Essentials of
Services Marketing

4th Edition

Jochen Wirtz

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With gratitude and in loving memory of Christopher Lovelock,
One of the guiding lights of services marketing.

Co-author, mentor, and friend.
And above all, an inspiration.

JW

About the Author

Jochen Wirtz is Vice Dean, MBA Programmes, and Professor of Marketing at the National University of Singapore (NUS). He is also an international fellow of the Service Research Center at Karlstad University, Sweden; an Academic Scholar at the Cornell Institute for Healthy Futures (CIHF) at Cornell University, USA; and a Global Faculty of the Center for Services Leadership (CSL) at Arizona State University, USA.

Previously, Professor Wirtz was the founding director of the dual degree UCLA–NUS Executive MBA Program from 2002 to 2014, an Associate Fellow at the Saïd Business School, University of Oxford, from 2008 to 2013, and a founding member of the NUS Teaching Academy (the NUS think-tank on education matters) from 2009 to 2015.

Dr. Wirtz holds a PhD in services marketing from the London Business School and has worked in the field of services for over 25 years. His research focuses on service marketing and has been published in over 300 academic articles, book chapters, and industry reports. He is an author of over 20 books, including *Services Marketing—People, Technology, Strategy* (World Scientific, 9th edition, 2022), and like *Essentials of Services Marketing*, it has become one of the world's leading services-marketing textbooks, translated and adapted for over 26 countries and regions, with combined sales of some 1 million copies. He is also the author of *Intelligent Automation: Learn How to Harness Artificial Intelligence to Boost Business & Make Our World More Human* (2021) and *Winning in Service Markets* (World Scientific, 2017).

In recognition of his excellence in teaching and research, Professor Wirtz has received over 50 awards, including the prestigious Christopher Lovelock Career Contributions to the Services Discipline Award in 2019 (the highest recognition of the American Marketing Association [AMA] service community), the Academy of Marketing Science (AMS) 2012 Outstanding Marketing Teacher Award (the highest recognition of teaching excellence of AMS globally), and the top university-level Outstanding Educator Award at NUS. He was also the winner of the inaugural Outstanding Service Researcher Award 2010 and the Best Practical Implications Award 2009, both by Emerald Group Publications. He serves on the editorial review boards of over 10 academic journals, including the *Journal of Service Management, Journal of Service Research,* and *Cornell Hospitality Quarterly*, and is an ad hoc reviewer for the *Journal of the Academy of Marketing Science* and *Journal of Marketing*. Professor Wirtz hosted the American Marketing Association's Frontiers in Services Conference in 2019 and the SERVSIG Conference in 2005.

Professor Wirtz was a banker and took the banking exam at the Chamber of Commerce and Industry in Munich. He has since been an active management consultant, working with international consulting firms, including Accenture,

Arthur D. Little, and KPMG as well as major service firms in the areas of strategy, business development, and customer feedback systems. He has been involved in a number of start-ups, including Dataswift (www.dataswift.io) and TranscribeMe (TranscribeMe.com).

Originally from Germany, Professor Wirtz spent seven years in London before moving to Asia. Today, he shuttles between Asia, the United States, and Europe. For further information, see www.JochenWirtz.com.

Brief Contents

Contents

The following cases are available for free download and class distribution on the
Instructor's Resource Website for courses that adopt *Essentials of Services Marketing,* 4th edition.

Preface

Services dominate the expanding world economy as never before, and technology continues to evolve in dramatic ways. Established industries and old, illustrious companies are declining and may even disappear as new business models and industries emerge. Competitive activity is fierce. This book has been written in response to the global transformation of our economies to services. Clearly, skills in marketing and managing services have never been more important!

As the field of services marketing has evolved, so too has this book. This new edition has been revised significantly since the third edition to capture the reality of today's world, incorporating recent academic and managerial thinking while illustrating cutting-edge service concepts.

This book is based on *Services Marketing: People, Technology, Strategy*, 9th edition (World Scientific). It has been significantly condensed and sharpened to provide a crisp introduction to key topics in services marketing. In addition, the case selection, visuals, and design have been designed to appeal to undergraduate and polytechnic students.

WHAT'S NEW IN THIS EDITION?

The fourth edition represents a significant revision. Its contents reflect ongoing developments in the service economy, dramatic developments in technology, and new research findings.

New Topics, New Research

▶ Each of the 15 chapters has been revised. All chapters incorporate **new examples** and the **latest academic research**.

▶ New **applications of technology** are integrated throughout the text, ranging from service robots, artificial intelligence (AI), and intelligent automation (IA), to peer-to-peer sharing platforms and digital business models.

▶ Chapter 3, "Positioning Services in Competitive Markets," has a new section on **digital services** and **platform business models**.

▶ Chapter 4, "Developing Service Products and Brands," has now a tighter focus on **productizing services** (i.e., "bundles of output"), an expanded section on branding of services, and a new section on service design thinking.

▶ **Use High Published Prices and Frame Fences as Discounts.** Rate fences framed as customer gains (i.e., discounts) are generally perceived as fairer than those framed as customer losses (i.e., surcharges) even if the situations are economically equivalent. For example, a customer who patronizes her hair salon on Saturdays may perceive the salon as profiteering if she finds herself facing a weekend surcharge. However, she is likely to find the higher weekend price more acceptable if the salon advertises its peak weekend price as the published price and offers a $5 discount for weekday haircuts. Furthermore, a high published price helps to increase the reference price and related quality perceptions.

▶ **Communicate Consumer Benefits of Revenue Management.** Marketing communications should position revenue management as a win–win practice. By providing different prices and value propositions, firms can enable a broader spectrum of customers to self-segment and enjoy the service. For example, higher prices can be charged for the best seats in a theater because some people are willing and able to pay more for a better location. This also makes it possible to sell other seats at lower prices. When customers become more familiar with certain revenue management practices, unfairness perceptions are likely to decrease over time.

▶ **"Hide" Discount through Bundling, Product Design, and Targeting.** Bundling a service into a package effectively obscures the discounted price. When a cruise line includes the price of air travel or ground transportation in the cruise package (Figure 6.23), the customer knows only the total price and not the cost of the individual components. Bundling usually makes price comparisons between the bundles and its components impossible and thereby side-steps potential unfairness perceptions and reductions in reference prices.

Figure 6.23 Cruise packages bundle (and tours into their total package price.

Natalie Dahlstedt USTAT

176 Chapter 6 • Setting Prices and Implementing Revenue Management

- Chapter 8, "Designing Service Processes," has new in-depth coverage of **service robots** and **AI-powered self-service technologies** (SSTs).

- Chapter 14, "Improving Service Quality and Productivity," features a heavily revised section on **customer feedback systems** and **collection tools** to reflect the rapid development of automated rating systems, user-generated content on review sites, and third-party (social) media, as well as their analysis using natural language processing, image processing, and other technologies.

- Chapter 15, "Building a World-Class Service Organization," features new sections on the strategic pathways toward achieving **cost-effective service excellence (CESE)** and the **wallet allocation rule**.

FOR WHAT TYPES OF COURSES CAN THIS BOOK BE USED?

This text is equally suitable for courses directed at undergraduate and polytechnic students. *Essentials in Services Marketing* places marketing issues within a broader general management context. The book will appeal to students heading for a career in the service sector, whether at the executive or the management level.

Whatever their job is in the services industry, a person has to understand the close ties that link the functions of marketing, operations, IT, and human resources in service firms. With that perspective in mind, the book has been designed so that instructors can make selective use of chapters and cases to teach courses of different lengths and formats in either services marketing or services management.

WHAT ARE THE BOOK'S DISTINGUISHING FEATURES?

- You'll find that this text takes a **strongly managerial perspective** yet is **rooted in solid academic research**, complemented by memorable frameworks. This book's goal is to bridge the all-too-frequent gap between theory and the real world.

- Each chapter provides a succinct **chapter overview in pictorial form**.

- Every effort has been made to create a text that is **clear, readable, and focused**.

- An **easy-to-read text** combines with visuals to make important concepts accessible.

- A **global perspective** has been cultivated by carefully selecting examples from around the world.

Why Study Services
- Services dominate the global economy.
- Most new jobs are generated by services.
- Understanding services offers personal competitive advantage.

Service Sector Industries
- Real estate
- Business and professional services
- Government services
- Wholesale and retail trade
- Transport, utilities, and communications
- Healthcare and education services
- Finance and insurance
- Accommodation and food services
- Arts, entertainment, and recreational services
- Other private sector services

Key Trends
General Trends
- Government policies
- Social changes
- Business trends
- Advances in technology
- Globalization

B2B Services Growth
- Outsourcing
- Firms' increasing focus on core competencies
- Increasing specialization of economies

Definition of Services
- Services provide benefits without ownership
- Services are economic activities performed by one party to another. Often time-based, these performances bring about desired results to recipients, objects, or other assets. In exchange for money, time, and effort, service customers expect value from access to labor, skills, expertise, goods, facilities, networks, and systems.

Categories of Services by Type of Processing
- People processing (e.g., passenger transport, hairstyling)
- Possession processing (e.g., freight transport, repair services)
- Mental stimulus processing (e.g., education)
- Information processing (e.g., accounting)

Services Pose Distinct Marketing Challenges
Services tend to have four frequently cited characteristics: *i*ntangibility, *h*eterogeneity (variability of quality), *i*nseparability of production and consumption, and *p*erishability of output, or IHIP for short. The key implications are
- most services cannot be inventoried (i.e., output is perishable)
- intangible elements typically dominate value creation (i.e., services are physically intangible)
- services are often difficult to understand (i.e., services are mentally intangible)
- customers are often involved in co-production (e.g., if people processing is involved, the service is inseparable)
- people (service employees) may be part of the service product and experience
- operational inputs and outputs tend to vary more widely (i.e., services are heterogeneous)
- the time factor is often very important (e.g., capacity management)
- distribution may take place through nonphysical channels (e.g., information processing services)

Functions
Need to be tightly integrated as together they shape the customer experience, especially
- marketing
- operations
- human resources
- information technology

Service-Profit Chain
Shows the tight links between
- leadership
- internal quality and IT
- employee engagement
- customer value, satisfaction, and loyalty
- profitability and growth

Putting Service Strategy into Action
This books is structured around an integrated model of services marketing and management that covers
- understanding Service Products, Consumers, and Markets
- applying the 4 Ps of Marketing to Services
- designing and managing the Customer Interface using the additional 3 Ps of Services Marketing (Process, People, and Physical Environment)
- developing Customer Relationships
- striving for Service Excellence

Figure 1.3 *An introduction to services marketing.*

- To ensure a **systematic learning approach**, each chapter has clear **learning objectives**, an **organizing framework that provides a quick overview** of the chapter's contents and line of argument, and **chapter summaries in bullet form** that condense the core concepts and messages of each chapter.

- **Opening vignettes** and **boxed inserts** within the chapters are designed to capture student interest and provide opportunities for in-class discussions.

The following table links the cases to the chapters in the book.

CASES		PRIMARY CHAPTERS
1	Sullivan Ford Auto World	1
2	Susan Munro, Service Consumer	2
3	Dr. Beckett's Dental Office	1, 2
4	Uber's Unintended Burdens	3, 11
5	Kiwi Experience	4, 5, 7
6	The Accra Beach Hotel: Block Booking of Capacity during a Peak Period	6
7	Revenue Management at The View	6, 8, 9
8	Aussie Pooch Mobile	7, 8
9	Service Robots in the Frontline: How Will Aarion Bank's Customers Respond?	8, 11
10	Digital Luxury Services: Tradition versus Innovation in Luxury Fashion	10
11	National Library Board, Singapore: Delivering Cost-Effective Service Excellence through Innovation and People	8, 11, 14
12	Red Lobster	11
13	Banyan Tree: Branding the Intangible	3, 4, 7, 11
14	Singapore Airlines: Managing Human Resources for Cost-Effective Service Excellence	11, 15
15	Menton Bank	11
16	Dr. Mahalee Goes to London: Global Client Management	12
17	Platform versus Pipeline Business Models: Are Airbnb and Marriott Right to Move into Each Other's Turf?	3, 12, 15

SECONDARY CHAPTERS	CONTINENT	COUNTRY	INDUSTRY
2	Americas	United States	Automobile Servicing
	Americas	United States	Range of B2C Services
	Americas	United States	Medical
4, 5, 7, 12	Americas/Global	United States	Transportation
3, 11	Oceania	New Zealand	Tourism
9	Americas	Barbados	Resort
	Australia	Australia	Food & Beverage
5	Australia	Australia	Pet Grooming
11, 14, 15	Global		Banking
2, 8, 11	Global		Luxury Retail
15	Asia	Singapore	Library
	Americas	United States	Food & Beverage
5	Asia/Global		Resort
3, 4, 8	Global		Airline
	Americas	United States	Banking
8	Europe	United Kingdom	Private Banking
	Americas/Global	United States	Hotels

SECONDARY CHAPTERS	CONTINENT	COUNTRY	INDUSTRY
6	Asia	Hong Kong	Food and Beverage
	Americas	United States	Cable Service
	Americas	United States	Streaming Service
2, 3	Asia/Global	Mauritius	Resort
3	Asia/Americas	Philippines/United States	Management Consulting/Auditing
4, 5, 7, 12	Asia/Americas	China/United States	Transportation
	Asia	Philippines	Fast Food
	Europe	Eastern Europe	Hotel/Hospitality
11	Asia/Global		Clothing Retailing
	Europe	Italy	Tourism
	Asia	Singapore	Industrial Supplies
	Asia		Logistics

What Aids Are Available for Instructors?

