3 Service strategy principles

‘People do not want quarter-inch drills. They want quarter-inch holes.’
Professor Emeritus Theodore Levitt, Harvard Business School

Case example 2: *Mobile communication services*

A well-known provider of mobile communication services has the advertising slogan, ‘Can you hear me now?’ Another provider has the slogan, ‘Fair and Flexible’.

What dimensions of value does each slogan promote?

(Answer at the end of Section 3.1)

3.1 Value creation

3.1.1 Mind the gap

Calculating the economic value of a service can sometimes be straightforward in financial terms. In other instances, however, it is harder to quantify the value although it may still be possible to qualify it. Value is defined not only strictly in terms of the customer's business outcomes: it is also highly dependent on customer's perceptions (Figure 3.1). Perceptions are influenced by attributes of a service that are indications of value, present or prior experiences with similar attributes, and relative endowment of competitors and other peers. Perceptions are also influenced by the customer's self-image or actual position in the market, such as those of being an innovator, market leader, and risk-taker. The value of a service takes on many forms, and customers have preferences influenced by their perceptions. Definition and differentiation of value is in the customer's mind.

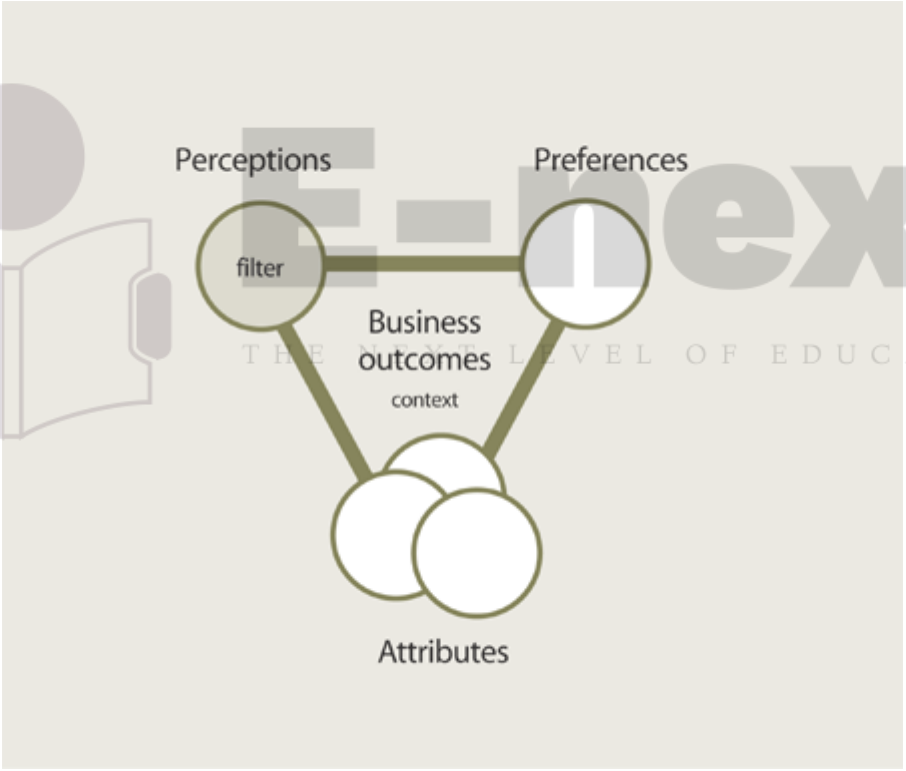

Figure 3.1 Attributes, perceptions and preferences

The more intangible the value, the more important the definitions and differentiation become. Customers are reluctant to buy when there is ambiguity in the cause-and-effect relationship between the utilization of a service and the realization of benefits. It is incumbent on providers to demonstrate value, influence perceptions, and respond to preferences.

Perceptions of value are influenced by expectations. Customers have reference values on which they base their perceptions of added value from a service. The reference value may be vaguely defined or based on hard facts. An example of reference value is the baseline that customers maintain on the cost of in-house functions or services. What matters is that it is important for the service provider to understand and get a sense of what this reference value is. This may be obtained through extensive dialogue with the customer, prior experience with the same or a similar customer, or through research and analysis available in the market. The economic value of the service is the sum of this reference value and the net difference in value the customer associates with the offered service (Figure 3.2). Positive difference comes from the utility and warranty of the service. Negative difference comes from losses suffered by the customer from utilizing the service due to poor quality or hidden costs. As stated earlier, value is defined strictly in the context of business outcomes.

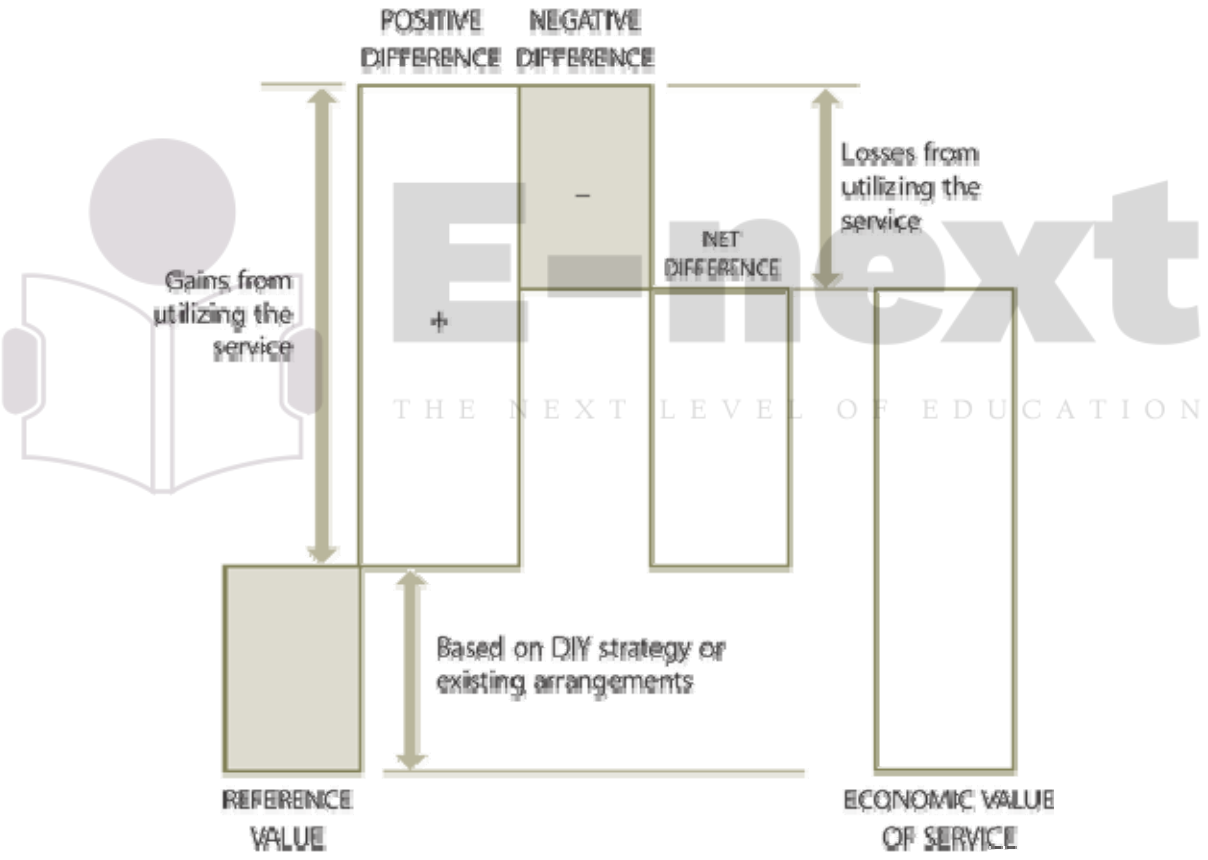

Figure 3.2 Economic value of a service14

Focus on business outcomes over everything else is a critical advance in outlook for many service providers. It represents a shift of emphasis from efficient utilization of resources to the effective realization of outcomes. Efficiency in operations is driven by the need for effectiveness in helping customers realize outcomes. Customers do not buy services; they buy the fulfilment of particular needs. This distinction explains the frequent disconnection between IT

organizations and the businesses they serve. What the customer values is frequently different from what the IT organization believes it provides. Mind the gap.

3.1.2 Marketing mindset

What are the outcomes that matter? How are they identified and ranked in terms of customer perceptions and preferences? Effectiveness in answering such questions requires a marketing mindset, which is quite different from engineering and operations mindsets. Rather than focusing inward on the production of services, there is a need to look from the outside in, from the customer's perspective. A marketing mindset begins with simple questions:

- What is our business?
- Who is our customer?
- What does the customer value?
- Who depends on our services?
- How do they use our services?
- Why are they valuable to them?

Value can be added at different levels. What matters is the net difference (Figure 3.2). For example, service providers differentiate themselves from equipment vendors purely through added value even while using the equipment from those same vendors as assets. Differentiation can arise from the provision of communication services instead of routers and switchboards. Further differentiation may be gained from the provision of collaboration services instead of simply operating email and voice mail services. The focus shifts from attributes to the fulfilment of outcomes. With a marketing mindset it is possible to understand the components of value from the customer's perspective. As described in Section 2.2.2, value consists of two components: *utility* or fitness for purpose and *warranty* or fitness for use.

Fitness for purpose comes from the attributes of the service that have a positive effect on the performance of activities, objects, and tasks associated with desired outcomes. Removal or relaxation of constraints on performance is also perceived as a positive effect.

Fitness for use comes from the positive effect being available when needed, in sufficient capacity or magnitude, and dependably in terms of continuity and security.

It is useful to separate the logic of utility from the logic of warranty for the purpose of design, development, and improvement (Figure 2.2). Using the marketing mindset in service management provides deep insight into the challenges and opportunities related to the customer's business. Such insight is necessary for success in strategy. It is therefore critical, first and foremost, to understand the

positive effect that customers perceive a service can have on their business outcomes. For customers, the positive effect is the utility of a service. The assurance of the positive effect is the warranty.

3.1.3 Framing the value of services

There is scepticism about the value realized from services when there is uncertainty in the service output. It is not good for the customer that there is certainty in costs and uncertainty in utility from one unit of output to another. When the utility of a service is not backed up by warranty, customers worry about possible losses due to poor service quality more than the possible gains from receiving the promised utility. To allay such concerns and influence customer perceptions of possible gains and losses, it is important that the value of a service is fully described in terms of utility and warranty.

The utility effect of a service is explained as the increase in possible gains from the performance of customer assets, leading to an increase in the probability of achieving outcomes (Figure 3.3). Warranty of services is explained as the decrease in possible losses for the customer from variation in performance (Figure 3.4). Customers feel more certain that every unit of demand for service will be fulfilled with the same level of utility with little variation.

Figure 3.3 Utility increases the performance average

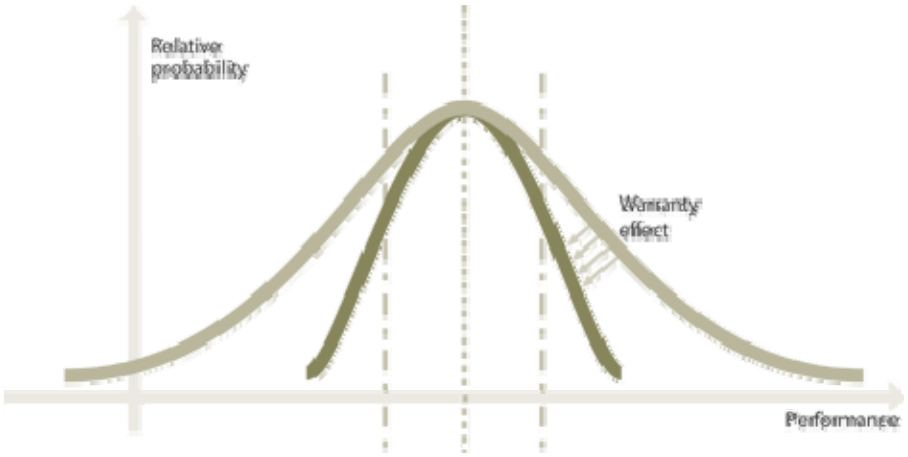

Figure 3.4 Warranty reduces the performance variation

This approach can change customer perceptions of uncertainty in the promised benefits of a service. Customers expect to see a strong link between the utilization of a service and the positive effect on the performance of their own assets, leading to higher return on assets (Figure 3.5).

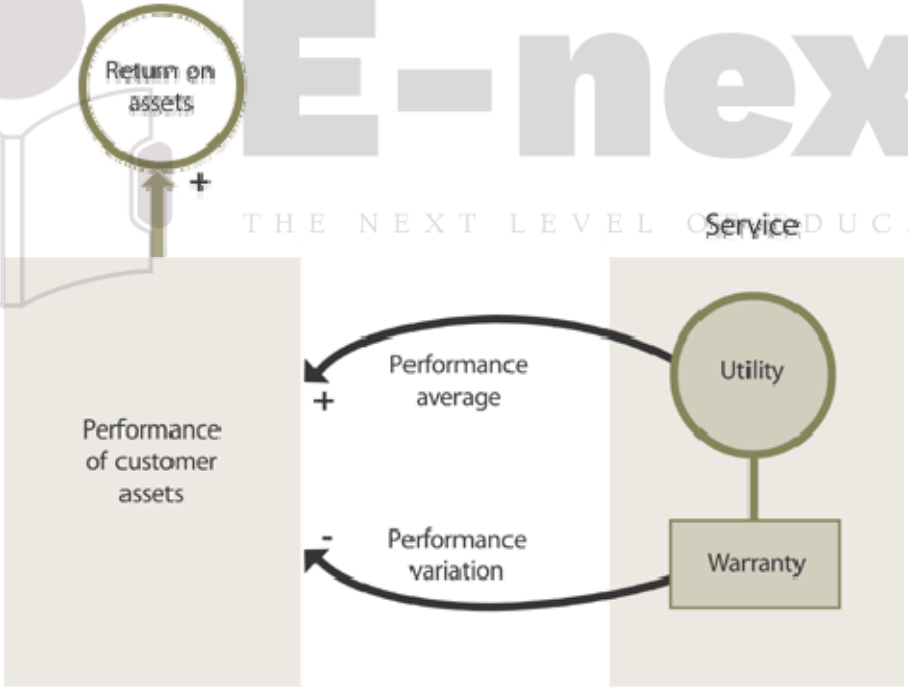

Figure 3.5 Value of a service in terms of return on assets for the customer

A mere graphic is, however, not sufficient to convince customers. They must be assured of the actual mental mapping made by groups engaged in different parts of the Service Lifecycle. Customers may also expect evidence that policies, procedures, and guidelines are in place to uncover all costs and risks associated with service delivery and support. In the absence of such institutionalized

practice, the promise of a service can just as easily turn to peril during the course of carrying out the terms of the contract or service agreement.

3.1.4 Communicating utility

3.1.4.1 In terms of outcomes supported

Take the example of a bank that earns profit from lending money to credit-worthy customers who pay fees and interest on loans. The bank would like to disburse as many good loans as possible within a time period (desired outcome). The bank has a lending process that includes the activity of determining the credit rating of loan applicants. The bank uses a commercial credit reporting service, which is available over the phone and internet. The service provider undertakes to supply accurate, comprehensive, and current information on loan applicants in under a minute. The lending process is the consumer of the credit report, the loan officer being the user. The utility of a credit reporting service is from the high quality of information it provides to the lending process (customer asset) to determine the credit-worthiness of borrowers, so that loan applications may be approved in a timely manner after calculating all the risks for the applicant (Figure 3.6). By reducing the time it takes to obtain good quality of information, the bank is able to have a high-performance asset in the lending process.

