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1 Introduction

‘How do you become not optional?’

William D. Green, CEO, Accenture

1.1 OVERVIEW

In 1937, British-born economist Ronald Coase concluded that the boundaries of firms are determined by *transaction costs*.²

The concept of *transaction costs* used here is not to be confused with the discrete cost of transactions such as requests, payments, trades and updates to databases. What is referred to here are the overall costs of economic exchange between two parties, including but not limited to costs incurred in finding and selecting qualified suppliers for goods or services of required specifications, negotiating an agreement, cost of consuming the goods or services, governing the relationship with suppliers, to ensuring that commitments are fulfilled as agreed.

Policing and enforcement costs are the costs of making sure the other party sticks to the terms of the contract, and taking appropriate action (often through the legal system) if this turns out not to be the case.

Sometimes it makes sense for a business to own and operate assets, or conduct activities in-house. At other times, the sensible thing is to seek alternatives from the open market. As prevailing conditions change, boundaries of the firm contract or expand with decisions such as *make, buy, or rent*. Coase received the Nobel Prize in Economics for this remarkable idea.

The world is changing at a faster pace than ever before. The forces of the internet, inexpensive computing, ubiquitous connectivity, open platforms, globalization, and a fresh wave of innovation are combining in ways that dramatically alter the transaction costs in almost every business. The result is greater dynamism and flexibility in the definition of markets for services. Markets are created almost spontaneously with innovative business models and value propositions. They emerge within enterprises, defy standard industry classifications, and extend farther in geography. The digitization of commercial activities, social interactions and government has meant fewer physical constraints on new business models, strategies and relationships. Knowledge and productive capacity are more dispersed than ever before. Organizations can *rent* what they were earlier forced to *make* or *own*. Generic concepts like *rent* translate into collaborative relationships

with service providers who provide access to capabilities and resources otherwise not available to the organization.

There is similar growth in consumer services driven by various social and economic factors and technology. Among the forces driving the consumption of services are rising per capita incomes, demand for social services, size and role of the public sector, complexity of work environments, increased specialization (division of labour), and relaxation of trade barriers.³ These trends are contributing worldwide to the growth of the service economy in a remarkable fashion.

Information technologies (IT) enable, enhance, and are embedded in a growing number of goods and services. They are connecting consumers and producers of services in ways previously not feasible, while contributing to the productivity of numerous sectors of the services industry such as financial services, communications, insurance, and retail services.³ Government agencies, too, have experienced similar gains associated with the use of IT.

- Organizations exploit resources as and when needed without owning them, even when those resources are remotely located and simultaneously shared.
- They use self-service channels such as websites, mobile phones, and kiosks to expose business functions such as billing, order processing, reservations, and technical support to consumers. Quality of service is no longer constrained by the capacity of branches, stores, and other staffed locations.
- Entrepreneurs and individuals compose new services assembled from existing services available in the commercial and public space.
- Service-oriented architectures are allowing organizations to not only reduce complexity of their business applications and infrastructure but to further exploit such assets in new ways.

Tremendous change and growth is taking place in information-based services. Information, previously a supporting element, has become the basis for value by itself. The relaxation of physical constraints has changed our thinking about how information is produced and consumed. Recent years have seen significant increases in valuation for businesses that simply facilitate interactions or the exchange of information. Capabilities and resources in the management of IT and the management of services are no longer perceived as merely operational concern or

detail. They are the basis for creating value, for competition, and distinctive performance.

The trends noted above require IT organizations to have a keener sense of the nature and dynamics of services as a means for providing value to customers. It is not surprising that growth and prosperity of a trade are accompanied by greater demands on the tools of the trade. The practice of service management grows, learns, and matures under the pressure of new challenges and opportunities.

Imagine you have been given responsibility for an IT organization. How would you decide on a strategy to serve your customers? Perhaps you would examine requirements in detail and plan appropriately. You might track ongoing demand and adjust accordingly, while maintaining operational efficiency. Surely an attentive service provider with low costs must inevitably succeed. Unfortunately, while these are all necessary factors, things are rarely so straightforward.