We have developed pedagogical aids to help instructors develop and teach courses built around this book and to create stimulating learning experiences for students both in and out of the classroom.

Teaching Aids within the Text

▶ An opening vignette, which highlights key issues discussed in the chapter

▶ Learning objectives and milestone markers for these when a section provides material that meet these learning objectives

▶ Boxed inserts throughout the chapters, which often lend themselves well to in-class discussion

▶ Interesting graphics, photographs, and reproductions of advertisements, which enhance student learning, and provide opportunities for discussion

▶ Keywords, which help to reinforce important terms and concepts

▶ Chapter summaries, which meet each chapter's learning objectives

▶ Review Questions and Application Exercises located at the end of each chapter

Pedagogical Materials Available from the Publisher

Case Bank: A large set of additional cases that can be used in courses that adopt this textbook. Available in both Word and PDF versions as a resource for instructors. A table shown in the textbook will suggest which cases to pair with which chapters.

Instructor's Manual: A repository of detailed course design and teaching hints, including sample course outlines; chapter-by-chapter teaching suggestions, plus discussion of learning objectives and sample responses to study questions and exercises; suggested student exercises and comprehensive projects (designed for either individual or team work); detailed case teaching notes, including teaching objectives, suggested study questions, in-depth analysis of each question, and helpful hints on teaching strategy designed to aid student learning, create stimulating class discussions, and help instructors create end-of-class wrap-ups and "takeaways."

Test Bank: Multiple choice, true/false, short-answer, and essay questions, with difficulty level provided for each question. Contents are classified into general and application. This is available in TestGen format, a test-generating program that allows instructors to add, edit, or delete questions from the test item file; analyze test results; and organize a database of exams and student results.

PowerPoint Slides: The slides are linked to each chapter and featuring both "word" slides and graphics. All slides have been designed to be clear, comprehensible, and easily readable.

Image Bank: A collection of images in the textbook.

EBook: Electronic version of the text that includes useful features such as highlighting and search. It can be viewed on a variety of browsers and devices.

Acknowledgments

Finally, if you have interesting research, examples, stories, cases, videos, or any other materials that would look good in the next edition of this book, or any feedback, please do contact me via www.JochenWirtz.com. I'd love to hear from you!

JOCHEN WIRTZ

THE *ESM* FRAMEWORK

PART I

Understanding Service Markets, Products, and Customers

- Introduction to Services Marketing
- Understanding Service Consumers
- Positioning Services in Competitive Markets

PART II

Applying the 4 Ps of Marketing to Services

- Developing Service Products and Brands
- Distributing Services through Physical and Electronic Channels
- Setting Prices and Implementing Revenue Management
- Promoting Services and Educating Customers

PART III

Managing the Customer Interface

- Designing Service Processes
- Balancing Demand and Capacity
- Crafting the Service Environment
- Managing People for Service Advantage

PART IV

Developing Customer Relationships

- Managing Relationships and Building Loyalty
- Complaint Handling and Service Recovery

PART V

Striving for Service Excellence

- Improving Service Quality and Productivity
- Building a World-Class Service Organization

Understanding Service Markets, Products, and Customers

Part I lays the building blocks for studying services and learning how one can become an effective service marketer. It consists of the following three chapters:

Chapter 1 Introduction to Services Marketing

Chapter 1 highlights the importance of services in our economies. We also define the nature of services and how they create value for customers without transfer of ownership. The chapter highlights some distinctive challenges involved in marketing services and introduces the 7 Ps of services marketing.

The framework shown on the facing page will accompany us throughout as it forms the basis for each of the four parts in this book. It describes in a systematic manner of what is involved in developing marketing strategies for different types of services. The framework is introduced and explained in Chapter 1.

Chapter 2 Understanding Service Consumers

Chapter 2 provides a foundation for understanding consumer needs and behavior related to services. The chapter is organized around the three-stage model of service consumption that explores how customers search for and evaluate alternative services, make purchase decisions, experience and respond to service encounters, evaluate service performance, and finally, develop loyalty.

Chapter 3 Positioning Services in Competitive Markets

Chapter 3 discusses how to develop a customer-driven services marketing strategy and how a value proposition should be positioned in a way that creates competitive advantage for the firm. This chapter first links the customer, competitor, and company (commonly referred to as 3 Cs) to a firm's positioning strategy. The core of the chapter is then organized around the three key elements of positioning—segmentation, targeting, and positioning (commonly referred to as "STP")—and shows how firms can segment a service market, position their value proposition, and finally focus on attracting their target segment.

introduction to
SERVICES
MARKETING

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

▶ **LO 1** Understand how services contribute to a country's economy.

▶ **LO 2** Know the principal industries of the service sector.

▶ **LO 3** Identify the powerful forces that are transforming service markets.

▶ **LO 4** Understand how B2B services improve the productivity of individual firms and drive economic development.

▶ **LO 5** Define services using the non-ownership framework.

▶ **LO 6** Identify the four broad "processing" categories of services.

▶ **LO 7** Be familiar with the characteristics of services and the distinctive marketing challenges they pose.

▶ **LO 8** Understand the components of the traditional marketing mix applied to services.

▶ **LO 9** Describe the components of the extended marketing mix for managing the customer interface.

▶ **LO 10** Appreciate that marketing, operations, human resource management, and IT functions need to be closely integrated in service businesses.

▶ **LO 11** Understand the implications of the service–profit chain for service management.

▶ **LO 12** Know the five-part framework for developing effective services marketing strategies.

rawpixel\123rf

Figure 1.1 Tertiary education may be one of the biggest service purchases in life.

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Definition of Services
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B2B Services Growth
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- Firms' increasing focus on core competencies
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- leadership
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Figure 1.3 An introduction to services marketing.

CHAPTER SUMMARY

LO 1 ▶ Services represent an important and growing contribution to most economies in the world. As economies develop, services form the largest part of their GDP. Globally, most new jobs are generated in the service sector.

LO 2 ▶ The principal industries of the service sector include (in order of contribution to GDP) the following:
- o Real-estate services
- o Business and professional services
- o Government services
- o Wholesale and retail trade
- o Transport, utilities, and communications services
- o Healthcare services
- o Finance and insurance
- o Accommodation and food services
- o Arts, entertainment, and recreation services

LO 3 ▶ Many forces are transforming our economies, making them more service-oriented. They include government policies, social changes, business trends, advances in information technology, and globalization.

LO 4 ▶ Business services allow manufacturing firms and other service organizations to outsource non-core activities, processes, and assets. The benefits include the following:
- o Economies of scale and scope as well as high quality and productivity levels
- o Tight cost and quality control (performance can be benchmarked across many sites)
- o Application of process improvements and R&D

The rapid growth of business services leads to an increasing specialization of advanced economies with significant gains in overall productivity and standards of living.

LO 5 ▶ What exactly is a service? The key distinguishing feature of a service is that it is a form of rental rather than ownership. Service customers obtain the rights to hire the labor, skills, and expertise of personnel; use a physical object or space; or access shared facilities, networks, and systems. Services are performances that bring about the desired results or experience for the customer.

LO 6 ▶ Services vary widely and can be categorized according to the nature of the underlying process. There are four broad categories of services:
- o People processing
- o Possession processing
- o Mental stimulus processing
- o Information processing

Mental stimulus and information processing can collectively be called information-based services.

LO 7 ▶ Services have unique characteristics that make them different from products:
- o Most service products cannot be inventoried (i.e., they are perishable).
- o Intangible elements usually dominate value creation (i.e., they are physically intangible).
- o Services are often difficult to visualize and understand (i.e., they are mentally intangible).
- o Customers may be involved in co-production (i.e., if people processing is involved, the service is inseparable).
- o People may be part of the service experience.
- o Operational inputs and outputs tend to vary widely (i.e., they are heterogeneous).
- o The time factor often assumes great importance.
- o Distribution may take place through nonphysical channels.

LO 8 ▶ Due to the unique characteristics of services, the traditional marketing mix of the 4 Ps needs to be amended. Some important amendments are as follows:
- o *Product elements* include not only the core elements, but also supplementary service elements such as the provision of consultation or hospitality, or the handling of exceptions.
- o *Place and time* elements refer to the delivery of the product elements to the customer.
- o *Pricing* includes non-monetary costs to the consumer and revenue management considerations.
- o *Promotion* does not focus only on advertising and promotions but is also viewed as a form of communication and education that guides customers through service processes.

LO 9 ▶ Services marketing requires three additional Ps that cover management of the customer interface:
- o *Process* refers to the design and management of customer service processes, including managing demand and capacity and related customer waits.
- o *Physical environment*, also known as the servicescape, facilitates process delivery and provides tangible evidence of a firm's image and service quality.
- o *People* covers the recruitment, training, and motivation of service employees to deliver service quality and productivity.

CHAPTER SUMMARY

LO 10 ▶ To be successful, marketing, operations, human resource, and IT management functions need to be tightly integrated. Integration means that the key deliverables and objectives of the various functions are not only compatible but also mutually reinforcing.

LO 11 ▶ The service–profit chain shows how successful service firms integrate key management functions and deliver high-quality performance in several related areas:

o Customer relationships must be managed effectively, and there must be strategies to build and sustain loyalty.

o Value must be created and delivered to the target customers in ways that lead them to see the firm's offerings as superior to competing offerings.

o Service quality and productivity must be continuously improved through better processes, systems and tools, and IT.

o Service employees must be enabled and motivated.

o Top management's leadership needs to drive and support all the components of the service–profit chain.

LO 12 ▶ A framework for services marketing strategy forms the underlying structure of this book. The framework consists of the following five interlinked parts:

o Part I begins with the need for service firms to understand their markets, customers, and competition.

o Part II shows us how to apply the traditional 4 Ps to services marketing.

o Part III covers the 3 Ps of the extended services marketing mix and shows how to manage the customer interface.

o Part IV illustrates how to develop lasting customer relationships through a variety of tools, ranging from the Wheel of Loyalty and CRM to effective complaint management and service guarantees.

o Part V discusses how to improve service quality and productivity. This part closes with a discussion on how change management and leadership can propel a firm to become a service leader.

Endnotes

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2. Roland T. Rust and Ming-Hui Huang, "The Service Revolution and the Transformation of Marketing Science," Marketing Science 33(2) (2014): 206–221; and Ming-Hui Huang and Roland T. Rust, "Artificial Intelligence in Service," *Journal of Service Research* 21(2) (2018): 155–72.

3. This section is based on Jochen Wirtz and Michael Ehret, "Service-Based Business Models: Transforming Businesses, Industries and Economies," in Raymond P. Fisk, Rebekah Russell-Bennett, and Lloyd C. Harris (eds.), *Serving Customers: Global Services Marketing Perspectives* (Melbourne: Tilde University Press, 2013), pp. 28–46. For firms' motivation to use non-ownership services, see also Kristina Wittkowski, Sabine Möller, and Jochen Wirtz, "Firms' Intentions to Use Non-Ownership Services," *Journal of Service Research* 16(2) (2013): 171–85.

4. Lesley Brown (ed.), *Shorter Oxford English Dictionary*, 5th edition (2002).

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6. Evert Gummeson (citing an unknown source), in "Lip Service: A Neglected Area in Services Marketing," *Journal of Consumer Services* 1 (Summer 1987): 19–22.

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2

understanding
SERVICE
CONSUMERS

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

▶ **LO 1** Understand the three-stage model of service consumption.

▶ **LO 2** Use the multi-attribute model to understand how consumers evaluate and choose between alternative service offerings.

▶ **LO 3** Learn why consumers often have difficulty evaluating services, especially those with many experience and credence attributes.

▶ **LO 4** Know the perceived risks customers face in purchasing services and the strategies firms can use to reduce consumer risk perceptions.

▶ **LO 5** Understand how customers form service expectations and the components of these expectations.

▶ **LO 6** Understand the "moment of truth" metaphor.

▶ **LO 7** Contrast how customers experience and evaluate high-versus low-contact services.

▶ **LO 8** Be familiar with the servuction model and understand the interactions that together create the service experience.

▶ **LO 9** Obtain insights from viewing the service encounter as a form of theater.

