SERVICES IN THE MODERN ECONOMY

As consumers, we use services every day. Turning on a light, watching TV, talking on the telephone, riding a bus, visiting the dentist, mailing a letter, getting a haircut, refueling a car, writing a check, or sending clothes to the cleaners are all examples of service consumption at the individual level. The institution at which you are studying is itself a complex service organization. In addition to educational services, today's college facilities usually include libraries and cafeterias, counseling, a bookstore, placement offices, copy services, telecommunications, and even a bank. If you are enrolled at a residential university, campus services are also likely to include dormitories, health care, indoor and outdoor athletic facilities, a theater, and perhaps a post office.

Customers are not always happy with the quality and value of the services they receive. People complain about late deliveries, rude or incompetent personnel, inconvenient service hours, poor performance, and needlessly complicated procedures. They grumble about the difficulty of finding sales clerks to help them in retail stores, express frustration about mistakes on their credit card bills or bank statements, shake their heads over the complexity of new self-service equipment, mutter about poor value, and sigh as they are forced to wait in line almost everywhere they go.

Suppliers of services often seem to have a very different set of concerns than the consumer. Many suppliers complain about how difficult it is to make a profit, how hard it is to find skilled and motivated employees, or how difficult it has become to please customers. Some firms seem to believe that the surest route to financial success lies in cutting costs and eliminating "unnecessary" frills. A few even give the impression that they could run a much more efficient operation if it weren't for all the stupid customers who keep making unreasonable demands and messing things up!

Fortunately, in almost every industry there are service suppliers who know how to please their customers while also running a productive, profitable operation staffed by pleasant and competent employees. By studying organizations such as Charles Schwab, Intrawest, Aggreko, Southwest Airlines, eBay, and the many others featured in this book, we can draw important insights about the most effective ways to manage the different types of services found in today's economy.

What Is a Service?

Because of their diversity, services have traditionally been difficult to define. The way in which services are created and delivered to customers is often hard to grasp since many inputs and outputs are intangible. Most people have little difficulty defining manufacturing or agriculture, but defining **service** can elude them. Here are two approaches that capture the essence of the word.

- A service is an act or performance offered by one party to another. Although the process may be tied to a physical product, the performance is essentially intangible and does not normally result in ownership of any of the factors of production.
- Services are economic activities that create value and provide **benefits** for customers at specific times and places, as a result of bringing about a desired change in—or on behalf of—the recipient of the service.

More humorously, service has also been described as "something that may be bought and sold, but which cannot be dropped on your foot."

service: an act or performance that creates benefits for customers by bringing about a desired change in—or on behalf of—the recipient.

benefit: an advantage or gain that customers obtain from performance of a service or use of a physical good.

Understanding the Service Sector

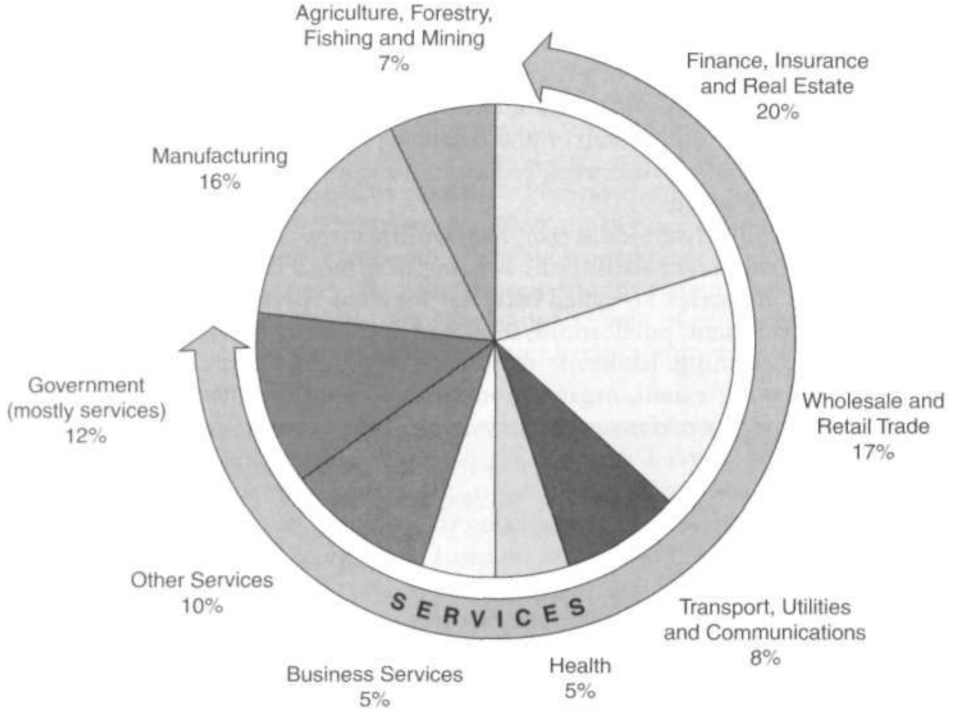
Services make up the bulk of today's economy, not only in the United States and Canada where they account for 73 percent and 67 percent of the gross domestic product (GDP), respectively, but also in other developed industrial nations throughout the world.[1] Figure 1.1 shows how service industries contribute to the economy of the United States relative to manufacturing, government (itself mostly services), agriculture, mining, and construction.

The **service sector** accounts for most of the new job growth in developed countries. In fact, unless you are already predestined for a career in a family manufacturing or agricultural business, the probability is high that you will spend your working life in companies (or public agencies and nonprofit organizations) that create and deliver services.

service sector: the portion of a nations economy represented by services of all kinds, including those offered by public and non-profit organizations.

As a nation's economy develops, the share of employment between agriculture, industry (including manufacturing and mining), and services changes dramatically. Figure 1.2 shows how the evolution to a service-dominated employment base is likely to take place over time as per capita income rises. Service jobs now account for 76 percent of private sector payrolls in the United States, with wages growing at a faster pace than in manufacturing jobs.[2] In most countries, the service sector of the economy is very diverse and includes a wide array of different industries, ranging in size from huge enterprises that operate on a global basis to small entrepreneurial firms that serve a single town.

It comes as a surprise to most people to learn that the dominance of the service sector is not limited to highly developed nations. For instance, World Bank statistics show that in many Latin American and Caribbean nations the service sector accounts

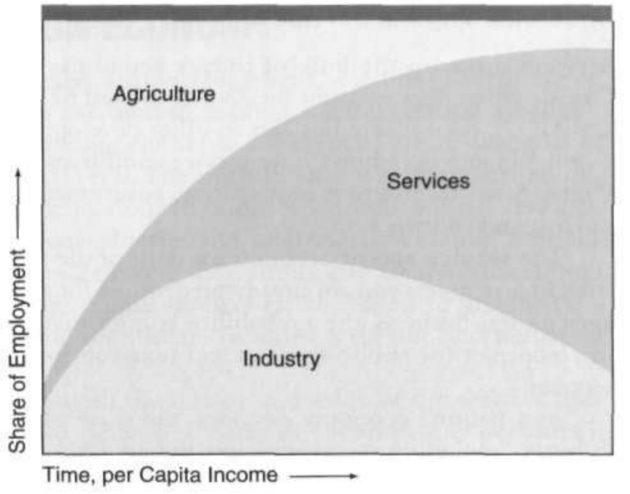


Source: U.S. Bureau of Economic Analysis, *Survey of Current Business*, December 2000, Table 1, p. 29.

