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The myth and reality of service society

ARE WE MOVING TOWARDS A SERVICE SOCIETY?

The trends are suggestive. The most highly developed nations, such as the United States and the Scandinavian countries, have experienced a change in the basic structure of their economic activities, and some two-thirds of their gross national product already derives from non-agricultural and non-industrial operations. Regardless of how we define these terms, the trend seems clear.

But trends and figures can be deceptive, both in their historical interpretation and in their implications for the future. Looking back, several considerations should be taken into account. First, to some extent we are simply looking at illusory tricks of the art of accounting. When a housewife sends her children to nursery school so that she can take a job with a big cleaning company (one of whose clients may be the nursery school), the accountant can point proudly at an increase in economic activity; but what has really happened is that certain activities which were previously performed outside the marketplace have now come into the market and have therefore appeared in the books. So to some extent what we are now experiencing is a reorganization of existing services rather than the emergence of new ones.

Secondly, the rise of the service sector has become possible largely as a result of increasing effectiveness in the goods-producing sector. There is a close parallel here with an earlier historical 'wave': the shift from agriculture to industrial

manufacture became possible because of the enormous increase in agricultural productivity, which left people free to do other things. But there is a complex mutual interrelationship here; the increase in agricultural productivity was in large measure a result of progress in industry, with the development of more efficient farming machinery. And now, unless productivity in the manufacturing sector continues to grow, we cannot afford an increase in the service sector.

Looking forward, we know of course that trends cannot continue indefinitely. Development goes on, but in other combinations among economic sectors. Campaigns for 'reindustrialization' are gaining ground, and engineering and the natural sciences have been proclaimed as professions of the future. In the European economies there is a growing recognition of the problems with the welfare state. Lack of resources in the public sector has led to the private production of services in health care and education, for example. Another contributing cause has been the desire of certain groups of citizens for greater freedom of choice.

This should serve as a memento for us to be cautious in relating official figures of GNP per capita to the real standard of living. It is by no means certain that transferring childcare from families to institutions, or substituting institutional health care for self-care activities in the family, represents a real rather than a formal increase in the value production of society. Similarly, in those countries where the informal economy performs a large share of the value-producing activities (it is not uncommon to encounter estimates of 25% of GNP for a country like Italy), the GNP per capita figures typically underestimate the standard of living of such societies.

Thirdly, what is accounted for as 'services' rather than, say, 'manufacturing' may vary substantially. For example, from one year to another, companies like the RCA Corporation were moved from the Fortune Industry 500 to the Fortune Service 500 because it had been acquired by what had previously been considered a service company. But a company like IBM, where a very small proportion of the jobs are in 'manufacturing', remained in the Industry 500. Recognizing that the boundary was becoming increasingly unclear, Fortune—which in 1984 (at last!) had acknowledged the existence of the service society by establishing a separate 'Service 500'—merged the two lists some 10 years later.

In the following pages we will make a brief analysis of what is happening – and this at two different levels. First we will look at things from a macro point of view, and then we will interpret the macro data and tentatively explain them in terms of a distinctive shift that is now taking place in the nature of value production in society.

AN INTERPRETATION OF THE MACRO TRENDS

According to a study by FA-Rådet in Sweden (the Swedish Council for Management and Work Life Issues) the evolution of employment in society is the following:

Active labour force in Sweden (%)

	Agriculture	Manufacturing	Services
1870	73	12	5
1900	61	24	9
1950	21	34	42
1980	6	23	71
1990	5	21	75
2000	4	17	79

Source: I framtidens kölvatten (In the Wake of the Future), H. de Geer *et al.*, Liber 1985

Likewise, proponents of the arrival of a service society will get support for their ideas by looking at other statistics. For example, out of the 100 largest companies in the world which were started in the 1960s and 1970s, 56 were in pure services, another eight were in services where some tangible product was part of the service (and this includes hamburger chains!). The remaining third was dominated by high tech companies particularly in the information industry, such as Apple, Compaq, and so forth (ESIF data). The 'service wave' as a phenomenon becomes even more persuasive when we consider that between 80% and 85% of information technology products are sold to the service sector and the remainder to the manufacturing sector.

