

Service Strategy

Learning Objectives

After completing this chapter, you should be able to:

1. Formulate a strategic service vision.
2. Describe how a service competes using the three generic service strategies.
3. Perform a SWOT and Five Forces Analysis.
4. Explain what is meant by qualifiers, service winners, and service losers.
5. Discuss the competitive role of information in services and its limits.
6. Explain the concept of the virtual value chain and its role in service innovation.
7. Discuss service firm sustainability and the triple bottom line impact.
8. Explain what features of a service firm lead to economics of scalability.
9. Categorize a service firm according to its stage of competitiveness.

As machine technology once changed an agricultural economy into an industrial economy, today's information technology has transformed our industrial economy into a service economy. The availability of computers and global communication technologies has created industries for collecting, processing, and communicating information. Today everyone on the globe can be in instant communication with everyone else, and this revolution is changing world society in many ways. Consider the impact of the private satellite network industry, which provides uplinks and downlinks for personnel training, product introductions, credit checks, billing, financial exchanges, and overall telecommunications.

Kmart was among the first retail box stores to establish a private satellite network using the new small-dish antenna VSAT (Very Small Aperture Terminal) placed on store roofs to receive and transmit masses of data. The VSAT at each Kmart is linked to the

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services presents challenges such as *low entry barriers, product substitution, and limited opportunities for economies of scale that must be overcome.*

Three generic strategies have been found successful in formulating strategies that allow a firm to outperform competitors. The strategies of *overall cost leadership, differentiation, and market focus* are approaches that service firms have adopted in various ways to gain competitive advantage. With each of these strategies, however, management must not lose sight of the fact that only a focus on the customers and on satisfying their needs will result in a loyal customer base.

Before entering a market, an analysis of a company's position relative to its competitors and other players is advisable. Such an analysis begins with the well-known *five forces model* to gain an appreciation of the competitive nature of the industry. A SWOT analysis to assess strengths, weakness, opportunities, and threats follows.

Winning customers in the marketplace means competing on several dimensions. Customers base their purchase decisions on many variables, including price, convenience, reputation, and safety. The importance of a particular variable to a firm's success depends on the competitive marketplace and the preferences of individual customers.

A framework for viewing the contribution of information to the competitive strategy of the service firm also is presented. Using the dimensions of strategic focus both external and internal and competitive use of information both online and offline, four strategic roles of information are identified: creation of barriers to entry, revenue generation, database asset, and productivity enhancement. Industry examples for each role illustrate how firms have used information effectively.

Service product innovation is driven by an appreciation of the virtual value chain that assembles information on customer needs based on changing demographics and lifestyles. This database can be mined to develop new service offerings targeted at an existing customer base. However, there are limits to the use of information including questions of privacy, fairness, reliability, and data accuracy.

The chapter concludes with a framework that categorizes service firms according to their level of competitiveness with respect to key operational dimensions.

The Strategic Service Vision

The purpose and place of a service firm in the market begins with an entrepreneur's idea and an unmet need. Table 2.1 presents a framework in the form of questions one should ask in formulating a *strategic service vision*. The basic categories presented from left to right are: service delivery system, operating system, service concept

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The Strategic Service Vision

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To demonstrate the effectiveness of this framework, Table 2.2 illustrates the initial strategic service vision of Southwest Airlines when it served only three cities in Texas (i.e., Dallas, Houston, and San Antonio). With start-up firms such as Southwest Airlines, it is best to apply the strategic service vision from right to left beginning with the target market.



TABLE 2.2 Southwest Airlines Strategic Service Vision

Service Delivery System	Operating Strategy	Service Concept	Target Market Segment
<ul style="list-style-type: none"> • Fun cabin atmosphere to differentiate service • Use only Boeing 737 aircraft to control maintenance and operating costs • Hire cabin crew based on attitude 	<ul style="list-style-type: none"> • Quick turnaround at gate results in high utilization of aircraft • No assigned seating rewards punctuality and promotes on-time performance 	<ul style="list-style-type: none"> • Short flights with frequent departures • Serves peanuts and soft drinks only • Use of inner-city or low traffic airports avoids congestion • Carry-on luggage 	<ul style="list-style-type: none"> • State of Texas residents • Business traveler who drives because of inadequate airline service • Inexpensive family travel on weekends

Understanding the Competitive Environment of Services

In general, service firms compete in a difficult economic environment, and there are many reasons for this difficulty:

- *Relatively low overall entry barriers.* Service innovations are not patentable, and in most cases, services are not capital-intensive. Thus, innovations can easily be copied by competitors. However, other types of entry barriers exist, such as locating a resort hotel on the best beach on an island (e.g., Club Med's former location on the island of Moorea in French Polynesia).
- *Minimal opportunities for economies of scale.* The necessity of physical travel for many services limits the market area and results in small-scale outlets. Franchised firms can realize some economies of scale by sharing purchasing or advertising costs; in other instances, using the Internet can be a substitute for physical travel (e.g., ordering from Amazon.com).

