SWP 42/92 THE LOGIC OF INTERNATIONAL GROWTH FOR SERVICE FIRMS

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1 - INTRODUCTION

In considering the tension between international expansion opportunities and development within domestic market boundaries, service companies face some particular problems. Service industries were historically defined as "local" industries. They were characterised by low entry barriers, diseconomies of scale, close local control, high personal service and "image" content, with service delivery at the point of sale or interaction with the customer or client (Sasser et al, 1978; Normann, 1984; Daniels, 1985; Albrecht & Zemke, 1985; Heskett, 1986; Hindley, 1987; Carlzon, 1987; Lovelock, 1988). This heavy emphasis on downstream value activities has traditionally suggested that international expansion of service businesses represented higher levels of risk as compared to manufacturing businesses (Carman & Langeard, 1980). Specifically, the risk resided in being distant from "local" customers and in problems of maintaining quality control, which had always to be delivered locally. In addition, the front-office (downstream) capabilities on which service delivery depends meant that service businesses were inappropriate candidates for global strategies, since they might be disadvantaged by the worldwide coordination required (Hout, Porter & Rudden, 1982; Bartlett & Ghoshal, 1986, 1987, 1989; Kogut, 1990).

In their international expansion, service firms seek to benefit from the same sources of potential advantage as manufacturing firms. These were collected by Ghoshal (1987) under the three headings of: national differences (e.g. to obtain beneficial factor costs, or offset country-specific government policies); scale economies (e.g. to spread cost-reduction and experience effects across national boundaries, to expand or exploit scale in purchasing, distribution, capital costs, etc.) and scope economies (e.g. shared investments, knowledge and learning across products and markets). The issue is whether such benefits from international expansion are as attainable for service firms as for manufacturing firms.

This paper argues that the sources of competitive advantage in service industries are changing. This is in turn affecting the competitive strategies appropriate for service companies. A combination of structural, market and technological changes has provided a shift in the nature of the activities within a service firm. Greater emphasis on "back-office" activities may be lowering the levels of perceived risk, and enhancing the potential benefits, attached to international expansion and even, in some circumstances, to globalisation, as a competitive strategy available to service firms.

Two related trends may be observed as being of particular importance in the internationalisation of service companies. First, the impact of high levels of investment in information technology (IT) by service businesses fragmentation to concentration in the structure of many service sectors. Consideration is given to the cumulative impact of concentration and IT on assumptions about both the lack of economies of scale in services and the strength of economies of scope.

This paper utilises, for services, the approach that Chandler (1977, 1986, 1990) developed in his model of the "dynamic logic" of industry growth and competition. An initial exploration of this and other related frameworks is provided, to show the consistent development of economies of scope as well as those of scale, for cost advantage, first-mover advantage in terms of service industry restructuring and the creation of some international oligopolies in services. It is asserted that the current dynamic of growth of service firms is beginning to parallel that in manufacturing.

2 - THE APPLICATION OF CHANDLER'S "LOGIC" TO SERVICES

The Manufacturing"Logic"

Chandler's work (1977, 1986, 1990) addresses the circumstances under which a firm will continue to grow to maintain a position of dominance. The economic basis of Chandler's model is "the cost advantages that scale and scope provide in technologically advanced, capital-intensive industries" (1990 p.32). It was a model of the managerial enterprise built on manufacturing industry data (e.g. oil, pharmaceuticals, agricultural machinery, steel) and from which industries which remained technologically simple and labour-intensive (e.g. textiles, leather, publishing) were excluded. Chandler (1986) showed that in sectors where few large firms appeared, it was because neither technological nor organisational innovation substantially increased minimum efficient scale. Therefore, in those industries, large plants did not offer significant cost advantages over smaller ones and "opportunities for cost-reduction through more efficient coordination of high-volume throughput by managerial teams remained limited" (1986 p.417). Hierarchies, (Chandler's "visible hand" (1977)) emerged and spread "only in those industries or sectors whose technology and markets permitted administrative coordination to be more profitable than market coordination" (p.11).

Elements of these arguments have been pursued by other researchers, with regard to globalisation strategies. Although the accumulated evidence so far is almost entirely based on manufacturing industries, by providing indicators of what works and what does not work in the globalisation strategies of manufacturing firms, some useful reinforcement is given to Chandler's growth "logic". Cvar (1986) in her case studies which included e.g. disposable syringes, pet food,and telecommunications equipment, and Baden-Fuller & Stopford (1991) in their longitudinal study of the European white goods industry, indicate some similarity of enabling and blocking conditions for global competitive strategies of firms. These included both fragmentation of demand, both within and across national boundaries; the extent to which important cost factors were susceptible (or not) to scale economies; the extent of aggressive investment in R&D and new technology, which may in turn affect levels of efficiency and profitability; the organisational efforts devoted to coordination and integration; the strategic intent of managerial hierarchies in making or withholding such investments.

