Service Breakthroughs

Changing the Rules of the Game

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Preface

Services have replaced used car and aluminum siding salespeople as the most frequent butt of jokes and complaints. Who doesn't have a favorite bad service war story? In fact, the abysmal quality of services in America has been made out by some to be a national scandal.

And yet, a number of firms have been successful at designing and activating what we call breakthrough services. These are services that revolutionize an entire industry's rules of the game by setting new standards for consistently meeting or exceeding customers' service needs and expectations. In some cases, these services are perceived by customers as being of exceedingly high quality, whether that is defined in terms of speed, accuracy, or other features. In other cases, the services produce unusually high value by delivering consistent quality at low prices.

A breakthrough service is significantly differentiated from competition both on matters important to customers and the manner in which it achieves its results, whether that be through a well-defined, focused, and positioned service concept; a high-commitment organization; a comprehensive database; a hard-to-duplicate network or technology; clever financing arrangements; or other methods.

We're concerned here not so much with the competitive strategies elected by service firms, but with the ways in which those strategies are implemented. This takes us to the very core of the service firm, to its human, technological, and financial resources and the way they are marshaled and brought to bear on delivering a service concept.

It requires attention to detail. At a meeting several years ago, a senior executive of the Trust House Forte hotel chain related how it had taken the English-based company 18 months just to implement a program in which its receptionists regularly greeted prospective guests with "———hotel, how may we help you?'' This executive was quite pleased when, during a break in the program, a member of the audience called a local Trust House Forte hotel and received the proper response.

It also requires that as much attention be given to the server as to the served. In a service, the two are much more closely linked than in most manufacturing processes.

Our concerns are selfish. Most of us, as citizens of post-industrial societies, live and work in a service economy, one in which services provide a vast and increasing majority of the jobs and national income.

Technology, in particular communications and information systems, has brought us to a point in time for services that is comparable to the era of the industrial revolution in manufacturing. It is a point in time when the nature of work and relationships among service workers are being transformed. In implementing service strategies, managers have a choice. They have an opportunity to benefit from the mistakes of their manufacturing forbears. Or they can make the same mistakes that led to worker alienation, the decline of product quality, militant union organization, and, according to many political economists, Marxist leadership in some parts of the world.

Consequently, the major objectives of this book are to: (1) identify elements common to methods that successful service firms adopt for activating strategies, (2) examine the implications that these methods have for the long-term benefits to servers as well as the served, and (3) suggest ways in which service-producing companies can avoid the mistakes of the industrial revolution as they bring modern technology to bear in creating a service revolution.

Our emphasis is on those things that are particularly critical to service-producing organizations and set them apart from their counterparts in manufacturing or extractive industries. They include:

1. The skillful organization and integration of marketing, operations, and human resource management critical to a successful service enterprise
2. The ''real-time'' nature of many service production and delivery (''marketing'') processes, with the profound implications it has for the training, compensation, and motivation of people; the design of information support systems for them; the design of other elements of the service delivery system, many of them associated with the place where both work is performed and customers are encountered; and the control of quality and productivity.
3. The management of people working simultaneously and often in an interactive mode in geographically far-flung networks connected only by a communications system, a marketing program, and whatever culture-building activities management may design and implement.

4. The fact that customers of many service-producing organizations have direct access to or contact with *most* of the members of those organizations, including people associated with *most* of the financial departments of the service-producing firm.
5. The demands that all of this places on the management of the service firm, particularly in the implementation and ongoing management of efforts to maintain a knowledge of customer needs and the way they are or are not being met; to design work and workplaces in ways intended to meet those needs most profitably; to select, develop, and assign people suitable to various tasks; and to devise ways of insuring that the service and the way it is produced and delivered will change to reflect new customer and server needs, technologies, and competitive dynamics.

We first examine in Chapter 1 ways in which successful firms orchestrate the service encounter between a customer and employee to create what we've called a "self-reinforcing service cycle." This, in addition to the strategic service vision reviewed in Chapter 2, provides the framework with which we organize our thoughts in the remainder of the book.

