PART
1

Formulating Strategy

The first decisions of a service firm take place long before staff is hired, facilities built, or even a corporate logo designed. This section provides several frameworks for considering a service organization's basic strategic decisions:

- Who will be our customers?
- What can we offer potential customers that competitors do not?
- On which customer desires will we compete?
- How will the business grow?

The answers to these basic questions both limit and guide the decisions concerning facilities, people, and procedures that an operating system will eventually possess. Basic strategy becomes the blueprint for making the managerial trade-offs discussed later in this text.

Several conceptual models are presented in Chapter 2 to aid the strategy formulation process. Conceptual models of firm growth are also discussed, including the service life cycle, industry roll-ups, and franchising.

Due to the perceived necessity of competing for business on the Internet, Chapter 3 is devoted to business-to-consumer Internet strategies for service firms.

Increasing environmental regulation, environmental case law, the rise of environmental standards bodies such as ISO 14000, combined with a large population segment that is concerned with corporate response to environmental issues force firms to consider environmental planning in their basic strategic outlook. Specialized strategies concerning environmental issues are contained in Chapter 4.

CHAPTER

2

Strategic Positioning and Service Strategy

LEARNING OBJECTIVES *The material in this chapter prepares students to:*

- Link the desires of targeted customers to operational tactics.
- Evaluate the strategic position of a service company.
- Identify the different operational requirements over the life cycle of a service.
- Choose an appropriate growth strategy.
- Make appropriate operational tradeoffs when pursuing a strategy.

Chapter 1 ended with a figure (Figure 1.4) that showed the wide array of challenges and tactical decision areas that have to be addressed to successfully manage a service organization. This figure begs two critical questions:

1. How does a service business decide which quadrant of the matrix to position itself in?
2. How does a service business decide how to balance the tradeoffs between the various "challenges for managers?"

These two questions in general form the basis for this section on "Formulating Strategy," and in detail form the basis for this chapter. For now, the short answer to the questions is, "A company has to consider both external issues (e.g., customer expectations, competitors, the government) and internal issues (e.g., capacity, location, inventory, quality) in order to intelligently decide how to position itself and how to set service strategies to balance the tradeoffs." But which is more important, external forces or internal competencies? And which comes first, "strategic positioning" or "service strategy?" Possibly more importantly, how does an executive make sure that strategic positioning, service strategy, and tactical execution are all consistent and working in the same direction? This chapter will explore these and other questions related to strategic positioning and service strategy.

As a starting point, Table 2.1 presents one way to think about how these pieces fit together. Understanding internal capabilities allows a company to identify its own "strengths and weaknesses," while examining external entities is an excellent way to identify potential "opportunities and threats." Taken together, a company can

TABLE 2.1: *Strategic Positioning and Service Strategy*

	External	Internal
Strategy	Strategic Positioning	Service Strategy
Execution	Frontroom Operations	Backroom Operations

evaluate how what it does relates to what competitors do and what the market values; i.e., SWOT (SWOT = Strengths, Weaknesses, Opportunities, and Threats) analysis. But, as we'll see in this chapter, companies will end up in very different strategic places depending on whether they start with SW or with OT.

A Strategic Hierarchy and Strategic Consistency

Strategic positioning, service strategy, and tactical execution form a hierarchy of strategic planning. That is, strategic positioning sets out a corporate-level set of objectives, goals, missions, etc.; service strategy takes these corporate-level strategies and refines them into a set of specific operational objectives, goals and missions; and tactical execution does just that, executes the service strategy. Specifically, strategic positioning determines how a company will compete, what markets it will serve, and how it will distinguish its service from its competitors. Service strategy translates these strategic positioning decisions into a clear operational plan. This operational plan would address at a high level issues like capacity, facility size and location, growth strategies, employee skill level, and how inventory would be used (if it could be used at all). Finally, tactical execution would take care of specific decisions like supplier selection and management, hiring, firing, training of staff, franchisee selection, determining amounts and location of inventory, and determining how many facilities there will be, where they will be, and how big each one will be. Figure 2.1 shows this hierarchy.

FIGURE 2.1: *The Strategic Planning Process for Services*

Strategic Positioning

- Sets "target market"
- Five-forces or core competence
- Decisions: Mission, high-level goals, high-level objectives

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Service Strategy

- Sets "service concept," "operating system," and "service delivery system"
- Competitive priorities, order winners, and qualifiers
- Decisions: Location, facility size, type and number, capacity, inventory, etc.

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Tactical Execution

- Represents managing day-to-day service operations
- Decisions: Supplier selection, order size and timing, staffing levels, etc.

