Competing in a Service Economy

How to Create a Competitive Advantage Through Service Development and Innovation

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Michael D. Johnson

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Executive Summary

This book shows how to create a competitive advantage through service development and innovation. For executives who set service strategy and managers in charge of implementing the process, it provides the frameworks and tools to compete successfully in a service economy. Its approach is useful to traditional service companies as well as those manufacturing companies that are moving down the value chain to include services as part of their customer offering.

Chapter One describes the importance and evolution of service in our economies and what makes services different from products. Case studies involving SAS, an international airline, and Sterling Pulp Chemicals, a supplier to the chemical industry, show the important role that services play in creating a sustainable competitive advantage.

Chapter Two describes a strategy for developing a service advantage:

- **Build the culture.** Believe as an organization that certain ways of doing business are essential to long-run performance.
- **Stay focused.** Decide whom to serve and whom not to serve.
- **Link activities.** Create a seamless system of linked activities that solves customer problems or provides unique experiences.
The story of IKEA, a global furniture retailer, illustrates how a company built on a strong culture that stays focused on its market segment can link activities over time to become a formidable competitor.

The next three chapters relate the strategy to three different stages of what we call the hierarchy of service development. For each stage, they provide step-by-step processes and tools. Chapter Three presents an approach to service maintenance as a process of removing things gone wrong. The nature of service production means that things will go wrong during service delivery that require attention. A number of tools can be used to identify service defects that need correction and that provide input for an ongoing service improvement cycle.

Moving beyond the correction of defects, Chapter Four describes a process for improving service performance. This includes understanding the drivers of satisfaction and loyalty, setting priorities for improvement and innovation, and linking new activities through service development.

As fellow engineers in the service process, customers are unencumbered by your organization and its constraints. Chapter Five describes how to take advantage of the essential role that customers play in generating service ideas and developing innovative service designs.

Chapter Six provides important insights regarding your role as a leader in the overall service development process.
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To our colleagues at CTF:
The Centrum för Tjänsteforskning
(Service Research Center)
at Karlstad University, Sweden
Welcome to the University of Michigan Business School Management Series. The books in this series address the most urgent problems facing business today. The series is part of a larger initiative at the University of Michigan Business School (UMBS) that ties together a range of efforts to create and share knowledge through conferences, survey research, interactive and distance training, print publications, and news media.

It is just this type of broad-based initiative that sparked my love affair with UMBS in 1984. From the day I arrived I was enamored with the quality of the research, the quality of the MBA program, and the quality of the Executive Education Center. Here was a business school committed to new lines of research, new ways of teaching, and the practical application of ideas. It was a place where innovative thinking could result in tangible outcomes.

The UMBS Management Series is one very important outcome, and it has an interesting history. It turns out that every year five thousand participants in our executive program fill out a marketing survey in which they write statements indicating
the most important problems they face. One day Lucy Chin, one of our administrators, handed me a document containing all these statements. A content analysis of the data resulted in a list of forty-five pressing problems. The topics ranged from growing a company to managing personal stress. The list covered a wide territory, and I started to see its potential. People in organizations tend to be driven by a very traditional set of problems, but the solutions evolve. I went to my friends at Jossey-Bass to discuss a publishing project. The discussion eventually grew into the University of Michigan Business School Management Series—Innovative Solutions to the Pressing Problems of Business.

The books are independent of each other, but collectively they create a comprehensive set of management tools that cut across all the functional areas of business—from strategy to human resources to finance, accounting, and operations. They draw on the interdisciplinary research of the Michigan faculty. Yet each book is written so a serious manager can read it quickly and act immediately. I think you will find that they are books that will make a significant difference to you and your organization.