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- *Erratic sales fluctuations.* Service demand varies as a function of the time of day and the day of the week (and sometimes seasonally), with random arrivals. Can you think of some exceptions?
- *No advantage of size in dealing with buyers or suppliers.* The small size of many service firms places them at a disadvantage in bargaining with powerful buyers or suppliers. Many exceptions should come to mind, however, such as McDonald's buying beef and Marriott buying mattresses.
- *Product substitution.* Product innovations can be a substitute for services (e.g., the home pregnancy test). Thus, service firms must not only watch other service competitors but also anticipate potential product innovations that might make their services obsolete.
- *Customer loyalty.* Established firms can use personalized service to create a loyal customer base, which becomes a barrier to entry by new services. For example, a hospital supply firm may place its own ordering computer terminals at customers' sites. These terminals then facilitate the placement of new orders to the extent that competitors are effectively excluded.
- *Exit barriers.* Marginal service firms may continue to operate despite low, or even non-existent, profits. For example, a privately held firm may have employment of family members rather than maximizing profit as its goal. Other service firms, such as antique stores or scuba diving shops, have a hobby or romantic appeal that provides their owners with enough job satisfaction to offset low financial compensation. Thus, profit-motivated competitors would find it difficult to drive these privately held firms from the market.

For any particular service industry, there are firms that have overcome these competitive difficulties and prospered. For example, McDonald's has achieved a dominant position in the fast-food industry by overcoming many of the difficulties listed here. New entrants, however, must develop a service strategy that will address the important competitive features of their respective industries. Three generic strategies have been successful in providing a competitive advantage, and illustrations of how service firms have used these strategies will be our next topic.

Competitive Service Strategies²

There are three generic competitive strategies: overall cost leadership, differentiation, and

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Competitive Service Strategies²

There are three generic competitive strategies: overall cost leadership, differentiation, and focus. Each strategy will be described in turn, with examples of how service firms use them to outperform their competition.

Overall Cost Leadership

An *overall cost leadership* strategy requires efficient-scale facilities, tight cost and overhead control, and often innovative technology as well. Having a low-cost position provides a defense against competition, because less efficient competitors will suffer first from competitive pressures. Implementing a low-cost strategy usually requires high capital investment in state-of-the-art equipment, aggressive pricing, and start-up losses to build market share. A cost leadership strategy sometimes can revolutionize an industry, as illustrated by the success of McDonald's, Walmart, and Southwest Airlines. Moreover, service firms have been able to achieve low-cost leadership using a variety of approaches.

Seeking Out Low-Cost Customers

Some customers cost less to serve than others, and they can be targeted by the service provider. For example, the United Services Automobile Association (USAA) occupies a preeminent position among automobile insurers because it serves only military personnel and their families. This group also entails lower cost because its members, who are relatively nomadic, are accustomed to and willing to do business by telephone, mail, or online. Consequently, USAA is able to eliminate any need for the extensive sales force employed

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by traditional insurers. Another example of this strategy is provided by low-cost retailers such as Sam's Wholesale Club and Costco, which target customers who are willing to buy in quantity, do without frills, and serve themselves.

Standardizing a Custom Service

Typically, income tax preparation is considered to be a customized service. H&R Block, however, has been successful in serving customers nationwide when only routine tax preparation is required. Also, storefront legal services and urgent care clinics are attractive means of delivering routine professional services at low cost. The key word here is *routine*. However, product substitution always is a danger (e.g., Turbo Tax).

Reducing the Personal Element in Service Delivery

The potentially high-risk strategy of reducing the personal element in service delivery can be accepted by customers if increased convenience results. For example, convenient access to ATMs has weaned customers from personal interaction with live tellers and, consequently, has reduced transaction costs for banks.

Reducing Network Costs

Unusual start-up costs are encountered by service firms that require a network to knit together providers and customers. Electric utilities, which have substantial fixed costs in transmission lines, provide the most obvious example. Federal Express conceived a unique approach to reducing network costs by using a hub-and-spoke network. By locating a hub in Memphis with state-of-the-art sorting technology, the overnight air-package carrier was able to serve the United States with no direct routes between the cities that it served. Each time a new city is added to the network, Federal Express only needs to add one more route to and from the hub instead of adding routes between all the cities served. The efficiency of the hub-and-spoke network strategy has not been lost on passenger airline operators, either.

Taking Service Operations Offline

Many services, such as surgery and passenger transportation, are inherently "online," because they can be performed only with the customer present. For services in which the customer need not be present, the service transaction can be "decoupled," with some content performed "offline." For example, a shoe repair service could locate dispersed kiosks for customer drop-off or pickup, thus consolidating orders for delivery to an off-site repair factory, which even could be located offshore. Performing services offline represents significant cost savings because of economies of scale from consolidation, low-cost facility location (e.g., American Airlines has a call center located in the Caribbean), and absence of the customer in the system. In short, the decoupled service operation is run

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Differentiation

The essence of the *differentiation* strategy lies in creating a service that is perceived as being unique. Approaches to differentiation can take many forms: brand image (e.g., McDonald's golden arches), technology (e.g., Sprint's fiber-optic network), features (e.g., American Express's travel services), customer service (e.g., Nordstrom's reputation among department stores), dealer network (e.g., Century 21's nationwide real estate presence), and other dimensions. A differentiation strategy does not ignore costs, but its primary thrust lies in creating customer loyalty. As illustrated here, differentiation to enhance the service often is achieved at some cost that the targeted customer is willing to pay.

