SECOND EDITION

MANAGING SERVICES

MARKETING, OPERATIONS, AND HUMAN RESOURCES

Christopher H. Lovelock

MANAGING SERVICES

Marketing, Operations, and Human Resources

Second Edition

CHRISTOPHER H. LOVELOCK

International Institute
For Management Development
(IMD)

Prentice Hall, Englewood Cliffs, New Jersey 07632

Library of Congress Cataloging-in-Publication Data
Managing services: marketing, operations, and human resources
[compiled by] Christopher H. Lovelock. — 2nd ed.
p. cm.
Includes bibliographical references and index.
ISBN 0-13-544701-1
1. Service industries — Management. I. Lovelock, Christopher H.
HD9980.5.M345 1992
658 — dc20 91-26857
CIP

Acquisition Editor: Tim Kent
Production Editor: Joanne Palmer
Cover Design: 20/20 Services, Inc.
Prepress Buyer: Trudy Pisciotti
Manufacturing Buyer: Robert Anderson
Editorial Assistant: Ellen Ford

Published by Prentice Hall
A Simon and Schuster Company

Printed in the United States of America

10 9 8 7 6 5 4 3 2 1

ISBN 0-13-544701-1

Prentice-Hall International (UK) Limited, *London*
Prentice-Hall of Australia Pty. Limited, *Sydney*
Prentice-Hall of Canada Inc., *Toronto*
Prentice-Hall Hispanoamericana, S.A., *Mexico*
Prentice-Hall of India Private Limited, *New Delhi*
Prentice-Hall of Japan, Inc., *Tokyo*
Simon & Schuster Asia Pte. Ltd., *Singapore*
Editora Prentice-Hall do Brasil, Ltda., *Rio de Janeiro*

To the memory of
Daryl Wyckoff

PREFACE

The field of service management has been evolving rapidly in recent years. Both managers and academics are waking up to the fact that better management of service businesses — and of the service divisions of manufacturing firms — is vital to competitive success and, indeed, to economic development. It is not only customers who benefit from dealing with well-managed service organizations but also employees. The satisfaction they derive from their jobs is closely related to the quality of management and the way in which those jobs are defined.

In developing the second edition of *Managing Services: Marketing, Operations, and Human Resources,* I have been able to introduce new thinking, new examples, and the findings of recent research projects to complement some classic conceptual articles and cases. Among the 26 readings in this book, 17 are new to this edition, 4 have been substantially revised, and 5 are carried over from the first edition. Of the 15 cases, 7 are new, 2 have been revised, and 6 have been retained unchanged.

SCOPE OF THE BOOK

The value of a book of readings and cases lies not only in bringing together an array of materials previously published over several years in a variety of locations, but also in grouping them in meaningful clusters and in structuring the sequence in which they appear. The framework of this book reflects my experience in teaching courses in service management — initially at the Harvard Business School, subsequently in Harvard University Extension, and more recently at IMD during two years as a visiting professor.

As the title of this book suggests, effective management of service businesses requires the integration of three key functions—marketing, operations, and human resources. Each function can be examined independently, of course, but effective implementation requires ongoing coordination between them. In manufacturing firms, by contrast, marketing tends to be most heavily involved only after the product leaves the factory gates and it's the rare organization where production and operations personnel have direct contact with customers.

Managing Services is divided into eight parts:

- Part I—The Challenge of Services
- Part II—Understanding Services: Breaking Free from Industry Tunnel Vision
- Part III—Designing and Delivering Services
- Part IV—Managing Capacity and Managing Demand
- Part V—The Search for Service Quality
- Part VI—Adding Value Through Customer Service
- Part VII—The Human Dimension in Services Management
- Part VIII—Strategy and Integration

The early parts of the book provide an understanding of the service sector and a framework for analyzing service organizations. Later parts address specific management issues. Finally, Part VIII focuses on organizational issues and on how to integrate marketing, operations, and human resources.

With the exception of Part I, which is composed of readings only, the several readings in each part are followed by two or three cases. Brief synopses in front of each reading and case are designed to orient readers and help them to identify materials of particular interest. An index at the end of the book provides useful reference to key topics in both readings and cases.