Customer and employee loyalty are at the heart of all service breakthroughs. In addition to reporting important new research results concerning the value of customer retention, Chapters 3 and 4 discuss ways in which a service strategy can be focused to foster such loyalty.

Service quality and productivity are our concerns in Chapters 5 through 7. This material reflects our conclusions that: (1) service quality is a positive force for attracting and retaining both the most desirable customers and employees, leading directly to superior productivity, (2) the starting point for the upgrading of quality is the measurement of costs and benefits, (3) nothing less than total customer (and employee) satisfaction should be the goal, and (4) the task is complex and never-ending.

A great deal of available service capacity often is wasted because it is perishable and must be held in reserve for just those moments when customers need it. But service demand and supply can be managed in ways described in Chapter 8.

Important building blocks of outstanding service—networks, information technology, and especially people—are addressed in Chapters 9 through 12. The creation and management of networks comprising physical facilities (such as routes), information (communications), and relationships (between people and organizations) will receive increasing attention in the coming decade, something we've tried to anticipate in Chapter 9. Many hopes for increasing service quality and productivity are centered around the potential for and capabilities of information technology, the subject of Chapter 10. Chapters 11 and 12 address the ways in which people in leading service organizations are being energized through truly innovative methods of selection and development, rewards and recognition, and organizing work itself. These are methods that provide high levels of satisfaction to service personnel as well, a significant goal in societies in which as many as 80% of all jobs are in services.

The future holds the prospect for delivery of more services anywhere and any time, a condition that has been called "future perfect." In Chapter 13 we discuss forces underlying the trend toward future perfect as well as possible limits on management efforts to achieve it.

The final chapter reviews the major themes of the book by comparing breakthrough and what we have termed "merely good" service organizations on a number of dimensions. The time-constrained reader can thus obtain a good sense of the book by reading Chapter 14 and then sampling in greater depth those chapters of greatest interest.

The organization of the book parallels that of a companion volume, *The Service Management Course,* which contains in-depth case studies of many of the companies referred to here.

This book conveys deep convictions. They are ours, but they have been influenced and fueled by managers who have found them essential in the development of service breakthroughs.

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Acknowledgments

In November 1987, we had the extraordinary opportunity to spend an evening and the following day on the Harvard Business School campus with CEOs of 15 of the leading service firms in their respective industries. It was a chance of a lifetime for three students of service management. The purpose of our CEO Workshop was to discuss broad-ranging issues confronting service companies which members of the group might identify. But because their firms spanned most service industries, we were apprehensive about whether members of the group could settle on an agenda of mutual interest. We need not have worried. Much of this book, especially those sections concerning organization, human resources, and strategies for becoming an "employer of choice," was inspired by that meeting. Furthermore, we were challenged to go beyond those discussions to identify other characteristics of breakthrough services in a broader spectrum of firms.

We are indebted to Rand Araskog; William W. Bain, Jr.; Edward H. Budd; M. Anthony Burns; Donald C. Clark; J. Michael Cook; James R. Emshoff; Thomas P. Fagan; Mitchell S. Fromstein; Ray J. Groves; Bruce Henderson; Paul H. Henson; J. Willard Marriott, Jr.; Joseph Neubauer; and William E. Phillips for a memorable experience and the inspiration for many of the ideas developed in this book.

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Our all-too-brief association with the late D. Daryl Wyckoff had a significant impact on our work as well as that of practicing managers in leading service firms. Daryl had a discerning eye; he could spot emerging service breakthroughs. He wrote cases on Federal Express, Singapore Airlines, and Stanford Court Hotels long before these firms became models for service excellence in the popular press. Daryl had the ability to make the complicated seem very simple with a cleverly done diagram or chart; he used data very effectively to make his points. He contributed a great deal to our thinking.

Among our current associates, Regina E. Herzlinger, Dwight B. Crane, Leonard A. Schlesinger, Minette E. Drumwright, and Timothy B. Blodgett have been particularly willing to share ideas and time with us.

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Sarah Markham was instrumental in supervising the production of the manuscript.

As always, Marilyn Heskett, Connie Sasser, and Joan Livingston have provided support and encouragement whenever it was needed.

