CHAPTER 1

THE SERVICE ECONOMY

# TEACHING NOTE

This introductory chapter is intended to motivate students and arouse their interest in the importance of services in our economy and career opportunities in the 21st Century. Material on the "experience economy" illustrates the current economic evolution beyond the postindustrial economy. The role of information technology, innovation, and changing demographics in service sector growth can lead to speculation about the future. The chapter continues by answering the question “why study services” with a discussion of the distinctive characteristics of service operations. The question of “what is a service” is answered with the service package and grouping services by delivery process using the "service process matrix." Service-dominant logic is presented as an alternative paradigm to the traditional goods-centered view of value creation. The open systems view of service management represents a departure from the traditional role of the operations management found in manufacturing.

# SUPPLEMENTARY MATERIALS

“The Hitchhiker’s Guide to Cybernomics: A Survey of the World Economy”, *The Economist*, September 28, 1996.

A 46 page special insert loaded with figures and graphs that present the transformation from an industrial economy to a service economy driven by information technology. The article discusses new jobs, productivity, and the difficulty of measuring economic output when the metrics were designed for industrial production.

Joseph Pine and James Gilmore, "Welcome to the Experience Economy," *Harvard Business Review*, July-August 1998, pp. 97-105.

The authors describe the features of the emerging experience economy represented by firms such as the Rainforest Café that stage an experience rather than just deliver a service.

James L. Heskett, " Lessons in the Service Sector”, *Harvard Business Review*, March-April 1987, pp. 118-129.

This is a classic article articulating the need to integrate marketing and operations to achieve excellence in services. The author formulates a strategic service vision that is both internally directed (employees) and externally directed (customers).

# LECTURE OUTLINE

1. Service Definitions
2. Facilitating Role of Services in an Economy (Figure 1.1)
3. Economic Evolution (Figure 1.2 and 1.3)
4. Stages of Economic Development (Table 1.2)
5. Nature of the Service Sector (Figure 1.4 and Figure 1.5)
6. The Experience Economy (Table 1.3, Table 1.4, and Figure 1.6)
7. Distinctive Characteristics of Service Operations
8. The Service Package (Figure 1.7 and Table 1.5)
9. Grouping Services by Delivery Process (Figure 1.8 and Figure 1.9)
10. Service-Dominant Logic (Table 1.6)
11. Open-Systems View of Service Operations Management (Figure 1.10)

# TOPICS FOR DISCUSSION

1. *Illustrate how the type of work that he or she does influences a person's lifestyle. For example, contrast a farmer, a factory worker, and a schoolteacher*.

A farmer's lifestyle is, to a certainextent, still influenced and conditioned by the elements, the weather, the quality of the soil, and the availability of water. Life is partly a game, but mostly it is a struggle against nature. The rhythm of life is shaped by nature and the pace of work varies with the season.

In the case of the factory worker, the struggle is against a fabricated nature: a world of cities, factories and tenements. Life is machine-paced (or at least appears to be). Efficiency is the watchword and productivity is its measure. The standard of living is measured by the quantity of goods a person has. The worker becomes just a part, a person in the bureaucratic and faceless organizations that spring up to achieve the task of production and distribution of these goods. The individual is the unit of social life, with society considered as the sum of all the individual decisions being made in the marketplace. Protection from the organization is often sought through labor unions.

A schoolteacher interacts on a face-to-face basis with his/her students in an intellectual environment. A career in teaching involves continual reading in the subjects taught and searching for innovative ways to motivate students. Life is reflective, ordinarily not physically demanding, and work is conducted in a pleasant campus environment.

2. *Is it possible for an economy to be based entirely on services*?

Economies based on services only are exceptions and rare ones at that, e.g., Andorra and Liechtenstein, resort islands in the South Pacific and the Caribbean, and Monte Carlo (gambling). Such countries must import their food, consumer goods, and durables. But as a rule, this cannot be done for larger economies where production of food and/or goods is essential.

