

Evolving Service Innovation for The Late-mover Industry: The Case of Islamic Banking

Ruspita Rani Pertiwi*

Islamic Banking Department, Faculty of Islamic Economics and Business
Universitas Islam Negeri Sunan Kalijaga Yogyakarta

*Corresponding author: ruspitarani@gmail.com

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ABSTRACT

Research Aims: This paper investigates how, as a late-comer industry, Islamic banking in Indonesia evolved service innovation in order to attract customers and compete with established conventional banking.

Design/methodology/approach: This qualitative research examines Indonesian Islamic Banking as a case study. This study involves two stages: investigating the case in-depth, detail, and context analysis using secondary data from various sources and in-depth interviews with stakeholders. Triangulation was employed to validate the entire result using various methods and data source triangulation.

Research Findings:

This research reveals that the development of service innovation in late movers is influenced by the sort of industry, the goals and values of the new industry's establishment, the resources owned, and market characteristics. While the dimensions of service innovation developed by late movers typically focus on new value systems, they emphasise value; meanwhile, in terms of technical or working models of the innovation, they tend to replicate or modify from first movers.

Keywords: service innovation, late-mover industry, Islamic Banking

INTRODUCTION

Background of the Study

The banking industry will be the fourth most affected by digital disruption (Bradley et al., 2015). In response to digital disruption, financial technology offers faster technology, greater capacity, faster access, and greater accuracy. These changes impact customer needs and desires for product and service offerings, allowing companies' revenue and business model to change. New digital disruption values will replace current banking service values, making service innovation more important.

The ability to anticipate changes in customer behavior, needs, and expectations through better design services and the creation of new service concepts for the solution is referred to as service innovation (P. den Hertog, 2010a). Service innovation is frequently associated with organizational performance (Lin, 2013), with the implication being market share related to customer engagement and financial performance. The relationship between those variables may not be direct, but may be mediated by customer perception and

behavior toward the service, such as satisfaction with the service, perception of brand value, perception of service quality, and loyalty to the service provider (Gounaris & Tzempelikos, 2009). This phenomenon is also observed in the banking industry.

Commercial banks and rural banks are the two types of banks accepted by Indonesian banking law. Commercial banks are distinguished from rural banks by the fact that the latter are not directly involved in the payment system and have limited operational areas. In terms of operational definition, Indonesian banks are classified as non-Sharia and Sharia-compliant commercial banks (Otoritas Jasa Keuangan, 2019). Sharia-compliant commercial banks are also referred to as Islamic banks. This research uses Indonesian Islamic Banking as a case study.

Islamic banking operations refer to Islamic law, which employs the partnership and mutual benefit principle to provide an alternative banking system that benefits both the public and the bank. This banking system ensures transactional fairness and ethical investment. Conventional banking is prohibited by Islamic law because it uses a system that is not in accordance with Islamic law, such as interest (*rib*), gambling (*maysir*), uncertainty (*gharr*), and other prohibited (*harm*) elements (Otoritas Jasa Keuangan, 2020). Given that Indonesia has an 80% Muslim population, some scholars believe that establishing Islamic banking is an alternative solution for Muslims and a promising business opportunity.

Indonesian Islamic Banking serves as a case study for two reasons. For first off, Indonesian Islamic Banking has been present in Indonesia for over 25 years and has seen significant growth in terms of the number of institutions, assets, financing, and deposits. However, the rate of development remains below the regulator's target. The target market for Indonesian Islamic Banking is the Muslim community, with a market share of around 5.94% today (Departemen Perbankan Syariah, 2015). Market share is one indicator of customer engagement as a result of customer perception and satisfaction with the company's product or service; at this point, Indonesian Islamic Banking should reconsider its service innovation strategy.

The second reason is that Indonesian Islamic Banking faces three levels of service innovation challenges. Indonesian Islamic Banking establishments provide Muslims with innovative halal solutions to modern financial problems. Meanwhile, it derives from religious values, of which there is no 'working model' in operational services (Laldin & Furqani, 2016). Indonesian Islamic Banking will be considered a competitor because it operates in the same industry as conventional banking. Conventional banking is regarded as a first mover in the banking industry; it has existed in Indonesia since 1828 and is regarded as a mature industry, whereas Indonesian Islamic Banking, as a late-comer banking system, is still seeking an identity in terms of service provision. Meanwhile, both banking systems are currently experiencing digital disruption, which necessitates more service innovation than ever before.