Making the Intangible Tangible

By their very nature, services often are intangible and leave the customer with no physical reminder of the purchase. Recognizing the need to remind customers of their stay, many hotels now provide complimentary toiletry items with the hotel name prominently affixed.

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The Hartford Steam Boiler Inspection and Insurance Company (now part of Munich Re) writes insurance on industrial power plants, but this company has enhanced its service to include regular inspections and recommendations to managers for avoiding potential problems.

Customizing the Standard Product

Providing a customized touch may endear a firm to its customers at very little cost. A hotel operator who is able to address a guest by name can make an impression that translates into repeat business. Hair salons have added many personalizing features (e.g., personal stylist, juice bar, relaxed surroundings, mood music) to differentiate themselves from barbershops. Burger King's efforts to promote a made-to-order policy is an attempt to differentiate itself from McDonald's classic make-to-stock approach to fast-food service.

Reducing Perceived Risk

Lack of information about the purchase of a service creates a sense of risk-taking for many customers. Lacking knowledge or self-confidence about services such as auto repair, customers will seek out providers who take the extra time to explain the work to be done, present a clean and organized facility, and guarantee their work (e.g., Village Volvo). Customers often see the "peace of mind" that is engendered when this trusting relationship develops as being worth the extra expense.

Giving Attention to Personnel Training

Investment in personnel development and training that results in enhanced service quality is a competitive advantage that is difficult to replicate. Firms that lead their industries are known among competitors for the quality of their training programs. In some cases, these firms have established college-like training centers (e.g., McDonald's Hamburger University in Oak Brook, Illinois, near Chicago).

Controlling Quality

Delivering a consistent level of service quality at multiple sites with a labor-intensive system is a significant challenge. Firms have approached this problem in a variety of ways, including personnel training, explicit procedures, technology, limits on the scope of the service, direct supervision, and peer pressure, among others. For example, to ensure consistency, the Magic Pan chain of restaurants designed a foolproof machine to produce its famous crêpes. The question of service quality is further complicated by the potential gap between customer expectations and experiences. Influencing customer quality expectations thus becomes an issue, which is explored in Chapter 6, Service Quality.

Focus

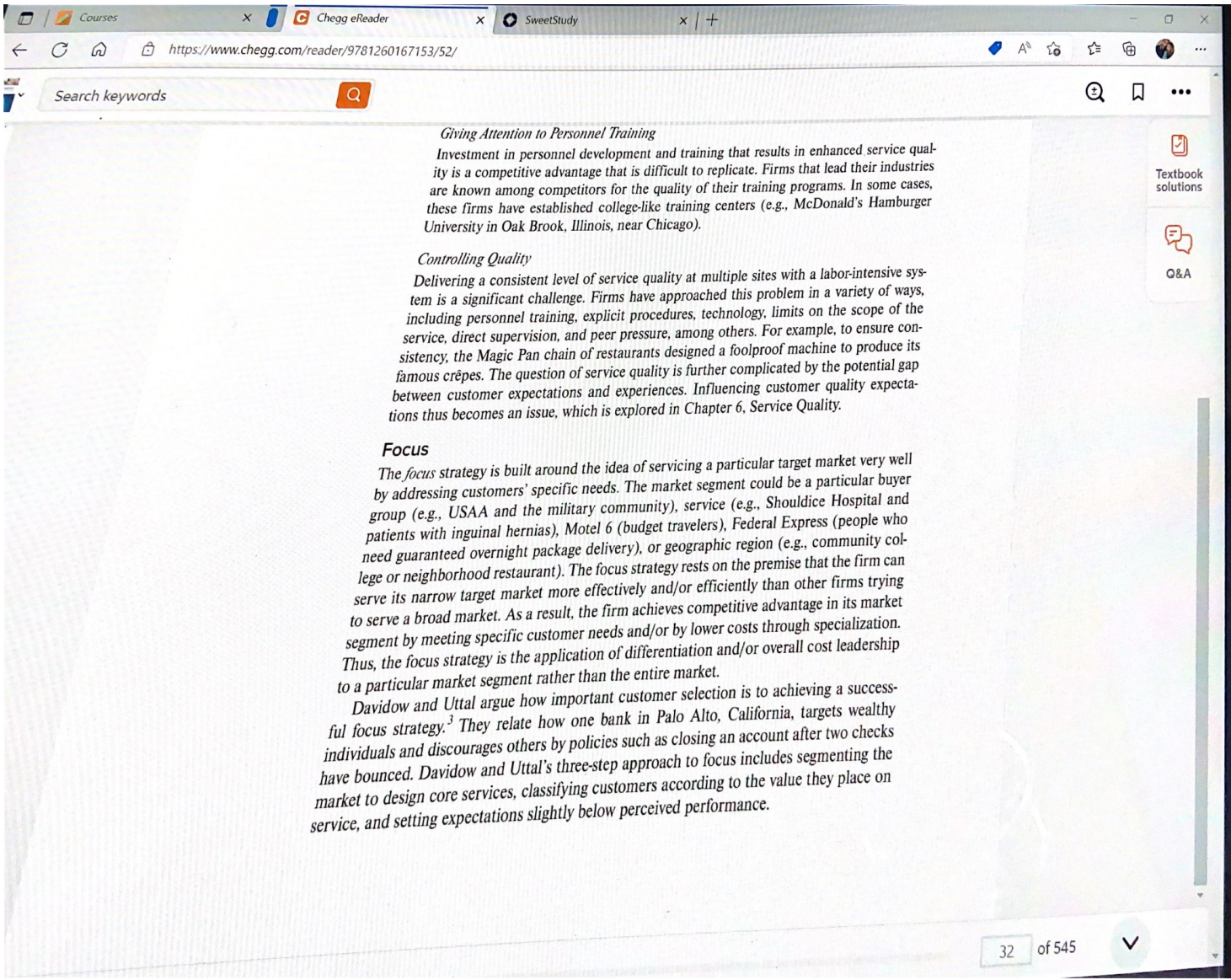
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Focus

