PART 1

THE COMPETITIVE LANDSCAPE

CHAPTER 1

Competitive Challenges for Service Businesses

Introduction

Once the forgotten stepchild of the manufacturing and industrial economy, the services sector has grown in importance over the last half of the 20th century until it now accounts for a sizeable percentage of the developed world's gross domestic product (GDP).

In the United States, services have grown from 68 percent of GNP—the measure then in use—in 1986 to more than 82 percent of GDP by 2000.[1, 2, 3] Employment in services has also kept pace; from 71 percent (1986) through 76 percent (1990) up to a total of 79 percent (1999).[1, 2, 4] Just as manufacturing and goods production transformed the established agrarian society over the last half of the 19th century, services have displaced industrial activity in the 20th. Even within the manufacturing sector, some 65–75 percent of employees perform service tasks such as research, logistics, maintenance, and design rather than make the goods.

Similar trends showing the growing role of services in the economy can be found in the countries of the European Union. As a percentage of GDP, Luxembourg enjoys the highest rate at 76 percent with the U.K. a close second at 73 percent.[4] Employment levels also show the importance of services, with countries like Sweden having 74 percent of its work force active in such businesses. Even countries that are still more agricultural show services labor participation rates well over the halfway mark, with Greece at 59 percent and Portugal at 60 percent.

Another forgotten aspect of services is that they are not as marginal in purchasers' hierarchies of needs as products, although the converse is generally held to be true. During recessions, consumers will often defer product purchases while continuing to make services purchases. Medical care, education, travel, and personal care do not necessarily represent choices that people can put off. Statistics show that the services sector as a whole does not suffer as much contraction during a recession as does the goods-producing sector.[1]

Given the obvious importance of services, why then do perceptions of services' marginality and lack of importance in the overall economy persist? Some of the reason, no doubt, rests in the nature of service businesses, which tend to be smaller in size, although large, global service firms do exist. Another reason is that services outputs are harder to measure and often involve subjective elements, such as goodwill, which does not lend itself to quantification.

These and additional factors, which will be discussed below, perhaps explain why there are also so few consistent definitions of just what is a service business. In fact, a search of business books, both famous and not-so-famous, indicates a lack of definitions, period. Even venerable classics, such as *In Search of Excellence*, do not even have the term "service business" or "service industry" in their indexes. Those books that do attempt some definition of services tend to offer discussions rather than precise, neat descriptions.

This lack of a definition or willingness to focus on the service business extends to the literature devoted to competition and competitive intelligence (CI). Most of the models, case studies, discussions, and research strategies recommended in these works focus on goods-producing businesses. Perhaps this is the final manifestation of the nature of service businesses; those involved in competitive intelligence want to avoid tackling the issue of CI precisely because the "beast" is untameable. It is much easier to discuss manufacturing and goods.

Defining the Service Business

Even books that do introduce the concept of competition in services do so only sparingly. Michael Porter, in his 1980 classic, *Competitive*

Strategy, has but four references to service industries in the index. From these we can glean some indication of how Porter defines a service business. He sees services as an industry that is fragmented, where no firm has significant market share nor can any one organization influence industry outcomes by setting the agenda for the industry (which does occur in goods-producing sectors, such as beer or steel, where one or two behemoths dominate). Such service industries he describes as being populated by a large number of small and medium-sized companies. Later in his book, Porter cites issues arising from where the service is performed, such as at the customer's premises or requiring the customer to come to where the service is produced, as further characteristics separating service businesses from goods-producing entities. The final characteristics are the close local or personal control of the ownership and the personal service, approach of the service provider.

This latter description is echoed by Ian Gordon in his book, *Beat the Competition*, where a service business is described as being characterized or differentiated on the basis of the service provider and the key role of relationship management. This changes the focus of competition for the service firm; factors such as recruitment of personnel and training may prove of greater significance in gaining competitive advantage than they would for a goods-producer; conversely, goods producers may be concerned about manufacturing throughput and capacity utilization, which have no relevance for the service firm.

Another facet of service business that helps define them is that they often deal with concepts and ideas. And concepts and ideas are easily replicated. Operators of service businesses do not have the protection of patents; at the very most, they can take out a trademark or servicemark on the name of a service or "package" of activities they have invented.

