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CHAPTER 2: SERVICE STRATEGY

Teaching Note

This chapter sets forth the strategic theme of the book that the operations function is central to the competitive strength of a service firm. The chapter begins with the strategic service vision that relates the service delivery system to the target market segments via an operating strategy and service concept using Southwest Airlines as an example. The application of the three generic competitive strategies—cost leadership, differentiation, and focus—to service firms is explored with examples. Porter's five forces model and SWOT analysis are applied to service firms. Taking a page from manufacturing strategy, we apply the concept of service winners, qualifiers, and service losers to the dimensions of service competition. Sustainability is addressed using the triple bottom line approach to social, economic, and environmental criteria. The important role that information plays in a firm's competitive strategy is illustrated by the emerging areas of the internet of things (IoT) and data analytics. The concept of a virtual value chain that can create competitive advantage in the "marketspace" is illustrated with examples from USAA. Privacy questions and anticompetitive behavior are issues that limit the use of information. The chapter concludes with a discussion of the stages in service firm competitiveness and a "whodunit" Case about two niche-market banks.

Supplementary Materials

Heskett, J. L., Earl Sasser, W. Jr., & Hart, C. W. L. (1990). *Service breakthroughs*. New York: Free Press.

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The authors describe how breakthrough managers develop counterintuitive strategic service visions and a service concept that focuses on achieving results for their customers.

Case: Southwest Airlines (A) (HBS case 575-060)

Southwest Airlines began as a small intrastate Texas airline, operating commuter-length routes between Dallas (Love Field), Houston, and San Antonio. In June 1971, having overcome legal hurdles raised by entrenched Braniff and Texas International, Southwest inaugurated service with a massive promotional campaign and many innovations designed to attract passengers. On February 1, 1973, Southwest must decide how to respond to Braniff's "Half Price Sale."

Case: Zipcar: Refining the Business Model (HBS Case: 9-803-096)

The expense of owning or leasing a modest car in urban locations can exceed $500 per month when insurance and parking expenses are included. Using a website for reservations and wireless communication, the concept of car sharing has become a reality with Zipcar and its tag line, "wheels when you want."

Case: British Airways: Using Information Systems to Better Serve the Customer (HBS case 9-395-065)

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British Airways developed an information system, Customer Analysis and Retention System (CARESS) to ensure rapid response to customer complaints. The case explores how this system is able to melt the complaint iceberg in order to resolve customer complaints quickly and improve retention as well as to provide data for root-cause-analysis of problems.

Case: Ritz Carlton: Using Information Systems to Better Serve the Customer (HBS Case 9-395-064)

Ritz-Carlton, a Malcolm Baldrige National Quality Award winner, relies on two information systems to promote customer loyalty: COVIA to handle centralized reservations and Encore, a local system that keeps track of guest preferences.

Note: Service in E-Commerce: Findings from Exploratory Research (HBS Module Note N9-800-418).

This note explores the concept of scalability in the context of customer support and logistics. The authors also discuss the E-commerce customer experience cycle that includes navigation, information, customer support, and logistics leading to loyalty when well executed.

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Lecture Outline

1. The Strategic Service Vision (Table 2.1 and 2.2)
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2. Understanding the Competitive Environment of Services
3. Competitive Service Strategies
4. Strategic Analysis (Figure 2.1 and Table 2.3)
5. Winning Customers in the Marketplace
6. The Competitive Role of Information in Services (Figure 2.2)
7. The Virtual Value Chain (Figure 2.3)
8. Data Analytics in Services (Figure 2.4 and Table 2.4)
9. Internet of Things (Figure 2.5)
10. Limits in the Use of Information
11. Economics of Scalability (Tables 2.5 and 2.6)
12. Sustainability in Services (Figure 2.6)
13. Stages in Service Firm Competitiveness (Table 2.7)

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Topics for Discussion

1. *Give examples of service firms that use the strategy of focus and differentiation and the strategy of focus and overall cost leadership.*

Reed College in Portland, Oregon, is a small private college that is focused primarily on an undergraduate education in liberal arts and sciences. The school differentiates itself from most other higher education institutions in such areas as the selectivity of its admissions requirements, the rigorousness of its courses, and the requirement of a research thesis for an undergraduate degree. Another firm that exemplifies the strategies of focus and differentiation is Amy's Ice Cream in Austin, Texas. Amy's is focused on kneading various condiments into the ice cream, a service that also is provided by a number of other firms. But the servers at Amy's are accorded extraordinary freedom to interact with customers, and it is the nature of this service encounter that differentiates Amy's from other ice creameries.