Whatever their source, we're certain that few of the ideas in this book are ours alone. Many of them are being tested in the real laboratory, the one where services actually are being delivered. But since we've done the sorting and organizing of other people's work in an effort to discover and communicate significant patterns in it, we obviously bear the responsibility for the contents of this book. It's a small burden to bear for the stimulation and enjoyment of being able to spend so much time with managers of breakthrough services.

J. L. H.
W. E. S.
C. W. L. H.

Contents

1

Creating Breakthrough Services

Outstanding service organizations are managed differently from their merely good competitors. Missions are stated differently. Managers act differently. Actions are based on totally different assumptions about the way success is achieved. And the results show it, both in terms of conventional measures of performance and the impact these services have on their competitors.

Recently one of us visited the Tyson's Corner Mall in northern Virginia. The visit resulted in one surprise after another as salespeople in large stores and small exhibited unusual interest in providing unexpectedly outstanding service. At first we attributed it to Southern hospitality. But the experience wasn't consistent with others we've had in the same area. And then it dawned on us. Among the four department stores which the huge mall contained, one was Nordstrom. And Nordstrom's level of service exceeded even that provided by other retailers that same day. The experience was a clear reflection of a strong conviction often expressed by Nordstrom's service managers that a store manager's primary responsibility is to satisfy customers.

Naturally, we had seen many of the things written about the high level of service provided by this fashion retailing organization. But we had not witnessed the impact it could have on an entire shopping center, one of the largest in the United States. The experience triggered a line of thinking about those one or two firms in every service industry that stand out from the pack. Firms that seem to gain momentum, almost as if they are propelled by an added force not available to their competitors. Firms that seem to have broken through some sort of figurative "sound barrier," that have passed through the turbulence that precedes the barrier into the relatively quiet, smooth zone beyond in which a management action produces exaggerated results, results that often exceed reasonable expectations. Firms that alter the very basis of competition in their industries.

We began to think of the offerings of these firms as breakthrough services and set out to try to capture in words, numbers, and diagrams the essence of what managers do to break the figurative sound barrier.

We started with three simple beliefs: (1) it is possible to manage a good firm through the barrier that distinguishes the good from those that are moving beyond Mach 1; (2) outstanding services and the firms that provide them are made, not born; and (3) breakthrough services managers don't think like their merely good counterparts in competing organizations.

Having tested these ideas through numerous field observations, we are convinced more than ever that our starting beliefs hold up. But we have found out a great deal more along the way about how managers think and act in designing and delivering breakthrough services. They invariably start with the service encounter.

THE SERVICE ENCOUNTER

At the heart of every service is the service encounter. Everything flows from it. A service encounter is the event at which a customer comes into contact with a service provider, its people, its communications and other technology, and the services it provides. It is the point in time at which especially marketing, operations, and human resource management are brought to bear on the process of creating and delivering a service that meets customers' needs, perceived risks, and expectations. It has been termed by Jan Carlzon, CEO of SAS (Scandinavian Airlines System), the ''moment of truth'' at which the representatives of a service company must prove to their customers that their company is the best alternative.[1]

The most important relationships in a service encounter, based on research done to date, are summarized in Figure 1–1. We have purposely been selective in choosing elements of this model. The first is based on research findings; the others follow from it. They are:

1. The quality of service (customer satisfaction) = service quality delivered – service expected.
2. The value of a service to a customer = service quality (both the results realized and process by which they were achieved) divided by (price and other customer costs of acquiring the service).

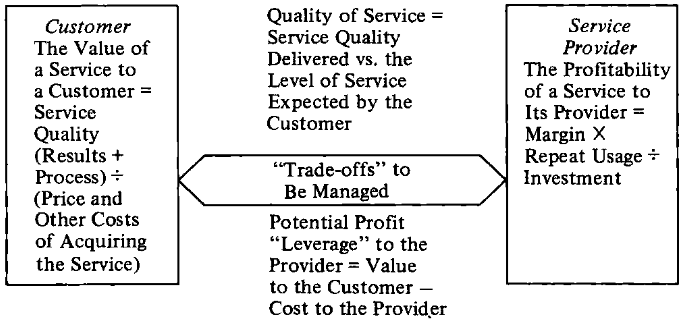

FIGURE 1–1 The Service Encounter as a Set of Trade-Offs

3. Potential profit "leverage" in providing the service = value to the customer − cost to the service provider.
4. The profitability of a service to its provider = margin × repeat usage ÷ investment.

