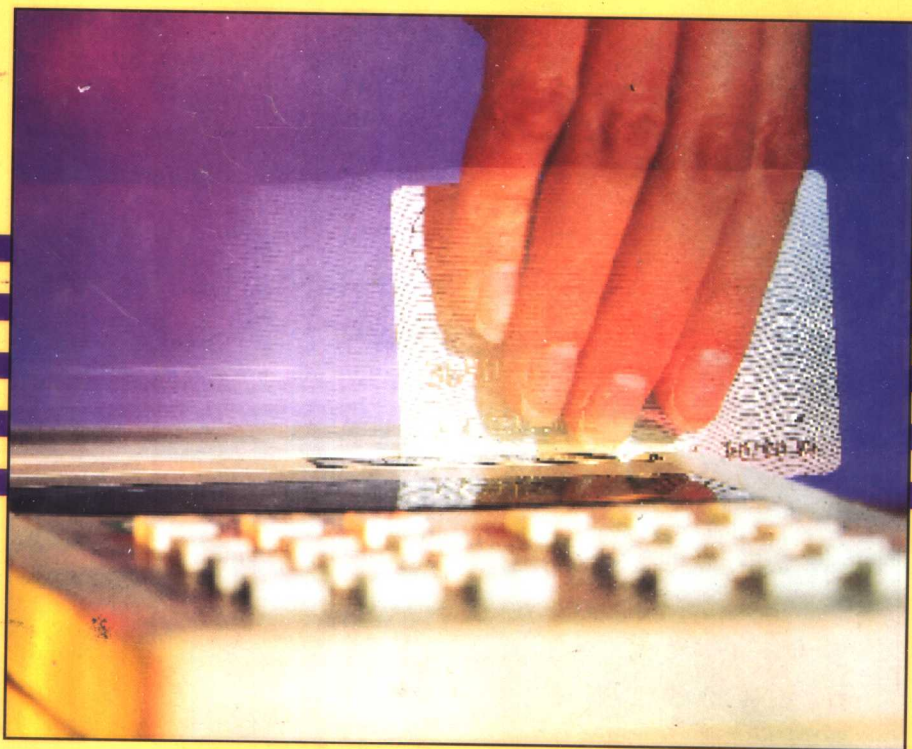


T H I R D   E D I T I O N

# SERVICES MARKETING



CHRISTOPHER H. LOVELOCK

# SERVICES MARKETING

THIRD EDITION

**CHRISTOPHER H. LOVELOCK**



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# Preface

Writing a new edition gives an author the opportunity to rework old ideas and frameworks, add new concepts, and insert cutting-edge insights and examples. This new edition of *Services Marketing* is particularly timely. Marketing practice in the service sector continues to evolve rapidly and more and more schools are now offering courses in services marketing.

Today, there's a larger store of knowledge available on service management, not only in marketing but also in functions that necessarily interact with marketing, such as human resources and operations. Service industries continue to face dramatic changes in their environment, ranging from developments in computerization and telecommunications (including the Internet) to the emergence of a global marketplace. Perhaps the most significant trend—representing both a threat and an opportunity—is the increasingly competitive nature of service markets.

The theme of this book is that service organizations differ in many important respects from manufacturing businesses, requiring a distinctive approach to planning and implementing marketing strategy. By this, I don't mean to imply that services marketing is uniquely different from goods marketing. If that were true, it would undercut the whole notion of marketing as a coherent management function. Rather, I stress the importance of understanding service organizations on their own terms and then tailoring marketing goals and strategies accordingly. Within this group I include the service divisions of manufacturing firms.

The first edition of *Services Marketing*, published in 1984, was based on the MBA course, Marketing of Services, that I had developed and taught at the Harvard Business School. I continue to be grateful for the support and inspiration provided while I was at Harvard—and since—by Jim Heskett, Ted Levitt, Earl Sasser, and the late Daryl Wyckoff. Important early insights also came from my research at MSI with John Bateson (now at Gemini Consulting) and Pierre Eiglier and Eric Langeard of the Université d'Aix-Marseille. The second edition, published in 1991, incorporated insights gained from further research. I tested new concepts in corporate seminars and in programs at Harvard University Extension and at MIT's Sloan School, where I was happy to have the opportunity to work with Gabriel Bitran.

