

Value Co-creation Oriented Leadership for Promoting Service-Centric Business

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Abstract: Today more and more manufacturing companies are transforming themselves from product-centric into service-centric companies, in order to gain an advantage in competitive markets. Such companies need to cultivate a leadership style that will promote the transition to a service-centric business. In this paper, we focus on leadership: a vital factor in any company's success. Although the roles of leaders have been described in many leadership models, only a few studies have focused on managing the transformation into a service-centric business. The purpose of this paper is to build a conceptual leadership framework that reveals the effectiveness of value co-creation oriented leadership in a service-centric business. A literature review of leadership and service-centric theories, including Vargo and Lusch's S-D logic (2004) concept, was employed in this paper. This study analyzes the changes in competitive resources and the distinct processes of creating value in service companies. As a result, we see a transformation in seven areas: followership, value source, communication, goal setting, influential power, corporate climate, and decision making tools. This transformation is the key for enhancing value co-creation abilities in service-centric companies. These findings will help enable leaders to strengthen their effective leadership and lead their employees to create maximum value with their customers.

Keywords: Leadership, value co-creation, enterprise transformation, organizational communication

1. Introduction

Vargo and Lusch (2004) defined two types of marketing: goods-dominant logic (G-D logic) and service-dominant logic (S-D logic). Most product companies are transforming themselves from G-D logic into S-D logic companies. They work hard to deliver new services and constantly innovate to stay ahead of the competition.

In goods-dominant companies, work is broken down into elaborate units and different people are assigned to execute these steps. High productivity and a low operational cost structure are vital to their business success. Most leaders can issue direct orders and tell employees what to do. Leadership in this logic emphasizes how well followers execute procedures and rules. It can be interpreted from the "heroic man" notion of great leaders (Lowney, 2003), through trait theory, behaviorist theory, and to contingency theory. Each of these provides some perspectives into the characteristics of successful leaders, but there has been a shift in focus from the generic characteristics and behaviors of the individual to contingent factors of different situations and

contexts. Burns initially introduced the concept of transforming leadership in his descriptive research book, *Leadership* (1979). According to Burns, transforming leadership is a process in which “leaders and followers help each other to advance to a higher level of morale and motivation” (p.20). He emphasized the leaders’ role in relation to followers and established two concepts: transactional leadership and transformational leadership. Bass (1985) extended the perspectives of Burns by conceptualizing the transactional and transformational leadership with seven leadership factors, which he labeled charisma, inspirational, intellectual stimulation, individualized consideration, contingent reward, management-by-exception, and laissez-faire leadership. More recently, Northouse (2001) defined leadership as “a process whereby an individual influences a group of individuals to achieve a common goal” (p. 3). He claimed that leadership is a process, identifying it not as a trait or characteristic, but as an interactive occurrence between leader and followers.

In service-dominant companies, one proposition is that the customer becomes a co-creator of value (Vargo & Lusch, 2004). In the new logic, effectiveness lies in a greater level of collaboration between employees and management. When a product-dominant company implements new strategies to transform into a service-dominant company, it must take the leadership challenge into account. Because of the changes in value creation, the critical resources have changed from operand resources, such as materials and equipment, into operant resources: the knowledge and skills of the staff. In the new logic, the role of leadership is to create a strong and innovative followership. The old hierarchical relationship, the vertical communication between leaders and employees, will not work well any more. The leadership theories of the past dealt with the qualities and behaviors of individual leaders in a contingency business situation, but said little about the influential factors stemming from changes in value creation.

Based on the foundational premises in the new logic, this paper presents the changing role of leadership when companies transform from product-centric companies into service-centric companies.

2. Value Creation in Goods-dominant Logic and the Leadership Theory Review

The traditional process of value creation is company-oriented. Product design, the production process, productivity, and cost control are vital factors for a manufacturer. Work is broken down into various elaborate units. Materials and information are passed from one department to the next. Staff are assigned to implement these steps and are structured in a hierarchy according to “superior-subordinate” relationships (Savage, 1990). The achieving of value is primarily dependent on the company’s products — the final outputs, and services are simply regarded as adjuncts of the products to enhance the value of goods (Vargo & Lusch, 2008a). Companies and consumers have the distinct roles of production and consumption, respectively (Prahalad & Ramaswamy, 2004). Consumers are outside the processes of value creation that occur inside the company. The company is the supplier of products to the consumer, the process framework in this logic is shown in Figure 1.