The structure of service industries lay outside Chandler's "logic". Despite considerable variance across sectors, service industries have been neither so technologically advanced nor so capital-intensive as manufacturing. They have exhibited minimum efficient scale at low levels, with significant diseconomies of scale reached at modest levels of growth. (For a recent example of all these industry features see Dermine & Röller (1990) on the French mutual funds industry, where economies of both scale and scope are demonstrated for small to medium-size firms but disappear for larger firms.) Service businesses have also long been viewed as having specific characteristics: intangibility, perishability, simultaneity of production and consumption, and some interaction between buyer and supplier in the supply of the service (Eiglier & Langeard, 1977; Lovelock & Young, 1979; Grönroos, 1982; Normann, 1984; Flipo, 1988). These factors affected both demand for, and supply of, services. Thus the growth paths of service firms have indicated a different "logic".

For Chandler's model of growth now to be applicable to service industries, it would be necessary to review movement in service industries on all these dimensions. In particular, technology change and market change must be sufficient to justify change in the asset structures and strategies of service firms. The rest of this paper will review and assess this set of changes affecting the evolution of growth strategies of service firms.

<u>Scale and Scope in Services</u>

Any applicability of Chandler's "logic" to service businesses must consider how cost advantages derived from investments in volume, may yield economies of scale and scope in services. Table 1 lists some of the potential sources of economies of scale and economies of scope in services.

Any asset which yields scale economies, can also be the basis for scope economies if it provides input into two or more processes. Economies of scope are usually defined as existing when the cost of producing two outputs jointly is less than the cost of producing each output separately (Teece, 1980 & 1982). In clarifying the relationship between economies of scope and the scope of the business enterprise, Teece (1980) specified two important circumstances when integration of activities across a multiproduct firm would be needed to capture scope economies; first second, when a specialised indivisible asset is a common input into two or more products. Both of these conditions are now routinely to be found in service enterprises.

Table 1 Sources of Economies of Scale and Scope in Services

Economies of Scale	Economies of Scope
Geographic networks	IT/IS & shared information networks
Physical equipment	Shared learning & doing
Purchasing/supply	Shared innovation
Logistics & distribution	Shared R&D
Marketing	Shared channels for multiple offerings
Technology	Shared investments & costs
Production resources	Reproduction formula for service system
Management	Range of services & service development
Organisation	Complementary services
Operational support	Branding & international franchising
Knowledge	Training
Innovation	Diffusion of corporate identity
Culture	Internal exploitation of economies
Reduced transaction costs	Reinforcement effects of concentration
	Common governance

Source: authors' compilation and Normann (1984), Ghoshal (1987), Enderwick (1989).

Dunning (1989) suggests that knowhow and specialised assets often combine in service firms, with knowledge featuring as a special asset in services (see also Erramilli, 1990). The capability to acquire, process and analyse information is the key asset or core competence of many services (e.g. financial, software, brokerage, professional, the agency function of computerised reservation systems linking many service businesses). "Knowhow" here literally consists of the knowledge of how to combine human and physical resources to produce and process information.

Additionally, despite the traditional service industry assumptions, knowledge need not be perishable. It has a shelf life, during which time it may be repeatedly used at little or no cost (e.g. an advertisement, a software programme). Many services comprise a firm-specific pool of tacit knowledge. Service firms (e.g. management consultancies and other PSF's, fast food chains, hotel chains) are increasingly attempting to codify this inherited knowledge as the basis of standardisation of their products, to achieve cost-reduction and increased productivity, as well as reliability of service levels. Some of the strongest brands in services are based on perceived accumulated knowhow e.g. McKinsey, Reuters, Neilsen, in fixed costs which in itself exerts pressure to lower unit costs by spreading output over larger markets (for scale economies) and a wider variety of products (for scope economies).

In exploring "knowhow", Teece (1982) reviews its "fungible" character, i.e. that individual and organisational knowledge represent a generalisable capability rather than necessarily referring to the particular products and services which the enterprise is currently producing (captured recently by Prahalad & Hamel (1990) as "core competences"). This implies that where diversification is based on scope economies, the comparative advantage of the firm is defined in terms of capabilities rather than in terms of outputs. It therefore makes sense for service firms utilising scope economies to manage their international expansion by means of internalisation (i.e. the internal control and coordination of assets and activities) rather than by market transactions. Internalisation (Dunning, 1985) enables firms to bring managerial control to bear on internal capablities, giving greater control over their realisation. Thus internalisation is especially important in the growth of service firms in regard not just to efficiency, but to the harnessing of capabilities and the management of the "moments of truth" (Normann, 1984; Carlzon, 1987) in which the quality of service firms is experienced by their customers.

The Changed Services "Logic": Phase 1 - The Industry Evolution Phase

Chandler's "dynamic logic of growth and competition" occurs at the level of the firm and arises out of the investment and expansion decisions of the management hierarchy. Figure 1 is a diagrammatic representation of the path of those decisions. It shows the early stages of industry evolution.