3. *What is the value of self-service in an economy?*

Measuring self-service is a problem in its own right and currently is not included in the GNP. A creative discussion of methods to measure self-service indirectly would include accounting for customer labor in transactions such as buying a meal at a fast-food restaurant where you are expected to bus your own table or the savings in pumping your own gas at a filling station. Self-service has additional value because the labor is present only when it is needed. In Chapter 5 “Technology in Services” the topic of self-service technology (SST) will be explored.

4. *Determine if the U.S. service sector currently is expanding or contracting based upon the Non-Manufacturing Index (NMI) found at ISM Report on Business on the Institute of Supply Management website:* [*http://www.ism.ws/pubs/ismmag/*](http://www.ism.ws/pubs/ismmag/)*.*

The ISM Report of Business has a wealth of survey data from industry respondents on the current level of business activity for the month. The first table presents the ISM series index for the current and previous month for several measures (e.g., new orders, employment, inventories, etc.). An index value above 50 indicates an expanding service sector economy, below 50 a declining economy. The table also contains a measure of the index direction and rate of change.

5. *What are some of the management problems associated with allowing service employees to exercise judgment in meeting customer needs*?

Some consistency and, therefore, perceived quality of service might be lost when different employees handle situations in different ways. Much more training of customer contact personnel is required to develop their decision-making skills and to provide them with the confidence to use their own judgment. Service personnel also need to be trained in the limits of the service that should be provided

6. *Critique the “Distinctive Characteristics of Service Operations” by arguing that the characteristics of, customer participation, simultaneity, perishablity, intangibility, and heterogeneity, may apply to goods as well.*

The following analysis is based upon the article “The Four Service Marketing Myths: Remnants of a Goods-Based, Manufacturing Model,” *Journal of Service Research*, 6, no. 4, (May 2004), pp. 324-335 by Stephen L. Largo and Robert F. Lushc. Note how the arguments are a precursor of Service-Dominant Logic.

Customer participation in the service process This characteristic was not one of the original four unique characteristics of services offered by our colleagues in marketing. In taking a process perspective customer participation should be expanded beyond a physical presence in the process, for example, providing health history to a physician, investing savings in a bank, or entrusting one’s automobile to a repair shop. Customer participation in the service delivery process is the hallmark of all services but could be found in collaborative product design in manufacturing. Interestingly the attempt to reduce customer-employee interaction through the promotion of self-service just reinforces the customer role as co-producer.

## Simultaneity In an attempt to achieve manufacturing efficiencies, some services decouple part of the delivery process from the customer. The typical example is auto repair that involves processing a customer’s tangible possession in a factory setting that does not require the simultaneous presence of the customer. Most services such as restaurants, banks, and hotels have a front and back office operation with part of the service produced in the back office where customer demand can be batched and processed with manufacturing efficiency.

## Perishability The concept that services cannot be produced at one point in time, inventoried, and later sold upon demand led to the concept of service perishability. However, service capability can be stored in systems, databases, knowledge, and people to be used when called upon. In fact, service capacity as measured, for example, in hotel rooms or airline seats is routinely referred to as inventory to be sold at a later date. Unlike manufacturing, service capacity is inventoried prior to production rather than after. Finally, when customers form a queue waiting for service, one might consider this to be an inventory of raw material.

Intangibility With few exceptions, essentially all goods have a service component, whereas all services have some facilitating goods in the service package. Thus, goods and services can be placed on a continuum according to the relative degree of tangibility. For example, in the purchase of a home entertainment center the financing offered by the store is a service. On a domestic airline flight, passengers in coach are offered a drink and peanuts.

## Heterogeneity Process variability destroys efficiency and consistency in quality both in manufacturing and services. Standardization in services, such as limited menus at fast-food restaurants, is an attempt to reduce input variability. In the medical field, standardization of procedures has a major impact on reducing infection and recurrence.

# INTERACTIVE CLASS EXERCISE

*The class breaks into small groups. Each group identifies service firms that should be listed in the Fortune 100 and places them in rank order of estimated annual revenue.*

Post on the backboard the combined results of the student groups. Bring to class an PowerPoint slide or overhead of the most recent listing of the *Fortune 100* to compare with the students’ lists (see <http://www.fortune.com>).