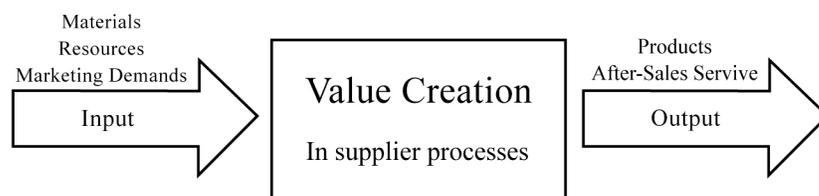


Figure 1. A Conceptual Framework for Value Creation in Product-Centric Organizations

So the leadership theories in goods-dominant logic strive to solve problems and promote management effectiveness mainly based on the individual leader or the relationship between superior and subordinate. During the past century, each era has had its dominant form of leadership. These theories have developed from trait theories and behavioral theories, to contingency theories and transformational theories.

Traits leadership considers the personal qualities and characteristics that differentiate leaders from non-leaders. The consensus was that leaders were born not made. People with some specialized traits could be leaders (Stogdill, 1974). The limitation to trait theories was that, while some leaders might have possessed certain traits, the lack of them did not necessarily mean that the person could not be a leader. After McGregor's identification of Theory X & Theory Y managers (McGregor, 1960), research attention shifted to behavioral theories. X & Y Theory was classified by assumptions about human nature. Trait research provided a theory for selecting the right leaders for organizations, while behavioral theories studied the critical behavioral determinants of leadership and held that people could be trained to be leaders. Lewin (1935) established three major leadership styles: authoritarian, democratic or laissez-faire. In 1945, a group of researchers at The Ohio State University embarked on identifying the observable behaviors of leaders instead of personality traits. They identified two dimensions of leader behavior: initiating structure and consideration, while the University of Michigan provided two other dimensions of leader behavior: employee orientation and production orientation. Blake & Mouton (1964) developed a managerial grid, with concern for production on the horizontal axis and concern for people on the vertical axis, and plotted five basic leadership styles: impoverished management, task management, middle-of-the-road management, country club management, and team management.

Trait and behavioral theories defined particular leadership characteristics and behaviors, but they gave little consideration as to what produces effective leadership in different situations. Contingency theories strived to solve this problem. They focused on situational factors; in other words, leadership effectiveness was dependent on the situation around the leaders' operations. Representative of these theories were the Fiedler model (Fiedler, 1967), the Hersey-Blanchard leadership model, the leader-participation model and path-goal management theory. According to Fiedler, there is no ideal leader. Both task-oriented and relationship-oriented leaders can be effective if their leadership orientation fits the situation. The condition of a managerial task was analyzed for three situations: leader-member relations, task structure, and defined position powers. The Hersey-Blanchard leadership model (Hersey & Blanchard, 2001) also took a situational perspective of leadership and argued that successful leadership was achieved by

selecting the right leadership style which was contingent on the level of followers' acceptance and readiness. It created four specific leadership styles: telling, selling, participating, and delegating. The leader-participation model (Vroom & Yetton, 1973) provided a group of contingency variables to determine the form and amount of participative decision making in different situations. Path-goal theory (House, 1971) argued that leaders should encourage and support their followers by making the path clear and easy. The theory identified achievement-oriented, directive, participative, and supportive leader behaviors.

Bass extended Burns' theory (1979) by explaining the psychological mechanisms that underlie transactional and transformational leadership. He explained the multiple intelligences, particularly social and emotional, that contribute to the extent to which leaders are seen as transformational. Bass discussed four components of transformational leadership: intellectual stimulation, individualized consideration, inspirational motivation, and idealized influence. Transactional leadership emphasizes the transaction between leaders and employees in which the leader discusses with followers what is required and corresponding rewards or penalty. Transformational leadership achieves superior results by inspiring employees' consciousness of the goal and vision, by motivating followers to go beyond their own individual interests for the good of the organization (Bass, 1985, 1990, 2008).

3. Value Creation and the Roles of Leadership in Service-dominant Logic

Vargo and Lusch (2004) argue for a new dominant logic for marketing, in which the provision of services rather than goods is fundamental to economic exchange. They originally provided eight foundational premises (FP) that underpin their case for the S-D logic. After substantial concurrence, debate, dialog and inquiry, Vargo and Lusch (2008b, p. 7) modified and extended the original FPs into ten, as described below.