Heskett, Sasser, and Schlesinger (1997) describe this hierarchy as "target market," "service concept," "operating strategy," and "service delivery system." Target market describes whom the firm will serve. For services this poses a real challenge because not all customers are equal. A customer that is not part of the target market distracts resources away from the group of customers the service is intended for. The service concept, stated from the customer's point of view, describes the reason that the customer would choose one service over a competitor's. The operating strategy, stated from the point of view of the company, describes how the company should be structured in order to meet the service concept. Finally, the service delivery system is the specific set of operational decisions that have to be made in order to provide the service.

Though it sounds obvious that all of the decisions made in this hierarchy should be consistent and support one another, in practice it is more difficult to accomplish. One company (for confidentiality reasons we must change the context of the process to "new loan type" to disguise it) decided to add a new loan product to serve the high-end mortgage market for extremely well-qualified buyers. Because this segment is quite small, the company chose to use relatively skilled workers in relatively small numbers. They put in place processes, procedures, and technology, then told the sales force that they would be compensated based on the total number of loan requests they generated. What happened? The strategic position was to target a small, specialized market. The service strategy entailed meeting the high customer contact needs of the market by using high-skilled labor and low capacity. The execution (i.e., what happened because of the sales compensation system) was to flood the process with potential borrowers that had no business being considered. This caused the process to choke on filtering out inappropriate loan risks, which in turn caused the process to be unable to meet the needs of the real target market. Failure to ensure strategic consistency caused the entire product line to appear to be unprofitable.

The best way to avoid these sorts of problems is to have a clear understanding of each of the three components of the strategic hierarchy, and a clear understanding of how they relate to each other. Service Operations Management In Practice: Two Different Strategies, Two Different Operating Systems compares how Delta Air Lines and Southwest Airlines approached strategic consistency and ended up in radically different places.

Strategic Positioning

There are two dominant ways of thinking about strategic positioning, and they are nearly exact opposites. The first view of strategic positioning derives from Michael Porter's work (1979) on corporate strategy, "generic strategies," and industry analysis. This point of view starts with external conditions (OT in the SWOT vernacular) in order to set internal operations (SW). The second view, derived from C.K. Prahalad and Gary Hamel's work (1990) on core competencies of the corporation, begins with internal competencies (SW) and builds out to address external conditions (OT). Regardless of the approach taken, the objective of strategic positioning is to define the "target market" the company will serve, as well as to define the organization's strategy, including its mission and objectives.

Industry and Competitor Analysis Approach to Strategy

Porter's influential work in the area of strategy focuses on two related issues: what generic strategies are available for a company to choose from, and how external

SERVICE OPERATIONS MANAGEMENT PRACTICES

Two Different Strategies, Two Different Operating Systems

The impact of strategy on a company's operating system and financial performance simply can't be overstated. The following table compares Delta Air Lines to Southwest Airlines. Their strategic positions are very different, as are their operating systems (number of employees, number and types of planes, flight length, etc.). The impact of these differences is clearly seen when you consider that Delta lost almost twice as much money as Southwest earned in 2003.

Criterion	Delta Air Lines	Southwest Airlines
Strategy	Full-service airline serving as many routes as feasible	Limited service carrier serving smaller domestic markets
Generic strategy	Differentiation based on route structure and frequency of departures	Focus on short hop domestic travelers, cost leader
Core competence	"Fortress hub" in Atlanta with spoke route structure	Plane turn time at gate
Types of planes	737, 757, 767, 777, MD-11, MD-88, MD-90, ATR-72, CRJ-100/200, CRJ-700	737s only
Number of planes	838	388
Cities served	491	58
Flights per day	3,910 (including ASA and Comair)	2,800
Flights per plane per day	4.7	7.2
Average flight length (miles)	852 (excluding ASA and Comair)	558
2003 fuel use (gal)	2.4 billion	1.1 billion
Employees	60,000+	34,000
2003 revenue	$13.3 billion	$5.9 billion
2003 net income (loss)	($773 million)	$422 million
How they spell "airline"	"air line," with a space	"airline," with no space

forces like suppliers, customers, and competitors influence the choice of generic strategies. In this view, the three generic strategies a company might pick are *overall cost leadership*, *differentiation*, and *focus*. *Overall cost leadership* is self-explanatory, but *differentiation* and *focus* require a bit more explanation. *Differentiation* entails trying to serve the needs of a broad group of constituencies in the industry while having everyone in the industry perceive the specific bundle of product and service a company offers as unique, different from everyone else's. This can be accomplished through various mechanisms like having a unique brand image, distribution network, or service delivery system. What makes *differentiation* different from *focus* is that *focus* is not aimed at the needs of everyone in the industry, only the specific needs of a small, focused subset of the industry (hence the name). *Focus* as a generic strategy describes who the customers are, but the company can still choose to compete on *cost leadership* or *differentiation* within this market segment. Within an industry like hotels, Motel 6 and other discount properties compete on *cost leadership*. Frequent traveler programs, like Marriott's Rewards program create *differentiation*, and upscale hotels like The Ritz-Carlton Hotel Company focus on a particular market niche.