To better illustrate the dynamics of change we will introduce the following framework (Figure 1.1). A matrix with the inherent

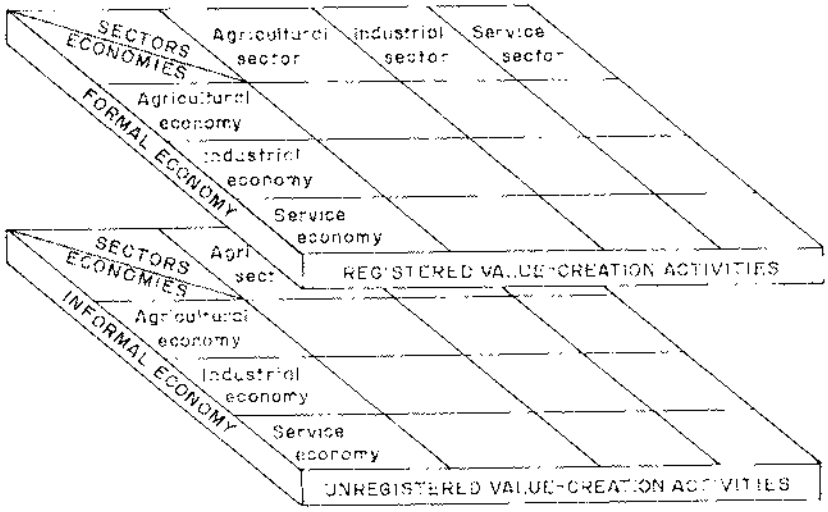

Figure 1.1 Sectoral matrix

natural agricultural, industrial and service economies along one dimension is compared with the classical economic sectors of agriculture, industry and services. All activities which contribute to productive value are by definition in one of the three economies.

- The 'agricultural economy' is all those 'agricultural activities' related to the basic production of foodstuffs from the soil and similar activities.
- The 'industrial economy' comprises the 'industrial activities' in which the main focus is on transforming physical materials into tangible products.
- The 'service economy' consists of 'service activities' which are brought to bear on physical objects, human subjects, information or institutional entities in such a way that these are somehow influenced without being physically transformed; or where the focus is on the *use* and *functioning* of the objects which are subject to the activities rather than on the physical transformation of them.

Sectors are an arbitrary convention used to record activities within an economy, and the transactions between economies. Accountants and economists assign a value to such transactions and

make determinations as to the sectors in which they should be credited. As subsequent examples will show, the sector record is often an imperfect representation of real economic activity. The 'sector' convention, of course, was once introduced as a reflection of what was then - probably usefully and appropriately—perceived as an inherent difference between types of activities. What we suggest is that the nature of economic activities has now changed to the extent that the sector convention is superfluous.

In order to understand more fully the impact of services we have to add another dimension, a second plane, to our framework which differentiates between the formal and the informal economy. The matrix in Figure 1.1 allows us to examine the 'official' or formal economy, that which officially is deemed to be a part of the GNP. However, a significant contribution to the process of 'production of value' is made by activities outside the official economy which are not recorded or assigned value. These contributions of the informal economy include unpaid work in the home, barter, and volunteer effort, be it helping friends or organized group efforts.

Let us now look at some of the dynamics within this three-dimensional matrix.

The 'formal–informal' dimension does not necessarily relate to some imagined 'real value' for society and for citizens. If a parent places his/her young child in a daycare facility, the service activity has moved from the informal economy to the formal economy. Similarly, if a family which is caring for an elderly relative in the home places him or her in a care facility for the elderly, the service has merely been transferred to the 'formal' economy.

Traditionally the agricultural economy was constructed of a multitude of largely self-sufficient economic units operating within the informal economy; i.e. most transactions from production to consumption occurred within a unit of production, the small family farm. Industrial society, with its physical, temporal, and functional separation and specialization of activities, created a profound shift. There was an explosion of transactions taking place between units of production rather than within units of production. The formal economy is largely a function of the differentiated and specialized economy in which different units fulfil different functions which are interdependent and require

transactions. With the coming of industrial society, an increasing proportion of the production of value within the agricultural economy shifted from the informal to the formal dimension. And the increasing interdependencies between the industrial economy and the agricultural economy resulted in both an increase in the production of value, owing to mechanization, and an increase in transactions amongst the units of production within the agricultural and industrial economies.

It is clear that the agricultural sector moved into the industrial economy in the developed countries a long time ago.

My brother is a farmer, and looking at his farm I can hardly imagine a more rapid and decisive process of industrialization. Investments are enormous, specialization high, and the farm is totally dependent on specific, specialized external inputs on a continuous basis. Labour per unit of area has decreased drastically and electronics and other technology have taken over.

What I fear– for him– is the second move. Agriculture and the farm now operate in the industrial economy. Farming will surely move from the industrial economy to the service economy. Currently, the internal dynamics are those of an industrial economy. Output is still standardized and anonymous. Focus on customer contacts, and integration of the farm's processes with the customers' processes, are practically non-existent. Information flows are not with customers, and so forth.