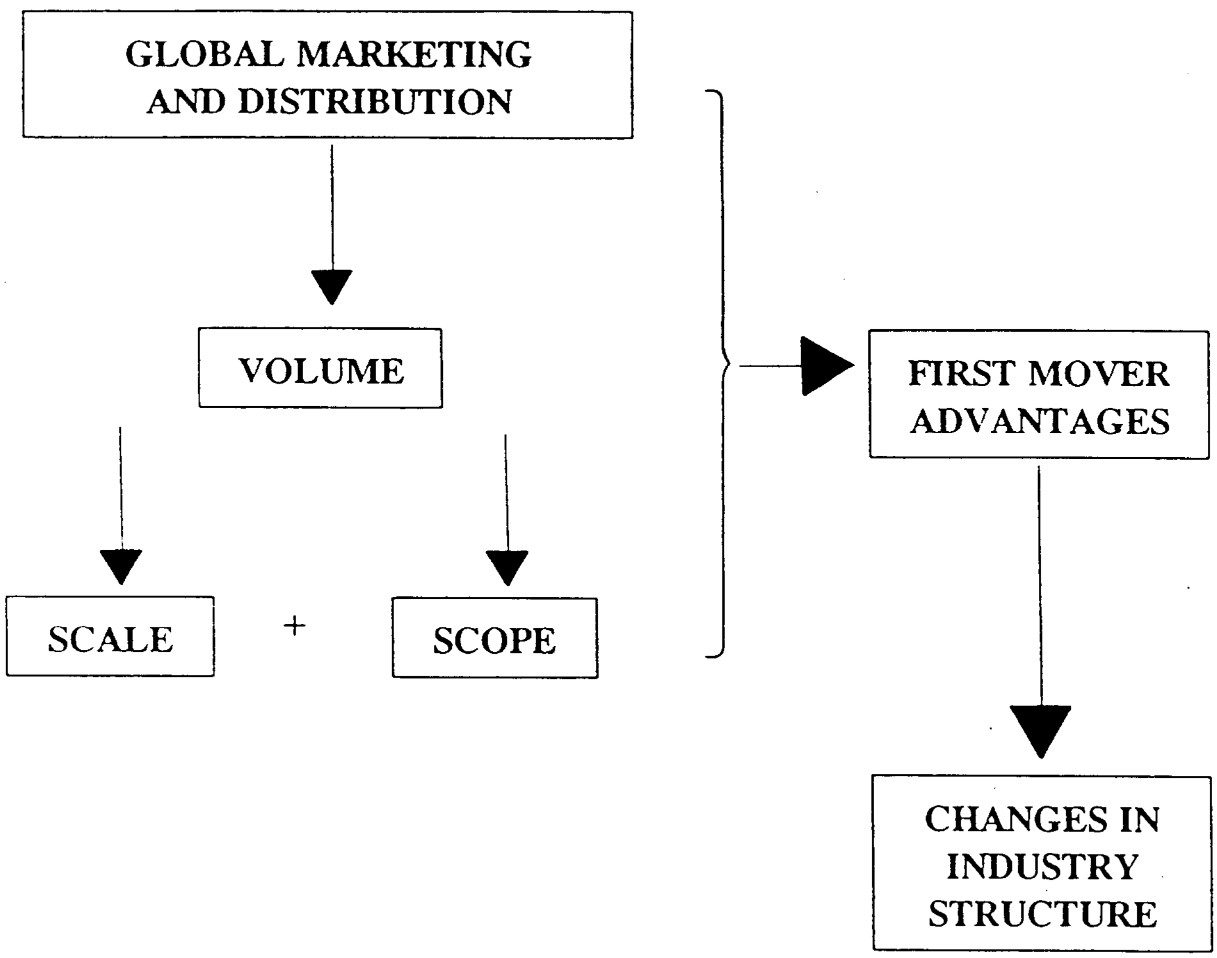
Figure 1 Chandler's Model of Growth and Competition: Phase 1

FIGURE 1 ABOUT HERE

Chandler's evidence explains the growth of firms to a position of dominance in their sector, through the early pursuit of cost advantages derived from volume. An example which may be helpful in illustrating the application of this "logic" in a service firm can be found in the financial services company American Express, which will be used here as a base case. Scale and scope are fundamentally cost-driven and Chandler shows that companies which create and sustain dominant positions in their

Figure 1

Chandler's Model of Growth & Competition: Phase 1



Source: Chandler (1986, 1990)

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which enable the firm to strongly influence the evolving structure of the industry and the critical bases of competition within it. American Express is a company in which scale and scope operate in a massive way. Over time it has successsively made the investments in marketing, distribution, volume, product and process outlined by Chandler for manufacturing. In so doing it created a world-scale service industry which it has dominated for more than a century after its' first international expansion moves.

As denoted in Figure 1, phase 1 of Chandler's "logic" consists of four sets of core investments: in volume, to achieve cost advantages of scale; in scope, to achieve consistent capacity utilisation; in national, and then international, marketing and distribution networks; and in a management hierarchy to coordinate and allocate current and future resource utilisation. Firms which moved first to make these coordinated sets of large investments could dominate their industries and influence its path of development, both in the short-term and longer-term. This is because challengers would have to match the first-mover advantages in comparable costs, build distribution and reputation to a point where the dominant incumbent could be effectively challenged, recruit teams of experienced managers and match specialised experience curve effects.

