

# Services and their management

## Learning objectives

After studying this chapter, readers will be able to:

- discuss the overall global significance of services
- explain the concept, nature and structure of services
- understand management concepts and theories
- discuss the main issues associated with the strategic management of services.

## Introduction

There are many texts that focus on the strategies, plans and operational functions associated with the management of particular industries and organisations. Others explore the application of management concepts in industry sectors such as agriculture and manufacturing, or analyse services from operational or marketing perspectives. However, few books have attempted to examine global services from a strategic management perspective, which combines all management functions within an integrated approach. The reasons for this neglect reflect the complex nature of services, their unclear boundaries and shifting structures, their 'intangible' outputs, the perceived social and economic significance of services, and their inherent resistance to the direct transfer of manufacturing models of management.

However, services can no longer be ignored, nor their proper management responsibilities be abrogated, due to their primacy in the economies of all developed, and most developing, countries in the world. It is apparent that there is a need for the development of a strategic management approach for this important sector of the global economy. Services have now supplanted both the *primary* (agriculture, mining) and the *secondary* (manufacturing) economic sectors, as a predominant *tertiary* sector. As a clear example of the significance of services, 11 of the 16 Australian Bureau of Statistics (ABS) standard industry classifications are directly services-related, namely:

- public service departments and utilities;
- transportation and storage;
- tourism and hospitality;

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- communication services;
- property and business services;
- cultural and recreational services;
- education;
- retailing;
- finance/insurance;
- health and community services; and
- personal and other services.

### Global significance of services

The main reasons for the remarkable rise in the global significance of services over the last decade or so are associated with dynamic changes in the world economy, customer expectations and demands, and the opportunities offered by new technologies. The collapse of former centrally planned economies and/or their replacement with market-based economies (for example, the former Soviet Union and the People's Republic of China), and the development of new labour markets, including highly educated middle-class consumers, stimulated the growing demand for both more traditional (hospitality, retail) and more innovative (virtual retailing, telephony) services. Both the primary and secondary industry sectors (that is, agriculture/mining and manufacturing) have been transformed due to labour costs and production process issues, with the aggregation or conglomeration of global agricultural and mining corporations (for example, the Vestey pastoral company, the merger of BHP Billiton, Western Mining Corporation), and the transfer of many manufacturing operations to less developed countries with reduced labour costs (for example, Country Road, Nike, automobiles and white goods). Apart from these broad labour market issues and global business perspectives, which view the world (rather than particular countries or regions) as their marketplace, many primary and secondary sector organisations have realised that new technologies, such as automated production and electronic distribution, demand the reduction of workforces and the replacement of employees with technical processes.

In addition, the combined influences of new consumers (for example, Generation X and Generation Y, and an increasing global middle class) have both broadened and deepened customer expectations of the quantity and quality of services provided by service organisations, including innovative and value-added qualities, and the challenge of competitive advantage (Porter, 1999) through enhanced service quality. These expectations include immediate and personalised attention, corporate rather than product branding, and value-adding activities integrated with more traditional functions.

Some sources suggest that up to 88 per cent of the workforce in the United States is employed in services (Verma and Boyer, 2000, p. 5), compared with around 73–75 per cent in Australia (Matthews, 2004). Singapore's international trade in services was US\$26.4 billion in 2001 (Aggarwal, 2003); Thailand's economic survival is heavily dependent upon the success of the tourism segment of its services sector; and, as Table 1.1 shows, similar imperatives underpin the economic policies of such diverse countries as Indonesia, Hong Kong and Korea. Some observers have even attributed Japan's slow economic recovery recently to the lack of growth in its services sector.

