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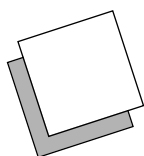
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## Purchasing business services

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### Introduction

In the service sector of the economy, business services experienced the fastest growth in number of establishments (22 percent) and sales (34 percent) between 1987 and 1992 (*Censuses of Service Industries*, 1987, 1992). Business services represent 17 percent of all services establishments and this sector claims the largest proportion of service jobs (29 percent).

A recent survey estimates outsourcing contracts with business services increased by about 40 percent in 1994, up from a 23 percent increase in 1993 (Lewis, 1995). As manufacturers focus their attention on being world class competitors, they will constantly have to reassess when to produce their own services and when to buy them. Many have found that specialized companies can now handle their accounting, legal, payroll, benefits, maintenance, repair, or even research and design functions much more effectively than can be done in-house (Tschetter, 1987). This is one of the factors contributing to the rapid growth of the business services industry in recent years. A recent cross-sectional examination of 11 segments of the business service sector indicates that all these segments exceeded GNP growth, and four grew at least twice as fast as GDP in the ten-year period 1982-1992 (Wilson and Smith, 1996). Again, the rapid growth reflected a significant tendency developed to “rent” services from independent providers as opposed to providing them from “in-house” personnel (Wilson and Smith, 1996, p. 166).

A recent survey by National Association of Purchasing Management revealed that the majority of the purchase dollars (54 percent) were spent for services not for goods. This was true for the total number of organizations, as well as the organizations in the service (81 percent) and government sectors (62 percent). In the manufacturing sector, as expected, the majority of purchase dollars (61 percent) were spent on goods (Fearon and Bales, 1995). In addition, a survey reports that industrial buyers are experiencing an increase in the purchase of services with more than one out of ten purchases being a service rather than a product (Dowst, 1987). Table I shows a breakdown of the types of services being purchased and the percent of survey respondents reporting each. This list of services indicates that a growing number of firms are making the “do-versus-buy” decision in favor of buying services formerly accomplished in-house.

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World class competitors

“Do-versus-buy” decision

| Business service                      | Percent purchased (%) |
|---------------------------------------|-----------------------|
| Standard office machine maintenance   | 79                    |
| Production equipment maintenance      | 69                    |
| Computer and peripherals maintenance  | 68                    |
| Building repair and construction      | 63                    |
| Janitorial and ground-keeping service | 58                    |
| Waste treatment and disposal          | 54                    |
| Auto and truck maintenance            | 48                    |
| Computer programming and software     | 47                    |
| Outside material processing           | 43                    |
| Product testing                       | 41                    |
| Temporary personnel                   | 40                    |
| Travel booking                        | 38                    |
| Instrument testing and calibration    | 38                    |
| Plant security                        | 33                    |
| Moving services                       | 31                    |
| Laundry and food service              | 30                    |

Source: Dowst (1987, p. 65)

Table I. Business services purchased by percent of survey respondents

Many reasons are given for this trend, among them are the specialized training needed to provide some services (computer software, maintenance), uneconomical nature of providing the service internally (plant security, laundry, waste disposal), obtaining expertise (travel booking, product testing), and paying for the service only when it is needed (temporary personnel, moving service).

Turning to external sources for a variety of services allows the organization to focus on what it does best. This, in turn, increases the responsibility of the purchasing function of the organization.

### A more complex process

The differences between goods and services, and how they should be marketed have been often examined (Berry, 1980; Lovelock and Yip, 1996; Stock and Zinszer, 1987; Thomas, 1978; Zeithaml, 1981; Zeithaml *et al.*, 1985). The majority of the previous studies, however, has focused on consumer services. Even a few studies discussing the differences in the industrial setting generally have ignored the organizational buyers of services (Jackson *et al.*, 1995). When the purchase of services is compared to that of goods, we find a more complex process with different risks to the buyer. Services are less tangible, making the evaluation of the vendor difficult to measure and the specification of the service desired less precise. Furthermore, it is difficult to judge if the services being delivered are meeting expectations because they are not subject to close scrutiny. There is no incoming inspection of deliveries as is the case for material goods. For example, how does one know if the contractor supplying plant security is being effective?