What makes Porter's point of view so powerful, though, is the technique for industry and competitor analysis he developed. Porter identifies "five forces" that have to be considered before a company can decide on its strategy. These forces are potential entrants, suppliers, buyers, substitute products, and current competitors. By looking outside the company to these external forces, a company can determine how to position itself in the industry. Table 2.2 shows how this industry and competitor analysis framework would ensure strategic consistency, starting with the five forces analysis and ending with internal operations management. In other words, all operational decisions are completely subordinate to the external strategic analysis conducted as part of the five forces analysis.

Core Competence Approach to Strategy

Prahalad and Hamel attack the question of strategy in nearly a completely opposite way from Porter. This "resource based view of the firm" looks at what resources and competencies the company possesses, then looks outward to find markets and opportunities to exploit. A core competency must meet three tests. It must:

1. Provide access to a wide array of potential markets,
2. Contribute to the customers' perceptions of the benefits of the end product or service, and
3. Be difficult for other competitors to imitate.

One of the classic examples of a core competency is Honda Motors and its competency with engines. Honda leverages its expertise to serve markets from cars to lawnmowers. However, it is a little harder to apply these three tests to services. For example, Southwest Airlines is known to have a competency in how it manages the

TABLE 2.2: *Industry/Competitor Analysis Approach to Strategic Consistency*

	External		Internal	
Strategy	Step 1	Five Forces analysis	Step 2	Design the operating system
Execution	Step 3a	Manage interaction with external entities like customers and suppliers	Step 3b	Manage internal operations to meet objectives of operating system design

time an airplane is on the ground between flight segments. It clearly contributes to the customers' perception of value because it directly contributes to Southwest being able to price their tickets so cheaply (because the planes spend so little time on the ground, Southwest gets more flights per day out of each plane, which means fewer planes to serve the same number of passengers). This competency has proven to be quite difficult to imitate, but it is not so clear that it provides access to a wide array of potential markets. It does mean that Southwest could fly more routes if it were to choose to, but that is not the same as Honda making great minivans, racecars, lawnmowers, and tillers.

When doing strategic analysis and planning using the resource based view, the requirement of strategic consistency still stands. But the way that it is achieved is quite different from the way it is achieved under Porter's approach. Table 2.3 shows how the core competence approach ensures strategic consistency by starting with internal strengths and weaknesses, then determining external threats and opportunities.

Service Strategy

Once the strategic position is determined, by whichever means, the next step is to determine the service strategy. Generally, service strategy involves setting the service concept, the operating strategy, and the service delivery system the company will pursue (what Heskett, et al. call the "strategic service vision"). The service strategy is critical because it links the company's strategic position with tactical execution. A significant portion of determining the service strategy is determining which "competitive priorities" the company will emphasize as order winners or as order qualifiers.

Competitive Priorities, Order Winners, and Order Qualifiers

One way to think about what matters to a target market and what a company will do to meet those market desires is to ask, "What characteristics must my service have just to be able to compete, and if I manage that, what characteristics should I emphasize to convince the customer to buy my service instead of my competitors'?" The set of operationally oriented dimensions that companies can compete on are called *competitive priorities*. It is generally acknowledged that there are five (some with subcategories): cost, quality (conformance or high-performance design), time (delivery speed, development speed, on-time delivery), service, and flexibility (volume flexibility, customization). We would argue that a sixth *competitive priority* is the natural environment (we will make this case in detail in Chapter 4). As examples, UPS and FedEx emphasize delivery speed and delivery reliability as important competitive priorities, while Southwest Airlines emphasizes cost.

TABLE 2.3: *Core Competence Approach to Strategic Consistency*

	External		Internal	
Strategy	Step 3	Determine markets to be served by the core competence	Step 2	Determine core competence of the corporation
Execution	Step 4a	Manage interaction with external entities like suppliers	Step 1	Scan operating system for potential competencies
			4b	Manage internal operations to meet objectives of operating system design

Companies have to decide which competitive priorities to emphasize. The first step is to be sure to emphasize the competitive priorities that are order qualifiers. Order qualifiers are those competitive priorities that everyone in the industry must have just to be able to compete. In the fast food business, speed is a qualifier since every fast food joint gets the customer's food to them in a matter of a minute or two. For package delivery, quality is a qualifier since no one wants his or her package to be crushed. In general, being better at order qualifiers does not help a business. Using package delivery as an example, delivering a "more not crushed package" won't get a company more business.

