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ADVANCES IN GLOBAL SERVICES AND RETAIL MANAGEMENT

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Dr. Cihan Cobanoglu

Dr. Valentina Della Corte



Co-Editors

Dr. Cihan Cobanoglu, University of South Florida, USA

Dr. Valentina Della Corte, University of Naples Federico II, Italy

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The Evaluation of S-D Orientation on Service Innovation and Performance of Airline

İnci Polat¹ and Özlem Atalık²

¹Department of Aviation Management
Süleyman Demirel University, Turkey

²Department of Aviation Management
Eskişehir Technical University, Turkey

Abstract

The aim of the study is to reveal the relationship between S-D orientation and service innovation and performance variables. The empirical data were collected from airline passengers in Turkey through an online survey. PLS-SEM method was used to test the relationship between variables of the study. The results of the study exposure that there is a significant relationship between S-D orientation and service innovation. There is also a correlation between service innovation and firm performance. However, this does not apply to the relationship between S-D orientation and firm performance. The major results indicated that S-D orientation has a critical role in service innovation. As a result of the study, it can be concluded that service innovation is a key element that allows airline firms to achieve better performance and to become more service oriented. There were few studies examining the relationship between service innovation and S-D orientation. Therefore, this study would contribute to the understanding of S-D orientation, service innovation, and firm performance.

Keywords: S-D orientation, value co-creation, service innovation, performance, airline

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Introduction

In the service sector, which has a share of 70% in terms of economic value created worldwide (Chen et al., 2016), changes in production and consumption roles lead to the emergence of new questions and problems regarding the management of innovation processes and performance. In order for service businesses to maintain their market shares and increase their performance, it is necessary to better read the differentiating cyclical changes and to ensure that the actors in the ecosystem are included in the processes. Service-Dominant (S-D) Logic (Vargo & Lusch, 2004; 2006; 2008), which expresses how it should be conceptualized with a common mindset with the actors in the ecosystem, defines the concept of service as the basic purpose of change. The S-D logic also ensures a theoretical understanding that organizations, customers, and other service system actors can create value together through interactions with each actor. According to Vargo and Lusch (2004), the capability of a business providing better service and being able to generate valuable customer experiences is critical in creating a competitive advantage. The operant capabilities that facilitate and develop the value co-creation process with the S-D logic

perspective are strategic resources that are assumed to have a central role for an organization to gain a competitive edge (Karpen et al., 2012; Karpen et al., 2015). Karpen et al., (2015) defined S-D orientation as “the process of transforming into the behavior of S-D logic”. Therefore, the S-D orientation is a consideration of interaction abilities that will enable the process of shared value co-creation in particular. The customer’s co-creator position which is advanced for this process requires the redefinition of the service provider and the customer roles (Gummesson, 2007). S-D orientation represents an operant resource set that assists customers and other value network actors to obtain more “value in context” through resource integration and service interaction processes (Karpen et al., 2012).

Previous studies in the marketing literature examined to determine the theoretical basis of a new paradigm, S-D logic (Vargo & Lusch, 2004; Vargo & Morgan, 2005; Lusch et al., 2006; Lusch & Vargo, 2006; Lusch et al., 2007; Vargo, 2007; Lusch et al., 2008; Vargo & Lusch, 2008; Merz et al., 2009; Vargo & Akaka, 2009; Gummesson et al., 2010; Vargo & Lusch, 2011; 2016). However, despite researchers’ theoretical contribution in marketing literature, empirical studies on the S-D logic paradigm and its effects have been found to be limited at the strategic level (Karpen et al., 2015; Wilden & Gudergan, 2017; Yiu et al., 2020; Alves et al., 2020). In this context, the study was conducted to reveal the relationship between S-D orientation and service innovation and firm performance variables based on airline-passenger interaction. S-D orientation, service innovation and firm performance variables were expressed in the study based on the literature. Conceptual models and hypotheses were also stated, and the model was tested empirically. Finally, the results and findings of the analysis were evaluated.

Literature Review

S-D Orientation

Karpen, Bove, and Lukas (2012), who first conceptualized the abilities showing the S-D logic, define the S-D orientation as organizational skills that facilitate and develop the mutual resources integration through relational (RIC), ethical (ETIC), individuated (INIC), empowered (EPIC), concerted (CIC) and developmental (DIC) interaction. Karpen et al., (2012: 25-32) interpret the S-D orientation as a higher-level value co-creation capability comprising six interaction capabilities and explain each interaction capability individually.

