



Services: Designing Companies

By Tom Van Riper, May 8, 2006

American companies have shown they can build better mousetraps, but can they create shorter waiting lines and fairer insurance premiums?

For all the kudos and profits garnered by consumer product companies like Apple Computer (nasdaq: AAPL - news - people) and Procter & Gamble (nyse: PG - news - people) for innovative gadgets like the iPod and the Swiffer, it's the service industry that now drives nearly 80% of the U.S. economy. And most players in that space--from banks to retailers to insurers--are just beginning to recognize their need to offer their customers the type of innovation that industrial designers have long brought to consumer products.

That specialized breed calling themselves business design consultants think service companies represent the next wave of their work, adapting to service industries the principles that product makers have used to differentiate themselves in the fight for retail shelf space.

For one, product developers have recognized that they need not always belt a home run. For every smash such as an iPod, more often there are incremental product improvements like Black & Decker's new power tape measure or Sears' (nasdaq: SHLD - news - people) hot stainless steel refrigerators going into remodeled kitchens, that drive sales.

Both P&G and Black & Decker (nyse: BDK - news - people) grew sales at double digit rates in 2004 and 2005. At PepsiCo (nyse: PEP - news - people), whose Frito-Lay unit now offers Doritos in a thin plastic tube that fits perfectly into a teenager's backpack, sales are up 21% over the past two years.

What's trickier for service organizations, though, is the difficulty of measuring quick, tangible results. While Black & Decker can see immediate sales data of a new chain saw, it's hard for Bank of America (nyse: BAC - news - people) to gauge the effect of placing television sets in branches to pacify customers stuck in teller lines (a practice it began earlier this year). Many CEOs are slow to warm to initiatives that are difficult to quantify immediately. How much do you spend on research & development for a new service, as opposed to a product?

"It's the business geeks who want to build a design ROI," says Jeneanne Rae, president of design consultant Peer Insight. The evidence, she says, lies in the fact that innovation is the long term lifeblood of a company.

That means organic growth, rather than the more broadly popular growth through acquisition. While sensible in some cases, it can take a longer time to bear fruit. Indeed, investment manager Brent Wilsey of Wilsey Capital Management says Wall Street values organic growth as a sign of long-term strength.

"We always want to see growth come from within, an acquisition can take two or three years to really hit the bottom line," he says.

Rae cited two hotel chains that have benefited from being ahead of the service innovation curve. Starwood extensively researched all customer touch points, resulting in shorter lines and initiatives to provide broadband to guests. Marriot, meanwhile, shook up its dull image by segmenting into multiple brands like Courtyard and Residence Inn. Shares of both have roughly tripled over the past three years.

But many banks that have completed big mergers haven't optimized the very cross-selling synergies they were after, since customer information is usually stored in separate silos in different parts of the operation. And corporate IT departments are usually focused more on keeping things stable than on being innovative.

"If I'm both a business customer and a personal customer, the way I'm dealt with is totally different. The idea is to have business and IT together early in the process," says Shelly Evenson, a former consultant who teaches service design at Carnegie Mellon. She tabbed Wells Fargo (nyse: WFC - news - people) as a major bank that's begun looking into tinkering with its systems architecture to help create a more seamless experience for customers.

IBM (nyse: IBM - news - people), which derives half its \$24 billion in annual revenues from services, is marrying its technology to the insurance industry to develop more accurate premium models. In collaboration with U.K.-based insurer Norwich Union, Big Blue recently began a pilot program for a pay system for car insurance based on the specific behavior of drivers, a method that measures risk beyond the traditional models of age and gender. Some 7,000 cars have been equipped with computer chips to track driving behavior, the result being a system that spits out a separate premium each month. So those who avoid the pubs after 11 P.M. can count on a break on their car insurance.

Meanwhile, a handful of big service companies are quietly assembling near the northeast corner of the country, where they can experiment with design improvements under the radar without worrying about material effects on quarterly result.

The Business Innovation Factory of Providence, Rhode Island, an offshoot of the state's Economic Development Corporation that's partially aimed at wiring all of Rhode Island for broadband, provides a cozy million-person test lab for businesses. Service company members include CVS (nyse: CVS - news - people), Citizen's Bank, Blue Cross-Blue Shield and UPS (nyse: UPS - news - people).

CVS, headquartered in nearby Woonsocket, Rhode Island, sees the state's initiative as a way to grow its pharmacy business, according to Senior Vice President Helen Foulkes. The company may soon experiment across the state by wiring employees to take pharmacy orders remotely.

Nationally, the company has turned to customer-specific marketing by segmenting its female customers--responsible for the bulk of sales--into three groups represented by names beginning with the company moniker: Caroline (the 18-34 year-old who represents the future), Vanessa (she's 35-54, taking care of the family), and Sophie (over 65 and sees the pharmacy not as a place to go when you're sick but as a means to stay healthy). Promotions for new products and specials are meted out accordingly.

"Retailers traditionally just house products, but what we want is to create a point of difference," says Foulkes.

The practice has resulted in targeted promotions for price specials and new products aimed specifically at each segment. Diapers are directed at Vanessa, the pharmacy at Sophie. And since further research showed their average female client stands five-foot-four, CVS lowered its shelves by a foot to an average of five feet from the ground.

The company, which just announced a 14% spike in first quarter profits over a year ago, grew same store sales 6.5% last year, up a full point from 2004. That's comparable to top rival Walgreen (nyse: WAG - news - people) and well ahead of competitors Duane Reade and Rite Aid (nyse: RAD - news - people), each of which saw less than a 2% rise in same-store sales over 2004.