I permit myself to think that the lack of recognition on the pressures on agriculture to move into the service economy lies at the root of many current problems of the agricultural sector. The individual farmers, agribusiness executives, government officials and politicians are trying to solve these problems using recipes belonging to an old era– continued industrialization and regulation. There are a growing number of exceptions, however. Quite a few agricultural businessmen establish direct contact with the consumer through farm-outlet stores and the like.

Within the formal economy, a comparison of the level of recorded activity of the industrial and service sectors of different countries reveals one of the problems with the arbitrary convention of economic sectors. For example, in West Germany sectoral economic statistics indicate that, comparatively, the service sector is considerably smaller relative to the industrial sector than in the United States or Sweden. Does this mean that the German service

economy is relatively underdeveloped? Such a conclusion cannot be drawn without further analysis. German industrial sector companies tend to contain, within themselves, relatively more service functions; these functions are typically performed in specialized, separate legal entities in many other countries. In this example, the institutional settings differ substantially; however, the economics are not necessarily different.

There is no reason to believe that the specialization trend will stop. We can expect a further shift of activities from the informal to the formal realm. This specialization now increasingly is into service rather than industrial types of activities, however.

What we see today is a gigantic reshuffling of activities between different types of units in society, creating a new specialization pattern in which one type of specialization may create opportunities for other units to in fact despecialize and perform a broader range of activities than in the past.

This is amply illustrated by the present trend in consumer appliances and electronics. Many of the new products and services today permit the consumer to perform a broader range of activities and functions for himself: listen to and play music, bake his own bread, cook gourmet food, bring the world of cinema into his home, perform more health care in his home, get involved in 'Outward Bound' and similar types of adventures, and so forth.

We believe there is a fascinating change of logic in the reshuffling of functions taking place in the present-day ('service'-dominated) economy *vis-à-vis* the industrial economy. Whereas the industrial economy was characterized by 'specialization-relieving', thus in fact impoverishing consumers in terms of their range of activities, the present trend is towards 'specialization-enabling', enriching the individual's activity options. Present-day goods and services are designed in such a way that the individual can save time, become more and more independent of location restrictions, squeeze more accumulated knowledge into every time-location unit, and be better able to use his own knowledge and resources for things he could not do before. (Stanley M. Davis in *Future Perfect* (1987) suggests that with our new technologies we are transforming our concepts of time, space (or location) and matter. The new technology encourages and demands an increasing

knowledge component in goods and services. Inherent capacities of the technology and the presence of an increased knowledge component have a dramatic effect on time, space, matter, the nature of products/services and the producer/consumer relationship).

The movement of activities from the informal economy to the formal economy is by no means uni-directional. Now, as we encounter growth in the service economy we see a rapid reverse movement from the formal to the informal economy as many value-production service activities move back into the informal domain. With the advent of relatively cheap and efficient communications equipment, forwarding by mail and the traditional means of payment become superfluous. The human service component moves to the informal economy.

The *trend towards self-service* has been extensively analysed (Toffler, 1980; Naisbitt, 1982). We cannot afford to buy time from others, but we have an increasing amount of discretionary time which we can use to service ourselves. We become both producers and consumers of the service – or, to use a new and telling expression, 'prosumers'. The 'prosumer' or self-service trend is really about a reciprocal plus-sum game between the formal and the informal economy.

A steady shift is taking place in the structure of the service sector. The basic way in which services are conceived – as regards content and the process of production—is changing radically. Companies have to look at consumers in different ways. The new creative service company must consider the consumer as part of its workforce. The innovative service company sells not only services – it also sells knowledge, organization and management. All this presents us with a tremendous challenge and, above all, with new opportunities, which will be examined in subsequent chapters.

NEW IDEAS ABOUT MANUFACTURING COMPANIES

Taking the 'industrial sector' as the point of departure, it is obvious that much of it already functions according to the service economy, or is quickly moving there.

The distinction between manufacturing companies and service companies is, at best, hazy. In 1980, 85% of the profits of General Electric derived from the sale of products; now three-fourths of the profits come from the sale of services (*The Economist*, 1999). Is IBM selling goods or services? Is Volvo becoming a service company insofar as a good deal of its production is being leased out (in package deals including insurance and maintenance) rather than sold? How should one interpret the fact that manufacturing is being increasingly automated, while a growing proportion of the jobs in manufacturing companies are now concerned with information processing and internal services rather than with manufacturing as such? Statistics about the relative number of manufacturing and service *companies* might give us one picture, statistics about manufacturing and service *jobs* quite another.