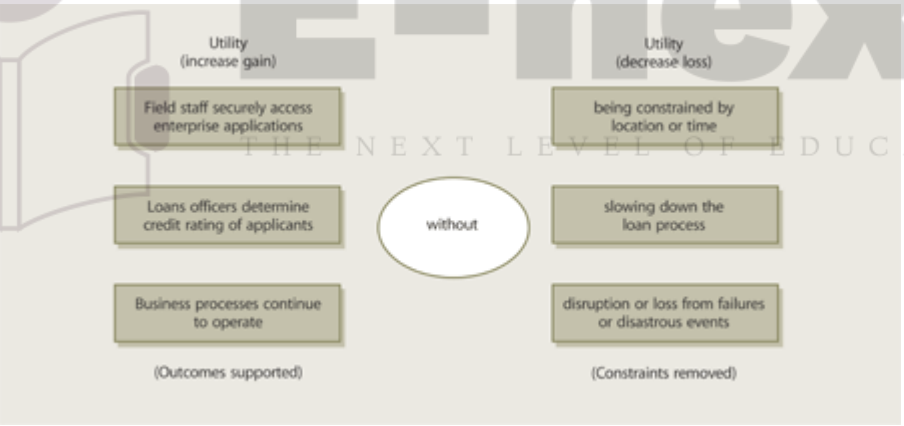

Figure 3.6 Utility framed in terms of outcomes supported and constraints removed

3.1.4.2 In terms of ownership costs and risks avoided

Value of the credit-reporting service also comes from the lending division being able to avoid certain costs and risks it would incur from operating a credit inquiry system on its own instead of using the reporting service. For example, the costs of maintaining capabilities and resources required to operate a credit reporting system would be borne entirely by the lending division. The cost per credit report would become prohibitive within the scope of the loan approval process, and would have to be passed on to the cost of the loan or be absorbed elsewhere

within the banking system. Under prevailing conditions, buying the service turns out to be a good decision for the bank. It increases gains and reduces losses.

An alternative strategy is for the lending division to convince other divisions within the same bank, financial services group, or industry to use its credit reporting system. This may be a viable option in which the lending division would now offer a credit reporting service to lenders along with its core service to borrowers. This is a strategic choice that has to be made by the senior managers of the lending division and their leadership at the bank. The risks of such a choice include the lending division straying from its core capabilities, inability to convince others of its competence, and attracting too little demand to make the credit reporting service economically viable.

By *using* a credit reporting service rather than *operating* a credit reporting system, the lending division is deliberately *avoiding* specific risks and costs. In effect, the lending division frees itself from certain business constraints. Sets of constraints are often traded for others provided the overall performance of the business is not lessened. Such trade-offs are made by the senior leadership of customers who are in the best position to decide. The senior leadership of service providers become business partners when they are able to support their counterparts in managing constraints on business strategies.

From the business perspective in the example above, service providers support the business strategies of their customers by removing or relaxing certain types of constraints on business models and strategies. The constraints are of the type that imposes specific costs and risks that customers wish to avoid, as follows:

- Maintaining non-core and under-utilized assets: customers would like to avoid ownership and control of assets which drain financial resources from core assets, and those used rarely or sporadically. In such cases the return on assets is typically low or uncertain, making the investments risky.
- Opportunity costs due to limited capacity and overloaded assets: assets that are overloaded are unable to serve additional units of demand or accommodate unexpected surges in demand. Insufficient capacity also means that new opportunities cannot be pursued with high probability of success.

3.1.5 Communicating warranty

Warranty ensures the utility of the service is available as needed with sufficient capacity, continuity and security. Customers cannot realize the promised value of a service that is fit for purpose when it is not fit for use.

Warranties in general are part of the value proposition that influences customers to buy. For customers to realize the expected benefits of manufactured goods

utility is necessary but not sufficient. Defects and malfunctions make a product either unavailable for use or diminish its functional capacity. Warranties assure the products will retain form and function for a specified period under certain specified conditions of use and maintenance. Warranties are void outside such conditions. Normal wear and tear is not covered. Most importantly, customers are owners and operators of purchased goods.

In the case of services, the customers are neither the owners nor the operators of service assets that provide utility. That responsibility is with service providers along with maintenance and improvements. Customers simply utilize the service. There is no wear and tear, misuse, neglect, and damage of service assets limiting the validity of warranty.

Service providers communicate the value of warranty in terms of levels of certainty. Their ability to manage service assets instils confidence in the customer about the support for business outcomes. Warranty is stated in terms of the availability, capacity, continuity and security of the utilization of services.

3.1.5.1 Availability

Availability is the most elementary aspect of assuring value to customers. It assures the customer that services will be available for use under agreed terms and conditions. The availability of a service is its most readily perceived attribute from a user's perspective. A service is available only if users can access it in an agreed manner. Perceptions and preferences vary by customer and by business context. The customer is responsible for managing the expectations and needs of its users. Within specified conditions, such as area of coverage, periods, and delivery channels, services are expected to be available to users that the customer authorizes.

Availability of a service is more subtle than a binary evaluation of available and unavailable. The customer's tolerance for graceful degradation of availability should be determined and factored into service design. For example, if a subset of users is responsible for a vital business function, service instances for these users can be hosted on dedicated resources with fault tolerance so that the customer retains some critical capability to operate.

3.1.5.2 Capacity

Capacity is an assurance that the service will support a specified level of business activity or demand at a specified level of quality. Customers drive business activity with the assurance of adequate capacity. Variations in demand are accommodated within an agreed range. Service providers undertake to maintain resources to give customers freedom from capacity shortfalls and underutilized assets. Capacity is of particular importance where the utility of the service arises from access to shared resources. Service providers help customers with shortages during periods of peak-demand.

Guaranteed capacity during particular periods or at particular locations is also valuable to customers who need to start up new or expanded operations with time-to-market as a critical success factor. Such business plans require low set-up costs and lead times. Additionally, due to the high-risks of new or expanded operations, customers may prefer not to make the investments required to own and operate business assets. Businesses that face highly uncertain demand from their own customers also find value in services on demand with little or no latency. Opportunity costs are high in terms of lost customers.

Without effective management of capacity, service providers will not be able to deliver the utility of most services. Capacity Management is a critical aspect of service management because it has a direct impact on the availability of services. The capacity available to support services also has an impact on the level of service continuity committed or delivered. Effective management of service capacity can therefore have first-order and second-order effects on service warranty.

3.1.5.3 Continuity

Continuity assures the service will continue to support the business through major failures or disruptive events. The service provider undertakes to maintain service assets that will provide a sufficient level of contingency and recovery. Specialized systems and processes will kick in to ensure that the service levels received by the customer's assets do not fall below a predefined level. Assurance also includes the restoration or normalcy in a predefined time to limit the overall impact of a failure or event. Continuity is assured primarily through redundancy and dedicated resources isolated from ripple effects.

3.1.5.4 Security

Security assures that the utilization of services by customers will be secure. This means that customer assets within the scope of service delivery and support will not be exposed to certain risks. Service providers undertake to implement general and service-level controls that will ensure that the value provided to customers is complete and not eroded by any avoidable costs and risks. Service security covers the following aspects of reducing risks:

- Authorized and accountable usage of services as specified by customer
- Protection of customers' assets from unauthorized or malicious access
- Security zones between customer assets and service assets.

Service security plays a supporting role to the other three aspects of service warranty. Effectiveness in security has a positive impact on those aspects.

Service security inherits all the general properties of the security of physical and human assets, and intangibles such as data, information, coordination, and

communication. Service security has challenges imposed by the following characteristics of service management:

- Service assets are typically shared by more than one customer entity
- Value is delivered just-in-time through the orchestration of several service assets
- Customer action or inaction is a source of security risks.

3.1.6 Combined effect of utility and warranty

Value creation is the combined effect of utility and warranty. Value for customers can be increased by either of the two factors. Both are necessary: neither is sufficient by itself. Each should be considered a separate factor of value creation (Figure 3.7).

The ability to deliver a certain level of warranty to customers by itself is a basis of competitive advantage for service providers. This is particularly true where services are commoditized or standardized. In such cases, it is hard to differentiate value largely in terms of utility for customers. When customers have a choice between service providers whose services provide more or less the same utility but different levels of warranty, then they prefer the greater certainty in the support of business outcomes.

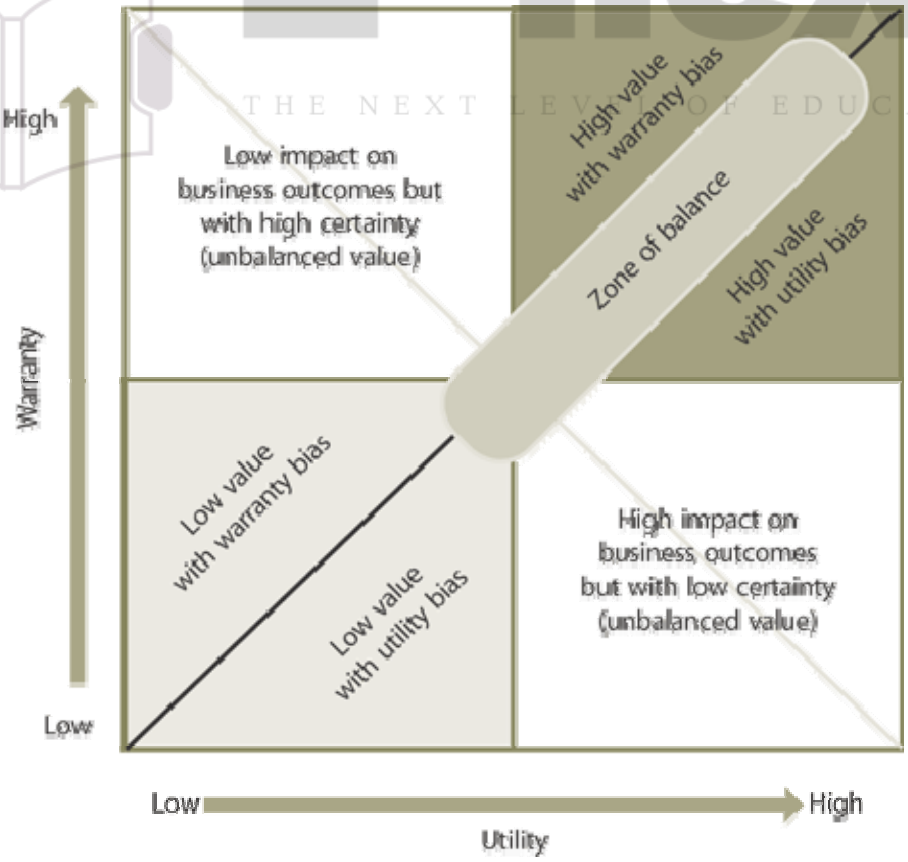

Figure 3.7 Combined effects of utility and warranty on customer assets

'Fewest calls dropped on average' is the value proposition of one major provider of mobile communication services expressed in its advertisements. An equally large competitor counteracts with the value proposition of best available coverage in the majority of urban areas. The other perpetual basis of differentiation is the number of calls made for a flat fee within peak hours of usage. This is an indirect measure of the capacity of over-subscribed service assets that service providers are assuring for the exclusive use of their customers. Of course, when competitive action leads to reduced differentiation based on warranty, service providers respond with service packages that offer additional utility, such the GPS navigation or wireless email on mobile phones.

Certain parcel delivery firms and retailers are market leaders in highly commoditized businesses simply because they offer a level of certainty unsurpassed by their peers. Their services guarantee delivery of goods on time regardless of location, time zone, or size of shipments. They are able to offer such warranties because they have developed certain service management capabilities and resources that instil a level of confidence in their operations.

Service providers should be able to develop such levels of confidence so they are able to support the business strategies of their customers. They add value to their customers by injecting this level of confidence in those strategies. Service providers emulate each other, leading to situations where providers offer similar levels of utility or warranty. Service providers must continually improve their value propositions to break away from the pack. The improvements can drive through one or more of the service management processes.

The guidance provided in the Service design, Service transition, and Service operation processes is useful in this strategic context. Service Design processes provide new and improved designs delivering better utility or better warranty. Service Transition processes ensure design improvements are directed into Service Operation while minimizing costs and risks. Service Operation processes inject the new value propositions into the customer's business by delivering higher levels of utility and warranty. The processes of Continual Service Improvement coordinate the flow of knowledge between the processes and provide feedback throughout the lifecycle.

Case example 2 (solution): *Warranty and utility*

A casual observer may quip that both provide identical services: mobile communication services. However, by adopting a marketing mindset, each provider focuses on different aspects of customer outcomes or value creation.

The slogan 'Can you hear me now?' differentiates value based on a customer's desire for warranty: service availability regardless of location.

The slogan ‘Fair and Flexible’ differentiates value based on a customer’s desire for utility: fair pricing under a variety of service usage scenarios

3.2 Service assets

'A basic code of good business behaviour is a bit like oxygen: We take an interest in its presence only when it is absent.'
Amartya Sen, Nobel Laureate in Economics

Case example 3: *Financial services*

Some time in the late 1990s, a leading financial services company launched a direct banking service. The service offered an internet-based savings and loans service.

After eight days, the company received almost 2 million website hits and over 100,000 enquiries. After five weeks, demand was so high that the company warned customers of delays of up to 28 days.

As CIO, what do you suspect is the problem?

(Answer given in Section 3.2.1)

3.2.1 Resources and capabilities

Resources and capabilities are types of assets (Figure 3.8). Organizations use them to create value in the form of goods and services. Resources are direct inputs for production. Management, organization, people, and knowledge are used to transform resources. Capabilities represent an organization's ability to coordinate, control, and deploy resources to produce value. They are typically experience-driven, knowledge-intensive, information-based, and firmly embedded within an organization's people, systems, processes and technologies. It is relatively easy to acquire resources compared to capabilities. Supplementary guidance on capabilities and resources is presented in Appendix B, Section B.1.

Case example 3 (solution): *Chokepoints in staff (overlooking customer assets)*

The constraint, it turns out, was not infrastructure capacity or availability, but a customer asset shortcoming in the form of 250 staff members. Once this chokepoint was resolved (250 hires), the company went on to win over 500,000 new customers and £5B in deposits in less than six months.

The performance or growth of services will ultimately be limited either by limits in a resource or capability, or its own potential. Attempts to push a service beyond a resource or capability limit can have strong consequences – often negating any benefits achieved.

The constraint, in this case, did not appear to be technology-related. They were account processors. The CIO missed it because he only considered service assets, overlooking the constraining effect of customer assets on the performance of his organization's services. The CIO's customer, in this case, includes the processing department.