- RIC - empowering emotional and social ties with customers in service interactions.
- ETIC - developing equitable and non-opportunistic customer service interactions.
- INIC - understanding the service process, context, and desired result of individual customers.
- EPIC - enabling to give form the nature and content of customers in service interactions.
- CIC - simplifying coordinated and combined service processes involving customers.
- DIC - helping to develop customers' knowledge and competencies in service processes.

S-D Orientation, Service Innovation, and Firm Performance

Lusch and Nambisan (2015) provided an idea about the adoption of an integrated or synthesised approach for service innovation researches. According to this idea, service innovation which adopts the S-D logic, could contribute to the service ecosystem, service platform, and creating

common value. Thus, the S-D orientation leads to service innovation. The S-D logic perspective advocates that service science aims to combine basic science and engineering theories, applications and models with all aspects of the management field to increase and improve service innovation (Paton & McLaughlin, 2008). Therefore, the innovation in the service industry is the cause of the competitive edge and the growth (Nam & Lee, 2010). The co-creation of the value between providers, customers, and other actors in service ecosystems during the interaction has become a dominant point of view in service management researches (Lusch & Vargo, 2014). The service ecosystem actors contribute to the innovative and beneficial processes more than R&D department professionals, which is becoming an important issue for service innovation (Sundbo, 2008). It is considered that the customers and service users assist to service innovation by offering their creative ideas (Kristensson & Magnusson, 2010) and proposal on how to combine a new service into an existing service ecosystem (Tax & Stuart, 1997; Åkesson et al., 2016). Although it has been discussed in theoretical context that the adoption of the S-D logic causes a competitive advantage for the firms, the relationship between S-D orientation and service innovation hasn't been investigated empirically enough (Yiu et al., 2020). In this context, the hypothesis of the study is established as follows.

- H1: There is a significant correlation between S-D orientation and service innovation.

Karpen et al., (2015) discussed the “S-D orientation influences business performance” hypothesis based on the theoretical discussions (Barney, 1991; Day, 2006) about internal resources that provide a competitive advantage. Teece and Pisano (1994) argue that “The competitive advantage of businesses stems from dynamic capabilities that operate within the enterprise and are embedded in the processes of the enterprise and are based on high-performance routines conditioned according to the past.” It is claimed that as the value co-creation capabilities of an enterprise the S-D orientation significantly increases the business performance (Karpen et al., 2012). According to Karpen et al., (2015), S-D orientation increases the relationship building, resource access, resource exchange, and knowledge acquisition by directly supporting customers and focusing on cooperation with customers. Thus, it contributes to the revenues of the business by strengthening customer interests and expenses. S-D orientation, therefore, encourages the achievement of shared value creation goals and facilitates shared value creation processes. Although there are few studies revealing the relationship between S-D orientation and firm performance, Karpen et al. (2015) and Alves et al. (2020) tested the relationship between these variables. Therefore, it is proposed the following hypothesis:

- H2: There is a significant correlation between S-D orientation and firm performance.

The need of uncovering the resources that provide a competitive edge in the service sector, especially innovation as a resource for gaining competitive advantage and its effects on performance results is increasingly attracting the consideration of researchers (Van Riel et al., 2004; Prajogo, 2006). Based on this context, businesses that focus more on service innovation are argued to be likely to commercialize new services and, as a result, achieve greater firm performance than businesses that do not focus on new services or the development of service processes (Eisingerich et al., 2009). Firms that don't make innovation encounter low performance or low productivity (Wilkinson & Thomas, 2014).

Empirical studies on innovation and its effect on firm performance have traditionally focused primarily on product-related innovations (Chandy & Tellis, 2000; Avlonitis et al., 2001; Li & Atuahene - Gima, 2002; Yuan et al., 2010; Tung, 2012; Goedhuys & Veugelers, 2012; Ramadani et al., 2019). The effects of innovation related to services have become important in the literature since last two decades (De Jong et al., 2003; Cainelli et al., 2004; Lee et al., 2011; McDermott & Prajogo, 2011; Sommer & Haug, 2011; Lin, 2013; Chuang & Lin, 2015; Ryu & Lee, 2018; Johansson et al., 2019; Tajeddini et al., 2020; Feng et al., 2020). As a result of the literature review, the following hypothesis is put forward for the relationship between service innovation and firm performance:

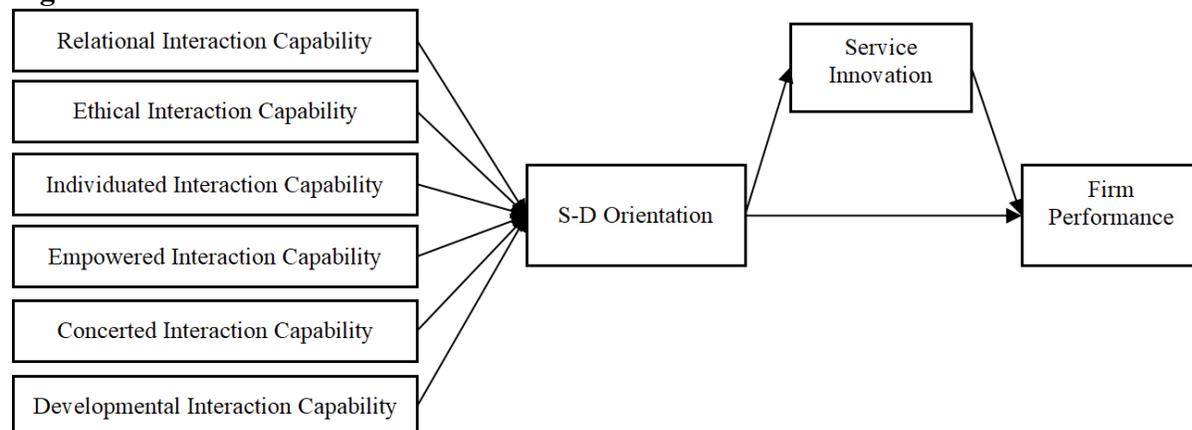
- H3: There is a significant correlation between service innovation and firm performance.

Methods

Research Context

IATA (2019) estimates that Turkey's air transport market will grow 109% under the “current trends” scenario in the next 20 years. This means that an additional 91 million passengers will travel by 2037. Thus, this increased demand will result in a return of approximately \$ 94 billion in GDP and 1.5 million jobs. This situation shows that Turkey has a great market in terms of passengers. Therefore, the study data were collected from airline passengers in Turkey, with an online survey. Senior managers and the marketing academicians were interviewed about the content of the survey before its implementation. Basically, the survey is rated by using 5-point Likert scale (1-Strongly Disagree, ..., 5-Strongly Agree) and covers dependent and independent variables of the study. 767 returns were received. Upon the exclusion of the uncompleted and incoherent surveys, only 563 of them were used for the analysis of the hypotheses, and Figure 1 shows the research model of the study.

Figure 1. Research Model



The study has three major hypotheses based on S-D orientation, service innovation, and firm performance. The S-D orientation has six interaction capabilities (RIC, ETIC, INIC, EPIC, CIC, DIC). The interaction capability items were consistent with those in the study of Karpen et al., (2015) and individually measured with twenty-four questions. The service innovation items were consistent with the Elche and González (2008)’s studies and the service innovation scale

measures with six items. And for the firm performance scale, the researchers used the scale in the study by Deshpandé et al., (1993) and measured it with four items. For the measurements of the constructs, a 5-point Likert scale ranging from ‘strongly disagree’ to ‘strongly agree’ was used.

Findings

PLS-SEM (Partial Least Squares-Structural Equation Modelling) method was used in the study to test the hypotheses. The PLS-SEM model has become a popular method for testing the relationships between variables. In this model, a PCA (Principal Component Analysis), and OLS (Ordinary Least Squares) regression is applied to predict the relationships (to maximize the explained variance and minimize the error terms of the endogenous constructs) (Hair et al., 2017). The results of the model are measured by a two-step process; assessing the measurement model and then the structural model.

Primarily the validity and reliability analysis of the scales was performed. The measurement model includes outer loadings, composite reliability (CR), convergent validity, discriminant validity, and Cronbach’s alpha (Table 1). The outer loadings of the constructs’ items are above the threshold value of 0.7 (Hair et al., 2014). And the Composite Reliability (CR) and Average Variance Extracted (AVE) values of all constructs are above the threshold value (CR>0.7; AVE>0.5) (Bagozzi & Yi, 1988; Fornell & Larcker, 1981). The Cronbach’s Alpha reliability results of the structural model showed that the constructs had high reliability.

