Division of Research
Graduate School of Business Administration
The University of Michigan

November 1985

SERVICE DEVELOPMENT: A DYNAMIC PARADIGM

Working Paper No. 451

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Abstract

This paper reports on the initial phase of a research program to examine the process for the development of new services by major multinational firms. It involved in-depth interviews with 80 senior executives in 16 firms and confirmatory sessions with 269 executives from 197 firms. The findings show that there is an attempted movement by these firms toward a service orientation, prompted by deregulation, the perspective of higher margin yields, and the ability to more clearly differentiate the firm from competitors. The process for the development of new services occurs on tactical and strategic dimensions. Line extensions emanating from the "bottom-up" are the main tactical process, with de novo development and joint venturing dominating the strategic process. Finally three major changes for implementing movement from a product to a service orientation are presented.

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INTRODUCTION

The United States has had a significant service sector for the past half century and the economy has been services dominant since 1975 (Table 1). This pattern appears to be part of a long-term trend, not an anomaly, brought on by three basic factors:

1. Existing service firms have grown faster than existing manufacturing firms.
2. New service firms outsell new manufacturing firms.
3. Manufacturing firms have begun offering services.

The order of these methods does not imply historical, or relative importance. Actually the mix among the three probably varies from year to year. Nevertheless the evidence (Table 1) clearly indicates a growth in services.

TABLE 1

ALLOCATION OF GROSS NATIONAL PRODUCT

	Percentage of GNP Allocated		
Year	Goods	Services	Structures
1960	50.18	38.26	11.55
1970	46.30	43.30	10.36
1975	44.79	45.52	9.68
1980	43.34	46.55	10.10
1981	43.77	46.41	9.80
1982	41.60	49.22	9.18
1983	41.02	49.60	9.37

Source: U.S. Bureau of Economic Analysis, The National Income and Product Accounts of the United States, 1929-1976, and the Survey of Current Business, July Issues

While the second of the factors above has important implications for the examination of entrepreneurial activities, our focus is on the first and third factors. Thus, the research described in this paper has a principal purpose to confirm the attempted move of firms toward a service orientation and to specify the process for the development of new service offerings fueling that attempted movement.

PREVIOUS RESEARCH

The services literature has experienced significant growth in the past decade. For example, a recent bibliography lists over 1900 titles (Fisk and Tansuhaj, 1985). Nevertheless, critical knowledge gaps exist. The new service development process is one such void, with only incomplete research and theory attention. The existing material is best characterized as experiental or anecdotal, with much of it consulting based observations (Booms, Davis and Guseman 1984; Clements, Stiff and Czepiel 1984; Hansen and Zeithaml 1984; Hise 1977; Langeard and Eigler 1983; Lovelock 1984; Murphy and Robinson 1981; Schneider and Bowen 1984; Shostack 1981, 1984; and Zimney 1984). In summary, there has not been a comprehensive examination across service categories concerning the process of new service development. Likewise the critical link to macro economic issues has been ignored.

Nevertheless, a particular useful construct was advanced by Kotler (1984,pp.492-493) that identifies four major categories of offerings to the marketplace:

Product Only
Product & Service, with the Product Dominant
Service & Product, with the Service Dominant
Service Only

A NEW PARADIGM

Utilizing the Kotler construct we constructed the following paradigm:

FIGURE 1

IV SERVICE ONLY	I PRODUCT ONLY
III SERVICE & PRODUCT Service Dominant	II PRODUCT & SERVICE Product Dominant

Based on the data in Table 1 and exploratory interviews with three marketing research firms that regularly participate in new service development for major corporate clients, we hypothesized the following:

> Firms have moved or have attempted top move in an overall clockwise direction from Quadrant I to II to III to IV. They have not generally attempted counterclockwise moves or moves from Quadrant IV to I.

Our goal was to verify this clockwise movement in a U-shaped curve, with a second major objective to discover the process that surrounds this attempted movement.

RESEARCH DESIGN

In attempting to document the hypothesized clockwise movement and to explore the dimensions of the new service development process, a two-phase research design was employed. Phase One involved in-depth interviews with 80 senior level executives from 16 different U.S. based multi-national firms. These respondents represented various functional areas within each firm: strategic planning, finance, marketing, human resources, and operations.

The interviewing format was identical for each interview, which lasted from 1 to $1\frac{1}{2}$ hours. The interviewing team for Phase One consisted of the co-authors.

In Phase Two the analyses of the in-depth interviews were presented in small group discussion sessions involving 269 executives representing 197 different firms. In each of these sessions one of the co-authors served as discussion leader. Similar to Phase One, the participants represented differing functional areas within their firms. These were basically confirmatory session seeking to ascertain the correlation between Phase Two firms and the results from the Phase One in-depth interviews.