As applied to the development of American Express, there were a series of "phase 1"-style investments. The company was founded in New York, USA, in 1850 by Wells & Fargo, progressing rapidly from the express carriage of cash and parcels, to bonded carrier of freight and finance, handling European imports to all US Customs interior ports-of-clearance. Investment in its distribution network proceeded beyond national US coverage to the beginnings of its European network in freight forwarding from an initial office in Liverpool, UK, in 1881, to 300 European agency offices in 1890. Beyond scale expansion of the network, these also provided considerable expansion in scope, through the increased range of services offered, utilising additional capacity in the same network of outlets. The company was already benefitting from a virtuous cycle of scale, volume and scope effects which enabled it to advertise in brochures in Europe at this time that American Express could "pay money on Telegraphic Order, at a moment's notice, between points thousands of miles apart and sell small Drafts or Money Orders which.......can be cashed at 15,000 places." (Amex Company documents).

It began extending its management hierarchy in Europe by beginning its own directly owned chain of offices in Europe in 1895. The freight express business encompassed many developing financial service activities e.g. paying foreign money order remittances from emigrants, or commercial credit transactions begun in Rotteerdam in 1907. Via major new product development (e.g. Amex Express Money Order, 1882; Amex Travellers Cheque, 1891; Amex Charge Card, 1958), it is possible to illustrate Chandler's proposition that incumbent first-mover advantage : determine demand to provide additional services to tourists, such as itineraries and tickets. A European, and eventually worldwide, travel network was established, uniquely combined with the Amex portfolio of financial products and services to create a new set of asset structures for a specialised segment of the financial services industry. By the 1960's 38,000 outlets worldwide sold American Express "travel-related financial services" (TRS), which is still the source of 70% of the American Express Company's revenues in the 1990's.

From this specific illustration of Chandler's "logic" as applied to services, some more general observations may be made concerning scale and scope in services. The typology in figure 2 gives a customary representation of the spread of availability of scale and scope economies in different types of service businesses. Box 1 follows from the preceding discussion of American Express. Box 2 is illustrated by the high scale effects arising from concentration of retailer buying power, combined with limited scope opportunities, although some large food multiples also trade in clothing and homewares, and even financial services. Box 3 is illustrated by management consultancies or other professional service firms (PSF's), high on potential scope economies from e.g. shared client databases or shared teams of expertise, but with low potential economies of scale since these services are frequently customised, often with regulatory differences and culture-specific. Box 4 are typically small-scale service businesses, highly location-specific.

Figure 2 Potential for Scale and Scope Economies in Different Service Businesses

	Scope Economies: High	Low
Scale Economies: High	(1) Reuters American Express	(2) Food retailers
Low	(3) Management consultancies	(4) Car repair Hairdressing

Although this represents the traditional view of these varying types of service businesses, what is interesting from the point of view of this paper is the drift towards Box 1 (top left) on the matrix for many firms in consultancy firms and other PSF's, is part of the search for greater efficiencies in capacity utilisation of scarce resources and for productivity gains from implementation of standardised methodologies (see also Figure 5 below). Equally, food and non-food retailers have begun to operate beyond domestic boundaries (Treadgold, 1988; Segal-Horn & Davison, 1991) seeking to spread investments in information technology, logistics networks and branding. Finally, many erstwhile small service businesses are moving leftward on the matrix towards specialisation and standardisation (e.g. car exhausts or brakes only) to benefit from economies of scale in purchasing, operations and volume throughput. Clearly also, none of these shifts would be possible without at least some perceived shift on the demand side in consumer buying behaviour.

Economies of scope in services can lower transaction costs for customers. Common examples include the effect of retailer buying power on quality and price in multiple retail chains (Segal-Horn & McGee, 1989); worldwide reservation systems of hotel chains and airlines; cheaper products in banking and insurance; and in all brokerage services such as travel agents or investment analysts. Indeed, Nayyar (1990) discusses the potential benefit to diversified service firms from leveraging customer relationships across service businesses. He argues that buyers of services will attempt to economise on information acquisition costs by transferring reputation effects to other services offered by a firm, thus enabling the service firm to obtain quasi-rents from firm-specific buyer-seller relationships. This research contributes to our understanding of the growing importance of the branding of services and reinforces, for services, two of the main propositions regarding the competitive advantages of MNE's. First, (Caves, 1982) the ability of MNE's to create and sustain a successful brand image and its concomitant goodwill; second, the MNE's ability to monitor quality and reduce buyer transaction costs by offering services from multiple locations (Casson, 1982).

The Changed Services "Logic": Phase 2 - The Industry Dynamics Phase

In order to complete the discussion of the second phase of Chandler's model, the phase covering international growth and competition, it is necessary to reconsider the special characteristics of services described above. The applicability of Chandler's model of growth to services rests on fundamental shifts having occurred in the historically "local", domestic and small-scale character of service businesses. There is now de facto evidence that internationalisation of services is occurring. International chains exist in virtually all types of service businesses, even highly "local", regulated and culture-specific services such as education or medical services, (e.g. AMI health care group, EF language schools, international campuses trading on well-known university brand names). Some documented examples of national and international concentration and competition in services cover professional accountancy firms (Daniels et retailing (Treadgold, 1988; Segal-Horn & Davison, 1991), contracting (Enderwick, 1989), airlines (McKern, 1990; Olaisen et al, 1990), news agencies (Boyd-Barrett, 1989).