As noted by Parasuraman *et al.* (1985), service quality has many dimensions including reliability, responsiveness, assurance, empathy, and tangibles. Reliability is the ability to perform the promised service both dependably and accurately. Responsiveness is the willingness to help customers and to

### Business services need to be customized

provide prompt service. Assurance is the ability of servers to convey trust and confidence in a courteous manner. Empathy is the provision of caring, individualized attention to customers. Tangibles refer to the condition and appearance of the facility, equipment, and communication materials. Service quality is judged by the customer during the service performance as “process quality” and after the service is performed as “output quality.” These judgments are compared to pre-purchase expectations to evaluate service satisfaction (Berry *et al.*, 1985). Brensinger and Lambert (1990) and Bienstock *et al.* (1997) attempted to measure service quality in an industrial services context. However, Babakus *et al.* (1995) argue that research efforts on service quality should be expanded to include business services and even services within manufacturing industries to test service quality models and propositions.

The purchase process is complicated also by the need to satisfy a larger number of affected personnel. Contracted services such as travel booking, janitorial, and food services are examples that affect all employees personally, not in the detached way that material goods acquired for use in the production process are viewed.

Business services often need to be customized to meet an organization’s needs, especially in the case of production-related services. Also, business services tend to be more technological in nature than consumer services, because of the greater complexity of organizational needs (Jackson and Cooper, 1988).

This suggests that the decision process might differ depending on the service to be purchased. For example, the purchase of computer software must involve the active participation of the end users. The final selection will be based on many attributes; of which some, such as user friendliness, are difficult to quantify. The purchase of waste disposal service, however, could be handled in a routine manner with cost being the important criterion. However, given the legal liability associated with waste disposal, the selection of a vendor with knowledge and experience in your industry is important.

#### Classification of business services

Aljian and Farrell (1982) first defined business services as including four different types:

- (1) professional;
- (2) facilities and equipment-related;
- (3) personnel-related; and
- (4) labor and craft services.

### Three different categories of business services

Similarly Dobler *et al.* (1992) suggested three different categories of business services: personal, equipment and processing, and personnel and employee-related services. Criticizing these early classifications as being imprecise, Graw and Maples (1994) proposed a comprehensive listing of business services including facility-related, materials/logistics-related, communication, employee-support, and professional services. Jackson *et al.* (1995) divided business services into two categories: maintenance, repair, and operation (MRO) services and production services. Most recently, Boyt and Harvey (1997) classified industrial services into elementary service, intermediate service, and intricate service. However, these reported studies have failed to provide a classification scheme for categorizing all business

## Tangibility of service

services which not only include the broad array of services, but recognize unique aspects of industrial purchasing situations.

The service purchase decision has been differentiated on the basis of the tangibility of the service to be purchased (Schonberger, 1978). While services have generally been labeled as intangible, the extent to which a service lacks tangibility does vary. Further, it has been suggested that this lack of tangibility results in a service decision process that can be highly complex and difficult because the inputs available to the purchasing agent often become vague or ambiguous (Stock and Zinszer, 1987). Widely held characteristics of services such as inseparability, heterogeneity, perishability arise from the intangibility of services. Inseparability refers to the simultaneous production and consumption of services resulting in the fact that services cannot be stored for future sale. Heterogeneity of services is a recognition that a service is an experience and thus cannot be duplicated exactly for each customer. Service perishability recognizes that a service not performed is a lost opportunity, for example, flying empty seats on an airplane.

Bell (1986) proposed a two-dimensional array for classification of goods and services. Although the scheme involves both tangibility and degree of customization, it does not recognize the unique aspects of business services nor account for the special considerations needed in the purchase decision such as the criticality or importance of the service.

The degree of tangibility describes the extent to which the service has physically measurable output properties. At one extreme one might find a janitorial or laundry service. Such services are highly tangible with well defined and measurable output. At the other extreme one finds public relations or advertising services. For these services the output is significantly less measurable and more difficult to define. While differentiating services on the basis of tangibility does indicate the potential level of difficulty faced by the purchaser, it fails to provide the purchaser with significant information to assist in the service purchase decision.

## Strategic insights

Lovelock (1983) proposed several classifications of services for strategic insights including one in which he considered the direct recipient of the service to be either people or things. We propose expanding Lovelock's list of service recipients to include the business process. Thus the focus of the business service (property, people, and process) will be the principal dimension for our taxonomy and we treat the degree of service tangibility as an attribute to be considered when purchasing a service focused on any one of these three recipients. However, in general service tangibility will decrease as we move our service focus from property to process. The addition of a process focus accounts for the common practice of firms outsourcing one or more business functions to specialists. A service firm performing a business process function for the client (e.g. advertising) is thus enabling the outsourcing of that service.