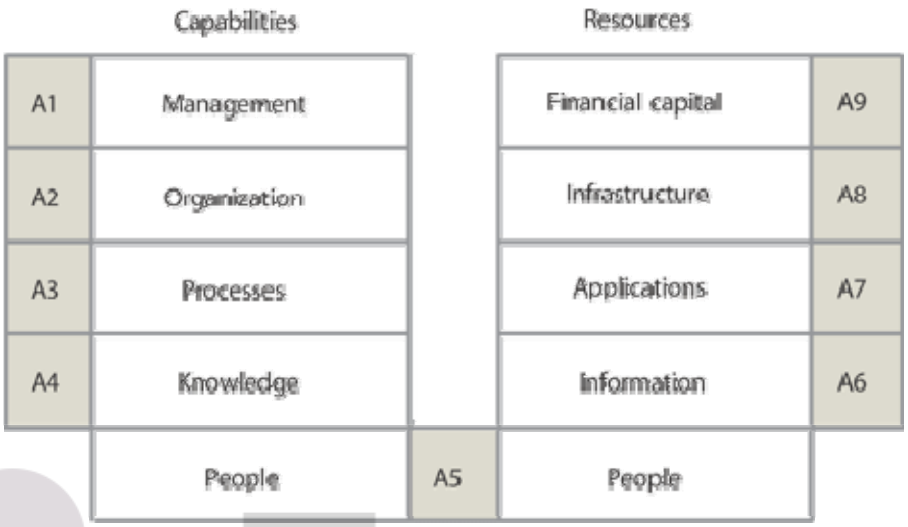

Figure 3.8 Resources and capabilities are the basis for value creation

Capabilities are developed over time. The development of distinctive capabilities is enhanced by the breadth and depth of experience gained from the number and variety of customers, market spaces, contracts, and services. Experience is similarly enriched from solving problems, handling situations, managing risks, and analysing failures. For example, the combination of experience in a market space, reputation among customers, long-term contracts, subject matter experts, mature processes, and infrastructure in key locations, results in distinctive capabilities difficult for alternatives to offer. This assumes the organization captures knowledge and feeds it back into its management systems and processes. Investments in learning capabilities are particularly important for service providers for the development of strategic assets (See Section 4.3).

Service providers need to develop distinctive capabilities to retain customers with value propositions that are hard for competitors to duplicate. For example, two service providers may have similar resources such as applications, infrastructure, and access to finance. Their capabilities, however, differ in terms of management systems, organization structure, processes, and knowledge assets. This difference is reflected in actual performance.

Capabilities by themselves cannot produce value without adequate and appropriate resources. The productive capacity of a service provider is dependent on the resources under its control. Capabilities are used to develop, deploy and coordinate this productive capacity. For example, capabilities such as Capacity Management and Availability Management are used to manage the

performance and utilization of processes, applications and infrastructure, ensuring service levels are effectively delivered.

3.2.2 Business units and service units

3.2.2.1 The business unit

A business unit is simply a bundle of assets meant to create value for customers in the form of goods and services (Figure 3.9). Customers pay for the value they receive, which ensures that the business unit maintains an adequate return on assets. The relationship is good as long as the customer receives value and the business unit recovers costs and receives some form of compensation or profit.

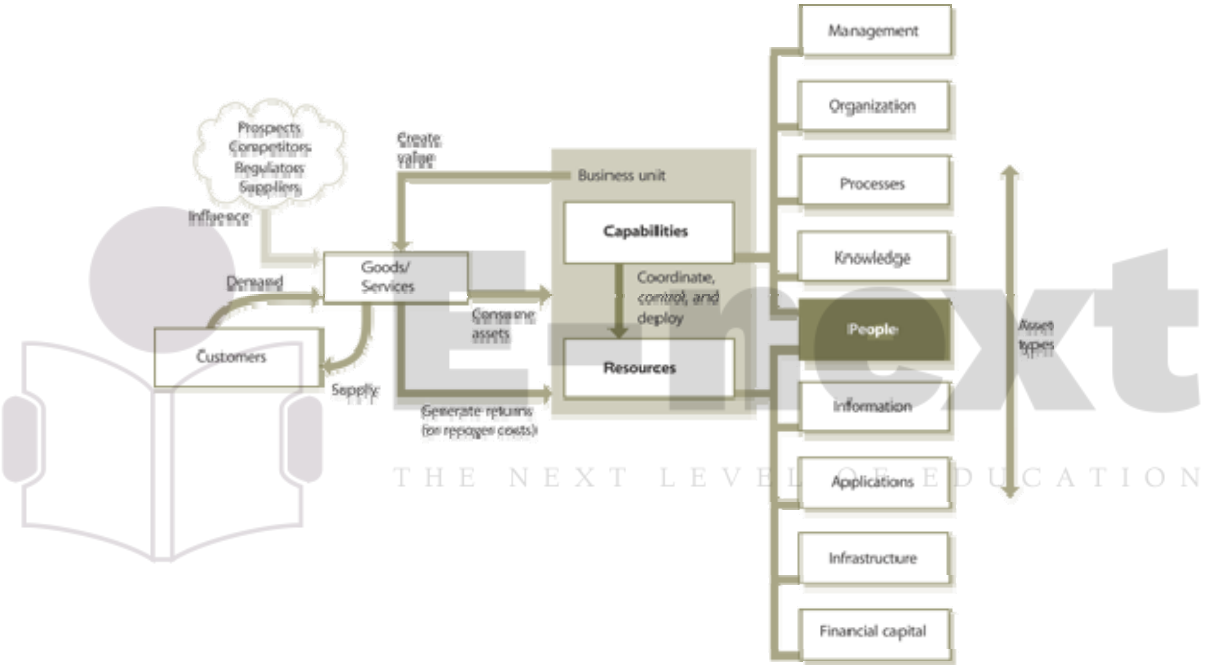

Figure 3.9 Business units are coordinated goal-driven collections of assets

The business unit's capabilities coordinate, control, and deploy its resources to create value. Value is always defined in the context of customers. Some services simply increase the resources available to the customer. For example, a storage service may assure that a customer's business systems can achieve a particular level of throughput in transaction processing with the availability of adequate, error-free and secure storage of transaction data. The storage service simply increases the capacity of the system, although one might argue that it actually enables the capability of high-volume transaction processing. Other services increase the performance of customer's management, organization, people and processes. For example, a news-feed service provides real-time market data to be used by traders to make better and quicker decisions on trades.

The relationship with customers becomes strong when there is a balance between value created and returns generated. The catalogue of goods and services amplifies the effect and strengthens the capabilities and resources of the business unit. Better returns or cost recovery allow for greater investments in capabilities and resources. The resources and capabilities complement each other.

The business unit could be part of an organization in the public or private sectors. Instead of revenue from sales there could be revenue from taxes collected. Instead of profits there could be surpluses. The customers of the business unit could be internal or external to the organization.

Understanding the customer's business

Back at the office

Pick a customer and carefully analyse their business to understand the ecosystem in which they operate. What conditions make the customer's business grow? How do your services create or sustain such conditions? What challenges and opportunities does their business face? How do your services help your customer address them?

Suggestion: Visualize the ecosystem diagram with the various boxes and connectors that constitute the closed-loop system for creating and sustaining value.

3.2.2.2 The service unit

Service units are like business units, a bundle of service assets that specializes in creating value in the form of services (Figure 3.10). Services define the relationship between business units and service units. In many instances, business units (customers) and service units are part of the same organization. In other instances service units are separate legal entities.

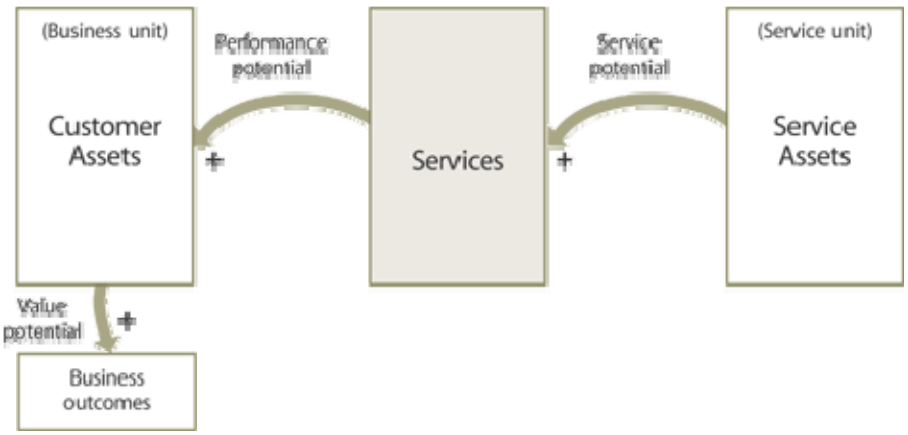

Figure 3.10 Customer assets are the basis for defining value

There are many possible relationships between business units and service units (Figure 3.11). In the example below, Service X is provided to Business Unit A by Enterprise 2. It is hosted by Service Unit 1 and Service Unit 2. Service Y is provided to Enterprise 1 by Service Unit 2. It is shared by Business Units A, B and C. Demand for Service Y is consolidated across Enterprise 1. By pooling demand across the business units, Enterprise 1 negotiates better terms and conditions for Service Y, including pricing discounts. Enterprise 2 is willing to accept those terms and conditions because consolidated demand represents a lower risk of poor return on assets for Service Unit 2 – thereby reaching the break-even point sooner.

Service Z is provided to Business Unit D by Service Unit 3, both of which exist within Enterprise 3. Service Unit 3 commercially offers Service Z to the business units of Enterprise 1. This increases the return on assets required for the service and potentially reduces the unit costs of providing the service internally to Business Unit D.

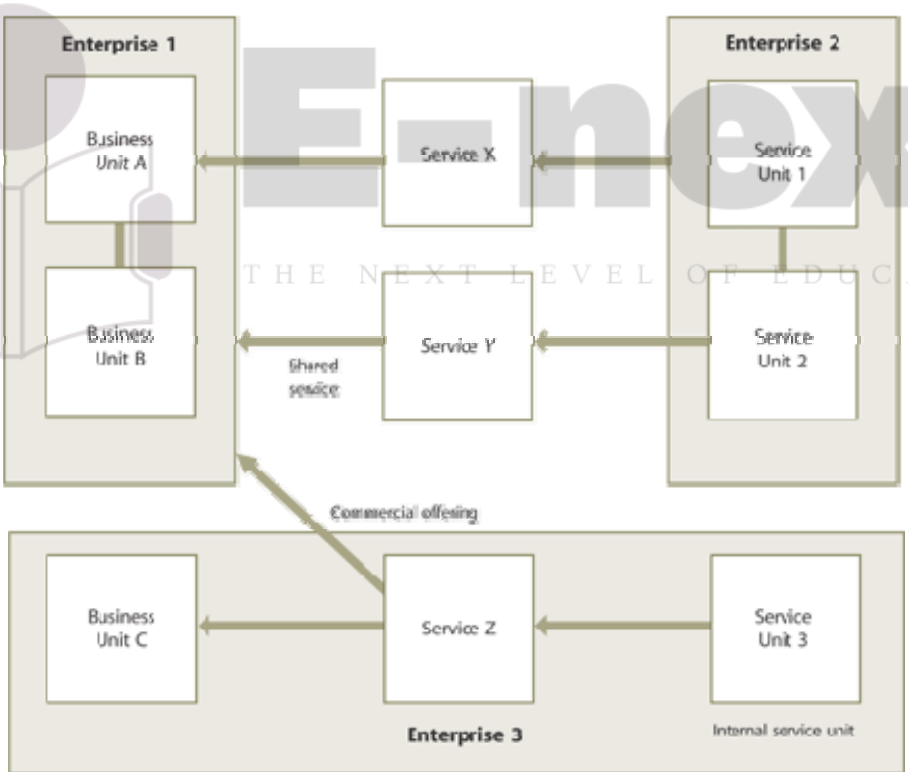

Figure 3.11 Common relationships between business units and service units

Customers and service providers are usually a part of a larger value chain or value network. Customers have their own customers to serve, and service providers are in turn served by their service providers

3.3 Service provider types

'There is no such thing as a service industry. There are only industries whose service components are greater or less than those of other industries. Everybody is in service.'
Professor Emeritus Theodore Levitt, Harvard Business School

Case example 4: Infrastructure services

Some time in the late 1990s, the internal IT Service Provider for a global conglomerate decided to source all data centre operations to external service providers. The primary driver was lower costs. Five years and several mergers and acquisitions later, and despite having achieved its cost reductions, the internal provider is considering in-sourcing all data centre operations.

What do you suspect is the reason?

(Answer at the end of Section 3.3)

It is necessary to distinguish between different types of service providers. While most aspects of service management apply equally to all types of service providers, others such as customers, contracts, competition, market spaces, revenue and strategy take on different meanings depending on the type. There are three archetypes of business models service providers:

- Type I – internal service provider
- Type II – Shared Services Unit
- Type III – external service provider

3.3.1 Type I (internal service provider)

Type I providers are typically business functions embedded within the business units they serve. The business units themselves may be part of a larger enterprise or parent organization. Business functions such as finance, administration, logistics, human resources, and IT provide services required by various parts of the business. They are funded by overheads and are required to operate strictly within the mandates of the business. Type I providers have the benefit of tight coupling with their owner-customers, avoiding certain costs and risks associated with conducting business with external parties.

The primary objectives of Type I providers are to achieve functional excellence and cost-effectiveness for their business units.11 They specialize to serve a relatively narrow set of business needs. Services can be highly customized and resources are dedicated to provide relatively high service levels. The governance and administration of business functions are relatively straightforward. The decision rights are restricted in terms of strategies and operating models. The

general managers of business units make all key decisions such as the portfolio of services to offer, the investments in capabilities and resources, and the metrics for measuring performance and outcomes.

Type I providers operate within internal market spaces. Their growth is limited by the growth of the business unit they belong to. Each business unit (BU) may have its own Type I provider (Figure 3.12). The success of Type I providers is not measured in terms of revenues or profits because they tend to operate on a cost-recovery basis with internal funding. All costs are borne by the owning business unit or enterprise.

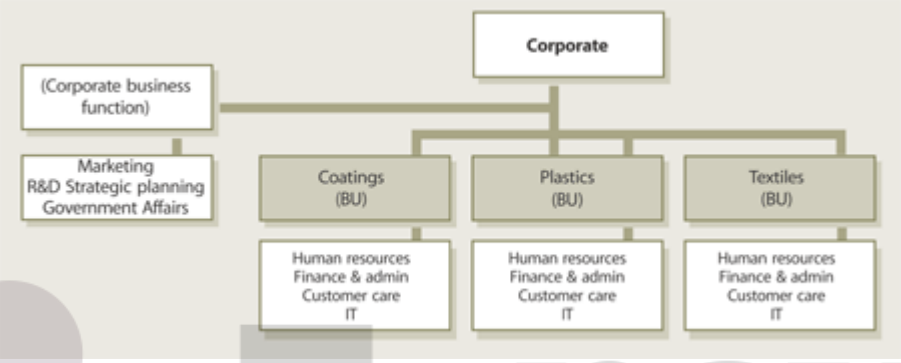

Figure 3.12 Type I providers

Competition for Type I providers is from providers outside the business unit, such as corporate business functions, who wield advantages such as scale, scope, and autonomy. In general, service providers serving more than one customer face much lower risk of market failure. With multiple sources of demand, peak demand from one source can be offset by low demand from another. There is duplication and waste when Type I providers are replicated within the enterprise.