▶ **LO 10** Know how role, script, and perceived control theories contribute to a better understanding of service encounters.

▶ **LO 11** Describe how customers evaluate services and what determines their satisfaction.

▶ **LO 12** Understand service quality, its dimensions and measurement, and how quality relates to customer loyalty.

▶ **LO 13** Know why customer loyalty is such an important outcome of excellent service experiences.

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Figure 2.1 New York University is the gateway to a brighter future for students like Susan Munro.

Stages of Service Consumption

1. Pre-purchase Stage

Awareness of need
Information search
• Clarify needs
• Explore solutions
• Identify alternative service products and suppliers

Evaluation of alternatives (solutions and suppliers)

• Review supplier information
   (e.g., websites, brochures, advertising)
• Review information from third parties
   (e.g., online reviews, ratings, comments on the
   web, blogs, awards)
• Discuss options with service personnel
• Get advice and feedback from third-party advisors,
   friends and family, other customers

Make decisions on service purchase and
often make a reservation

2. Service Encounter Stage

Request service from a chosen supplier or initiate self-
   service (payment may be upfront or billed later)
Service delivery by personnel or self-service

3. Post-encounter Stage

Evaluation of service performance

Future intentions and behaviors

Key Concepts

Need arousal

Evoked set

Consideration set

Multi-attribute model

Search, experience, and
   credence attributes

Perceived risk

Formation of expectations
• Desired service level
• Predicted service level
• Adequate service level
• Zone of tolerance

Low- versus high-contact encounters
Servuction system
Theater as a metaphor
Role and script theories
Perceived control theory

*Confirmation/disconfirmation of
   expectations*
*Dissatisfaction, satisfaction,
   delight*
Service quality

Word of mouth
Repurchase
Loyalty and engagement

Figure 2.3 The three-stage model of service consumption.

OPENING VIGNETTE

SUSAN MUNRO, SERVICE CONSUMER[1]

Susan Munro, a final-year business student, had breakfast and then checked the weather app on her iPhone. It predicted rain, so she grabbed an umbrella before leaving the apartment. On the way to the bus stop, she dropped a letter in a mailbox. The bus arrived on schedule. It was the usual driver, who recognized her and greeted her cheerfully as she showed her commuter pass.

On arriving at her destination, Susan walked to the College of Business. Joining a crowd of other students, she found a seat in the lecture theater where her marketing class was held. Susan made several contributions to the discussion and felt that she had learned a lot from listening to others' analyses and opinions.

After class, Susan and her friends ate lunch at the recently renovated Student Union. It was a well-lit and colorfully decorated food court, featuring a variety of small stores. These included both local suppliers and brand-name fast-food chains. Although Susan wanted a sandwich, there was a long queue at the Subway outlet. Instead, she joined her friends at Burger King and then splurged on a caffe latte from the Have-a-Java coffee stand. The food court was unusually crowded, perhaps because of the rain. When they finally found a table, they had to clear away dirty trays. "Lazy slobs!" her friend Mark remarked, referring to the previous customers.

After lunch, Susan stopped at an ATM, inserted her bank card, and withdrew some money. Then she remembered that she had a job interview at the end of the week, so she telephoned her hairdresser and made an appointment for later. When she left the Student Union, the rain had stopped and the sun was shining.

Susan looked forward to her visit to the hairdresser. The store, which had a bright, trendy décor, was staffed by friendly hairdressers. Unfortunately, the hairstylist was running late,

and Susan had to wait for 20 minutes. She used that time to review a human resources course.

Eventually, it was time for a shampoo, after which the hairstylist proposed a slightly different cut. Susan agreed, although she drew the line at the suggestion that she lighten her hair color. She had never done it before and was unsure about how it would look. She did not want to take the risk just before her job interview. She sat still, watching the process in the mirror and turning her head when asked. She was pleased with the result and complimented the hairstylist on his work. She tipped him and paid at the reception desk.

On the way home, Susan stopped by the dry cleaners to pick up some clothes. The store was gloomy and smelled of cleaning solution, and the walls needed repainting. She was annoyed to find that although her silk blouse was ready as promised, the suit that she needed for the interview was not. The assistant, who had dirty fingernails, mumbled an apology in an insincere tone. Although the store was conveniently located and the quality of work was good, Susan thought the employees were unfriendly and unhelpful, and she was unhappy with their service. However, she had no choice but to use them as there were no other dry cleaners nearby.

Back at her apartment building, she opened the mailbox in the lobby. Her mail included a bill from her insurance company. However, it required no action, as the payment had been deducted automatically from her MasterCard account. She was about to throw away the junk mail when she noticed a flyer promoting a new dry-cleaning store nearby. It even included a discount coupon. She decided to try out the new firm and kept the coupon.

This story of Susan's day as a service consumer will follow us throughout this chapter to illustrate service-related consumer behavior concepts and theories.

Figure 2.2 Susan is just another customer facing a large selection of services out there.

CHAPTER SUMMARY

LO 1 ▶ Service consumption can be divided into the following three stages: (1) pre-purchase stage, (2) service encounter stage, and (3) post-encounter stage.

- o The pre-purchase stage consists of the following four steps: (1) need awareness, (2) information search, (3) evaluation of alternative solutions and suppliers, and (4) making a purchase decision.

LO 2 ▶ The following theories help us understand consumer behavior during the pre-purchase stage:

- o Recognizing a need motivates customers to search for solutions to satisfy that need. Several alternatives may come to mind, and these form the evoked set. This is further narrowed down to a few alternatives that form the consideration set.

- o During the search process, consumers also learn about service attributes they should consider and form expectations about how firms in the consideration set perform on those attributes.

- o *Multi-attribute model*. Many decisions involve complex trade-offs along several attributes. The multi-attribute model simulates this decision-making by combining customers' attribute performance expectations for each firm in the consideration set and the importance weights of each attribute.

- o Two common consumer decision rules in the multi-attribute model are the linear compensatory rule and the conjunctive rule. Given the same attribute ratings, consumers can arrive at different decisions when different decision rules are applied.

- o Firms should actively manage key variables in the multi-attribute model to increase the chances of their service being the one chosen.

LO 3 ▶ *Service attributes*. Services are often difficult to evaluate because they tend to have a low proportion of search attributes and a high proportion of experience and credence attributes. Tangible cues become important, and firms need to manage them carefully to shape their customer's expectations and perceptions of experience and credence attributes.

LO 4 ▶ *Perceived risk*. Consumers perceive higher risk when buying services than when buying goods. As customers do not like to take risks, successful firms employ risk-reduction strategies such as offering free trials and guarantees.

LO 5 ▶ *Service expectations*. These are shaped by information search and the evaluation of service attributes. The components of expectations include desired, adequate, and predicted service levels. Between the desired and adequate service levels is the zone of tolerance, within which customers are willing to accept variation in service levels.

Purchase decision. The outcome of the pre-purchase stage is a purchase decision, based largely on service-level expectations and associated risk perceptions. Many decisions involve complex trade-offs along several attributes, typically including price.

LO 6 ▶ In the service encounter stage, the customer initiates, experiences, and consumes the service. A number of concepts and models help us to better understand customer behavior in this stage:

- o The "moments of truth" metaphor refers to customer touchpoints that can make or break a customer relationship.

LO 7 ▶ We distinguish between high- and low-contact services. High-contact services are challenging as they have many points of contact and moments of truth that have to be managed. In contrast, low-contact services are mostly delivered via apps, websites, chatbots, self-service machines (e.g., ATMs), or customer contact centers with relatively few customer interfaces.

LO 8 ▶
- o The *servuction model* encompasses a technical core and a service delivery system.

- o The technical core is backstage and invisible to the customers, but what happens backstage can affect the quality of frontstage activities. Therefore, backstage activities have to be coordinated with frontstage activities.

- o The *service delivery system* is frontstage and visible to the customer. It encompasses all the interactions that create the service experience. In a high-contact service, it includes customer interactions with the service environment, service employees, and other customers. Each type of interaction can create or destroy value. Firms have to orchestrate all these interactions to create a satisfying service experience.

LO 9 ▶ *Theater can be used as a metaphor for service delivery*. Firms can view their service as the "staging" of a performance with props and actors and manage them accordingly. The props are the

CHAPTER SUMMARY

service facilities and equipment. The actors are the service employees and customers.

LO 10 ▶ o The actors need to understand their roles and scripts in order to perform their part of the service well. Firms can make use of the *role* and *script theories* to better design, train, communicate, and manage both employee and customer behaviors.

o Consumers have a need to feel in *control*. There are three types of control that can be designed into a service encounter: *behavioral control* (customers can change the service encounter according to their individual preferences), *decisional control* (they can choose between fixed options), and *cognitive control* (they understand what is happening and why, and they know what will happen next; the latter is also called *predictive control*).

o However, if processes, scripts, and roles are tightly defined (e.g., as in fast food or consumer banking), the scope for behavioral control is limited. Here, firms can focus on giving customers more decisional, cognitive, and predictive control.

LO 11 ▶ In the post-encounter stage, customers evaluate the service performance and compare it to their prior expectations.

o The *expectancy-disconfirmation model of satisfaction* holds that satisfaction judgments are formed by comparing service expectations with performance perceptions.

o Satisfaction is a continuum ranging from great satisfaction to deep dissatisfaction. As long as perceived performance falls within the zone of tolerance (that is, above the adequate service level), customers will be reasonably satisfied. If performance perceptions approach or exceed desired levels, customers will be very satisfied. Performance below the adequate service level will result in dissatisfaction.

LO 12 ▶ o Excellent *service quality* means that a firm *consistently* meets or exceeds customer expectations.

o While customer satisfaction is transaction-specific and refers to a single service experience, service quality refers to a consumer's beliefs and attitudes about the general performance of a firm.

o Consumers use five broad dimensions to evaluate service quality: (1) tangibles, (2) reliability, (3) responsiveness, (4) assurance, and (5) empathy.

o In situations where customer satisfaction and service quality deviate (e.g., "I think the firm in general is great, but the last transaction was poor"), customers use their relatively stable perception of service quality to form their performance expectations for the next purchase. However, a second or third dissatisfaction evaluation will reduce the overall service quality perception of the firm more dramatically and jeopardize repeat visits.

o *SERVQUAL* is a 21-item scale that was designed to measure the five dimensions of service quality. The scale is frequently adapted to the specific context of a particular service, including Internet shopping and online services.

LO 13 ▶ Loyalty is a customer's willingness to continue patronizing a firm over the long term, preferably on an exclusive basis. Customer loyalty extends beyond behavior and includes preference, liking, and future intentions. The term *customer engagement* is increasingly used to refer to non-repurchase-related loyalty behaviors such as recommending a firm to friends and associates, helping other customers, providing feedback, and writing reviews. Loyalty is an important outcome of satisfied customers.

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3

positioning
SERVICES in COMPETITIVE MARKETS

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Understand how **c**ustomer, **c**ompetitor, and **c**ompany analyses (i.e., the *3 Cs*) help to develop a customer-driven services marketing strategy.

LO 2 Know the key elements of a positioning strategy (i.e., *s*egmentation, *t*argeting, and *p*ositioning; *STP*) and explain why they are so crucial for service firms.

LO 3 *S*egment customers on the basis of needs before using other common bases to further identify and profile the segments.

LO 4 Distinguish between important and determinant attributes for segmentation.

LO 5 Use different service levels for segmentation.

LO 6 *T*arget service customers using the four focus strategies for competitive advantage.

LO 7 *P*osition a service to distinguish it from its competitors.

LO 8 Understand how to use positioning maps to analyze and develop competitive strategy.

LO 9 Know how to apply positioning to digital services and platform business models.

LO 10 Develop an effective positioning strategy.

Customer Analysis

Market attractiveness
- Market size and growth
- Profitability
- Market trends

Customer needs
- Under- or unserved needs
- More valued benefits

Define and Analyze Market Segments

- Needs-based segmentation followed by demographic, psychographic, and behavioral segmentation
- Identify attributes and service levels valued by each segment

Competitor Analysis

- Current positioning
- Strengths
- Weaknesses

Select Target Segments to Serve
- Determine customers the firm can serve best
- Identify and analyze possibilities for differentiation
- Decide on focus strategy (i.e., service, market, or fully focused)
- Select benefits to emphasize to customers
  - Benefits must be meaningful to customers
  - Benefits must not be well met by competitors

Company Analysis

- Current positioning and brand image
- Strengths
- Weaknesses
- Values

Articulate Desired Position in the market

- Positioning must address an attractive market
- Positioning must give a sustainable competitive advantage over competition

Determine Services Marketing Strategy and Action Plan
- Positioning strategy
- 7 Ps of services marketing
- Customer relationship management strategy
- Service quality and productivity strategy

Figure 3.1 Developing a services marketing positioning strategy.