As shown in Figure 1, the purchase process consists of need identification, information search, vendor selection, and performance evaluation. To account for all these purchasing activities, we feel that it is more important for the purchasing manager to know what aspect of the firm the service is directed at rather than just the degree of tangibility.

A second dimension representing the criticality or importance of the service to the buying firm must be considered in the purchase decision. The

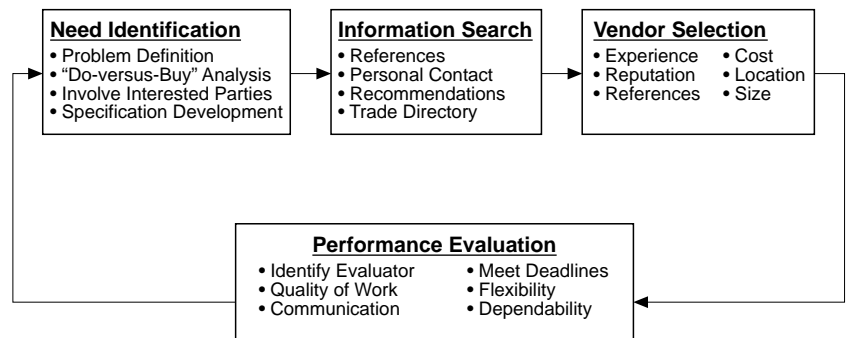


Figure 1. Purchase process

importance of the service is considered either high or low depending on the relationship of the service to the firm's core business activity. Services important to the core business will attract higher level management involvement in the purchase decision because the fit with corporate goals is critical with substantial exposure to risk if failure occurs. This is obvious for sensitive areas such as product testing, medical care, public relations, and advertising. Other services such as laundry, waste disposal, plant security, and travel booking would, in general, be considered less important to a firm's core business.

However considering a service as low in importance is a relative viewpoint. For example, the uniforms of personnel working in clean rooms of semiconductor manufacturers must be laundered under exacting conditions to avoid introducing contamination into the manufacturing process. Thus, a particular firm, based on their own circumstances, may wish to modify our classification of a service according to importance.

The result of this two-way classification is a six-cell matrix with each cell given a descriptive title for the business service category: facility support, equipment support, employee support, employee development, facilitator, and professional. In reviewing the taxonomy presented in Figure 2 it is possible to make several propositions regarding the process of purchasing business services.

### Propositions

#### *Proposition 1*

*As the focus of service moves from property to people to process, the difficulty of evaluating the service increases with the level of the decision maker involvement in the purchase increasing either by providing input to the decision process or actually making the decision.*

The evaluation difficulty arises from the proportion of the service that is intangible but also from the length of time until the final outcome can be determined, as in the case of professional services. Furthermore, as the focus of service moves from property to people to process, the service becomes more difficult to evaluate because the service involves proportionately more credence and fewer search or experience properties (Zeithaml, 1981). When the primary focus is property, because of the higher level of tangibility, it is possible to measure performance on the basis of an immediate before-after comparison (i.e. dirty to clean laundry or broken to repaired equipment). When the degree of tangibility is high, the before-after comparison provides a "perceived quality" measure which most organization members can agree

### A six-cell matrix

|                  |          | Importance of Service  |   |
|------------------|----------|--|---|
|                  |          | Low  | High  |
| Focus of Service | Property | <b>Facility Support:</b><br>–Laundry<br>–Janitorial<br>–Waste Disposal               | <b>Equipment Support:</b><br>–Repairs<br>–Maintenance<br>–Product Testing |
|                  | People   | <b>Employee Support:</b><br>–Food Service<br>–Plant Security<br>–Temporary Personnel | <b>Employee Development:</b><br>–Training<br>–Education<br>–Medical Care  |
|                  | Process  | <b>Facilitator:</b><br>–Bookkeeping<br>–Travel Booking<br>–Packaged Software         | <b>Professional:</b><br>–Advertising<br>–Public Relations<br>–Legal       |

Figure 2. A taxonomy for purchasing business services

on without need for senior management intervention. As the degree of tangibility decreases and the service outcomes are delayed, agreement becomes difficult resulting in a wide range of possible performance measures and need for expertise (e.g. selection of software). This increases the perceived risk inherent in the purchasing decision, stimulating risk handling behavior (Dowling, 1986) with the involvement of senior management in the decision (e.g. selection of an advertising agency).

