# Product and Service Innovation within Small Firms: An Exploratory Case Analysis of Firms in the Restaurant Industry

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**ABSTRACT**

*This exploratory study examined predictors of product and service innovation within a small group of independently owned and operated restaurants located within the same geographic market. Based on interviews with owners and managers, results indicate that small firms engage in innovation for a variety of strategic reasons, that small firms may be just as likely to engage in innovation as a defensive mechanism to counter moves of competitors as to utilize innovation as an offensive market maneuver, and that, even though many past studies have failed to find significant relationships between elements of the external environment and innovation in small firms, the recent economic downturn has resulted in product adaptations in firms being targeted more specifically at reducing costs, increasing margins, or both. Implications and suggestions for future research are provided.*

Innovation is frequently a key source of competitive advantage in small firms and may contribute directly to the long-term success and viability of operations (e.g., Wolff and Pett, 2006). Small firms are frequently incubators of innovation and, relative to larger firms, tend to be less formalized, more flexible, and thus, may be better equipped to promote innovation (Palmer, Wright, and Powers, 2001). A number of past studies have found that aspects of competitive environments may prompt firms to engage in innovation, with firms operating in hostile competitive settings engaging more frequently in innovation (e.g., Covin and Slevin, 1989). However, studies by Wolff and Pett (2006) and Palmer and Wright (2008) reported non-significant relationships between environmental hostility and innovation. Authors of these studies noted that hostile competitive environments may prompt smaller firms to engage more in defensive behavior aimed at conserving organizational resources rather than investing in innovation.

A large number of studies have also examined relationships between competitive strategies that firms adopt and rates of innovation. Perhaps not surprisingly, many of these studies have reported positive associations between the adoption of proactive competitive orientations (characterized by placing an emphasis on such factors as risk-taking and a strong market orientation) and innovation in firms (e.g., Slater, 2006). Within such firms, innovation may become an integral ingredient of a firm's overall strategic orientation (Olson, Slater, and Hult, 2005). Innovation in firms may also be impacted by resource availability. For example, studies by Moche and Morse (1977) and Westwood and Sekine (1988) reported positive associations between resource availability and innovation in larger organizations. However, Palmer and Wright (2008) reported non-significant relationships between resource availability and innovation in smaller firms. Thus, findings suggest that smaller firms may be more inclined than their larger counterparts to invest residual resources in activities unrelated to innovation and/or may be more inclined to adopt innovations as a competitive tactic even when resources are relatively scarce. The paucity of consistent results across studies suggests that a number of underlying factors not addressed in past studies may impact innovation adoption in firms. This situation is likely to be particularly true in smaller firms where one or only a few individuals are involved in strategic decision-making.

***PURPOSE***

Utilizing a case analysis approach, the purpose of this study is to examine specific factors contributing to product and service innovations within a group of small, independently owned restaurants operating within the same geographic market. By engaging in case study research, characterized by in-depth interviews with owners and managers, it is hoped that a richer understanding can be gained regarding why product and service adaptations are undertaken within small firms.

Specifically, the purpose of this study is:

1.) To identify strategic reasons why owners and managers have made adopted innovations. In particular, this study will examine whether adaptations were made in an effort to attract new customers, to retain current customers at their current rate of frequenting establishments, or in an attempt to get current customers to frequent their establishments more often (i.e., efforts aimed at market development, stability, and market penetration).
2.) To examine what types of changes owners and managers might have made in response to the recent economic downturn.
3.) To assess potential relationships between owner/manager perceptions of their establishments' key sources of competitive advantage (e.g., price, location, atmosphere, food quality, etc.) and product or service innovations.
4.) To allow owners and managers to discuss in detail any other factors that may have led to product or service innovation within their establishments.
Below, results of the study are reported and suggestions for future research are provided.

***METHODOLOGY***

Seven owners and managers of independently owned and operated restaurants located within a Midwestern city of approximately 40,000 people were interviewed. While interviewers made use of a standardized survey that asked several questions related to owner/manager demographics, firm demographics, number of menu and service innovations made within restaurants over the past three years, strategic orientations, perceptions of resource availability, and overall satisfaction levels with recent financial performance, owners and managers were also encouraged to elaborate in detail about motivations driving product and service innovations made within their establishments. In the past, there has been some confusion among researchers regarding the meaning of the term "innovation" (especially with regard to its relationship with such terms as "invention", "creation", "adoption", and "newness"). However, this study will adopt the definition of innovation proposed by Toal (2006). According to Toal, innovation is "an approach new or novel to the business, to product, process or service changes in the business" (pg. 2). This particular study examines specifically those changes related to products or services.