Underlying these trends is what Levitt (1986) called "the industrialisation of service". Echoing Chandler's central themes, Levitt argues that the key point in the industrialisation of service is "volume....sufficient to achieve efficiency, sufficient to employ systems and technologies that produce reliable, rapid and low unit cost results. That in turn requires....managerial rationality...."(Levitt, 1986 p.61). Services can be industrialised in a variety of ways. First, by automation, substituting machines for labour e.g. automatic car-wash, automatic toll collection, ATM cash machines, etc. Second, by systems planning, substituting organisation or methodologies for labour e.g. self-service shops, fast food restaurants, packaged holidays, unit trust investment schemes, mass-market insurance packages. Third, by a combination of the two (e.g. extending scope in food retailing via centralised warehousing and transportation/distribution networks for chilled, fresh or frozen foods in technically advanced temperature - and humidity-controlled trucks).

Such industrialisation of service is based on large-scale substitution of capital for labour in services, together with a redefinition of the technology-intensiveness and sophistication of service businesses. Building on these changes in the concentration and industrialisation of services, phase 2 of Chandler's model relating to growth via the international expansion of scale and scope, may now be discussed.

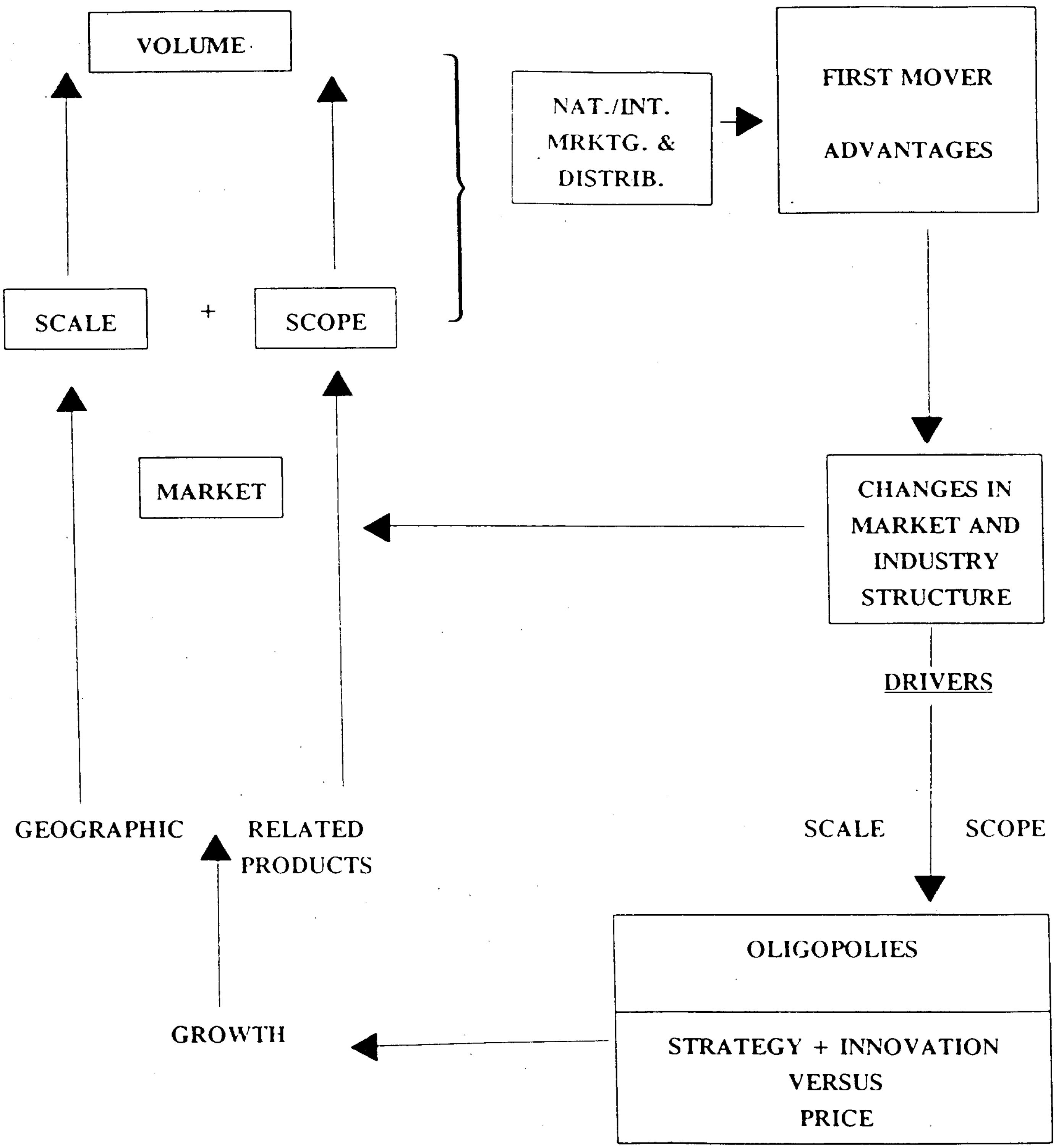
Figure 3 Chandler's Model of Growth and Competition: Phase 2