OPENING VIGNETTE

POSITIONING A CHAIN OF CHILD-CARE CENTERS AWAY FROM THE COMPETITION[1]

Roger Brown and Linda Mason met at business school following previous experience as management consultants. After graduation, they operated programs for refugee children in Cambodia and ran a "Save the Children" relief program in East Africa. When they returned to the United States, they saw a need for child-care centers with educational environments that would assure parents of their children's well-being.

Through research, they discovered that the child-care industry in the United States had many weaknesses. It lacked regulation, and there were no barriers to entry. The profit margins and economies of scale were low. The industry was also labor intensive and had no clear brand differentiation. Brown and Mason developed a service concept that would allow them to turn these weaknesses into strengths for their own company, Bright Horizons. Instead of marketing their services directly to parents—a one-customer-at-a-time sale—Bright Horizons formed partnerships with companies seeking to create on-site day-care centers for employees with small children. The advantages included

► A powerful, low-cost marketing channel

► A partner who would supply the funds to build and equip the center and would therefore want to help Bright Horizons achieve its goal of delivering high-quality care

► Benefits for parents, who would be attracted to a Bright Horizons center (rather than competing alternatives) because of its nearness to their own workplace, thus lowering travel time and offering greater peace of mind

Bright Horizons offered a high pay and benefits package to attract the best staff so that they could provide quality service, an aspect that was lacking in many of the other providers. Most traditional approaches to child care either did not have a proper teaching plan or had strict, cookie-cutter lesson plans. Bright Horizons developed a flexible teaching plan called "World at Their Fingertips." Although it had a course outline, it gave teachers control over daily lesson plans.

Bright Horizons sought accreditation for its centers from the National Association for the Education of Young Children (NAEYC) and actively promoted it. Its emphasis on quality allowed it to meet or exceed the highest local and state government licensing standards. As a result, lack of regulation became an opportunity rather than a threat for Bright Horizons and gave it a competitive edge.

With the support and help of its clients, which included many hi-tech firms, Bright Horizons developed several innovative technologies. These included videos of its classrooms that could be streamed to the parents' smartphones; posted artwork; menus, calendars, and student assessments; as well as online student assessment capabilities. Its smartphone app allows parents to manage their schedule on the go, communicate their availability, schedule assignments, and simplify communication with the child-care center. All of these served to differentiate Bright Horizons and helped it to stay ahead of the competition.

Bright Horizons sees labor as a competitive advantage. It seeks to recruit and retain the best people. In 2020, it was listed for the nineteenth time as one of the "100 Best Companies to Work for in America" by *Fortune* magazine. By then, Bright Horizons was the only child-care organization on the Fortune 500 list, with over 30,000 employees globally (ten times that of its nearest competitor), and it was operating for more than 1,000 clients in the United States, Canada, and Europe. These include the world's leading corporations, hospitals, universities, and government offices. Clients want to partner with Bright Horizons because they know they can trust the staff.

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CHAPTER SUMMARY

▶ **LO 1** ▶ Developing an effective positioning strategy links *customer, competitor*, and *company analysis*, often called the *3 Cs*.

- o *Consumer analysis* looks at the market attractiveness (e.g., market size and growth, and trends) and customer needs (e.g., desired service levels, level of contact, delivery channels, time of consumption, and price sensitivity).
- o *Competitor analysis* examines the competitors' current positioning, strengths, and weaknesses to spot opportunities for the firm.
- o *Company analysis* focuses on a firm's brand positioning and image, its strengths and weaknesses, and how its values shape the way it does business.

▶ **LO 2** ▶ The key elements of developing a customer-driven services marketing strategy are *segmentation, targeting*, and *positioning*, commonly referred to as *STP*.

▶ **LO 3** ▶ *Segmentation* is the division of a market into groups. Those customers within the same segment share common service–related needs. Segmentation is often based primarily on customer needs. This enables the firm to focus on what customers truly want and what drives their purchase decisions. Subsequently, demographic, psychographic, and behavioral variables can be used to further define and describe key segments.

▶ **LO 4** ▶ Understanding the difference between important and determinant attributes for consumer choice is crucial for customer segmentation.

- o *Important attributes* are important to the consumer, but they may not be important for the actual buying decision (e.g., safety is important, but all airlines considered by a traveler are seen as safe). If that is the case, such an attribute should not be used as a basis for segmentation.
- o *Determinant attributes* are often further down on the list of service characteristics important to customers. However, they are attributes on the basis of which customers see significant differences between competing alternatives (e.g., convenience of departure times, or quality of in-flight service). Thus, they determine the final purchase decision. Differences among customers regarding determinant attributes are therefore crucial for segmentation.

▶ **LO 5** ▶ Once the important and determinant attributes are understood, the management needs to decide which service level different customers prefer on each of the attributes. Service levels are often used to differentiate customer segments according to their willingness to trade off price and service level.

▶ **LO 6** ▶ Each company needs to focus its efforts on those customers it can serve best—its *target segment*. Firms must have a competitive advantage on attributes valued by their target segment. There are three focused strategies firms can follow to achieve competitive advantage:

- o *Fully focused*: A firm provides a limited range of services (perhaps only one) to a narrow target segment (e.g., Shouldice Hospital).
- o *Market focused*: A firm concentrates on a narrow market segment but offers a wide range of services to address the many diverse needs of that segment (e.g., Rentokil).
- o *Service focused*: A firm offers a narrow range of services to a fairly broad market (e.g., Lasik eye surgery clinics, Starbucks cafés, and LinkedIn).
- o There is a fourth, the unfocused strategy. However, it is generally not advisable for firms to choose such a strategy as it will require them to spread themselves too thin to remain competitive.

▶ **LO 7** ▶ Once we have understood determinant attributes and related service levels of our target segment(s), we can decide how to best position our service in the market. *Positioning* is based on establishing and maintaining a distinctive place in the market for a firm's offerings. The essence of positioning is:

- o A company must establish a position in the minds of its targeted customers.
- o The position should be singular, providing one simple and consistent message.
- o The position must set a company apart from its competitors.
- o A company cannot be all things to all people—it must focus its efforts.

▶ **LO 8** ▶ *Positioning maps* are an important tool to help firms develop their positioning strategy. They provide a visual way of summarizing customer perceptions of how different services are performing on determinant attributes compared to the competition. They can help firms to see where they might reposition and even anticipate competitors' actions.

▶ **LO 9** ▶ *Digital services and platform business models* (i.e., largely AI-empowered services offered through apps and online platforms) can be positioned using the 3 Cs and STP. Nevertheless, there are important differences:

o   Digital services tend to have fewer attributes they can position on as these services typically aim to be scalable and do not have (many) service employees, a service environment, or equipment. This means that the number of attributes a digital service can position on is reduced, so the few remaining ones gain in importance. For example, ease of use, convenient onboarding, and an intuitive customer journey become critically important.

o   Many digital services are based on platforms and ecosystems. The way the different players are orchestrated and governed can be a differentiating factor if it enhances value and reduces risk for its users.

o   Network effects can lead to superior service and powerful differentiation. However, this does not apply to all types of platforms, and it is important to differentiate between two types of network effects:

- Direct network effects mean that the value to users increases as more users join. For example, the value for Facebook, TikTok, and Instagram is enhanced if others join. Here, network size can become an effective competitive barrier.

- Indirect network effects relate to platforms where the value for users increases when a new user of a different "group" joins the platform. For example, an additional Uber driver generates value for riders and an additional rider generates value for drivers. However, once matching quality does not increase significantly with additional users, these indirect network effects tend not to provide a strong competitive advantage as competitors can also scale to the required level.

▶ **LO 10** ▶ The outcome of these analyses is the *positioning statement* that articulates the desired position of the firm's offering in the marketplace. With this understanding, marketers can then develop a specific plan of action that includes its positioning strategy along the 7 Ps of services marketing, its customer relationship management and loyalty strategies, and its service quality and productivity strategies.

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THE *ESM* FRAMEWORK

PART I

Understanding Service Markets, Products, and Customers

- Introduction to Services Marketing
- Understanding Service Consumers
- Positioning Services in Competitive Markets

PART II

Applying the 4 Ps of Marketing to Services

- Developing Service Products and Brands
- Distributing Services through Physical and Electronic Channels
- Setting Prices and Implementing Revenue Management
- Promoting Services and Educating Customers

PART III

Managing the Customer Interface

- Designing Service Processes
- Balancing Demand and Capacity
- Crafting the Service Environment
- Managing People for Service Advantage

PART IV

Developing Customer Relationships

- Managing Relationships and Building Loyalty
- Complaint Handling and Service Recovery

PART V

Striving for Service Excellence

- Improving Service Quality and Productivity
- Building a World-Class Service Organization

Applying the 4 Ps of Marketing to Services

Part II revisits the 4 Ps of the traditional marketing mix (*P*roduct, *P*lace, *P*rice, and *P*romotions). However, the 4 Ps are expanded to take into account the specific characteristics of services that make them different from goods marketing. It consists of the following four chapters:

Chapter 4 Developing Service Products and Brands

Discusses the meaningful service concept that includes both the core and supplementary elements. The supplementary elements both facilitate and enhance the core service offering. This chapter also covers branding and tiered service products and explains how service firms can build brand equity.

Chapter 5 Distributing Services through Physical and Electronic Channels

Examines the time and place elements. Manufacturers usually require physical distribution channels to move their products. Some service businesses, however, are able to use electronic channels to deliver all (or at least some) of their service elements. For the services delivered in real time with customers physically present, speed and convenience of place and time have become important determinants of effective service delivery. This chapter also discussed the role of intermediaries, franchising, and international distribution and market entry.

Chapter 6 Setting Prices and Implementing Revenue Management

Provides an understanding of pricing from both the firm and customer's point of view. For firms, the pricing strategy determines income generation. Service firms need to implement revenue management to maximize the revenue that can be generated from available capacity at any given time. From the customer's perspective, price is a key part of the costs they must incur to obtain the desired benefits. However, the cost to the customer also often includes significant non-monetary costs. This chapter also discusses ethics and fairness in service pricing and how to develop an effective pricing strategy.

Chapter 7 Promoting Services and Educating Customers

Deals with how firms should communicate with their customers about their services through promotion and education. Since customers are co-producers and contribute to how others experience service performances, much communication in services marketing is educational in nature to teach customers how to effectively move through a service process. This chapter covers the service marketing communications funnel and the services marketing communications mix, including communications through online, mobile, and social networks.

4

developing
SERVICE
PRODUCTS and
BRANDS

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Understand what a service product is.

LO 2 Understand the benefits of having well-defined service products.

LO 3 Know the three components of a service product.

LO 4 Be familiar with the Flower of Service model.

LO 5 Know how facilitating supplementary services relate to the core product.

LO 6 Know how enhancing supplementary services relate to the core product.

LO 7 Understand service branding.

LO 8 Know the four brand architecture options at the corporate level.

LO 9 Understand how individual services and experiences can be branded.

LO 10 Understand how branding can be used to tier service products.

LO 11 Discuss how firms can build brand equity.

LO 12 Understand what is required to deliver a branded service experience.

LO 13 List the categories of new service development, ranging from simple style changes to major innovations.

LO 14 Know how design thinking applies to new service design.

LO 15 Describe how firms can achieve success in new service development.

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UNDERSTANDING SERVICE PRODUCTS

Services are often intangible and poorly defined. This can make them difficult for customers to understand, and as a result, difficult for the firm to position, differentiate, communicate, and sell. What we want are concrete service products rather than something fuzzy that is poorly specified, poorly understood, and poorly communicated.[2] Developing powerful service products and branding them address these challenges (this process is also called productizing services). This chapter discusses service products and their components, their branding, and new service development. An overview of the structure of this chapter is provided in Figure 4.2.

Components of a Service Product

- **Core Product**

- **Supplementary Services**

Facilitating Supplementary Services	Enhancing Supplementary Services
• Information	• Consultation
• Order-taking	• Hospitality
• Billing	• Safekeeping
• Payment	• Exceptions

- **Delivery Process**

Branding Service Firms, Service Products, and Experiences

Corporate Brand Architecture
- Branded house
- Sub-brands
- Endorsed brands
- House of brands

Building Brand Equity
- Company's presented brand
- External brand communications
- Customer experience with company
- Brand awareness
- Brand meaning

Branding Services
- Branding service products to define different bundles of services
- Use branding to define different service levels (tiering of service)

Delivering Branded Experiences
- Alignment of product and brand with the delivery process and servicescape and service employees
- Create an emotional connection

New Service Development (NSD)

Hierarchy of NSD
- Style changes
- Service improvements
- Supplementary service innovations
- Process line extensions
- Product line extensions
- Major process innovations
- Major service innovation

Design Thinking in NSD

Five Principles:
- User-centered from the customer's perspective
- Co-creative, involving all key stakeholders
- Sequential, following the customer journey
- Evident, making intangible aspects tangible
- Holistic, considering the entire service experience using all five senses

Achieving Success in NSD

Key success factors:
- Market synergy
- Organizational factors (alignment and support)
- Market research factors
- Involvement of customers early in the process, ideally at idea generation

Figure 4.2 Overview of the structure of Chapter 4.