- FP1: Service is the fundamental basis of exchange.
- FP2: Indirect exchange masks the fundamental basis of exchange.
- FP3: Goods are a distribution mechanism for service provision.
- FP4: Operant resources are the fundamental source of competitive advantage.
- FP5: All economies are service economies.
- FP6: The customer is always a co-creator of value.
- FP7: The enterprise cannot deliver value, but only offer value Propositions.
- FP8: A service-centered view is inherently customer oriented and Relational,
- FP9: All social and economic actors are resource integrators.
- FP10: Value is always uniquely and phenomenologically determined by the beneficiary.

Based on the above foundational premises, two propositions become prominent: first, the fundamental source of competitive advantage is not operand resources but operant resources, which are mostly stored in the employees' brains; second, the customer becomes a co-creator of value who determines the value of service and whose satisfaction and loyalty are mostly affected by the employees of the service provider. These two aspects converge at one key point: that employees have never been so vital. They substitute for physical resources and become the

organization’s competitive advantage.

In service-dominant logic, the value creation process is changed. A conceptual framework for value co-creation in this logic is shown in Figure 2. Within a company, various back offices provide support for customers. The value of both tangible products and intangible services is co-created by provider and customers. The product may be the same, but customers can have different service experiences. For example, while a number of people have the same iPhone, one might use it to play games, another to read e-books, and someone else might use it to send Facebook messages to friends. Apple’s co-creator-application developers use it to discover users’ likes and dislikes; this is really a revolutionary mode for application development. How can it provide so many different valuable experiences? Apple has its iTunes. It can attract so many providers, users and other stakeholders to co-create at the same time together. So, although Apple has iPod, iPhone, iPad and computers, we still regard it as a service-dominant logic company. This is also why Apple can achieve so much success. But Apple can also be in danger if it does not make continuous service innovations. We are all familiar with another global company, Amazon, the largest online retailer. Now Amazon also has a tablet product similar to Apple’s, the Kindle Fire. It is as popular as iPad in America, and some people even predict it could become more popular than iPad. Why? First, the Kindle Fire costs only \$199, which is much cheaper than the \$499 iPad, making it very attractive to non-Apple fans. But more importantly, it has a strong cloud computing service that enables all the stakeholders to co-create together as well. In service dominant logic, those who can attract the most numbers of co-creators are most likely to dominate the market.

Innovation needs ideas from human brains; it requires a different leadership style than in manufacturing, where the goal is to make sure that every employee executes every production process properly. Innovation effectiveness is based on a greater level of collaboration between employees and management. Many service organizations adopt flatter structures, to make it easier to collaborate internally and serve their customers. Along the way, the followers achieve a sense of strong self-motivation, commitment, and responsibility that inspires greater contribution and innovation.

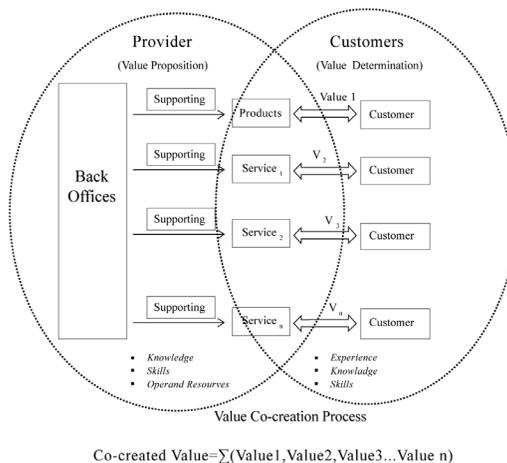


Figure 2. A Conceptual Framework for Value Co-Creation in Service-Dominant Logic

Meanwhile, people in service-dominant companies increasingly work in teams consisting of people from different departments and even from outside of the company. Since the goal of such companies is not to make and sell products but to provide customized service and co-create value with their customers, the role of companies as product suppliers changes. For these companies, effectiveness lies in a greater level of collaboration between employees and management. The challenge for leaders is to gain the collaboration of individuals outside their hierarchical span of control.

4. Issues of Leadership in Service-dominant Logic

In goods-dominant logic, its products-based nature makes it a comparatively simple matter to determine which work contributes to the expected results and which does not. So, obedience, rules, and process are vital factors to a successful manufacturer. Many leaders in these companies are like military commanders. They are directional leaders who can give their employees well-defined instructions (Annunzio & Lies, 2001). On the other hand, running a successful service organization is not the same as running a product-oriented one. Goods are no longer the whole value of exchange and descend to a carrier for service provision (FP3). Service is the fundamental basis of exchange (FP1); superb service doubtlessly derives from people's knowledge and brainstorming. Follow-up, responsibility, and thinking based on self-motivation propel the operant resources, replacing operand resources as the fundamental source of competitive advantage (FP4).