One thing is certain; many organizations which used to think of themselves as manufacturing companies will have to learn (or are already starting to learn) to see themselves more as service organizations and to accept the consequences of this new view. Many such manufacturing companies have been fighting a tough battle as they have shifted from a traditional production to a marketing orientation; for several, the next step will involve a shift towards a service orientation.

This is a logical and not necessarily a dramatic development. The capacity to manufacture a good product that fulfils genuine needs, and a strong market orientation, provide a good basis for becoming service-oriented. And I predict that many good market-oriented and customer-oriented manufacturing organizations will be taking a keen interest in the new insights and the new management concepts that are now being developed to promote more effective service performance.

A simple analysis of the cost structure of goods today reveals that service activities account for a substantial portion of the value and the price of manufactured goods. If we define manufacturing functions as activities that:

- physically change materials,

and service functions as activities that:

- relate to the transactions of intangibles,

- influence access to and availability of physical objects, and
- influence the utilization of other tangibles or intangibles,

we can easily infer that there can be no such thing as a pure industrial economy. Service activities –internally or externally produced– are a necessary, and an ever-increasing portion of the cost structure of manufacturing companies. These functions generally add value by increasing the accessibility and utilization of goods. They tend to be in closer proximity to the consumer than the manufacturing functions. It is rather typical that service activities account for half or more of the price of goods.

We expect the service functions to be important in the consumer goods industries; however, many tend to underestimate their importance in other industries. (An internal study in SMG revalued that nearly two-thirds of the cost of a North Sea oil rig was attributable to service activities.)

There is a new logic of value-adding in industry. Its affinity to the service economy rather than the industrial economy is revealed by the increasing importance of service functions in the cost structure. In addition, the very nature of service functions is changing. An example is provided by the change that has taken place in means of export transportation in the Swedish economy (Table 1.1).

Table 1.1 Swedish exports (except iron ore): evolution of means of transportation towards 'time/location flexibility and precision intensive' methods

	Ship and railway	Truck and air
1967	76%	24%
1970	69%	31%
1975	64%	36%
1980	54%	46%
1986	45%	55%

Source: Andersson and Strömquist (1988)

Why is there a trend towards relatively more expensive means of transportation? Our interpretation is that this is a sign of the shift of focus from the process of physical production to the process of utilization of what is produced. The market tells us that it is now more important to have the goods (the same could be

demonstrated to apply to services) available in the right place, at the right time, than it is to minimize the cost of each unit of bulk or weight. The buyer is becoming time-sensitive, not just price-sensitive. Part of the value attributed to a purchase is the impact that the purchasing activity and subsequent use of the good or service have on the buyer's time. As we will see, in the service economy the management of time becomes a primary focus of attention. The essence of the service economy is the precise matching of complex activity sets between different units.[1] Matching is partly about being able to build, develop, and cultivate *relationships*, a central concept in service management.

THE INDUSTRIALIZATION OF SERVICES

One more shift within our matrix deserves to be pointed out, namely the 'industrialization of services'.

To the extent that services deal with intangibles many techniques that we associate with 'industrialization' have typically been applied to the provision of services in the last decades, in many cases with an explosion of productivity as a consequence.[2]

The critical importance of 'intangibles' in the service equation has contributed to services being seen more as art than science. There has been a tendency to regard service and service production as not basically susceptible to the benefits of Big Management and Big Organization—that is, to the advantages of scale. This also may have been due in part to a misconception that advantages of scale were only possible in the mass production of

[1] Time sensitivity as a service attribute and the precise matching of activity sets is explored in greater depth in *Designing Interactive Strategy* by Normann and Ramírez (1994).

[2] However, in our view the notion of productivity in services—or, more appropriately, in the service economy—has not yet been sufficiently studied or even conceptually understood. The reason for the latter is that 'productivity' must be related to the objective function of 'value production'; and the logic of value production is different in the agricultural, industrial, and service economies. In this book I will only hint at some of the points of departure for a new notion of value production; for an in-depth exploration of that, see *Designing Interactive Strategy*, by Normann and Ramírez (1994). A key proposition is that it is not only futile but also illogical to try to isolate productivity in the service sector from productivity in the total economy. Another is that productivity improvements increasingly take place through what the authors call reconfiguration and restructuring of activities across traditional boundaries.

physical products. But the last couple of decades have witnessed a change in this fundamental view.