▶ *Market research factors*. Detailed and scientifically designed market research studies are conducted early in the development process with a clear idea of the type of information to be obtained. A good definition of the service concept is developed before undertaking field surveys.

Furthermore, researchers have found that in the idea-generation stage, the nature of submitted ideas differed significantly depending on whether they were created by professional service developers or by customers. Customers' ideas were judged to be more original and to have a higher perceived value for customers. However, these ideas were usually harder to convert into commercial services.[20] The emergence of online crowdsourcing platforms as innovation partners provides additional opportunities for cost-effective innovation that can lead to new breakthroughs in service development.[21] We will discuss the role of customer feedback in improving and developing (new) services in greater detail in Chapter 8 on process design and in Chapter 14 on improving service quality and productivity.

CHAPTER SUMMARY

LO 1 ▶ A *service product* is a "bundle of output" that comprises all the elements of the service performance, both physical and intangible, that create value for customers.

LO 2 ▶ Key benefits of having well-defined service products include the following:
- o Customers can more easily understand the service and its value proposition, including what the service comprises (e.g., what its key elements are), how it is created (e.g., what the main phases and experiences are, and what will happen when), and what value they will receive (e.g., what is delivered, what is the experience and outcome, why it works, and what is so special about it). It also includes the structure and way of purchasing.
- o Well-designed service products also help employees to understand them and enable them to better explain and sell these products to customers.

LO 3 ▶ A service product consists of three components:
- o The *core product* delivers the principle benefits and solutions customers seek.
- o *Supplementary services* facilitate and enhance the core product.
- o *Delivery processes* determine how the core and supplementary service elements are being delivered to the customer.

LO 4 ▶ The *Flower of Service* consists of two components:
- o Core product
- o Supplementary services

As the core product often becomes commoditized, supplementary services can play an important role in differentiating and positioning the core product.

LO 5 ▶ The Flower of Service concept categorizes supplementary services into facilitating and enhancing supplementary services.
- o *Facilitating supplementary* services are needed for service delivery or help in the use of the core product. They include information, order taking, billing, and payment.

LO 6 ▶ o *Enhancing supplementary services* add value for the customer. They include consultation, hospitality, safekeeping, and dealing with exceptions.

LO 7 ▶ Strong brands enable customers to better visualize and understand services. *Branding* can be employed at the corporate, product, experience, and service level. A good brand is not only easily recognized but also has meaning for customers by representing a particular way of doing business.

LO 8 ▶ Firms can use four brand architecture options at the corporate level:
- o *Branded house*: applying a brand to multiple, often unrelated services (e.g., Virgin Group)
- o *Sub-brands*: using a master brand (often the firm name) with a specific service brand (e.g., ground service of FedEx)
- o *Endorsed brands*: featuring the corporate brand even while the product brand dominates (e.g., Holiday Inn of Intercontinental Hotel Group)

CHAPTER SUMMARY

o *House of brands*: promoting individual services under their own brand name without the corporate brand (e.g., KFC of Yum! Brands)

LO 9 ▶ Services can be branded at the individual service, experience, and service levels:

o Branding of individual service products helps firms to differentiate one bundle of output from another. Most service firms offer a line of products, with each one having a different combination of service attributes and their respective performance levels. Branding of individual service products is used to increase the tangibility of the service offering and value proposition.

o Individual experiences as part of a larger service can be branded and provide differentiation (e.g., LUX*'s Cinema Paradiso).

LO 10 ▶ o In many industries, branding is used to differentiate service levels, which is called service tiering. There are some industries where service tiering is common, such as hotels, airlines, and credit cards. B2B service support is often tiered with a "platinum" service offering the highest level of responsiveness and access to more senior technicians.

LO 11 ▶ *Building brand equity* is not just about distinctive brand names and market communications.

o A service firm's presented brand (e.g., through advertising) is more effective in building brand awareness than brand equity.

o The customer's service experience with the brand (i.e., the moments of truth) is ultimately more powerful in building brand equity.

LO 12 ▶ Delivering a branded service experience requires the transformation of a series of service elements and processes into a consistent and recognizable service experience. To build great brands, firms need to align processes, servicescapes, and people with its brand positioning. The remaining Ps of services marketing (price, distribution, and communications) also need to support the positioning.

LO 13 ▶ Firms need to improve and develop new services to maintain a competitive edge. The seven levels in the hierarchy of new service development are

o *style changes*: introducing highly visible changes that create excitement but do not typically involve changes in service performance or processes.

o *service improvements*: introducing modest changes in the performance of current products.

o *supplementary service innovations*: significantly improving or adding new facilitating or enhancing service elements.

o *process line extensions*: developing new ways of delivering existing service products, such as

creating self-service options and AI-powered delivery.

o *product line extensions*: adding new services that typically deliver the same core service but are specific to different needs.

o *major process innovations*: using new processes to deliver current products, such as adding online courses to traditional classroom-delivered lectures.

o *major service innovations*: developing new core products for markets that have not been previously defined. Major service innovations are relatively rare. More common is the use of new technologies to deliver existing services in new ways, enhance or create new supplementary services, and greatly improve performance on existing ones through process redesign. However, digital startups, quickly improving hardware (from processors and cameras to sensors), and new technologies such as robots, AI, virtual reality, speech processing, and the Internet of Things create opportunities for service innovations that can dramatically improve the customer experience, service quality, and productivity.

LO 14 ▶ Service design thinking is an effective approach to aligning key internal and external stakeholders around the creation of innovative and holistic service experiences. The following five principles are central to service design thinking:

o User-centered, from the customer's perspective

o Co-creative, involving all key stakeholders

o Sequential, following the customer journey

o Evident, making intangible aspects tangible

o Holistic, considering the entire service experience using all five senses

LO 15 ▶ Key factors that enhance the chances of success in new service development are

o *market synergy*: The new service fits well with the firm's existing image, expertise, and resources; is better at meeting customers' needs than competing services; and receives strong support during and after the launch from the firm's management and employees.

o *organizational factors*: There is strong cooperation between the different functional areas in a firm. Employees are aware of the importance of the new services. They understand them and their underlying processes.

o *market research*: Customer ideas and research are incorporated at an early stage in the new service design process. There is a clear idea of the type of information to be obtained.

KNOW YOUR SERVICES MARKETING

Review Questions

1. What is a service product?

2. What are the benefits of well-developed service products for customers and frontline employees?

3. Explain what is meant by the core product and its supplementary services.

4. Explain the Flower of Service concept and identify each of its petals. What insights does this concept provide for service marketers?

5. What is the difference between enhancing and facilitating supplementary services? Give examples of each.

6. How is branding used in marketing services? What is the distinction between a corporate brand such as Marriott, the names of its various inn and hotel chains, its packaged solutions for specific occasions (e.g., for marriage celebrations and honeymoons), and its specific features (e.g., Westin's Heavenly Bed)?

7. What is meant by using brands to tier service levels?

8. How can service firms build brand equity?

9. What are the approaches firms can take to innovate, enhance, and create new services?

10. Why do new services often fail? What are the factors associated with the successful new service development?

WORK YOUR SERVICES MARKETING

Application Exercises

1. Select a specific service product you are familiar with and identify its core product and supplementary services. Select a competing service and analyze the differences between the two in terms of the core product and supplementary services.

2. Identify two examples of branding in financial services (e.g., specific types of retail bank accounts or insurance policies) and define their characteristics. How meaningful are these brands likely to be for customers?

3. Select a service firm that you believe is successful and has strong brand equity. Conduct a few interviews to find out how consumers experience its service. Use your findings to identify the factors that helped the service firm to build its strong brand equity.

4. Select a service brand you consider to be outstanding. Explain why you think it is outstanding. Also explore any weaknesses of this brand. You should select an organization you are familiar with.

5. Using a firm you are familiar with, analyze what opportunities it might have to create product line extensions for its current and/or new markets. What impact might these extensions have on its present services?

6. Identify two new service developments that have failed. Analyze the causes for their failure.

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5

distributing
SERVICES through
PHYSICAL and
ELECTRONIC CHANNELS

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Know the four key questions that form the foundation of any service distribution strategy: What? How? Where? When?

LO 2 Describe the three interrelated flows that show *what* is being distributed.

LO 3 Know *how* services can be distributed using three main options, and understand the importance of distinguishing between the distribution of core and supplementary services.

LO 4 Recognize the issues of delivering services through electronic channels, and discuss the factors that have fueled the growth of service delivery via cyberspace.

LO 5 Understand the determinants of customers' channel preferences.

LO 6 Know the importance of channel integration.

LO 7 Describe the *where* (place) decisions of physical channels, and be familiar with the strategic and tactical location considerations.

LO 8 Describe the *when* (time) decisions of physical channels and the factors that determine extended operating hours.

LO 9 Understand the role, benefits, and costs of using intermediaries in distributing services.

LO 10 Know why franchising is such a common way of delivering services to end users.

LO 11 Understand the challenges of distribution in large domestic markets.

LO 12 Be familiar with the forces that drive service firms to go international.

LO 13 Appreciate the special challenges of distributing services internationally.

LO 14 Explain the determinants of international market entry strategies.

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Key questions for designing an effective service distribution strategy:

What **"What flows through the channel?"**	**How** **"How should the service reach the customer?"**	**Where** **"Where should the service be delivered?"**	**When** **"When should the service be delivered?"**
• Information and promotion flow (e.g., promotional materials) • Negotiation flow (e.g., make a reservation or sell a ticket) • Product flow (including core and remaining supplementary services)*	• Customers visit the service site • Service providers go to their customers • Transaction is conducted remotely (e.g., via mobile apps, the Internet, telephone, mail, and email) • Channel integration is key	• Strategic location considerations (including customer needs and type of service) • Tactical considerations (i.e., specific location characteristics) • Location constraints (e.g., due to required economies of scale)	• Customer needs • Economics of incremental opening hours (fixed vs. variable costs) • Availability of labor • Use of self-service facilities

Intermediaries
"What tasks should be delegated to intermediaries?"

• Roles
• Benefits
• Costs (e.g., of franchisees, agents, and distributors)
• Risks (e.g., channel conflicts and losing control of the customer relationship)

Distributing Service Internationally
"How should the service be distributed?"

• Export the service concept
• Import customers/possessions
• Deliver remotely

Entering International Markets
"How can the value-add be protected?"

• Export the service
• Licensing, franchising, joint venture
• Foreign direct investment

*Note that information and negotiations are types of supplementary services, but were listed separately here to emphasize their importance in any service distribution strategy.

Figure 5.2 The Flow Model of Service Distribution.

CHAPTER SUMMARY

▶ **LO 1** ▶ *What? How? Where? When?* Responses to these four questions form the foundation of any service distribution strategy.

▶ **LO 2** ▶ *What* is distributed? The Flow Model of Distribution can be mapped onto the Flower of Service concept and includes the following flows of service distribution:

- o Information and promotion flows (includes the information and potentially the consultation petals)
- o Negotiation flow (includes the order taking and potentially the billing and payment petals as well)
- o Product flow (includes the core product and the remaining petals of the Flower of Service)

A service distribution strategy encompasses all three flows.

▶ **LO 3** ▶ *How* can services be distributed? Services can be distributed through three main modes:

- o Customers visit the service site (e.g., for people-processing services such as an MRI scan).
- o Service providers go to their customers (e.g., for tree pruning or private banking services for high net-worth individuals).
- o Service transactions are conducted remotely (i.e., for Skype or for buying travel insurance online).

Some core services require a physical location (e.g., people-processing services), and this severely restricts their distribution. However, information-based core services and many supplementary services can be distributed and delivered remotely.

▶ **LO 4** ▶ Developments in telecommunications, online technology, service apps, and sophisticated logistics solutions have spurred innovations in remote service delivery.

- o All information-based core products and supplementary services (i.e., information, consultation, order taking, billing, and payment) and many possession-based services can be delivered remotely.

- o Key drivers of the growth of service delivery via cyberspace are (1) convenience, (2) ease of search, (3) a broader selection, (4) potential for lower prices, and (5) 24/7 service with prompt delivery.

▶ **LO 5** ▶ Customer preferences drive channel choice:

- o Customers who are technologically savvy often prefer remote channels due to the greater convenience they offer. Such customers usually have confidence in and knowledge about the service and/or the channel.
- o However, consumers rely more on personal channels when the perceived risk is high and when there are social motives behind the transaction.

▶ **LO 6** ▶ Customers are likely to use different service channels with the same service organization (e.g., bank customers use the entire gamut of channels ranging from mobile banking apps and websites to ATMs and bank branches). Thus, channel integration is essential for delivering consistent and seamless service experiences.