Southwest Airlines is an example of firms that employ the strategies of focus and overall cost leadership. Southwest concentrates on serving a select geographic region at low cost. The airline achieves low cost by providing "no-frills" service, and it maximizes utilization of its assets by maintaining a quick turnaround practice at airports. United Services Automobile Association (USAA) is another example of an organization that has a well-defined focus, primarily that of providing insurance and financial services for American military officers and their families. The company is able to provide the lowest possible rates in the industry to its customers, in part, by doing business over the phone instead of using field agents.

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2. *What ethical issues are associated with micromarketing*?

The ethical issue associated with micromarketing involves the customer's right to privacy. Scanner data and other personal information that target specific customers might be very beneficial for businesses, but the inappropriate use of the information can allow businesses to mislead or manipulate their customers. From an ethical standpoint, there must be some limits to the nature and amount of information a business can obtain from its customers.

3. *For each of the three generic strategies (i.e., cost leadership, differentiation, and focus), which of the four competitive uses of information is most powerful*?

Productivity enhancement is the most powerful use of information for achieving *cost leadership*, because it allows firms to reduce inventory, reduce waste, and eliminate paperwork, all of which save money. Improved productivity allows companies to make more efficient use of their assets such as retail shelf space.

Creating barriers to entry is the most powerful use of information for protecting a *differentiation* strategy. When customer loyalty is high, cost cutting by competitors is less

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effective. Switching costs can also create barriers to entry, for example, when suppliers use a computer order-entry network to establish a direct link to customers.

Database assets are the most powerful use of information for building a *focus* strategy. These assets allow a company to develop profiles of their customers and their buying habits. This information allows the firm to develop new services and to be seen as responsive to its customers' needs. Advertising and distribution economies can be realized.

4. *Give an example of a firm that began as world-class and has remained in that category.*

Federal Express and Disney come to mind.

5. *Could firms in the "world-class service delivery" stage of competitiveness be described as "learning organizations'?*

Learning in organizations means the continuous testing of experience and the transformation of that experience into knowledge that is accessible to the whole organization and relevant to its purpose (see Senge, et al., *The Fifth Discipline Field Book*, Doubleday, New York, p. 49). Table 2.6 in the text confirms this definition as illustrated by the world-class service delivery category. Consider the following example comments:

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- Learning organizations raise customer expectations, seek challenges, and improve continuously.
- A learning organization is proactive, develops its own capabilities, and generates opportunities
- The learning organization regards the customer as a source of stimulation, ideas, and opportunities.
- The workforce of a learning organization is innovative and creates new procedures.
- Top management of a learning organization looks to frontline management as a source of ideas.

6. *Compare and contrast sustainability efforts in service operations and manufacturing*.

At the outset, certain environmental wastes such as pollution generated by manufacturing plants are glaring problems in industrialized nations. Therefore, it is easy for most people to relate the physical nature of sustainability efforts to manufacturing. Such efforts include emission control and other measures to protect our air and water from contamination.

Waste reduction through lean management and value recovery apply to service and manufacturing firms alike, however. Regulations by agencies such as EPA, WEEE, and RoHS apply equally to service firms. Beyond those regulations, service

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firms must build an image of responsible organizations that are committed to sustainability by cultivating a culture that eliminates negative impacts on environmental and social issues. Service firms have a responsibility equal to that of the manufacturing sector in achieving sustainability especially for long-term viability of the firm.

7. *Conduct a triple bottom-line evaluation for a hospital by identifying its social, economic, and environmental attributes that enhance the sustainability movement.*

Social:

- Proper health education for all constituencies.
- Free screening for essential medical issues.
- Appropriate medical outsourcing.
- Linking health and wellness programs for a holistic approach to health care.

Economic:

- Use of lean management for cost savings—for example, process control, better materials management, better record-keeping, elimination of unnecessary tests.
- Cost-efficient payment structure for medical access and health insurance

Environmental:

- Managing medical wastes—for example, biodegradable products such as contaminated dressings.
- Responsible medical disposals—for example, used syringes.

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Overall, in promoting health, hospitals need to use fewer resources (economic), provide support for employee self esteem (social), and become better stewards of their medical resources and products (environmental).

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Interactive Class Exercise

The class divides and debates the proposition "Frequent flyer award programs are or are not anticompetitive."