This third edition represents another substantial revision and update, which has involved reworking every chapter. It has benefited not only from my teaching, consulting, and research efforts, but also from suggestions by instructors who used the previous editions in their own courses. The increased emphasis on international issues reflects, in part, my two-year assignment as a visiting professor at IMD in Switzerland, where I worked closely with Sandra Vandermerwe (now at Imperial College, London). I've also learned a lot from teaching in a variety of other international settings, including the Theseus Institute in France.

The third edition of *Services Marketing*, like its predecessors, continues to be targeted for use in upper division undergraduate courses, MBA programs, executive MBA courses, other management seminars, and university extension programs. As before, the book contains three types of materials: Original text, reprints of provocative articles written by authors from both business and academic backgrounds, and cases for class discussion.

The text has been expanded from 12 chapters to 14, and now features new chapters on “Adding Value to Core Products with Supplementary Services” and “Globalizing Services Marketing.” Existing materials have been refined and restructured, with tighter integration between chapters. Many important new concepts, tools, and strategic guidelines have been added. There are 17 readings, of which 13 are new to this edition. Two basic types of readings are included: (1) state-of-the-art concepts and strategic insights, presented by leading academics and thoughtful practitioners, and (2) descriptions of innovative practices adopted in recent years by successful service firms. Finally, there are 16 cases of varying lengths and levels of difficulty, covering a wide array of industries and marketing situations. A majority of these cases are new to this edition.

Both cases and readings were selected for their ability to complement or reinforce issues raised in the chapters (and are cross-referenced within those chapters). Many of them also provide insights into the problems and challenges that service marketers face in a broad array of real-world settings. Researchers will find extensive references at the end of each chapter and in several articles reprinted from academic journals and conference proceedings. There is also a detailed index (covering text, readings, and cases) and an up-to-date bibliography at the end of the book.

The structure and content have been influenced by advice and suggestions from many people, and by the writing and conference presentations of an even larger number. In particular, my thinking has been shaped in important ways by David Maister of Maister Associates, Chuck Weinberg of the University of British Columbia, George Yip of UCLA (who collaborated with me on the chapter on globalization), and my wife, Molly, who has had wide experience in managing nonprofit service organizations. I’m also delighted to acknowledge the contributions of my son, Timothy, who educated me on technology issues, contributed to the section on the World Wide Web, and prepared several of the figures.

Many friends have provided me with valuable insights—not only in terms of concepts and research findings but also advice on how best to teach services marketing. They include Ken Bernhardt of Georgia State University, Len Berry of Texas A&M University, Steve Brown and Mary Jo Bitner of Arizona State University, Ray Fisk of the University of Central Florida, Cathy Goodwin of the University of Manitoba, Bill George of Villanova University, Christian Grönroos of the Swedish School of Economics in Finland, Evert Gummesson of Stockholm University, “Parsu” Parasuraman of the University of Miami, John Quelch, Len Schlesinger, and John Sviokla of Harvard Business School, Fred Reichheld of Bain & Co., Benjamin Schneider of the University of Maryland, Jochen Wirtz of the National University of Singapore, Lauren Wright of California State University at Chico, Bob Young of Northeastern University, and Valarie Zeithaml of Partners for Service Excellence.

I've also learned much from managers and consultants in many different service industries, through both conversations and conference presentations, notably those sponsored by the American Marketing Association and the Marketing Science Institute (MSI). If I may single out just four of them for special acknowledgment, they are Alden Clayton and Diane Schmalensee (both formerly of MSI), Lynn Shostack of Joyce International, and Dick Munn of the Information Technology Services Marketing Association (ITSMA). My thanks are due, too, to the authors of the readings and cases in this book—some of whom are mentioned above—as well as to their publishers for permission to reprint their work here.

Finally, I'd like to acknowledge the valued assistance of the people who helped to bring this book into being. They include my editor, Don Hull, senior project manager, Alana Zdinak, marketing manager, John Chillingworth, and editorial assistant John Larkin at Prentice Hall as well as Tom Colaiezzi at Tele-Composition, Inc.

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A native of Great Britain, Christopher Lovelock graduated with a BCom and an MA in economics from the University of Edinburgh, then worked in marketing positions in Britain and Canada before going on to obtain an MBA from Harvard and his PhD from Stanford. He has written or co-authored 12 books, published more than 60 articles, and developed almost 100 teaching cases. A past recipient of the *Journal of Marketing* Alpha Kappa Psi award for his contributions to advancing marketing practice, he is also a four-time winner of a European Case of the Year award. In 1995, he received the American Marketing Association's Award for Career Contributions to the Services Discipline.