FIGURE 1.1
Services in the U.S. Economy: Share of GDP by Industry, 1999

FIGURE 1.2

Changing Structure of Employment as an Economy Develops



Source: International Monetary Fund, *World Economic Outlook*, Washington, D.C.: International Monetary Fund, May 1997.

for more than half the gross national product (GNP) and employs more than half the labor force.[3] These countries often have a large "underground economy" that is not captured in official statistics. In Mexico, for instance, it has been estimated that as much as 40 percent of trade and commerce is "informal."[4] Significant service output is created by undocumented work in domestic jobs (e.g., cook, housekeeper, gardener) or in small, cash-based enterprises such as restaurants, laundries, rooming houses, and taxis.

Service organizations range in size from huge international corporations like airlines, banking, insurance, telecommunications, hotel chains, and freight transportation to a vast array of locally owned and operated small businesses, including restaurants, laundries, taxis, optometrists, and numerous business-to-business ("B2B") services. Franchised service outlets—in fields ranging from fast foods to bookkeeping—combine the marketing characteristics of a large chain that offers a standardized product with local ownership and operation of a specific facility. Some firms that create a time-sensitive physical product, such as printing or photographic processing, are now describing themselves as service businesses because speed, customization, and convenient locations create much of the value added.

There's a hidden service sector, too, within many large corporations that are classified by government statisticians as being in manufacturing, agricultural, or natural resources industries. So-called **internal** services cover a wide array of activities including recruitment, publications, legal and accounting services, payroll administration, office cleaning, landscape maintenance, freight transport, and many other tasks. To a growing extent, organizations are choosing to outsource those internal services that can be performed more efficiently by a specialist subcontractor. As these tasks are outsourced, they become part of the competitive marketplace and are therefore categorized as contributing to the service component of the economy. Even when such services are not outsourced, managers of the departments that supply them would do well to think in terms of providing good service to their internal customers.

internal services: service elements within any type of business that facilitate creation of, or add value to, its final output.

Governments and nonprofit organizations are also in the business of providing services, although the extent of such involvement may vary widely from one country to another, reflecting both tradition and political values. In many countries, colleges, hospitals, and museums are publicly owned or operate on a not-for-profit basis, but for-profit versions of each type of institution also exist.

MARKETING SERVICES VERSUS PHYSICAL GOODS

The dynamic environment of services today places a premium on effective marketing. Although it's still very important to run an efficient operation, it no longer guarantees success.The service product must be tailored to customer needs, priced realistically, distributed through convenient channels, and actively promoted to customers. New market entrants are positioning their services to appeal to specific market segments through their pricing, communication efforts, and service delivery, rather than trying to be all things to all people. But are the marketing skills that have been developed in manufacturing companies directly transferable to service organizations? The answer is often no, because marketing management tasks in the service sector tend to differ from those in the manufacturing sector in several important respects.

Basic Differences Between Goods and Services

Every **product**—a term used in this book to describe the core output of any type of industry—delivers benefits to the customers who purchase and use them. **Goods** can be described as physical objects or devices and services are actions or performances.[6] Early research into services sought to differentiate them from goods, focusing particularly on four generic differences, referred to as intangibility, heterogeneity (or variability), perishability of output, and simultaneity of production and consumption.[7] Although these characteristics are still cited, they have been criticized for over-simplifying the real-world environment. More practical insights are provided in Figure 1.3, which lists nine basic differences that can help us to distinguish the tasks associated with service marketing and management from those involved with physical goods.

product: the **core output** (either **a** service **or a** manufactured **good)** produced by **a firm.**

goods: physical objects or devices that **provide benefits** for customers **through** ownership or use.

It's important to note that in identifying these differences we're still dealing with generalizations that do not apply equally to all services. In Chapter 2, we classify services into distinct categories, each of which presents somewhat different challenges for marketers and other managers. We also need to draw a distinction between *marketing of services* and *marketing goods through service.* In the former, it's the service itself that is being sold and in the latter, service is added—usually free of charge—to enhance the appeal of a manufactured product. Now, let's examine each of the nine differences in more detail.

Customers Do Not Obtain Ownership Perhaps the key distinction between goods and services lies in the fact that customers usually derive value from services without obtaining permanent ownership of any substantial tangible elements. In many instances, service marketers offer customers the opportunity to rent the use of a physical object like a car or hotel room, or to hire the labor and skills of people whose expertise ranges from brain surgery to knowing how to check customers into a hotel. As a

- customers do not obtain ownership of services
- service products are intangible performances
- there is greater involvement of customers in the production process
- other people may form part of the product
- there is greater variability in operational inputs and outputs
- many services are difficult for customers to evaluate
- there is typically an absence of inventories
- the time factor is relatively more important
- delivery systems may involve both electronic and physical channels

FIGURE 1.3
Basic Differences **Between** Goods and Services

Checking in: People are part of the product in hotel services, so customer satisfaction depends on both employee performance and the behavior of the other customers.

purchaser of services yourself, you know that "while your main interest is in the final output, the way in which you are treated during service delivery can also have an important impact on your satisfaction.

intangible: something that is experienced and cannot be touched or preserved.

Service Products as Intangible Performances Although services often include tangible elements—such as sitting in an airline seat, eating a meal, or getting damaged equipment repaired—the service performance itself is basically an intangible. The benefits of owning and using a manufactured product come from its physical characteristics (although brand image may convey benefits, too). In services, the benefits come from the nature of the performance. The notion of service as a performance that cannot be wrapped up and taken away leads to the use of a theatrical metaphor for service management, visualizing service delivery as similar to the staging of a play with service personnel as the actors and customers as the audience.

Some services, such as rentals, include a physical object like a car or a power tool. But marketing a car rental performance is very different from attempting to market the physical object alone. For instance, in car rentals, customers usually reserve a particular category of vehicle, rather than a specific brand and model. Instead of worrying about styling, colors, and upholstery, customers focus on price, location and appearance of pickup and delivery facilities, extent of insurance coverage, cleanliness and maintenance of vehicles, provision of free shuttle buses at airports, availability of 24-hour reservations service, hours when rental locations are staffed, and quality of service provided by customer-contact personnel. By contrast, the core benefit derived from owning a physical good normally comes specifically from its tangible elements, even though it may provide intangible benefits, too. An interesting way to distinguish between goods and services is to place them on a scale from tangible dominant to intangible dominant (illustrated in Figure **1.4).**

Customer Involvement in the Production Process Performing a service involves assembling and delivering the output of a combination of physical facilities and mental or physical labor. Often, customers are actively involved in helping create

FIGURE 1.4
Value Added by Tangible versus Intangible Elements in Goods and Services

the service product, either by serving themselves (as in using a laundromat or ATM) or by cooperating with service personnel in settings such as hair salons, hotels, colleges, or hospitals. As we "will see in Chapter 2, services can be categorized according to the extent of contact that the customer has with the service organization.

People as Part of the Product In high-contact services, customers not only come into contact with service personnel, but they may also rub shoulders with other customers (literally so, if they ride a bus or subway during the rush hour). The difference between service businesses often lies in the quality of employees serving the customers. Similarly, the type of customers who patronize a particular service business helps to define the nature of the service experience. As such, people become part of the product in many services. Managing these service encounters—especially those between customers and service employees—is a challenging task.