FIGURE 3 ABOUT HERE

Figure 3 provides a completed representation of Chandler's model. Arising from investments in scale, scope, distribution and management, large firms will have built dominant positions sufficient to influence the structure, key assets and capabilities relevant to competing in their industry. Thus economic advantages of scale and scope lead to national and international concentration, so that competition rapidly becomes oligopolistic. Such oligopolistic competition is based more on innovation than price, although firmly rooted in continuously enhanced cost structures. Growth thus becomes a continuous search for improved quality,

Figure 3

Chandler's Model of Growth & Competition: Phase 2



Source: Chandler (1986, 1990)

as well as new markets and lower costs. Some growth comes from acquisition, but the main emphasis for long-term growth is two-fold: first, geographic expansion into international markets in the continuous drive for increments in scale and cost advantages; second, related product markets in the pursuit of enhanced scope economies. Together these formed a dynamic spiral of volume, scale, scope and cost curves, reinforced by organisational capabilities developed to cope within fierce oligopolistic competition. Chandler emphasises repeatedly that the opportunity to create such first-mover investments is short-lived. The logic of sustainable international competition is to make long-term scale investments to create organisational capabilities, and then to continue to reinvest in these assets.

To return to our base case company, American Express, to illustrate this industry concentration phase of the model, many of Amex' innovations in new products, new markets, branding, advertising and distribution, have already been referred to above. Amex followed closely the twin routes for long-term growth, geographic expansion into international markets and the development of related product markets in the pursuit of enhanced scope economies. Amex had the earliest branded products in financial services and advertised these branded products heavily from the 1880's onwards. It invested heavily and continuously in distribution and marketing and in the extension of its network of outlets for its products and services worldwide. There was some growth via acquisition, as in the purchase of Fireman's Fund in 1968 to consolidate its move from a travel company across into financial services. Its related product markets now cover the express business, the travel business, financial services, movement of goods, movement of people, and the flow of money. These related businesses provide scale and volume, supported by company-wide global communications, data and information systems networks, which in turn support volume, worldwide geographic coverage and the monitoring of service quality in all outlets. Following Chandler, Amex does not compete on price but on product innovation, market development and levels of service. Whether its scale, scope and cost advantages are still sufficient to fight off the current new efficient competitors in its main markets (e.g. VISA) remains to be seen.

3 - THE EVOLUTION OF COMPETITION IN SERVICES

Since the Chandler growth model assumes a large enough market size to achieve benefit from scale effects, some consideration of the evolution in both markets and industry structure in services is appropriate.

Much of the historic pattern of competition in services occurred within domestic market boundaries as a result of the small-scale, fragmented structure of service industries, and their culture-specific patterns of demand and consumption. Under these conditions clearly scale and volume service sectors restructuring has led to concentration replacing fragmentation in industry structure. In addition, some homogenisation of demand in services is also observable.

Evolving Patterns of Demand in Services

There has been a lengthy and vigorous debate surrounding the validity of the argument that an increasing similarity exists between sets of consumers across international markets. The debate centres around the question of standardisation of products or services for broadly defined international market segments. The belief in consumer homogeneity is controversial, since it coexists with the view that fragmentation rather than homogenisation may more appropriately describe international consumer trends. Much discussion has taken place over the opportunities for, and barriers to, such standardisation (Kotler, 1985; Quelch & Hoff, 1986; Douglas & Wind, 1987; Link, 1988; Jain, 1989). It was triggered by Levitt (1983) who argued for convergence as a result of economic and cultural interdependencies across countries and markets. He argued that old-established differences in national preferences were being reduced by mass culture and communications technologies and urged companies to examine growing similarities between consumer preferences in the markets they served. Lifestyle segmentation has been around for a long time (Sheth, 1983). However the argument for homogenisation means that such segments should be defined internationally. International segmentation does not usually mean providing the same product in all countries, but offering local adaptations around a standardised core.

Well-known examples of this approach in services include the retail chain Benetton, which has built its whole strategy around the standardised core of Benetton's "one united product", with some adaptation of such things as colour choice for different domestic markets. Similarly, the restaurant chain Pizza Hut protects the core elements of its brand by copyrighting its individual product brand names (such as Perfect Pizza) and operating strict specifications of product ingredients. However, the Pizza Hut concept is adapted to suit local needs by varying some elements of the menu (such as desserts), or store design, or the way in which products are served to the customer. Some internationally standardised services would include those of American Express, which bases much of its marketing on worldwide consistency of quality, as do the international airlines and hotel chains. International segmentation (e.g. the business traveller) can give advantages of economies of scale, as well as branding, marketing and reputation benefits.

Many services (e.g. credit cards, airline seats, automatic carwash) are relatively recent products which, in international terms, have the advantage of no prior patterns of usage or acculturation, thereby making them more easily acceptable across national boundaries. However, for services, there are additional economic and political pressures on governments to create, or remove, regulatory barriers. These may be highly visible, as in the deregulation of international trade in financial services, or the 1970's deregulation of USA airlines, gradually also being pursued within EC competition policy in Europe. The current GATT round is devoted to services and, if satisfactorily concluded, should greatly simplify many current difficulties affecting international trade in services, such as intellectual copyright protection.

This brief discussion of segmentation and regulatory issues merely indicates some of the most important enabling conditions upon which international market development for services rests. Also of relevance is the way in which the structure of service industries is evolving, often across traditional notions of industry boundaries.