To leverage economies of scale and scope, Type I providers are often consolidated into a corporate business function when there is a high degree of similarity in their capabilities and resources. At this level of aggregation Type I providers balance enterprise needs with those at the business unit level. The trade-offs can be complex and require a significant amount of attention and control by senior executives. As such, consolidated Type I providers are more appropriate where classes of assets such as IT, R&D, marketing or manufacturing are at the core of the organization's competitive advantage and therefore need careful control.

3.3.2 Type II (shared services unit)

Functions such as finance, IT, human resources, and logistics are not always at the core of an organization's competitive advantage. Hence, they need not be maintained at the corporate level where they demand the attention of the chief executive's team.11 Instead, the services of such shared functions are

consolidated into an autonomous special unit called a shared services unit (SSU) (Figure 3.13). This model allows a more devolved governing structure under which SSU can focus on serving business units as direct customers. SSU can create, grow, and sustain an internal market for their services and model themselves along the lines of service providers in the open market. Like corporate business functions, they can leverage opportunities across the enterprise and spread their costs and risks across a wider base. Unlike corporate business functions, they have fewer protections under the banner of strategic value and core competence. They are subject to comparisons with external service providers whose business practices, operating models and strategies they must emulate and whose performance they should approximate if not exceed. Performance gaps are justified through benefits received through services within their domain of control.

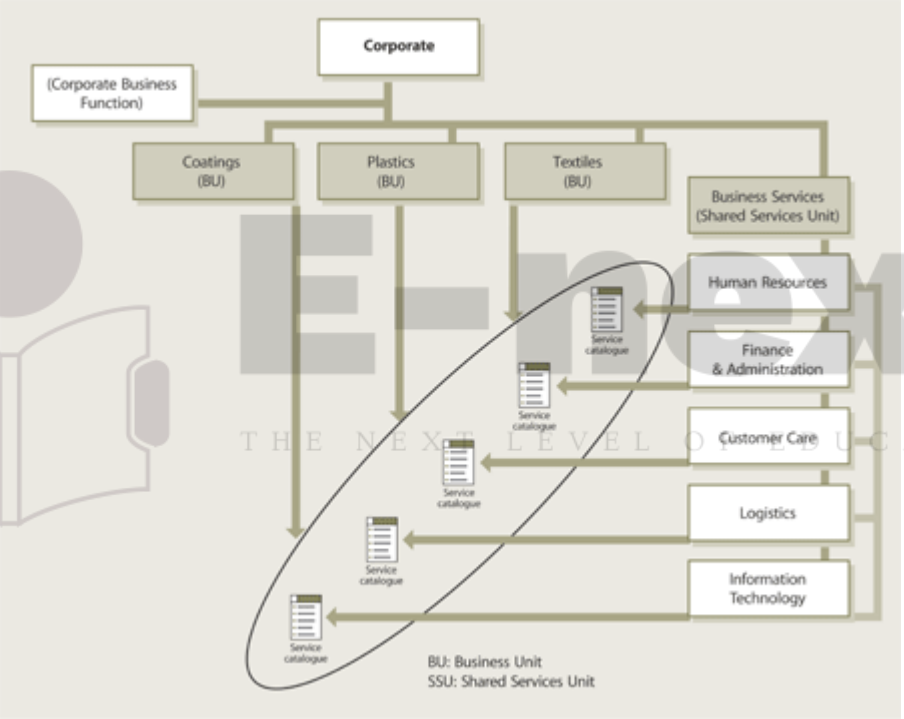

Figure 3.13 Common Type II providers

Customers of Type II are business units under a corporate parent, common stakeholders, and an enterprise-level strategy. What may be sub-optimal for a particular business unit may be justified by advantages reaped at the corporate level for which the business unit may be compensated. Type II can offer lower prices compared to external service providers by leveraging corporate advantage, internal agreements and accounting policies. With the autonomy to function like a business unit, Type II providers can make decisions outside the constraints of business unit level policies. They can standardize their service offerings across business units and use market-based pricing to influence demand patterns.

Market-based pricing

With market-based pricing there is minimal need for complex discussions and negotiations over specific requirements, technologies, resource allocations, architectures, and designs (that would be necessary with Type I arrangements) because the prices would drive adjustments, self-corrections and optimization on both sides of the value equation.

While Type II providers benefit from a relatively captive internal market for their services, their customers may still evaluate them in comparison with external service providers. This balance is crucial to the effectiveness of the shared services model. It also means that poorly performing Type II providers face the threat of substitution. This puts pressure on the leadership to adopt industry best practices, cultivate market spaces, formulate business strategies, strive for operational effectiveness, and develop distinctive capabilities. Industry-leading shared services units have successfully been spun off by their parents as independent businesses competing in the external market. They become a source of revenues from the initial charter of simply providing a cost advantage.

3.3.3 Type III (external service provider)

The business strategies of customers sometimes require capabilities readily available from a Type III provider. The additional risks that Type III providers assume over Type I and Type II are justified by increased flexibility and freedom to pursue opportunities. Type III providers can offer competitive prices and drive down unit costs by consolidating demand. Certain business strategies are not adequately served by internal service providers such as Type I and Type II. Customers may pursue sourcing strategies requiring services from external providers. The motivation may be access to knowledge, experience, scale, scope, capabilities, and resources that are either beyond the reach of the organization or outside the scope of a carefully considered investment portfolio. Business strategies often require reductions in the asset base, fixed costs, operational risks, or the redeployment of financial assets. Competitive business environments often require customers to have flexible and lean structures. In such cases it is better to buy services rather than own and operate the assets necessary to execute certain business functions and processes. For such customers, Type III is the best choice for a given set of services (Figure 3.14). The experience of such providers is not limited to any one enterprise or market. The breadth and depth of such experience is often the single most distinctive source of value for customers. The breadth comes from serving multiple types of customers or markets. The depth comes from serving multiples of the same type.

From a certain perspective, Type III providers are operating under an extended large-scale shared services model. They assume a greater level of risk from their customers compared to Type I and Type II. But their capabilities and resources are shared by their customers – some of whom may be rivals. This means that

rival customers have access to the same bundle of assets, thereby diminishing any competitive advantage those assets bestowed.

Security is always an issue in shared services environments. But when the environment is shared with competitors, security becomes a larger concern. This is a driver of additional costs for Type III providers. As a counter-balance, Type III providers mitigate a type of risk inherent to Types I and II: business functions and shared service units are subject to the same system of risks as their business unit or enterprise parent. This sets up a vicious cycle, whereby risks faced by the business units or the enterprise are transferred to the service units and then fed back with amplification through the services utilized. Customers may reduce systemic risks by transferring them to external service providers who spread those risks across a larger value network.

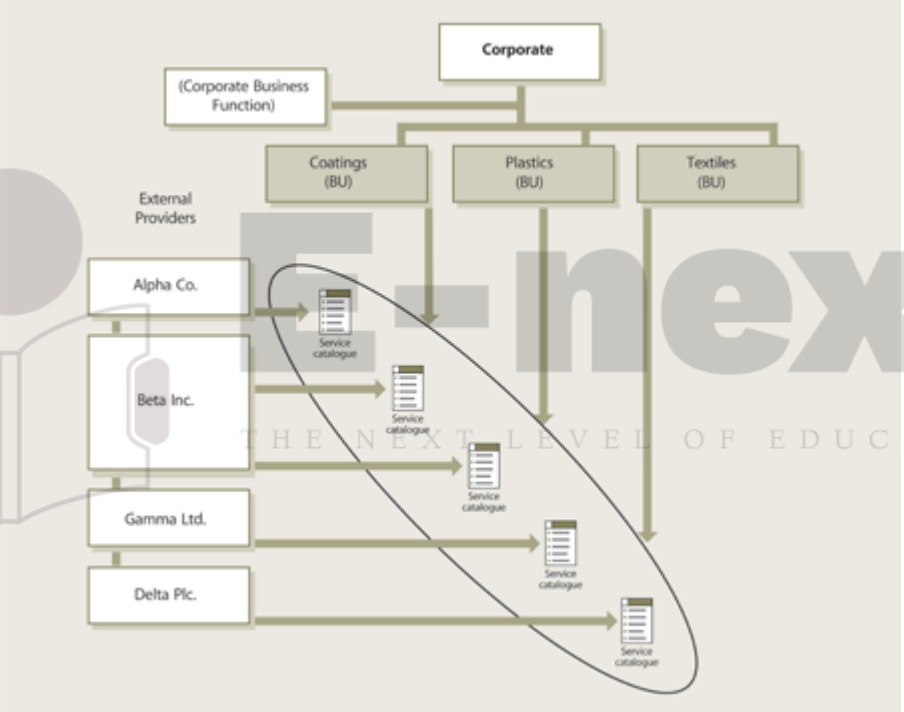

Figure 3.14 Type III providers

3.3.4 How do customers choose between types?

From a customer's perspective there are merits and demerits with each type of provider. Services may be sourced from each type of service provider with decisions based on transaction costs, strategic industry factors, core competence, and the risk management capabilities of the customer. The principles of specialization and coordination costs apply.

The principle of transaction costs is useful for explaining why customers may prefer one type of provider to another. Transaction costs are overall costs of

conducting a business with a service provider. Over and above the purchasing cost of services sold, they include but are not limited to the cost of finding and selecting qualified providers, defining requirements, negotiating agreements, measuring performance, managing the relationship with suppliers, cost of resolving disputes, and making changes or amends to agreements.

Additionally, whether customers keep a business activity in-house (aggregate) or decide to source it from outside (disaggregate) depends on answers to the following questions.15

- Does the activity require assets that are highly specialized? Will those assets be idle or obsolete if that activity is no longer performed? (If yes, then disaggregate.)
- How frequently is the activity performed within a period or business cycle? Is it infrequent or sporadic? (If yes then disaggregate.)
- How complex is the activity? Is it simple and routine? Is it stable over time with few changes? (If yes, then disaggregate.)
- Is it hard to define good performance? (If yes, then aggregate.)
- Is it hard to measure good performance? (If yes, then aggregate.)
- Is it tightly coupled with other activities or assets in the business? Would separating it increase complexity and cause problems of coordination? (If yes, then aggregate.)

Based on the answers to those questions, customers may decide to switch between types of service providers (Figure 3.15). Answers to the questions themselves may change over time depending on new economic conditions, regulations, and technological innovation. Transaction costs are discussed further under the topics of Strategy, tactics and operations (Chapter 7), Service structures (Section 3.4) and Challenges and opportunities (Chapter 9).

From/To	Type I	Type II	Type III
Type I	Functional reorganization	Disaggregation	Outsourcing
Type II	Aggregation	Corporate reorganization	Outsourcing
Type III	Insourcing	Insourcing	Value net reconfiguration

Figure 3.15 Customer decisions on service provider types

Customers may adopt a sourcing strategy that combines the advantages and mitigates the risks of all three types. In such cases, the value network supporting a customer cuts across the boundaries of more than one organization. As part of a carefully considered sourcing strategy, customers may allocate their needs across the different types of service providers based on whichever type best provides the business outcomes they desire. Core services are sought from Type I or Type II providers, while supplementary services enhancing core services are sought from Type II or Type III providers.

In a multi-sourced environment, the centre of gravity of a value network rests with the type of service provider dominating the sourcing portfolio. Figure 3.15 shows the range of sourcing options available to customers based on the types of service providers between which controls are transferred. Outsourcing or disaggregating decisions move the centre of gravity away from corporate core. Aggregation or in-sourcing decisions move the centre of gravity closer to the corporate core and are driven by the need to maintain firm-specific advantages unavailable to competitors. Certain decisions do not shift the centre of gravity but rather reallocate services between service units of the same type.

The sourcing structure may be altered due to changes in the business fundamentals of the customer, making one type of service provider more desirable than the other. For example, a customer merger or acquisition may dramatically alter the economics that underpin a hitherto sound sourcing strategy; see Case Example 4. The customer decides to in-source an entire portfolio of services now to be offered by a newly acquired Type I or Type II.

3.3.5 The relative advantage of incumbency

Lasting relationships with customers allow organizations to learn and improve. Fewer errors are made, investments are recovered, and the resulting cost advantage can be leveraged to increase the gap with competition (Figure 3.16).

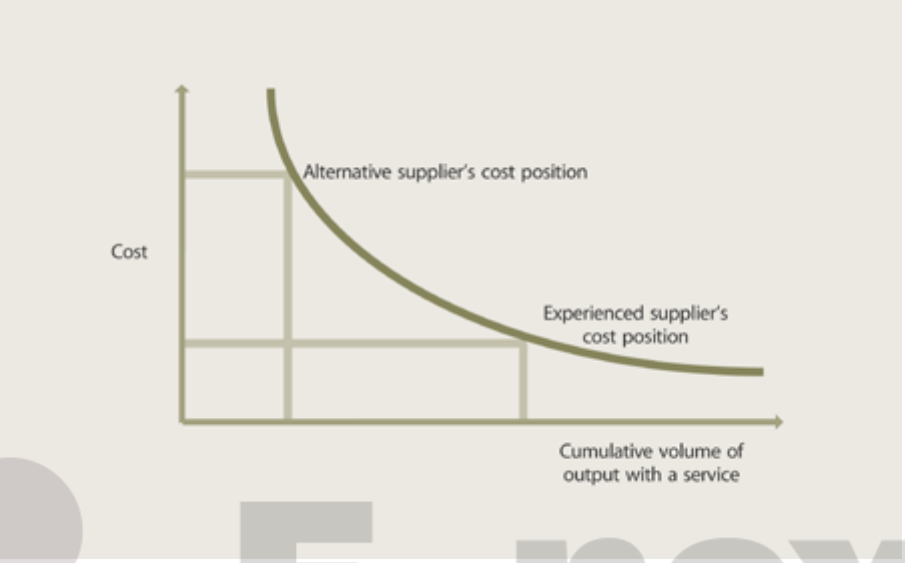

Figure 3.16 Advantage of being a well-performing incumbent

Customers find it less attractive to turn away from well-performing incumbents because of switching costs. Experience can be used to improve assets such as processes, knowledge, and the competencies that are strategic in nature.

Service providers must therefore focus on providing the basis for a lasting relationship with customers. It requires them to exercise strategic planning and control to ensure that common objectives drive everything, knowledge is shared effectively between units, and experience is fed back into future plans and actions for a steeper learning curve.

Case example 4 (solution): *Newly acquired service provider types*

The Type II provider for the conglomerate had achieved its cost reductions through a relationship with a Type III. As a result of mergers and acquisitions activity, however, the company grew to include additional Type I providers.

When the company re-examined its service strategy, it realized it could in-source and consolidate all service providers into a single Type II – at a lower cost and with an enhanced technological distinctiveness unavailable from any Type III.

3.4 Service structures

‘All models are wrong, but some of them are useful.’
George Box, statistician

Case example 5: *Commerce services*

A web-commerce company thrives despite a severe economic slowdown. The business model, based on online auctions, is profitable. However, the business model does not explain why its services succeed in creating sustainable value as other sites fail.

Process flows fail to provide insight. A value net analysis, however, reveals the distinctiveness between the auctioneer and its competitors.

What did the value net reveal about the services that a process flow could not?

(Answer in Section 3.4.1)

3.4.1 From value chains to value networks

Business executives have long described the process of creating value as links in a value chain. This model is based on the industrial age production line: a series of value-adding activities connecting an organization’s supply side with its demand side. Each service provides value through a sequence of events leading to the delivery, consumption and maintenance of that particular service. By analysing each stage in the chain, senior executives presumably find opportunities for improvements.