Order winners, on the other hand, are those competitive priorities that an individual company emphasizes to cause a customer to choose it over its competitors. By letting customers configure their computers to match their own needs, Dell emphasizes customization as an order winner; people choose Dell because they can customize. People choose Southwest Airlines because it is cheap; the company emphasizes cost as an order winner.

Service Concept and Operating Strategy

The service concept can be broadly described as the set of competitive priorities that the target market values. The service concept focuses on the results that must be produced for the customer, ranging from fast and reliable delivery for UPS, to inexpensive and no-frills (i.e., not high-performance design) flights for Southwest, and on the elements of the service that will be offered. The service concept also describes how the target market, the employees of the service company, and the market as a whole would perceive the service elements.

The operating strategy, by comparison, describes the competitive priorities that the internal operations will emphasize (both order winners and qualifiers). The operating strategy details how the different business functions (e.g., marketing, strategy, finance, operations, etc.) will support the service concept. The operating strategy also defines the measures and systems that will be used to control the cost and quality of the service, and how the service is intended to stack up against competitors on these dimensions.

Coming back to the earlier point about strategic consistency, emphasizing a competitive priority in the operating strategy that is not valued by the customers as part of the service concept leads to what Hill (2000) describes as "mismatch." Car rental companies provide a good example of a mismatch between the service concept (i.e., customer desires) and the operating strategy (i.e., the company's operations). Most car rental customers want the rental transaction to be fast so they can get on with their travel plans; delivery speed is a critical competitive priority. Many car rental companies ask their counter agents to up-sell the type of car, offer insurance, and sell a pre-paid tank of gas; the company focuses on service as a competitive priority. The mismatch arises because the things the counter agent does to provide more service explicitly causes the company to perform poorly on the thing that the customer desires (speed). Once the service concept and the operating strategy are set and are consistent, the company can design the service delivery system.

Service Delivery System

Designing the service delivery system sets in place the physical and procedural assets that are needed to execute the service concept. Components of the service delivery system that must be considered are job responsibilities, technology requirements, equipment requirements, facility layout, management policies and procedures, service process designs, operating capacity, and quality management systems. The service delivery system should clearly position the service in a way that is different from competitors and hopefully in a position that is difficult for competitors to imitate. Finalizing the service delivery system completes the service strategy design, but that leaves tactical execution to get right.

Tactical Execution

Tactical execution entails managing the service's day-to-day activities to meet the requirements of the target market segment. We will not explore this in too much depth now because it represents the bulk of the remainder of this book. Tactical execution includes tasks like managing staffing levels to meet capacity strategies, managing quality systems to continually improve the efficiency and effectiveness of the service delivery system, selecting the specific site for a new location, and determining what items to stock in inventory, and at what levels. The impact of tactical execution should not be taken for granted. First, it is much harder to execute well than most students think. Second, as a company executes its strategic service vision its competencies may change, and its markets will definitely change. So one critical component of execution is to develop appropriate strategic feedback loops that make sure that a company is not very efficient at delivering a service no one wants. As an example, Motorola launched a satellite phone system called Iridium. The handsets were of superior quality, the company had a market niche they intended to serve but no one wanted the service.

Strategically Planning for Service Growth

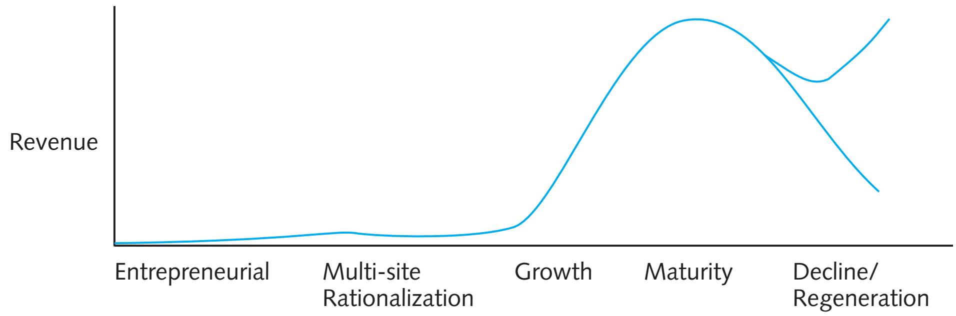
One strategic issue is so different from its counterpart in manufacturing it deserves special attention, and that is growth strategies. Manufacturing companies can grow by adding machines one at a time, by expanding an existing plant, by building a new plant, or by making an acquisition to add capacity. But because services entail significantly more customer contact, the location of the new service capacity matters in a way that it simply doesn't for manufacturing. Specifically, for service companies that operate in a multi-site environment, growth strategies have to reflect this difference in customer contact.

