Chapter 1

Service–Dominant Logic
Foundations of E–Novation

Stephen L. Vargo
University of Hawaii at Manoa, USA

Robert F. Lusch
University of Arizona, USA

ABSTRACT

A major change is taking place in most national economies, and even the world economy. It has been variously described under rubrics of globalization, global flattening, and global outsourcing, and has resulted in debate over how firms and nations gain and retain competitive advantage. Innovation has become perhaps the most often used term to capture the process of achieving this competitive advantage.

INTRODUCTION

Frequently, along with noting the change in globalization, time-series statistics on employment in different sectors of the economy are offered as evidence of the direction firms and nations need to move. The data suggest that relatively fewer people are working in agriculture and other extractive industries, such as logging, mining, and fishing and fewer also are working in manufacturing sectors. They also indicate that there has been a corresponding ascendance in what is characterized as “services” industries. That is, the developed countries, if not the global economy in general, is going through a service revolution and the world is moving toward a service economy. Thus, not surprisingly, the mantra has become: to be globally competitive, firms need to learn to innovate in services.

We disagree. Rather, though it might appear paradoxical (if not incoherent), we argue that, whereas the world economy is going through a significant shift and the national and global economies are service based, there is no services revolution there is just a service revelation. That is, what appears to be a services revolution is an artifact of wrong thinking about economic exchange. We argue that economic activity has always been
primarily about the exchange of service— one party using its knowledge and skills to do something for another party, under conditions of reciprocity. We call this orientation service-dominant (S-D) logic and contrast it with goods-dominant (G-D) logic, the traditional orientation, in which services are seen either as add-ons to goods (e.g., after-sale service) or a special (often inferior) class of (intangible) goods.

On the other hand, we suggest that there is an economic (and social) revolution taking place, one that is having a profound impact on our view of economic activity. It is a revolution dealing with the manner in which we can detangibilize, store, and transmit information, which, together with the natural progression in development of specialized knowledge and skills, is making the real nature of exchange more apparent and compelling. In short, there is an information technology (IT) revolution and an information communication technology (ICT) revolution, which, together, are revealing that economic activity is actually all service based, rather than goods based.

This distinction is important as we wrestle with issues of innovation, because the locus and process of value creation, and thus of innovation, are strikingly different in a goods-centered and a service-centered model, regardless of whether innovation is being discussed in relation to an organization traditionally characterized as “manufacturing” or “services,” local or global, or profit or non-profit. The advances in IT and ICT, along with increasing specialization, reveal a service logic that points toward a model of innovation in which electronic, digital information and communication are at the heart of developing new interactive and collaborative, networked approaches to value creation, such as “open innovation,” “customer-initiated innovation,” and the “democratization of innovation” (e.g., von Hippel, 2005). It points toward E-Novation, innovation reframed in terms of collaboration in resource integration through collaborative platforms for value creation.

In the following sections we will: (1) contrast goods-dominant with service-dominant logic and show why Adam Smith, and thus economic science and business, relied on what has become known as G-D logic as the key to wealth creation, based on conditions of world trade and purposes of scholarship which do not apply today; (2) elaborate the foundations of S-D logic; (3) explore the concept of service ecosystems as value creation platforms and (4) explain how S-D logic and a service ecosystems conceptualization can provide a foundation for E-Novation.¹

CONTRASTING GOODS-DOMINANT WITH SERVICE-DOMINANT LOGIC

The easiest way to conceptualize S-D logic is by contrasting it with G-D logic. In its most rudimentary form, goods-dominant logic postulates the following (see Vargo and Lusch 2004):

1. The purpose of economic activity is to make and distribute products, ideally tangible goods, at a profit.
2. These products are embedded with value (utility) by the firm(s) during the production and distribution processes.
3. To maximize profits, production efficiency should be maximized; thus the (ideally tangible) good should be standardized, produced away from the market, and inventoried until demanded.

In short, the purpose of the firm is to make value-laden, (ideally) tangible goods efficiently and sell them at a profit. In this logic, “services” are seen either as add-ons to goods (i.e., value added, such as after-sale service) or a particular type of good, characterized by their intangibility, inability to be standardized (heterogeneity), inability to be produced away from the market (inseparability) and inability to be inventoried (perishability) (Zeithaml, Parasuraman & Berry, 1993).