RESULTS

SERVICE ORIENTATION STRATEGY

The strategy of attempting a clockwise movement, postulated in Figure 1, was consistently supported during the Phase One interviews and strongly endorsed by the Phase Two participant firms. All 349 participating executives were probed for the impetus for this attempted move toward a service orientation. There were five reasons that evolved:

1. Present margins are being impacted by many factors, including global competition, currency fluctuations, etc.
2. There is a persistent perception that the service component in Quadrants II, III, or IV (Figure 1) offer higher potential margins.
3. There is a perception that excelling in a service component can differentiate the firm more concisely from its competition.
4. The offering of expanded services allows the firm to reach new, less price-sensitive target markets.
5. The general era of deregulation and the subsequent lowering of barriers to entry make service offerings easier and more attractive.

The more important finding from these interview probes was the discovery of a barrier that exists between the second and third quadrants. This is illustrated by the bold vertical axis in Figure 2.

FIGURE 2

IV SERVICE ONLY	I PRODUCT ONLY
III SERVICE & PRODUCT Service Dominant	II PRODUCT & SERVICE Product Dominant

The executives who describe their firms as having moved from a product to a service orientation or those who were still product oriented identified the move from II to III as a major hurdle to be viewed with apprehension. They consistently identified three changes needed to accomplish this move:

1. Major adjustments in the corporate culture.
2. Rethinking of the corporate mission.
3. Re-definition of the individual strategic business units or, in some instances, a re-definition of the total firm.

Other than the traditional service oriented firms, few of the executives described their firms as having successfully and completely moved across this barrier. The non-successful respondents described the pervasiveness of this hurdle, in the mind-set of their colleagues, as posing more of an impediment than the legal, marketing, or operational issues combined. They reported a current concentration in Quadrant II, but with an objective to move into Quadrants III and IV.

In summary we see confirmation of the hypothesis that a movement toward a service orientation is being attempted; that a massing of traditional product oriented firms has occurred in Quadrant II; and that attempts to breakaway from this product orientation will require more than simple strategic or tactical moves, but rather will concentrate on the fundamental redefinition and remissioning of the firm and on a major change in corporate culture. As a result we suggest that the recent growth in the service sector (Table 1) has been due to new firms or expansion of existing service firms. However, there is a potential for change and for the mass of firms in Quadrant II to become the catalyst for service growth, if they can accomplish the major task of overcoming the hurdle illustrated in Figure 2.

NEW SERVICE DEVELOPMENT PROCESS

The development of new offerings can be analyzed on either the right or left side of Figure 2. However, the right side is well documented in the new product development and strategic planning literature. As detailed earlier it is the left side of the paradigm where there is not the richness of documentation concerning development of new offerings.

The executives who described their firms or strategic business units as already participating in Quadrants III and IV were probed further in both phases as to the process for the development of new service offerings. Emerging from this was the identification of two distinct types of activities, one tactical and the other strategic in nature. The tactical process for development of new offerings within or between quadrants was the modification of the existing service base. Conceptually these service innovations can be thought of as "line extensions." The strategic process, usually for movement from Quadrant III to IV were categorized as "new businesses."

Tactical - Line Extension Service Development

Since the in-depth interviews cut across service categories, our synthesis divides into four parts: the perception of new service development, the process for new service development, the critical analysis, and the conclusion.

Perception. The perception by the participating executives is that tactical new service development (line extensions) is an unsophisticated process. Perhaps the most telling description is: "it just happens." This perceived lack of sophistication can be further delineated.

The process is first viewed as uncomplicated. Indeed the notion of "blueprinting" (Shostack 1981) the entire sequence of new service activities is not familiar or practiced within their firms. The process is viewed as not formal, in contrast to the new product development model (Booz, Allen, et.al. 1981). Indeed there is no internal manual in these firms to provide checkpoints and give direction for the next sequence of steps to follow. Only one of the participating firms reported any activity to develop such a developmental schema.

Secondly there is a perception that the investment in new service development "line extensions" is minimal. The executives centered the investment concentration on adjustments to computer or operating systems. Since the line extension builds on existing service strengths, the perceived risk of such new offerings is quite low or non-existent. As a further example of low perceived risk, the majority of participants describe this type of new service as offering easy entry and withdrawl. Development time is also viewed as less than for new products, contributing to a faster life cycle.

Process. The actual process is perceived as a haphazard procedure, thus we present only unifying constructs here.