Some services have long been thriving in certain large business organizations. In the transportation industry there is a need to develop geographical networks and to invest significantly in the equipment and infrastructure to service that network. 'Bigness', in this instance, is a form of market coverage. Similarly, the banking and insurance industries are fundamentally based on the laws of big numbers and statistical averages. As these examples illustrate, there is a size threshold which is a prerequisite to participation in certain industries.

Traditionally, 'bigness' in some services—particularly those with low entry barriers (limited capital required, no sophisticated skills required)—was seen as unnecessary or even counterproductive. However, recent developments include the rise of giant corporations in what used to be considered simple, traditional service industries such as food and lodging, cleaning, industrial food services, security, etc. The large-scale advantages are not immediately apparent. Unlike a motor car manufacturer, the cleaning firm cannot jam 50 000 cleaners together in one place and obtain scale effects. The cleaners have to go out into the field singly to manufacture their 'product'. So where is the scale effect?

The answer is not a simple one; it will have to be formulated in several dimensions. The new innovative views about what the service company produces and how it produces it are part of the answer. Scale effects can apply to marketing, purchasing, management, organization, knowledge and even to esoteric factors like 'culture', and it is the recognition and the creative implementation of these dimensions which have made possible the emergence of vast enterprises like McDonald's, the Club Méditerranée, and McKinsey & Co.

Another factor furthering the development of large-scale enterprise is the importance accorded to image and 'brands' in today's world of business. Your customers are surrounded by 'information static'; once you have penetrated the static and successfully implanted yourself in their minds, it is essential to capitalize on your success. Consider Coca Cola, which has now begun to define itself as a 'brand management' company. One of many other examples is the Disney movie, *The Lion King*. At the time of the premiere, almost 200 *Lion King* products, from T-shirts to

CDs, were put on the market. A year later, *The Lion King* opened as a play on Broadway; when leaving the theatre the audience had to pass through a shop that sold all the products associated with *The Lion King* brand that had been built up. Another interesting case is that of Bernard Loiseau, the French chef. In December, 1998, his three-star French gourmet restaurant became the first establishment of its kind to list its shares on the stock market as a business that would exploit the powerful image which it had built up.

THE POSITIONING OF THIS BOOK

As we now leave the three-dimensional matrix we will take the opportunity to use it for framing the content of this book.

First, this book is about management of companies and similar production/provision organizations, not about society or macro economics. It has business management focus. It attempts to provide managers with insights into enhancing the profitability and growth potentials of their companies.

Secondly, the major focus of this book is in the front right-hand corner of the upper or 'formal economy' plane of our matrix: companies providing mainly intangibles functioning according to the service economy logic. I have chosen this limitation because I felt it was the most practical way to transfer, in a 'pure' sense, a set of ideas about *the engineering of the intangible*. These ideas, I believe, will drive the development of the service economy across all sectors.

Our whole culture, tradition, and language, is much more comfortable in dealing with the physical, the concrete, the tangible, than with the abstract and intangible. (Compare the problems that areas like psychology, sociology, economics, etc. have had in becoming accepted as 'sciences'. Western thinking is highly oriented towards 'rationality', positivism, quantification, and measurability. Oddly enough, the concept of 'measuring' has the same roots as the Sanskrit word 'maya', but in Sanskrit 'maya' means 'illusion'! Systematic reflection on the world of the intangible has been reserved for priests and philosphers. *But value creation in today's economy is increasingly related to intangibles, and*

managers who do not have even a systematic language for looking at those processes will inevitably lag behind.

We will refer to other examples and 'boxes' in our matrix, but our focus and our point of departure is the service sector, within the formal service economy. Much of the value creating process for the customer is an interplay between that which takes place within the formal economy and that which takes place within its substantial shadow component in the informal economy. Therefore, we will make frequent reference to this depth relationship. Examples from and reference to other parts of the matrix will serve to illustrate the movement of economic activity to the service economy, and to differentiate the strategic and management implications of the service economy.

THE STATUS PROBLEM OF THE SERVICE INDUSTRIES

It is sometimes claimed that service businesses lack the status associated with manufacturing, and that this is the reason for many of their problems. It is true that some service businesses are low status; however, there are many others which have relatively high status. Problems are not unique to those with low status, although some problems are more acute for such businesses.

Those service businesses with the reputed low status tend to be those which perform functions:

1. that were traditionally performed by individuals granted lesser status when they were part of the informal economy;
2. that everybody claims expertise in and knowledge of (albeit not always correctly);
3. that require employees with lesser formal education; and,
4. that are considered 'dirty' work or necessary evils.