ACKNOWLEDGEMENTS

By definition, a book of readings and cases is a collaborative effort. I'm very appreciative of the contributions made by each of the authors and co-authors of the materials in this book. Their names and affiliations will be found in the following section, "About the Contributors." I'm grateful, too, to the copyright holders for granting permission to reproduce previously published articles and cases.

Thanks are also due to the following reviewers: Cleveland Gilcrest, formerly of Merrimac College; Peter McClure, University of Massachusetts—Boston; Curtis McLaughlin, University of North Carolina; Mike Myers, DePaul University; and James Fitzsimmons, University of Texas—Austin, who provided valuable suggestions for enhancing the second edition. I'm grateful, too, to my secretary at IMD, Josiane Cosendai, and to Joanne Palmer at Prentice Hall for their help in bringing the volume to publication.

Over the years, many people have helped me in my teaching activities on services and have contributed helpful comments on my own cases and research output. My thanks are especially due to Gabriel R. Bitran, James L. Heskett, Theodore Levitt, David H. Maister, Christopher W. L. Hart, John A. Quelch, W. Earl Sasser, Sandra Vandermerwe, and Charles B. Weinberg. Earlier, I also benefitted significantly from collaborative work with John E. G. Bateson, Pierre Eiglier, and Eric Langeard. I have learned much, too, from discussions with my own students and with participants in IMD's executive programs.

My thinking has also been influenced in useful ways by the Marketing Science Institute and the American Marketing Association. MSI, initially under the leadership of Alden Clayton and Diane Schmalensee, has played a key role in facilitating research in services. And AMA, particularly under the presidencies of Stephen Brown and Leonard Berry, has helped to bring together academics and managers from different fields to discuss how marketing management in service businesses can be better integrated with other management functions.

Finally, I would like to pay special tribute to the late D. Daryl Wyckoff, a friend and colleague at the Harvard Business School, who died in 1985 at the age of 47. Daryl, who

held the James J. Hill Chair of Transportation, was one of several Harvard faculty members who helped to pioneer the application of production and operations management techniques to service businesses. Having earlier taught Management of Service Operations at Harvard, Daryl was scheduled to take over the Service Management course from me in January 1985. My last memory of him is at a meeting we had in his office the previous December to discuss his plans for the course.

No one who had ever been in Daryl's office at Harvard could easily forget it. It epitomized his zest for life — which he knew might be cut short early — and his enthusiasm for his field. Glowering at the visitor from the opposite wall was a gold-framed oil portrait of James J. Hill, founder of the Great Northern Railroad. Decorative Chinese artifacts in red and gold, souvenirs of his visits to the Far East, hung from the high ceiling. A large poster advertised the Twentieth Century Limited as it was in the heyday of US rail travel. There were model trains and model aircraft, two of the latter bearing the colors of Midway Airlines of which he was a director. Linking his interest in both railroading and restaurants was a collection of British railway memorabilia, presumably acquired through his association with the Victoria Station restaurant chain, on whose board he also served.

Although visibly ailing on this occasion, Daryl spoke with enthusiasm about some innovations he planned for the course, including several sessions on service quality based on his own work in this field. His article, "New Tools for Service Quality," (reproduced in Part V of this book) had just been published and the two of us had used some of the concepts and tools it presented when teaching together in a corporate seminar some months earlier. Sadly, health problems prevented Daryl from teaching the course, and less than two months later he was gone. Had he lived, he would surely have had a major impact on how managers approach the task of improving service quality. The second edition of this book, like the first, is dedicated to his memory.

Christopher H. Lovelock
Lausanne, Switzerland

ABOUT THE CONTRIBUTORS

AUTHOR AND EDITOR

- **Christopher H. Lovelock** is visiting professor at the International Institute for Management Development (IMD) in Lausanne, Switzerland. He has had extensive experience working with service organizations. For 11 years, he was on the faculty of the Harvard Business School, where he developed courses in both Marketing of Services and Service Management. Dr. Lovelock has also held visiting appointments at MIT's Sloan School of Management, Stanford University, and the University of California at Berkeley. A native of Great Britain, he graduated with an MA in economics and a BCom degree from the University of Edinburgh, later obtaining an MBA from Harvard and a PhD from Stanford. He has written or co-authored twelve books and numerous articles and cases, including 7 of the readings and 11 of the cases reproduced in this second edition of *Managing Services: Marketing, Operations, and Human Resources.*