It appears that for these tactical offerings, the sources of new service ideas is dependent on individual innovators. No evidence was presented of utilization of formal idea generation techniques. Staff input is described as minimal in each firm, with ideas for new offerings coming from line personnel who interact with customers. Based on perceptions of competitors' activities, customer communications, and/or customer behavior improvements in current services were brought forward. This indicates a poorly defined or non-existent service charter (Crawford 1983, p. 75). However, since the ideas for these new service offerings are driven by market interaction, the service charter (the boundaries within which new offerings will be developed) is informally understood and ideas stayed within acceptable parameters.

One important new product source for ideas does not have a true service counterpart. The research and development centers, common for product innovation, are not in evidence among these service firms. Two of the firms did report some rudimentary laboratory development efforts, but these were generally less structured than we had anticipated from information supplied by line managers for those firms. We conclude that the development of new service constructs is concentrated in non-laboratory settings and is more market, than technology driven.

The idea generation typically comes from the bottom and there is a "bubbling-up" to the critical decision-making level of the organization. Important to this upward movement is the presence of a service champion, typically from lower level management, who guides the idea through conception, definition and initial testing. The champion's major role is advancing the potential offering toward approval, usually based on senior management's perceived risk. Critical to addressing this risk perception is a program of internal marketing on behalf of the service champion. In essence, the champion is marketing two offerings at this point -- the service innovation and themselves. Among the participating executives in both phases of our study was a concensus that the service champion's enthusiasm for continuing the process is based on internal feedback versus market need. Thus, the idea advanced upward is one that has attracted a lower management individual, who applies his/her line experience to assess the feasibility of the concept. If internally feasible to the potential champion, the next step is to broach this concept to a higher level decision-maker. Depending on that executive's degree of initial enthusiasm, the champion now proceeds to further develop or drop the concept. Our participants indicated that this step was crucial, since there is no appeal process available to a disappointed champion. However, given a positive reaction, the champion now begins the process of gathering data to support a formal decision to proceed.

The participating executives report that champions, at this point in the process, rely heavily on anecdotal evidence from customers and line personnel, on cursory competitive analyses, and on other available secondary data. This data is now used by the champion and the executive "angel" to frame a go/no go decision.

More intense and sophisticated research is undertaken after the go/no go decision with the objective of internal marketing within the firm by the champion. A key element in the process for many of the participant firms is the use of test marketing. It is viewed primarily as a key element in the internal marketing effort, not as a decision-making tool. As part of this internal marketing effort, test marketing is used to monitor employee reactions, especially those of line personnel who may have to demonstrate the new service to the marketplace. Basically a test confers legitimacy on the idea within the organization, with a secondary objective being the more familiar gauge of customer reactions. The participating executives described test marketing as having little to do with measuring external acceptance and more to do with internal compliance.

A positive test market result potentially is connected to a more thorough economic analysis by the service champion for review by senior management. The participants reported that among the management group it is common for a member to assume the role of a champion...either through quasi-assignment, election by peers, or true desire to acquire the role. This upward passing of the champion responsibility signals senior management acceptance within the firm. The challenge to the senior management champion is now to be certain that appropriate operating units within the organization offer the innovation.

Analysis. There is agreement between executive perceptions and the reality of new service development; however, critical differences are also apparent. There is a correlation between perceptions and reality concerning the informal nature of the entire process. These areas of agreement are: (1) Forward progress is not dependent on specific checkpoints, but on a general concensus that the firm can handle a new offering; and (2) Development time is quicker for a new service than a new product. However the latter point maybe due to equating development time as stopping after a test market and not at the point of general market introduction.

The differences between perception and reality highlight problem areas for many service firms as they offer line extensions. One of the most tenuous is the notion that capital investment is low and experience high, thus the risks are minimal. The failure is for the perceptions to encompass the human capital investment, such as hiring and training, or even retraining. Those firms where there has been considerable service line extensions report heavy such capital investments. Indeed, these firms report that calculating the total cost for a new service is quite difficult because of the uncertainty of the "human systems" component. The non-human-resource executives participating did not completely consider this factor and concentrated on actual equipment costs. A second area of cost miscalculation involved the computer system that supports the service offering. The majority of the executive participating were not cognizant of the complexity involved with even minor modifications in the service offering that might ultimately entail major reprogramming or other software modifications. The associated costs of "debugging" such adjustments is also frequently overlooked.

Perceived risk is accentuated by the difficulty in withdrawing from a service offering. There is a "tar baby" effect: once the service is offered, the firm is "stuck" with it. Customers begin using it and adjust their behavior to fit the service. While some services can be unilaterally cancelled, most involve an implicit customer expectations or actual contract. Our participating executives report that severing the customer ties to these offerings is difficult and, in many cases, dependent on long-term customer attrition.