The *focus* strategy is built around the idea of servicing a particular target market very well by addressing customers' specific needs. The market segment could be a particular buyer group (e.g., USAA and the military community), service (e.g., Shouldice Hospital and patients with inguinal hernias), Motel 6 (budget travelers), Federal Express (people who need guaranteed overnight package delivery), or geographic region (e.g., community college or neighborhood restaurant). The focus strategy rests on the premise that the firm can serve its narrow target market more effectively and/or efficiently than other firms trying to serve a broad market. As a result, the firm achieves competitive advantage in its market segment by meeting specific customer needs and/or by lower costs through specialization. Thus, the focus strategy is the application of differentiation and/or overall cost leadership to a particular market segment rather than the entire market.

Davidow and Uttal argue how important customer selection is to achieving a successful focus strategy.³ They relate how one bank in Palo Alto, California, targets wealthy individuals and discourages others by policies such as closing an account after two checks have bounced. Davidow and Uttal's three-step approach to focus includes segmenting the market to design core services, classifying customers according to the value they place on service, and setting expectations slightly below perceived performance.

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Strategic Analysis

Strategic analysis begins with a stated objective, such as "should we enter an industry with a new service offering?" Two popular planning tools include (1) Porter's five forces analysis of the target industry structure and (2) SWOT analysis to assess the organization's strengths, weaknesses, opportunities, and threats in a market.

Porter's Five Forces Analysis⁴

The five forces model is used at the industry level (e.g., airlines) to determine the competitive intensity and, therefore, attractiveness of a market. The five forces affect the ability of a firm to attract customers and make a profit. Figure 2.1 shows a model of the five forces with example issues to consider in each case.

Consider Netflix as an example firm entering the video rental industry. Our discussion begins with the center block (Competitive Rivalry within Industry) upon which the external forces act.

- *Competitive Rivalry within Industry.* Often this factor is the major determinant of industry competitiveness. Rivals might be aggressive price competitors or they might use nonprice strategies such as innovation, branding, or superior quality. Industry capacity relative to total customer demand is an important indicator of whether a new entrant will find customers. An exception was Southwest Airlines, which entered the Texas market offering low-cost fares and frequent departures that tapped a latent demand of business commuters who usually traveled by car. When Netflix entered the market offering DVDs exclusively by mail, its only rivals were rental stores such as Blockbuster.
- *Potential New Entrants.* Profitable markets that yield high returns invite new competitors. For example, at one time Walmart challenged Netflix, but subsequently left the field because it was unable to overcome Netflix's established brand.
- *Threat of Substitutes.* For services, substitutes often take the form of a product. For example, Turbo Tax software is a substitute for the services of a tax accountant. Netflix is somewhat immune from product substitution but faces competition from the likes of Amazon Prime movie streaming on Internet-enabled smart TVs.
- *Bargaining Power of Suppliers.* Suppliers of inputs can be a source of power over the firm because of product uniqueness or monopoly source. The most important suppliers

FIGURE 2.1
Porter's Five Forces Model

Potential New Entrants

- Barriers to entry
- Brand equity
- Capital requirements

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TABLE 2.3
SWOT Analysis

<p>Strengths</p> <ul style="list-style-type: none"> • What are your company's advantages? • What do you do better than anyone else? • What unique resources do you have? • What do people in your market see as your strengths? <p>Opportunities</p> <ul style="list-style-type: none"> • What are your competitors' vulnerabilities? • What are the current market trends? • Does technology offer new service options? • Are there niches in the market your organization can fill? 	<p>Weaknesses</p> <ul style="list-style-type: none"> • What could you improve? • What should you avoid? • What factors lose sales? • What are people in your market likely to see as a weakness? <p>Threats</p> <ul style="list-style-type: none"> • What obstacles do you face? • What are your competitors doing? • Is changing technology threatening your position? • Do you have cash-flow problems?
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to Netflix are the DVD distributors, but Netflix has considerable leverage because of volume purchases.