Objective of the Study

The purpose of this study is to investigate how Indonesian Islamic Banking, as a late-mover evolving service innovation, can create solutions for customers and gain a competitive advantage over competitors. This paper addresses three core research questions: the initial one is regarding service innovation implementation in Indonesian

Islamic Banking; the second focuses on the Indonesian Islamic Banking service innovation typology; and the third is about service innovation in late-mover industries.

Those three research questions arise to answer this paper's purposes. The paper aims to create a map and typology of service innovation implementation, capture lessons learned about late movers in evolving service innovation, record emerging organizations in designing an "operational framework" of religious values into services and, at the same time, compete with established industry.

This qualitative paper has four sections. The first section, the introduction, explores the phenomenon, why this study is essential, and research questions and novelty. The second section is a literature review; it presents the structured literature review as a theoretical foundation. The third section presents a methodology that provides how conducted this research. Next, section findings and implications of the findings. Finally, the conclusion and recommendation offer a future research agenda and the research limitations.

LITERATURE REVIEW

Service Innovation in Banking Industry

Service according to classis literature defined as "an activity of more or less intangible nature that normally, but not necessarily, takes place in interactions between the customer and service employees and physical resources or goods and the service provider, which provides as solutions to clients problems" (Gronroos, 1984). With service-dominant logic, service is the fundamental basis of exchange. Service is the process of using one's competencies (knowledge and skills) for the benefit of another party, while goods act as distribution mechanisms to provide services. Furthermore, the customer is always a co-creator of value (Fadhila et al., 2022; Wieland et al., 2016; Vargo & Lusch, 2004).

As services become more important for society and customers demand more complex and personalized solutions, research is more intense to understanding their innovation processes. Service innovation and new service development processes are becoming priorities for academic research. One of the most significant contributions said that service innovation followed a 'reverse product cycle' (Hanif & Asgher, 2018; Kubeczko et al., 2006 Barras, 1986).

Service innovation may refer to new service design and development, process, and organizational innovation (P. den Hertog et al., 2010; D. Hertog & Innovatie, 2016; Lay Hong et al., 2016). It can be related to changes in the concept of a service, the client interface, the delivery system, or technological options. It creates value for customers, employees, business owners, alliance partners, and communities through new or improved service offerings/processes/business models (Ettlie & Rosenthal, 2012). Service innovation's goals are generating solutions to the customers' problems, which provide added value for both customers and companies (Pertiwi et al., 2020).

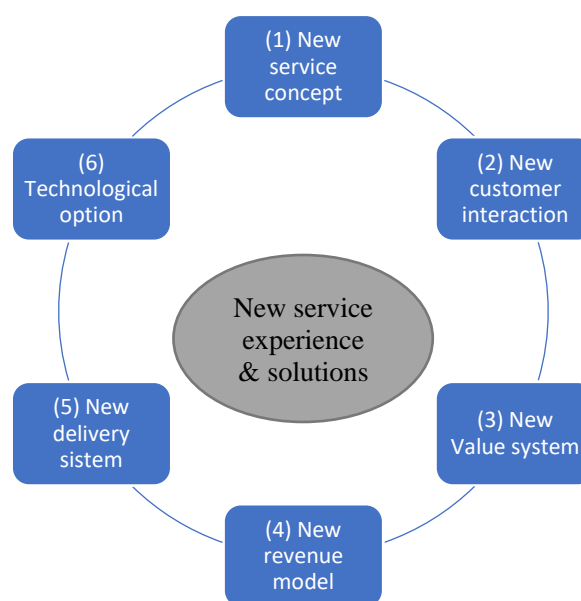
The banking industry is now competing based on services rather than physical products, as it is hard to distinguish between products of competing brands in each product category (Lay Hong et al., 2016). It is the service offered by the banks that manifests actual value. Although banks are service oriented, they still have products such as investment instruments, including stocks, bank deposits, and lending instruments, such as loans and credit cards (Romanova & Kudinska, 2016).