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# Contents

<i>Preface</i>	vii
<i>About the Author and Contributors</i>	xi
<b>Part I: Understanding Services</b>	<b>1</b>
Chapter 1: Distinctive Aspects of Services Marketing	1
Chapter 2: Developing Frameworks for Analyzing Services	26
Chapter 3: The Customer Experience	48
<i>Readings</i>	
Service is Everybody's Business <i>Ronald Henkoff</i>	69
The Development and Emergence of Services Marketing Thought <i>Stephen W. Brown, Raymond P. Fisk, Mary Jo Bitner</i>	76
The Dramaturgy of Services Exchange: An Analytical Framework for Services Marketing <i>Stephen J. Grove, Raymond P. Fisk</i>	97
Critical Service Encounters: The Employee's Viewpoint <i>Mary Jo Bitner, Bernard H. Booms, Lois A. Mohr</i>	106
<i>Cases</i>	
Sullivan's Auto World	122
Euro Disney: An American in Paris	127
Metropol Base-Fort Security Group	141
Singapore Airlines	150
<b>Part II: Strategic Issues in Services Marketing</b>	<b>163</b>
Chapter 4: Positioning a Service in the Marketplace	163
Chapter 5: Targeting Customers and Building Relationships	184
Chapter 6: Managing Demand	204
<i>Readings</i>	
Pick a Card: Visa, American Express and MasterCard Vie in Overseas Strategies <i>Steven Lipin, Brian Coleman, Jeremy Mark</i>	224
Measuring Marketing Success <i>David H. Maister</i>	228
Service Positioning Through Structural Change <i>G. Lynn Shostack</i>	232
Loyalty-Based Management <i>Frederick F. Reichheld</i>	245
<i>Cases</i>	
Boston Center for Adult Education	254
Federal Express: Business Logistics Services	268
BT: Telephone Account Management	281
Marriott's Rancho Las Palmas Resort	293

<b>Part III: Tools for Service Marketers</b>	<b>311</b>
Chapter 7: Creating and Delivering Services	311
Chapter 8: Adding Value to Core Products with Supplementary Services	337
Chapter 9: Understanding Costs and Developing Pricing Strategies	361
Chapter 10: Communicating and Promoting Services	376
<i>Readings</i>	
The Power of Branding <i>Torin Douglas</i>	398
Making Money on the Web <i>Kate Maddox, Mitch Wagner, Clinton Wilder</i>	402
Advertising Strategies for Service Firms <i>Donna Legg, Julie Baker</i>	409
Why Cross-Selling Hasn't Worked <i>David H. Maister</i>	418
Database Marketing: A Potent New Tool for Selling <i>Jonathan Berry, John Verity, Kathleen F. Kerwin, Gail DeGeorge</i>	422
<i>Cases</i>	
Vancouver Public Aquarium	431
Fare Combat	442
Crosse & Whitewall: Cross-selling Professional Services	446
Menton Bank	451
<b>Part IV: Challenges for Senior Management</b>	<b>460</b>
Chapter 11: Enhancing Value by Improving Quality and Productivity	460
Chapter 12: Developing and Managing the Customer-Service Function	490
Chapter 13: Organizing and Implementing the Marketing Effort	508
Chapter 14: Globalizing Services Marketing	534
<i>Readings</i>	
Service Quality From the Customers' Perspective <i>Susan J. Devlin, H. K. Dong</i>	562
The Horizontal Corporation: It's About Managing Across, Not Up and Down <i>John A. Byrne</i>	573
Putting the Service-Profit Chain to Work <i>James L. Heskett, Thomas O. Jones, Gary W. Loveman, W. Earl Sasser, Jr., Leonard A. Schlesinger</i>	582
McDonald's Conquers the World <i>Andrew E. Serwer</i>	594
<i>Cases</i>	
The Toronto-Dominion Bank: Customer Service Index	602
Shouldice Hospital Limited	614
Peters & Champlain	628
Air BP: Aviation Service Centers	633
 Appendix: Studying and Learning From Cases	 645
 Selected Bibliography	 649
 Index	 651

## Part I UNDERSTANDING SERVICES

# 1

### *Distinctive Aspects of Services Marketing*

The service sector of the economy is going through a period of almost revolutionary proportions in which established ways of doing business continue to be shunted aside. Around the world, innovative newcomers offering new standards of service have succeeded in markets where established competitors have failed to please today's demanding customers. Consider the following examples:

- From its original home base in Dallas, Texas, Southwest Airlines has expanded from just three aircraft serving just three Texan cities to almost 200 aircraft, all Boeing 737s, serving some three dozen states. Aided by sometimes zany promotions, Southwest has positioned itself in the market as the friendly, no-frills, low-fare airline targeting price-sensitive, domestic travelers who seek frequent service on short-haul routes. It has been consistently profitable during a period when other American carriers have lost billions of dollars and many famous names in commercial aviation—such as Braniff, Eastern, and PanAm—have disappeared. Southwest boasts the nation's best record for punctuality, baggage handling, and customer satisfaction. Other airlines sometimes abandon routes

when Southwest enters a new market. Both US-based competitors and domestic airlines in other countries are studying the keys to Southwest's success and trying to emulate them.

- In Singapore, "World of Sports" stores look like retail sporting outlets of the type that could be found in a suburban shopping mall in almost any developed country. The chain, which also operates in three other southeast Asian countries (Brunei, Malaysia, and Taiwan) offers a large stock of well-known brand names in many sporting product categories (about the only thing missing is skis, since Singapore is close to the Equator!). WOS competes on service. "Where product differentiation is not marked," says founder and managing director, Danny Tan, "Customer service makes all the difference!" Tan describes his three corporate values as "Speed, Simplicity, and Service" and is proud of WOS's ability to supply customers quickly with the style and size they want. He emphasizes staff selection and training, as well as tight control over logistics through information technology. WOS became the second leading sports retailer in Singapore after only one year of operation, and also won first place in the annual American Express Service Excellence Award for retail outlets in this island nation.
- When marketing research studies of British banking customers showed that a majority would prefer to visit their local retail branch as little as possible and that 27 per cent would like to do more banking transactions by telephone (but with a live person on the other end), Midland Bank established a brand-new operation, Firstdirect, to offer all standard retail banking services by telephone (backed up by mail and use of ATMs), 24 hours a day, every day of the year. Innovative ideas in banking and technology were studied around the world to create Firstdirect, the world's first all-telephone bank—the bank with no branches that never sees its customers. Yet after five years it had attracted more than 650,000 customers (many of them through referrals from satisfied clients). Other financial institutions are now busily copying its methods.

## **SERVICES MARKETING IN A FAST-CHANGING ENVIRONMENT**

It has been said that the only person in the world who appreciates a change is a wet baby. But 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 go down to defeat at the hands of more agile and adaptive competitors. Among the keys to competing effectively in this new and challenging environment are skills in marketing strategy and execution—areas in which many service firms have traditionally been weak.

Marketing can be described in several ways. It can be seen as a strategic thrust pursued by top management, as a set of functional activities performed by line managers (such as product policy, pricing, delivery, and communications), or as a customer-driven orientation for the entire organization.<sup>1</sup> This book seeks to integrate

all three perspectives. It also recognizes that the services marketing function is much broader than the activities and output of the traditional marketing department, requiring close cooperation between marketers and those managers responsible for operations and human resources.

## **UNDERSTANDING THE SERVICE SECTOR**

The service sector of the economy can best be characterized by its diversity. Service organizations range in size from huge international corporations in such fields as 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 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.

Many services are concerned with the distribution, installation, and upkeep of physical objects; they include such diverse operations as retailing and storage, computer installation and car repair, office cleaning and landscape maintenance. Increasingly, firms that create a time-sensitive physical output, such as printing and photographic processing, describe themselves as being service businesses. 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 in public ownership or operate on a not-for-profit basis, but for-profit versions of each type of institution also exist.

As currently defined by government statistics, services account for two-thirds to three-quarters of the gross national product, not only in the United States but also in many other highly developed industrial nations. But there is a hidden service sector, too, within many large corporations that are classified by government statisticians as being in manufacturing, agricultural, or extractive industries. So-called “internal services” cover a wide array of activities, potentially including recruitment, publications, legal services, payroll administration, office cleaning, 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.<sup>2</sup> As these tasks are outsourced, they become part of the competitive marketplace and are therefore categorized as contributing to the services component of the GNP. Even when such services are not outsourced, however, managers of the departments that supply them would do well to think in terms of providing good service to their internal customers.