The statement "Frequent flyer award programs are anticompetitive" was voiced following airline deregulation. The frequent flyer award is an attempt by airlines to create customer loyalty in a commodity market and to avoid price competition. Priceline.com and other internet ticket sellers have reintroduced price competition making frequent flyer awards less effective.

Case: United Commercial Bank and El Banco

1. *Compare and contrast the strategic vision of El Banco and United Commercial Bank.*

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	Service Delivery System	Operating Strategy	Service Concept	Target Market Segments
El Banco	Spanish spoken Hispanic physical setting	Franchise Low cost informal store fronts	Fee based services Attract first time bank customers	Latinos
United Commercial Bank	Chinese spoken Conservative Import–export services	Branches in Chinese-American communities Offices in China, Taiwan, Hong Kong	Loans to businesses High interest CDs Low fees	Chinese-Americans

2. *Identify the service winners, qualifiers, and service losers for El Banco and United Commercial Bank.*

	Service Winners	Qualifiers	Service Losers
El Banco	Check cashing Money transfers	Spanish spoken Informal location	Lack of sophisticated services
United Commercial Bank	Low fees Import–export services	Chinese spoken Soundness and safety	Lowering interest rate on CDs

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3. *What are the differentiating features of banks that target ethnic communities*?

- Products that match unique customer needs (trade finance, check cashing)
- Well articulated cultural focus on target community (language, physical setting)
- Convenient location accessible to community (ethnic population centers, places frequently visited by community members)

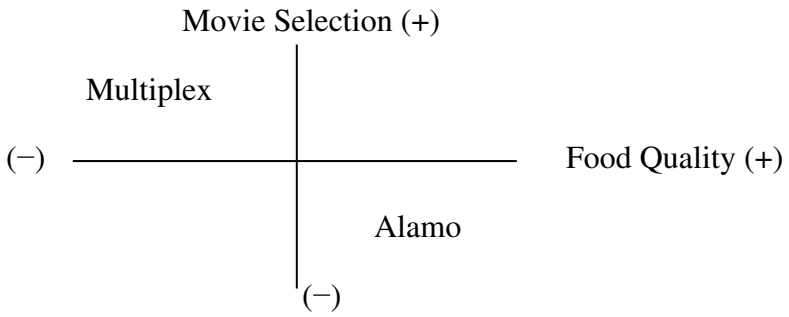
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Case: The Alamo Drafthouse

1. *Marketing analysts use market position maps to display visually the customers' perceptions of a firm in relation to its competitors regarding two attributes. Prepare a market position map for Alamo Drafthouse using "food quality" and "movie selection" as axes.*



2. *Use the "Strategic Service Vision" framework to describe Alamo Drafthouse in terms of target market segments, service concept, operating strategy, and service delivery system.*

Target Market	Service Concept	Operating Strategy	Service Delivery
· 18- to 30-year-old, male, alcohol consumers, cult film appeal · 25–40 year olds with sophisticated taste in films	· Meal and second run or cult films · Single screen theater with every other row replaced with narrow tables	· Low cost old theater · Inexpensive second run movies · Food made to order with less waste	· Unobtrusive wait people · Acceptable sound and projection equipment · Excess capacity midday

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3. *Identify the service qualifiers, winners, and service losers for Alamo Drafthouse. Are the Alamo purchase decision criteria appropriate for the multiplex movie theater market? What do you conclude?*

Qualifiers include good sound system, reasonable prices for the meals, availability of beer and wine, and menu selection. A service winner is the unique "date" experience including the special events and film showing. Service losers include movie projection and sound that do not meeting minimal standards. For the multiplex movie theater market the qualifier is the desired movie showing, a winner would be convenient location and available time of showing, and the loser would be a long waiting line at the box office. The difference in the criteria would lead us to conclude that Alamo does not compete in the multiplex movie market.