Innovation is vital in recent banking research; this consideration for the customer and anticipation of their future needs has become one of the leading concepts in business excellence. Knowing that service excellence is of great value, a bank can differentiate from the competition based on customers' selection criteria by attracting new customers and building effective long-term relationships with them, leading to a remarkable competitive advantage (Lymeropoulos et al., 2006; OECD, 2020).

Service Innovation Dimensions

Previous research propose service innovation dimensions and the most common use is the Carter dimension, called service quality (servqual), and contains compliance, assurance, reliability, tangibility, empathy, and responsiveness (Khan, 2016). The other dimension is the Six-Dimensional Model of service innovation, which comprises new service concepts, customer interaction, value system, revenue model, delivery system, and technology (P. den Hertog et al., 2010; Mahpudin, 2022). Other researcher proposed 4P's of Innovation models consists of product innovation, process innovation, position innovation, and paradigm innovation (Bessant & Tidd, 2013); three service innovation dimensions: the Bank provides reliable and effective remote banking services; Products updated continually, and Flexible products that meet customer needs (Blommerde & Lynch, 2017; Eisawi, 2012); and the last proposes dimensions that consist of new service development, new technological options, new customer-firm interface and new service delivery system (Lin, 2013). This research uses the Six-Dimensional Model of service innovation from (P. den Hertog, 2010b).

Six-Dimensional Model of service innovation from (P. den Hertog, 2010b) as shown in figure 1 below, consist of new service concept, new customer interaction, new value system/business partners, new revenue model, new service delivery system, and technological option. The six-dimensional model is the upgraded version of the Den Hertog's 4-Dimensions Model that consist of service concept, client interface , service delivery systems and technology options (Kubeczko et al., 2006).



Source: Den Hertog (2010).

First-mover and Late-mover Service Innovation

Islamic banking emerged in modern times with no clear precedence on the operational framework of financial intermediaries in the Islamic framework. Contemporary Muslim scholars and financial practitioners have no option but to rely on conventional economic structure/model because of the past's absence of a 'working model' of banking institutions. They put their effort into producing a prototype that captures all the Islamic principles in financial practices and is also viable to operationalize in a modern context (Laldin & Furqani, 2016). Critics of the concept of Islamic finance do not see any difference between Islamic and conventional economics; if any exists, it is artificial and not substantive. Changing the names, titles, or designations for such products does not alter the distinguishing nature and element of what is Islamic and what is not (Al-Salem, 2009). There is a strong relationship between product and service innovation with market attention; the more innovative Islamic banking makes the product and services, the faster the market will grow.

The term a first mover is the company that is the first to enter a market with a commercial perspective. Early followers are the companies that enter an existing market early; meanwhile, late followers are the companies that enter a mature market. Differentiated followers are the companies that create a niche in an already existing market. Me-too followers are the companies that enter an existing market with existing products (Fjelkner et al., 2004). First-mover advantage is the advantage that gives the first mover a competitive advantage by being the first mover. The second-mover advantage is a competitive advantage from which the first mover cannot gain. The finding reveals that first-movers with the ICT-driven service innovation may not have the same as those in the manufacturing industry; the service innovations are easy to be imitated by competitors (Shang & Wu, 2012).

RESEARCH METHOD

This qualitative study is a case study that examines in-depth Indonesian Islamic Banking service innovation as focused samples. The data collection process consists of two steps. The first step is desk research to answer the first research question (Bassot, 2022), and the second step is qualitative research to answer the second research question. The first procedure is to develop a service innovation implementation map by critically examining secondary data (companies' annual reports, previous research, national news, and websites) (Hollweck, 2016). This context analysis process employs all Indonesian Islamic Banking (14 banks) and is assessed using six-dimensional service innovation from den Hertog. The inter-rater assessed this process (three researchers already trained in six-dimensional service innovation) to validate the data. The output of this process is answers the first research question: how is service innovation implementation in Indonesia Islamic Banking. Figure 1 illustrates the flow of this study.