Greater Variability in Operational Inputs and Outputs The presence of personnel and other customers in the operational system makes it difficult to standardize and control **variability** in both service inputs and outputs. Manufactured goods can be produced under controlled conditions, designed to optimize both productivity and quality, and then checked for conformance with quality standards long before they reach the customer. (Of course, their subsequent use by customers will vary widely, reflecting customer needs and skills, as well as the nature of the usage occasion.) However, when services are consumed as they are produced, final "assembly" must take place under real-time conditions, which may vary from customer to customer and even from one time of the day to another. As a result, mistakes and shortcomings are both more likely and harder to conceal. These factors make it difficult for service organizations to improve productivity, control quality, and offer a consistent product. As

variability: a lack of consistency in inputs and outputs during the service production process.

a former packaged goods marketer observed some years ago after moving to a new position at Holiday Inn:

> *We can't control the quality of our product as well as a Procter and Gamble control engineer on a production line can. . . . Wlien you buy a box of Tide, you can reasonably be 99 and 44/100ths percent sure that this stuff will work to get your clothes clean. When you buy a Holiday Inn room, you're sure at some lesser percentage that it will work to give you a good night's sleep without any hassle, or people banging on the walls and all the bad things that can happen in a hotel.*[9]

Not all variations in service delivery are necessarily negative. Modern service businesses are recognizing the value of customizing at least some aspects of the service offering to the needs and expectations of individual customers. In some fields, like health care, customization is essential.[10]

Harder for Customers to Evaluate Most physical goods tend to be relatively high in "search attributes."These are characteristics that a customer can determine prior to purchasing a product, such as color, style, shape, price, fit, feel, and smell. Other goods and some services, by contrast, may emphasize "experience attributes" that can only be discerned after purchase or during consumption (e.g., taste, wearability, ease of handling, quietness, and personal treatment). Finally, there are "credence attributes"—characteristics that customers find hard to evaluate even after consumption. Examples include surgery and auto repairs, where the results of the service delivery may not be readily visible.[11]

No Inventories for Services Because a service is a deed or performance, rather than a tangible item that the customer keeps, it is "perishable" and cannot be inventoried. Of course, the necessary facilities, equipment, and labor can be held in readiness to create the service, but these simply represent productive capacity, not the product itself. Having unused capacity in a service business is rather like running water into a sink without a stopper. The flow is wasted unless customers (or possessions requiring service) are present to receive it. When demand exceeds capacity, customers may be sent away disappointed, since no inventory is available for backup. An important task for service marketers, therefore, is to find ways of smoothing demand levels to match capacity.

Importance of the Time Factor Many services are delivered in real time. Customers have to be physically present to receive service from organizations such as airlines, hospitals, haircutters, and restaurants. There are limits as to how long customers are willing to be kept waiting and service must be delivered fast enough so that customers do not waste time receiving service. Even when service takes place in the back office, customers have expectations about how long a particular task should take to complete—whether it is repairing a machine, completing a research report, cleaning a suit, or preparing a legal document.Today's customers are increasingly time sensitive and speed is often a key element in good service.

Different Distribution Channels Unlike manufacturers that require physical distribution channels to move goods from factory to customers, many service businesses either use electronic channels (as in broadcasting or electronic funds transfer) or combine the service factory, retail outlet, and point of consumption at a single location. In the latter instance, service firms are responsible for managing customer-contact personnel. They may also have to manage the behavior of customers in the service factory to ensure smoothly running operations and to avoid situations in which one person's behavior irritates other customers who are present at the same time.

AN INTEGRATED APPROACH TO SERVICE MANAGEMENT

This book is not just about service marketing. Throughout the chapters, you'll find continuing reference to two other important functions: service operations and human resource management. Imagine yourself as the manager of a repair garage. Or think big, if you like, as the CEO of a major airline. In either instance, you need to be (1) concerned on a day-to-day basis that your customers are satisfied, (2) your operational systems are running smoothly and efficiently, and (3) your employees are not only working productively but are also doing a good job either of serving customers directly or of helping other employees to deliver good service. Even if you see yourself as a middle manager with specific responsibilities in marketing, operations, or human resources, your success in your job will often involve the understanding of these other functions and periodic meetings with colleagues working in these areas. In short, integration of activities between functions is the name of the game. Problems in any one of these three areas may signal financial difficulties ahead.

The Eight Components of Integrated Service Management

When discussing strategies to market manufactured goods, marketers usually address four basic strategic elements: product, price, place (or distribution), and promotion (or communication). Collectively, these four categories are often referred to as the "4Ps" of the marketing mix.[12] However, the distinctive nature of service performances, especially such aspects as customer involvement in production and the importance of the time factor, requires that other strategic elements be included. To capture the nature of this challenge, we will be using the "8Ps" of **integrated service management,** which describe eight decision variables facing managers of service organizations.

integrated service management: the coordinated planning and execution of those marketing, operations, and human resources activities that are essential to a service firm's success.

Our visual metaphor for the 8Ps is the racing "eight," a lightweight boat or shell powered by eight rowers, made famous by the Oxford and Cambridge boat race that has taken place annually on the River Thames near London for almost 150 years. Today, similar races involving many different teams are a staple of rowing competitions around the world, as well as a featured sport in the Summer Olympics. Speed comes not only from the rowers' physical strength, but also from their harmony and cohesion as part of a team. To achieve optimal effectiveness, each of the eight rowers must pull on his or her oar in unison with the others, following the direction of the coxswain, who is seated in the stern. A similar synergy and integration between each of the 8Ps is required for success in any competitive service business (Figure 1.5). The cox—who steers the boat, sets

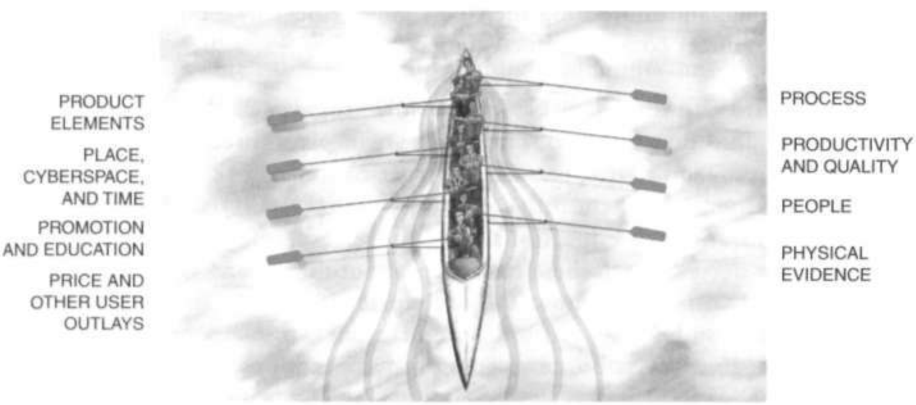


FIGURE 1.5

The Eight Components of Integrated Service Management the pace, motivates the crew, and keeps a close eye on competing boats in the race—is a metaphor for management.

product elements: all components of the service performance that create value for customers.

Product Elements Managers must select the features of both the core product and the bundle of supplementary service elements surrounding it, with reference to the benefits desired by customers and how well competing products perform.

place, cyberspace, and time: management decisions about when, where, and how to deliver services to customers.