Cleaning, cooking and to some extent care of younger children are services, traditionally performed by women in the home, and about which we tend to claim knowledge. As the feminist movement has correctly pointed out, these services and the people who perform them have been and continue to be undervalued. Other services such as security, sanitation and waste disposal we

consider 'dirty' or evil necessities. As consumers we are inclined to despise what these service suppliers do, and often only notice them at all when they fail!

These image-generating factors tend to reflect on the whole company, a sort of anti-halo effect. We tend to think that working in companies concerned with such activities, even perhaps as managing director, is not particularly prestigious. This is unfortunate, for not only are the services performed inherently valuable, the sophistication required to manage such service business well is high.

In fact, no other businesses are perceived as covering such a wide range on the status scale as the service industries. Some service organizations cater for our most esoteric requirements (the church, the arts, and so on). Others cater for needs and deal in resources which are extremely precious to us all (money: banking; health: health care). Both these types tend to enjoy very high status, although we do not always think of them as advanced 'businesses'. Many types of service are represented by companies of the lowest as well as the highest status: a modest barber's shop is not ascribed much status by anyone, while 'Monsieur Alexandre' can expect invitations to the most glamorous of parties.

Why these reflections on status? Because they have implications for the management of services, for the possibilities of recruiting people who are both motivated and skilled, for the methods of developing and maintaining a 'culture'. The problem of recruiting bright, motivated and skilful managers to businesses which are sometimes regarded as enjoying little status and yet which are extremely sensitive to the quality of their management is certainly a serious one. In fact, it seems to me that these businesses must be among the most difficult and the most professionally challenging to manage.

Since the first edition of this book was written, a number of works have been published that seek to distinguish between 'service companies' and 'knowledge companies'. Strictly speaking, I find the concept of 'knowledge companies' as ordinarily used to be highly misleading. The difference between BMW, McDonald's and McKinsey is not that one is more or less knowledge-intensive than the other; all of them are based on knowledge. The difference lies in the degree to which the knowledge has been

successfully built into what the firm offers to its customers. When people speak of knowledge companies, they usually mean those whose structural capital is relatively limited by comparison with a manufacturing enterprise, and where knowledge must be transmitted to customers through people who are expert at solving the specific problems of each situation.

At the extreme, one might even say that the concept of a knowledge company often refers to a firm which has failed—or not yet succeeded—in effectively incorporating knowledge into its structure, or into its products and services. Actually, many companies formally based on problem-solving by individuals are destined to evolve into ones that with increasing effectiveness 'package' the knowledge of individual professionals. Thus, many professional groups today—such as consultants, accountants, physicians—are finding that numerous tasks which previously required the problem-solving ability of the individual professional can now be accomplished with information technology. Thus, setting premiums at insurance companies is now done largely by computer programs, to take one example. And there are many others.

The concept of a knowledge company is thus misleading, although I myself employ it at times, since it has become so well established. In this book I use 'service' as a concept that also refers to companies which offer problem solving by highly trained individuals. But the distinction between companies that supply standardized service (usually based on extensive structural capital), and those that provide service in the form of professional problem solving, is, of course, valuable nonetheless, since the management and structural issues facing the two types of companies may differ sharply.

INTERNATIONALIZATION

There is also another perspective. In most advanced and industrialized economies there should logically be greater dependence on international trade in services for the maintenance of equilibrium in the international balance of trade. However, most authorities and industry associations have so far failed to realize

that service industries can be a resource in this context. The facts tell us though, that the service sector is an important one and is becoming more so. In the foreign trade of the United States, a massive surplus in the service sector offset an equally large deficit in manufactured goods.

Economies such as those of the Scandinavian countries, which have organized their societies so that as many of the necessary services as possible are being produced in the public sector, are now having tremendous balance of payments problems, and one of the main causes has not even been recognized. The task of producing services (the growth industry) and of investing, for major segments of the service economy, has been handed over to the public sector. In a time when the export of services could have a significant impact on the economy, a major portion of the resources invested in service capacity is in the hands of organizations which are not designed for operating in open markets and which have no incentive to exploit their knowledge internationally. In most instances their current mandate precludes such activity. The American experience illustrates the potential value of service economy exports. In Sweden both the public sector and business circles have long considered 'industry' more prestigious than services. Moreover, establishing various forms of 'welfare services' has come to be viewed as a matter for the public sector and basically not an area in which private business should get involved (Normann, 1980). As a consequence, precisely this sector of society—which is a very large one as well as a growing international 'industry'— has been deprived of the competition that brings innovation and improved quality. And in the same sector little or no international business has been developed by Swedish enterprise. It would be appropriate to speak of a knowledge capital in captivity, a national investment which has been severely deprived of opportunities to earn a good return. I would term this phenomenon 'the Swedish captivity' (Figure 1.2).