**Table 1.1** Country statistics: GDP (US\$ million) and services value-added, 1997–2001 (% of GDP)

Country	1997	1998	1999	2000	2001
Australia	419.1 (69.9)	374.0 (70.8)	407.6 (70.7)	390.1 (N/A)	368.6 (N/A)
China	898.2 (30.9)	946.3 (32.1)	991.4 (33.0)	1,079.9 (33.2)	1,159.0 (32.9)
Hong Kong, China	171.0 (85.2)	162.6 (85.0)	158.3 (85.5)	162.6 (N/A)	N/A
India	409.7 (44.9)	414.1 (45.8)	445.2 (47.8)	457.0 (48.2)	477.6 (48.4)
Indonesia	215.7 (39.6)	95.4 (36.7)	140.0 (37.0)	152.2 (35.9)	145.3 (37.1)
Japan	4 313.2 (64.8)	3 940.5 (65.8)	4 499.6 (66.4)	4 841.6 (N/A)	4 245.2 (N/A)
Korea, Rep.	476.5 (51.6)	317.1 (51.2)	406.1 (52.4)	461.5 (52.9)	422.2 (54.1)
Macao, China	7.0 (71.7)	6.5 (71.2)	6.1 (71.0)	6.2 (N/A)	N/A
Malaysia	100.2 (44.3)	72.2 (42.8)	79.0 (42.7)	89.7 (39.7)	87.5 (41.9)
Singapore	94.6 (65.1)	82.8 (64.5)	83.8 (65.2)	92.3 (65.6)	N/A
Thailand	151.1 (50.2)	111.9 (49.5)	122.5 (49.7)	122.3 (49.5)	114.8 (49.8)
Vietnam	26.8 (42.2)	27.2 (41.7)	28.7 (40.1)	31.3 (39.1)	32.9 (N/A)
World	29 795.7 (62.4)	29 604.5 (63.0)	30 664.1 (63.7)	31 498.1 (N/A)	31 283.8 (N/A)

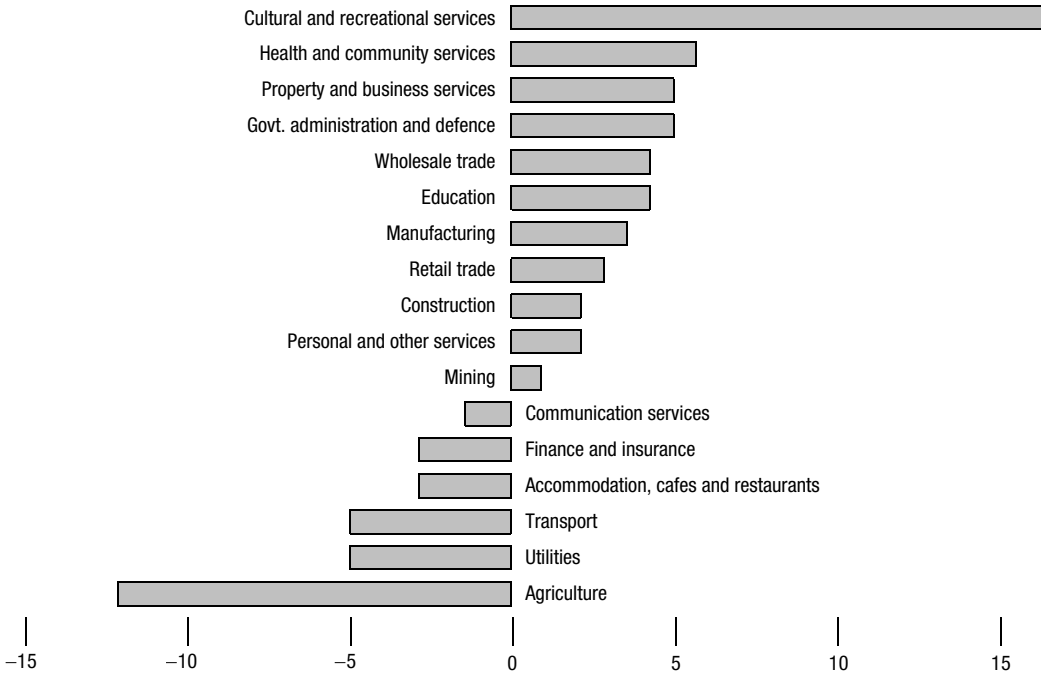
*Note:* GDP (gross domestic product) is expressed in current US dollars.

*Source:* World Bank, *World Development Indicators 2002*, [www.worldbank.org/data/dataquery.html](http://www.worldbank.org/data/dataquery.html).

In support of the growing social and economic importance of the services sector, the Singapore government has recently formed a Coalition of Services Industries in order to coordinate, streamline and promote its service sector, and to 'help to synergise business opportunities' (Aggarwal, 2003, p. A29). While Singapore is somewhat unique in the Asian region due to its significant lack of natural resources, comparatively higher levels of education, proportionately higher incomes, and acceptance of government intervention in its economy, the coalition is focused on managerial, technical and professional services, and provides a useful example for neighbouring countries, including Australia and New Zealand.