# CASE: VILLAGE VOLVO

1. *Describe Village Volvo's service package*.

The following descriptions address the four elements of Village Volvo's service package: supporting facility, facilitating goods, explicit services, and implicit service.

Supporting facility The new Butler building with ample service bays (two bays per mechanic) and comfortable waiting room promotes the customer's positive perception of the organization. The suburban location could mean difficult access and the possible need for a shuttle.

## Facilitating goods Specialized tools and an inventory of select auto parts are obvious items in this element.

## Information The unique and possibly differentiating feature is the Custom Care Vehicle Dossier (CCVD), which serves as a powerful information tool for both mechanic and customer. The CCVD acts as a prompt to the customer to seek continuing service in a pattern (based upon mileage or time). Analysis of customer patterns can assist Village Volvo in predicting demand and scheduling its operations to make full use of capacity.

## Explicit services The two owners of Village Volvo are former authorized Volvo dealer mechanics and have 22 years of combined experience between them. They have earned a respected reputation and satisfied customer following. Service availability is enhanced by the use of "express times" when customers can come in and get quick, routine jobs done while they wait.

## Implicit services The owners' attitudes and emphasis on customer satisfaction is illustrated by encouraging inspection of replaced parts. The policy of confirming work prior to commencement is essential to the customer's perception of reliability and participation in the service process.

2. *How are the distinctive characteristics of a service firm illustrated by Village Volvo*?

Village Volvo exemplifies many characteristics of a service firm, one of which is that the inputs are the customers themselves. Listed below are the distinguishing characteristics of a service firm and the specific attributes of Village Volvo, which exemplify those characteristics.

## Customer participation in the service process

The client brings his or her car to Village Volvo for specific needs or routine services during scheduled times. There is continuous interaction between the client and the service manager and the assigned mechanic as evidenced by the discussion of problems and the test drive of the vehicle prior to the time when the repair work is done. Once the repair is complete, the client does the quality control inspection and is furnished with the worn parts.

## Simultaneity

For routine repairs, customers can wait in the attractively furnished waiting area. In most cases the customers drop off their vehicles early in the morning and return for pickup at the end of the day. This allows Village Volvo some latitude in scheduling the daily work. For repair services, production and consumption of the service need not occur simultaneously, because the service is performed on the customer's property, which can be inventoried.

## Perishability

Village Volvo is aware of this problem and has taken action to smooth demand, first by encouraging clients to make appointments for diagnosis and repair of specific problems and then by scheduling "drop in" times for Wednesday afternoon and Thursday morning. During peak hours, all mechanics are asked to deal with customers to reduce customer-waiting time.

## Intangibility

Most customers are unable to judge the quality of an automobile repair service and thus, reputation becomes very important. If Village Volvo did not have such a good reputation, it would be difficult to persuade customers to use the private garage rather than the dealership. Village Volvo tries to reduce this intangibility by providing customers with their worn out parts.

## Heterogeneity

Village Volvo is a service shop with the capability to handle a variety of auto repair problems. The mechanics treat each customer's problem individually by explaining to the customer exactly what has occurred and what will happen.

3. *Characterize Village Volvo in regard to the nature of the service act, the relationship with customers, customization and judgment, the nature of demand and supply, and the method of service delivery.*

**•** Car repair represents a tangible action performed on an object and therefore, is a service directed at a physical possession.

**•** By keeping a Custom Care Vehicle Dossier (CCVD) on customers’ vehicles, Village Volvo is attempting to develop a “membership” relationship. The repair service itself is a discrete transaction, but sending reminders for routine maintenance gives the appearance of continuous monitoring.

**•** For routine maintenance (e.g., oil changes) customization and judgment are limited in scope. However, for major repairs the opposite is true.

**•** Demand for emergency auto repairs can vary considerably, but reservations for work is common and a loaner car can be provided for extended repairs. Routine maintenance can be scheduled to fill low demand periods.