- *Bargaining Power of Customers.* Netflix customers might be able to exert price pressure and, thus, restrict high margins. In the travel industry the use of Priceline.com and Hotwire.com has shifted the information asymmetry to the advantage of the customer. However, Netflix uses information about customer purchases to recommend other movies with similar themes, thereby stimulating demand.

SWOT Analysis: Strengths, Weaknesses, Opportunities, Threats

Following the industry level of analysis, using the five forces model, SWOT analysis is conducted at the individual firm level. A *SWOT analysis* identifies an organization's internal strength and weakness as well as threats and opportunities in the external environment. The aim of the analysis is to reveal competitive advantages, analyze prospects, prepare for problems, and allow for development of contingency plans. A SWOT analysis begins with a stated objective and concludes with a summary of strengths to be maintained, built upon, or leveraged; weaknesses to be remedied; opportunities to be prioritized, captured, or built upon; and threats to be countered, minimized, or managed. A SWOT analysis is subjective, and people often arrive at different final versions, thus emphasizing the value of collaboration. Table 2.3 presents a sample of typical questions that might be asked in each of the four quadrants of a SWOT analysis.

Winning Customers in the Marketplace

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Winning Customers in the Marketplace

Depending on the competition and personal needs, customers select a service provider using criteria listed here. This list is not intended to be complete, because the very addition of a new dimension by a firm represents an attempt to engage in a strategy of differentiation. For example, initiation of the frequent flyer program "AAAdvantage" by American Airlines was an attempt to add the dimension of customer loyalty to competition among airlines.

- *Availability.* How accessible is the service? The use of ATMs by banks has created 24-hour availability of some banking services (i.e., service beyond the traditional "banker's hours"). Use of 800 numbers and websites by service firms facilitates access to information and personal accounts 24/7.
- *Convenience.* The location of the service defines convenience for customers who must travel to that service. Gasoline stations, fast-food restaurants, and dry cleaners are examples of services that must select locations on busy streets if they are to succeed.

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- **Dependability.** How reliable is the service? For example, once the exterminator is gone, how soon do the bugs return? A major complaint regarding automobile repair services is the failure to fix the problem on the first visit. For airlines, on-time performance is a statistic collected by the FAA.
- **Personalization.** Are you treated as an individual? For example, hotels have discovered that repeat customers respond to being greeted by their name. The degree of customization allowed in providing the service, no matter how slight, can be viewed as more personalized service.
- **Price.** Competing on price is not as effective in services as it is with products, because it often is difficult to compare the costs of services objectively. Comparing costs in the delivery of routine services such as an oil change might be easy, but in professional services, competition on price can be considered counterproductive because price often is viewed as being a surrogate for quality.
- **Quality.** Service quality is a function of the relationship between a customer's prior expectations of the service and his or her perception of the service experience both during and after the fact. Unlike product quality, service quality is judged by both the process of service delivery and the outcome of the service.
- **Reputation.** The uncertainty that is associated with the selection of a service provider often is resolved by talking with others about their experiences before a decision is made. Unlike a product, a poor service experience cannot be exchanged or returned for a different model. Positive word-of-mouth is the most effective form of advertising.
- **Safety.** Well-being and security are important considerations because in many services, such as air travel and medicine, the customers are putting their lives in the hands of the service provider.
- **Speed.** How long must I wait for service? For emergency services such as fire and police protection, response time is the major criterion of performance. In other services, waiting sometimes might be considered a trade-off for receiving more personalized services, or in reduced rates.

Writing about manufacturing strategy, Terry Hill used the term *order-winning criteria* to refer to competitive dimensions that sell products.⁵ He further suggested that some criteria could be called *qualifiers*, because the presence of these dimensions is necessary for a product to enter the marketplace. Finally, Hill said that some qualifiers could be considered *order-losing sensitive*.

We will use a similar logic and the service criteria listed earlier to describe the service purchase decision. The purchase decision sequence begins with qualifying potential service firms (e.g., is there a fast-food restaurant nearby?), followed by making a final selection from this subset of service firms using a service winner (e.g., are their burgers known

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Qualifiers

Before a service firm can be taken seriously as a competitor in the market, it must attain a certain level for each service-competitive dimension, as defined by the other market players. For example, in airline service, we would name safety, as defined by the airworthiness of the aircraft and by the rating of the pilots, as an obvious *qualifier*. In a mature market such as fast foods, established competitors may define a level of quality, such as cleanliness, that new entrants must at least match to be viable contenders.