It occurred to us that most service managers understand these relationships. Why then do so few use this understanding to produce services that achieve true competitive superiority? The primary reason, we've concluded, is that most view these relationships as a set of trade-offs to be designed and managed in traditional ways that have been handed down from one generation of operating manager to the next for years. This is the view that assumes that nearly all decisions involve trade-offs. That higher quality requires greater investment or higher costs, or that lower costs naturally are associated with lower quality. That higher prices naturally reduce demand. And that the primary avenue to higher profits is higher margins. While these assumptions ignore the way in which customers assess the value of a service, they represent conventional, accepted management thinking.

Breakthrough managers look at the same relationships and see something else. They see the service encounter as a dynamic force with a potential for fueling a set of self-reinforcing relationships shown in Figure 1–2. They take advantage of relationships that propel a firm through the competitive sound barrier, often by defying conventional logic concerning trade-offs. These managers spend less to achieve higher value and higher margins. They lower prices to increase margins. They raise prices and sell more. They understand customer value, quality, and ways of leveraging value over cost. Most important, they understand how to develop fanatical loyalty among customers, employees, suppliers, and investors, loyalty that produces the flow of results bordering Figure 1–2. In short, they frequently astound and often confuse their merely good competitors, who work just as hard but end up being second- or third-best.

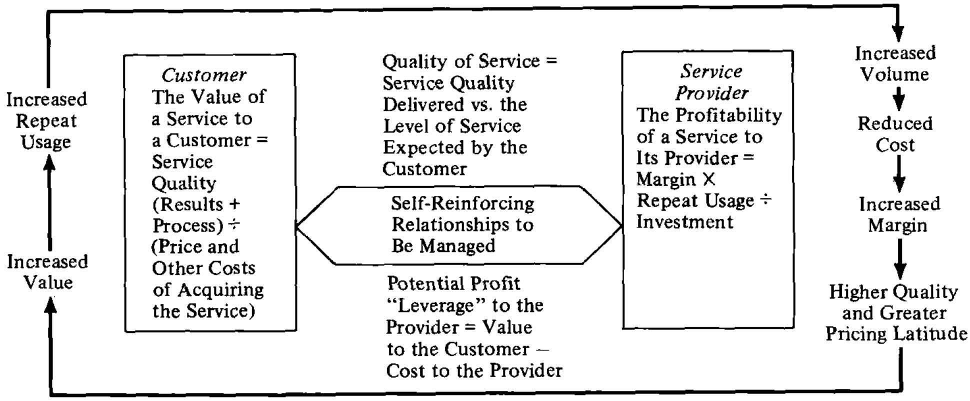

FIGURE 1–2 The Service Encounter as a Self-Reinforcing Process

Consider, for a moment, the underlying policies of Nordstrom and how management implements them. As we said earlier, everything flows from the mission of providing outstanding service to customers. The way this is achieved is by stocking fashion merchandise in greater depth and breadth than competitors; having pleasant, well-located stores; providing incentives to salespeople and managers to deliver superior service to customers; and then leaving it up to individual store managers and salespeople as to how superior service is to be achieved.