Place, Cyberspace, and Time Delivering product elements to customers involves decisions on both the place and time of delivery and may involve physical or electronic distribution channels (or both), depending on the nature of the service being provided. Messaging services and the Internet allow information-based services to be delivered in cyberspace for retrieval by telephone or computer wherever and whenever it suits the customer. Firms may deliver service directly to their customers or through intermediary organizations like retail outlets owned by other companies, which receive a fee or percentage of the selling price to perform certain tasks associated with sales, service, and customer-contact. Customer expectations of speed and convenience are becoming important determinants in service delivery strategy.

process: a particular method of operations or series of actions, typically involving steps that need to occur in a defined sequence.

Process Creating and delivering product elements to customers requires the design and implementation of effective processes. A process describes the method and sequence in which service operating systems work. Badly designed processes are likely to annoy customers because of slow, bureaucratic, and ineffective service delivery. Similarly, poor processes make it difficult for front-line staff to do their jobs well, result in low productivity, and increase the likelihood of service failures.

productivity: how efficiently service inputs are transformed into outputs that add value for customers.

quality: the degree to which a service satisfies customers by meeting their needs, wants, and expectations.

Productivity and Quality These elements, often treated separately, should be seen as two sides of the same coin. No service firm can afford to address either element in isolation. Improved productivity is essential to keep costs under control but managers must beware of making inappropriate cuts in service levels that are resented by customers (and perhaps by employees, too). Service quality, as defined by customers, is essential for product differentiation and for building customer loyalty. However, investing in quality improvement without understanding the trade-off between incremental costs and incremental revenues may place the profitability of the firm at risk.

people: customers and employees who are involved in service production.

People Many services depend on direct, personal interaction between customers and a firm's employees (like getting a haircut or eating at a restaurant). The nature of these interactions strongly influences the customer's perceptions of service quality.[14] Customers often judge the quality of the service they receive largely on their assessment of the people providing the service. Successful service firms devote significant effort to recruiting, training, and motivating their personnel, especially—but not exclusively—those who are in direct contact with customers.

promotion and education: all communication activities and incentives designed to build customer preference for a specific service or service provider.

Promotion and Education No marketing program can succeed without an effective communication program. This component plays three vital roles: providing needed information and advice, persuading target customers of the merits of a specific product, and encouraging them to take action at specific times. In service marketing, much communication is educational in nature, especially for new customers. Companies may need to teach these customers about the benefits of the service, where and when to obtain it, and how to participate effectively in service processes. Communications can be delivered by individuals, such as salespeople and trainers, or through such media as TV, radio, newspapers, magazines, billboards, brochures, and Web sites.

Physical Evidence The appearance of buildings, landscaping, vehicles, interior furnishing, equipment, staff members, signs, printed materials, and other visible cues all provide tangible evidence of a firm's service style and quality. Service firms need to manage physical evidence carefully because it can have a profound impact on customers' impressions. In services with few tangible elements, such as insurance, advertising is often employed to create meaningful symbols. For instance, an umbrella may symbolize protection, and a fortress, security.

physical evidence: visual or other tangible clues that provide evidence of service quality,

Price and Other User Outlays This component addresses management of the *outlays* incurred by customers in obtaining benefits from the service product. Responsibilities are not limited to the traditional pricing tasks of establishing the selling *price* to customers, which typically include setting trade margins and establishing credit terms. Service managers also recognize and, where practical, seek to minimize other costs and burdens that customers may bear in purchasing and using a service, including additional financial expenditures, time, mental and physical effort, and negative sensory experiences.

price and other user outlays: expenditures of money, time, and effort that customers incur in purchasing and consuming services.

Unking Service Marketing, Operations, and Human Resources

As shown by the component elements of the 8Ps model, marketing cannot operate in isolation from other functional areas in a successful service organization. Operations specialists, who usually have responsibility for productivity improvements and quality control, manage the processes required to create and deliver the service product. Similarly, employees are recruited and trained by human resource managers. Even those who have customer-contact responsibilities often report to operations managers.

In future chapters, we will be raising the question of how marketers should relate to and involve their colleagues from other functional areas—especially operations and human resources—in planning and implementing marketing strategies. Firms whose managers succeed in developing integrated strategies will have a better chance of surviving and prospering. Those that fail to grasp these implications, by contrast, are likely to be outmaneuvered by competitors that are more adept at responding to the dramatic changes affecting the service economy.

You can expect to see the 8Ps framework used throughout this book. Although any given chapter is likely to emphasize just one (or a few) of the eight components, you should always keep in mind the importance of integrating the component(s) under discussion with each of the others when formulating an overall strategy. For a quick clue about the principal focus of each chapter, find the boat diagram on the opening page of the chapter. You'll see that each oar represents one of the 8Ps. Note which of the eight oars are highlighted for the chapter you are studying. Oars highlighted in dark blue indicate those components that will be covered extensively in a particular chapter, while a medium blue highlight identifies one that receives relatively brief coverage. If an oar remains white, it signals that this component is not featured in the chapter.

THE EVOLVING ENVIRONMENT OF SERVICES

We've already noted that the service sector is in an almost constant state of change. What are the forces that drive its growth, shape its composition, and determine the basis for competition? As shown in Figure 1.6, numerous factors are at work. They can be divided into five broad groups: government policies, social changes, business trends, advances in information technology, and internationalization and globalization.