Much of the value of service management, however, is intangible and complex. It includes knowledge and benefits such as technical expertise, strategic information, process knowledge and collaborative design. Often the value lies in how these intangibles are combined, packaged, and exchanged. Linear models have shown themselves to be inadequate for describing and understanding the complexities of value for service management, often treating information as a supporting element rather than as a source of value. Information is used to monitor and control rather than to create new value.

Case example 5 (solution): *Commerce services*

Most services focus on making a profit or performing social benefits. A value net analysis revealed the online auctioneer did both.

The value net revealed a hidden participant and their intangible exchanges: hobbyists. Hobbyists discovered they could take part in the auctioneer’s micro-

economy. They became professional participants with their own value capture. They created a sense of community, loyalty, feedback mechanisms and referrals.

By indirectly creating prosperity for the hobbyists, the auctioneer created prosperity for itself. The auctioneer used this insight to create a new class of services directed at hobbyists.

Value chains remain an important tool. They provide a strategy for vertically integrating and coordinating the dedicated assets required for product development. The framework focuses on a linear model but as discussed throughout this publication, linear models are seldom ideal for the complexities of service management. In this case, it is the assembly line metaphor. Upstream suppliers add value and then pass it down to the next actor downstream. This approach assumes that definitions and needs are stable and well understood. If there was a problem or delay, it was because of a weak or missing link in the chain. In this traditional service model, there are three roles: the business, the service provider and the supplier. The service provider acquires goods and services from its suppliers and assembles them to produce new services to meet the needs of the business. The business, or customer, is the last link in the chain.

The economics for linear models is based on the law of averages. If the aggregate cost of a service is competitive, then seeking a cost advantage at every link in the chain is not required or even feasible. In the day-to-day practice of manufacturing, for example, it is not practical to break down processes into independently negotiated transactions. Tight coupling is the nature of the chain.

Global sourcing and modern distribution technologies, however, have undermined this logic. A service provider no longer has the luxury of compensating for weak performance in one area with the strength of another. Further, there are often many actors performing intermediary and complementary functions who are not reflected. Also, most important in a service strategy, the focus must be on the value creating system itself, rather than the fixed set of activities along a chain.

It is important to understand the most powerful force to disrupt conventional value chains: the low cost of information. Information was the glue that held the vertical integration. Getting the necessary information to suppliers and service providers has historically been expensive, requiring dedicated assets and proprietary systems. These barriers to entry gave value chains their competitive advantage. Through the exchange of open and inexpensive information, however, businesses can now make use of resources and capabilities without owning them.

Lower transaction costs allow organizations to control and track information that would have been too costly to capture and process just years ago. Transaction costs still exist, but are increasingly more burdensome within the organization

than without. This in turn has created new opportunities for collaboration between service providers and suppliers. The end result is a flexible mix of mechanisms that undermine the rigid vertical integration. New strategies are now available to service providers:

- Marshal external talent – no single organization can organically produce all the resources and capabilities required within an industry. Most innovation occurs outside the organization.
- Reduce costs – produce more robust services in less time and for less expense than possible through conventional value-chain approaches. If it is less expensive to perform a transaction within the organization, keep it there. If it is cheaper to source externally, take a second look. An organization should contract until the cost of an internal transaction no longer exceeds the cost of performing the transaction externally. This is a corollary to 'Coase's Law': a firm tends to expand until the costs of organizing an extra transaction within the firm become equal to the costs of carrying out the same transaction on the open market. The concept of Coase's law was first developed by Tapscott.16
- Change the focal point of distinctiveness – by harnessing external talent, an organization can redeploy its own resources and capabilities to enhance services better suited to its customer or market space. Take the case of a popular North American sports league and its Type I service provider. By harnessing the capabilities of Type III infrastructure service providers, the Type I is free to redeploy its capabilities to enhance its new media services, namely, web-based services with state-of-the-art streaming video, ticket sales, statistics, fantasy leagues and promotions.
- Increase demand for complementary services – an organization, particularly a Type I, may lack the breadth of services offered by Type II and Type III service providers. By acting as a service integrator, such organizations not only remedy the gap but boost demand through complementary offerings.
- Collaborate – as transaction costs drop, collaboration is less optional. There are always more smart people outside an organization than inside.

Value network

A value network is a web of relationships that generates tangible and intangible value through complex dynamic exchanges through two or more organizations.

Once we view service management as patterns of collaborative exchanges, rather than an assembly line, it is apparent that our idea of value creation is due for revision. From a systems thinking perspective it is more useful to think of service management as a value network or net. Any group of organizations engaged in both tangible and intangible exchanges is viewed as a value network (Figures 3.17 and 3.18), whether or not they are in the same self-contained enterprise, whether private industry or public sector.

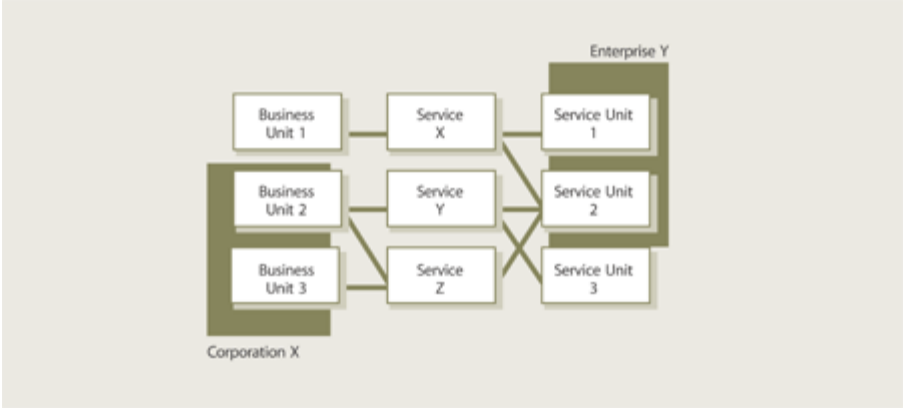

Figure 3.17 Generic value network

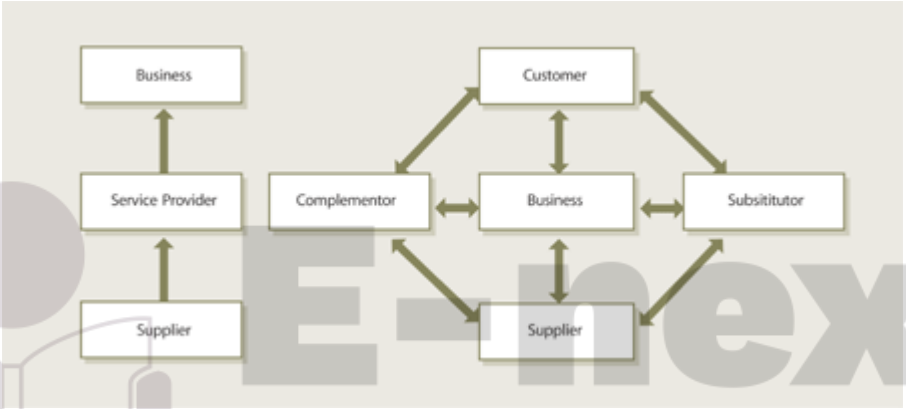

Figure 3.18 Basic value chain and value network

Take, for example, the financial services industry. Brokerage services leveraged IT to provide customers with market access, real-time market data and the ability to execute trades. The costs of computing, network and data were high, creating significant barriers to entry for competitors. The value proposition was based on the ability to perform these services reliably and securely.

Online brokerages, however, disaggregated these services from the proprietary systems. The same services are offered to their customers, but are now aggregated through intermediaries. The online brokerages do not own the computing, the networks or the real-time data. The value proposition is based on the services provided to the customer, not the activities performed. As a result of this strategy, the design, operations and improvement of services are performed in ways radically different from previous models.

3.4.2 Service systems

Services are often characterized by complex networks of value flows and forms of value, often involving many parties that influence each other in many ways. Value nets serve to communicate the model in a clear and simple way. They are

designed to leverage external capabilities. These sources complement the core enterprise within a business. Despite many actors, the services operate with the efficiency of a self-contained enterprise, operating on a process rather than an organizational basis. The core enterprise is the central point of execution, rather than one actor in a chain, and is responsible for the whole value network. This includes the infrastructure by which other business partners can collaborate to deliver goods and services. Intangible exchanges are not just activities that support the service; they are the service.

First consider customer expectation. Only then consider the resources and capabilities required to deliver services. This model requires high-performance information flows, not rigid supply chains. Not too long ago, business employees were the only consumers of its IT Services. The pervasive examples of banking ATMs, airport kiosks, and online reservation systems illustrate this is no longer the case. Collaborative services such as Wikipedia, YouTube and Second Life suggest increasing levels of sophistication in customer interactions. As customers and suppliers become the direct users of IT Services, the expectations and requirements become more demanding – requiring a value net approach.

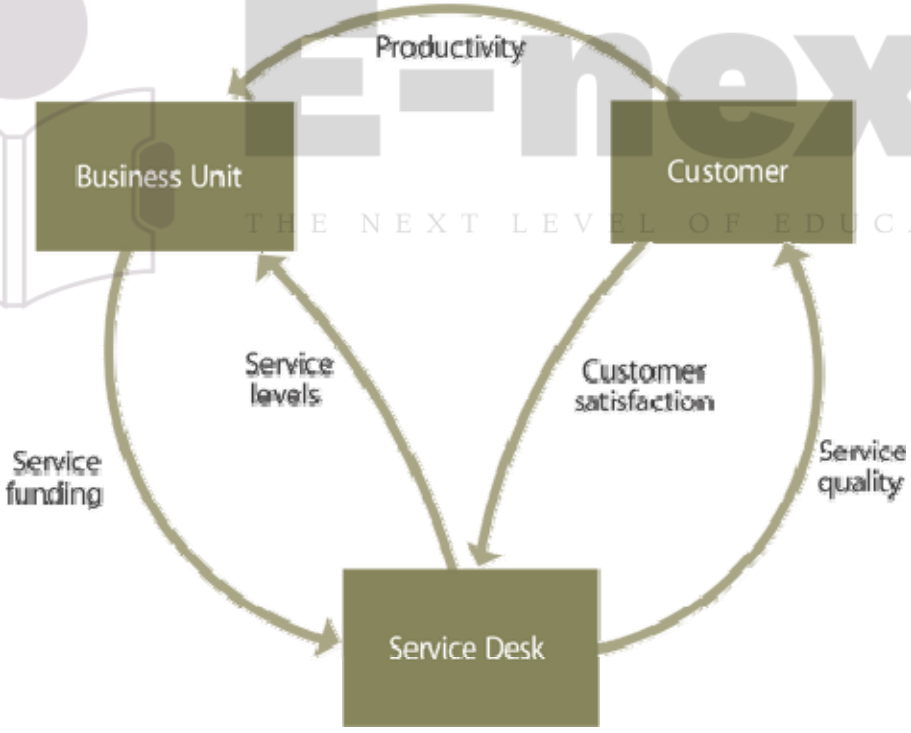

Figure 3.19 Example value network

In a value net diagram, an arrow designates a transaction. See Figure 3.19. The direction of the arrow denotes the direction of the transaction or impact on a participant: service provider or customer. Transactions can be temporary. They

may include deliverables, tangible or intangible. Dotted arrows can be used to distinguish intangible transactions.

Figure 3.20 Unit of analysis for value nets in service management

The following questions are useful in constructing and analysing the dynamics of a service model. See Figure 3.20.

- Who are all the participants in the service?
- What are the overall patterns of exchange or transactions?
- What are the impacts or deliverables of each transaction on each participant?
- What is the best way to generate value?

Case example 6: *Service Desk*

A Type I provider for a healthcare business unit performed an assessment of their Service Desk. A map of the Service Desk process was developed: Figure 3.21. This flow chart described how the Service Desk function worked. While the flow chart looked orderly, the experience of the staff did not match the documented flow. A value net analysis was subsequently performed.

The staff described informal processes used to manoeuvre around the constraints of the process model. The informal processes were needed in order to be effective. Newcomers to the staff predictably took longer to become effective as they learned these undocumented ways to do things.

The analysis moved the focus away from the linear depiction of the process. Rather, it focused on the people who were fulfilling different roles. It became apparent that simple steps on the flowchart were complex instead. They involved multiple staff members and required continuing activities throughout the entire process: Figure 3.22.

The value net appeared messy. But staff agreed that it accurately described how the Service desk really worked. The analysis captured the intangibles for which staff were accountable but were not reflected in the flow chart.

The goal was not to replace process modelling or to map the entire organization. The method was used to describe a complex, non-linear process that had been artificially forced into the linear flow diagram.

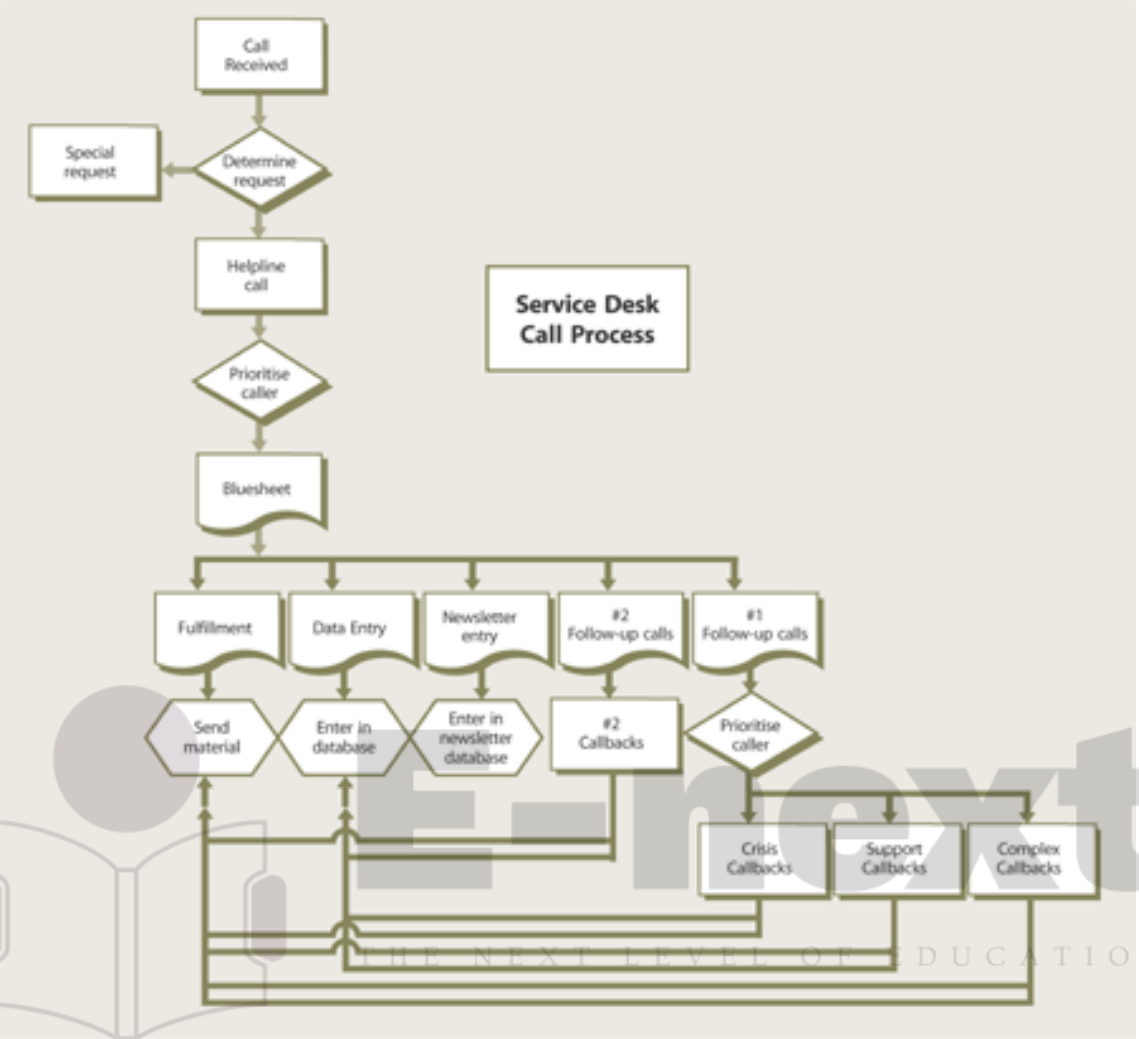

Figure 3.21 Existing flowchart of how the Service Desk was supposed to work (adapted from Allee)17