This particularly places the pioneers or innovators in services at a disadvantage. Those consultants who truly were the first to introduce the concept of Total Quality Management to the American marketplace soon found a host of copycats claiming to offer the same processes. Apart from any numerical competition this created, as more and more consulting firms jumped on the quality bandwagon, there was also the equal competitive threat of dilution or degradation of the service offering. It is one thing to say or advertise that you offer a quality process;

it is another to be able to deliver results. Botched delivery by another service provider who doesn't know what they're doing is just one aspect of services competition, as will be discussed later in Chapters 2 and 12. Another way of defining the services sector is that the key unit of inventory is time. As just about every adult learns, time is a valuable commodity and one that you can only spend in fixed amounts. From a business owner's point-of-view, it has an added liability because it cannot be stockpiled. Nor can it be returned and reused or resold; few service business owners have not had the experience of working on a project, providing a set number of hours to a client, only to have the client—for whatever reasons—refuse to pay their bill. Whereas in the goods sector, there is always the possibility, if the customer decides to return the merchandise, that it can be resold or the parts reused, there is no such option in services. Once you are in March, you cannot take back the first two weeks of February and resell them.

It is also possible to expand this facet of "time as inventory" and focus on time with the value-add of expertise. When we refer to a service business in this book, we mean any service based on human expertise, the input of human labor with the value-add of knowledge, brain power, or intellect. For our purposes, the types of service business we will be discussing in the case histories and other examples in the book include law firms, accounting firms, actuarial firms, management consulting firms, executive recruiters, marketing organizations, advertising and PR agencies, research companies, property management firms, energy auditors, investment/portfolio managers, economic forecasters, business brokers, and more. These are the types of business where, as ad man David Ogilvy once observed, "the inventory goes down in the elevator each night."

Foundations for Analysis

Given these various descriptions or definitions of a service firm, how can the manager or owner of such a business use this to better understand the environment in which he or she operates and therefore competes? By recognizing that certain realities will always be present and need to be reckoned with, the owner-operator or management team of a service firm can develop tools, solutions, and strategies to defend their existing business and find ways to use their knowledge to grow the business. The main tool for doing this is CI, although there are several specific challenges to face and overcome.

The services environment, as Michael Porter points out, will always be fragmented with multiple players, many of them small or even obscure. This immediately suggests that studying other providers—or traditional competitors—will be time consuming. The channels through which services are delivered—at the provider's location or the customer's—are nearly invisible to the outside observer and thus hard to study.

The pivotal nature of the relationship between provider and client and how this relationship is managed also goes on behind closed doors. It can be equally difficult to study customer service issues and how each service provider interacts with its customers, yet service levels and the rate of customer retention is a key factor in any service business' success.

The service itself tends to be elastic and readily tailored to suit each customer or client. This poses problems for analysis of competition because there may never be an exact match between services offered *within* a firm, never mind between firms. Most service providers of any longevity will have made it a practice to be flexible. One client may want a presentation and no report, another a report and no presentation. From day to day, each service firm adapts to meet the specific needs of its clients.

Marketing may also occur in private, by way of proposals or quotes, which never enter the public domain. Marketing may also be an entirely in-person phenomenon, dependent on the competing firm's personnel going out to call on prospective customers. There may never be any ads placed, there may be no Web site, there may not even be a brochure. Yet such a firm may have a wealth of business based on the most ancient and invisible marketing tactic of all, "word-of-mouth."

Other service providers may have different ways of managing their inventory (time) and different amounts of time to manage, distributed as it may be across a staff of full-time, part-time and freelance or contract workers, so studying this aspect of other service businesses can be challenging.

Then, within the scope of the value-added components, since services expertise rests with the individuals employed at a service provider, only by knowing the workers and their strengths and weaknesses can an assessment of the traditional competitor be made. Whereas in the goods-producing sector, it is possible to study the firm or company as an aggregate of its parts or people, in services, more needs to be known about the components or individuals that make up the total. Do all contract lawyers work at the same rate and produce the same results per hour? Do all executive recruiters interview the same number of candidates per day? The answer to these and similar questions is no, but these differences form an element of competition and need to be examined.

And, as if these factors were not enough of a challenge to study, there is the real *bête noir* of competitive intelligence gathering in the services sector: pricing. For many products, there are what are known as sticker or shelf prices, which are rarely negotiated. Even when the price of a product is negotiated, it usually rests on some factor such as quantity or turnaround time on delivery, which makes this facet of competition more visible and easier to study. Studying how a traditional competitor prices its services is extremely challenging because the service provider has full flexibility in adjusting its prices or presenting them in different ways to different customers. These issues will all be explored in Part 2 of the book.

How Services Competition Differs

Managers of service firms need to be aware of a broad spectrum of competitive factors, over and above the competition offered by other providers.