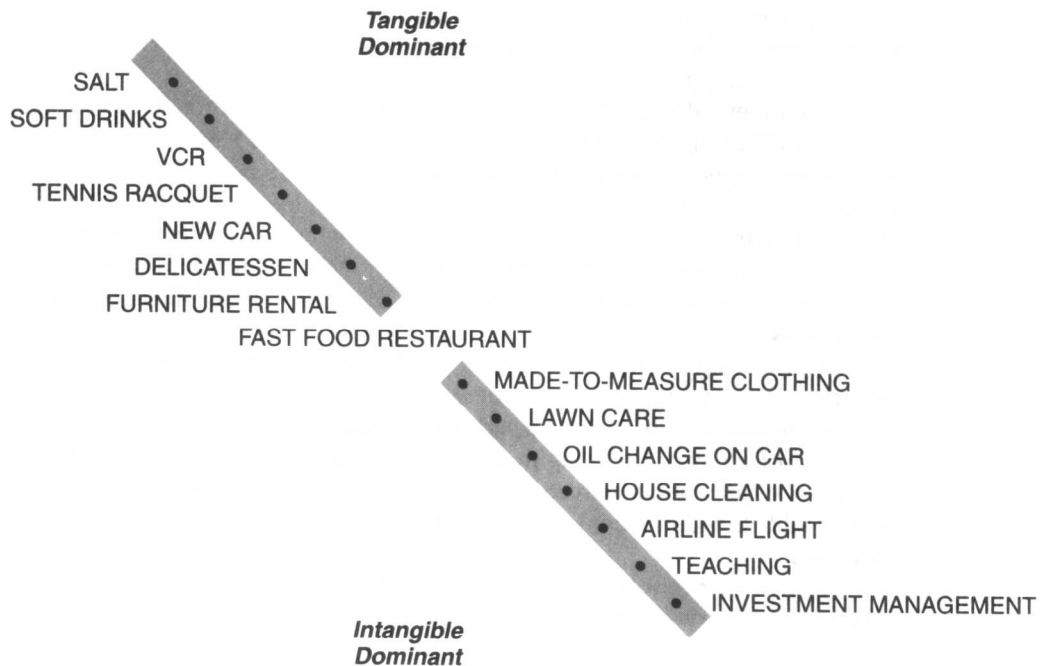
All *products*—a term that will be used in this book to describe the core output of any type of industry—deliver a bundle of benefits to the customers who purchase and use them. Perhaps the key distinction between goods and services lies in the fact that

customers usually derive value from services without obtaining permanent ownership of any 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 for a short period of time the labor and expertise of people whose skills range from brain surgery to knowing how to check customers into a hotel. Although purchasers are interested primarily in the final output, the manner in which they are treated during the process of service delivery can also have an important impact on their satisfaction.

Most services are multidimensional and some are quite complex, being composed of numerous different elements. In certain instances, customers of what is defined as a service organization still obtain and consume physical elements—such as a meal, spare parts installed in a car, or medical supplies used up during a hospital stay. In practice, few services are without tangible elements and few goods do not include a service component. As proposed by Shostack, goods and services can be ranked along a spectrum, from tangible dominant to intangible dominant (Figure 1.1).<sup>3</sup> Sasser et al suggest an alternative continuum, based on the proportion of the selling price accounted for by service elements, thus reflecting the value added by service.<sup>4</sup>

**FIGURE 1.1** DOMINANCE OF TANGIBLE VERSUS INTANGIBLE ELEMENTS IN GOODS AND SERVICES



For service marketers, the key question, perhaps, is: How much leverage in a competitive marketplace is exerted by the service elements of the total package? Henkoff argues that “On the front line of the new service economy, service—bold, fast, innovative, and customized—is the ultimate strategic imperative” (see “Service is Everybody’s Business,” p. 69).

### ***Services as an Academic Field***

The study of services management as an academic field evolved much later than that of management in manufacturing organizations. One reason was that the term *service* was ill-defined. To the extent that services were studied at all, it was usually on an industry by industry basis—an approach that discouraged cross-fertilization of ideas across different industries. Research into services brought new conceptual frameworks and analysis to bear on service problems. The article, “The Development and Emergence of Services Marketing Thought” (p. 76) describes the evolution of the field of service marketing and highlights some of the key contributions.

Better understanding of services marketing has not only led to greater marketing sophistication in traditional service industries, but has also had a significant impact on the management practices of service-driven manufacturing firms. At the same time, most service marketers would readily admit that they have also learned a lot from experts in service operations and human resource management.