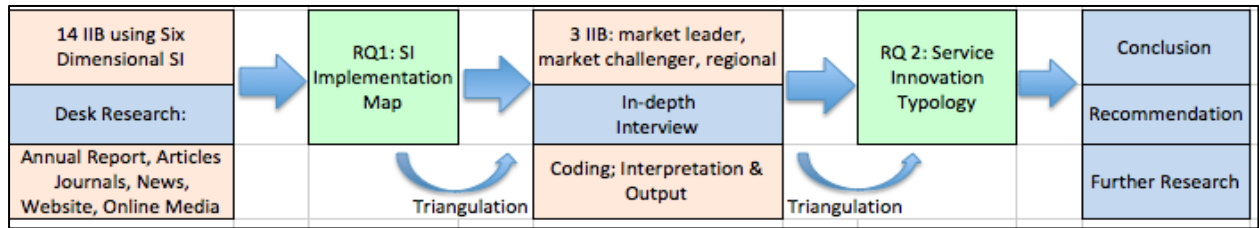


Figure 1. Research Design Flowchart

The second step of the research process is conducting in-depth interviews in August 2019 with six managers related to service innovation at three Islamic banks in Indonesia (State-owned enterprise (SOE), private, Regionally Owned Enterprise (ROE)). The semi-structured interview lasted approximately 120 minutes. The interview questions elicit information about the bank's service offering, the implementation of service innovation, and the challenges and obstacles to developing service innovation. The next step is triangulation to validate in-depth interviews with Indonesian Islamic Banking stakeholders, which include OJK members as regulators and customers of Islamic/conventional banking.

RESULTS AND DISCUSSIONS

Service Innovation Implementation at the Indonesian Islamic Banking

This qualitative study investigates 14 Indonesian Islamic Banking as samples, employing the six-dimensional service innovation from P. den Hertog by inter-rater, and utilizing desk research from various secondary data sources (Bassot, 2022). As a result, table 1 depicts the implementation of service innovation in Indonesian Islamic banking as an answer to the first research question. Following this map, we triangulate with an in-depth interview with stakeholders.

Table 1 (in the appendix section) shows that only two Indonesian Islamic Bankings create new services, while three others add value to or modify conventional banking. The rest of those fourteen banks tend to replicate or modify their parent banks' services (conventional banking). The two Indonesian Islamic Bankings that create new service innovation are the market leader and the market challenger in Indonesian Islamic Banking. They actively raise awareness of the importance of service innovation in serving customers and competing with either Indonesian Islamic Banking or conventional banking, as mentioned by (Khan, 2016; Ullah et al., 2020).

When this finding was cross-checked through interview analysis, it was discovered that some Indonesian Islamic banks already conduct innovation competitions or sharing to stimulate innovation. However, some barriers emerge, such as (1) a limited human resource that has mastered both banking and Sharia law, making it difficult to create innovation in banking while also fulfilling Sharia compliance; (2) difficulties in designing new service innovation because innovation in the banking industry is already robust and established; and (3) while learning to strengthen management, they must also move forward, so the most efficient choices are modified.

Service Innovation Dimensions at the Indonesian Islamic Banking

This paper tests the six-dimensional service innovation implementation at Indonesian Islamic Banking using secondary data, as shown in table 1 (in the appendix), and then summarizes the surfaced dimensions. Table 2 shows the results.

Table 2. Service Innovation Dimensions in Indonesian Islamic Banking

No.	Dimension	Number of Islamic Banking that implemented
1.	New service concept	2
2.	New customer interaction	10
3.	New value system/ business partners	13
4.	New revenue model	12
5.	New service delivery systems	11
6.	Technology options	10

Table 2 shows that the majority respondent (13 out of 14 Islamic banks) focus on the third dimension i.e., new value system. It has two causes; first, regarding the new values system, Indonesian Islamic Banking wants to create a service that contains values as the manifestation of Islamic or Sharia law, and then considering a set of new business partners, Indonesian Islamic Banking tends to prevent customer who is interested in Indonesian Islamic Banking. On the contrary, Indonesian Islamic Banking focuses on dimension one only two banks, which means Indonesian Islamic Banking still needs to create innovation in their services productively. Other dimensions show that Indonesian Islamic Banking services are modified from conventional banking. This inline with previous research by (Dusuki, 2008; Khan, 2016; Pertiwi et al., 2021).

Service Innovation service innovation in late-mover industry

As a latecomer, Indonesian Islamic Banking encountered challenges in evolving its service innovation to compete with conventional banking, which was the first mover (Chang et al., 2015; Querbes, 2017). Indonesian Islamic Banking remains committed to its original mission, that its market is Muslim and concerned with Sharia values, but data show that only 8,64% of its customers meet these requirements. As a component of the banking industry, Indonesian Islamic Banking should serve as more than just a legal means of avoiding *riba* or other prohibited transactions.