First, issues surrounding services are complex. Not only in their individual details but also in the dynamic complexity that comes with many moving and interrelated parts. Long-term behaviour is often different from short-term behaviour. There are many tools for dealing with details but few offer insight into how the problems we have today have developed over time. What are needed are methods to help organizations understand the likely consequences of decisions and actions.

Second, customer specifications are not always clear, certain or even correct. Much is lost in the translation from requirements document to service fulfilment. The most subtle aspect of strategic thinking lies in knowing what *needs* to happen. Customer outcomes, rather than specifications, are the genesis of services. Strategic plans, while critical for enacting change, are not enough.

A strategic perspective begins with the understanding of competition. Sooner or later, every organization faces competition. Even IT organizations with a relatively captive internal market of *owner-customers* are not entitled to a perpetual monopoly. The recent trends in outsourcing of business functions and operations have made that clear. A change in prevailing business conditions or a new business strategy pursued by the customer can suddenly expose the IT organization to competition. Even government and non-profit IT organizations have shown themselves to be subject to competitive forces. It is important for IT organizations to review their positions and know for sure how they provide *differentiated value* to their customers.

Customers perceive value in economic terms or in terms of social welfare, as is the case with pure public services offered by government agencies, or both. The differentiation can be in traditional terms such the organization's knowledge and experience with the customer's business, excellence in service quality, capabilities to reduce cost, or innovation.

The idea of *strategic assets* is important in the context of good practice in service management. It encourages IT organizations to think of investments in service management in the same way businesses think of investing in production systems, distribution networks, R&D laboratories, and various forms of intellectual property such as brands and patents. Assets such as people, processes, knowledge and infrastructure are by themselves valuable for the benefits they generate for their owners. Strategic assets are those that provide the basis for core competence, distinctive performance, durable advantage, and qualifications to participate in business opportunities. IT organizations can use the guidance provided by ITIL to transform their service management capabilities into strategic assets.

Having a cost advantage over competition is one among many options. Being the lowest-cost provider is necessary but not always sufficient to support business strategies. There is a need to develop other strengths over and above efficiency in costs. Helping customers enter new markets and quickly scale up operations, for example. An IT organization can better serve customers and outperform competition by better understanding the complexity, uncertainty, and trade-offs the customer is facing. The key is to decide on an objective or end-state that differentiates the value of what you offer, on what terms, and in what form so that it outperforms what customers consider to be alternatives. Strategy need not simply be an exercise in gathering requirements or the pursuit of operational effectiveness. It is a means to become *not optional*.

Formulating strategy has traditionally been in the hands of upper levels of management. Yet in the world of IT, where conditions change rapidly and the knowledge and expertise required for sound decisions are usually found on the front lines, IT leaders have an important role to play. From CIOs to front-line managers, each has the ability to shape and execute service strategies. The rigid 'plan and deploy' model is giving way to the dynamic 'engage and collaborate' model.

The ultimate success of service management is indicated by the strength of the relationship between customers and service providers. The publications of the core ITIL library provide the necessary guidance to achieve such

success. In addition to this publication, the volumes *Service Design*, *Service Transition*, *Service Operation* and *Continual Service Improvement* define a body of knowledge and set of good practices for successful service management. They provide guidance for:

- Converting innovative ideas and concepts into services for customers
- Solving problems with effective and enduring solutions
- Controlling costs and risks that can potentially destroy carefully created value
- Learning from successes and failures to manage new challenges and opportunities.

The guidance can be applied by IT organizations in the public and private sectors; by for-profit and non-profit organizations; for internal service providers with cost-recovery objectives; and commercial outfits with profitability targets. Terms such as profitability, income, pricing, revenue and competition can be interpreted or substituted to be meaningful in the context of all service providers with rare exceptions. As such they are used throughout this publication with minimal annotation or clarification to avoid interrupting the flow of text.

Finally, the frequently cited objective of ‘alignment with the business’ characterizes a common problem faced by the leadership of IT organizations in general and CIOs in particular. Those who succeed in meeting this objective are those who understand the need to be business-minded. The increasing popularity of managed services and outsourcing places tremendous pressures on internal providers to adopt the structure and behaviour of a professionally managed business. A well-managed IT organization can act like a business within a business and deliver value that meets or exceeds the value proposition of commercial alternatives. For this reason, concepts such as utility, warranty, market spaces, portfolios and playing fields, are introduced.