Service Winners

Service winners are dimensions such as price, convenience, or reputation that are used by a customer to make a choice among competitors. Depending on the needs of the customer at the time of the purchase, the service winner may vary. For example, seeking a restaurant for lunch might be based on convenience, but a dinner date could be influenced

by reputation. For fast food, a dimension that once was a service winner, such as a drive-in window, over time could become a qualifier because some customers will not stop otherwise.

Service Losers

Failure to deliver at or above the expected level for a competitive dimension can result in a dissatisfied customer who is lost forever. For various reasons, the dimensions of dependability, personalization, and speed are particularly vulnerable to becoming *service losers*. Some examples might be failure of an auto dealer to repair a mechanical problem (i.e., dependability), rude treatment by a doctor (i.e., personalization), or failure of an overnight service to deliver a package on time (i.e., speed).

Sustainability in Services

Most casual observers might wonder why a service firm needs to worry about sustainability because no pollution-making fumes come out of a typical service facility. But when looked at thoughtfully, service firms have as big a role to play in the sustainability movement as manufacturing plants. Responsibilities of service firms go far beyond recycling their papers and reducing energy usage. A wide range of opportunities and threats in sustainability efforts can affect a service operation significantly.

For most service firms, environmental, social, and economic *sustainability* are essential features for the long-term viability of operations. Designing efficient processes and practices—as well as cultivating corporate cultures that eliminate negative environmental and social impacts and improve corporate image—requires significant organizational commitment to sustainability.⁶

Several forces that motivate a service firm to consider sustainability as a strategy include:

- **Regulations/legislation:** The U.S. Environmental Protection Agency (EPA) outlines regulations to protect human health and the environment. Directives from the Waste Electrical and Electronic Equipment (WEEE) and Restriction of Hazardous Substances (RoHS) set targets for collection, recycling, and recovery for all types of electrical and other hazardous materials. Also, international standards such as ISO 14000 and ISO 26000 exist for environmental protection and social responsibility.
- **Perception/image building:** Many of the sustainability efforts by service firms cater to public relations. Customers often seek out providers that are leaders in the sustainability movement.
- **Economic:** Certain aspects of sustainable operations actually save money for a firm, for example, waste reduction (as a part of lean operation) and value recovery.

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For most service firms, environmental, social, and economic *sustainability* are essential features for the long-term viability of operations. Designing efficient processes and practices—as well as cultivating corporate cultures that eliminate negative environmental and social impacts and improve corporate image—requires significant organizational commitment to sustainability.⁶

Several forces that motivate a service firm to consider sustainability as a strategy include:

- **Regulations/legislation:** The U.S. Environmental Protection Agency (EPA) outlines regulations to protect human health and the environment. Directives from the Waste Electrical and Electronic Equipment (WEEE) and Restriction of Hazardous Substances (RoHS) set targets for collection, recycling, and recovery for all types of electrical and other hazardous materials. Also, international standards such as ISO 14000 and ISO 26000 exist for environmental protection and social responsibility.
- **Perception/image building:** Many of the sustainability efforts by service firms cater to public relations. Customers often seek out providers that are leaders in the sustainability movement.
- **Economic:** Certain aspects of sustainable operations actually save money for a firm, for example, waste reduction (as a part of lean operation) and value recovery.

Triple Bottom Line (TBL)

The term *triple bottom line* (TBL or 3BL) was coined to evaluate a firm on social, economic, and environmental criteria in relation to sustainability.⁷ Different forms of triple bottom line concepts are possible. Shell Oil Company, for example, popularized the model, “People, Planet, and Profit.” The 20th-century urban planner and educator, Patrick Geddes, used the phrase “Folk, Work and Place” in the same vein as today’s 3BL.

Social issues include labor practices, workforce diversity, human rights, and community outreach. Economic issues include capital efficiency, growth enhancement, cost reduction, and risk management. Environmental issues include clean air, water and land, emission control, and waste management. In addition to these issues, we also can find overlapping criteria. Socioeconomic issues include job creation, skill enhancement, and business ethics. Eco-efficiency refers to resource efficiency and life-cycle management. Social-environmental issues include global climate change, environmental justice, and health safety. As shown in Figure 2.2, when all three basic criteria are satisfied, true sustainability can be achieved.

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Some factors that support a movement to sustainability in service operations include:

- Labor, material, and energy costs will continue to grow.
- Public pressure for environmental, health, and safety performance is likely to remain strong.
- Consumer demand for services offered by 3BL companies is likely to grow.
- Strong nongovernmental organization (NGO) activities concerning sustainable business practices exist.