Table 1. Measurement Model Statistics

Construct	Items	Loadings	CR	AVE	CR’s Alpha
Relational Interaction Capability	RIC1	0,814	0,900	0,693	0,852
	RIC2	0,884			
	RIC3	0,808			
	RIC4	0,821			
Ethical Interaction Capability	ETIC1	0,758	0,891	0,672	0,836
	ETIC2	0,852			
	ETIC3	0,842			
	ETIC4	0,823			
Individuated Interaction Capability	INIC1	0,877	0,934	0,779	0,905
	INIC2	0,892			
	INIC3	0,893			
	INIC4	0,868			
Empowered Interaction Capability	EPIC1	0,791	0,891	0,672	0,837
	EPIC2	0,867			
	EPIC3	0,815			
	EPIC4	0,805			
Concerted Interaction Capability	CIC1	0,876	0,921	0,744	0,885
	CIC2	0,907			
	CIC3	0,777			
	CIC4	0,886			
Developmental Interaction Capability	DIC1	0,832	0,910	0,717	0,868
	DIC2	0,885			
	DIC3	0,866			
	DIC4	0,801			
Service Innovation	SERVIN1	0,822	0,937	0,713	0,919
	SERVIN2	0,831			
	SERVIN3	0,855			
	SERVIN4	0,864			
	SERVIN5	0,875			
	SERVIN6	0,817			
Firm Performance	FPER1	0,761	0,915	0,731	0,876
	FPER2	0,873			
	FPER3	0,906			
	FPER4	0,872			

For discriminant validity, the square root of AVE shown in parentheses (Table 2) should be greater than the absolute values of these correlations (Fornell & Larcker, 1981). The results showed that all the constructs met this criterion. Therefore, the measurement model of the study had enough convergent and discriminant validity.

Table 2. Construct Correlations and the Squared Roots of AVE

	RIC	ETIC	INIC	EPIC	CIC	DIC	SERVIN	FPER
RIC	(0,832)							
ETIC	0,693	(0,820)						
INIC	0,654	0,627	(0,882)					
EPIC	0,663	0,601	0,732	(0,820)				
CIC	0,748	0,722	0,669	0,705	(0,863)			
DIC	0,674	0,625	0,675	0,720	0,775	(0,847)		
SERVIN	0,636	0,554	0,605	0,664	0,708	0,690	(0,844)	
FPER	0,535	0,469	0,507	0,533	0,576	0,524	0,806	(0,855)

Note: Diagonal components are the squared roots of the AVE scores.

The bootstrapping technique (5,000 re-samples) was applied and the T statistics and the path coefficients of the model were calculated to test the hypotheses of the study. The results of the path analysis and the hypotheses are summarized in Table 3. The results indicated that the direct effect of S-D orientation on service innovation was positive and significant ($\beta = 0.751$, $p \leq 0.01$). The S-D orientation had no significant effect on firm performance ($\beta = 0.025$, $p \geq 0.01$). Also, service innovation positively and significantly affected firm performance ($\beta = 0.785$, $p \leq 0.01$). It was revealed that the H1 and H3 hypotheses were confirmed and the H2 hypothesis was not confirmed. The R² value for service innovation was 0.563 which means S-D orientation variables accounted for 56% of the variance of service innovation. For the firm performance, the R² value was 0.649 (S-D orientation variables accounted for 64% of the variance of firm performance).

Table 3. Direct Effects and Hypothesis Tests

Paths	Paths Coefficients	Standard Deviation (STDEV)	T Statistics ((O/STDEV))	P Values	Conclusion
SDO -> SERVIN (H1)	0,751	0,025	29,919	0,000	Supported
SDO -> FPER (H2)	0,025	0,039	0,569	0,569	Not Supported
SERVIN -> FPER (H3)	0,785	0,034	23,392	0,000	Supported

Conclusions

Theoretical Implications

The study was conducted to examine the relationship between S-D orientation, service innovation, and firm performance. The hypotheses were tested with the survey data collected from airline passengers. The study revealed that S-D orientation did not have a direct effect on firm performance; however, service innovation could have an indirect effect on S-D orientation and firm performance. Therefore, the H1 and H3 hypotheses were confirmed, but the H2 wasn't confirmed.