The Treaty of Rome which provides for free movement of people and free establishment of a service operation in any style once it has been accepted in one state, should considerably promote the internationalization of services within the European Community. To facilitate this process, however, a set of concepts appropriate to the service sector is required.

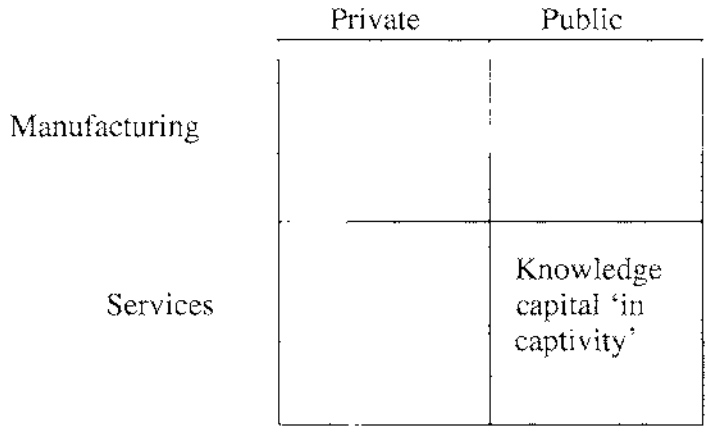

Figure 1.2 'The Swedish captivity'

IS THE MANAGEMENT OF SERVICES DIFFERENT FROM MANUFACTURING MANAGEMENT?

The answer to the question in the heading is yes and no, depending on how clearcut we want our definitions to be. My aim here is not to argue one way or the other, but to single out what is of primary importance in the management of service activities.

Much of what we already know about good management in general naturally also applies to service activities, but when my colleagues and I began to work more systematically with service companies we soon identified several factors that distinguished the best from the less successful, and a pattern began to emerge. It is interesting to note that a few other professionals in the field in other parts of the world were beginning to tackle these problems at roughly the same time, but from different angles.

At the Harvard Business School, for example, one group started to attack the problem from the point of view of manufacturing strategy, discovering that traditional approaches were inadequate when it came to the production of intangibles which could not be stocked (Sasser, Olsen and Wyckoff, 1978). At the same time, marketing people such as Eiglier and Langeard (1975, 1977) were approaching service organizations from their own particular angle, while the group with which I am associated was starting out from the point of view of strategy and organization as well as the role of management and leadership.

What are the characteristics of service organizations? At this stage let us just consider some of the most obvious features (see Table 1.2 below).

Table 1.2 Some typical differences between manufacturing and service industries

Manufacturing	Service
The product is generally concrete	The service is intangible
Ownership is transferred when a purchase is made	Ownership is not generally transferred
The product can be resold	The product cannot be resold
The product can be demonstrated	The product cannot usually be effectively demonstrated (it does not exist before purchase)
The product can be stored by sellers and buyers	The product cannot be stored
Consumption is preceded by production	Production and consumption generally coincide
Production, selling and consumption are locally differentiated	Production, consumption and often even selling are spatially united
The product can be transported	The product cannot be transported (though 'producers' often can)
The seller produces	The buyer/client takes part directly in the production
Indirect contact is possible between company and client	In most cases direct contact is necessary
Can be exported	The service cannot normally be exported, but the service delivery system can

One is the basic *intangibility* of services (as opposed to the concreteness of manufactured goods). This immediately suggests several related properties: services cannot be stocked; they cannot easily be demonstrated; and while they can be sold, there is not necessarily any transfer of ownership. Some of the consequences of a 'production' approach to logistics and marketing will be immediately apparent to the reader.

Secondly, most services actually consist of *acts*, and *interactions* are typically social events. The control and management of social events calls for certain special skills and techniques.

Thirdly, the production and consumption of a service cannot always be clearly kept apart, since they generally occur simultaneously and at the same place. The 'manufacturing' takes place in the field, as Levitt (1972) has pointed out. One consequence of this is that the structure of service operations is generally much more dispersed and local than the structure of manufacturing operations. And functional differentiation, between producing and selling for example, tends to become vague or disappear altogether.

Moreover, as has been suggested above, the customer is often more than just a customer—he is also a participant in the production of the service. A haircut, the cashing of a cheque, education—none of these can conceivably be produced without the participation of the consumer. Thus the service company not only has to get in contact with the consumers and to interact with them socially; it is also necessary to 'manage' them as part of the production force (Normann, 1982).