***RESULTS***

The average age of the seven restaurant owners and managers was 40.6. On average, respondents had 19.1 years of experience working within the restaurant industry and 13.0 years operating their current businesses. The mean number of menu item changes made within the past three years was 12.9 per establishment and the mean number of customer service and other changes in amenities was 8.7 per establishment. Interestingly, owner/managers of two of the firms with a large number of menu item changes (averaging 17.5 such changes over the past three years) and the largest number of changes in customer services and amenities (averaging 25 such changes) reported that the largest number of menu item changes were made in an effort to attract new customers. But, in contrast, 62.5% of customer service and amenity changes were made in an effort to get current customers to frequent establishments more often. Thus, adaptations to menus appeared to be an integral part of market development attempts by these businesses whereas customer service and amenity adaptations were more often made by these businesses as elements of market penetration strategies. The remaining five firms reported that a majority of adaptations to both menu items (averaging 11.0 per restaurant) and service/amenity items (averaging 2.0 per restaurant) were made in an effort to either get current customers to frequent their establishments more often or to maintain current customer visits at their current rates (i.e., market penetration or stability strategies).

A surprising finding associated with two of the businesses with the largest number of menu item innovations, customer service and/or amenity adaptations was that neither business owner characterized his/her competitive strategy as predominately "cutting edge" (e.g., proactive). But, in contrast, three of the remaining five businesses (those that had made fewer adaptations) reported that their competitive strategies were predominately "cutting edge". Contrary to findings from many past studies, these results suggest that there may not always be a direct relationship between competitive strategy and innovation. In fact, one of the two firms with the largest number of adaptations indicated that his firm's primary competition was from franchises and that the firm's strategy when it came to making changes was reactive (e.g., let competitors make changes first then follow suit). Thus, even though the business had made a very large number of changes, most were made in response to competitor moves. This situation provides evidence that many adaptations made by firms may be reactive in nature thus explaining why strategic orientations (i.e., proactive versus reactive) may not always explain the frequency with which such adaptations are made by businesses. Even though virtually all business owners indicated that food and service quality were either equal to or more important sources of competitive advantage than low prices, all owners indicated that the recent economic downturn prompted cost-related adaptations of some type to menu items.

Four of the seven owners indicated that they had recently added menu items with lower cost ingredients in order to boost margins. In addition, two of the restaurants recently raised menu prices in order to compensate for the higher cost of ingredients and one restaurant recently started making use of loss leader menu specials in order to attract customers. While previous studies examining innovation in small businesses have reported non-significant relationships between elements of the competitive environment and rates of innovation (e.g., Wolff and Pett, 2006; Palmer and Wright, 2008), it appears as though, even in the restaurants that normally assume a proactive competitive posture, many of the more recent adaptations to menu offerings had been made in response to changes in the external environment.

### *IMPLICATIONS AND DIRECTIONS FOR FUTURE RESEARCH*

While this study is exploratory in nature and only makes use of information obtained from a small number of business owners, results seem to provide a number of important insights for researchers and practitioners interested in learning more about how and why innovation occurs in small firms. First of all, results suggest that, in addition to assessing relationships between product and service innovations and competitive strategies that firms adopt, studies should also assess the impacts of specific marketing objectives and innovation. For example, some firms in this study made menu and service adaptations primarily in an effort to attract new customers (market development strategies) whereas others made adaptations primarily in an effort to get current customers to frequent establishments more often (market penetration strategies). Therefore, motivations for engaging in such adaptations may vary markedly for firms and may help to explain a portion of the variation in the types and quantity of innovations that small businesses adopt.

This study also provides evidence that small businesses may adopt many innovations in response to moves by competitors. Therefore, researchers may wish to make a distinction between "proactive" adaptations made by firms and more "reactive" adaptations. In the past, many researchers have assumed that innovation is an integral part of a proactive competitive strategy. However, our results suggest that some firms may be more likely to engage in innovation in response to competitive pressures. As a result, some firms adopting reactive competitive strategies may engage in innovation as frequently as those firms with more proactive strategies. The fact that most owners and managers reported that product and service adaptations were made primarily in an effort to retain current customer bases or to get current customers to frequent establishments more often also points to an interesting phenomenon in that respondents may have generally viewed their target markets as consisting of a finite number of individuals. If this is the case, then unlike many larger firms with broader market reach, smaller firms located in small geographic markets may not rely to the same extent on growth-based strategies generated through innovation. Thus, motivations for engaging in innovation may vary significantly by firm size, geographical location, and/or perceptions of market reach.

Finally, results indicate that, despite owner perceptions of the main sources of competitive advantage for businesses, the recent economic downturn also had an impact on recent menu item changes. While some past studies have indicated that, with regard to engaging in innovation, many small business owners and managers are not overly-responsive to changes in the external environment, findings here suggest that the perceived severity or criticality of those environmental changes may impact relationships with innovation. As a result, the time period over which studies are conducted may also have a moderating influence on observed relationships. For comparability purposes, this research examined factors contributing to innovation in small firms in a single industry sector that were located in a one geographic market. However, future studies should focus on examining businesses in other sectors and across different geographic markets. These types of studies will assist researchers in assessing degrees to which our results can be generalized and in gaining a broader based understanding of factors promoting innovation in smaller firms.

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