Beyond its internal sustainable efforts, a service firm needs to consider the following external factors:⁸

- *Ripple effect:* Often the biggest impact a service firm has is not its service offerings themselves, but how the firm affects the behavior and choices of its customers. When a bank approves a mortgage for a homebuyer, its influence goes beyond the financial aspects and includes factors that could affect the quality of life in the community, local traffic flow, diversity of residents, home-insurance costs, and even the national economy (recall the 2008 financial crisis).
- *Strategic threats:* Sustainability-related trends can threaten the foundation of a business. Global warming has resulted in lack of snow at several ski resorts, which in

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turn shortens the ski season and decreases profits. Extreme climate concerns the insurance industry because it generates severe losses from more devastating storms. Nongovernmental organizations (NGOs) are known to call out service firms for unethical practices. Home Depot, for example, was criticized by the Rainforest Action Network for selling products from old-growth forests that are ecologically sensitive and illegally logged.

- *Emerging opportunities:* The sustainability movement opens doors for making positive contributions to society and for building goodwill. Starbucks, sometimes vilified for unethical business practices, attracts responsible coffee growers with premium-price, long-term contracts and guidelines for environmental responsibilities (shade-grown, bird-friendly) and social concerns (labor practices).

We see many examples of sustainable efforts by multinational companies such as Nike and Walmart. Lee Scott, former president and CEO of Walmart, gave his defining "Twenty First Century Leadership" speech on October 24, 2005, in which he laid out three long-term goals: (1) to be supplied 100 percent by renewable energy, (2) to create zero waste, and (3) to sell products that sustain our resources and environment.⁹ Following that speech, Walmart embarked upon a search for waste elimination and improved efficiency. For example, it condensed products like laundry detergent into small, easily packed shipping containers; retrofitted long-haul trucks with small air conditioners to allow sleeping drivers to turn off their diesel engines; reduced plastic and cardboard packaging; and started buying directly from farmers with emphasis on organic food. Saving money by being green was the objective.

Critics argue that Walmart's green initiatives are unsustainable, mainly owing to exorbitant cost (more than \$500 million per year), a suboptimal product assortment, and criticism of factory labor conditions. But Walmart claims that the public goodwill and the improved assurance of supply as a result of its sustainability efforts are worth much more than the direct profit generated.¹⁰

As a result of sustainable efforts by service firms, the U.S. economy has seen a new area of job employment, that is, "green-collar" jobs. Salient features for these jobs include concern for the environment, skill development for operating sustainable businesses, increased interest in energy efficiency, and exploring the human connection to the environment. Green-collar jobs are not the highest paying jobs, but their attraction lies in social responsibility. As the motto goes: *Green, Not Greed, Is Good!!*

The Competitive Role of Information in Services¹¹

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Competitive Role of Information in Services¹¹

For service management, information technology is helping to define the competitive strategy of successful firms. Figure 2.3 illustrates the different roles in which information technology can support a service firm's competitive strategy. We shall explore each of these roles in turn with illustrations from successful applications.

Creation of Barriers to Entry

As noted earlier, many services exist in markets that have low entry barriers. However, barriers to entry can be created by using economies of scale, building market share, creating switching costs, investing in communications networks, and using databases and information technologies to strategic advantage. We will discuss three uses of information for creating barriers to entry: reservations systems, frequent flyer or similar programs to gain customer loyalty, and development of customer relationships to increase switching costs.

Reservation Systems

A barrier to entry can be created by investing in online reservations systems that are provided to sales intermediaries such as Expedia. American Airline's SABRE system is an example of the kind of subtle barrier to entry that is created by a comprehensive

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information system. United and Delta have duplicated this reservations system at great cost, but most smaller carriers use these existing systems for a fee. The competitive importance of online reservations systems became evident in late 1982. At this time, the Civil Aeronautics Board (CAB) and the U.S. Department of Justice began a joint investigation of possible antitrust violations by airline reservations systems. In this investigation, Frontier Airlines filed charges accusing United of unfairly restricting competition in the use of its Apollo computerized reservations system.

Frequent User Club

It was a small step for American Airlines, given its massive reservations system, to add passenger accounts to accumulate travel credit for frequent flyer awards. These programs, which award free trips and other awards, create strong brand loyalty among travelers, particularly business travelers who are not paying their own way. Thus, the discount fares of a new competitor have no appeal to these travelers. In recent years, however, the frequent-user benefits for airlines in particular have become very restricted; for example, credits that are generated by a given trip are greatly reduced, credits that are needed for a "free" flight are greatly increased, short expiration dates are implemented (a boon for magazine publishers), and availability of seats for free travel are sharply reduced and often relegated to undesirable times and connections. Therefore, the advent of online search engines that identify bargain fares might cause the restrictive frequent-user benefits to erode customer loyalty.

Switching Costs

Establishing customer relationships creates a cost in the form of a *switching cost*, an inconvenience for the customer to switch to another provider. Think of the hassle of changing your bank after you have arranged for automatic bill payment from your checking account.