Robert E. Quinn, Consulting Editor
M.E. Tracy Distinguished Professor
University of Michigan Business School
Preface

Services have come to dominate our economies. Whether you manage a traditional service firm or a manufacturing company, adding value through services has become an essential way to compete. This evolution toward services is a function of increased time demands, the availability of self-service technologies, the growth of outsourcing and networking, and increased competition. The evolution of competition forces you to compete on more than just product value. Today customers are looking for service value, comprehensive solutions, and memorable experiences.

Our experience with a variety of both manufacturing and service organizations reveals a stark contrast. Whereas physical goods emerge from a structured development process, new service ideas are lucky to emerge from what is, at best, an ad hoc process. Increasing your success rate for new services requires more than just taking systems that work in a product context and applying them to services. Don’t kid yourself—services are very different. Our motivation in writing this book is to bring structure to the process of new service development and innovation in a way that recognizes just what makes services and service customers unique.
In our first contribution to the University of Michigan Business School Management Series (*Improving Customer Satisfaction, Loyalty, and Profit: An Integrated Measurement and Management System*), we described how to develop a customer satisfaction measurement and management system. This second contribution to the series builds on our earlier work by focusing on how all of a company’s improvement systems work together in a service context.

The book is intended for executives and managers with direct responsibility for developing a service strategy and putting systems in place to make it work. If you are an executive, your job is to set strategy and enable employees to continuously improve. If you are a front-line manager, your job is to better understand the problems your customers are trying to solve and how your company can help them. Our approach helps you meet these challenges through a strategy of service improvement and innovation that creates and sustains a competitive service advantage. Excellent service firms pursue a three-part strategy: build the culture, stay focused, and link activities. This strategy provides the basis for a number of tools that support an ongoing process of service maintenance, improving service performance, and service innovation.

Throughout, the book emphasizes the role that customers play as coworkers and fellow engineers in the service process. As you will see, they are indeed an essential source of information, innovation, and creativity. Cases and other research into the practices of such companies as IKEA, Ritz-Carlton, Sterling Pulp Chemicals, and SAS will show how successful service providers have immersed themselves in customers to link activities consistent with the company’s culture and market focus.

The book’s discussion of service strategies and practices will also yield some important lessons regarding your role as a leader in the process. These insights will center around the importance of living your company’s culture, managing by walking around, emphasizing creativity, and remaining focused on your market segment.
Acknowledgments

Many people have been critical to our success. We dedicate the book to our colleagues at CTF (Centrum för Tjänsteforskning, or Service Research Center) at Karlstad University in Sweden. Without the CTF research team this book would simply not have been possible. We especially thank Bo Edvardsson for both his support and his contribution to our ideas. We thank Bob Quinn of the University of Michigan Business School for his commitment to making the school’s Management Series such a great success. We thank the Jossey-Bass team, including Cedric Crockor, Byron Schneider, and especially our editor Kathe Sweeney, for making this project a reality. This book has benefited tremendously from the inclusion of cases and examples from various companies and organizations, including Disney, Ericsson, IKEA, the National Association of Convenience Stores, Ritz-Carlton, Scandinavian Airline Systems, Sterling Pulp Chemicals, and Telia Mobile. Very special thanks go out to Alan Venable. This is the second time we have worked closely with Alan as a developmental editor through multiple drafts. His talent and attention to detail continue to teach us a better way to communicate.

Finally, to our spouses, Lena and Jill Marie, and our children, Amie, Samuel, Alexander, Andrew, and Thomas, we thank you for the love and support that keeps us going. These past six years of working together and watching our families grow have been a highlight of our lives.

March 2003

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Competing in a Service Economy
Competing Through Services

Competing through services has become more than just a trend. Whether you compete in a traditional service industry or produce physical goods, adding value through services has become a way of life. As an executive, your job is to set a service strategy and enable your people to both innovate and continuously improve your services. As a front-line service manager or even an engineer in the field, your job is to better understand your customers and the problems they are trying to solve, and to improve their lives. Whether your role is that of enabler or doer, the delivery of high-quality services is your responsibility. The business logic of competing through services is simple: solving customer problems with cost-effective service