1.2 CONTEXT

1.2.1 Information technology and services

Information technology (IT) is a commonly used term that changes meaning with context (Table 1.1). From the first perspective, IT systems, applications and infrastructure are components or sub-assemblies of a larger product. They enable or are embedded in processes and services. From the second perspective, IT is an organization with its own

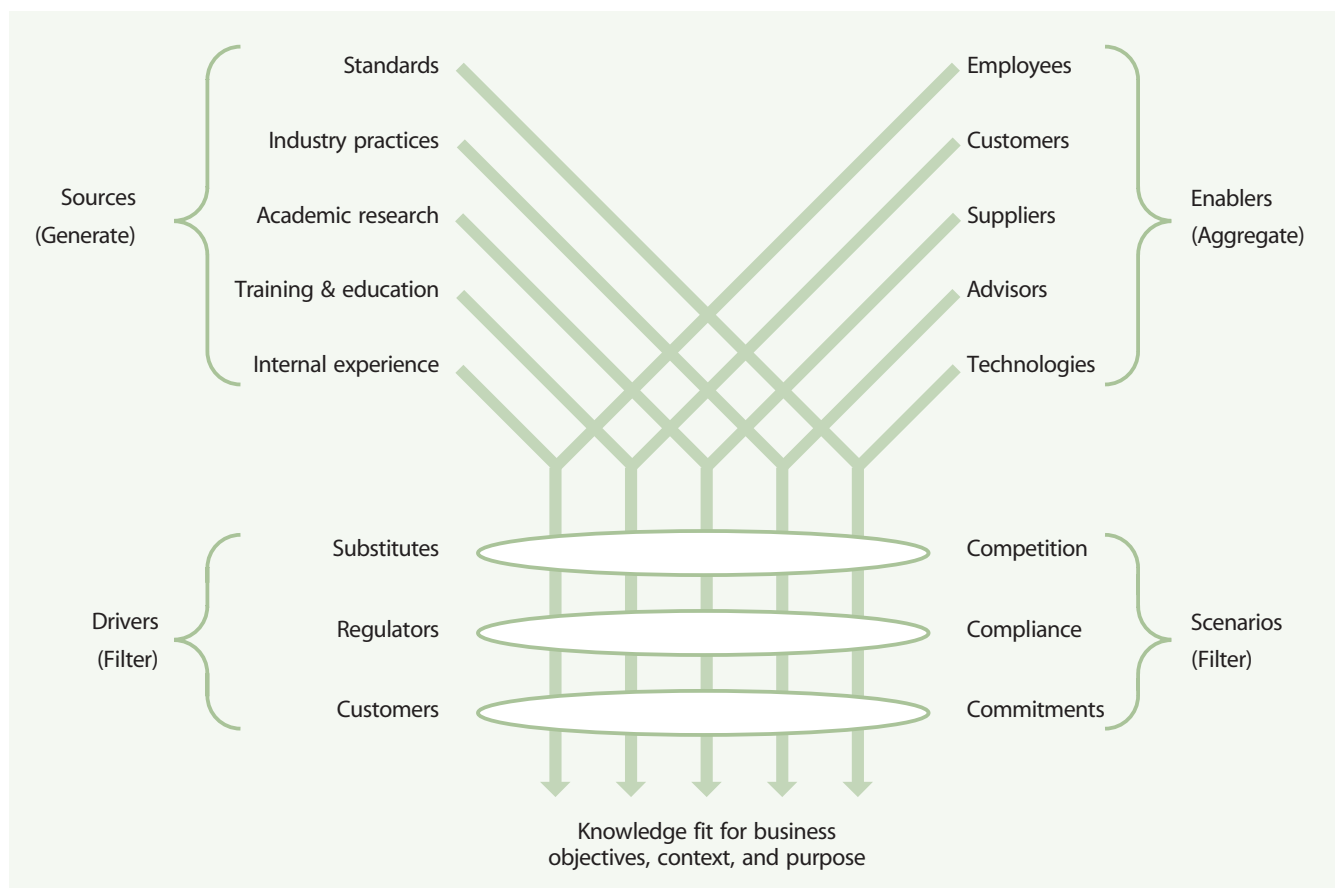


Figure 1.1 Sourcing of service management practice

set of capabilities and resources. IT organizations can be of various types such as business functions, shared services units, and enterprise-level core units.