The shift from a goods-dominant logic leadership to a service-dominant logic leadership can be concluded in seven commensurate shifts. These are discussed in the following sections and summarized in Table 1: (1) When measuring the result of leadership, a shift to a focus on followers' effectiveness rather than the discipline of obedience; (2) the value of offerings is derived from staff members' thinking rather than from prescriptive procedures; (3) a shift to conversation as opposed to mandate; (4) a shift to lighting a beacon for people rather than paving an even path; (5) a shift to a focus on the influence of personal power rather than the right of positional power; (6) building a peer climate in place of a hierarchy climate, (7) a shift to an additional emphasis on human ideas via SNS (Social Network Software) for decision-making rather than depending on ERP (Enterprise Resource Planning) alone.

| Category | Goods-dominant Logic | Service-dominant Logic |
|------------------------------|----------------------|------------------------|
| Efficiency (Followership) | Obedience | Following |
| Effectiveness (Value source) | Procedure | Thinking |
| Communication | Mandate | Conversation |
| Goal Setting | Path-goal | Beacon-goal |
| Influential Power | Positional Power | Personal Power |
| Corporate Climate | Hierarchy Climate | Peer Climate |
| Decision-Making Tools | ERP | ERP+SNS |

Table 1. Contrasting the Leadership in G-D logic and S-D logic

5. Value Co-creation Oriented Leadership in Service-dominant Logic

5.1. From Obedience to Following

A hierarchical organization clearly defines each employee's role and the nature of their relationship with other employees. In product-centric companies, the hierarchical organization works well because it can ensure command and control of the organization and the quality manufacturing process. Every employee has a boss who determines what activities are to be carried out and how (Savage 1990, p. 67). A staff member needs approval from a supervisor who in turn needs approval from a manager. The effectiveness of good leadership in this logic can be measured by the degree of top-down obedience.

Innovation needs ideas; it requires more from the leader than just making sure that every employee executes every production process properly. With S-D logic, operant resources are the fundamental source of competitive advantage (FP4). Effectiveness lies in a greater level of communication between employees and management. Leadership is defined by followership. Following is always a voluntary activity. The best organizations are those in which people are not managed by others, but rather manage their own relationships and commitments to others. Along the way the followers develop strong self-motivation, commitment, and a sense of responsibility that inspire even greater contribution and innovation.

5.2. From Procedure to Thinking

In goods-dominant logic procedures are designed for maximum process control, efficiency, and profit maximization; this usually results in product standardization, even when that is not responsive to the market. In contrast, service-dominant logic is focused on the interaction of the providers and the recipients as they co-create value through collaborative processes (Lusch, Vargo & Malter, 2006). In other words, manufacturers get competitive advantages by controlling the manufacturing procedure and get the best and standard product quality, while service companies have to use people's thinking competence. Finely tuned bureaucracies with carefully defined policies, procedures, and job descriptions are no match for the knowledge era (Drucker, 2006). Only if the creative abilities of the employees are unleashed can they expect to respond effectively to market challenges. Goods-dominant companies used the dexterity of their employees' hands to grow, but service companies need to build upon the dexterity of their minds (Savage, 1990).

Google, for example, does not have a top-down culture in which people must seek approval for everything they do. There is an incredible amount of freedom for employees to do what they think is right and to spend time on their own interests. This would be a challenging mode for most goods-dominant companies, but it is suitable for Google, a company that must innovate continually. "If people have been working at a company too long they're inculcated in a development process that is relatively predictable," Google's executive chairman Eric Schmidt said, "Real innovation is hard to do when you have a process culture with Six Sigma. Risk management is around the process, keeping it the same."

5.3. From Mandate to Conversation

When Louis Gerstner entered IBM in 1993 as its chairman and chief executive officer, the company had lost \$16 billion in the last three years. An active plan was in place to disaggregate the company. Gerstner reversed this plan, realizing from his previous experiences at RJR Nabisco and American Express that there remained a vital need for total IT solutions. Instead of breaking the company into disparate pieces, Gerstner kept it together (Gerstner, 2003). The key to IBM's eventual turnaround was Gerstner's decision to take the company away from its roots as a hardware manufacturer and lead it into services. The subsequent refocusing on the IT services business, which grew to nearly 50% of IBM's revenues, is widely seen as having resulted in one of the most remarkable turnarounds in recent memory. In 2002 services accounted for 40 percent of IBM's revenue. In the nine years since Gerstner took over, the value of a share of IBM stock catapulted from \$13 to \$80 (Palmisano, 2003).