Industry Boundaries and Firm-Specific Advantages in Services

Reference has already been made to the contribution of fragmented industry structure to the evolution of competition in services, and to the restructuring and concentration which has been exhibited in most service sectors in recent years. Many service industries (such as travel, fast food, some financial services, information services) now meet Kobrin's (1991 p.18) definition of a global industry, defined in terms of "the significance of the competitive advantages of international operations" arising mainly from the structural characteristics of scale economies and technological intensity. However, service industry growth has often been across traditional industry boundaries (e.g. retail/financial services; retail/leisure; leisure/travel; travel/hospitality; accounting/management consultancy; advertising/public relations; etc.).

This leads to the notion of increasingly "fuzzy" industry boundaries in services, with industries not viewed discretely but as fuzzy sets. The base case of American Express used above is an example of service firm growth within a fuzzy industry set across leisure/travel/financial services. It also demonstrates how it is precisely because Amex operates across this fuzzy set that it is able to sustain such strong branding across its portfolio of related services. This may suggest that "growth " for service firms may not involve a deepening of asset structure as in manufacturing companies, but a horizontal accretion of assets across different markets and different industries (i.e. scope).

At the same time, the concepts of economies of scale and economies of scope explored in this paper operate at the level of the firm. The Chandler model of growth used in this paper is a resource-based explanation of successful international competition, driven by sustained investment in the development of firm-specific asset structures. Therefore, while the issue of change in service industry structure is central to any discussion most important factors determining successful international expansion in services should be understood at the level of the firm. This is particularly important with regard to the managerial and organisational capabilities of the firm. The point has been made with regard to MNE activity in general (Dunning, 1989), and service MNE activity in particular (Enderwick, 1989), that the way in which firms organise their international activities may itself be a crucial competitive advantage. This is strongly reinforced in recent work by Rumelt (1991), concluding that the most important sources of long-term business rents "are not associated with industry, but with the unique endowments, positions and strategies of individual businesses" (p.168).

These points may go some way towards explaining the successes and failures in international expansion undertaken by individual service firms. Figure 4 attempts to capture a range of international expansion strategies of service firms and the potential advantages and disadvantages of the logic underpinning them. It attempts to provide some insight into the nature of the expansion choices companies are prepared to make. It explores two different dimensions of capability in the international growth of service firms: cultural fit and economic risk. Each represents a significant barrier to internationalisation. The availability of economic gains accruing to service firms with a significant proportion of back-office investment and activity, must be weighed against the considerable organisational problems in achieving them.

Figure 4 Economic & cultural barriers affecting the international expansion of service firms

Change in economic & technical capabilities

Change in Corporate Culture	Low	High	
Low	Car rental Restaurants Insurance	Retailing Airlines Hotel chains Information services	Mainly Non-equity Licensing JV's
High	Advertising Management consultancies PSF's	Financial services Public utilities Telecommunications	Mainly FDI

Service firms attempting such competitive repositioning and particularly attempting to broaden the base of the firm in order to enhance scale and longer-term trauma. Some well-publicised examples include Saatchi & Saatchi and WPP in advertising; Arthur Andersen in accountancy / management consultancy; Citicorp, Chase Manhattan, Midland Bank in financial services.

4 - EVOLUTION OF THE INTERFACE: SERVICES AS "AUGMENTED" PRODUCTS

Rethinking Services as Augmented Products

Chandler's model is of international growth and competition based on firm-specific assets. It is interesting to note that such resource-based theories of the firm are making a comeback in competitive strategy (Grant, 1991), counterbalancing the industry structure-driven emphasis of strategic thinking of the 1980's. Since such assets may erode over time (Geroski & Vlassopoulos, 1991) and must be continually upgraded to sustain their advantage, it is important to review the implications of this approach to the changing nature of competition in services.

Enderwick (1989) provides insight into firm-specific advantages (FSA) and location-specific advantages (LSA) available to the service multinational enterprise (MNE). He builds on the work of Dunning (1981, 1985, 1989), and the eclectic paradigm of international production based on ownership, location and internalisation (OLI) advantages. Ownership incorporates competitive advantages; location incorporates configuration advantages; and internalisation incorporates coordination advantages. These issues have also been conceptualised in international strategy by Porter (1986) as issues of configuration and coordination in the allocation of value chain activities by the firm.

Enderwick includes under FSA, factors familiar from the earlier scale and scope debate in services: priveleged access to assets such as good will and brand name, particularly important in buying decisions for services (some aspects of this were discussed above under "knowhow"); scale economies obtainable from high fixed costs and low variable costs of operation; other economies of common governance available from single hierarchical management of complementary assets; and agglomerative (scope) economies which enable incumbent firms to offer innovatory or complementary services which reinforce their competitive position. Under LSA factors, most significant is the differential between services which are location-specific because production and consumption are inseparable and therefore where wide international representation is mandatory, compared to those services which are tradeable and therefore choice of international location would result from considerations of comparative advantage.