From the third perspective, IT is a category of services utilized by business. These services are typically IT applications and infrastructure that are packaged and offered as services by internal IT organizations or external service providers. IT costs are treated as business expenses. From the fourth perspective, IT is a category of business assets that provide a stream of benefits for their owners, including but not limited to revenue, income and profit. IT costs are treated as investments. It is important to be clear what the term means in a given context. It is often used with different meanings in the same sentence or paragraph, often exacerbating problems.

1.2.2 Good practice in the public domain

Organizations operate in dynamic environments with the need to learn and adapt. There is a need to improve performance while managing trade-offs. Under similar pressure, customers seek advantage from service providers. They pursue sourcing strategies that best serve their own business interest. In many countries, government agencies and non-profit organizations have a similar propensity to outsource for the sake of operational effectiveness. This puts additional pressure on service providers to maintain a competitive advantage with respect to the alternatives that customers may have. The increase in outsourcing has exposed internal service providers in particular to unusual competition.

To cope with the pressure, organizations benchmark themselves against peers and seek to close gaps in

Table 1.1 The multiple views of IT

View	Visualization	Vernacular
IT/Component	Components of systems and processes	<p>'Our billing system is IT-enabled.'</p> <p>'We use IT to improve interactions with our customers through self-service terminals at key locations.'</p> <p>'IT touches every part of our business. Without appropriate controls, that in itself is a risk.'</p>
IT/Organization	Internal unit or function of the enterprise or commercial service provider	<p>'Our IT is headed by a CIO with tremendous experience in the transportation business.'</p> <p>'Our heavily centralized IT suits our business model which more than anything requires stability and control over business operations.'</p> <p>'IT does not understand the language of our business. Much is lost in translation.'</p>
IT/Service	Type of shared service utilized by business units	<p>'I haven't been able to access the internet since yesterday. When do you expect the service to be restored?'</p> <p>'Our remote-access service is very secure but it is also very difficult to set up and use.'</p> <p>'We decided not to build our own enterprise applications for administrative functions. We are better off utilizing IT services provided to us under a commercial contract.'</p>
IT/Asset	Capabilities and resources that provide a dependable stream of benefits	<p>'IT is at the core of our business process. We use IT to create value for our customers. It is part of our core production process.'</p> <p>'Our IT investments are like Cost of Goods Sold (COGS). They are direct costs, not overheads.'</p> <p>'IT is our business.'</p>

capabilities. One way to close such gaps is the adoption of good practices in wide industry use. There are several sources for good practices including public frameworks, standards, and the proprietary knowledge of organizations and individuals (Figure 1.1).

Public frameworks and standards are attractive when compared with proprietary knowledge:

- Proprietary knowledge is deeply embedded in organizations and therefore difficult to adopt, replicate, or transfer even with the cooperation of the owners. Such knowledge is often in the form of tacit knowledge, which is inextricable and poorly documented.
- Proprietary knowledge is customized for the local context and specific business needs to the point of being idiosyncratic. Unless the recipients of such knowledge have matching circumstances, the knowledge may not be as effective in use.
- Owners of proprietary knowledge expect to be rewarded for their long-term investments. They may make such knowledge available only under commercial terms through purchases and licensing agreements.
- Publicly available frameworks and standards such as ITIL, COBIT, CMMI, eSCM-SP, PRINCE2, ISO 9000, ISO/IEC 20000, and ISO/IEC 27001 are validated across a diverse set of environments and situations rather than the limited experience of a single organization. They are subject to broad review across multiple organizations and disciplines. They are vetted by diverse sets of partners, suppliers, and competitors.
- The knowledge of public frameworks is more likely to be widely distributed among a large community of professionals through publicly available training and certification. It is easier for organizations to acquire such knowledge through the labour market.