CONTRIBUTING AUTHORS

- **George R. Beam** was formerly a casewriter at the Colgate Darden Graduate School, University of Virginia.
- **Leonard L. Berry** holds the J.C. Penney Chair of Retailing Studies and is Director of the Center for Retailing Studies at Texas A&M University.
- **Gabriel R. Bitran** is Professor of Management at the Sloan School of Management.
- **Richard B. Chase** is professor of operations management and director of the Center for Operations Management, Education, and Research at the University of Southern California.
- **Sydney Coffey** was formerly a graduate student at the University of North Carolina.
- **Linda R. Cooper** is vice president and director of Consumer Affairs at The First National Bank Chicago.

- **Shauna Doyle** was formerly a research assistant at the Harvard Business School.
- **Peter F. Drucker** is Clarke Professor of Social Sciences at the Claremont Graduate School in California.
- **Susan C. Faludi** is a staff reporter at *The Wall Street Journal.*
- **Sula Fiszman** was formerly a research assistant at the Harvard Law School.
- **James R. Freeland** is a professor of business administration at the Colgate Darden Graduate School, University of Virginia.
- **Paul E. Green** is S. S. Kresge Professor of Marketing at the Wharton School, University of Pennsylvania.
- **Christian Grönroos** is a professor at the Swedish School of Economics in Helsinki, Finland.
- **James. L. Heskett** is UPS Foundation Professor of Business Logistics at the Harvard Business School.
- **Johannes Hoech** is a consultant with McKinsey & Co.'s office in San Jose, California.
- **Michael Kelly** is a writer and journalist in Chicago.
- **Karen L. Katz** is a consultant at Index Group, Inc., Cambridge, Massachusetts.
- **Sheryl E. Kimes** is assistant professor at the School of Hotel and Restaurant Administration, Cornell University.
- **Jane Kingman-Brundage** is president of Kingman-Brundage, Inc., a consulting firm based in North Salem, NY.
- **Robert J. Kopp** is associate professor at Babson College.
- **Blaire M. Larson** is a consultant at Index Group, Inc., Cambridge, Massachusetts.
- **Richard C. Larson** is professor of electrical engineering and computer science at the Massachusetts Institute of Technology.
- **David H. Maister** is president of Maister Associates, a Boston consulting firm specializing in management of professional service firms.
- **Curtis R. McLaughlin** is professor of business administration at the University of North Carolina.
- **A. Parasuraman** is Federated Professor of Marketing at Texas A&M University.
- **Rocco Pigneri** was formerly a research assistant at the Harvard Business School.
- **Frederick F. Reicheld** is a vice president in the Boston office of Bain & Company and leads the firm's customer retention practice.
- **Tom Richman** writes for *Inc.* magazine.
- **Stephen S. Roach** is principal and senior economist at Morgan Stanley & Co. in New York.
- **W. Earl Sasser, Jr.** is professor of business administration at the Harvard Business School.
- **Marsha Scarbrough** is director of product development for Courtyard by Marriot.
- **Daniel Schechter** is in the Department of Psychology at the University of Maryland.
- **Leonard A. Schlesinger** is associate professor of business administration at the Harvard Business School.
- **Roger W. Schmenner** is visiting professor at the International Institute for Management Development (IMD), on leave from the School of Business at Indiana University.
- **Douglas Shifflet** is president of D. K. Shifflet & Associates, a marketing consulting firm.
- **Sandra Vandermerwe** is professor of marketing and service management at the International Institute for Management Development (IMD).
- **Jerry Wind** is Lauder Professor of Marketing at the Wharton School, University of Pennsylvania.
- The late **D. Daryl Wyckoff** was James J. Hill Professor of Transportation at the Harvard Business School at the time of his death in 1985.
- **Valarie A. Zeithaml** is associate professor at the Fuqua School of Business Administration, Duke University.

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PART I
The Challenge of Services

Are Services Really Different?

CHRISTOPHER H. LOVELOCK

The service sector is in a state of rapid change, reflecting a variety of factors from regulatory changes to globalization and use of new technologies. The net effect is increased competition. A clear understanding of the distinctive characteristics of service management, free of traditional misconceptions, is needed if service businesses are to succeed in the future.