**•** Village Volvo has a single site and requires customers to bring their cars (or have them towed) to the facility.

4. *How could Village Volvo manage its back office (i.e., repair operations) like a factory*?

After receiving the cars for repair at the beginning of the day, the scheduling of repairs can be planned in accordance with the availability of the mechanics and the promised delivery times. Thus, the back office can be run much like a manufacturing job shop. Routine work like brake pad replacement and minor tune-ups can be delegated to apprentice mechanics in order to achieve cost savings.

5. *How can Village Volvo differentiate itself from Volvo dealers*?

Dealers have traditionally neglected their service departments because more money was made in the sale of vehicles. The turnover of dealer mechanics also has been high because good mechanics leave to open their own shops such as Village Volvo. The appeal of the independent mechanic is the personal relationship and trust that develops between vehicle owner and mechanic. The Custom Care Vehicle Dossier is a method that Village Volvo uses to establish the customer's loyalty.

**CASE: XPRESSO LUBE**

[Students Robert Ferrell, Greg Miller, Neil Orman, and Trent Reynolds prepared this analysis.]

*1. Describe Xpresso Lube’s service package?*

* **Supporting facility**: Xpresso Lube has a fixed amount of operational capacity because it has a limited number of service lifts – two to be exact. Other components of its supporting facility are tools and equipment, an equipment storage area, a spacious waiting room, chairs, a service counter, street access and parking.
* **Facilitating goods**: oil, filters, auto parts, coffee, snacks, cups, napkins, sugar, and milk.
* **Information**: for regular customers a reminder card could be sent for routine maintenance.
* **Explicit services**: a car with new oil and filter, maintenance checks of the car, and a cup of coffee.
* **Implicit services**: trust, a feeling of not “getting screwed,” a feeling of keeping the car maintained, the satisfaction that comes from taking care of one’s car, the good feeling that comes from recycling the old oil, a caffeine lift, and the satisfaction of drinking good coffee while you wait.

1. *How are the distinctive characteristics of a service operation illustrated by Xpresso Lube?*

* **Customer Participation in the Service Process**: Customers bring their cars to Xpresso Lube and wait for the oil change. Customers are invited to inspect the car while on the lift to observe other needed repairs.
* **Simultaneity**: Using the coffee shop as a pleasant diversion allows Xpresso Lube to reduce partially the need for working on arriving cars immediately. Providing a shuttle service to the nearby University and State Capital would allow scheduling of oil changes.
* **Perishability**: The number of car lifts at the shop limits Xpresso Lube’s capacity. This oil change business also owns an auto repair facility next door so the two businesses can deploy mechanics between them to utilize labor capacity in the most efficient way.
* **Intangibility**: When an oil change is done in a typical pit, the customer cannot actually see the process and, after the service, the car’s performance probably will not be noticeably different. In this situation, customers rely on the word of the oil change service person. Xpresso Lube’s car lift design allows customers to watch its service, which gives customers more assurance that their needs are being met.
* **Heterogeneity**: Different cars provide some variability in the oil change routine. Some customers even come only for the coffee.

3. *Characterize Xpresso Lube in regard to nature of the service act, relationship with customers, customization and judgment, nature of demand and supply, and method of service delivery.*

* Changing the oil is the primary function of Xpresso Lube. This is a tangible action performed on the car, but the secondary service is serving coffee, which recognizes the personal needs of the owners.
* Xpresso Lube’s service relationships consist of discrete, one-time transactions, but the company’s focus on fostering customer trust and a pleasant waiting environment might lead to more long-term customers.
* Fairly low customization is possible, but the accessibility of the service area and the mechanics can lead to customization opportunities if there are problems with the cars.
* There is a significant demand fluctuation based on the obvious convenience of having the service performed after work or during the weekend. This peaked demand pattern easily can exceed Xpresso Lube’s capacity. But Xpresso Lube’s service environment encourages people to accept longer waits and, by providing transportation, it enables customers to drop off their cars in the morning and retrieve them later in the day. The supply of the service cannot be altered very easily, given the company’s fixed number of two carports and lifts.