Ignoring public frameworks and standards can needlessly place an organization at a disadvantage. Organizations should cultivate their own proprietary knowledge on top of a body of knowledge based on public frameworks and standards. Collaboration and coordination across organizations are easier because of shared practices and standards. According to research by the UK Department of Trade and Industry (DTI), the value to the UK economy from standards is estimated to be about £2.5 billion per annum.⁴

The following public frameworks and standards are relevant to service management:

- ISO/IEC 20000
- ISO/IEC 27001

- Capability Maturity Model Integration (CMMI®)
- Control Objectives for Information and related Technology (COBIT®)
- Projects in Controlled Environments (PRINCE2®)
- Project Management Body of Knowledge (PMBOK®)
- Management of Risk (M_o_R®)
- eSourcing Capability Model for Service Providers (eSCM-SP™)
- Telecom Operations Map (eTOM®)
- Six Sigma™.

Organizations find the need to integrate guidance from multiple frameworks and standards. Expectations on the effectiveness of such integration efforts should be reasonably set as suggested by the following expert on standards:

‘Frameworks like standards invariably form part of larger complex business systems and as such relating them to each other rigorously requires a systems discipline. Without this you are left with a few cross-references, some guidance notes, and a lot of “tacit knowledge” gluing them together.’

Paul McNeillis, head of professional services at the British Standards Institution⁴

1.2.3 ITIL and good practice in service management

The context of this publication is the ITIL framework as a source of good practice in service management. ITIL is used by organizations worldwide to establish and improve capabilities in service management. ISO/IEC 20000 provides a formal and universal standard for organizations seeking to have their service management capabilities audited and certified. While ISO/IEC 20000 is a standard to be achieved and maintained, ITIL offers a body of knowledge useful for achieving the standard.

The ITIL Library has the following components:

- The ITIL Core: best practice guidance applicable to all types of organizations who provide services to a business.
- The ITIL Complementary Guidance: a complementary set of publications with guidance specific to industry sectors, organization types, operating models, and technology architectures.

The ITIL Core consists of five publications (Figure 1.2). Each provides the guidance necessary for an integrated approach as required by the ISO/IEC 20000 standard specification:

- Service Strategy

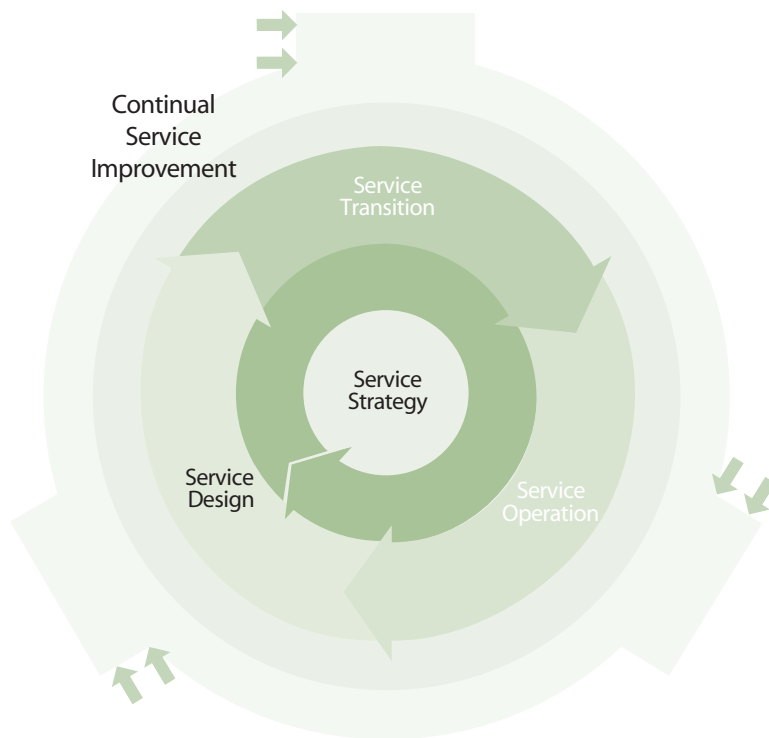


Figure 1.2 The ITIL Core

- Service Design
- Service Transition
- Service Operation
- Continual Service Improvement.

Each publication addresses capabilities having direct impact on a service provider's performance. The structure of the core is in the form of a lifecycle. It is iterative and multidimensional. It ensures that organizations are set up to leverage capabilities in one area for learning and improvements in others. The core is expected to provide structure, stability and strength to service management capabilities with durable principles, methods and tools. This serves to protect investments and provide the necessary basis for measurement, learning and improvement.