The Multi-Site Service Lifecycle

Like the more well known "product life cycle" discussed in many marketing courses, Sasser, Olsen, and Wycoff (1978) suggested that the service concepts of multi-site service firms follow a lifecycle. Figure 2.2 shows the cycle of growth for a successful firm (in fact, only a small percentage of firms make it out of each stage). Revenues start low in the "entrepreneurial" stage as the service concept and delivery system seek to define themselves. In "multi-site rationalization" firms move away from the owner's personality quirks and the specific limitations of their first location toward a "cookie-cutter" approach that can be replicated. Successful firms then move on to "growth," where the service concept is replicated over many units. The "maturity" phase maintains and extends the brand, and is the most profitable phase. Finally, because of competitive copying, changes in consumer tastes, or some other reason, a firm either enters decline or must rethink its service concept to progress to regeneration.

These stages matter because what would make an entrepreneurial firm successful would not help a firm in maturity. In other words, a firm's strategy will naturally

FIGURE 2.2 *The Multi-Site Service Firm Lifecycle*



Source: Adapted from Sasser, Olsen, and Wycoff (1978).

change over time, which means that its operational structures, marketing plans, and personnel may need to change as well.

In the entrepreneurial stage, the skills that matter are local marketing and public relations, and a charismatic founder who can personally motivate the few personnel at an initial site. In this phase, most personnel are probably underpaid relative to competitors in the mature phase, and they are often in serious jeopardy of seeing very few paychecks because most businesses in this phase fail. Yet, these people must find a way to innovate and develop the service strategy (i.e., the service delivery system and operating strategy around the service concept), or even change the service concept on the fly when trying to gain market acceptance.

In multi-site rationalization, the firm must select a dominant paradigm for marketing, operations, and human resources. It then must standardize its systems around this paradigm. The entrepreneur's motivation to go the extra mile must be replaced with procedures replicable by another employee far away who is just reading a manual. This stage requires developing training programs and accounting systems, and writing detailed procedures. Such development may mean taking much of the uniqueness and individual personality that characterized the entrepreneurial stage out of the various tasks.

The operations and design should already be set when the service enters the growth stage. Selling the service concept to wider consumer and managerial audiences becomes a critical skill. Wider-scale advertising becomes both feasible and more important than local public relations, and investors or franchisees must be found to fund the growth (a topic we will return to shortly).

During maturity, the managerial challenges involve maintaining market position and awareness and somehow keeping a well-known concept "fresh." Operationally, maintaining standards and operational control over less-than-inspired, geographically dispersed employees becomes paramount. The lower-level employees are no longer at the hub of an exciting new idea, but instead work at a safe job in perhaps a dull, established firm. Keeping employees motivated and vigilant is difficult.

Finally, when the service concept becomes stale, revising the service concept and operationally implementing such revisions over a large network that is comfortable with the old service concept again requires the personal charisma reminiscent of an entrepreneur. Understanding this lifecycle provides significant insight into how a service company might manage in the growth stage. Two dominant strategies a service firm might use are *industry rollups* and *franchising*.

Industry Roll-Ups

One strategy for growth that is peculiar to services is called an industry "roll-up." The technique is relatively recent, with quite a few roll-ups taking place in the late 1990s. The idea behind a roll-up is for a company to use its publicly traded stock to buy up dozens of small firms in a fragmented industry. Typically, a small, privately owned "mom and pop" firm trades its ownership of a single unit for shares of stock in a firm encompassing many units in the same industry. Although a few manufacturing-based roll-ups occurred, most roll-ups combine single-unit service firms. The precise number of roll-ups is unavailable because the practice does not have to be officially registered, but 86 are listed as still being publicly traded as of September 2000 (Ho, 2000).

Some people consider roll-ups to be financial tricks driven by Wall Street. A recent article in the *Los Angeles Business Journal* quotes a money manager who says, "I am very skeptical of these roll-up stories. A company needs to be more than a one-trick pony, and that is what a roll-up is. I like to see a company with a strategic vision or some unique creativity embedded in their culture." This may be a bit one-sided; like nearly every business concept, roll-ups are neither intrinsically good nor bad. It depends on how the roll-up fits into the strategic positioning of the firm. Table 2.4 presents a list of characteristics that make an industry a good target for roll-ups.

Operationally, roll-ups succeed because once-independent competitive units can share facilities, supplies, marketing expenses, and operational expertise. Successful roll-ups allow small operators to retain their local connections and personal touch while achieving economies of scale. A prominent example is Service Corporation International (SCI), which operates 4,500 funeral homes, cemeteries, and crematoriums. Customers usually don't see the SCI name, because the funeral homes retain their individual names. In this particular business, the back-office embalming operations of a single unit are not highly efficient due to queuing effects (discussed in Chapter 11). However, groups of funeral homes that use the same back-office facilities can be highly efficient.