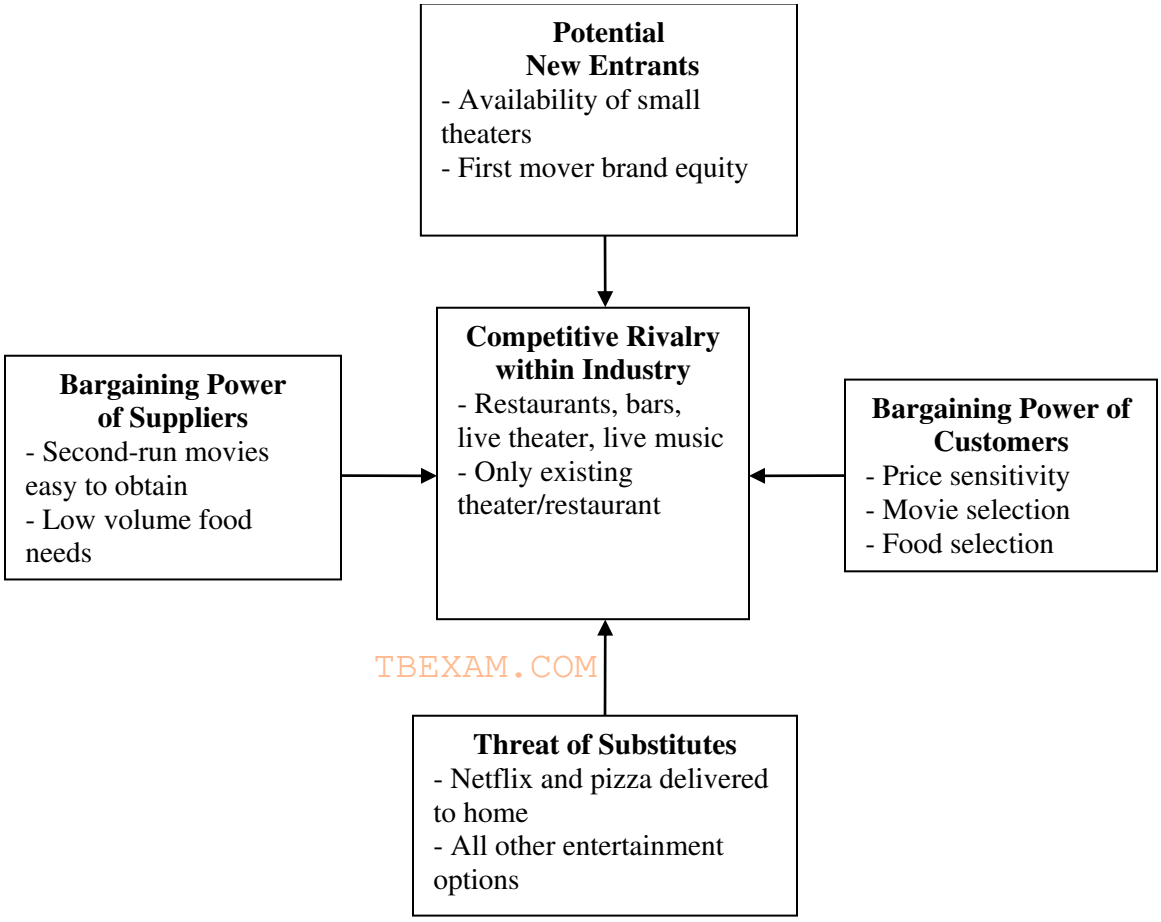
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4. *Use Porter's Five Forces Model to assess the strategic position of Alamo Drafthouse in the "entertainment industry."*

Porter's Five Forces Assessment of Alamo Drafthouse



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5. *Conduct a SWOT analysis to identify internal strengths and weaknesses as well as threats and opportunities in the external environment.*

Strengths	**Weaknesses**
• Small theater with kitchen is unique. • People in your market see dinning and movie combination as your strength.	• Projection and sound quality could be improved. • Attracting mid-week audience.
Opportunities	**Threats**

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• Expand by purchasing small movie theaters. • Business meeting could be a market niche.	• Cash-flow problem. • Concept copied by competitor.

Chapter Quiz Questions

True/False

1. A characteristic of the overall cost leadership strategy is the incurring of start-up losses to build market share. (T)
2. On-line networks between suppliers and their customers create a barrier to entry. (T)
3. When pursuing a differentiation strategy, a service firm should work to ensure that the service being offered is standardized. (F)
4. Service winners are the competitive dimensions used by customers to decide among qualified service providers. (T)
5. Quality is considered to be a structural element of the strategic service concept. (F)
6. Service industries have low entry barriers because economy-of-scale opportunities are limited. (F)
7. The use of micromarketing has the potential to create customer concerns about invasion of privacy. (T)
8. Implementing a low-cost strategy can sometimes revolutionize an industry. (T)
9. A cost-leadership strategy often involves customizing a standard service. (F)
10. The competitive dimension of dependability is a likely candidate for becoming a service loser. (T)
11. Selling information and developing new services are examples of the role that information technology plays in generating revenue. (F)
12. Information technology can be used to promote customer loyalty. (T)
13. The IRS has identified frequent-user programs as anti-competitive. (F)
14. American Airlines' early development of the SABRE reservation system became the foundation for its yield management innovation. (T)
15. Information databases are an asset, because they represent a source of revenue. (T)
16. Information is a substitute for inventory. (T)
17. Focus is a competitive strategy that creates a service perceived as being unique. (F)