Another difference highlighting the conflict between reality and perception is the ability of the firm to reproduce the service across the intended market area. The majority of the participants report this was not an important consideration, if considered at all. The operative concensus on this point is "it'll work out." Unfortunately the executives who had service development operating experience lamented the downplaying of this issue. They indicate the early success with a service pilot program is reversed when the line extension "went public."

Conclusion. In all the firms there was agreement that line extension new service development is informal in nature and perceived as less risky than the development of new product offerings. This latter point is caused by the very intangibility of the service and the lack of committing production facilities to the new service. In 14 of the 16 firms the procedure for the development of line extension services is not a clearly defined written procedure and is ad hoc in nature. This is supported by 90% of the firms participating in the confirmatory interviews. Perhaps even more important, the participants reported the movement of the new concept through the approval process is **not** the efficacy of the idea, but rather the support of the champion. In most cases the champion is self-selected and motivated by personal goals, such as career advancement.

While the historical generation of new line extension concepts within firms did vary in complexity and significance, one overriding factor did emerge from the interviews: the rate and quantity of the new ideas and service champion support is highly dependent on the culture of the corporation. There is an acknowledged relationship between the corporation's support for innovation and the proliferation factor. Among the participant firms we found a range of corporate culture from enthusiastic encouragement for new ideas and respect for the possibility of failure to a "you bet your corporate life" atmosphere. However, in all the firms there is a concerted effort to move the perceived culture toward a more permissive and innovative style. While the phenomenon of corporate culture was not the immediate object of this stage of the project, we do observe the rate of innovation and speed with which the firm moves from a product to a service orientation is clearly linked to the innovative freedom within the organization.

Strategic: Service Development Through New Businesses

The strategic development of services centers on the engagement into new businesses that are removed from the central core of the firm's present commitment. By definition they deviate from any service charter conceived within the firm. Indeed they directly impact the definition and mission of the firm, thus being intimately interwoven with the strategic plan.

The impetus for new business ventures is driven by the margin impacts described earlier, plus the general era of deregulation and the freedom to bridge outside traditional boundaries. Contrasted with the tactical line extension development, this type of new service development is decididly "top-down." The participants reported a more "wide-open" idea generation phase involving senior management (often the CEO) when contemplating new business entry. Many of the firms have "innovation retreats" or similar off-premise activity meant to spur creativity. It is during these concept generation exercises that the senior management service champion emerges. This champion has two roles: (1) keeping the other senior management informed of progress, and (2) giving credibility to the new business offering among middle management. This latter activity, an aggressive internal marketing effort, is most important to recruit the requisite middle management to facilitate subsequent analyses.

The initial go/no go analysis consists of an economic business valuation focused on the vehicle for such a diversity of offering. Basically the choice is three-fold: de novo development, acquisition/merger, or joint venture. In the firms we researched, including those in the confirmatory interviews, there was a preference for joint ventures. Additional support for this phenomenon was reported recently by the **Wall Street Journal** (11/8/85, p. 1). This predisposition toward joint ventures is driven by the quickness of skill and resource acquisition, not internally available, and a perception that the down-side risk is less than through the other two alternatives. Our participant executives described joint ventures as a temporary union that faced eventual dissolution. Interestingly only one of the 16 multi-national firms participating had any long-term experience with a joint venture, and it had dissolved the partnership and elected to continue the service offering as a single organization.

The major hurdle that the participant firms identified for a joint venture new service offering is the difficulty in marrying diverse corporate cultures into the joint venture. While viewed as a major hurdle, all but one (and it consistently rejected this alternative) of the firms interviewed reported being involved in current multiple joint ventures.

Summary and Conclusions

The participant executives report support for our hypothesis that major multinational firms are trying to move toward a more pure service orientation in their marketplace offerings. As we have reported these new offerings are either tactical (line extension) or strategic (new businesses) in nature. Essentially the significant difference between the two is that new businesses have the distinction of putting the strategic planning process "on-the-line" and causing greater modification or composition of the plan. Important in both line extensions and new businesses is the service champion. In the tactical development of new services the champion's concentration on an internal marketing effort after having made the individual decision as to the concept's integrity is significant. Highlighting this is the use of research as a selling tool rather than for decision making purposes. By contrast the service champion for a new business uses research (principally business/economic analyses) for decision making purposes. The objective of this new business evaluation is more concentrated on the efficacy of the overall concept and the structure for its future development.

We see the major conclusion from this research to be the identification of the three major changes needed to move from a product to a service orientation: (1) major adjustments in the corporate culture or atmosphere, (2) rethinking of the corporate mission, and (3) redefinition of the individual SBU's or even a redefinition of the total firm.

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