"Hierarchy means very little to me. Let's put together in meetings the people who can help solve the problem, regardless of position. Reduce committees and meetings to a minimum. No committee decision making. Let's have lots of candid, straightforward communications" (Gerstner, 2002, p.24).

Successful companies revolve around encouraging their staff to put forward their ideas without hesitation and develop the business with great enthusiasm. They encourage communication and collaboration between individuals with diverse backgrounds, as individuals with more diversity challenge the existing behaviors and beliefs that actually hinder future development. (Nonaka & Takeuchi, 1995)

5.4. From Path-goal to Beacon-goal

Path-Goal leadership (Evans, 1970) emphasizes changing leaders' behavior to satisfy followers' needs by setting a clear path, removing hurdles and roadblocks, assisting, providing direction and support, and offering rewards to achieve goals.

But sometimes in the service dominant era the leaders themselves do not know exactly how to proceed, because the innovative service is brand new. Sometimes leaders only know the direction, perhaps only have an intuition of the path that they must follow. In the face of a fierce business situation, however, excellent leaders can always light a beacon goal for their employees and inspire them to proceed, even when they cannot pave a smooth path on the way to service innovation.

An example of this is Alibaba.com (lists on the Hong Kong Stock Exchange) which was founded in 1999. In the "internet winter" of 2008 there was no clear direction for Yun Ma, CEO of Alibaba.com and his teams to take. He did not know precisely how to establish a path for the company. But he realized that the Internet would continue to be the dominant trend in the future, and he inspired his employees with the idea that the e-commerce beacon existed and that they could reach it. "Today is difficult. Tomorrow may be more difficult. The day after tomorrow will be beautiful, because most of our competitors will be dead by tomorrow evening. They will not live long enough to see the rising sun on the day after tomorrow." Under tough business conditions, "staying alive through the internet winter" would be the most

successful business principle. These words represented his leadership style: he could light a beacon for his employees. Now Alibaba.com has become the global leader in e-commerce for small businesses, with offices in more than 70 cities across Greater China, India, Japan, Korea, Europe, and the United States.

5.5. From Positional Power to Personal Power

Positional power is derived from the person's position in the organization. It exists because organizations find it necessary to grant certain powers to leaders so that they can work effectively. Personal power, on the other hand, is gained through knowledge and experience.

The customer is always a co-creator of value (FP6). In service-dominant logic organizations people increasingly work in teams consisting of people from different departments and people from outside the company. The challenge for leaders is to gain the collaboration of individuals over whom they have no hierarchical power. To effectively lead these collaborative teams a leader must rely on personal power rather than positional power (Buchanan & Badham, 2008). Whether the leader is heading an interdepartmental team; leading a combined company and customer project; or building support for a new service innovation, the ability to influence others is extremely important.

We saw the importance of personal power when, the instant after the launch of the iPhone 4, many media articles began to analyze the performance of Apple's new CEO, Timothy Cook, who had taken the place of Steve Jobs; most of them gave Cook a passing mark. It was merely a new product release, but it attracted an extraordinary amount of attention from the media. When Steve Jobs left Apple, he did not take away the company's management system, but his own leadership, which was widely regarded as the important power behind Apple's service innovation. It was Jobs' personal power in leadership which energized all the stakeholders — his staff, customers, and indeed the entire world — even if people were not really sure why they trusted him so much. This is why some industry insiders worried about Apple's innovation capacity in his absence.

5.6. From Hierarchy Climate to Peer Climate

Schneider (1990) defined corporate climate as the “shared perceptions of the events, practices, and procedures and the kinds of behaviors that get rewarded, supported, and expected in a setting” (p. 384). Traditional leadership in a hierarchy climate may fear that innovative ideas and initiatives from below could undermine their authority and ultimately their position in the organization. But value co-creation oriented leaders view innovation as a collective endeavor that is about creating a peer climate that sustains individual creativity. A peer climate helps staff to feel more comfortable in taking accountability, trying new things, and exchanging information more freely (Shalley & Gilson, 2004). Many organizations are willing to select leaders who can facilitate positive interactions (Bass, 2008).