The guidance in ITIL can be adapted for use in various business environments and organizational strategies. The Complementary Guidance provides flexibility to implement the Core in a diverse range of environments. Practitioners can select Complementary Guidance as needed to provide traction for the Core in a given business context, much like tyres are selected based on the type of automobile, purpose, and road conditions. This is to increase the durability and portability of knowledge assets and to protect investments in service management capabilities.

1.2.3.1 Service Strategy

The Service Strategy volume provides guidance on how to design, develop, and implement service management not only as an organizational capability but also as a *strategic asset*. Guidance is provided on the principles underpinning the practice of service management that are useful for developing service management policies, guidelines and processes across the ITIL Service Lifecycle. Service Strategy guidance is useful in the context of Service Design, Service Transition, Service Operation, and Continual Service Improvement. Topics covered in Service Strategy include the development of markets, internal and external, service assets, Service Catalogue, and implementation of strategy through the Service Lifecycle. Financial Management, Service Portfolio Management, Organizational Development, and Strategic Risks are among other major topics.

Organizations use the guidance to set objectives and expectations of performance towards serving customers and market spaces, and to identify, select, and prioritize opportunities. *Service Strategy* is about ensuring that organizations are in a position to handle the costs and risks associated with their Service Portfolios, and are set up not just for operational effectiveness but also for distinctive performance. Decisions made with respect to Service Strategy have far-reaching consequences including those with delayed effect.

Organizations already practising ITIL may use this publication to guide a strategic review of their ITIL-based service management capabilities and to improve the alignment between those capabilities and their business strategies. This volume of ITIL encourages readers to stop and think about *why* something is to be done before thinking of *how*. Answers to the first type of questions are closer to the customer's business. Service Strategy expands the scope of the ITIL framework beyond the traditional audience of IT Service Management professionals.

1.2.3.2 Service Design

The Service Design volume provides guidance for the design and development of services and service management processes. It covers design principles and methods for converting strategic objectives into portfolios of services and service assets. The scope of Service Design is not limited to new services. It includes the changes and improvements necessary to increase or maintain value to customers over the lifecycle of services, the continuity of services, achievement of service levels, and conformance to standards and regulations. It guides organizations on how to develop design capabilities for service management.

1.2.3.3 Service Transition

The Service Transition volume provides guidance for the development and improvement of capabilities for transitioning new and changed services into operations. This publication provides guidance on how the requirements of Service Strategy encoded in Service Design are effectively realized in Service Operation while controlling the risks of failure and disruption. The publication combines practices in Release Management, Programme Management, and Risk Management and places them in the practical context of service management. It provides guidance on managing the complexity related to changes to services and service management processes, preventing undesired consequences while allowing for innovation. Guidance is provided on transferring the control of services between customers and service providers.

1.2.3.4 Service Operation

This volume embodies practices in the management of service operations. It includes guidance on achieving effectiveness and efficiency in the delivery and support of services so as to ensure value for the customer and the service provider. Strategic objectives are ultimately realized through service operations, therefore making it a critical capability. Guidance is provided on ways to maintain stability in service operations, allowing for changes in

design, scale, scope and service levels. Organizations are provided with detailed process guidelines, methods and tools for use in two major control perspectives: reactive and proactive. Managers and practitioners are provided with knowledge allowing them to make better decisions in areas such as managing the availability of services, controlling demand, optimizing capacity utilization, scheduling of operations and fixing problems. Guidance is provided on supporting operations through new models and architectures such as shared services, utility computing, web services and mobile commerce.

1.2.3.5 Continual Service Improvement

This volume provides instrumental guidance in creating and maintaining value for customers through better design, introduction, and operation of services. It combines principles, practices, and methods from quality management, Change Management and capability improvement. Organizations learn to realize incremental and large-scale improvements in service quality, operational efficiency and business continuity. Guidance is provided for linking improvement efforts and outcomes with service strategy, design, and transition. A closed-loop feedback system, based on the Plan, Do, Check, Act (PDCA) model specified in ISO/IEC 20000, is established and capable of receiving inputs for change from any planning perspective.