TABLE 2.4: *Characteristics of Industries to Target for Roll-ups*

Characteristics	Comments
Favorable market conditions, not just fragmented	An industry should be growing enough in its own right to warrant consolidation. Stitching together a bunch of stagnant companies may show growth in the short term, but will be impossible to manage for growth when the roll-up stops.
Enough competitors that roll-up partners can be selectively chosen	In order to succeed, companies that are rolled up must be sufficiently compatible that managerial systems and culture can coexist, or be brought together. Buying a company just to buy a company is a recipe for failure.
Conviction that a real business can be built	In other words, roll-ups must add business value, not simply allow for consolidation. How will the new business be run? How will it compete? What is its strategic position? Service strategy?

Characteristics are adapted from *Roll-ups: Are they right for you? http://www.netpreneur.org/events/doughnets/990422/article.html,* accessed 4/29/04.

Prominent roll-ups have occurred in waste management (Waste Management, Inc.), general practice physicians (Physicians Resource Group), tow-truck operators (Miller Industries), video rental (Blockbuster, prior to being acquired by Viacom), and direct marketing firms (TeleSpectrum Worldwide). Recently roll-ups have begun in electronic commercial security systems and transportation/logistics services. In the case of commercial security systems, a few of the roll-up transactions have been fairly big (over $1 billion), but many are targeted at acquiring companies with sales between $5 and $10 million. One anonymous head of corporate development quoted by USBX Advisory Services called these smaller deals his “sweet spot.”

Franchising

Franchising is a second strategy that can be used to facilitate multi-site service growth. Unlike roll-ups, which increase market coverage by buying up competitors, franchising increases market coverage by selling the right to operate to someone else. For example, McDonald’s will sell the right to set up a new restaurant to an investor for an upfront “franchise fee.” McDonald’s will help set up the restaurant, provide equipment and production methods, and train the new owner. Then the restaurant pays a portion of its sales to McDonald’s as royalties for using the McDonald’s name and methods. Franchising is quite common; there are about 1,500 firms seeking to sell franchises (i.e., franchisers) and more than 300,000 franchised units in the United States. In fact, roughly one-third of all retail dollars spent are spent at franchises (most auto dealers are franchises).

Franchising provides a way for a service company to grow more rapidly than it could if it had to fund the expansion out of its own cash flow. Most service concepts cannot be patented, so a successful service concept can be more easily copied and implemented by a competitor than in a manufacturing setting, which means that quick expansion in services requires a physical presence to serve a geographic market. Obtaining the necessary capital from a bank to open multiple units of a new service firm quickly is nearly impossible. The loan “collateral” in a service business often consists of a real estate lease, specific décor that wouldn’t fit other firms, and a good idea, none of which is worth much to a bank in a foreclosure sale if things go wrong. Franchising, however, is self-financing. Franchisees usually pay an up-front fee and a percentage of gross revenue, so a significant financial base for the franchiser is not necessary. (See Service Operations Management in Practice: “Is Opportunity Knocking for You?” to see Blockbuster’s franchise pitch.)

Like every other strategy, franchising represents a series of tradeoffs. For example, paradoxically, franchised stores tend to be more profitable than company-owned stores, which tends to reduce the company’s overall profit potential. In other words, franchising reduces the financial risk for the franchiser by shifting a portion of the risk onto the franchisee. So while the franchised store is more profitable, a significant portion of the profits of the store goes to the franchisees to compensate them for the risk shifted onto them, thus reducing the profitability of the franchiser. Table 2.5 presents several more pros and cons of franchising.

Some risks of franchising are just now being understood. These risks relate to the rise of the Internet. In 1999, the company-owned Internet presence of Toys “R” Us wanted to offer steep discounts to compete against other Internet toy sites. They were not allowed to because the discounts would have undercut the 700 franchised Toys “R” Us stores. Also in 1999, the franchisees of H&R Block sued the parent company over selling tax preparation software over the Internet and in retail stores, stating that such sales violated their contracts to exclusive areas. In both instances,

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Is Opportunity Knocking for You?

If you become a BLOCKBUSTER® franchisee, you will be in very good company. Today, we have more than 8,500 corporate and franchise stores in 28 countries. The BLOCKBUSTER franchising initiative is one of the fastest and most exciting ways to grow in attractive new markets and in under-served existing markets. Our franchisees get to associate with a world leader in home entertainment. In return, we're assured high-quality, on-site management to service BLOCKBUSTER customers.