The PC industry is undergoing a smart transformation. Today's users have many smart devices and desire an integrated experience of hardware, software and cloud services. Lenovo, the world's second largest PC maker, is building a new cloud computing service that will allow

users to share content among multiple devices and manage their personal information and social networking. To encourage service innovation, eliminate the hierarchy barrier in collaboration, and respond to customer demands promptly, Lenovo has implemented the transformation to a corporate peer climate. For instance, Lenovo requires all employees to use their name only, without job title, when they communicate with each other. Peer relationships are the bedrock of service innovation. Many other international companies are creating a corporate culture that strongly supports an empathetic peer climate.

5.7. From ERP to ERP+SNS

ERP (Enterprise Resource Planning) is an important enterprise application that integrates all the individual departments and functions inside a single management software. ERP makes it easier to track work-flow across various departments and analyze running data for timely decision making. It can also be used to alter how a product is manufactured, keep better track of products, and integrate cost, profit, and revenue information. It has been successfully used to solve many problems in manufacturing companies and was the main tool enterprise leaders used to run companies and make decisions.

New social network software (SNS) changes the traditional ERP structure, the core of which was business process and data, organizing network and knowledge resources through mutual communication and dialog. The positive impact of networks in driving innovation has been strongly supported in previous work (Bel, 2010). The Beehive research project at IBM is one example. Beehive is an internal social networking site that provides employees across the organization a “rich connection to the people they work with” on both a personal and a professional level. Beehive helps employees make new connections, track current friends and coworkers, and renew contacts with people they have worked with in the past.

Yammer provides its customers with social networking services inside their enterprise, revolutionizing internal communications by bringing together all of a company’s employees inside a private and secure enterprise social network. Yammer, a similar service, is as easy to use as other personal communication tools like Facebook or Twitter. One of its customers is Deloitte Australia, a member of Deloitte Touche Tohmatsu, the world’s largest professional services organization. With 12 offices across the country, the firm provides audit, tax, consulting, and financial advisory services to public and private clients. The CEO of Deloitte Australia reviewed Yammer: “It has helped drive innovation and build community at Deloitte, and we’re finding new value in the tool every day.” (Bian, 2010).

Many companies are starting to implement social network communities to promote collaboration and innovation among their employees. Over 200,000 companies worldwide are using Yammer social network systems for their inside communications and innovations. ERP is still an important tool for corporate leaders to capture accurate, relevant, and timely business information, but there is no doubt that ERP integrated with SNS will update the traditional ERP mode and play a greater role in decision-making for leaders.

Reviewing the above seven shifts, we perceive their convergence in business management. Leaders with powerful personal power attract their subordinates to follow voluntarily. They encourage followers to approach old situations in new ways and value attempts to use previously

untested methods to solve problems with the ability of creative thinking. These leaders inspire followers to be at their best and establish a peer climate with employees that makes them feel engaged and empowered. Meanwhile, by providing a beacon-goal for the organization, these leaders promote greater levels of challenge and meaning around the service business being pursued. They make full use of technical enterprise-level SNS to interact with employees freely and ensure that the decision-making process adequately absorbs individual knowledge in the organizational network.

6. Conclusions

Service-dominant logic focuses primarily on the application of dynamic operant resources-service (Vargo & Lusch, 2006a, 2006b). These resources are intangible and human-centric. To manage them is very different from organizing tangible resources such as materials and equipment. Traditional leadership is challenged by the situation of creating value through intangible resources with customers.

This paper conceptualizes the key factors of transformation. The result of leading employees should be following, not obedience. Leaders should not overly emphasize working procedures, as in manufacturing, but instead make full use of staff's thinking ability. Peer climate and conversation not only cultivate service innovation but also enable value co-creation oriented leaders to utilize their personal power. Leaders with personal power are most likely to light an inspiring beacon-goal for their employees. Traditional ERP systems are still vital decision-making tools, but in a service-centric environment, it is necessary to update those tools by integrating enterprise-level SNS with ERP.

We have provided a new framework for the relationship between leadership and followership in a new logic company. This framework can help transforming companies to redesign their leadership. It can also be a helpful reference for service-centric companies to evaluate their leadership and make it more effective. But we must note that the whole relationship chain for value creation is made up of leaders, employees, and customers. This paper details the relationship between leaders and employees, but the interaction between employees and customers is not discussed. In future, it is necessary to extend the research to the whole relationship chain and address business problems in value co-creation by combining theories and practice.

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