Because the banking industry has strict government oversight and clear standards, creating service innovation is a difficult process. Islamic banking, which is also based on Sharia law, adds a layer of stringent regulations to the process of developing a service. A value derived from Islamic values must be adapted to the modern financial industry's rapid development. Meanwhile the presence of disruption in financial technology raises the importance of innovation in the service sector (Gideon, 2019; Komaladewi et al., 2012; Romanova & Kudinska, 2016).

Islamic banking services development as a late-mover pattern: (1) tracing the services offered by conventional banks as first movers, then minimizing things that are prohibited by Sharia law (*haram*), such as interest (*rib*), uncertainty (*gharr*), and gambling (*qimar*); (2) attempting to integrate both products and services, either by changing or adding features from first mover services; and (3) developing completely new service innovations. The first

and second points of that pattern have a significant impact on perspectives and public trust, both of which need to be strengthened. The public perceived Islamic banks to be conventional banks "wearing skullcaps" or conventional banks labeled with Islamic terms.

The challenges of developing service innovation in Islamic banks in the future, on the one hand, must be more genuine (i.e., genuinely reflect the shariah principles), solid (indeed based on the shariah requirements) and comprehensive (truly reflect the objectives of shariah) (Hamad et al., 2016; Laldin & Furqani, 2016; Shafiq et al., 2016). Nevertheless, on the other hand, it must remain following the context of the times in improving services to customer needs. For this reason, qualified human capital is needed, namely those who know business and sharia knowledge, as well as support from the legal and regulatory framework from both the DPS and DSN and from business stakeholders.

CONCLUSION AND RECOMMENDATION

Evolving service innovation for late-mover, such as Indonesian Islamic Banking, can be benefited because the banking system is already established by conventional banking. The risk is then to be difficult to win or at least equal. In the condition that there is no operating framework, Indonesian Islamic Banking uses a modified approach from conventional banking services; consequently, Indonesian Islamic Banking performance needs to catch up. Service innovation in Indonesian Islamic Banking still maintains the strategy of "imposing" sharia values in its service so that what happens is not the profit being pursued. Suppose Indonesian Islamic Banking sticks to this strategy and that Indonesian Islamic Banking's vision is for the people's welfare. In that case, Indonesian Islamic Banking can put themselves as "differentiated followers" or the companies which create a niche in an already existing market. Suppose Indonesian Islamic Banking still believes that the Muslim majority is a potential market. In that case, the service innovation development must be the same as the banking industry, facing disruptive digital challenges but still within the sharia law corridor. Further research could examine the service innovation strategy in different industry cycles so it can recognize opportunities and balance them with risks.