The first hypothesis of the study in which the sample group including passengers in airline ecosystem was asked to evaluate airline business was established and supported to test whether the S-D orientation had a significant effect on service innovation. Some researchers have suggested that S-D logic has theoretically a significant effect on service innovation. This result shows similarity with the theoretical studies suggesting that S-D logic has an important role in

development of service innovation (Prahalad & Ramaswamy, 2002; Lusch et al., 2007; Lusch & Nambisan, 2015). Prahalad and Ramaswamy (2002) argued that innovations are successful in the value co-creation process. Findings of the study were compatible with the idea that was evaluated by Vargo and Akaka (2009) based on the S-D logic perspective, “not interactions with various stakeholders but creating something else, so innovation will be developed within the service system in an innovation that allows it to create value for the actor”. Value co-creation is a cornerstone of S-D logic researches. S-D oriented innovation value is created together with the efforts of actors on the service system. Customers know how to create the common value of a partner by incorporating or using an offer. Therefore, the customer is positioned as the persona who designates the value of an innovation that emerges through integrating their resources, context, and experience. Managers with S-D logic perspective can define and understand the activities desired by the customers by considering innovations as opportunities. In particular, airlines need to offer services focusing on customer experience, and hence, they need to be constantly renewed or refreshed. Having the capabilities of the S-D orientation of the airline in the airline-passenger interaction allows to see the passengers as joint innovators. It can be stated that as a conclusion, the airlines having the S-D orientation would increase the service innovation.

The second hypothesis of the study tested the effect of S-D orientation on the firm performance and it was found that there was no significant correlation. This finding offers a different result from the studies in the literature (Karpen et al., 2012; 2015; Wilden and Gudergan, 2017). Karpen et al., (2015) state that S-D logic directly affects both customers and business-related performance measurements. Wilden and Gudergan (2017) state that the S-D orientation does not have a direct impact on firm performance but is mediated through innovation such as technological capabilities. Although this result seems inconsistent with the literature, at first sight, it can be stated that the relationship between S-D orientation and firm performance has an indirect effect on service innovation. Therefore, the high S-D orientation of the airlines does not directly affect the performance.

The third hypothesis of the study tested the effect of service innovation on the airlines' performance. The result showed that service innovation had a statistically significant and positive effect on the airlines' performance. This result shows parallelism with the studies reporting that creating service innovation by using the innovation capability of a firm positively affects the firm performance (Hult et al., 2004; Panayides, 2006). Firms that are displaying innovation skills can reach leadership positions in the market where it operates. Therefore, service innovation provides value to the firms because of strategic advantages.

Managerial Implications

This study helps to create knowledge that combines observable reality and normative understanding with a managerial perspective by experimentally testing the S-D perspective in the concrete context. The results indicated that the airline businesses benefited from the value co-creation opportunities as a result of interaction with their passengers. Theoretically, S-D logic provides a mentality that guides managers in strategic decision making within a cognitive framework. The study is important for managers to better figure out the abilities that make up the S-D orientation and to decide which skills should be developed. The S-D perspective adopted by decision makers will help lay the foundation for specific talent development programs and

investment decisions to increase firm efficiency and effectiveness. In this context, the business manager could also support the rethinking of service in the industry by refocusing on service and value.

At the point reached in production and consumption activities, it is seen that businesses manage processes in a way that includes all ecosystem actors and customers take a more active role in these processes. The S-D perspective, where value is produced jointly, allows businesses to reshape their organizational structures, as well as increasing interactions in customer relationships, leading to more effective relationships than traditional methods. The S-D approach, which causes customers to take an active role in the organizational processes of the enterprises, also causes the service innovation activities to increase as it will provide information flow to the business about determining the demands and needs of the customers. Thus, ensuring the participation of the customer, who is the co-creator of value, in the production activities brings about an increase in business performance with service innovation. In this sense, airline companies should review again their organizational structure with an S-D perspective and train their employees in this direction with the awareness of the value co-creator of their customer's role.

This study makes contributions to the literature by investigating S-D logic from a firm strategy perspective. The services in the centre of the competitive advantages of firms can be enjoyable, efficient, and successful when created in collaboration with customers (Karpen et al., 2015). Excellent customer experiences will provide benefit in terms of not only the customer relationship but also the service innovation and indirectly firm performance. As the number of firms focusing on improving customer experiences increases, the need to create the conditions that facilitate and improve service design and focus on the service platform arises.

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