Advantages to Affiliating with Blockbuster

- The power of a brand leader with nearly 100% awareness among active movie renters in the U.S.
- As one of America's major advertisers, BLOCKBUSTER supplements its national advertising with targeted marketing to millions of active BLOCKBUSTER members.
- Training, operations and marketing guidance from BLOCKBUSTER.
- Surprisingly simple store operation that doesn't require the operational nightmare of handling perishables, monitoring food preparation and managing dozens of employees.

Franchise Requirements

Financial requirements are a minimum net worth of $400,000 and a minimum liquidity of $100,000.

If you are interested in pursuing a Blockbuster franchise, please download our *Request for Consideration* document to get started with the approval process.

From: *http://www.blockbuster.com/bb/about/franchisingops/0,7707,NT-ABT,00.html* Accessed 4/29/04

Internet technology would have been an excellent way to reach customers, but that channel was not available because of franchising choices.

Other operational constraints apply. McDonald's wanted to institute a new set of business practices, but its Franchising 2000 plan met with stiff resistance, which, of course, would have been less likely if McDonald's owned the stores and the managers worked for the company. One might think that a franchiser could merely point to a clause in the franchise contract that may allow it to make such changes, but both laws favoring the rights of franchisees and the ability of disgruntled franchisees to make life difficult for franchisers militate against a "command-and-control" relationship between these parties. Consequently, making major changes to a system requires a firm to negotiate and develop a consensus with its franchisees.

The challenge for franchisers is to provide continuing value to franchisees. That is, providing a continuing reason why a franchisee should give 7% of its gross revenue away. For many franchisees, the reason is simple: They derive most of their

TABLE 2.5: *Pros and Cons of Franchising*

Functional Area	Advantages	Disadvantages
Finance	Self-financing Can finance rapid growth Less risky to franchiser	Limits income of successful concept Shifts profits to franchisee
Operations	Entrepreneurial spirit of franchisees	Control more difficult Operational changes more difficult
Human Resources	Career path for store owners not needed Revenue maximizing incentives naturally aligned	Ability to influence behavior curtailed Profit maximizing incentives not aligned
Marketing	Ability to use national marketing media	Can limit marketing channels Local innovations blur marketing message Potential for brand shirking Special events more difficult

business from the national reputation of the franchiser. A lone McDonald's in a small town located on a busy interstate highway derives much of its business from customers who will visit it only once and visit it only because of the brand association. However, a franchisee of Novus Windshield repair (a system with more than 1,000 units) does not benefit as substantially from such an association. The initial franchise value is often quite high. The franchiser trains the franchisee to run the accounting system, provides manuals for how to perform the work, what standards are appropriate, how to do local marketing, and how to deal with suppliers, but after several years in business and an understanding of these one-time issues, what keeps franchisees from branching out on their own? The key for many franchisers is to set up a system that provides continuing value, as described in the Service Operations Management Practices: Franchising at Dunkin' Donuts.

Where Do We Go From Here?

The rest of this book explores in more detail the issues raised in this chapter (Table 2.6 shows how the rest of the book fits into the strategic framework developed in this chapter). The next two chapters examine two emerging strategic issues: the Internet and the natural environment. Both of these are topics that have recently gained added strategic importance. Part 2 of the book looks at issues related to designing the service delivery system, including the recently hot topic of global outsourcing and offshoring. Because service concepts and service delivery systems are not static, Part 3 presents ways to improve on a service delivery design, including showing how Six Sigma can be used in a service environment. Parts 4 and 5 demonstrate a set of powerful tools to match supply to demand and to conduct more detailed analysis of service systems.

As students work through this book, they should remember that every decision that is described in subsequent chapters must be consistent with the strategic positioning of the firm. One way to increase the chance of successfully managing service operations is to make sure that everything is aimed to a common goal.

SERVICE OPERATIONS MANAGEMENT PRACTICES

Franchising at Dunkin' Donuts

Dunkin' Donuts has more than 4,000 franchised units and a thorough program for its franchisees. Initial franchisee training begins with several weeks at Dunkin' Donuts University (DDU). Additionally, financial planning and accounting assistance is available, as well as production scheduling assistance, an applied sanitation program, a technical assistance program, and an A/V system for shop employees. Corporate headquarters also provides "mystery shoppers" for marketing grading. Various physical plant programs include "operation facelift" to help with signage, a landscaping program, line striping for parking lots, pavement sealing, and a remodeling program. To assist franchisees in helping each other, bimonthly meetings of local franchisees are held at company expense, as well as a national franchisee meeting (sorry, they have to pay their own way), and an advisory system. DDU also provides refresher courses on a variety of topics.