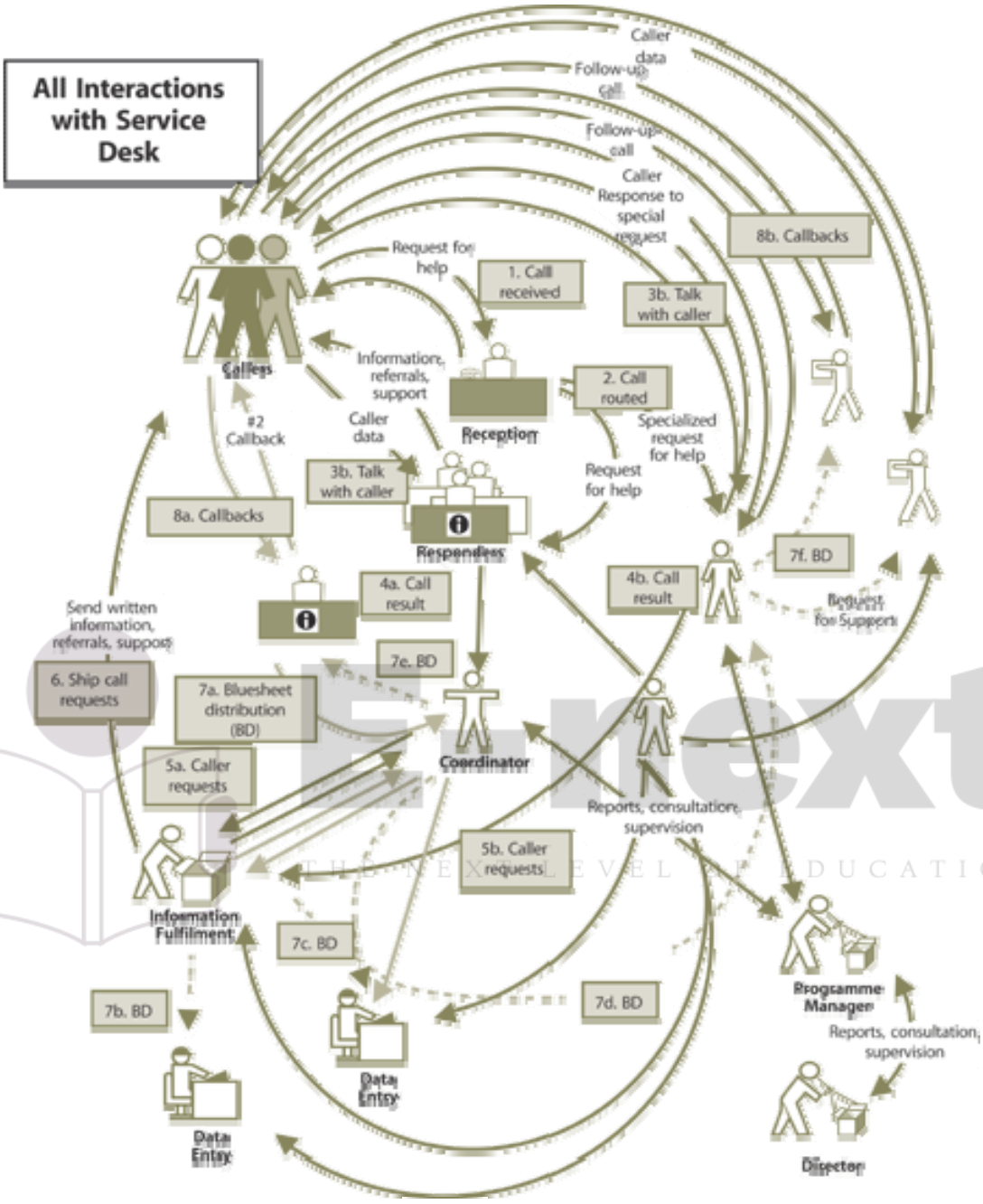

Figure 3.22 Value net exchanges showing how things really worked (adapted from Allee)17

Value net diagrams are tools for service analysis. They show what an organization does, how it is done and for whom. They need not be overly complex to be useful. Simple forms are used throughout the publication to illustrate service management structures and topics

3.5 Service strategy fundamentals

'The essence of strategy is choosing what not to do.'
Michael E. Porter18

Case example 7: *Security services*

Some time in 2001, a global network security services provider lost a major customer due to quality concerns materially affecting revenues and profits. Senior executives demanded that something be done – either cut costs or find a replacement customer.

While a replacement customer was sought, service operations dutifully reduced costs. Service quality was impacted, prompting three recently acquired customers to depart – further negatively affecting revenues and profits.

Senior executives again demanded that something be done – either cut costs of find replacement customers.

As CIO, what is your response or suggestion?

(Answer at the end of the chapter)

3.5.1 Fundamental aspects of strategy

Carl von Clausewitz remarked, 'Everything in strategy is very simple, but that does not mean that everything is very easy'. Strategic thought and action are difficult for the following reasons:

- A level of comfort is necessary in dealing with complexity, uncertainty and conflict beyond the comfort zones of experience and codes of practice.
- It is necessary to discern patterns, to project trends, and to estimate probabilities.
- One must consider all factors including the interactions between them.
- It is important to delve into underlying principles and when all else fails, it is often necessary to fall back on basic theory.

Theory is often discounted because of associations with the abstract or impractical. Theory, however, is the basis of good practice. The law of gravity, for example, is theory. Engineers use theory to solve practical problems. Investment banks use portfolio theory to validate investments. Key methods of Six Sigma are based on the theories of probability and statistics.

Managers rely on mental models that will assure them that they will indeed achieve desired outcomes. Trouble occurs when they use the wrong mental model for the problem at hand. What appears as unfixable or random often looks

that way because of a misunderstanding of a process or system. Without underlying principles, it is not possible to explain why a perfectly good solution fails in one instance after tremendous success in another.

A good business model describes the means of fulfilling an organization's objectives. However, without a strategy that in some way makes a service provider uniquely valuable to the customer, there is little to prevent alternatives from displacing the organization, degrading its mission or entering its market space. A service strategy therefore defines a unique approach for delivering better value. The need for having a service strategy is not limited to service providers who are commercial enterprises. Internal service providers need just as much to have a clear perspective, positioning and plans to ensure they remain relevant to the business strategies of their enterprises.

Customers continually seek to improve their business models and strategies. They want solutions that break through performance barriers – and achieve higher quality of outcomes in business processes with little or no increase in cost, as in Figure 3.23. Such solutions are usually made available through innovative products and services. If such solutions are not available within a customer's existing span of control, service contracts, or value network, they are compelled to look elsewhere.

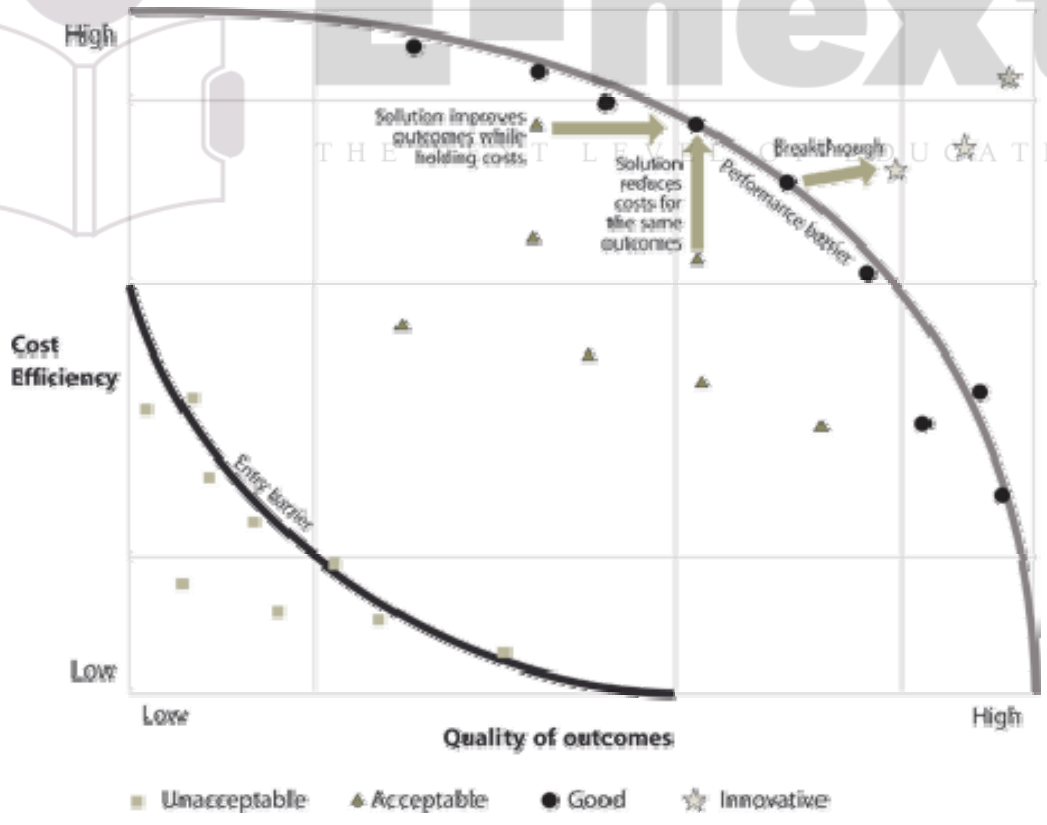

Figure 3.23 Innovative solutions break through performance barriers

Service providers should not take for granted their position and role within their customer's plans even though they have the advantage of being incumbents. The value of services from a customer's perspective may change over time due to conditions, events, and factors outside a provider's control. A strategic view of service management means a carefully considered approach to the relationships with customers and a state of readiness in dealing with the uncertainties in the value that defines that relationship.

Imagine you have been given responsibility for an IT organization. This organization could be internal or external, commercial or not-for-profit. How would you go about deciding on a strategy to serve customers? First, acknowledge that there exist other organizations whose aims are to compete with yours. Even government agencies are subject to competitive forces. While the value they create can sometimes be difficult to define and measure, these forces demand that an organization should perform its mission better than the alternatives.

Second, decide on an objective or end-state that differentiates the value of what you do, or how you do it, so that customers believe there is no true alternative. The form of value may be monetary, as in higher profits or lower expenses, or social, as in saving lives or collecting taxes. The differentiation can come in the form of barriers to entry, such as your organization's know-how of your customer's business or the broadness of your service offerings. Or it may be in the form of raising switching costs, such as lower cost structures generated through specialization or service sourcing. Either way, it is a means of doing better by being different.

The basic premise of service strategy is that service providers must meet objectives defined in terms of their customers' business outcomes while subject to a system of constraints. In a world of constrained resources and capabilities, they must hold their positions against competing alternatives. By understanding the trade-offs involved in its strategic choices, such as services to offer or markets to serve, an organization can better serve customers and outperform its competitors. The goal of a service strategy can be summed up very simply: superior performance versus competing alternatives.

Case example 8: *Internet service provider*

Some time in the mid-1990s, a line manager for a leading internet service provider (ISP) noticed a large amount of increased traffic on the bulletin board folders for two satiric stock analysts.

The ISP had adopted the strategic perspective of, 'Consumer connectivity first – any time, anywhere'.

Rather than caution the subscribers about the abnormal increase in capacity usage, the manager took an alternative path.

What do you think she did?

(Answer at the end of the chapter)

Successful strategies are based on the ability to take advantage of a set of distinct capabilities in offering superior value to customers through services. Such capabilities are viewed as strategic assets because a service provider can depend on them for success in a market space. Success comes from not only delivering value to customers but also being able to generate returns on investments. Strategic assets are carefully developed bundles of tangibles and intangibles, most notably knowledge, experience, systems, and processes. Service management is a strategic asset because it constitutes the core capabilities for service providers. Service management acts as an operating system for service assets in effectively deploying them to provide services.

A service strategy is sometimes thought of as a future course of action. When senior managers are asked to craft a strategy, the frequent response is a strategic plan detailing how the organization moves from its current state to a desired future state. But there are shortcomings with this definition of service strategy.

The first problem is conditions change. The pace of business change is quickening, no matter how large or small your organization or in what industry you compete. Opportunities arise while others disappear. The world does not hold still waiting for plans to unfold. What was good about a plan today may be rendered a liability tomorrow. A service strategy resolves big issues so that staff can get on with the small details – how best to provide services, for example, rather than debating what services to offer. But focusing on a strategic plan impedes the organization's ability to respond to changing conditions. Organizations with a high reliance on consistency and formalized procedures, for example, may lose flexibility, the ability to innovate or the ability to quickly adapt to unforeseen conditions. It turns out that a planning approach, while necessary, is insufficient – a service strategy requires more than a plan or direction.

The second problem is the constant focus on improving operational effectiveness. Operational effectiveness is absolutely necessary, but is not enough. A service strategy explains how a service provider will do better – either in what it does or how it does it – not only compared to itself but against competing alternatives. Customers hold government agencies and non-profit organizations to the same standards as service providers in the private sector. Customers must believe there are no reasonable alternatives. The form of value may be monetary, as in higher profits or lower expenses, or social, as in providing healthcare or preventing crime. If a provider's strategy focuses on

operational effectiveness at the expense of distinctiveness, it will not prosper for long. Sooner or later every organization runs into competitors.

The third problem is 'value capture'. Plans are not well suited to provide the ongoing insight needed to maintain a value capture capability. Value capture is that portion of value creation that a provider gets to keep. While strategy is hard, the underlying logic is simple: there are only two ways one service provider can outperform another – either get customers to pay more for a service or provide the service at a lower cost. To accomplish either requires being different – how else to justify charging more or using fewer resources? So while a service provider may create value through distinctiveness, it may not be able to keep any of it. Moreover, the conditions for capturing value do not last indefinitely. Take the case of a labour arbitrage strategy: service providers decrease labour costs by making use of less expensive off-shore personnel. Early adopters made great gains because, for a while, the services they offered were priced lower than any competing alternative. But as more and more service providers made use of off-shore resources, the cost of services was lowered for everyone. This was great for customers but bad for providers – this distinctiveness dissipated. Value was created for customers but service providers were not able to keep any of it.