I, II, III

"Stop the World, I Want to Get Off!" was a popular British song in the 1960s. Service managers of all nationalities in the 1990s can be forgiven if they sometimes feel the same way. Old ways of doing things have ceased to be either effective or profitable, reflecting the fast-changing shape and composition of service industries and radical changes in the ways in which they do business.

Consider some of the indicators:

- New airlines come and go while some long-established carriers adopt major changes in route structure and operational strategy, are merged out of existence, or are liquidated.
- Financial service firms expand into banking, brokerage, and insurance activities that were previously denied them, as brokers and insurance companies muscle in on the bankers' turf.
- Realty firms and restaurants, once the epitome of local "mom-and-pop" operations, go nationwide.
- Large manufacturing firms derive a third or more of their revenues from the service businesses that they operate.
- The old healthcare system of hospitals and doctors' offices is augmented—and in part displaced—by a complex array of delivery systems that now embraces health maintenance organizations, out-patient surgicenters, chains of small walk-in medical centers, and expensive diagnostic equipment that travels by truck from one location to another.
- A tiny island nation, Singapore, creates one of the world's largest and most successful airlines as well as a world-class telecommunications service.
- Service organizations once owned by governments are transformed into private enterprises, not only in Europe but around the world.

- Customers everywhere decry an alleged decline in service quality across a broad cross section of industries, lamenting loss of the personal touch, frequent failures, and uncaring employees.
- Acting without the assistance of service personnel, consumers use modern technology to conduct financial or other information-based transactions across thousands of miles, accurately and almost instantaneously.

FORCES FOR CHANGE

Why is the service sector in such a state of flux? What are the forces for change and the ingredients for success? Many factors underlie the ongoing transformation of service management that is taking place in both developed and developing nations. They include changes in both government regulations and professional standards, privatization, technological innovation, the growth of franchising, expansion of leasing and rental businesses, a growing focus on services within manufacturing firms, pressures on public and nonprofit organizations to act in more businesslike ways, and globalization of service firms.

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 in turn.

Changing Patterns of Government Regulation

Many service industries have traditionally been highly regulated. Regulatory agencies have mandated price levels, constrained distribution strategies by limiting transportation route structures and banking service areas, and, in some instances, prescribed product attributes.

Since the late 1970s there has been a trend in the United States toward complete or partial federal deregulation in several major service industries. Changes in the regulatory environment are taking place at the state level, too.

Reduced government regulation, especially in the United States, has already eliminated or minimized many constraints on competitive activity in such industries as airfreight, airlines, railroads, and trucking; banking, securities, and 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 often find themselves able to expand into new markets or new lines of business. Fears have been expressed, however, that if successful firms become too large — through a combination of internal growth and acquisitions — then there may eventually be a decline in the level of competition.

Other nations have been watching the American experience with interest and making changes of their own. Substantial relaxations of regulations on trade in services between the 12 member nations of the European Community are anticipated after 1992.

But not all changes represent relaxations of government regulations. Many steps continue to be taken to strengthen consumer protection laws, to improve safety and public security, and to protect both workers and the physical 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 firms or 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.

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 ahead at speed in a number of countries. 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.

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 form of privatization occurs when nonprofit organizations, notably hospitals in the United States, convert to for-profit status.

III

Computerization and Technological Innovation

New technologies are radically impacting service operations and altering the ways in which many services do business with their customers — as well as what goes on behind the scenes. Data-based services, such as information and 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. But technological change affects many other types of services — from airfreight to hotels to retail stores. Technology facilitates creation of new or improved services, ability to maintain more consistent standards through centralized customer service departments, replacement of personnel by machines for repetitive tasks, and greater involvement of customers in operations through self-service.

Growth of Franchising

Franchising has become a very popular method of financing the expansion of multisite service chains that deliver a consistent service concept. The growth of franchising is seeing large franchise chains replace or absorb a vast array of atomistic service businesses in fields as diverse as bookkeeping, car rentals, haircutting, muffler repair, photocopying, plumbing, quick service restaurants, and real estate brokerage. Among the requirements for success are creation of mass media advertising campaigns to promote brand names nationwide (and even worldwide), standardization of service operations, formalized training programs, an ongoing search for new products, continued emphasis on improving efficiency, and dual marketing programs directed at customers and prospective franchisees, respectively.