Merely good competitors whose managers practice by the "trade-off" philosophy look at Nordstrom and shake their heads. Because Nordstrom has more complete stocks of fashion merchandise, its inventory carrying costs should be higher than industry averages, right? Wrong. Nordstrom's inventory carrying costs in relation to sales are not higher. Well-designed stores in good locations featuring such amenities as live music performed on a grand piano in each store have to result in higher overhead and occupancy costs than for competitors, right? Wrong again. Nordstrom's overhead and occupancy costs in relation to sales are not higher. Because Nordstrom relies heavily on sales commissions, paying successful salespeople roughly twice as much as they could make at its most serious competitors' stores, it must have the highest labor costs in the industry, right? Still wrong. In relation to sales, Nordstrom's labor costs are at or below industry averages. Delegating the control of service quality to the point of sale must involve risks of achieving highly uneven service quality, right? The evidence suggests not. Nordstrom has one of the most fiercely loyal group of customers of any firm anywhere. Most are recruited by word-of-mouth referrals, thus reducing advertising costs to one of the lowest levels of all fashion retailing firms.

The results of Nordstrom's breakthrough service are mirrored not only in the company's loyal customers but also in its high productivity of assets and personnel; in its ability to retain experienced, capable people; and in its substantial profit on investment even while growing rapidly. At the heart of Nordstrom's success is an understanding of not just how to deliver value to customers or how to control costs, but rather how to leverage value over cost to achieve profit.

LEVERAGING VALUE OVER COST TO ACHIEVE PROFIT

The difference between the value of a service to a customer and the cost of providing it determines profit potential. It is what we call profit leverage. The extent to which it is fully captured by the service provider depends on its pricing policy.

VALUE OF SERVICE

What we receive for what we pay is the basis for measuring value in services as well as products. Our perception of what we receive in a service, however, is based both on results obtained and the manner in which the results are achieved.

Quality of Service. Results and the process by which they are delivered are the components of what we call service quality.

Results from a service often are difficult to assess. As Valarie Zeithaml has pointed out, it is hard to know the results even after we have purchased many services.[2] In contrast, we see the result immediately when we try on a piece of clothing or wear it in public for the first time. We can get some idea of the potential result before we buy. Other goods and many services are harder to assess in advance. For example, we have to have our hair styled to know whether we received good results from the hair stylist. It's nearly as hard to correct a bad haircut in process as it is to reverse it after the fact.

With many services, including almost all educational (this book, for example), medical, legal, and other professional services, the problem is even more extreme. We don't know the results even after the service has been performed. Astute service providers understand this and take measures to assure us that the result will be a good one, often through the process by which the service is delivered.

While we may not be able to assess results before, during, or even after some services, we frequently are able to observe how a service is delivered.

This is why outstanding service organizations devote as much attention to the manner of service delivery as to the achievement of desired results.

Quality = Actual Service − Expected Service. Results and process, and thus quality, are evaluated by customers in terms of what they actually receive in relation to what they expected. Because needs and expectations vary by customer and situation, service quality is a highly subjective matter. Clearly, the customer defines quality.

Absolute measurements of service quality that do not include customer expectations miss the point. Customers have different expectations of the quality they can expect from different types of service providers, competitors within the same industry, and the same providers at different points in time and under varying conditions. This helps explain why customers regularly rate auto service quality at such chain organizations as Sears, Firestone, and Midas Muffler higher than at their authorized General Motors, Ford, or Toyota dealers. They expect more from the latter. And because they save their complex auto ''medical'' problems for the authorized dealer, they do not always come away satisfied. They expect only to get a muffler replaced at a certain price at Midas and it happens.

Customers often expect more rapid response from a Federal Express representative than they do from their doctor. Why? They have been conditioned to believe that the doctor is busier and a scarcer resource, whether it is true or not. One organization, Au Bon Pain, a French bakery café chain featuring sandwiches made with croissants, organized a ''Moments of Truth'' quality excellence program. As a result, it established several standards, including one borrowed from McDonald's, that no customer should wait more than two minutes in line to place an order. This standard, however, was modified to three minutes when customers indicated that they didn't expect Au Bon Pain to be as fast as a McDonald's because the food being served obviously took longer to prepare.[3]

Customers expect better service from a firm that has provided good service in the past than one that has not, suggesting the importance of a series of service encounters and results over time. And customer expectations may or may not take into account the impact of peak or slack business times on the quality of service or the fact that they may buy different classes of service from the same provider from time to time. Thus, airlines serving travelers who use first class on business but who are traveling coach class with families on vacation regularly run the risk of being perceived as offering poor service, suggesting the need to find ways of making available some form of ''first-class'' vacation travel to those customers and their families.