According to a recent ABS report, services provide 'the largest component of the Australian economy in terms of number of businesses, employment and gross value added' (ABS, 2002). Specifically, services embraced 65.5 per cent of all businesses and more than 73 per cent of total employment (ABS, 2002). The major employers include retail trade

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**Figure 1.1** Growth in services since 1997

Source: *Australian Financial Review*, 8 October 2002

(15 per cent), property and business services (11 per cent), health and community services (9.5 per cent), and education (7 per cent). Growth sectors included property and business services, personal and other services, and health and community services, with a small decline in the government administration and defence sector (ABS, 2002).

However, as Figure 1.1 shows, the growth in some sectors in the last five years (notably cultural and recreational services, health and community services, property and business services, government administration and defence, and education) has been considerably greater than in others (for example, finance and insurance, accommodation and restaurants, and transport). The relative decline in sectors such as communications, transport, and accommodation, cafes and restaurants can be attributed to the dot.com 'bust' in the late 1990s; the vagaries of regional tourism in the era of terrorism and regional epidemics such as Sudden Acute Respiratory Syndrome (SARS) and bird 'flu'; and the use of new technology and new employment conditions (for example, casual, contract and part-time employees) in the transport, utilities and agricultural sectors. Conversely, the growth in cultural and recreational, health and community, government administration, and property and business services reflects both the ageing of the population and community demands for greater flexibility, especially work/life balances (for example, more leisure, hospital and real estate investment options); while increases in defence services directly address regional terrorism concerns, and education and trade services have grown to meet identified domestic and global markets.

**Table 1.2** Fastest-growing job sectors, 1986–2001

Occupation	Growth in employment (number)	Employment in 2001	Growth in employment (%)
Special care workers	59,571	45,600	325
Child-care workers	71,076	53,700	309
Project and program administrators	92,131	68,200	285
Computing professionals	128,850	88,200	216
Marketing and advertising professionals	41,665	26,900	181
Business analysts	42,228	26,700	172
HR professionals	49,001	30,600	166
Financial dealers and brokers	39,789	24,700	163
Sales and marketing managers	101,290	61,000	151
Education aides	47,571	28,600	151
Waiters	83,662	47,100	128
Accountants	109,522	50,700	86

Source: National Institute of Labour Studies, *W.A. Business News*, 30 January 2003, p. 12.

Table 1.2 shows the kinds of service positions that have grown the most in Australia between 1986 and 2001. As the table illustrates, growth has been greatest in occupations such as special care and child-care workers, project administrators, information technology (IT) professionals, marketing and advertising specialists, business analysts, human resource (HR) professionals, financial dealers and brokers, accountants, and hospitality employees. As mentioned above, since 2001 the demand for IT professionals has declined significantly, but demand for carers (for both older people and children) is on the increase, due to the needs of ageing populations and dual working parents, business professionals responding to opportunities created by globalisation, and more competitive and personalised customer requirements.

These statistics highlight both the economic and social importance of services, as well as their diversity, comprised as they often are of multiple and apparently disconnected suppliers and disparate services. Given the unique nature, structure and outcomes of services, which are discussed later in this chapter and in more detail in the following chapters, it is challenging to construct a holistic model for the strategic management of this *tertiary* sector of the global economy. It is, however, both possible and necessary to appreciate the similarities as well as the differences between its constituent sectors, and therefore to develop principles, strategies, policies and practices that reflect and guide both strategists and operational managers within all service sectors.

This book strives to achieve these objectives by:

- analysing representative service sectors in terms of their structures, systems, functions and outcomes;
- comparing and contrasting management styles with those used in more traditional primary and secondary sectors; and

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- proposing a conceptual framework for the application of strategic management principles within this complex and fragmented sector.

An integrated services management model, which forms the backbone of all the subsequent chapters, is presented and explained later in this chapter.

Although Bureau of Statistics categories conveniently divide all organisations into goods- or services-based businesses, and assist us to identify the major components of services, they fail to specifically delineate the multiple meanings of the term 'services', or to explain the similarities and the differences between services and goods.

### The concept, nature and structure of services

Unlike manufactured goods, which are characterised by their amenability to measurement and quantification, services are often based upon a combination of intangibility, dynamic management, customer perceptions and expectations, and outcomes that are customised and variable, rather than uniform. Thus, shoes and automobiles are usually manufactured for mass consumer markets, according to rigid specifications, using standardised production processes and routine job functions. However, financial and tourism services may be highly personalised client interactions, or 'service encounters', within specialist markets (for example, 'high roller' gambling rooms and 'boutique' hotels) that involve sophisticated and varied service provider skills.