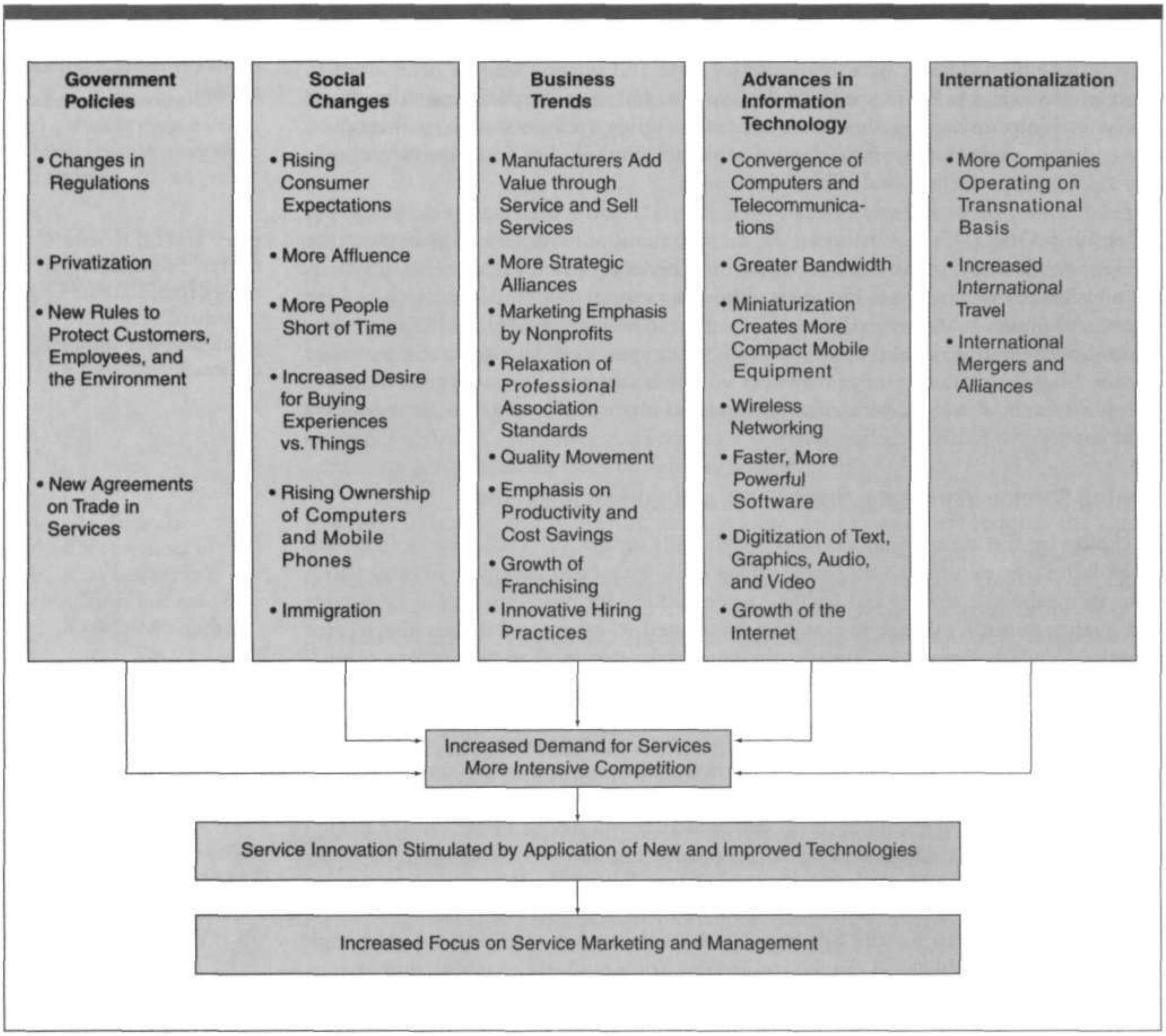


FIGURE 1.6
Factors Stimulating the Transformation of the Service Economy

Government Policies

Actions by governmental agencies at regional, national, and international levels continue to shape the structure of the service economy and the terms under which competition takes place. Traditionally, many service industries were highly regulated. Government agencies mandated price levels, placed geographic constraints on distribution strategies, and, in some instances, even defined the product attributes. Since the late 1970s, there has been a trend in the United States and Europe toward complete or partial deregulation in several major service industries. In Latin America, democratization and new political initiatives are creating economies that are much less regulated than in the past. Reduced government regulation has already eliminated or minimized many constraints on competitive activity in such industries as airfreight, airlines, railroads, trucking, banking, securities, insurance, and telecommunications. Barriers that had prevented new firms from entering the industry have been dropped in many instances: Geographic restrictions on service delivery have been reduced, there is more freedom to compete on price, and existing firms have been able to expand into new markets or new lines of business.

However, reduced regulation is a mixed blessing. Fears have been expressed that if successful firms become too large, through a combination of internal growth and acquisitions, there may eventually be a decline in the level of competition. Conversely, lifting restrictions on pricing benefits customers in the short run as competition lowers prices but leaves insufficient profits for needed future investments. For instance, fierce price competition among American domestic airlines led to huge financial losses within the industry during the early 1990s, bankrupting several airlines. This made it difficult for unprofitable carriers to invest in new aircraft and raised troublesome questions about service quality and safety.[15] Profitable foreign airlines, such as British Airways and Singapore Airlines, gained market share by offering better service on international routes instead of engaging in damaging price wars.

Another important action taken by many national governments has been privatization of what were once government-owned services. The term "privatization," first widely used in the United Kingdom, describes the policy of transforming government organizations into investor-owned companies. Privatization has been moving ahead rapidly in many European countries, as well as in Canada, Australia, New Zealand, and more recently in some Asian and Latin American nations. The transformation of operations like national airlines, telecommunication services, and utilities into private enterprise services has led to restructuring, cost cutting, and a more market-focused posture.

When privatization is combined with a relaxing of regulatory barriers to allow entry of new competitors, the marketing implications can be dramatic, with foreign competitors moving into markets that were previously closed to outside investment. Thus, French companies specializing in water treatment have purchased and modernized many of the privatized water utilities in Britain, while American companies have invested in a number of British regional electrical utilities. In turn, British Telecommunications has responded vigorously to new competition at home and made numerous investments around the world, including a strategic alliance with AT&T for delivery of global services to international companies.

Privatization can also apply to regional or local government departments. At the local level, for instance, services such as trash removal and recycling have been shifted from the public sector to private firms. Not everyone is convinced that such changes are beneficial to all segments of the population. When services are provided by public agencies, there are often cross subsidies, designed to achieve broader social goals. With privatization, there are fears that the search for efficiency and profits will lead to cuts in service and price increases. The result may be to deny less affluent segments the services they need at prices they can afford. Such fears fuel the arguments for continued regulation of prices and terms of service in key industries such as health care, telecommunications, water, electricity, and passenger rail transportation.

Not all regulatory changes represent a relaxation of government rules. In many countries, steps continue to be taken to strengthen consumer protection laws, safeguard employees, improve health and safety, and protect the environment. These new rules often require service firms to change their marketing strategies, their operational procedures, and their human resource policies.

Finally, national governments control trade in both goods and services. Negotiations at the World Trade Organization have led to a loosening of restrictions on trade in some services, but not all. Some countries are choosing to enter into free-trade agreements with their neighbors. Examples include the North American Free Trade Agreement (NAFTA) concluded between Canada, Mexico, and the United States;

Mercosur and Pacto Andino in South America; and, of course, the European Union, whose membership may soon be expanded beyond the current 15 countries.

Social Changes

The demand for consumer services—and the ways in which people use them—have been strongly influenced by a host of social changes. More people are living alone than before and there are more households containing two working adults (including telecommuters who work from in-home offices); as a result, more people find themselves short on time. They may be obliged to hire firms or individuals to perform tasks like childcare, housecleaning, laundry, and food preparation that were traditionally performed by a household member. Per capita income has risen significantly in real terms for many segments of the population (although not all have benefited from this trend). Increasing affluence gives people more disposable income and there has been an observed trend from purchasing new physical possessions to buying services and experiences. In fact, some pundits have begun speaking of the "experience economy."[16]

A combination of changing lifestyles, higher incomes, and declining prices for many high-technology products has meant that more and more people are buying computers, thus enabling them to use the Internet to send and receive e-mail and access Web sites from around the world. In the meantime, the rapid growth in the use of mobile phones and other wireless equipment means that customers are more "connected" than ever before and no longer out of touch once they leave their homes or offices.

Another important social trend has been increased immigration into countries such as the United States, Canada, and Australia. These countries are becoming much more multicultural, posing opportunities—and even requirements—for service features designed to meet the needs of non-traditional segments now living within the domestic market. For instance, many immigrants, even if they have learned to speak the language of their new country, prefer to do business in their native tongues and appreciate those service organizations that accommodate this preference by offering communications in multiple languages.