4. *What elements of Xpresso Lube’s location contribute to its success?*

Xpresso Lube is located on the main thoroughfare leading to the University of Texas and, thus, provides excellent visibility. The immediate business area is bustling and diverse, and attracts a broad spectrum of visitors. It’s also an area where customers don’t mind waiting because they can walk to a variety of popular shops (e.g., Wheatville Co-Op and Half-Priced Books).

5. *Given the example of Xpresso Lube, what other services could be combined to “add value” for the customer?*

Many examples exist in today’s business environment. One common service combination is selling concessions – candy, popcorn, or beer, for example – with showing movies, sports events, or concerts. Others include the combination of bookstores and coffeehouses, gaming activities such as pool or bowling with alcohol sales and prepared food (e.g., Dave & Busters), fast food and gasoline (e.g., Exxon and McDonald’s).

All of these combinations support one another and marry related customer needs. In the case of gas and hamburgers, for example, customers are in a hurry and the service combination provides them additional reasons to stop. Other examples take advantage of unfilled waiting time. By locating in a shopping mall, a one-hour eyeglass store provides its customers something to do while they wait for their glasses (i.e., shop at other mall stores).

# CHAPTER QUIZ QUESTIONS

True/False

1. Services are deeds, processes, and performances. (T)
2. The Clark-Fisher hypothesis notes the shift of employment from one sector of the economy to another. (T)
3. The fall in employment in the agricultural sector is the primary reason for the increase in service sector employment. (F)
4. The consumer participates in the service process, which is not the case in manufacturing. (T)
5. The classification of service systems using the "service process matrix" is based on two considerations: degree of labor intensity, and the degree of service customization. (T)
6. From an open-systems view, the output of a service system consists of satisfied customers. (T)
7. The service experience defined as escapism requires the most commitment from the customer. (T)
8. A study of service systems must begin with the fundamental idea that the basic inputs are supporting facility, facilitating goods, labor, and capital. The output is the service offered. (F)
9. In contrast to manufacturing, the aesthetics of the environment play a major role in the customer's perception of the service. (T)
10. The fact that services can be inventoried is an important characteristic, which distinguishes them from manufacturing. (F)
11. Reduction of the role played by the consumer is an effective way of improving productivity and decreasing the cost of the service. (F)
12. Services are time-perishable. An opportunity to provide a service, if forgone, is lost forever. (T)
13. Both manufacturing and services can suffer from technological obsolescence. (T)
14. Health care services are projected to have the greatest percent change in U.S. employment in the period 2008-2018. (F)
15. From a marketing perspective, services, unlike goods, involve transfer of ownership. (F)
16. It is convenient and often necessaryto combine the operations and marketing functions for service organizations.(T)
17. Sharing service resources among customers presents a challenge for mangers. (T)
18. Little or no interaction between customer and service provider is required when the service is customized (F)
19. Personnel training is a criterion for evaluating the explicit services feature of the service package. (T)
20. The decrease in the proportion of income spent on the basic necessities of life has encouraged the demand for more services and accelerated the transition to post-industrial society. (T)
21. Marketing helps smooth demand to match capacity in service operations. (T)
22. Service-dominant logic is the foundation of “service science.” (T)
23. Value for the “business service experience” is derived from co-creation. (T)
24. A standardized experience is a feature of the new experience economy. (F)
25. A business service experience (B2B) has three dimensions: co-creation of value, relationships, and sustainability. (F)

Multiple Choice

1. The service package consists of five features. Which one of the features listed below is not included in the package?

1. Explicit services
2. Supporting facility
3. Information
4. Cost of service\*

2. The major input into a large public hospital from a service point of view would be:

1. physicians' services.
2. patients.\*
3. nursing services.
4. federal reimbursement (Medicare/Medicaid).

3. Which of the following is not true of services?

1. The customer is the input.
2. The customer takes an active part in the service.
3. A service can be inventoried.\*
4. Production and consumption occur simultaneously.