Expansion of Leasing and Rental Businesses

Leasing and rental businesses represent a marriage between service and manufacturing businesses. To an increasing degree, both corporate and individual customers find that they can enjoy use of a physical product without actually owning it. Fixed costs may be transformed into semivariable costs, and there may be tax benefits, too.

Long-term leases may involve use of the product alone — such as a truck — or provision of a host of related services at the same time. In trucking, for instance, full-service leasing provides almost everything but the driver, including painting, washing, maintenance, tires, fuel, license fees, road service, substitute trucks, and driver safety programs. Personnel, too, can be rented rather than employed full time, as evidenced by the growth of temporary personnel services.

Manufacturers as Service Providers

Service profit centers within manufacturing firms are transforming many well-known companies in fields such as computers, automobiles, and electrical and mechanical equipment. Ancillary services once designed to help sell equipment — including consultation, credit, transportation and delivery, installation, training, and maintenance — are now offered as profit-seeking services in their own right, even to customers who have chosen to purchase competing equipment.

Many large manufacturers have become important players in the financial services industry as a result of developing credit financing and leasing divisions. Service profit centers often contribute a third or more of the revenues earned by such well-known "manufacturers" as IBM and General Electric.

Businesslike Behavior by Nonbusiness Organizations

Financial pressures facing public and nonprofit organizations are forcing such organizations to cut costs, develop more efficient operations, and pay more attention to customer needs and competitive activities. Faced, in many instances, with declining sources of free or inexpensive labor (such as that provided by volunteers or members of religious orders), many nonprofit agencies are having to take a more businesslike approach to recruitment, training, and motivation of managers and staff members.

Nonbusiness organizations are also rethinking their product lines, adding profit-seeking services such as museum shops, retail catalogs, restaurants, and consultancy; being more selective about the market segments they target; and adopting more market-oriented pricing policies.[1]

II

Globalization

The internationalization of service companies is readily apparent to any tourist or business executive traveling abroad. Airlines and airfreight companies that were formerly just domestic in scope now have foreign route networks. Numerous financial service firms, advertising agencies, hotel chains, fast-food restaurants, car rental agencies, and even hospital groups now operate on several continents. This strategy — which has not always been successful — may reflect a desire to serve existing customers better, to penetrate new markets, or both.

Many well-known service companies in the United States are owned by foreign investors, but American service businesses have also been expanding abroad. Franchising, of course, allows a service concept developed in one nation to be delivered around the world through distribution systems owned by local investors.

Internationalization of service businesses is being facilitated by free-trade agreements (such as those between Canada, Mexico, and the United States, and between the member nations of the European Community), but there are fears lest barriers be erected to impede trade in services between free-trade blocs and other nations, as well as between the blocs themselves.

DO SERVICES REALLY MATTER?

"What a silly question!" you may say. After all, more than two-thirds of the gross national product in many industrialized nations is now devoted to service industries (including the activities of government and nonprofit organizations). And yet some commentators still seem to hold the view that services that do not add value to a physical product (such as freight transportation) neither contribute to wealth nor create value.

This view of services as parasitical was shared by two writers at opposite ends of the political spectrum, Adam Smith and Karl Marx. Today, many people still seem to have a "macho" view of manufacturing as a symbol of strength and see services as a symbol of lost focus and industrial decline. Depending on one's values, some services may seem frivolous or a wasteful use of resources, but the same is also true of many manufactured products.

As late as the American presidential election of 1988, some candidates were still trotting out the tired old canard that a service economy is one in which we all take in each other's laundry.

Myths and Misconceptions

A number of erroneous myths continue to circulate about the service sector and it is worth demolishing them.[2]

Myth No. 1: A Service Economy Produces Services At the Expense of Other Sectors. What is sold reflects what customers (of all types) wish to buy. A more salient issue is whether the goods and services purchased were created domestically or by foreign suppliers. Many service industries are, in fact, major purchasers of manufactured products — consider airlines, hospitals, car rental firms, hotels, and the back offices of financial service firms.

Myth No. 2: Service Jobs Are Low-Paying and Menial. This view reflects headlines like the one in *The New York Times* that announced,