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THE ESSENTIALS FROM STRATEGY&

Service Operations as a Secret Weapon

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BY HARRY HAWKES, CURT BAILEY, AND PATRICIA RIEDL

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Service Operations as a Secret Weapon

Effectively managing service operations is crucial to controlling labor costs and improving customer satisfaction. By addressing six drivers of performance, executives can go a step further — turning their service operations into a key source of competitive advantage.

by Harry Hawkes, Curt Bailey, and Patricia Riedl

Many companies have successfully transformed their manufacturing, R&D, and other business functions, improving their performance while stripping out cost. Yet far fewer have optimized their service operations, even though they can have an outsized effect on customer acquisition and retention. When service levels and costs are properly balanced and optimized, they can deliver a substantial and sustainable competitive advantage that competitors will find hard to match.

By their nature, service operations are often labor intensive and complex to manage. Repetition and consistency, typical hallmarks of excellence in service operations, can work against a company that is trying to achieve step-change improvements in processes and behaviors. Additionally, executives across many industries are finding it increasingly challenging to keep service costs in check (especially labor costs, the single largest cost component of any service operation) while maintaining service levels. Recent technological advances — for example, self-service kiosks commonly found in airports, banks, and hotels — have helped improve overall productivity, but technology is only one part of the solution.

Designing a tailored set of service models based on customer segments is a prerequisite for providing the desired services without overspending. Whether the business is a retailer trying to optimize sales floor coverage, a hospital seeking to improve care delivery by better allocating nurses and beds, a hotel working to speed up check-in times, or a manufacturer delivering technical support in global markets, the leaders of the organization must rigorously and holistically manage the factors that affect service delivery and costs.

Six Principal Drivers of Service Quality and Cost

Service operations leaders must be in a position to identify and capture opportunities for improvement. To help, Booz & Company has developed a framework that encompasses the main factors determining the quality and cost of service.

1. Product and process design. The foundation for high-quality, cost-effective service operations is established far upstream of the point of service delivery — during product design or, in the case of services companies, process design. Design affects quality and total service costs in significant ways. In particular, it can reduce service costs early in product life cycles by reducing defects, and it can reduce total service costs by shrinking the time it takes for a product to move from infancy to a stable, mature stage.

Streamlining product architectures and configurations, for example, can have a beneficial effect on service. One computer equipment company saved on

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repair, order processing, and technical support costs simply by installing its largest hard drive in every unit sold.

Analyzing quality at the product level can also help discern problems that can lead to higher service costs. By uncovering notable differences in mean time between failures (how often a product breaks) and mean time to repair (how long it takes to fix it) between products developed internally and those developed by a third party, another computer manufacturer was able to take steps to close the gap by improving design and technician training for the inferior products.

Embedding remote diagnosis and repair capabilities in products and processes can simultaneously reduce service costs (right part, right place) and enhance customer satisfaction and loyalty.

2. Service-level labor requirements. Typically, labor is the largest cost in service operations and a key driver of customer satisfaction. Matching service requirements to customer needs, desires, and expectations is job number one. Some customers may want a lot of hand-holding, whereas others may be content with self-service options, for example, bank ATMs, grocery self-checkouts, and automated tech support online or via phone. Matching customer expectations with the service delivery method increases revenue and simultaneously lowers the cost-to-serve.

Service operations leaders analyze usage patterns and consider them in light of corporate targets, such as market share and revenue goals, to ensure the proper service coverage. One company with a large and active mail room undertook such an analysis and discovered that misalignments in its service coverage resulted in unnecessary idle time at some times of the day and backlogs at other times. By realigning coverage with demand, the company was able to process incoming demand within the agreed-upon service level, as well as reduce labor costs by decreasing coverage during slow periods. This change enabled the company to increase overall productivity, and improved customer satisfaction — resulting in increased revenues.

3. Service network structure. Over time, as business and economic growth rates vary, mergers and acquisitions occur, and companies change their product mix and market focus, service costs can get out of whack. Management layers become excessive, processes become less standardized, workloads no longer align with staffing levels, and unnecessary facility expenses are incurred. Sometimes it is necessary to rethink how a service delivery network is structured. One service outsourcer was maintaining two separate organizations to provide hardware installation and repair in the same geographic areas. This model had enabled fast response in the past, but as the volume of service requests declined, partially owing to design and quality improvements, it made more sense to consolidate the two organizations.

The efficiency of service operations also tends to vary greatly among geographic locations. By putting in place the proper tracking and reporting processes, companies can smooth out variances and improve service performance overall. Alternatively, companies can use shared-services models to significantly reduce overhead costs.

Outsourcing will often produce short-term cost savings, but if it negatively affects customer satisfaction and the company's competitive position, outsourcing can be counterproductive in the long term. The right mix of sourcing balances low costs and service quality in a way that enhances a company's competitive advantage.