4. Which of the following is not a type of service in the non-ownership classification?

1. Goods rental
2. Information\*
3. Labor and expertise
4. Network usage

5. The service process matrix classification consists of four categories of services. Which one of the four features listed below is not included in this classification?

1. Service factory
2. Service shop
3. Public service\*
4. Professional service

6. Which service offering is best described by the following service mix: a high degree of customer interaction and a high degree of labor intensity?

1. Public university
2. Cruise ship
3. Plumbing repair
4. Chiropractor\*

7. Division of labor is the central concept of:

1. Industrial societies\*
2. Preindustrial societies
3. Agrarian societies
4. Postindustrial societies

8. An empty airline seat or hotel room not occupied best illustrates the characteristic of a service's

1. time perishability.\*
2. labor intensity.
3. intangibility.
4. simultaneous production and consumption.

9. Which type of service falls under the category of "high labor/low customization?"

1. Service factory
2. Service shop
3. Mass service\*
4. Professional service

10. Which one of the following is not a value-added service provided by a manufacture to increase profits?

1. Financing or leasing
2. Customer-support call center\*
3. After-sales maintenance
4. Network and communication services

11. Which of the following is not a feature of the new experience economy?

1. The experience is memorable.
2. The experience is customized.\*
3. The customer is treated as a guest.
4. The experience is staged.

12. The key technology of a postindustrial society is \_\_\_\_\_\_\_\_.

1. machines
2. energy
3. information\*
4. intellectual capital of the workers

13. Capital decisions, technological advances, and managing demand are some managerial challenges for a

1. service factory. \*
2. service shop.
3. mass service.
4. professional service.

14. Which among the following strategies is used by fast-food restaurants to reduce costs?

1. Increase advertising via the Internet.
2. Allowing the customer to play an active part in the service process. \*
3. Increase prices.
4. Increasing menu items to cater to varying tastes.

15. Which one of the following reasons best explains the recession-resistant nature of services?

1. Services cannot be inventoried.\*
2. Many services, such as healthcare, are essential.
3. Many service employees, such as those who work on commission, do not need to be laid off during recessions.
4. The number of jobs in maintenance and repair services increases during recessions.

16. The concept of economies of scale is best described as

1. the replacement of fixed costs with variable costs.
2. selling a wider range of products.
3. a synonym for economies of scope.
4. the replacement of variable costs with fixed costs.\*
5. The presence of a friendly desk clerk in a budget hotel is an example of which of the four features of a service package?
6. supporting facility
7. facilitating goods
8. explicit services
9. implicit services \*

18. The concept of economies of scope is best described as

1. a synonym for economics of scale.
2. the use of brand extensions.
3. using existing channels of distribution to introduce a new product.\*
4. extending existing distribution channels to reach new customers.

19. Which of the following is not a principle on which service experience design is based?

1. Theme the experience.
2. Eliminate negative cues.
3. Mix in memorabilia.
4. Encourage customer feedback.\*

20. \_\_\_\_\_\_\_\_\_\_\_\_\_ is a foundation premise of Service-Dominant Logic

1. The customer is always right
2. Only post-industrial economies are service economies
3. Goods are distribution mechanisms for service provision\*
4. Money is the fundamental basis of exchange

21. Which of the following does not describe a business service experience?

1. stage\*
2. co-create
3. collaborator
4. sustained over time

22. The realms of an experience include all but one of the following:

1. Entertainment
2. Education
3. Estheticism
4. Elation\*

23. Which one of the following is not a dimension of a business service experience?

1. Co-creation of value
2. Problem solving\*
3. Relationships
4. Service capability

24 Which of the following is an example of a business service (B2B)?

1. Communications
2. Auditing\*
3. Retailing
4. Leasing

25 Service innovation is driven by which factor listed below?

1. New product technology
2. Customer needs
3. Observant contact employee
4. All of the above\*

26 In an experience economy the method of supply is

1. revealed over time.\*
2. stored in bulk.
3. delivered on demand.
4. inventoried.