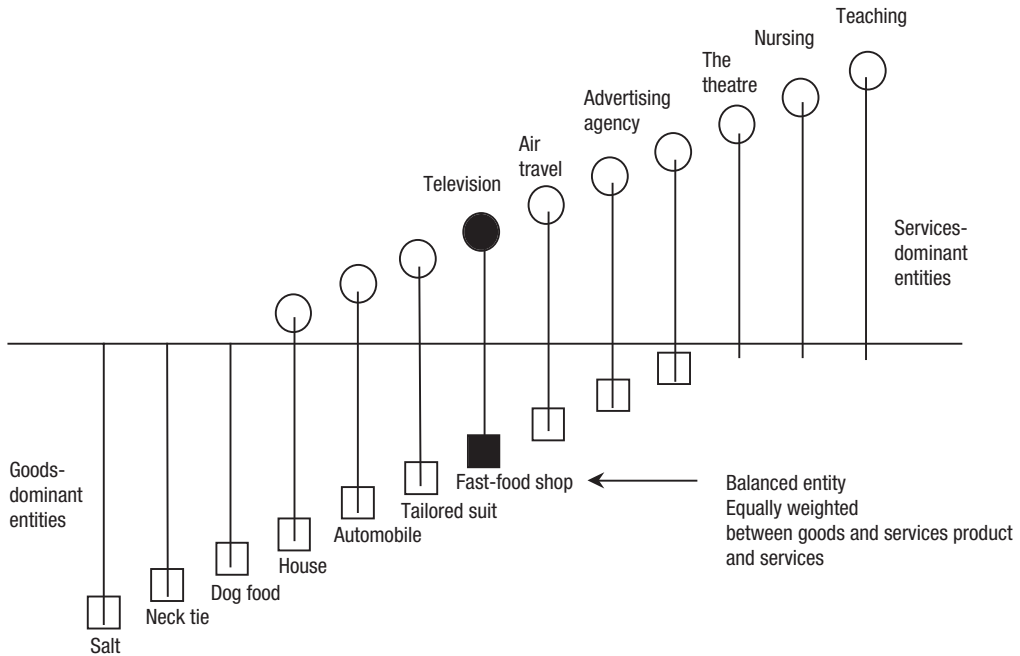
Some goods are highly customised for niche markets (for example, Ferrari vehicles, Rolex watches and Louis Vuitton travel goods), while other services (for example, McDonald's, supermarket scanners and automatic teller machines, or ATMs) are standardised and routinised for mass consumer markets. These observations suggest that there are both similarities and differences between goods and services for diverse consumer markets, and that the major defining feature of services is the more active involvement of customers and employees in their service delivery processes. This issue is discussed further in this chapter, and throughout the book.

Several authors (for example, Chase, 1991; Mersha, 1991; Cook et al., 1999) suggest that, rather than defining the specific differences between services and goods, it may be more useful to perceive them along a goods–services continuum (see Figure 1.2). These range from 'pure' goods to 'pure' services, with many organisations involved in a combination of both kinds of activities. The diverse perspectives presented in the following definitions give support for a more complex approach.

#### Concepts of 'services' and 'service'

There are many definitions of the term 'services'. The American Management Association, for example, in 1960 defined 'services' as:

Activities, benefits, or satisfactions which are offered for sale, or are provided in connection with the sale of goods. Examples are amusements, hotel service, electrical service, transportation, the services of barber shops and beauty shops, repair and maintenance service, the work of credit rating bureaus. . . . (Cook et al., 1999, p. 319)



**Figure 1.2** The goods–services continuum

Source: Adapted from G. Shostack, 'Service positioning through structural change', *Journal of Marketing*, vol. 51, no. 1, 1987, p. 41

The US government's definition (1972) is similar:

. . . a wide variety of services for individuals, business and government establishments, and other organisations: Hotels and other lodging places; establishments providing business, repair and amusement services; health, legal, engineering, and other professional services; educational institutions; membership organisations, and other miscellaneous services. (Cook et al., 1999, p. 319)

Other authors describe the term 'service' variously as: 'personal performance' (Levitt, 1972); 'a product which is a process' (Henkoff, 1994; Shostack, 1987); 'processes involving customer contact' (Chase, 1978); or 'a deed, an act, or a performance' (Berry, 1980).