Many of these forces do not exist in the same degree in the goods-producing sector. A quick perusal of the CI literature quickly illustrates that studying competition in goods-producing sectors is very much a cut-and-dried affair. Goods-producing competitors are likely to be companies making the exact same item or making a very similar item; they will likely have a few defined locations and distribution channels with defined target markets and end-products. To see how this is so, think of what ends up on the shelves at the grocery store in the cereal section or what you find when you go to an auto aftermarket retailer for spark plugs. There is a certain standardization of product, the competition sits cheek by jowl on the shelves, it is easy to make comparisons; the customer can see, touch, smell, and even hear or taste the competitive offering. Similarly, the goods shipped direct from one manufacturer to the warehouse of another original equipment manufacturer (OEM) in the industrial sector are very cut-and-dried products.

Competition in service businesses is, instead, changing constantly, reminiscent of a kaleidoscope, with the sources of competitive threats shifting rapidly from customer or client to the next customer or client. There is no predicting which competitive forces you will necessarily face from day to day or week to week; differing competitive forces from one company you serve to another makes it far more difficult to study them. Generalizations are dangerous, as are assumptions. An open mind about the competition for each and every customer is essential. What this means, for the service business wishing to study its competition and undertake competitive intelligence, is an exercise in trying to hit a moving target.

The Broad Spectrum of Competitive Forces

As the competitive threats that often loom larger than threats from traditional competitors are discussed in detail in Part 1, this chapter will provide a brief overview. There are, first and foremost, the customers or clients themselves, who are often the biggest competitive threat in a service business and need to be studied as such. Then, there is a very troublesome group known as the influencer, a particularly important source of competition in businesses that serve other businesses or industries, government, and institutions. The influencer is not actually a purchaser but has a tremendous influence on the buying process; he can be a very negative force and a serious competitive threat. Then, there are competitive forces such as government itself, which may be providing services for free or on an at-cost basis in your markets; there is left-field competition, which is the surprise competition originating via new delivery channels such as the Internet, which can introduce competition located hundreds of miles from where you are actually operating; and then there is inside competition, competitive forces that originate internally at the company and thwart its growth. And, of course, there are the traditional competitors, companies that purport to provide the same or similar service to yours but may, in fact, be offering something quite different, but to which you are constantly compared.

Why Undertake CI in Services?

If studying services competition is so challenging and collecting intelligence about competitive forces so difficult, why undertake these activities at all? The reason is the reward from the effort involved: finding ways to gain competitive advantage.

While studies about competitive intelligence for services are few and far between, those that have been undertaken indicate a beneficial result for those services firms that conduct CI. Companies doing CI and offering both personal and business services tend to enjoy higher average sales than companies that do no CI; business services doing CI, in particular, enjoyed a greater market share than their counterparts that did not.[5]

As the economy globalizes and services themselves are exported and imported—a state of affairs unthinkable even 50 years ago—all operators of service businesses need to be more vigilant about existing and emerging competition, to both protect their existing business and to find ways to grow it.

Failing to study competition means failing to find ways to develop what's known as sustainable competitive advantage. By learning not only what your traditional competitors are up to but also finding out how they interact with the larger environment and all its competitive forces, a service business, however small, can become more adept at spotting opportunities. Similarly, by studying the various competitive threats originating with customers, influencers, from out in left field and more, the manager or owner of a service firm can become more proficient at seeing the threats and dealing with them before they capsize her company.

A Word About Words

Before moving into the in-depth discussion of services competition, a word about some expressions and terms used throughout the text is in order.

Clients. The preferred term for customers of a professional service firm. However, some definitions say a client is a customer who has become a client through repeated use of the service.

Customers. Customer is sometimes used to describe the purchaser of a product or of a "blue-collar service." But it also has the meaning of being a first-time user of a professional service (see *Clients* above). For this reason, and for sake of variety, these terms have been used interchangeably.

Direct Competition or Competitors. Another term for head-on competition or for traditional competitors.

Indirect Competition. A term used to describe a competitive force which does not compete head-to-head, but which fosters direct competition or facilitates it. Much government-origin competition falls into this category.

Influencers. Also referred to as buying influences, these people are not a direct purchaser or decision-maker but have input into the buying decision.

Primary Competition. This term is used to describe "front-line" competition, which may come from any or all of the sources discussed. (See *Secondary Competition*.)

Providers. Providers are all other companies that purport to provide the same services as you do. Not all providers are competitors. (See *Traditional Competitors*.)

Secondary Competition. This describes competition that is not in the front ranks. For example, if government influence or an economic recession with clients' budget cutbacks are the primary competition, then the traditional competitors are the secondary competition.

Single or Sole Source Supplier. Professional and similar services are often acquired without a bid or tender or other review of several providers. If a firm has specialized expertise, its services will be purchased on a "single source" or "sole source" supplier basis.

Traditional Competitors. The subset of providers who do compete against you.

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