Breakthrough service managers understand that a high-quality service encounter raises expectations for future encounters, not only those involving a customer with the same service company, but also those of its competitors. Thus, it is both a competitive weapon and a prod for continued service improvement. In a sense, high-quality service is its own best competition. The term "personal best," sought by competitive track and field athletes, applies in successful service firms as their customers' expectations are ratcheted upward and they strive to meet or exceed them with new features, variety, and positive service "surprises."

This ratchet effect may vary from one targeted customer segment to another, however. For years, the success of McDonald's has been based in part on the fact that one of its primary customer targets, children, typically do not want change from one encounter to another. They want the successful experience repeated exactly as it was the last time, whether or not their dutiful parents concur.

Perceived service quality can be enhanced both through efforts to improve results produced for customers and through efforts to condition their expectations about the nature of the service encounter and the results it might produce. Both are important.

One of the major themes of this book is service improvement. But we shouldn't overlook the fact that many services are enhanced through the conditioning of expectations. The medical profession, for example, has done a masterful job of enhancing value of service perceptions by conditioning prospective patients to expect to be treated like small children, told little, accept much of what happens to them on faith, and not be disappointed with failures to correct medical problems.

One progressive hospital manager, Erie Chapman, CEO of the U.S. Health Corporation, compares the situation of hospital patients unfavorably to that of prison inmates. In his view, both are subjected to excessive questioning, stripped of their usual clothing and possessions, placed in a subservient, dependent relationship to those attending to them, and allowed visitors only during certain hours.[4] His organization is trying to do many things to correct this, including the creation of patient advocates and the designation of liaison people between staff and patients. But the fact is that today medical practitioners who exceed even by a small margin minimal expectations which have been established are regarded as delivering outstanding service.

In a less critical service encounter, a restaurant customer may be told to expect a 30-minute wait and then called to a table in only 20 minutes. Given the conditioning of expectations, the result can be a positive perception of service quality even at the end of a 20-minute wait.

Firms that raise customers' expectations before developing the ability to meet them may experience short-term sales gains and long-term customer losses. This may help explain why Delta Air Lines modified its slogan, "Delta is ready when you are," and why Holiday Inn did the same with its advertising campaign stressing, "No excuses. Guaranteed."[5]

High-value service results in part from high quality. But service value has another component, cost. This includes both the price of the service and the less easily measurable costs of acquiring it.

Costs of Service to Customers. The traditional view of service acquisition costs is that they are all viewed negatively by the customer and thus have to be "traded off" against increased quality for the same or lower prices.

For example, Levitz Furniture pioneered the concept of the furniture warehouse store, one in which customers purchase from displays set up adjacent to a large warehouse stocked with crated furniture. In addition, customers may carry out their own purchases, thus reducing some of the most onerous costs of the furniture business, delivery and setup, with attendant damage to the product. This perhaps explains why Levitz offers a significant price incentive to customers to cart away their own purchases from the "warehouse."

Breakthrough services, in contrast, have been designed around the proposition that customers' perceptions of service acquisition costs are not all negative. Some of the most imaginative applications of this are provided by managers who understand that acquisition costs include the costs of delayed gratification, noninvolvement in the service, and lack of customer control over the result. This has led to the design of services incorporating more and more self-service, but at higher rather than lower prices of full-service competitors. In the case of furniture retailing, we are beginning to learn that for many customers, immediate access to their furniture has value. Further, they often ignore or underestimate acquisition costs, thus resulting in positive perceptions of the cost of self-service.

As one observer put it:

> Many consumers are so convinced that self-service is the height of good service that they are willing to pay extra for the privilege—witness the people who pay fees for using teller machines in New York, or who pay extra to tap into data systems through their own computers.[6]

The Subjective Nature of Service Value. We have just observed that quality in services is subjective, defined by individual customers. At the same time, customers attach different costs to the same process of acquiring a service. As a result, service value, the difference between service quality and cost, for an identical service may vary a great deal from one customer to the next.