Quinn et al.'s definition is more analytical:

All economic activities whose output is *not* a physical product or construction, is generally consumed at the time it is produced, and provides added value in forms (such as convenience, amusement, timeliness, comfort or health) that are essentially intangible concerns of its first purchaser. (1990, p. 60)

The definitions use a variety of terms to capture the essence of 'services' (and their differences from goods), including activities, benefits, satisfaction, amusement, performance, process, deeds and acts, all of which imply that services are the result of dynamic interactions

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between service providers and customers, and vary according to the expectations and perspectives of both.

Other authors provide definitions focusing on differentiations that include:

- distinctions between 'rented goods services', 'owned goods services' and 'non goods services' (Rathmell, 1966, p. 33);
- differences between 'tangible' and 'intangible' services (Zeithaml et al., 1990); and
- distinctions between tangible actions directed at people's bodies or physical possessions, and intangible actions directed at people's minds or assets (Lovelock, 1996, p. 11).

Berry (1980, p. 25) simply delineates goods as 'an object, a device, a thing', in contrast to services, which he defines as 'a deed, a performance, an effort'. Mersha (1991, p. 391) summarises the above characteristics with the observation that services are 'a bundle of tangible goods and intangible benefits provided in a particular environment'. Nie and Kellogg (1999, p. 339) assert that 'products are possessed and services are rendered, participated in, and experienced', and Grönroos (2000, p. 45) concludes that 'goods and services merge – *but on the conditions of services*' (our italics).

The implications that may be drawn from these definitions are that: services are different from goods in both their nature and systems of delivery; they rely more heavily than goods on customer, or client, perceptions and expectations; and, consequently, their outputs are more difficult to quantify than are manufactured goods. The following sections explore in more detail the similarities and differences between goods and services.

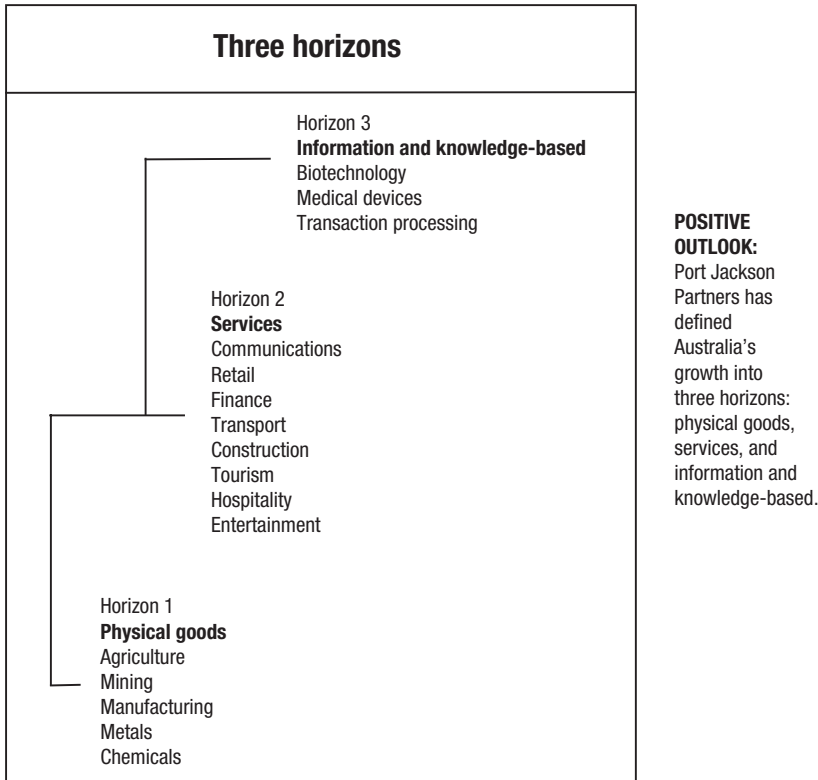
### Distinguishing features of services

Many authors have attempted to discern the differences between services and goods, and there is general agreement that the fundamental differences lie in the roles of both the service providers and the service consumers or clients. Figure 1.3 illustrates the types of organisations included within services, in contrast to those in the 'physical goods' category. It also suggests that we may be moving into an era where goods and services are becoming merged, as part of a transformed 'quaternary' sector. Thus, biotechnology, medical devices and transaction processing contain elements of service (for example, research and development, and administrative functions) as well as tangible goods, such as hearing aids, heart monitors and databases.

The distinguishing features of services have usually been viewed from a marketing perspective, which focuses on customer perceptions, rather than on management decisions about their specification. While this is valuable, the *strategic management of services* requires organisational managers to clearly delineate the nature of the services they provide through the development of measurable criteria and associated service operations, and by means of financial and HR management systems which ensure consistency and cost-effectiveness. This is the primary theme of this text.