▶ **LO 7** ▶ *Where* should service be delivered? This is an important decision for services that require physical locations.

- o First, strategic location considerations are involved as the site location is an integral part of the overall service strategy. The location strategy must be consistent with the firm's marketing strategy and the needs and expectations of its target customers.
- o Second, tactical location considerations are used to choose between specific sites. They include population size and characteristics; traffic; convenience of access; competitors in the area; nature of nearby businesses; availability of labor and sites; and rental costs, conditions, and regulation. Geographic information systems (GISs) are frequently used to help firms make specific location decisions.

o Locational constraints such as a need for economy of scale (e.g., because of high fixed costs such as in specialized medical facilities) and operational requirements (e.g., airports or distribution centers) limit a firm's location choice.

o Innovative location strategies can be at the core of new service models. Recent trends include ministores, the sharing of retail space with complementary providers, and the location of services in multi-purpose facilities (e.g., locating clinics in shopping malls).

LO 8 ▶ *When* should service be delivered?

o Key factors determining opening hours of a service channel include customer needs and wants and the economics of opening hours (fixed costs of a facility, variable costs of extending opening hours, incremental sales or contribution expected, and potential operational gains achieved by shifting demand from peak periods to extended opening hours).

o There is now a move toward extended operating hours, with the ultimate goal of 24/7 service every day of the year. This is often achieved through the use of self-service technology.

o Information-based core and supplementary services can be offered 24/7. Recent technological developments link CRM systems, smartphones, apps, websites, and smart cards to provide increasingly convenient and sophisticated online services.

LO 9 ▶ Service firms frequently use intermediaries to distribute some of the supplementary services. For example, cruise lines still use travel agencies to provide information, take reservations, collect payment, and often bundle complementary services such as air travel.

o Service organizations may find it cost effective to outsource certain tasks. Intermediaries often add reach and generate incremental sales.

o However, there are vast cost differences between channels, with a firm's own website

typically costing a fraction of transactions via intermediaries such as Travelocity in the travel industry. A careful cost-benefit analysis is needed, which generally leads strong brands to shift transactions toward their own channels. Brands that lack recognition and reach rely more on intermediaries.

o Potential channel conflicts have to be mitigated. For example, powerful intermediaries (e.g., Booking.com and Expedia) insist on rate parity, and hotels are not allowed to offer lower rates to guests who book directly from them. Hotels may still encourage guests to book direct by offering extras (e.g., late check-out and loyalty points) that are not extended to guests booking through intermediaries.

o In addition to cost, ownership of the customer relationship is an important consideration. If intermediaries own the customer relationship, they can easily switch a customer to a new service provider to capture a higher share of the margin.

o In either case, the challenge for the service firm is to ensure that the overall service experience is seamless and meets the consumer's expectations.

LO 10 ▶ Franchising is often used to distribute even the core service. There are advantages and disadvantages to franchising:

o It allows fast growth. Franchisees are highly motivated to ensure customer orientation as well as high-quality and cost-effective service operations.

o Disadvantages of franchising include the firm's loss of control over the delivery system and the customers' service experience. Hence, franchisors often enforce strict quality controls over all aspects of the operation.

LO 11 ▶ Large domestic markets (e.g., the United States, China, and India) are less homogeneous than national stereotypes suggest. Careful market

segmentation, focusing on specific segments, and balancing standardization and adaptation strategies enhance a firm's chances of succeeding in developing large national service penetration.

▶ **LO 12** ▶ Five important forces that drive service firms to go international are

- o market drivers (e.g., customers expect a global presence)
- o competitive drivers (e.g., competitors become global and put pressure on domestic firms)
- o technology drivers (e.g., the Internet allows global distribution and cost arbitrage)
- o cost drivers (e.g., economies of scale push toward adding markets)
- o government drivers (e.g., countries joining the World Trade Organization have to open many service sectors to international competition)

▶ **LO 13** ▶ Regulation remains a major challenge for many services that have highly regulated markets (such as air travel, health care, and financial services).

New business models in more mundane markets (such as Uber in the taxi market and Airbnb in the accommodation market) also face stiff regulatory hurdles around the world.

▶ **LO 14** ▶ The strategy for entering international markets depends on (1) how a firm can control its intellectual property (IP) and its sources of value creation and (2) the degree of customer interaction required for the creation of the service

- o If the value lies in the IP, then the service can simply be exported directly (as for e-books, music, and software).
- o If IP control and customer contact requirements are moderate, then licensing, franchising, or joint ventures may be used.
- o If a high degree of interaction is required, and the control of IP is low, then foreign direct investments may be effective. These may include the establishment of branches and subsidiaries as well as mergers and acquisitions.

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6

setting prices and
IMPLEMENTING REVENUE MANAGEMENT

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

▶ **LO 1** Recognize that effective pricing is central to the financial success of service firms.

▶ **LO 2** Outline the foundations of a pricing strategy as represented by the pricing tripod.

▶ **LO 3** Define different types of financial costs and explain the limitations of cost-based pricing.

▶ **LO 4** Understand the concept of net value and know how gross value can be enhanced through value-based pricing and reduction of related monetary and non-monetary costs.

▶ **LO 5** Describe competition-based pricing and situations where service markets are less price-competitive.

▶ **LO 6** Define revenue management and describe how it works.

▶ **LO 7** Discuss the role of rate fences in effective revenue management.

▶ **LO 8** Be familiar with the issues of ethics and consumer concerns related to service pricing.

▶ **LO 9** Understand how fairness can be designed into revenue management policies.

▶ **LO 10** Discuss the six questions marketers need to answer to design an effective service-pricing strategy.

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Figure 6.1 Dynamic pricing, a strategy to price the same product differently to different customers at various times, has gained popularity in many industries.

Objectives of Service Pricing

- Gain profit and cover costs
- Build demand and develop a user base
- Support positioning strategy

Components of the Pricing Tripod

Value to Customer
(Price Ceiling)

- Net value and price
- Value perception
- Related monetary and non-monetary costs

Competitor Pricing
(Competitive Benchmark)

- Price competition intensifiers
- Price competition inhibitors

Viable Price Range

Unit Cost to Firm
(Price Floor)

- Fixed and variable costs
- Contribution
- Break-even analysis
- Activity-based costing

Revenue Management (RM)

When Should RM Be Used?

- Fixed capacity and high fixed costs
- Variable and uncertain demand
- Varying customer price sensitivity

How to Apply RM?

- Predict demand by segment
- Reserve capacity for high-yield customers
- Maximize revenue per available space and time unit (RevPAST)
- "Pick up" competitor pricing through booking pace in the RM system
- Implement price segmentation through "rate fences"

Rate Fences

- Physical fences
  - Basic product
  - Amenities
  - Service level
- Non-physical fences
  - Transaction characteristics
  - Consumption characteristics
  - Buyer characteristics

Fairness and Ethical Concerns in Service Pricing

Ethical Concerns

- Service pricing is complex
- Confusiology
- Fees: Crime and punishment

Design Fairness into RM

- Clear, logical, and fair prices and rate fences
- Frame rate fences as discounts
- Communicate benefits of RM
- "Hide" discounts
- Take care of loyal customers
- Use service recovery to deal with overbooking

Putting Service Pricing into Practice

- How much should be charged?
- What should be the basis of pricing?
- Who should collect payment and where?
- When should payment be made?
- How should payment be made?
- How should prices be communicated?

Figure 6.3 Organizing framework for the pricing of services.

CHAPTER SUMMARY

LO 1 ▶ Effective pricing is central to the financial success of service firms. The key objectives for establishing prices can be to (1) gain profits and cover costs, (2) build demand and develop a user base, and/or (3) support the firm's positioning strategy. Once a firm sets its pricing objectives, it needs to decide on its pricing strategy.

LO 2 ▶ The foundations of a pricing strategy are the three legs of the pricing tripod:

o The costs the firm needs to recover set the minimum or floor price.

o The customer's perceived value of the offering sets a maximum or ceiling price.

o The price charged for competing services determines where, within the floor-to-ceiling range, the price can be set.

LO 3 ▶ The first leg of the pricing tripod is the cost to the firm.

o Costing services is often complex. Services frequently have high fixed costs, varying capacity utilization, and large shared infrastructures that make it difficult to establish unit costs.

o If services have a large proportion of variable and/or semi-variable costs, cost-accounting approaches work well (e.g., the use of contribution and break-even analysis).

o However, activity-based costing (ABC) is often more appropriate for complex services with shared infrastructure.

LO 4 ▶ The second leg of the pricing tripod is value to the customer.

o Net value is the sum of all the perceived benefits (gross value) minus the sum of all the perceived costs of a service. Customers will only buy the service if the net value is positive. The net value can be enhanced by increasing value and/or by reducing costs.

o Since value is perceived and subjective, it can be enhanced through communication and education to help customers better understand the value they receive.

o In addition to the price customers pay for the service, costs include related monetary costs (e.g., the taxi fare to the service location) and non-monetary costs (e.g., time, physical, psychological, and sensory costs) during the search, purchase and service encounter, and post-purchase stages. Firms can enhance net value by reducing these related monetary and non-monetary costs.

LO 5 ▶ The third leg of the pricing tripod is competition:

o Price competition can be fierce in markets with relatively similar services. Here, firms need to closely observe what competitors charge and price accordingly.

o Price competition intensifies with the (1) number of competitors, (2) number of substituting offers, (3) distribution density of competitor and substitution offers, and (4) amount of surplus capacity in the industry.

o Price competition is reduced if one or more of the following applies: (1) Non-price-related costs of using competing alternatives are high; (2) personal relationships are important; and (3) switching costs are high, and service consumption is time and location specific.

LO 6 ▶ Revenue management (RM) increases revenue for the firm through better use of capacity and reservation of capacity for higher-paying segments. Specifically, revenue management

o designs products using physical and non-physical rate fences and prices them for different segments according to their specific reservation prices.

o sets prices according to predicted demand levels of different customer segments.

o works best in service businesses characterized by (1) high fixed costs and perishable inventory, (2) several customer segments with different price elasticities, and (3) variable and uncertain demand.

o measures success by revenue per available capacity for a given space and time unit (RevPAST). For example, airlines seek to maximize revenue per available seat kilometer (RevPASK), while hotels try to maximize their revenue per available room night (RevPAR).

LO 7 ▶ Well-designed rate fences are needed to define "products" for each target segment so that customers who are willing to pay higher prices for a service are unable to take advantage of lower price buckets. Rate fences can be physical and non-physical.

o Physical fences refer to tangible product differences related to different prices (e.g., seat location in a theater, size of a hotel room, or service level).

CHAPTER SUMMARY

- o Non-physical fences refer to consumption (e.g., having to stay over a weekend at a hotel), transaction (e.g., two weeks' advance booking with cancellation and change penalties), or buyer characteristics (e.g., student and group discounts). The service experience is identical across fence conditions although different prices are charged.

▶ **LO 8** ▶ Customers often have difficulties understanding service pricing (e.g., RM practices and their many fences and fee schedules). Service firms need to be careful that their pricing does not become so complex and full of hidden fees that customers perceive them as unethical and unfair.

▶ **LO 9** ▶ The following ways help firms to improve customers' fairness perceptions:

- o Design price schedules and fences that are clear, logical, and fair.
- o Use published prices and frame fences as discounts.

- o Communicate consumer benefits of revenue management.
- o "Hide" discounts through bundling, product design, and targeting.
- o Take care of loyal customers.
- o Use service recovery to deal with overbooking.

▶ **LO 10** ▶ Service marketers need to consider seven questions to develop a well-thought-out pricing strategy:

1. How much should be charged?
2. What should be the specified basis for pricing?
3. Who should collect payment, and where should payment be made?
4. When should payment be made?
5. How should payment be made?
6. How should prices be communicated to target markets?

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promoting services and
EDUCATING CUSTOMERS

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Know the 5 Ws of the Integrated Service Communications Model; i.e., **W**ho, **W**hat, Ho**w**, **W**here, and **W**hen.

LO 2 Be familiar with the three broad target audiences (i.e., "**W**ho") for any service communications program.

LO 3 Understand the most common strategic and tactical service communications objectives ("**W**hat").

LO 4 Be familiar with the Services Marketing Communications Funnel and the key objectives in that funnel.

LO 5 Know a few important roles that service marketing communications can assume.

LO 6 Understand the challenges of service communications and know how they can be overcome ("Ho**w**").

LO 7 Be familiar with the Services Marketing Communications Mix ("**W**here").

LO 8 Know the communications mix elements of traditional marketing communication channels.

LO 9 Know the role of the Internet, mobile phones, apps, QR codes, and other electronic media in service marketing communications.

LO 10 Know the communications mix elements available via service delivery channels.

LO 11 Know the communications mix elements that originate from outside the firm.