*Proposition 2*

*As the focus of service moves from property to process, the service delivered becomes more difficult to evaluate with inputs to the decision process being dominated by surrogate measures such as past performance and professional certification.*

**Difficulty of evaluation**

These decision inputs, while helpful, are not the basis for comfortable decisions. As the difficulty of evaluation increases, it becomes a challenge to determine appropriate decision criteria on which decisions should be based and to evaluate service providers in an objective manner. When decision criteria are not well-formulated, purchasers will look for cues in the environment to aid them (Burton, 1990). As a result, the final selection is more likely to be made on the basis of secondary considerations. For example, in selecting from several travel agencies, all reputable and all providing the same basic service of booking travel, the final choice may be decided on the basis of ancillary services offered such as monthly billing rather than payment at the time of purchase and delivery of tickets. Also included is the interpersonal relationship between the supplier and the buyer. Jackson *et al.* (1995) suggest that organizational buyers will likely emphasize this factor in their frustrating attempt to evaluate services. One empirical study of consulting services found that buyers relied heavily on personal sources of information in evaluating services (Shostack, 1977).

*Proposition 3*

*The need for the supplier to be physically nearby decreases as a function of the movability of the target service (i.e. going from property to process).*

Process-focussed services

For example, a laundry, janitorial, or repair service needs to have an office relatively close to the facility in order to provide timely on-site service. In this case the target of the service is the property which is immovable and tangible. However, for professional services such as advertising and consulting, the vendor's location need not be in the same city and still provide satisfactory service. In the case of electronic service such as travel booking, physical distance does not represent a significant barrier to service delivery. Professional and electronic services are examples of process-focused services which are movable and intangible with the service provided off-site and proximity to the client is not an issue. However, people-focused services, such as providing food service or training services, are tangible but somewhat movable with an intermediate level of proximity required (i.e. some on-site such as plant security and some off-site such as education).

*Proposition 4*

*When the importance of the service is low, vendor selection is driven primarily by cost considerations.*

Purchasers place greater importance on price under conditions of evaluating less critical services, and on quality for more critical services (Ostrom and Iacobucci, 1995). Many non-critical services, such as janitorial, food service, and bookkeeping, can be considered as commodity services with price driving the purchase decision awarding contacts based on low bid. For important services, however, non-cost factors become of interest, such as immediate availability (i.e. 24-hour on call) in the awarding of a contract for repairs or experience in purchasing legal services. As a result, vendor selection becomes more uncertain with more important services. While the specifications may be exacting, it becomes more difficult to assess and to compare the ability of each potential supplier to meet those specifications because multiple criteria are involved in making the judgment.

*Proposition 5*

*For important services, the commitment to the service supplier is substantial and loyalty to the existing supplier is used as a risk reducing strategy.*

A higher level of commitment

For unimportant services the commodity nature of the service makes it easier for an organization to switch to a different supplier when the current supplier appears unsatisfactory. However, with more important services, the difficulty in identifying completed units of service as well as the time dependency of the evaluation process, pushes the organization to a higher level of commitment to the supplier as well as increased trust in the supplier. Along with possible pre-decision uncertainty as to expectations, this may result in the purchasing organization working closely with the supplier to "make it right". The tendency to be source loyal has been well established in industrial buying behavior. For example, Puto *et al.* (1985) reported the tendency among industrial buyers to remain loyal to existing suppliers, and Mitchell (1990) found that source loyalty was sometimes treated as a risk-reducing strategy for industrial buyers. Yet few studies have been done in the purchasing of business services.

**Implications for managers**

The purchase process diagram shown in Figure 1 is used to uncover the special considerations in the purchase of a business service from each of the six categories of our taxonomy. These purchasing considerations for each



category of business service are found in Table II grouped by the focus of the service.

Only the *facility support service* (property/low importance) can be treated in a manner similar to material goods purchase. Tight specifications can be prepared and vendor selection based on low bid would be appropriate. However, an interested person in the organization must be responsible for evaluating the performance of the service delivered with particular attention to quality and timeliness.

*Equipment support service* (property/high importance) creates an additional problem because the vendor should be located nearby to provide emergency service. In the service contract, someone in the organization must be identified as the person with the authority to request calls for emergency service. Because of the critical nature of maintenance and repair of industrial equipment or product testing, potential vendors should be limited to those with experience in the purchaser's industry. Vendor reputation supported with references is important in the selection criteria. In addition to quality of work performed, performance evaluation will include an assessment of communication problems and dependability.