Lastly, the internalisation issue is of exceptional importance in reviewing the growth strategies of service firms and must be considered in relation characteristics have been utilised as the rationale in one of the most influential models explaining growth paths of service firms. Carman & Langeard (1980) argue that international expansion is the most risky growth strategy for service firms. This arises from the "intangibility" and "simultaneity" characteristics of services. Carman & Langeard have particularly emphasised how the quality control problems inherent in the daily operational detail of face-to-face service delivery are exacerbated when firms attempt tp operate across national boundaries. However, increasingly in the services literature the assumptions concerning the inevitability of "intangibilty" and "simultaneity" are being eroded. Products may be tangible or intangible or a combination of both (Levitt, 1986 p.74). O'Farrell & Hitchens (1990) propose "a continuum of tangibility" as more accurate. Levitan (1985), Boddewyn et al, 1986), Dunning (1989) distinguishing between pure consumer services and producer or intermediate services and Erramilli (1990) distinguishing between "hard" and "soft" services, all support the separation of production and consumption in many services. Therefore for a considerable range of service businesses, one of the highest risks of international expansion is reduced.

Under changed technical and structural conditions it becomes necessary to reconsider the definition of what constitutes a service and also to consider how service firms package such reconstituted products together.

Figure 5 <u>Service Standardisation</u>

	Resource emphasis Back-office	Front-office
Standardisation	Retail banking	Contract catering & cleaning
Customisation	Software	Professional service firms

Figure 5 provides a simple illustration of some of these product design and reconfiguration possibilities. It reflects some of the differences in core assets and service delivery between "hard" and "soft" services. However, the examples in figure 5 are inevitably oversimplified (e.g. t ignores the standardisation). Consonant with Chandler's view of international growth and competition as a sustainable dynamic, it is inevitable that continuous shifts such as those between standardisation and customisation, should result in firms continually seeking optimisation of such features at the highest level of scale and cost position available to them. It is also to be expected that these positions of optimum efficiencies will be continually shifting.

The continual search for optimisation of OLI advantages in services, using the same models and criteria as for manufacturing firms, makes simple distinctions between product and service obsolete. Borrowing from Levitt's (1986) concept of the "augmented" product, services increasingly cross any notional product/service boundary line whether of tangibility, perishability or simultaneity, and may usefully be conceptualised as "augmented" products. Just as Levitt argues that augmented products arise in relatively mature markets or with relatively experienced or sophisticated customers, so many services once regarded as highly specialised (e.g. airline seats, bank accounts) have become commodities. This exerts strong pressure on service providers to simultaneously push down costs <u>and</u> provide additional augmentations (e.g. better in-flight catering; longer bank opening hours). This pressure is itself contributing to the erosion of clear product-service distinctions. Increasingly, manufacturing firms are seeking augmentation through service features exploiting the manufacturing/services interface (see Quinn et al 1988 & 1990; Vandermerwe, 1990).

Figure 6 <u>Customer Buying Process For Services</u>

Service Construction	**Delivery Interface** Simple	**Delivery Interface** Complex
Local/ "Soft"	Immediate Single product	Range of choice Local advice Distribution & branding
Remote/ "Hard"	EOS in production Simple buying criteria Price-driven	High search costs Product variety Selling skills
	Product-specific Augmentation	**Scope-driven Augmentation**

Figure 5 raised issues of distribution of resources, focus of investment, sources of productivity, cost structures, levels of supervision & expertise, human resources and skill base, and managerial content. However it said relatively little about the customer. Figure 6 looks at the complexity of the interface which has to be constructed for the service customer. It reflects the change of balance between back-office and front-office activities, a more complex mix of customers, greater sophistication in the design and consumption of services. It is also worth noting in this regard that international expansion may create less difficulty in services than in manufacturing, since each service delivery system is focussed more on a specific customer group (Carman & Langeard, 1980).

5 - CONCLUSION: THE INTERNATIONALISATION OF SERVICES

This paper has reviewed some of the changes in the nature of service provision which have led service companies to turn more readily to international expansion. These changes include: a trend towards increased concentration in service industries and the resultant creation of larger service firms; increased pursuit of scale and scope economies in services; changed economic characterisitics leading to changed asset structures of service firms as they invest to enhance firm-specific volume, cost and distribution advantages for international expansion.

To the extent that scale and scope economies affect competition in services, the result has been similar industry dynamics to manufacturing. Manufacturing businesses and service businesses appear to be following similar development paths, creating similar types of asset structures, and competing in similar ways. Even the most distinctive characteristic of services, the criticality of the interface with the customer, is increasingly a hygiene factor for all types of businesses. The emphasis on customer service in manufacturing and the emphasis on efficient deployment of back-office assets in services, are each trying to capture the advantages the other has traditionally utilised. While the solutions being adopted by service firms mirror those in manufacturing, so do the problems, whilst the price of inappropriate internationalisation strategies in services can be high if they fail to meet customer needs.

International expansion of service firms appears often to take place across traditional industry boundaries, so that industry-level analysis in services is of increasingly fuzzy sets. Strategic groups in most service sectors are likely to be more persistent because differentiation between service firms is becoming more clearly based on distinctive asset structures as firms move away from commodity-style services. Further review of strategic groups in service industries may be a useful way of advancing understanding of the growth paths of service firms beyond Chandler's strong argument for pre-emptive moves powering the evolution of an industry and creating oligopolistic competition in a sector. The

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