Business Trends

Over the past 25 years, significant changes have taken place in how business firms operate. For instance, service profit centers within manufacturing firms are transforming many well-known companies in fields such as computers, motor vehicles, and electrical and mechanical equipment. Supplementary services once designed to help sell equipment—including consultation, credit, transportation and delivery, installation, training, and maintenance—are now offered as profit-seeking services in their own right, even to customers who have chosen to purchase competing equipment. Several large manufacturers (including General Electric, Ford, and DaimlerChrysler) have become important players in the global financial services industry as a result of developing credit financing and leasing divisions. Similarly, many manufacturers now base much of their competitive appeal on the capabilities of their worldwide consultation, maintenance, repair, and problem-solving services. In fact, service profit centers contribute a substantial proportion of the revenues earned by such well-known "manufacturers" as IBM, Hewlett-Packard, and Xerox.

The financial pressures confronting public and nonprofit organizations have forced them to develop more efficient operations and to pay more attention to customer needs and competitive activities. In their search for new sources of income, many "non-business" organizations are developing a stronger marketing orientation that often involves rethinking their product lines; adding profit-seeking services such as shops, retail catalogs, restaurants, and consultancy; becoming more selective about the market segments they target; and adopting more realistic pricing policies.[17]

Government or legal pressures have forced many professional associations to remove or relax long-standing bans on advertising and promotional activities. Among the types of professionals affected by such rulings are accountants, architects, doctors, lawyers, and optometrists, whose practices now engage in much more vigorous competitive activity. The freedom to engage in advertising, promotion, and overt selling activities is essential in bringing innovative services, price cuts, and new delivery systems to the attention of prospective customers. However, some critics worry that advertising by lawyers, especially in the United States, simply encourages people to file more and more lawsuits, many of them frivolous.

With increasing competition, often price-based, has come greater pressure for firms to improve productivity. Demands by investors for better returns on their investments have also fueled the search for new ways to increase profits by reducing the costs of service delivery. Historically, the service sector has lagged behind the manufacturing sector in productivity improvement, but there are encouraging signs that some services are beginning to catch up. Using technology to replace labor (or to permit customer self-service) is one cost-cutting route that has been followed in many service industries. Reengineering of processes often results in speeding up operations by cutting out unnecessary steps. However, managers need to be aware that cost-cutting measures, driven by finance and operations personnel without regard for customer needs, may lead to a perceived deterioration in quality and convenience.

Recognizing that improving quality was good for business and necessary for effective competition has led to a radical change in thinking. Traditional definitions of quality (based on conformance to standards defined by operations managers) were replaced by the new imperative of letting quality be customer driven. This had enormous implications for the importance of service marketing and the role of customer research in both the service and manufacturing sectors.[18] Numerous firms have invested in research to determine what their customers want in every dimension of service, in quality improvement programs designed to deliver what customers want, and in ongoing measurement of how satisfied their customers are with the quality of service received. However, maintaining quality levels over time is difficult and customer dissatisfaction has risen in recent years.

Franchising has become widespread in many service industries, not only for consumer services but also for business-to-business services. It involves the licensing of independent entrepreneurs to produce and sell a branded service according to tightly specified procedures. Because these entrepreneurs must invest their own capital, franchising has become a popular way to finance the expansion of multi-site service chains that deliver a consistent service concept. Large franchise chains are replacing (or absorbing) a wide array of small, independent service businesses in fields as diverse as bookkeeping, car hire, dry-cleaning, haircutting, photocopying, plumbing, quick service restaurants, and real estate brokerage services. Among the requirements for success are creation of mass media advertising campaigns to promote brand names nationwide (and even worldwide), standardization of service operations, formalized training programs, an ongoing search for new products, continued emphasis on improving efficiency, and dual marketing programs directed at both customers and franchisees.

Finally, changes have occurred in service firms' hiring practices. Traditionally, many service industries were very inbred. Managers tended to spend their entire careers working within a single industry, even within a single organization. Each industry was seen as unique and outsiders were suspect. Relatively few managers possessed graduate degrees in business although they might have held an industry-specific diploma in a field such as hotel management or health care administration. In recent years, however, competition and enlightened self-interest have led companies to recruit more highly educated managers who are willing to question traditional ways of doing business and able to bring new ideas from previous work experience in another industry. Some of the best service companies are known for being very selective in hiring employees, seeking individuals who will share the firm's strong service quality culture and be able to relate to customers well. Within many firms, intensive-training programs are now exposing employees, at all levels, to new tools and concepts.

Advances in Information Technology

New and improved technologies are radically altering the ways in which many service organizations do business with their customers, as well as altering what goes on behind the scenes. Many types of technology have important implications for service, including biotechnology, power and energy technology, methods technology (how people work and how processes are organized), materials technology, physical design technology, and information technology. In some cases, technology enables service firms to substitute automation for service personnel. But in other instances, as suggested in recent advertising for Singapore Airlines (Figure 1.7), traditional personal service and new technology may go hand in hand to create an enhanced experience for customers.

Perhaps the most powerful force for change in service businesses comes from information technology, reflecting the integration of computers and telecommunications. Digitization allows text, graphics, video, and audio to be manipulated, stored, and transmitted in the digital language of computers. Faster and more powerful software enables firms to create relational databases that combine information about customers with details of all their transactions and then to "mine" these databases for insights into new trends, new approaches to segmentation, and new marketing opportunities. Greater bandwidth, made possible by innovations such as fiber-optic cables, allows fast transmission of vast amounts of information so that customer-contact personnel can interact almost instantly with a central database, no matter where they are located. The creation of wireless networks and the miniaturization of electronic equipment—from cell

FIGURE 1.7

Singapore Airlines Promotes Both Its People and Its High-Tech Entertainment Technology phones to laptops and scanners—allow sales and customer service personnel to keep in touch while on the move. Companies operating information-based services, such as financial service firms, have seen the nature and scope of their businesses totally transformed by the advent of global electronic delivery systems.

In recent years, the development of the Internet and its best-known component, the World Wide Web, have provided not only an important new medium of communication between service organizations and their customers, but also the potential for creating radically new business models for delivery of services. Properly designed and configured, such Internet-based services offer unprecedented speed and reach. For instance, by taking advantage of the Internet, Amazon.com became a global operation in just a few short years, marketing its huge array of books, music, and other items through its Web site and using modern business logistics to ship purchases quickly to customers all over the world.

However, for many "dot.com" companies, including Amazon, profitability has proved elusive and numerous start-up firms have failed. In some cases, the problem lies 111 development of inappropriate e-commerce business models that failed to generate sufficient revenues to cover expenses.[20] Greater competition than anticipated, failure to understand customer needs and expectations, poor execution, technology failures, insufficient working capital, and higher operating costs than predicted have all contributed to such failures. Underlying such failures is often a lack of understanding of some of the key principles of service marketing and management.

Technological change affects many other types of services, too, from airfreight to hotels to retail stores. Express package firms such as TNT, DHL, FedEx, and UPS recognize that the ability to provide real-time information about customers' packages has become as important to success as the physical movement of those packages. Technology does more than enable creation of new or improved services. It may also facilitate reengineering of such activities as delivery of information, order-taking and payment; enhance a firm's ability to maintain more consistent service standards; permit creation of centralized customer service departments; allow replacement of personnel by machines for repetitive tasks; and lead to greater involvement of customers in operations through self-service technology. All in all, technology is an important theme running through this book. It's covered in detail in Chapter 16.