## **A DYNAMIC ENVIRONMENT FOR SERVICES**

Perhaps even more than manufacturing, service industries are currently undergoing dramatic changes. Many factors underlie the ongoing transformation of service management that is taking place, not only in highly developed economies such as those of the United States, Canada, Japan, Australia, and the member nations of the European Union, but also in emerging economies around the world. Among these factors are:

- Changing patterns of government regulation
- Relaxation of professional association standards that restrict overt marketing communication efforts
- Privatization of public corporations and nonprofit organizations
- Technological innovations, especially computerization and advances in telecommunications
- The continued growth of company-owned and franchised service chains,
- Expansion of leasing and rental businesses
- Creation of service profit-centers within manufacturing firms
- Pressures on public and nonprofit organizations to find new income sources
- The globalization of service businesses

- The service quality movement
- Hiring and promotion of innovative managers

Like the factors underlying any revolution, some of the origins of today's service sector revolution go back a number of years, whereas others reflect a chain of relatively recent events that continues to unfold. Let's look at each of these dynamics.

### ***Changing Patterns of Government Regulation***

Many service industries have traditionally been highly regulated. Regulatory agencies mandated price levels, placed geographic constraints on distribution strategies, and, in some instances, prescribed product attributes. In the late 1970s the United States began a trend toward complete or partial federal deregulation in several major service industries. Changes in the regulatory environment took place at the state level, too.

Other nations watched the American experience and began making changes of their own. Substantial relaxations of regulations on trade in services between members of the European Union have already started to reshape the economic landscape of Europe. Meanwhile in Latin America, democratization and new political initiatives are creating economies that are today much less regulated than in the past. In the US, 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 to entry by new firms 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 may be able to expand into new markets or new lines of business.

But reduced regulation is not an unmixed blessing. Fears have been expressed, for example, 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 may benefit customers in the short run as competition lowers prices, but leave insufficient profits for needed future investments. For instance, fierce price competition among American domestic airlines has led to huge financial losses within the industry, bankrupting several airlines, making it difficult for unprofitable carriers to invest in new aircraft, and raising worrying questions about service quality and safety.<sup>5</sup>

Not all regulatory changes represent a relaxation of government rules. In many countries, steps continue to be taken to strengthen consumer protection laws, to improve safety and public security, and to protect the environment.

### ***Relaxation of Professional Association Standards***

Another American initiative, also copied elsewhere, has been government or legal pressure to force professional associations to remove or relax 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 than previously. The freedom to engage in advertising, promotion, and overt selling activities is, after all, essential in bringing innovative services, price cuts, and new delivery systems to the attention of prospective customers. On the other hand, critics worry that the huge surge in legal advertising in the US simply encourages people to file more and more lawsuits, many of them frivolous.

### ***Privatization***

The term “privatization” was coined in Great Britain to describe the policy of returning nationalized industries to private ownership. Led by Britain, privatization of public corporations has been moving rapidly ahead in a number of countries, notably in Europe, Canada, Australia and New Zealand, and more recently in some Asian and Latin American nations. The transformation of such service operations as national airlines, telecommunication services, and natural gas 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, as in the British telecommunications industry, the marketing implications can be dramatic.

Similar results have been achieved by government agencies—often at the local level—which have subcontracted certain services (such as trash removal) to private firms. Another type of change occurs when nonprofit organizations, notably hospitals in the United States, convert to for-profit status.

### ***Computerization and Technological Innovation***

New technologies are radically altering the ways in which many service organizations do business with their customers—as well as what goes on behind the scenes. Perhaps the most powerful force for change today comes from the integration of computers and telecommunications. Companies operating information-based services, such as financial service firms, are seeing the nature and scope of their businesses totally transformed by the advent of national (or even global) electronic delivery systems, including the World Wide Web.

But technological change affects many other types of services, too, from air-freight to hotels to retail stores. Technology facilitates creation of new or improved services, permits reengineering of such activities as order-taking and payment, enables firms to maintain more consistent standards through centralized customer service departments, replaces personnel by machines for repetitive tasks, and allows greater involvement of customers in operations through self-service.

### ***Growth of Service Chains and Networks***

More and more services are being delivered through national or even global chains or system networks. Respected brand names such as McDonald's, Body Shop, Meridien hotels, Citicorp, and Singapore Airlines (see p. 150) have spread far from their original