TABLE 2.6: *Service Excellence: Strategic Consistency and Tactical Execution*

	External	Internal
Strategy	**Topics** • Five forces • Core competence • Service strategy • Service lifecycle • Natural environment • Outsourcing and offshoring **Book Chapters** Chapters 1, 2, 4, 5, and 8	**Topics** • Capacity, location, and layout • Job design and staffing • Decoupling • Waste stream management • Technology infrastructure • Six Sigma **Book Chapters** Chapters 3, 4, 7, 9, 11, 14, and 16
Execution	**Topics** • Service experience • Customer selection • Supplier selection **Book Chapters** Chapters 6 and 18	**Topics** • Inventory • Waiting lines • Staff training and evaluation • Capacity and yield management • Project management • Internet security and reliability • Quality **Book Chapters** Chapters 3, 10, 12, 13, 14, 15, and 17

Summary

This chapter presented a hierarchical model of service strategy: strategic positioning, service strategy, and tactical execution. Regardless of whether the strategic position is determined by a five-forces approach or a core competence approach, the service strategy decisions of service concept, operating strategy, and service delivery system link the strategic position of the firm to its day-to-day tactical execution. One part of strategic planning that is quite different from manufacturing is planning for growth, because of the customer contact required by multi-site services. Firms that are aware of the multi-site service lifecycle can plan for growth using either a roll-up or a franchising approach.

Review Questions

1. What are the components of the strategic service vision?
2. For a service company like Delta Air Lines (or any other you choose) conduct a strategic analysis using both the five forces and core competence approach. How are the results different?
3. How does the service concept differ from the operating strategy?
4. How might the structure of a service firm change as it grows?
5. Imagine you run a very successful local landscaping company. You have grown as much as you can given capital limitations (i.e., you can't afford another truck). What growth strategies are available to you? Which do you prefer? Why?

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CASE STUDY

Can You Manage a Football Team Like You Manage a Retail Giant?

Arthur Blank, co-founder of The Home Depot and owner of the NFL's Atlanta Falcons, was making a presentation on leadership to a group of undergraduate business students at Emory's Goizueta Business School. During the question and answer session after the presentation one student asked Blank what he thought about competitors and competitor analysis. He answered saying, "At The Home Depot we didn't focus a lot of our attention on our competition. We focused on what was the right thing to do for our customers. Then we did that to the best of our ability." Most of the class appreciated this answer, but one person raised his hand to follow up, "That's easy to do when you are the clear market leader, and so much bigger than your closest competitor. But what about with the Falcons? You have to deal with a salary cap, free agency, player injuries, revenue sharing, and you've only had 8 winning seasons since 1966. That's nearly 40 years!"

Questions:

1. Think about strategic analysis for a market leader versus less dominant companies. Is it different? In what ways?
2. Conduct a brief five forces analysis for both The Home Depot (*http://www.homedepot.com*) and for The Atlanta Falcons (*http://www.atlantafalcons.com*).
3. Conduct a brief core competence analysis for both organizations.
4. Which approach is more appropriate for which organization? Why?

CASE STUDY

PC Repair

Since the introduction of the IBM PC in 1981, the personal computer market experienced explosive growth. This growth in turn created an increasing demand for computer repair services.

Devise a business strategy for a firm specializing in computer hardware repair. Choose the dimensions on which you will compete and articulate an operations strategy that supports your selected business strategy. Identify the key tasks for operations to accomplish. What infrastructural, structural, and integration choices would you make in support of the operations strategy?

Some dimensions you may wish to consider include the following:

- Spare parts stocking policy: Carry ample supplies of all parts? Some parts? Order as needed?
- Capacity: Having capacity for peak demand will mean idle time and increased costs during low demand periods, but having capacity for average demand will mean backlogged customer orders.
- Facilities: The number, types, and locations.
- Specialization of labor.
- Production control: If a customer calls and wants to know when his or her computer will be ready, how will you be able to provide an answer?

This list is not meant to be exhaustive; it is meant to stimulate discussion of the critical dimensions of an operations strategy. Feel free to use your imagination and incorporate other dimensions as you see fit.

The following information from marketing should be useful in formulating a strategy. Market analysis identifies several distinct groups of customers, each with the same profit potential: small business users, recreational home users, and specialized users.

The small business PC market includes those who privately own PCs but use them for business purposes. These users exhibit two special attributes: They abhor any amount of downtime and can be greatly unsophisticated about their computers; that is, they want their PCs fixed immediately and don't care what you have to do to get it going. Due to their lack of sophistication, many of the problems they need fixed are routine.

Recreational home PC users are generally concerned foremost about cost and tend to be unsophisticated as well.

Specialized users are the smallest segment but represent large potential per unit revenue. They perform routine maintenance themselves and call a repair service only when difficult problems arise. They typically have unique machine configurations and time-consuming, difficult repairs that require exotic parts.