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Appendix

Table 1. Service Innovation Implementation in Indonesian Islamic Banking

Indicator	(1) BSM	(2) BNI Sy	(3) Bank Muamalat	(4) Bank BRI Sy	(5) Bank Mega	(7) Bank Aceh	(8) Bank Bukopin	(9) Bank Panin Sy	(10) Bank NTB	(11) Bank Victoria Sy	(12) May-bank Sy	(13) Bank BTPN Syariah	(14) Bank BCA Sy
New Service concept or offering	- BSM OTO (new and second hand car & motorbike financing)	Hasanah Lifestyle as an Islamic lifestyle information app; Hasanah Personal as a simulation app for KPR and Umrah package;	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
New customer interaction and the role customers play in the creation of value	- Aisyah (Chatbot, Artificial Intelligence based) - BSM Sahabat (member get member program)	New features of the Hawalah contract: Ujrah & FLPP Products; Utilization of Cash Mngmt (BNI Direct) features; Integrated Handling Complaint System; EDC	- Promote the #Ayohijrah campaign by creating reliable products that are in the best interests of Islamic Community.	Improve BRIS Online (mobile banking); Elektronik form through eform.BRISyariah.co.id; BRIZZI BRIS (Co Branding)	Giro Utama IB Fasilitas virtual account, EDC, dan CMS, MMQ, Berkah IB	Tabungan Seulanga IB, Tabungan SIMPEDA IB	N/A	N/A	Creating services for migrant workers abroad, because those from NTB are quite large	N/A	N/A	Give various training provided at no cost for customer about financ mngmt and entrepreneurship for SMEs	Development of Sharia Bank Account Financing applications, Virtual Accounts,
New value system or set of new business partners	Sinergi Mandiri Group; BPR Host to Host; Remittance Products (Transfer D.U.I.T, BSM Transfer Valas, Western Union, Nusantara)	Sharia Channelling Office (SCO) and Collocation; Waqara & ITQON for Halal Tourism; Ustadzku for the field of Education; E-Procurement; Islamic Financial literacy programme	Intl remittance service; Improvement of School Education Solution; Digital platform for Mosque; Financing program for Islamic Organizations; Cooperate with Fintech	Coop with digital marketplace; Giro Faedah Government Segment; Cooperates with Hajj Organizing Team; the only sharia bank that cooperates with the Jakarta Hajj Hospital.	Prima dan Mega Net network; Developing service channels through synergy with Transmart and the Ministry of Religion Office; Develop a synergy of alliances with CT Corp	Linkage Financing Distribution (BPRS/BQ/Koperasi) ; Syndicated Financing; Jak Geutanyoe Menabung; Bank Aceh Lam Peukan (BALAP); Bank Aceh Saweu Campus (BASECAMP)	The Company has also cooperated with the Health Insurance Administering Agency (BPJS) in the Supply Chain Financing (SCF)	Partnership financing with sharia financial institutions (LKS)	Improve service that support local governments as regional cash holders who are the captive market for the Bank	Company Collective Financing	NA	develop a digital platform for bank agents, so that service becomes more extensive, and also opens new business opportunities.	Focus on channelling financing for commercial and MSME customers.
New revenue models	- Pembiayaan Dana Berputar - Pembiayaan Umrah - BSM Pembiayaan Warung Mikro	Microfinance transformation;	Focus on fee-based income from all segments, especially transactional banking business segment and the optimal utilization of the Hajj fund.	BRISSMART / Laku Pandai Service; Mikro Faedah IB and KUR IB (microfinancing); Current Accounts Saving Accounts (CASA)	-Change business segment from micro business to commercial business, consumer retail, and joint financing	Changing the composition of productive financing, optimizing potential per economic sector, Growth in Financing of SMEs, implementing the KUR and Linkage Program,	Launched a new financing product namely IB Musyarakah Mutanaqisah (MMQ) Financing	N/A	Remapping and establishment of operational zones after the conversion	Treasury dept: ALMA and AlysCo meeting	NA	Exploring fee-based income: coop with third parties/e-commerce/fintech in the development of financial or non product services.	Prudent financing distribution : focus on Umroh and Iogam mulia
New delivery system: personnel, organization, culture	Two firewall security devices in DC to protect the Company in providing excellent and safe	Flexible thematic marketing program;	Develop HC with appropriate ability and specific skills.	-Core values : PASTI OKE -workshops and trainings of the corporate members	NA	NA	B-secure	ICARE Corporate Culture; Daily & Weekly Activity Report (DAR-WAR) conducted on line	NA	Sales Tracking System	Personal Dev Program (PDP)	Employee rotation Gallup's Strength-Based; build online training programs w/ gamification systems	Most BCAS training programs have been integrated with e-learning systems.
New service delivery system: technological	"Two Site DC Topology" yang terdiri dari DC dan Disaster Recovery Center (DRC); BMS Mobile Banking (New Features & Multi Platform)	Halal Travel Card; IB hasanah card in collab with the academic community; DigVerse concept: Literation, Inclusion, Transaction, Distribution and Advocacion	Development of e-Channel Payment System Services	- BRISPay QR Code based shopping payment transactions - core digital banking T24 SYIAR	Information Technology network development to support synergy with all business partners	Development enhancement of reliable and responsive IT systems, as well as innovation of ITbased finance, funds, treasury products.	Rejuvenated two firewall security devices in the data center	N/A	NA	NA	NA	Launched m-Prospira digital mobile front end applications to more than 10,000 users in Tunas Usaha Rakyat (TUR)	Advanced App & Network Development : Core Banking System; Network Expansion and Distribution Channel