Strategic failure is often linked to contradictory issues like these. For an IT executive to be a strategist means not just holding opposing views but having the ability to synthesize them. They include the ability to react *and* predict, adapt *and* plan. In fact, high performing service providers are skilled in blending frames of reference when crafting service strategy.

Service providers must meet objectives defined in terms of their customers' business outcomes while subject to a system of constraints. By understanding the trade-offs involved in its strategic choices, such as services to offer or markets to serve, an organization can better serve customers and outperform its competitors. The goal of a service strategy can be summed up as *superior performance versus competing alternatives*.

A high-performance service strategy, therefore, is one that enables a service provider to consistently outperform competing alternatives over time, across business cycles, industry disruptions and changes in leadership. It comprises both the ability to succeed today and positioning for the future.

What distinguishes high-performing service providers is the manner in which they construct and maintain superior performance. While many providers compete on the basis of a single point of differentiation, the competitive essence is almost always achieved through the balance, alignment and renewal of three building blocks: market focus and position, distinctive capabilities and performance anatomy (Figure 3.24).

Service providers seeking to improve are most apt to encounter problems when they favour one building block to the exclusion of the others. For example, an external provider (Type III) may overemphasize the importance of scale – an over-reliance on advantage through market focus and position at the expense of distinctive capabilities. In other words, why does scale matter to the customer? Or a shared services (Type II) provider may overemphasize the importance of low cost – an over-reliance on advantage through distinctive capabilities at the expense of performance anatomy. That is, an inability to execute despite the cost advantage.

Service providers are also at risk when they fail to refresh and renew the building blocks – for example, by continuing to rely on capabilities that are no longer distinctive, or by resting on the laurels of a once successful strategy long after it has lost its relevance. For example, an internal provider (Type I) may continue to rely on customer know-how while its customer seeks lower cost structures. High-performance service providers continually balance, align and renew the building blocks.

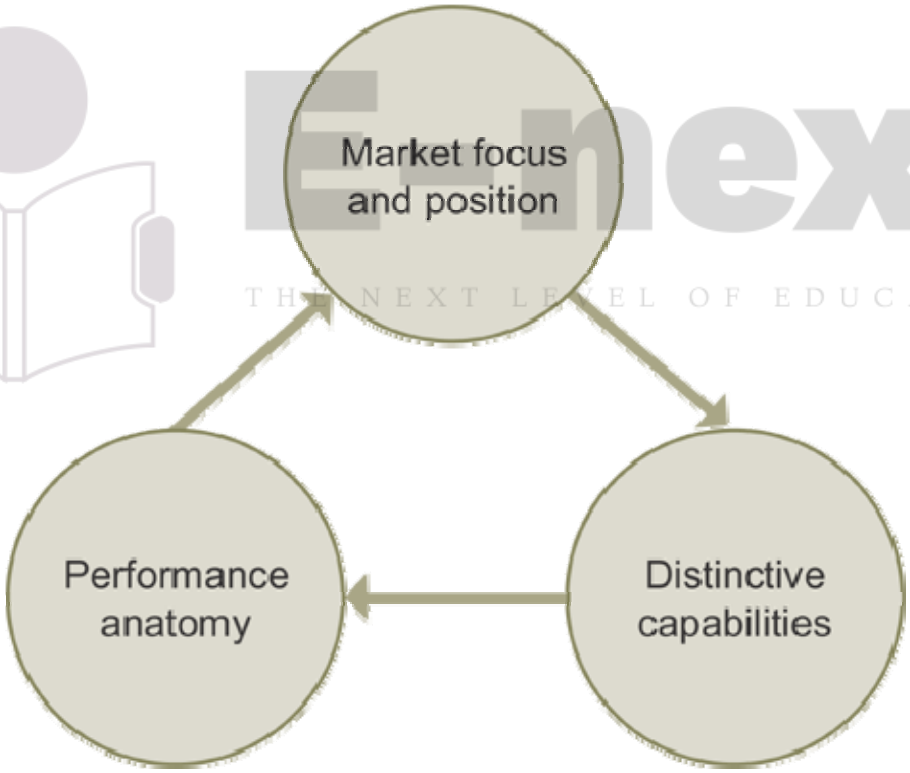

Figure 3.24 Building blocks of a high performance service strategy (based on Accenture research and analysis)

The three building blocks of high performance service providers:

Market focus and position – The spotlight is on optimal scale within a market space. A market space is defined by a set of outcomes that customers desire,

which can be supported through one or more services. This is the ‘where and how to compete’ aspects of a service strategy. High-performance service providers – even Type I and II providers – have remarkable clarity when it comes to setting this strategic direction. They understand the dynamics of their market space, and the customers within, better than their competing alternatives, and manage through appropriate strategies. Such strategies allow the provider to build and manage valuable Service Portfolios, achieve optimal scale, exploit positioning advantages in the value network, and identify and possibly enter alternative market spaces or serve new customers.

Distinctive capabilities – The spotlight is on creating and exploiting a set of distinctive, hard-to-replicate capabilities that deliver a promised customer experience. This is about understanding the critical interplay between resources, capabilities, value creation and value capture. To create value, a service provider develops a formula for doing business that successfully translates a big idea regarding customer needs into a distinctive and cost-effective set of connected capabilities and resources to satisfy those needs.19 This ability is sometimes referred to as ‘differentiation on the outside and simplification on the inside’.

To be a high-performance service provider, be clear about what capabilities really contribute to enhancing customer outcomes. Understand the need to build distinctive capabilities that are demonstrably better and, in the short term, difficult to replicate by competing alternatives. This includes mastering technical capabilities and excelling at innovation, as well as lower cost structures and customer know-how. Take for example, the Type I service provider who, after years of outsourcing, decided to in-source its application-hosting services. By incorporating virtualization and dynamic provisioning technologies, the provider created speed and cost structures no outsourcer could match – precisely the same distinctive capabilities that prompted the provider to outsource in the first place.

Performance anatomy – The spotlight is on creating cultural and organizational characteristics that move service providers toward their goal of out-executing competing alternatives. Performance anatomy comprises a set of organizational world views that are measurable and actionable by organizational leadership. Example views include:

- Services are a strategic asset
- Workforce productivity is a key execution differentiator
- Performance measurement is highly selective in its focus and metrics
- Continual improvement and renewal are real and permanent necessities.

3.5.1.1 Government and non-profit organizations

Government and non-profit organizations appear to operate in environments unaffected by the pressures of competition and markets. The ethics of social-

sector services are about helping people, not beating them. But strategic competition is not at odds with a social-sector's sense of mission. Government and non-profit organizations must also operate under limited and constrained resources and capabilities. Stakeholders and customers demand as much social return as possible for money invested. Eventually, these constituents will consider competing alternatives.

A government or non-profit organization's strategy, much like that of its commercial counterparts, explains how its unique service approach will deliver better results for society. When the need for social-sector services are so demanding, superior performance versus competing alternatives is a compelling imperative. No commercial enterprise can succeed by attempting to be all things to all people. Similarly, governments and non-profit organizations should make choices in what they will and, just as important, will not do.

3.5.2 The Four Ps of strategy

The lifecycle has, at its core, service strategy. The entry points to service strategy are referred to as 'the Four Ps' following Mintzberg20 (Figure 3.25). They identify the different forms a service strategy may take.

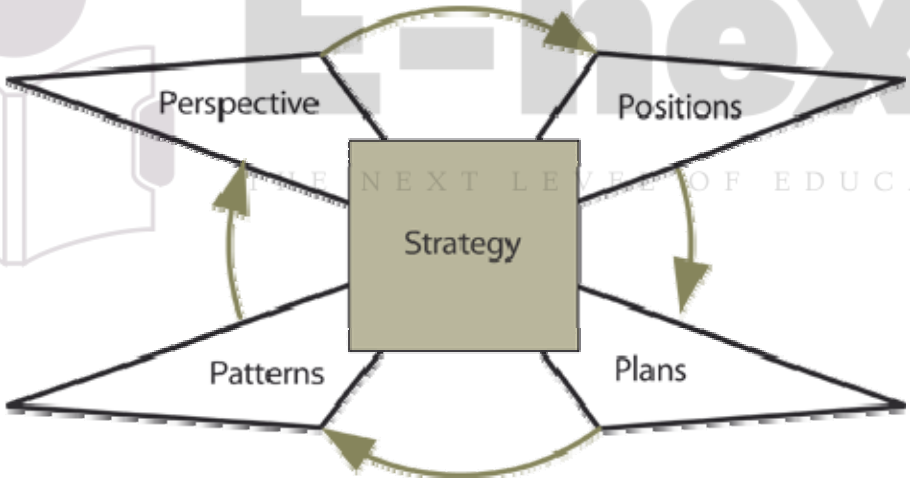

Figure 3.25 Perspectives, positions, plans and patterns21

- Perspective – describes a vision and direction. A strategic perspective articulates the business philosophy of interacting with the customer or the manner in which services are provided. For example, a shared service provider (Type II) for a global law firm may adopt the strategic perspective of, 'We will be a best-in-class service provider for our law firm'. The CIO determined that his business most values a certain type of service provider. By setting a perspective of competing against other industry-specific providers he not only narrows the field of competing alternatives, but also cements his own distinctiveness in the minds of his customers (Figure 3.26).

- Position – describes the decision to adopt a well-defined stance. Should the provider compete on the basis of value or low cost? Specialized or broad sets of services? Should value be biased towards utility or warranty? An internal service provider (Type I) restricted to serving one business unit may adopt a position based on 'product know-how' or 'customer responsiveness'. The law firm CIO may adopt a needs-based position: attorney-centric offerings for knowledge, collaboration and document management services.
- Plan – describes the means of transitioning from 'as is' to 'to be'. A plan might detail, 'How do we offer high-value or low-cost services?' Or in the case of our law firm CIO, 'How do we achieve and offer our specialized services?'
- Pattern – describes a series of consistent decisions and actions over time. A service provider who continually offers specific services with deep expertise is adopting a 'high-value' or 'high-end' service strategy. A service provider who continually offers dependable and reliable services is adopting a 'high-warranty' strategy. If mid-course corrections are to be made within the framework of an existing perspective and position, this is where those decisions and actions are formulated. The law firm CIO, for example, may decide to offer the same specialized services but with enhanced levels of client privacy (warranty).

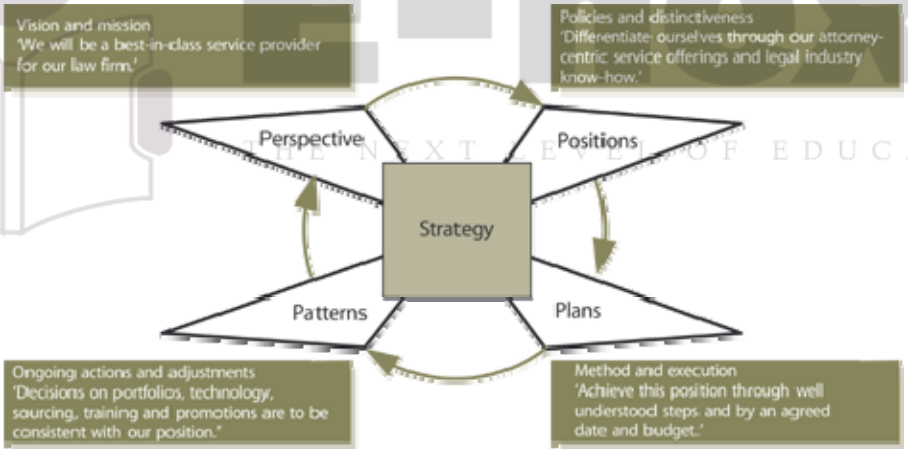

Figure 3.26 Strategic approach taken by a Type II provider for an international law firm

Requirements and conditions are dynamic. A service provider may begin with any one form and evolve to another. For example, a service provider might begin with a perspective: a vision and direction for the organization. The service provider might then decide to adopt a position articulated through policies, capabilities and resources. This position may be achieved through the execution of a carefully crafted plan. Once achieved, the service provider may maintain its position through a series of well-understood decisions and action over time: a pattern.

The use of all the Four Ps, rather than one over the other, allows for emergent as well as intended service strategies. Best-practice service strategies mix these in some way: maintain control while fostering learning; see the big picture while deciding on details.

3.5.3 Strategy as a perspective

Strategy as a perspective defines the governing set of beliefs, values, and a sense of purpose shared by the entire organization. It sets the overall direction in which the service provider moves to fulfil its purpose and construct its performance anatomy. Some pithy real-world examples:

- 'Focus on the user and all else will follow.'
- 'It's all about growth, innovation and the dependency of technology, led by the greatest people anywhere.'
- 'Consumer connectivity first – any time, anywhere.'
- '[Our] purpose is to improve the quality of life of the communities we serve.'
- 'We will be a best-in-class service provider in [our] industry.'

Despite its high-level abstraction, do not make the mistake of casually ignoring or trivializing perspective. Unlike plans or patterns, perspectives are not easily changed. Take the perspective of Swiss watchmakers, for example, when confronted with the emergence of quartz technology – a Swiss invention. Dismissing the technology as a novelty incompatible with the perspective of skill-intensive craftsmanship, the Swiss watch industry was nearly decimated by the Japanese. That is, until it adopted the technology for major market niches and reclaimed market share through a perspective centred on fashion rather than workmanship.

Or take the real-world service providers who held a perspective of:

- '... highly efficient back-office operations' during the emergence of service outsourcing
- '... low cost service provider' during the emergence of off-shore skilled labour
- '... technology-specific expertise' with the emergence of open systems and software.

Perspective is attained with the help of clarifying questions asked within the context of the service provider's stakeholders, which includes primarily its owners, its customers, and its employees. Conversely, well-defined perspective serves as a reference for subsequent positions, plans, or patterns of action the service provider may adopt and enact. Public assertions made by a service provider are usually based on strategy as a perspective and reflected in its value proposition to customers. The value proposition may be implicit in the customers

it serves, the services it offers, and the particular perspective of service quality it adopts. A clear perspective helps make this value proposition explicit. This strategy is defined at the highest level of abstraction and maintains the organization's farthest planning horizon. It drives other control views of strategy (the other 'Ps') and is modified based on feedback from those views.

Once a perspective has been attained, here is a test:

- Does it capture what you intend to do for only the next three to five years, or does it capture a more timeless essence of your organization's distinctiveness?
- Is it clear and memorable?
- Does it have the ability to promote and guide action?
- Does it set boundaries within which people are free to experiment?

The distillation of an organization's strategy into a memorable and prescriptive phrase is important. A sound strategy is of little use unless people understand it well enough to apply it during unforeseen or ambiguous opportunities.

3.5.4 Strategy as a position

Strategy as a position is expressed as distinctiveness in the minds of customers. This often means competing in the same space as others but with a differentiated value proposition that is attractive to the customer. Whether it is about offering a wide range of services to a particular type of customer, or being the lowest-cost option, it is a strategic position. Three broad types of positions are variety-based positions, needs-based positions, and access-based positions.