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18. Service encounter, quality, information, and capacity planning are all managerial elements of a strategic service concept. (F)

19. Ordering from L. L. Bean by telephone is an example of a service firm maximizing opportunities for economies of scale. (T)

20. A firm facing serious competition for the first time is in the journeyman stage of a service firm's competitiveness. (T)

21. World-class service operations strive to replace workers with enhanced automation. (F)

22. Firms classified as "available for service" view quality improvement efforts with disdain. (T)

23. For a firm achieving "journeyman" competitive status, the back-office function is considered an activity that plays an important role in service delivery. (F)

24. In a world-class service firm, the front-line management controls the process. (F)

25. The job design premise in a world-class service organization is division of labor. (F)

26. Porter's five forces analysis is used at the industry level to determine competitive intensity. (T)

27. SWOT analysis is objective with easily agreed upon results. (F)

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28. Scalability is a measure of how unit variable cost relates to transaction volume. (T)

29. Infinite scalability can occur only when the variable cost is zero. (T)

30. Healthcare is an example of a service that exhibits high scalability. (F)

31. A highly scalable firm such as Kelly Blue Book (kbb.com) requires a call center. (F)

32. Scalability is enhanced with self-service. (T)

33. Customers seldom take note of firms that are leaders in the sustainability movement. (F)

34. Recycling paper and reducing energy usage often is the first step towards sustainability. (T)

35. The use of RFID tags for tracking inventory is the first application of internet of things. (T)

36. Analytics and big data are associated terms. (T)

37. Big data proceeds from "hindsight" to "wisdom" in level of value and difficulty. (F)

38. Casinos use big data to manage their customer loyalty programs. (T)

39. The internet of things (IoT) has the potential for abuse. (T)

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40. The use of baby monitors is an early example of the internet of things. (T)

Multiple Choice

1. The qualifier for an airline offering short commuter flights is _____

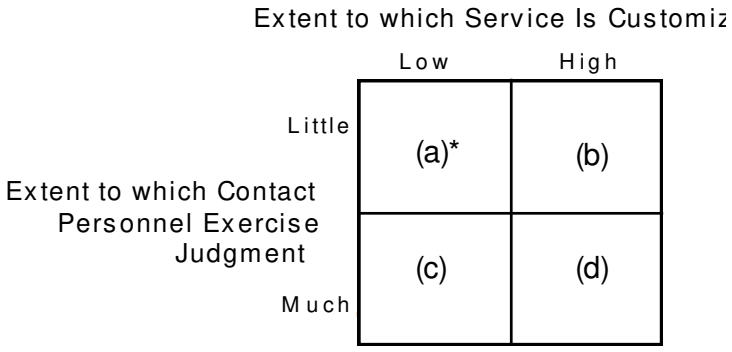
   a. quality of the meals.

   b. safety record.*

   c. politeness of the crew.

   d. on-time performance.

2. Place the McDonald's fast-food chain within the following matrix:



3. A difficult economic environment exists for service industries for all but one of the following reasons.

   a. relatively high overall entry barriers*

   b. product substitution

   c. minimal opportunities for economies of scale

   d. exit barriers

4. A personal training facility that is located in the exclusive Beverly Hills area with only one other competitor could adopt a service strategy that emphasizes _____.

   a. overall cost leadership

   b. differentiation*

   c. focus

   d. personalization

5. Of the nine dimensions of service competition, three are regarded as most likely to become service losers. Which of the following is not one of those three vulnerable dimensions?

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a. speed

b. price*

c. dependability

d. personalization

6. Which of the following is not identified as a strategy common to many successful service providers?

a. close coordination between the marketing and operations

b. the exploitation of information to generate new business

c. a project-oriented organizational structure*

d. redirection of the strategic service vision inward to focus on employees

7. Which of the following usually is not a good idea with respect to an overall cost leadership strategy?

a. offer as many different services as possible to spread overhead costs*

b. concentrate on routine/standardized services

c. replace labor with capital where possible

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d. perform some service activities off-line at a centralized site

8. The nature of the service act depends on to whom or to what the service is directed and the degree of "tangibility" of the service provided. An example of a tangible service directed to the possessions of a customer would be _____.