4. Service process management. Service processes are rarely static; they change in response to the needs of the business and its customers. This being the case, they need continual monitoring and adjusting to keep costs in check and ensure their ongoing effectiveness. Continuous improvement is a widely accepted idea, but in many companies, the culture does not easily support it. Further, service processes need gatekeepers who have decision rights for process changes and are accountable for their performance.

Meanwhile, companies can look to identify any process steps that can be standardized across customers and geographies. Process standardization (and automation when possible) can reduce labor requirements and enhance customer satisfaction. For example, one regional hospital reduced the wait time for new admissions from four and a half hours to one and a half hours by standardizing the admissions approval process.

5. Workforce management. The productivity of employees is a major consideration in all service operations. To optimize employee productivity, decision makers need to first calculate the total labor hours they need in each location, either in a bottom-up manner — by identifying labor drivers and creating a model for determining task times and frequencies — or in a top-down manner, one based on comparisons of operational performance to labor hours. Either method works, but the bottom-up approach offers an additional benefit in that it allows labor hours to be more easily adjusted as input drivers change. For example, one company created a detailed model, based on unique store demand patterns, to calculate the necessary staffing required to manage its truck tire service centers, generating a 12 percent savings in labor costs.

Once labor hours per location are determined, management can consider how the hours should be apportioned between full-time and part-time employees, and how these employees should be scheduled to meet customer demand and fulfill operational activities. For example, when one hotel studied its check-in process, it discovered that many guests were experiencing check-in waits of more than 20 minutes. A significant number of guests waited so long that they said they did not intend to stay at the hotel again. However, with the addition of just five part-time employees surgically inserted during peak periods, a small additional expenditure within the hotel's budget, more than 90 percent of guests could be checked in with less than a 15-minute wait.

6. Measurement and compensation. Unfortunately, few service operations and companies have sophisticated performance measurement and compensation structures. Most fall into one of three groups: those that track metrics in a consistent way at all levels, but have not aligned their compensation systems to the metrics; those that track metrics, but use inconsistent definitions across levels; and those that don't track metrics at all. Nonexistent, inappropriate, or inconsistent measurements result in missed improvement opportunities, the inability to understand whether process changes are working, and ineffective decision making.

Meanwhile, most service organizations, especially in the retail sector, are drowning in data and collecting more every day, yet are still thirsty for insights. To overcome this problem, companies should identify the data that is most relevant to the performance of their service operations and ensure that it is properly collected and used. It is important to collect nonfinancial data, such as customer profitability and customer satisfaction, as well as key financial and operational indicators.

The next step is to align compensation and reward systems with desired employee behaviors. By clearly defining compensation and rewards, and communicating the metrics that determine them, service operations can stimulate employee motivation and provide the clarity that people need in order to change their behaviors.

Further, service operations managers should work with HR to take a more proactive role in establishing and managing compensation and reward systems. They should recognize that tenured workforces come at a higher cost that often cannot be justified in terms of performance; a lack of salary caps and compensation bands can create wide variations in cost among similarly skilled employees; and market-based salary reference points are often inflated and thus serve as a poor guide to compensation. To address the problems that result from unsupported assumptions, companies can act with varying levels of aggressiveness to reduce labor costs. Levels of reduction will depend on internal and external factors that include individual performance, salary benchmarks, the financial condition and goals of the company, and labor supply conditions. (See also "Retooling Labor Costs: How to Fix Workforce Pay Structures," by Harry Hawkes, Albert Kent, Vikas Bhalla, and Nicholas Buckner, Booz & Company white paper, September 2010.)

Brass Tacks

Service strategy success always comes down to execution. As service operations leaders approach the quality and cost challenge, they should pay particular attention to the first two drivers: product and process design and service-level labor requirements. Too often, these drivers are overlooked because they must be activated in the design stage of products and processes: a stage in which service managers traditionally have not participated. The remaining four drivers — service network structure, service process management, workforce management, and measurement and compensation — are the levers that service leaders can pull to improve the quality and cost of existing operations. Savvy service leaders recognize the interconnected nature of these four drivers and approach them in an integrated and holistic manner.

High-quality, cost-effective service is essential to corporate success, but it is particularly challenging to achieve. Defining unique customer segments and models to profitably serve them requires frequent analysis. Service workforces tend to be large and have high turnover rates; they are difficult to mobilize. Service processes are complex and often dependent on the consistent execution of many detailed steps. And big, dramatic solutions to excessive costs are rare. Nevertheless, companies that take a measured and comprehensive approach to delivering service can improve their bottom line and gain a hard-to-match competitive advantage in the marketplace. +

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