1.3 PURPOSE

To operate and grow successfully in the long-term, service providers must have the ability to think and act in a strategic manner. The purpose of this publication is to help organizations develop such abilities. The achievement of strategic goals or objectives requires the use of strategic assets. The guidance shows how to transform service management into a strategic asset. Readers benefit from seeing the relationships between various services, systems or processes they manage and the business models, strategies or objectives they support. The guidance answers questions of the following kind:

- What services should we offer and to whom?
- How do we differentiate ourselves from competing alternatives?
- How do we truly create value for our customers?
- How do we capture value for our stakeholders?
- How can we make a case for strategic investments?
- How can Financial Management provide visibility and control over value creation?
- How should we define service quality?

- How do we choose between different paths for improving service quality?
- How do we efficiently allocate resources across a portfolio of services?
- How do we resolve conflicting demands for shared resources?

A multi-disciplinary approach is required to answer such questions. Technical knowledge of IT is necessary but not sufficient. The guidance is pollinated with knowledge from the disciplines such as operations management, marketing, finance, information systems, organizational development, systems dynamics, and industrial engineering. The result is a body of knowledge robust enough to be effective across a wide range of business environments. Some organizations are putting in place the foundational elements of service management. Others are further up the adoption curve, ready to tackle challenges and opportunities with higher levels of complexity and uncertainty.

1.4 EXPECTED USE

The Service Strategy volume is expected to be useful for IT organizations in developing capabilities in service management that set up and maintain a strategic advantage in their goals of being valuable service providers. Service Strategy covers several aspects of service management. It provides guidance useful in defining strategic objectives, providing direction for growth, prioritizing investments, and defining outcomes against which the effectiveness of service management may be measured. It is useful for influencing organizational attitudes and culture towards the creation of value for customers through services. The publication identifies objectives for effective communication, coordination, and control among various parts of a service organization having contact with customers, partners and suppliers. The knowledge in this publication is useful in determining and controlling the consequences of pursuing a particular service strategy with a given set of capabilities and resources. IT organizations are able to innovate and operate under constraints such as contractual commitments, service level requirements, and government regulations. Contracts include both formal legally binding agreements as well as informal internal agreements between parts of an organization. Strategic decisions and policies are made clear enough to every agent in the organization with a role in delivering service. High-level perspectives and positions defining service strategy are broken down into plans and actions assigned to specific roles and responsibilities in service management.

It is common practice to develop capabilities and resources that achieve strategic objectives. It is also true that strategic options considered are often constrained by capabilities at hand. Improvements and innovations can extend the range of capabilities and resources, allowing organizations to pursue new or modified objectives, in turn placing new demands on capabilities and resources. These are the dynamics of business, and service management plays an active role. Service management creates viable options for strategy and helps exercise those options through a portfolio of services. It is therefore important to understand the dependencies between strategy and service management processes.

1.4.1 Some warnings

Many problems and situations in IT resist improvement and lack predictability. At times a solution is conceived and deployed, only to present as many unintended consequences as intended ones. The long-term performance of a service or process may be frustratingly different from its short-term performance. Obvious solutions fail or worsen the situation (Figure 1.3).

Organizations find it difficult to maintain the benefits from initially successful process improvement programmes. Worse, despite the demonstrated benefits, many process improvement programmes end in failure.⁵ In some puzzling instances, successful programmes worsen business performance and decrease morale. This is phenomenon is referred to as the 'Improvement Paradox'.⁶

The phrase 'People, Process, and Technology' is a useful teaching tool. A closer examination, however, reveals complexities such as time delays, dependencies, constraints and compensating feedback effects. The following are observations in the real world:

- A process improvement programme reduces the time the staff have for existing service duties, causing a decrease in service quality – exactly the opposite of intended programme goals. As quality falls, pressure to work harder increases. Pressured staff then cut back on improvement efforts.
- Funding cuts affect service quality, which in turn diminishes demand for services. The reduced demand prompts yet more funding cuts.
- Increase in service demand generates increases in operations staff. The ratio of experienced staff to new staff decreases. Less mentoring and coaching opportunities are available for the newcomers; quality of service suffers; demand for services slows; morale and productivity decrease, and staff are let go.