LO 12 Understand when communications should take place ("**W**hen"), how budgets for service communications programs may be set, and how these programs may be evaluated.

LO 13 Appreciate ethical and consumer-privacy-related issues in service marketing communications.

LO 14 Understand the role of corporate design in communications.

LO 15 Know the importance of Integrated Marketing Communications to delivering a strong brand identity.

The 5 Ws of Service Marketing Communications

Communications Strategy Development

Who
is our target audience?

(Target Audience Decisions)

Key Target Audiences for Service Communications:
- Prospective customers, target segments
- Current customers, users of the service
- Employees as secondary audience

What
are our objectives?

(Communications Objectives)

Strategic Objectives:
- Position and differentiate the brand and service products

Tactical Objectives by Consumption Stage along the Service Communications Funnel
- Pre-purchase stage: Manage the customer search and choice process
- Service encounter stage: Guide customers through the service encounter
- Post-encounter stage: Manage customer satisfaction and build loyalty

Communications Strategy Implementation

How
should this be communicated?

(Message Decisions)

Challenges of Service Communications
- Problems of intangibility
  - Abstractness
  - Generality
  - Non-searchability
  - Mental impalpability
- Strategies to address intangibility
  - Advertising tactics to address intangibility (including showing consumption episodes, documentation, and testimonials)
  - Tangible cues
  - Metaphors

Where
should this be communicated?

(Media Decisions)

Communications Mix for Services from Three Key Sources
- Marketing communications channels
  - Traditional media (e.g., TV)
  - Online media (e.g., search engine advertising and social media)
- Service delivery channels
  - Service outlets
  - Frontline employees
  - Self-service delivery points
- Messages originated from outside the organization:
  - Word-of-mouth, social media
  - Blogs and Twitter
  - Traditional media coverage

When
should communication take place?

(Timing Decisions)

Timing Decisions
- Map timing against Service Communications Funnel
- Use media plan flowchart

Budget Decisions and Communications Program Evaluation
- Objective-and-Task Method
- Other budgeting methods (e.g., percentage of revenue, matching against competitor spent)
- Map performance against overall and specific objectives along the Service Communications Funnel

Ethics and Consumer Privacy
- Don't make exaggerated promises or use deceptive communications
- Respect and protect consumer privacy

Corporate Design
- Ensure a unified and distinctive visual appearance for all tangible elements of the firm and its services

Integrated Marketing Communications
- Integrate communication across all channels to deliver a consistent message, look, and feel

Figure 7.1 Integrated Service Communications Model.

the PR department of public relations; functional specialists of a company's website and its direct marketing and promotions activities; operations of customer service; and human resources of training. The service failure described above is due to lack of effective coordination among these various departments.

With so many channels delivering messages to customers and prospects, it becomes more and more important for firms to adopt the concept of Integrated Marketing Communications (IMC). IMC ties together and reinforces all communications to deliver a strong brand identity. This means that a firm's various media deliver the same messages and have the same look and feel, and the communications from the different media become parts of a single, overall message about the service firm and its products. Firms can achieve this by giving ownership of IMC to a single department (e.g., marketing) or by appointing a marketing communications director to help coordinate all of the firm's market communications.

CHAPTER SUMMARY

LO 1 ▶ Service marketers need to design an effective communications strategy. To do this, they can use the Integrated Service Communications Model as a guiding framework. The model is organized around the 5 Ws:

- o **W**ho is our target audience? Are they prospects, users, and/or employees?
- o **W**hat do we need to communicate and achieve? Do the objectives relate to consumer behavior in the pre-purchase, service encounter, or post-encounter stage?
- o Ho**w** should we communicate this? How can we overcome the challenges caused by the intangibility of services?
- o **W**here should we communicate this? Which media mix should we use?
- o **W**hen should the communications take place?

LO 2 ▶ There are three broad target audiences (**W**ho) of service communications. They are (1) prospects, who can be reached via traditional communications media as in goods marketing; (2) current customers, who can be reached via more cost-effective communication channels such as the firm's service delivery channels (e.g., service employees, branch networks, account statements, and self-service channels); and (3) employees as a secondary audience who can be highly motivated with the right communications messaging.

LO 3 ▶ At the most generic level, marketing communications objectives (**W**hat) are to inform, educate, persuade, remind, shape behavior, and build relationships.

Communications objectives can be strategic or tactical in nature and are typically an amalgamation of both.

- o *Strategic objectives* include building brand equity, positioning a brand against competition, and re-positioning it.

LO 4 ▶ o *Tactical objectives* can be organized according to the *Services Marketing Communications Funnel*, which details a range of potential objectives using the three-stage model of service-consumer behavior as a guiding framework. The funnel illustrates that communications objectives can be highly specific and can address any aspect of service consumption behavior in the (1) pre-purchase stage (e.g., emphasize the importance of attributes the firm outperforms, and reduce perceived risk), (2) service-encounter stage (e.g., guide customers through the service process, encourage proper queuing behavior, and manage performance perceptions), and (3) post-encounter stage (e.g., shape customer satisfaction and encourage referral and loyalty behaviors).

LO 5 ▶ Examples of a few important roles that service marketing communications can assume are:

- o Promote the tangible cues to communicate quality.
- o Add value through communication content (e.g., provide information and consultation as discussed in the Flower of Service model).
- o Facilitate customer involvement in production.
- o Promote the contribution of service personnel.
- o Stimulate and shift demand to match capacity.

CHAPTER SUMMARY

▶ **LO 6** ▶ Ho**w** can services best be communicated? The intangibility of services presents certain challenges for communications. These are

- o *Abstractness:* There is no one-to-one correspondence with a physical object.
- o *Generality:* Items are part of a class of persons, objects, or events and are not specific to the firm's performance.
- o *Non-searchability:* Services cannot be inspected or searched before purchase.
- o *Mental impalpability:* Services are difficult to understand and interpret.

There are a number of ways to overcome the communications problems posed by intangibility.

- o Abstractness: Use service consumption episodes and show typical customers experiencing the service.
- o Generality: For objective claims, use system documentation showing facts and statistics about the service delivery system and the firm's performance (including past performance statistics, such as the percentage of packages delivered on time). For subjective claims, use service performance episodes where the actual service delivery being performed by service personnel is shown.
- o Non-searchability: Use consumption documentation; that is, obtain testimonials from customers who have experienced the service. For services high in credence attributes, use reputation documentation, which shows the awards received or the qualifications of the service provider.
- o Impalpability: Use service process episodes by presenting what exactly will happen during the service experience; or case history episodes of what the firm did for a client and how it solved the client's problem; or a service consumption episode showing a customer's experience with a service.

Two additional ways to help overcome the problems of intangibility are

- o emphasize tangible cues such as the employees, facilities, certificates and awards, and customers of the firm.
- o use metaphors to communicate the value proposition. For example, Prudential uses the Rock of Gibraltar as a symbol of corporate strength.

▶ **LO 7** ▶ To reach our target audiences and achieve the communications objectives, we can use a variety of communications channels (**W**here):

- o Traditional marketing channels (e.g., advertising, direct marketing, online advertising), apps, and social media.
- o Service delivery channels (e.g., service outlets, front-line employees, service apps, and self-service websites).
- o Messages originating from outside the organization (e.g., word of mouth, social media, blogs, and coverage in traditional media).

▶ **LO 8** ▶ The traditional marketing channels include advertising, public relations, direct marketing (including permission marketing), sales promotions, and personal selling. These communication elements are typically used to help companies create a distinctive position in the market and reach prospective customers.

▶ **LO 9** ▶ Online communications channels include the firm's websites and online advertising (e.g., banner advertising and search engine advertising and optimization).

- o Developments in technology are driving innovations such as permission marketing and exciting possibilities of highly-targeted communications using online and mobile advertising, apps, social media, and podcasting.

▶ **LO 10** ▶ Service firms usually control service delivery channels and point-of-sale environments that offer them cost-effective ways of reaching their current customers (e.g., through its service employees, service outlets, and self-service delivery points).

▶ **LO 11** ▶ Some of the most powerful messages about a company and its services originate outside the organization and are not controlled by the marketer. They include traditional word of mouth, online reviews, blogs, Twitter and other social media, and coverage in traditional media.

- o Recommendations from other customers are generally viewed as more credible than firm-initiated communications and are sought by prospects, especially for high-risk purchases.
- o Firms can stimulate word of mouth from their customers through a number of means, such as by creating exciting promotions, developing referral reward programs, referencing customers, and presenting testimonials. All of these are increasingly being shifted to the online environment.

▶ **LO 12** ▶ Unlike goods marketing, where much of the communication happens before periods of heavy buying (e.g., before Christmas), service firms typically cannot cater to additional demand during peak periods. Therefore, communications is usually

connected to the specific objectives and their timing in the Services Marketing Communications Funnel (**W**hen). Budget decisions and performance management are mapped against these objectives (if the objective-and-task method is used).

LO 13 ▶ When designing their communications strategy, firms need to bear in mind ethical and privacy issues such as failure to fulfill promises or intrusion into people's private lives (e.g., through telemarketing or e-mail campaigns). Firms must protect the privacy and personal data of customers and prospects.

LO 14 ▶ Besides communication media and content, corporate design is key to achieving a unified image in customers' minds. Good corporate design uses a unified and distinctive visual appearance for tangible elements, including all elements of the Services Marketing Communications Mix, retail signage, uniforms, vehicles, equipment, and building interiors.

LO 15 ▶ With so many channels delivering messages to customers and prospects, it becomes crucial for firms to adopt the concept of Integrated Marketing Communications (IMC).

8. What tangible cues could a diving school or a dentistry clinic use to position itself as appealing to upscale customers?

9. Explore the websites of a management consulting firm, an online retailer, and an insurance company. Assess them for ease of navigation, content, and visual design. What, if anything, would you change about each site?

10. Register at Amazon.com and Hallmark.com and analyze their permission-based communications strategy. What are their marketing objectives? Evaluate their permission-based marketing for a specific customer segment of your choice. Mention what is excellent, what is good, and what could be improved.

11. Conduct a Google search for (a) undergraduate business programs and (b) vacation (holiday) resorts. Examine two or three contextual ads triggered by your searches. What are they doing right, and what can be improved?

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Recent research suggests that protecting consumers needs to extend beyond privacy and needs to cover the entire life cycle of data. It ranges from creation of data (e.g., capturing data through cameras and biometric identification and collecting data from wearable devices), to developing variables based on the data (e.g., credit scores or healthiness of lifestyle metric), making decisions based on the variables (e.g., whether to approve a loan, and if yes, at what interest rate), and finally the retirement of these data (e.g., the "right to be forgotten" in the European Union); see Lara Lobschat, Benjamin Müller, Felix Eggers, Laura Brandimarte, Sarah Diefenbach, Mirja Kroschke, and Jochen Wirtz, "Corporate Digital Responsibility," *Journal of Business Research* 122(January) (2021): 875–888.

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Managing the Customer Interface

Part III focuses on managing the interface between customers and the service organization. It covers the additional 3 Ps (Process, Physical environment, and People) that are unique to services marketing. It consists of the following four chapters:

Chapter 8 Designing Service Processes

Chapter 8 begins with design of an effective service delivery process, specifying how operating and delivery systems link together to create the promised value proposition. Very often, customers are actively involved in service creation, especially if acting as co-creators, and the process becomes their experience.

Chapter 9 Balancing Demand and Capacity

Chapter 9 relates to process management and focuses on the widely fluctuating demand and how to balance the level and timing of customer demand against available productive capacity. Well-managed demand and capacity leads to smooth processes with less waiting time for customers. Marketing strategies for managing demand involve smoothing demand fluctuations and inventorying demand through reservation systems and formalized queuing. Understanding customer motivations in different segments is one of the keys to successful demand management.

Chapter 10 Crafting the Service Environment

Chapter 10 focuses on the physical environment, which is also known as the servicescape. It needs to be engineered to create the right impression and facilitate effective delivery of service processes. The servicescape needs to be managed carefully because it can have a profound impact on customers' impressions, guide their behavior throughout the service process, and provide tangible clues of a firm's service quality and positioning.

Chapter 11 Managing People for Service Advantage

Chapter 11 introduces people, who are a defining element of many services. Many services require direct interaction between customers and contact personnel. The nature of these interactions strongly influences how customers perceive service quality. Hence, service firms devote a significant amount of effort to recruiting, training, and motivating their employees. Satisfied and engaged employees who perform well are often a source of competitive advantage for a firm.

designing SERVICE PROCESSES

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

▶ **LO 1** Know the difference between a service experience and a service process.

▶ **LO 2** Tell the difference between flowcharting, blueprinting, and customer journey mapping.

▶ **LO 3** Develop a blueprint for a service process with all the typical design elements in place.

▶ **LO 4** Understand how to use fail-proofing to design fail points out of service processes.

▶ **LO 5** Know how to set service standards and performance targets for customer service processes.