This list could be extended, and obviously some of the characteristics mentioned may apply to some manufacturing activities too; certainly there are a number of borderline cases. It is an old trick among some manufacturers, for example, to increase the element of intangibility in their product (General Motors, IBM and Christian Dior have all done this in different ways). Again, my point is not to try to exaggerate the differences but to try to identify what is intrinsic to services.

Table 1.2 can be seen as a typical 'first generation of service knowledge' statement of established truths, and thus serves a pedagogical purpose. However, it must be stated that those truths today are being challenged in many ways which will be highlighted later on in this book. For example, new communication and information technology clearly increase the possibilities to 'store services', and to make person-to-person interaction in their provision unnecessary.

THE MOMENT OF TRUTH

Most services are the result of social acts which take place in direct contact between the customer and representatives of the

service company. To take a metaphor from bullfighting, we could say that the perceived quality is realized at the moment of truth, when the service provider and the service customer confront one another in the arena (Figure 1.3). At that moment they are very much on their own. What happens then can no longer be directly influenced by the company. It is the skill, the motivation and the tools employed by the firm's representative and the expectations and behaviour of the client which together will create the *service delivery process*. A large service company may well experience tens of thousands of 'moments of truth' every day.

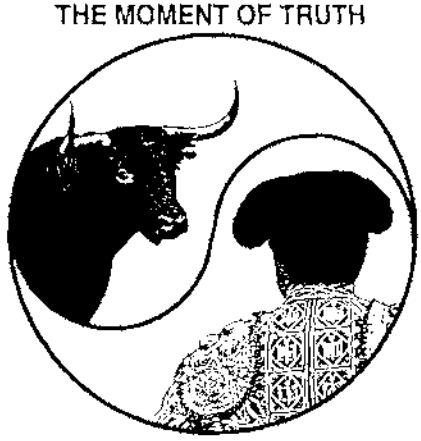

Figure 1.3 The moment of truth: where the quality of a service operation is created

This particular attribute of services also underlies many other typical features that have to be taken into account when effective service delivery systems are being designed. We shall refer to the concept frequently in the following pages.

PERSONALITY INTENSITY

It is often argued that service operations tend to be more labour-intensive than manufacturing, the implication being that personnel management is critical to success in a service business. However, I would maintain that while this is true in some cases,

the idea that services are more labour-intensive or personnel-intensive is basically mistaken—or rather, it is not the important point.

In fact, many services are extremely capital-intensive and are becoming more so. In addition to traditionally equipment-based services such as airlines, services such as security or banking are becoming increasingly based on equipment and advanced technology. Nonetheless, those services still retain an important element of person-to-person contact, and will continue to do so. And in many other services, too, the logic of the moment of truth holds, even though customers may not have face-to-face contact with the people providing the service. When we eat at a famous restaurant or fly in a jumbo jet we are certainly very much aware of the presence of the chef or the pilot, although we may never actually see them.

Instead of classifying businesses as capital-intensive or personnel-intensive, we have found it more useful in our group to classify them in terms of *'personality intensity'*. Most services, and many other business, are personality-intensive in the sense that the quality supplied to the customer is essentially a result of the way people perform in the specific situation (regardless of whether or not they are backed up by a large amount of capital and equipment).

When the performance of individuals or small groups, who may have a high degree of discretion to influence the specific situation, are a key factor in determining quality and economic performance, then there are important implications for the way in which a company is run. Even services which appear to be very standardized – such as the McDonald's hamburger restaurants – in fact depend a great deal on the performance of individual people. If you buy a car, it never occurs to you to wonder whether or not the production-line worker was smiling or showing pride in what he was doing, or to be interested in how he was dressed or whether he was a nice person; when you buy from the McDonald's 'production line', you are affected by all these things.

Service companies tend to be personality-intensive in this particular sense – in the day-to-day production of quality. Negative or positive performance by individuals may have a tremendous and immediate impact on how individual customers perceive the quality of what they have been given. There are relatively few

ways of covering up lack of enthusiasm or the absence of a decent performance on the part of the individual. The effects and the feedback are immediate and striking.

This is part of the basis for another observation that my colleagues and I have made, namely that *effective service companies are often based on social innovation.* Inventing the appropriate roles and role constellations, diagnosing and finding ways to use human capacity and energy, designing ways to make people and groups of people learn skills quickly and to maintain the skills while keeping alive the enthusiasm and the thrill of personal development – all these are typical examples of social innovation.

Social innovation is thus a means whereby quality and cost efficiency can both be achieved. In the following chapters we shall see many examples of such innovative approaches to the mobilization and focusing of human energy.