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#### **Focus on property**

Facility support service

- Low cost important
- Need to identify responsible party to evaluate performance
- Tight specifications can be written

Equipment support service

- Experience and reputation of vendor important
- Vendor should be located nearby for emergency response
- Designate person with authority to make service call and to check that service has been accomplished satisfactorily

#### **Focus on people**

Employee support service

- Contact vendor clients for references
- Specifications prepared with end user input
- Evaluate service provided on a periodic basis

Employee development service

- Experience with particular industry important
- Involve high levels of management in vendor identification and selection
- Contact vendor clients for references
- Use employees to evaluate vendor performances

#### **Focus on process**

Facilitator service

- Knowledge of alternate vendors important
- Involve end user in vendor identification
- References or third party evaluations useful
- Have user write detailed specifications

Professional service

- Involve high level management in vendor identification and selection
  - Reputation and experience very important
  - Performance evaluation by top management
- 

*Table II. Purchasing considerations*

Evaluation should be made periodically

For services that serve people, user input becomes important in defining the specifications for the service. Requests for *employee support service* (people/low importance) usually originates with a functional department (e.g. marketing need for temporary secretarial staff) and, thus, the need specification will be developed with their input. Evaluation of the service provided should be made periodically by this same department and be a condition for contract renewal. The process of vendor selection should include obtaining references from vendor clients, a common practice with temporary help service.

*Employee development* (people/high importance) *service* requests will also originate with a functional department usually with involvement by the personnel department or higher level management (e.g. corporate for medical care). Employee development is an investment in the firm's human capital with considerable importance and requiring some expertise to guide the purchase of the service. For example, changing the health insurance carrier for a firm's employees has many ramifications and vendor selection is not a trivial decision. High levels of management must be involved in developing the need specification and vendor selection with some possible outside expertise. Vendor reputation and experience with the particular industry will be important. Employees affected by the service can be useful in the evaluation process. For example, it is common practice for employees to rate the instructor after a training session.

The least tangible classification of business service deals with activities (of an information processing nature) in support of the organization's mission or process. The *facilitator service* (process/low importance) involves routine information processing such as bookkeeping and travel booking. End users should be able to write detailed need specifications and identify possible vendors. For example, the selection of a travel agency could benefit from employee inputs as to ancillary services desired (e.g. credit card payment). Published reviews (e.g. word processing software) or other sources of comparison among vendors can be useful both in identification of possible sources and appropriate selection criteria.

*Professional service* (process/high importance) has significant impact on the strategic future of the organization. As such it must have top management involvement from the very beginning – starting with need identification and including all stages of the purchase process and most importantly performance evaluation. Since trust in the supplier becomes a primary factor, vendor reputation and experience are perhaps the only important selection criteria.

### **Conclusions and future research**

Purchasing managers should be able to classify their business services using our taxonomy with ease because the dimensions of high and low importance and focus of service (property, people, process) are unambiguous. Once classified, purchasing business services sharing the same category can be facilitated by using a similar approach to the purchase process. Experience with one service in a category will thus contribute to the knowledge base for purchasing other services in the future. Thus, the taxonomy becomes a framework to promote organizational learning in a systematic manner.

As Hunt (1976) demonstrated the usefulness of classification schemes in marketing, the taxonomy also helps industrial marketing managers segment the business service market or position the service. The dimensions of importance and focus of service many serve as useful bases for micro-

Classifying business service with ease

### Perform the traditional function

segmentation. As Boyt and Harvey (1997) pointed out, micro-segmentation provides incremental insights into customer expectations relative to service levels.

The taxonomy helped organize our thinking about special considerations that have implications for purchasing managers when confronted with a request to purchase a business service. Thus, the complexity of purchasing a business service is reduced by knowing that other services in the same category have similar considerations in their purchase.

Reflections on the management implications of our taxonomy and the special considerations for purchasing business services leads to some speculations on the role of the purchasing department as more services are outsourced. Either the end user or high levels of management should be involved in the entire purchasing process (i.e. need identification, information search, vendor selection, and performance evaluation). Thus, the role of the purchasing department may be significantly diminished for services purchased with *ad hoc* management groups and department heads controlling the decision.

However, the purchasing department will continue to perform the traditional function of contract administration but with the requester's input to develop the scope of work and what constitutes acceptable performance. Many steps in vendor selection and evaluation such as contacting references and obtaining samples of work may still be done by the purchasing department.

The above speculations on the role of the purchasing department in the purchase of business services needs to be evaluated. A survey of both buyers of business services and suppliers of business services is proposed to test the taxonomy and propositions presented in this paper. A better understanding of the business services purchasing process could result from such a survey and potentially lead to improvements in management practice.

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