Many authors (for example, Zeithaml et al., 1990; Heskett et al., 1990; Grönroos, 2000; Verma and Boyer, 2000) have suggested that the defining characteristics of services revolve around four main qualities: their intangibility, inseparability, variability and perishability. These qualities are discussed in the following sections.





**Figure 1.3** Goods and services categories

Source: *Business News*, 30 January 2003, p. 12

### *Services are intangible*

Perhaps the most fundamental feature that distinguishes goods from services is the former's tangibility and the latter's intangibility. For, while most goods can be seen, touched or felt, services are seldom so palpable. We can readily touch or hold such everyday goods as hamburgers, automobiles, medicines, clothing and furniture. However, services such as legal advice, airline flights, a restaurant's ambience, medical or management consultations, educational experiences, or electronic funds transfer systems are not able to be touched or held. There is, nevertheless, a broad spectrum of types of services, ranging from those that combine the tangible and the intangible (for example, tailors, house builders, food vending machines), to others (for example, teaching, nursing, the theatre) that have considerably fewer tangible components (see Figure 1.2).

While services such as the preparation of legal wills and real estate conveyancing, and fast-food restaurants such as McDonald's or KFC, approach tangibility, some others (for example, ATMs, and theatre and car-park ticketing machines) have consciously reduced their personal (intangible) component to a minimum as part of their corporate business strategy. The following Air Asia example (Box 1.1) demonstrates how cost-minimisation corporate

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strategies, combined with targeted marketing plans, can provide a competitive industry position. In other words, it illustrates a strategic approach to the management of services organisations.

### Box 1.1 The minimisation of service 'Air Asia: No-frills seeker'

With its red and white livery, it looks like Virgin; with its supermarket specials and marketing style, it feels like Virgin; and with A\$18 one-way fares for the hour's flight from Kuala Lumpur to Penang, Asia's newest airline, Air Asia, wants to do a Richard Branson and 'release the travelling public from the airline tyranny'. It's not Branson's Virgin Blue that CEO Tony Fernandes wants to emulate, however; but, rather, the godfather of discount flying, Ireland's Ryanair, one of the world's best share market and profit performers in recent years. But Fernandes and his consultant, Connor McCarthy, have a job ahead of them. In an Asian market where discounted air travel is as rare as the one-sky policy that has seen discount flyers proliferate in Europe and North America, Air Asia is pioneering no-frills air travel from the seat of its principals' pants.

Air Asia is the latest of a lengthening line of Ryanair imitators in Asia, where travellers have long endured some of the highest fares on airlines with the poorest safety records. Japan has seen a spate of cheapie carriers – Skymark, Skyjet, and the now defunct Air Do – while in the Philippines, John Gokongwei's Cebu Pacific is taking on Philippine Airlines. Air Asia has considerably fewer cabin crew than traditional carriers, does not provide passengers with food, beverages or in-flight entertainment, and the pilots and flight attendants double as cabin cleaners or departure lounge staff. Air Asia is, however, required to abide by all the usual airline safety standards. While Air Asia cannot match Malaysian Airlines or Singapore Airlines on service, it seems ready to test them on price, setting up a hub in Johor Bahru and with plans to run cut-price flights on their stable routes to Jakarta, Bangkok, Surabaya and Bali. Even cheekier is an Air Asia plan to bus prospective passengers from downtown Singapore to Johor's under-trafficked Senai airport, a 30–45-minute journey on vacant freeways as against the 20–25-minute ride to Singapore's busy Changi. The extra 20 minutes might be compensated by fares 50 per cent under, say, the A\$700 it costs for the two-hour Singapore to Bali return fare.

(Source: Adapted from E. Ellis, 'Air Asia: No-frills seeker', *The Australian*, 24 September 2002, pp. 21–22)

While Air Asia, Ryanair and Virgin have actively pruned the services component of their businesses as the main thrust of their corporate management strategy, some goods-based companies have chosen the opposite business direction. As an example, Nike, best known for its popular range of sports shoes, has developed its own 'theme' stores, known as Nike Town. In these stores, 'freedom, entertainment, colour, fantasy, technical shoe performance information, videos and music are part of the goods and services attributes, which are bundled with the core good – shoes'. This has been described as a 'design-your-own service encounter activity sequence' (Collier and Meyer, 1998, p. 1228). Pine and Gilmore (1998), citing