3.5.4.1 Variety-based positioning

Variety-based positioning focuses on a particular variety of customers' needs and aims to meet them in distinctive fashion. It requires a relatively narrow catalogue of services but with depth in terms of service levels, options, and packages. Service assets are highly specialized to deliver this narrow catalogue. Service providers try to meet all the needs of any given customer segment. Success is in terms of performing exceptionally well in meeting a sub-set of needs (Figure 3.27). Capabilities are strong on leveraging economies of scale, managing similar demand from different customers, and fulfilling it with a small and stable catalogue of services. Growth is based predominantly on new opportunities for the same catalogue of services. For example, a service provider may specialize in payroll services for several groups within a business unit, several business units within an enterprise, or several enterprises within a region.

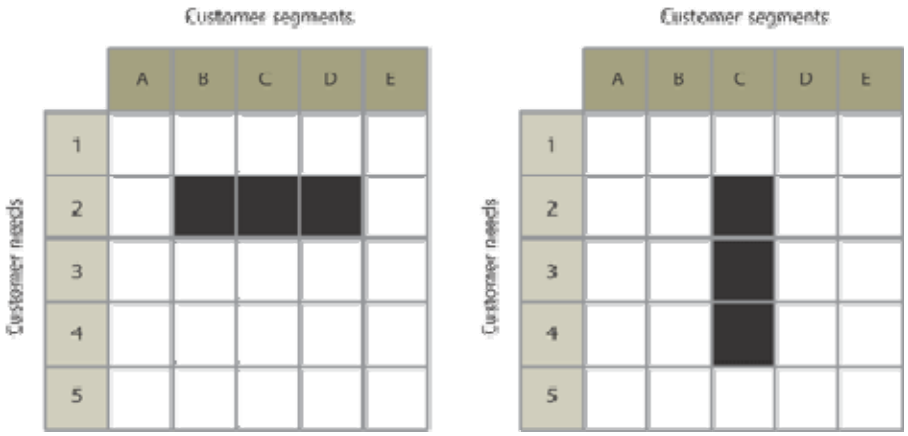

Figure 3.27 Variety-based (left) and needs-based (right) positioning

3.5.4.2 Needs-based positioning

In needs-based positioning, service providers choose to provide most or all of the needs of a particular type of customer (Figure 3.27). It requires a relatively wide catalogue of services covering various aspects of the customer's business. This is closer to the traditional approach of grouping customers in segments and then aiming to best serve the needs of one or more targeted segments. Service providers do not worry about meeting the needs of every type of customer. They distinguish themselves by performing exceptionally well in meeting most of the needs of a particular customer or segment. Capabilities are strong on leveraging economies of scope, managing different demands from the same customers, and fulfilling them with a flexible catalogue of services. Growth is based predominantly on new services in the catalogue from the same source of demand.

For example, a service provider may specialize in supporting most or all of the business needs of a group of hospitals. It may offer a catalogue of services that covers infrastructure services, application maintenance, information security, document management and disaster recovery services specialized for the healthcare industry. It maintains expertise on electronic medical records, privacy issues, medical equipment, and claims processing. Similarly, a provider focusing on the financial services industry has deep insight into the peculiar challenges and opportunities faced by investment banks, insurers, and brokerage firms.

Type I and Type II providers are often positioned to serve a customer segment of one. They have only one customer at the enterprise level even if there are several at the business unit level. Many internal IT organizations are expected to meet all the IT needs of the business that own them. They do not worry about meeting the needs of other enterprises and can therefore organize their service assets to best serve one enterprise customer.

3.5.4.3 Access-based positioning

In access-based positioning, service providers distinguish themselves through their ability to serve customers with particular needs with respect to location, scale, or structures (Figure 3.28). Customers vary in size, location, and structure. They deploy business assets in a manner that best serves their own business models and strategies. Some operate networks of retail branches, stores, trading desks, or point-of-sale terminals that serve as access points for users of their own services. Others have business assets concentrated at a few large-scale facilities such as factories, warehouses, distribution centres, and call centres. The employees of some customers are highly mobile with extensive travel and intensive communications needs. Others may have staff mostly in offices and laboratories.

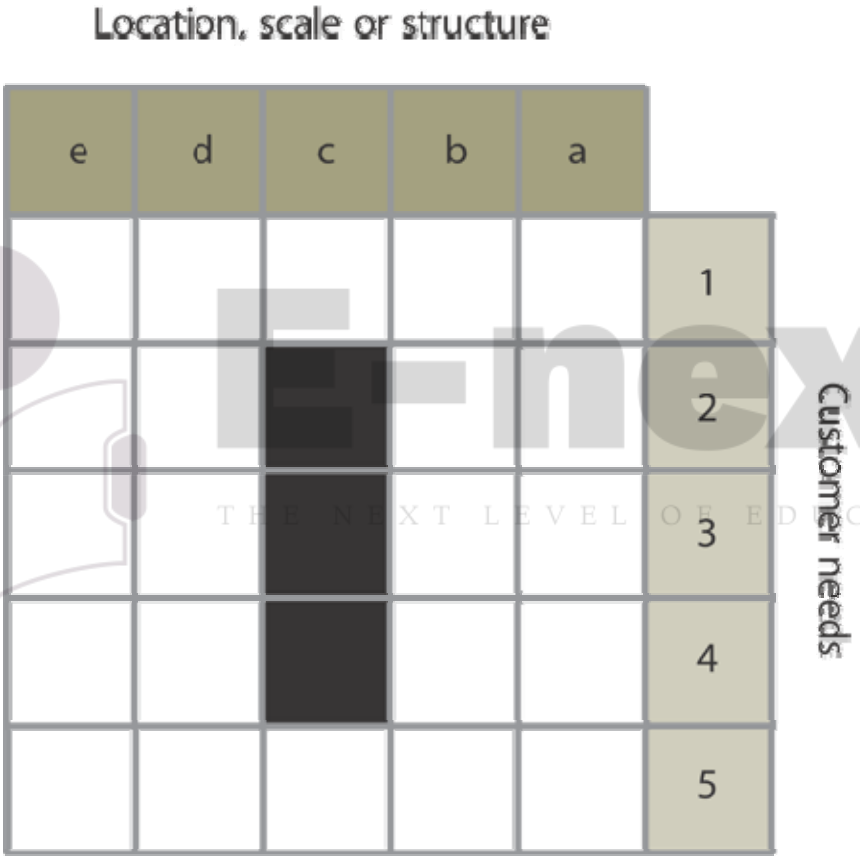

Figure 3.28 Positioning based on location, scale or structure

Positioning of any type requires service assets to be specialized and deployed in patterns that best satisfy the patterns of demand generated by business activities, cycles, and events of the target market spaces. This is mostly an opportunity to consolidate, stabilize, learn, and grow into a high-performing service provider with focus. Specialization of service assets allows service providers to deliver greater levels of utility to targeted segments. It also means risks from the high level of asset specificity when there are sudden or drastic changes in the market space from which some providers never recover.

Asset specificity

The more specialized an asset gets, the lower its usefulness for other purposes. A point-of-sale terminal has higher asset-specificity than a PC workstation or storage device that can be re-purposed. Asset specificity applies to organization and people assets as well. Type I providers who have never served more than one customer find it hard to adjust to corporate mergers and acquisitions.

When a tax collection agency decides to accept electronic filing of tax returns and electronic funds transfer (EFT), there is a significant change in its patterns of business activity. Consequently, some service providers, including the agency's own internal units, have better access-based strategies than others to serve the agency. An insurance company offers to initiate the claims process at the site of an accident. It does so by dispatching claims handling staff to the accident site with all the resources necessary for the claims process. This strategy not only provides distinctive value to its policyholders but also speeds processes and reduces administrative costs from lengthy cases. It puts an office-based clerical job out on the front-line in vehicles specially equipped with the necessary business applications. The insurance company itself adopts an access-based strategy to distinguish itself from competing insurers.

Other service providers in turn may compete to win the business of this progressive insurer by offering mobile workplace services that automate and integrate the claims processing vehicles with back-office systems. Service providers with knowledge and experience in mobile systems and applications, similar to those used by emergency medical services, would have a distinctive advantage.

Service providers may adopt one or more of these generic types of positioning (Figure 3.29). There are no universal rules for these positioning strategies, simply plans and patterns that work, or definitions to comply with. Concrete plans are required, however, to maintain strategic positions from which the mission and objectives are achieved. A sound position guides the organization in what to do and, just as important, in what not to do.

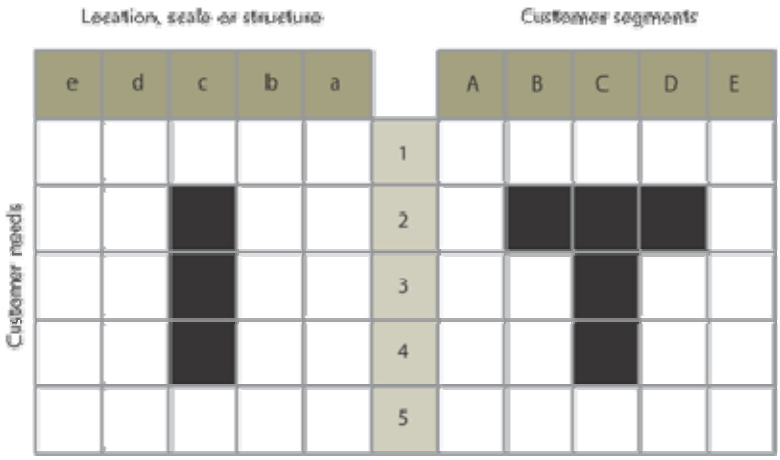

Figure 3.29 Combining variety-based, needs-based and access-based positioning

Once a position has been attained, here is a test:

- Does it guide the organization in making decisions between competing resource and capability investments?
- Does it help managers test the appropriateness of a particular course of action?
- Does it set clear boundaries within which staff should and should not operate?
- Does it allow freedom to experiment within these constraints?

3.5.5 Strategy as a plan

Strategy as a plan is a course of action from one point to another within a competitive scenario. Often referred to as an intended strategy, it is the deliberate course of action charting a path towards strategic objectives. The planning horizons are typically long term but lengths may vary across organizations, industries and strategic context. Again, plans are the direct means of achieving goals and objectives. They commonly focus on financial budgets, portfolio of services, new service development, investments in service assets, and improvement plans (Figure 3.30).

Each plan focuses on achieving well-defined outcomes or conditions in a particular context. The key inputs to a plan are frequently derived from the results of the strategic assessment, and are framed by the strategic position and perspective.

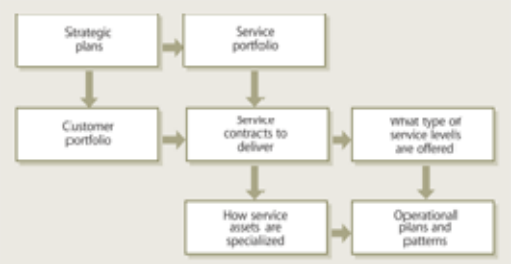

Figure 3.30 Operational plans and patterns are driven by strategic positioning

Plans are linked by the need to achieve certain strategic objectives. For example, building infrastructure capacity, consolidating staff at key locations, licensing a new set of software applications, and complying with an industry standard may all be parts of the same strategic plan to reach a distinctive position.

Service management can be viewed as a coordinated set of plans with which service providers plan and execute their service strategies. The difference between success and failure in strategic leadership and direction is largely dependent on how well this coordinated set is put together, put to work, and controlled in execution. Two service providers with equal sets of resources may achieve different degrees of success simply because of their strategic plans.

3.5.6 Strategy as a pattern

Strategy as a pattern is an organization's fundamental way of doing things. They are the basis of what are called emergent strategies, distinctive patterns in action reinforced over time by repeated success. For example, rather than pursuing a plan to cut service costs through service sourcing, the provider makes sourcing decisions one at a time – testing the validity of the idea. First it may source telecommunication services, then application hosting, then security services, and so on, until a strategic pattern has emerged.

The patterns are embedded in a service provider's way of doing business. Management systems, organization, policies, processes, schedules, and budgets are all discernible patterns of action that are documented and controlled. They are the consequence of perspectives, positions, and plans directed by senior leadership in service of a particular customer or market space. Others exist in the form of tacit knowledge carried by those who carry them out. They may be neither documented nor discernible because they are unexpected outcomes realized in pursuit of certain goals or objectives. Nevertheless, they deliver value to customers so managers must capture and codify them into the organization's documented practices.

Consistent and controllable patterns are part of the service provider's distinctive capabilities. These patterns are valuable because they emerge inside the organization as a direct consequence of actions taken by managers and their

teams. Therefore they are likely to be a signature of the organization and a source of competitive advantage. While industry practices and standards are available to all, signature processes can truly distinguish the value provided by a service provider.22 Best practices are patterns in action for superior outcomes over the normal expected performance using prevalent practice in comparable circumstances. Organizations can set their own improvement threshold for designating a pattern as a best practice. Other criteria may include elements of innovation, efficiency gains, external recognition, and the transferability of the related knowledge.

Patterns are useful in identifying areas of opportunity. Useful patterns in performance can be codified into practice and made available as reusable assets to other parts of the organization. When patterns in action become systems and processes, they are placed under Configuration Management so they may be stabilized, standardized, and improved. They are the past guidance from which to reaffirm or correct the current strategy. As business cycles continue, new patterns in action may emerge and provide feedback.

When managers put in renewal or improvement activities, they advance their organization to an advanced level of maturity. Strategy as patterns in action can therefore be a very powerful perspective of strategy because it engages all levels of management and rests on systematic learning. Service management can be viewed as an adaptive network of patterns through which strategic objectives are realized. Some patterns in action are shown in Table 3.1.

Example patterns of action	Description
How-to patterns	Set the operating style of the organization. The framing of how activities are performed, for example: • R&D staff must rotate through operations • All customer questions must be answered on the first email or calls • Operations staff must be minimally certified
Boundary patterns	Set the focal point of the organization. The body of opportunities that should, or should not, be pursued, for example: • Hardware acquisitions must be done through strategic vendors • New technologies must conform to a certain standard • New projects must follow a standard methodology
Priority patterns	Set the allocation of resources. The ranking of new opportunities, for example: • Service stability outweighs speed of deployment

	• Speed of deployment outweighs service stability
Timing patterns	Set the rhythm of the organization. Staff are synchronized with customer and business cycles, for example: • End-of-quarter and end-of-year required enhanced service levels • When legislature is in session, no changes are allowed

Table 3.1 Service management patterns

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Case example 7 (solution): *Surprisingly, the solution was to suspend new sales*

The CIO understood:

1. Service operations were caught in a vicious cycle with disastrous long-term consequences.
2. Customers were leaving due to a strategic weakness. Customers differentiated the value of security services through service quality. Perspectives and positions based on cost and technology were incorrect.
3. By refocusing staff and budget on service operations, the organization repaired and rebuilt its distinctive quality capabilities for remaining customers. Customer churn was halted.

The solution, while painful in the short term, allowed the provider to break the vicious cycle and pave a long-term strategy for regaining customers. The counter-intuitive breakthrough was based on (a) a big picture view of services and (b) the precept of *superior performance versus competing alternatives.*

Case example 8 (solution): *She used service management as a strategic* asset

Rather than caution the subscribers about the marked increase in capacity usage, the manager offered the irreverent analysts the chance to create their own site. The site, now called the Motley Fool, continues to be a heavily trafficked destination for financial advice. The line manager eventually became president of programming.

The manager understood the service provider's strategic intent: deeper consumer connectivity or broader distribution