Information technology in the form of online computer terminals has been used in the medical supplies industry to link hospitals directly to the suppliers' distribution networks. Both American Hospital Supply and the drug distributor McKesson have installed their online terminals in hospitals so that supplies and drugs can be purchased as the need arises. Significant switching costs are built into this arrangement, because the hospital is able to reduce inventory carrying costs and has the convenience of online ordering for replenishments. The supplier benefits by a reduction in selling costs because it is difficult for a competitor to entice away a customer who is already co-opted into its system.

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Revenue Generation

Real-time information technologies with a focus on internal operations can play a competitive role in increasing revenue opportunities. The concept of *yield management* is best understood as a revenue-maximizing strategy to make full use of service capacity (e.g., seats on an airline flight). The advent of smartphones and tablets has created opportunities for innovative point-of-sale suggestions, and the use of expert systems resident on servers and accessible by laptop computers in the field allows maintenance personnel to provide on-site customer service.

Yield Management

Through the use of its SABRE reservations system, American Airlines was the first to realize the potential of what is now called yield management. By constantly monitoring the status of both its upcoming flights and competitors' flights on the same route, American makes pricing and allocation decisions on unsold seats. Thus, the number of Supersaver fares allocated to a particular flight can be adjusted to ensure that remaining empty seats have a chance of being sold, but not at the expense of a full-fare seat. This real-time pricing strategy maximizes the revenue for each flight by ensuring that no seat goes empty for want of a bargain-seeking passenger while holding some seats in reserve for late arrivals who are willing to pay full fare.

Thus, yield management is the application of information to improve the revenue that is generated by a time-perishable resource (e.g., airline seats, hotel rooms). The success of yield management for American has not gone unnoticed by other service industries; for example, Marriott Hotels has a nationwide yield management system to increase occupancy rates. In addition, American Airlines is capitalizing on its innovation by selling its yield management software to noncompetitive industries such as the French national railroad. The topic of yield management is covered in more detail in Chapter 11, Managing Capacity and Demand.

Point of Sale

In China, Walmart introduced a new toy for the discount shopper: the VideOcart. As the shopper pushes the VideOcart through the store, nearby items on sale flash onto the attached video screen. The cart also helps customers find items in the store by listing hundreds of products by department and then displaying a map of the store. For another example, consider a commercial application for the iPad. With this device, a server in a restaurant can transmit an order directly to the kitchen monitor and the bill to the cashier at the same time. This saves unnecessary steps and allows more time for suggestive selling.

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Expert Systems

Otis Elevator Company puts an *expert system* together with laptop or tablet computers in the hands of its maintenance staff to speed repairs in the field. Collecting information on the behavior of its elevators over the years has led to a knowledge base that is incorporated into the expert system. Using the computer, a repair person in the field can access the system that is resident on a server and receive diagnostic help in identifying the source of a problem. As a result, elevators are placed back in service quickly, and fewer repair people are needed. Some of the earlier applications of expert systems have been in the medical field, to aid in disease diagnosis. As another example, an oil exploration expert system was able to identify promising drilling sites for a major oil company.

Database Asset

The database a service firm possesses can be a hidden asset of strategic importance. The expense of assembling and maintaining a large database is itself a barrier to entry by competitors. More important, however, the database can be mined for profiles of customers' buying habits, and these present opportunities for developing new services.

Rental car employees use handheld computers to speed up the car drop-off process, allowing customers to avoid missing flights.
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Selling Information

Dun & Bradstreet created a business by selling access to its database of business credit information. American Home Shield, a provider of service contracts for individual home heating, plumbing, and electrical systems, also discovered that it had a valuable asset in its database, accumulated over many years of repair experience; manufacturers now are invited to access this database to evaluate the performance patterns of their products. American Express has detailed information about the spending habits of its cardholders and now offers breakdowns of customer spending patterns to its retail customers.

Developing Services

Club Med, an all-inclusive resort company with locations worldwide, has evolved to reflect the maturing of its membership. Studying the database of member characteristics, Club Med realized that over time its once swinging singles members have become married with children. In order to continue capturing future vacation visits, Club Med modified some of its locations to accommodate families with young children. Now parents can enjoy the beach and water sports while their children are supervised by Club Med counselors at a children's park nearby. More recently, Club Med has added cruise ships to its vacation possibilities to attract the more senior members who are no longer interested in water sports. As this example illustrates, service firms that capture customer data at the time of the initial purchase have the opportunity to establish a lifetime relationship, with the potential for creating new or modified services for future purchase.

Micromarketing

Today, we can see a truly focused service strategy that can target customers at the micro level. Bar coding and checkout scanner technology create a wealth of consumer buying information that can be used to target customers with precision. Analysis of this database allows marketers to pinpoint their advertising and product distribution. To increase sales, Borden Inc. has used such information to select stores in which to feature its premium pasta sauce. Kraft USA saw its sales of cream cheese increase after targeting its flavors to the tastes of a particular store's shoppers. American Express, by analyzing information about its customers and their changing spending patterns in meticulous detail, can even tell when they get married.

Productivity Enhancement

New developments in the collection and analysis of information have increased our ability to manage multisite service operations. Through use of bar code information, retail

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