subject of changes,
2. target group
3. drivers of the changes
4. preconditions of the changes
5. expected outcomes

Table 2 summarises the key factors characterising the organizational changes or innovation in the organisations surveyed.

[4] Dortmund/Brussels Position Paper (2012), p. 1.

Table 2 Characteristics of Organizations Surveyed

Company Case	Subject of changes	Target group	Drivers of the change	Preconditions of the change	Outcomes
Nexon	Developer team Project-based approach based on internal and external knowledge sources Incremental	The whole organisation	Intensified customer orientation Outsourcing Facilitating knowledge transfer/sharing	Project management and marketing skills Training and coaching	Improved company performance Outsourcing of business functions
Schönherz	Supply flexible knowledge to IT-firms by developing strategic cooperation between IT-students, IT-firms and higher education institutions Collaborative training	IT-students (supply side), IT-firms (demand side), Higher education institutions	Labour regulation favours flexible forms of employment allowing cost saving and better skill match	Legal environment Firms investing in training (specific IT and social skills)	Cost saving employment of IT-and electrical engineers
Magyar Posta	Changing organisational culture Increasing sales and customer orientation Skill use shift, from mechanical, professional and bureaucratic skills to customer-	Front office employees	Liberalisation of postal services Maintaining competitiveness of the Hungarian Post	Heavy investment in formal training "Post-it" strategy: detailed list of competences, competence development via internal training and re-training	Competence development Strict reporting system Top-down approach during the implementation: less involvement Service

	orientated social skills				diversification Impact of the internet: mail service declining (e-mail), but packaging services rising (shopping via internet)
Avaya	Mobile and home-based telework	Support engineers and pre-sale experts	Increase competitiveness Increase motivation and the loyalty of the employees to the firm Flexible manpower and knowledge use	Skill base (self-organising skills) Collaborative and cooperative relations between management and employees Autonomy of local management	Relaxed working environment More autonomy for employees
Klinika	Web-based communication system	Staff: nurses and physicians	More efficient technology in daily operations	Lack of satisfactory IT-infrastructure Lack of necessary employee skills Underdeveloped IT-solution	Lack of use Expensive Increased conflicts
Mortoff	Merger of two consulting firms		Increased competitiveness Impact of the crisis	Company training practice: Informal training aimed at developing self-organising skills Mentoring system to master tacit skills	Smooth integration of the knowledge pools of the formerly two distinct firms into one common and efficient organisational knowledge base

Comparing the various types ("traditional", "systems firm", "knowledge intensive business service") and complexity of organizational innovations (e.g. "incremental", "modular", "architectural" and "radical", Shcienstock, 2004:18), the main features of our company/organizational cases are presented in the Table 3.

Table 4 Organizational Case Studies:

Types of services	Incremental innovation	Radical Innovation
1. Traditional service	-	-
2. "Systems firm"	"Hungarian Post"	"Clinic"
3. Knowledge intensive business service (KIBS)	"Nexon Consulting Firm" "Mortoff Consulting Firm"	"International IT Service Firm" "IT Cooperative+

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