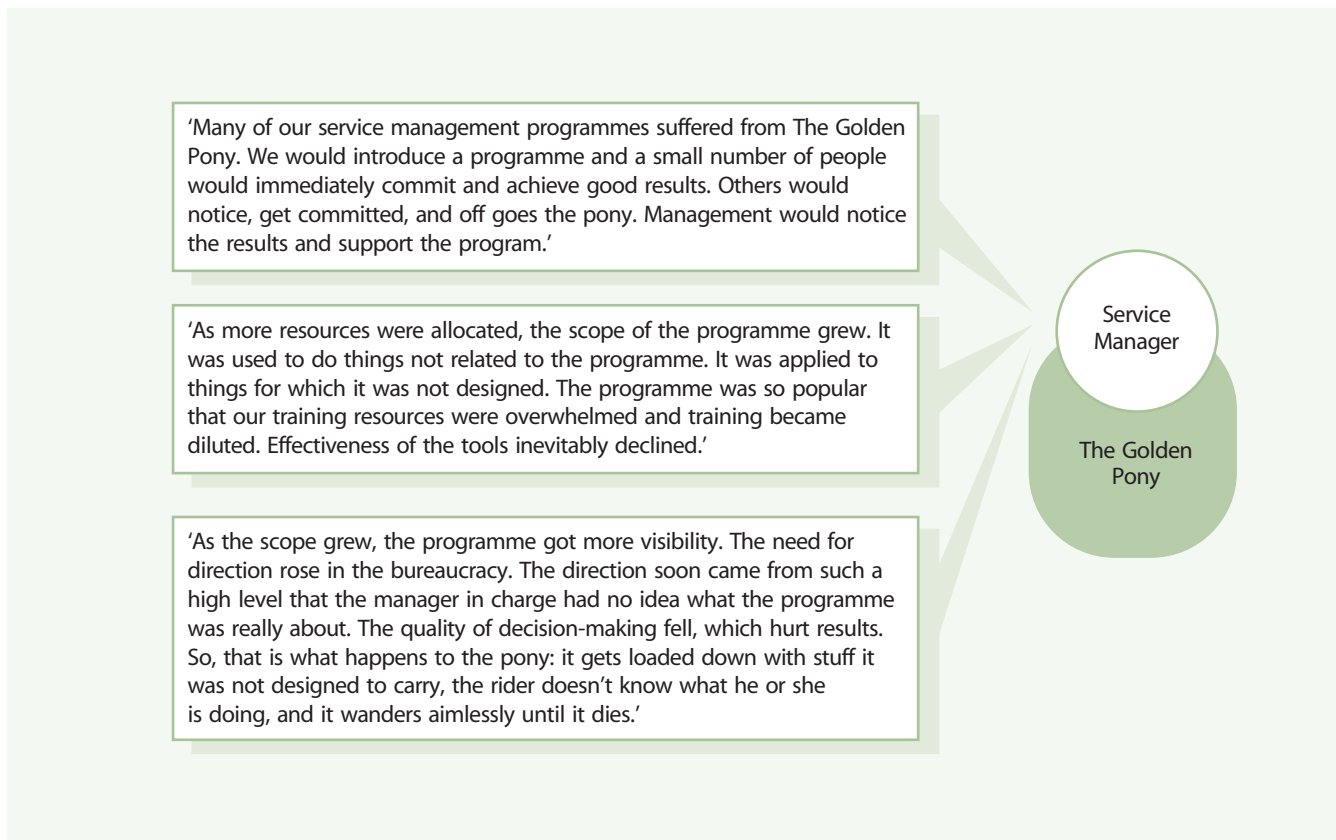


Figure 1.3 The Golden Pony (inspired by Nelson P. Repenning, MIT Sloan School of Management)

Apart from driving change through continual improvement, organizations must be prepared for rapid transitions and transformations driven by changes in an organization's environment or internal situation. Changes may be driven by mergers, acquisitions, legislation, spin-offs, sourcing decisions, actions of competitors, technology innovations and shifts in customer preferences. Service management should respond effectively and efficiently. The approach to service management provided is useful for understanding the combined effects of management decisions, dependencies, actions and their consequences.