a. a stay in a hotel

b. an investment advising session

c. a fortune telling session

d. a full-service car wash*

9. Which one of the following is not a key characteristic that leads to a difficult competitive environment for service industries?

a. low barriers to entry

b. lack of sustainable competitive advantage

c. lack of government regulation and oversight*

d. low switching costs for customers

10. In which of the following cases does the use of information raise ethical issues?

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a. yield management

b. selling information

c. micromarketing

d. all of these*p

11. American Airlines' SABRE reservation system fills the following strategic role of information _____.

a. revenue generation

b. productivity enhancement

c. creation of barriers to entry*

d. database asset

12. Services can create barriers to entry by _____.

a. using economies of scale

b. creating switching costs

c. using databases and information technology

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d. all of these*

13. Which of the following is an example of the competitive use of information in generating revenue?

a. reservation systems

b. data envelopment analysis

c. micromarketing*

d. expert systems

14. Which of the following is not a role of information technology?

a. creating a barrier to entry for competitors

b. generating revenues

c. displacing workers*

d. managing multisite operations

15. Using the dimensions of strategic focus and competitive use of information can identify four strategic roles of information. Which of the following is not a strategic role of information?

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a. create barriers to entry

b. generate revenue

c. create a database asset

d. provide global communications*

16. Real-time information technologies that have a focus on internal operations can play a competitive role in increasing revenue opportunities. Which one of the following uses of information does not play a role in generating revenue?

a. yield management

b. point of sale

c. expert systems*

d. sale of information

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17. Bar coding and checkout scanner technology have created a wealth of consumer buying information that can be used to target customers with precision. This process is an example of _____.

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a. service development

b. micromarketing*

c. data envelopment analysis

d. point of sale

18. Kraft targeted its cream cheese flavors to match the tastes of a store's customers using off-line analysis of POS (point-of-sale) data. This is an example of _____.

a. yield management

b. expert systems

c. data envelopment analysis

d. micromarketing*

19. Service firms use information technology to create barriers to entry, generate revenue, enhance productivity, and serve as data base assets. Where does productivity enhancement fit in the diagram below?

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Competitive Use of Information

Strategic Focus	On-line	Off-line
External	(a)	(b)
Internal	(c)	(d)*

20. Which of the following service quality descriptions would be considered "World Class?"

a. It raises the customer's expectations and improves continuously.*

b. It exceeds the customer's expectations and is consistent on many dimensions.

c. It is less important than cost and is highly variable.

d. It contributes to service and plays an important role in total service.

21. Not satisfied with just meeting customer expectations, this category of service firms expands upon the expectations to levels that competitors find difficult to meet.

a. available-for-service

b. journeyman

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c. distinctive competence achieved

d. world class service delivery*

22. The innovation of moving from a "country" store where the proprietor fills the shopper's list with items that are kept behind the counter to a self-service supermarket where the shopper fills a cart with items represents a move between which of the following pairs of competitive stages?

a. from available-for-service to journeyman

b. from available-for-service to distinctive competence achieved*

c. from journeyman to distinctive competence achieved

d. from distinctive competence achieved to world class service delivery

23. Which of the following stages of a firm's competitiveness describes customers who seek out a firm based upon its sustained reputation for meeting customer expectations?

a. available-for-service

b. journeyman

c. distinctive competence achieved*

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d. world class service delivery

24. Which one of the following does SWOT analysis not have as its aim?

a. reveal competitive advantages

b. determine the competitive intensity*

c. analyze prospects

d. development of contingency plans

25. Porter's five forces analysis does not include which one of the following considerations.

e. pricing power*

f. potential new entrants

g. threat of substitutes

h. bargaining power of suppliers

26. Which one of the following is not a dimension of scalability?

a. information versus goods content

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b. degree of self-service*

c. cost of after-sales service

d. shipping and handling costs

27. Which of the following is not considered a criterion for evaluating the triple bottom line?

a. social progress

b. economic growth

c. environmental stewardship

d. market share*

28. _____ is the highest level of value and difficulty in use of big data.

a. Predictive analytics*

b. Descriptive analytics

c. Prescriptive analytics

d. Diagnostic analytics

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29. The trajectory of internet of things (IoT) began with _____.

    a. vertical market applications

    b. ubiquitous positioning

    c. supply chain helpers*

    d. physical world web

30. Which of the following is an application of big data in service industries?

    a. drafting athletes

    b. health assessment

    c. pricing models

    d. All of these.*

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