Internationalization and Globalization

The internationalization of service companies is readily apparent to any tourist or business executive traveling abroad. More and more services are being delivered through national or global chains. Brand names such as Air Canada, Burger King, Body Shop, Hertz, Kinko's, and Mandarin Hotels have spread far from their original national roots. In some instances, such chains are entirely company owned. In other instances, the creator of the original concept has entered into partnership with outside investors. Airlines and airfreight companies that were formerly just domestic in scope now have extensive foreign route networks. Numerous financial service firms, advertising agencies, hotel chains, fast-food restaurants, car rental agencies, and accounting firms now operate on several continents. Some of this growth has been internally generated, but much has also come about through acquisitions of other companies.

A strategy of international expansion may be driven by a search for new markets or by the need to respond to existing customers who are traveling abroad in increasing numbers. A similar situation prevails in business-to-business services. When companies set up operations in other countries, they often prefer to deal with a few international suppliers rather than numerous local firms.

The net effect of such developments is to increase competition and to encourage the transfer of innovation in both products and processes from country to country. Developing a strategy for competing effectively across different countries is becoming a major marketing priority for many service firms. Franchising offers a way to enable a service concept developed in one nation to be delivered around the world through distribution systems owned by local investors. For example, FedEx and UPS have expanded into numerous countries by purchasing local courier firms.

Many well-known service companies around the world are American-owned; examples include Citicorp, McDonald's, and Accenture (Andersen Consulting). The upscale Four Seasons hotel chain is Canadian. North Americans are often surprised to learn that Dunkin' Donuts and Holiday Inn are both owned by British companies, while France's Groupe Accor owns Motel 6 and Red Roof Inns and the Hoyts chain of movie theaters is Australian owned. An alternative to mergers and takeovers is strategic alliances, where several firms working in the same or complementary industries in different countries join forces to expand their geographic reach and product scope. The airline and telecommunication industries are good examples.

Managing in a Continually Changing Environment

It has been said that the only person in the world who really appreciates a change is a wet baby. However, the willingness and ability of managers in service firms to respond to the dramatic changes affecting the service economy will determine whether their own organizations survive and prosper or are defeated by more agile and adaptive competitors. On the positive side, these changes are likely to increase the demand for many services, and the opening of the service economy means that there will be greater competition for that demand. In turn, more competition will stimulate innovation, notably through the application of new and improved technologies. Both singly and in combination, these developments will require managers of service organizations to focus more sharply on marketing strategy.

A STRUCTURE FOR MAKING SERVICE MANAGEMENT DECISIONS

As mentioned previously, this text has a strategic focus. The 8Ps of integrated service strategy are tools that service managers can use to develop effective strategies for marketing and managing many different types of services. The service decision framework reproduced in Figure 1.8 (and described in more depth in the introduction to Part I) outlines some of the key questions managers need to ask. Figure 1.8 also indicates which of the 8Ps are particularly relevant in each instance. Your challenge is to learn to ask the right questions and to learn to use the resulting answers to develop a viable strategy, employing different elements of the 8Ps as appropriate.

The framework begins with a question that lies at the heart of marketing and business strategy in general: ***What business are we in?*** Determining the nature of the business goes beyond just specifying the industry with which a specific service is usually associated. Astute managers recognize that competition may come from outside that industry as well as within it. Hence they ask: With what other goods and services do we compete?"The answers may show that there are several different ways for customers to satisfy their needs.The need for forward thinking in decision making requires that managers also ask themselves, "What forces for change do we face?" But perhaps the most valuable insights come from determining what *solutions* a service offers to customers. Only when service marketers understand what problems customers are trying to solve through use of their products can we truly say that they know what business they are in.

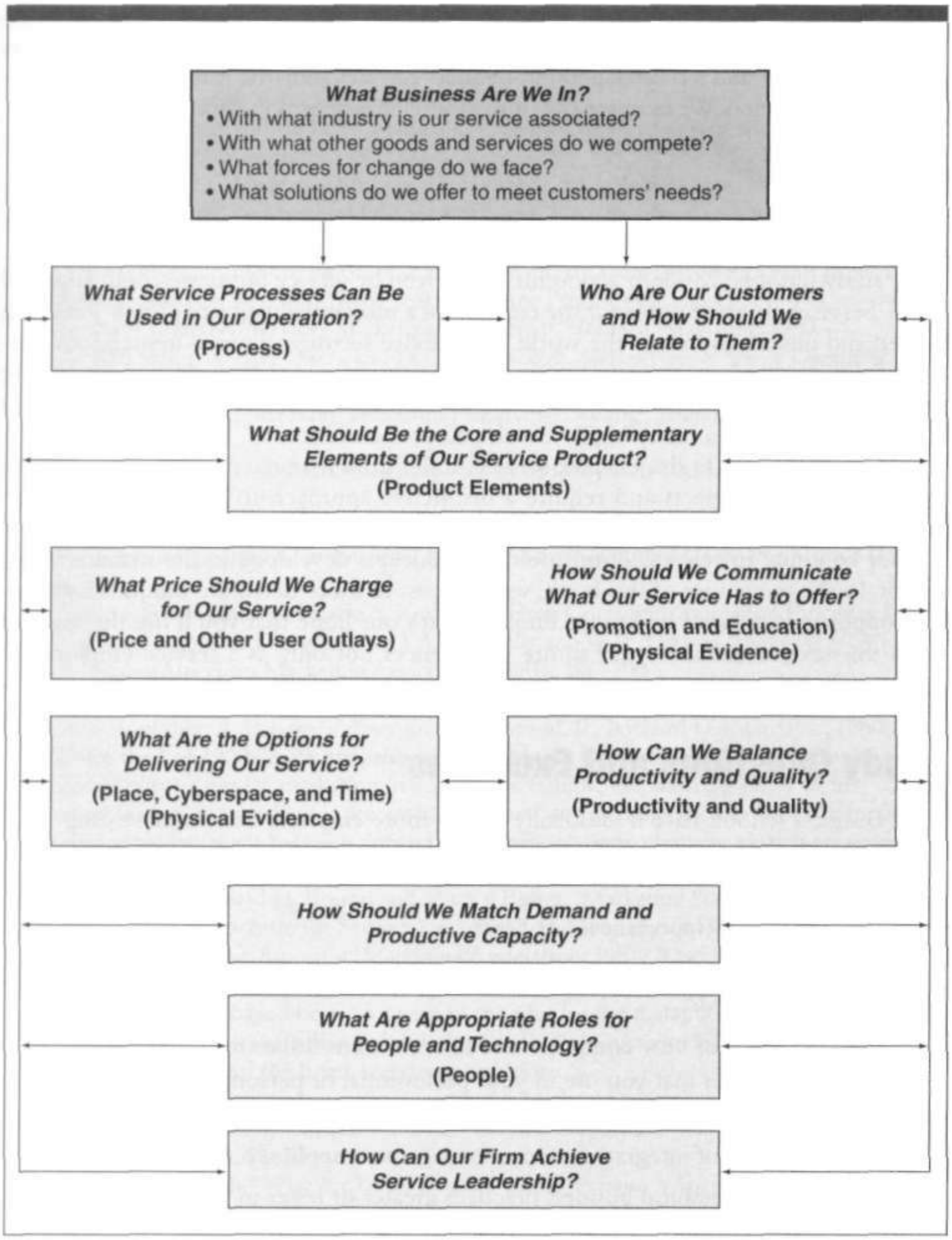


FIGURE 1.8

Relating the 8Ps to the Service Management Decision Framework

The question, ***Who are our customers and how should we relate to them?*** is also central to the study and practice of marketing. Recognizing that most readers of this book already have some familiarity with marketing, we try to build on this prior understanding rather than repeating the basics of introductory marketing theory and practice. Hence we leave detailed discussion of customers to Part II of the book and focus there on what is distinctive about service consumption.

One of the keys to strategy formulation in services, not normally addressed in goods marketing, is the question: ***What service processes can be used in our operation?*** As we show in this text, the importance of this question goes beyond operational issues. Marketers must understand how the processes used to create and deliver service affect their customers, influence the nature of the service product, and shape the options for delivering this service. Human resource managers must understand how the choice of processes influences skill requirements and job descriptions for employees, including the nature of their interactions with customers. We examine the issue of service processes in depth in Chapter 2.

Conclusion

Why study services? Modern economies are driven by service businesses, both large and small. Services are responsible for the creation of a substantial majority of new jobs, both skilled and unskilled, around the world. The service sector includes a tremendous variety of different industries, including many activities provided by public and nonprofit organizations. It accounts for over half the economy in most developing countries and for over 70 percent in many highly developed economies.

As we've shown in this chapter, services differ from manufacturing organizations in many important respects and require a distinctive approach to marketing and other management functions. As a result, managers who want their enterprises to succeed cannot continue to rely solely on tools and concepts developed in the manufacturing sector. In the remainder of this book, we'll discuss in more detail the unique challenges and opportunities faced by service businesses. It's our hope that you'll use the material from this text to enhance your future experiences not only as a service employee or manager, but also as a customer of many different types of service businesses!

Study Questions and Exercises

1. Business schools have traditionally placed more emphasis on manufacturing industries than on service industries in their courses. Why do you think this is so? Does it matter?
2. Why is time so important in services?
3. What are the implications of increased competition in service industries that have been deregulated?
4. Give examples of how computer and telecommunications technologies have changed services that you use in your professional or personal life.
5. Choose a service company you are familiar with and show how each of the eight elements (8Ps) of integrated service management applies to the company.
6. Is the risk of unethical business practices greater or lesser in service businesses than in manufacturing firms? Explain your answer.
7. Why do marketing, operations, and human resources have to be more closely linked in services than in manufacturing? Give examples.
8. Answer the four questions associated with "What business are we in?" from Figure 1.8 for Southwest Airlines, Charles Schwab, Aggreko, Intrawest, and eBay.

Endnotes

1. The gross domestic product (GDP) and gross national product (GNP) are both widely used measures of a nation's economic activity. They differ in their treatment of international transactions. For the United States, there is little difference between the two measures, since only a tiny percentage of Americans work abroad and the foreign earnings

of U.S. firms are broadly equal to the U.S. earnings of foreign firms. However, differences between GDP and GNP are substantial for countries where many nationals work abroad (e.g., Pakistan) or where foreign investment in the country greatly exceeds investment abroad by domestic firms (e.g., Canada).

2. James C. Cooper and Kathleen Madigan, "Fragile Markets Are Tying the Fed's Hands," *Business Week,* 4 November 1997', 33.
3. World Bank, *El Mundo delTrabajo en una Economia lntegrada* (Washington D.C., 1995).
4. Javier Reynoso, "Progress and Prospects of Services Management in Latin America," *International Journal of Service Industry Management,* 10, no. 5 (1999), 401-408.
5. See, for example, the discussion of outsourcing information-based services in James Brian Quinn, *Intelligent Enterprise* (NewYork: The Free Press, 1992), chap. 3, 71—97.
6. Leonard L. Berry,"Services Marketing Is Different," *Business,* May-June 1980.
7. W. Earl Sasser, R. Paul Olsen, and D. Daryl Wyckoff, *Management of Service Operations:Text, Cases, and Readings* (Boston: Allyn & Bacon, 1978).
8. G. Lynn Shostack, "Breaking Free from Product Marketing,"*Journal of Marketing* 41, no. 2 (April 1977).
9. Gary Knisely, "Greater Marketing Emphasis by Holiday Inns Breaks *Mold," Advertising Age,* 15 January 1979.
10. Curtis P. McLaughlin, "Why Variation Reduction Is Not Everything: A New Paradigm for Service Operations," *International Journal of Service Industry Management* 7, no. 3 (1996), 17-31.
11. This section is based onValarie A. Zeithaml, "How Consumer Evaluation Processes Differ Between Goods and Services," in J. A. Donnelly and W. R. George, *Marketing of Services* (Chicago: American Marketing Association, 1981), 186-190.
12. The 4Ps classification of marketing decision variables was created by E.Jerome McCarthy, *Basic Marketing: A Managerial Approach* (Homewood, IL: Richard D. Irwin, Inc., 1960).
13. Since the late 1970s, many theorists have tried to go beyond the 4Ps to capture the complexity of service marketing in memorable fashion, emphasizing singly or in combination, such factors as processes, personnel, and peripheral clues. Our 8Ps model of service management has been derived and expanded from a framework that encompassed seven elements: the original 4Ps, plus Participants, Physical evidence and Process; it was proposed by Bernard H. Booms and Mary J. Bitner, "Marketing Strategies and Organization Structures for Service Firms," in J. H. Donnelly and W. R. George, *Marketing of Services* (Chicago: American Marketing Association, 1981), 47-51. Subsequently, Booms created a cartoon diagram showing seven little "pea people," two of them carrying oars, lifting a peapod-shaped boat. This gave us the idea for the metaphor of a racing "eight," comprising eight rowers (the eighth being labeled "productivity and quality") plus a coxswain to control the boat's speed and direction.
14. For a review of the literature on this topic, see Michael D. Hartline and O C. Ferrell, "The Management of Customer Contact Service Employees," *Journal of Marketing* 60, no. 4 (October 1996): 52-70.
15. Timothy K. Smith, "Why Air Travel Doesn't Work," *Fortune,* 3 April 1995, 42-56; and Bill Saporito, "Going Nowhere Fast," *Fortune,* 3 April 1995, 58—59.
16. B.Joseph Pine II and James H. Gilmore, *The Experience Economy* (Boston: Harvard Business School Press, 1999).
17. See Christopher H. Lovelock and Charles B.Weinberg, *Public and Nonprofit Marketing,* 2/e (Redwood City, CA:The Scientific Press/Boyd and Davis, 1989); and Philip Kotler and Alan Andreasen, *Strategic Marketing for Nonprofit Organizations,* 5/e (Upper Saddle River, NJ: Prentice-Hall, 1996).
18. SeeValarie A. Zeithaml, A. Parasuraman, and Leonard L. Berry, *Delivering Quality Service* (New York: The Free Press, 1990); and Sandra Vandermerwe, "The Market Power Is in the Services Because the Value Is in the Results," *European Management Journal* 8, no. 4 (1990).
19. Diane Brady,"Why Service Stinks," *Business Week,* 23 October 2000, 118-128.
20. See MarciaVickers, "Models from Mars," *Business Week,* 4 September 2000,106-107; and Jerry Useem and Eryn Brown, "Dot-Coms: What Have We Learned?" *Fortune,* 30 October 2000, 82-104.