▶ **LO 6** Appreciate the importance of consumer perceptions and emotions in service process design.

▶ **LO 7** Explain the necessity for service process redesign.

▶ **LO 8** Understand how service process redesign can help improve both service quality and productivity.

▶ **LO 9** Understand the levels of customer participation in service processes.

▶ **LO 10** Be familiar with the concept of service customers as "co-creators" and the implications of this perspective.

▶ **LO 11** Understand the factors that lead customers to accept or reject new self-service technologies (SSTs) and services delivered by robots and artificial intelligence (AI).

▶ **LO 12** Know how to manage customers' reluctance to change their behaviors in service processes, including the adoption of new technologies.

▶ **LO 13** Appreciate the dramatic impact service robots and artificial intelligence will have on customer service processes.

▶ **LO 14** Understand the differences between service robots and traditional SST.

▶ **LO 15** Know the type of services that can best be delivered by service robots, by service employees, and by service employee-robot teams.

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Service Processes
- are the service experience from the customer's perspective
- are the architecture of service from the firm's perspective

Mapping and Designing Service Processes

Flowcharting of service processes
- maps a service process
- shows the nature and sequence of steps involved
- is an easy way to visualize the customer experience

Blueprinting of service processes
- is a more complex form of flowcharting
- shows how a service process is constructed
- maps the customer, employee, and service system interactions
- includes many design elements:
  - Front-stage activities
  - Physical evidence
  - Line of visibility
  - Backstage activities
  - Support processes and supplies
  - Potential fail points
  - Common customer waits
  - Service standards and targets
  - Details of pre-process, in-process, and post-process stages of service delivery

Process design considerations
- use poka-yokes to design fail points out of processes
- set service standards and targets to manage processes
- design customer emotions into the process:
  - Start strong
  - Build an improving trend
  - Create a peak
  - Get bad experiences over with early
  - Segment pleasure, combine pain
  - Finish strong

Redesigning Service Processes

Indicators for Redesign Need
- Excessive information exchange
- High degree of control activities
- Increased processing of exceptions
- Growing number of customer complaints about inconvenient and unnecessary procedures

Objectives of Redesign
- Reduced number of service failures
- Reduced cycle time
- Enhance productivity
- Increased customer satisfaction

How to Redesign Service Processes
- Examine the blueprint with key stakeholders (including customers, frontline and back office employees, and IT) and see how to reconstruct, rearrange, and substitute tasks
- Eliminate non-value-adding steps
- Address bottlenecks and balance processes
- Shift to self-service and intelligent automation

Service Robots
- can dramatically improve the customer experience, service quality, and productivity
- are system-based autonomous and adaptable interfaces that interact, communicate, and deliver service to an organization's customers
- differ from traditional SSTs as they can deal with unstructured interactions with customers and guide them through the process
- are suitable for services that are low in terms of their emotional and social complexity
- can deal effectively with tasks that require high cognitive and analytical skills
- cannot deal effectively with emotions that go beyond the surface display of a pleasant demeanor
- will work as part of human–robot teams to deliver tasks that require high cognitive and high emotional skills

Manage Customer Participation in Service Processes

Customers as co-creators
- educate, train, and motivate customers to do their part well
- use customer poka-yokes to reduce failures caused by customers
- consider peer-to-peer problem-solving as part of online brand communities

Self-Service Technologies (SSTs)
- Customer benefits:
  - Convenience and speed
  - Control, information, and customization
  - Cost savings
- Disadvantages and barriers:
  - Poorly designed SSTs
  - Unreliable SSTs
  - Poor service recovery procedures
  - Inadequate customer education
- Assessing and improving SSTs:
  - Does the SST work reliably?
  - Is the SST better than the interpersonal alternative?
  - If it fails, are systems in place to recover the service?

Managing Customers' Reluctance to Change
- Develop customers' trust
- Understand customers' habits and expectations
- Pre-test new procedures and equipment
- Publicize the benefits
- Teach customers to use innovations and promote trial
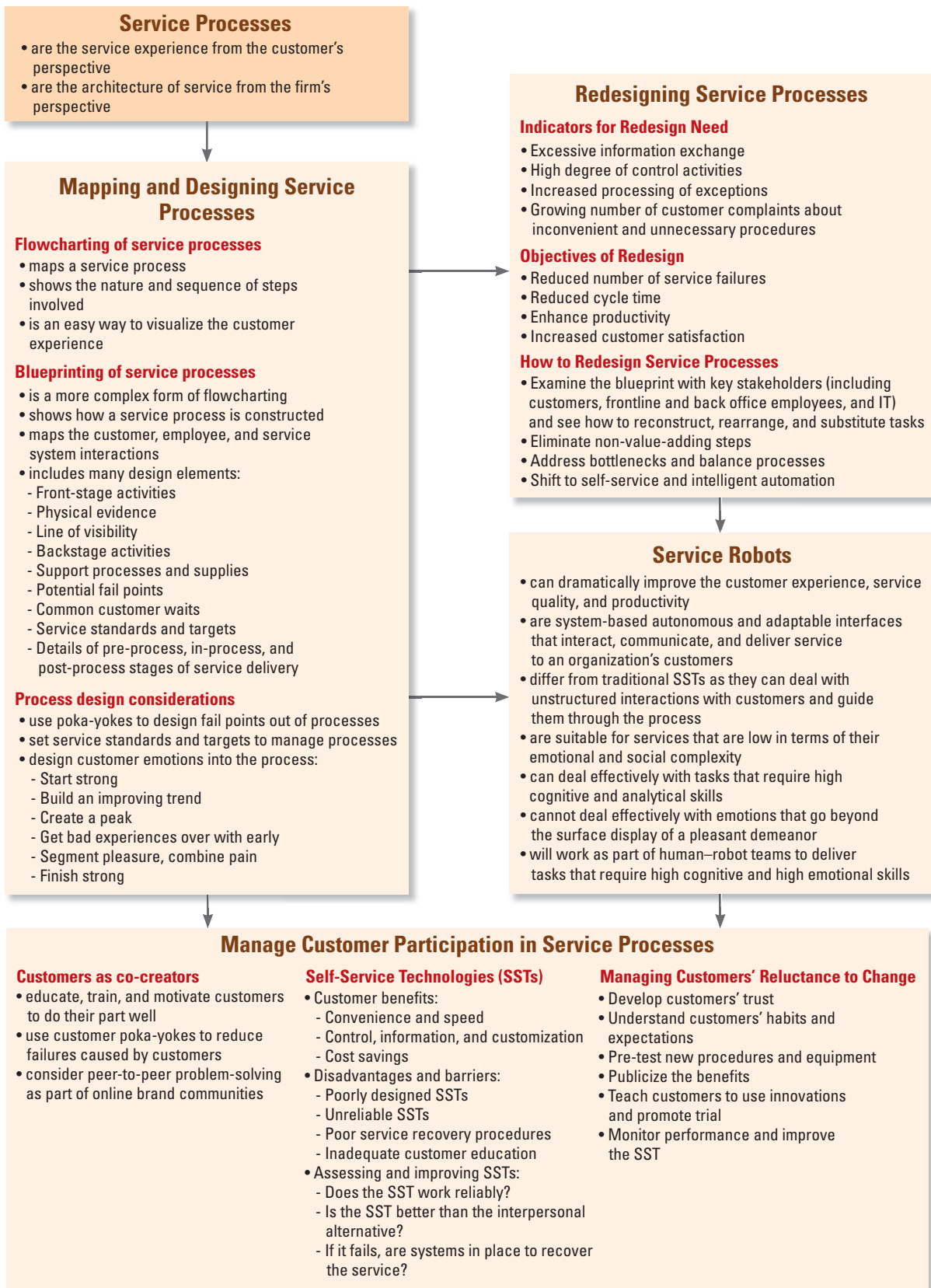- Monitor performance and improve the SST

Figure 8.1 Chapter overview: Designing and managing service processes.

CHAPTER SUMMARY

LO 1 ▶ From the customer's perspective, services are experiences. From the organization's perspective, services are the processes that are designed and managed to create the desired experience for customers. Processes are the underlying architecture of services.

LO 2 ▶ Flowcharting is a technique for displaying the nature and sequence of the different steps involved in delivering a service to the customer. It is a simple way to visualize the total customer journey and service experience. Blueprinting is a more complex form of flowcharting that specifies in detail how service processes are constructed, including what is visible to the customer and what goes on in the back office. Blueprints facilitate the detailed design and redesign of customer service processes.

LO 3 ▶ A blueprint typically has the following design elements:

- o *Front-stage activities* that map the overall customer experience, the desired inputs and outputs, and the sequence in which delivery of that output should take place.

- o *Physical evidence* that the customer can see and use to assess service quality.

- o *Line of visibility* that clearly separates what customers experience and see front stage from the back-stage processes customers can't see.

- o *Back-stage activities* that must be performed to support a particular front-stage step.

- o *Support processes* that are typically provided by information systems and supplies that are needed for front- and back-stage activities.

- o *Fail points* at which there is a risk of things going wrong and affecting service quality. Fail points should be designed out of a process (e.g., via the use of poka-yokes), and firms should have back-up plans for failures that are not preventable.

- o Common *customer waits* in the process, including potential points of excessive waits. These should preferably be designed out of the process. If that is not possible, firms can implement strategies to make waits less unpleasant.

- o *Service standards and targets* that reflect customer expectations. These should be established for each activity. They include specific times to be set for the completion of each task and the acceptable wait between two consecutive customer activities.

LO 4 ▶ A good blueprint identifies fail points where things can go wrong. Fail-safe methods, also called poka-yokes, can then be designed to prevent such failures (by both employees and customers) and/

or ensure service recovery. A three-step approach can be used to develop poka-yokes:

- o Collect information on the most common fail points.

- o Identify the root causes of those failures.

- o Create strategies to prevent the failures that have been identified.

LO 5 ▶ Service blueprints help to set service standards that are high enough to satisfy customers. As standards need to be measurable, subjective or intangible service attributes must also be operationalized. This can often be achieved through service process indicators that capture the essence of these attributes or at least approximate them. Once standards have been decided, performance targets can be set.

LO 6 ▶ Service processes need to be designed with emotional intelligence. The following are the key principles involved in the sequencing of services.

- o *Start strong.* The opening scenes of a service drama are particularly important because customers' first impressions can affect their evaluation of quality during the later stages of service delivery.

- o *Build an improving trend.* All things being equal, it is better to start a little lower and build higher than to start a little higher and fall off at the end.

- o *Create a peak.* Customers tend to remember the peak!

- o *Get bad experiences over with early.* If this is done, negative aspects of the experience are less likely to dominate the customer's memory of the entire service encounter.

- o *Segment pleasure, combine pain.* Service processes should extend the feeling of pleasurable experiences by dividing them. Unpleasant experiences should be combined into a single event as far as possible.

- o *Finish strong.* Ending on a high note is an important aspect of every service encounter, even if it is just a cheerful and affirmative "Have a nice day."

LO 7 ▶ Changes in technology, customer needs, and service offerings require customer service processes to be redesigned periodically. Symptoms indicating that a process is not working well include

- o a lot of information exchange (implying that the data available is not useful)

- o a high ratio of checking or control activities to value-adding activities

- o increased processing of exceptions

- o growing numbers of customer complaints about inconvenient and unnecessary procedures

A tool that helps manage customer emotions is emotionprints, which documents likely customer emotions at each stage of the service process. The objective is to manage the customer experience well.

LO 8 ▶ Service process redesign efforts aim to

- o reduce the number of service failures
- o reduce cycle time
- o improve productivity
- o increase customer satisfaction

Service process redesign involves the reconstruction, rearrangement, or substitution of service processes. These efforts typically include

- o examining the service blueprint with key stakeholders (customers, front-line employees, support staff, and IT teams are invited to review the blueprint and brainstorm for ideas on how to improve the process)
- o eliminating non-value adding steps
- o reducing bottlenecks and balancing process capacity
- o shifting to self-service
- o using smart services, including digitization and service robots

LO 9 ▶ Customer participation is required in many service processes and has to be managed.

LO 10 ▶ Customers are often involved in service processes as co-producers and can therefore be thought of as "service co-creators." Their performance affects the quality and productivity of output. Therefore, service firms need to educate and train customers so that they have the skills and motivation needed to perform their tasks well.

LO 11 ▶ The ultimate form of customer involvement is self-service, which is increasingly delivered online, via apps and service robots. Most people welcome SSTs and related smart technologies that offer more convenience (i.e., time savings, faster service, 24/7 availability, and more locations); cost savings; and better control, information, and customization. However, poorly designed technology and inadequate education in how to use them can cause customers to reject self-service and automated service. Three basic questions can be used to assess an SST's potential for success and to improve it:

- o Does the SST work reliably?
- o Is the SST better for customers than other service delivery alternatives?
- o Are there systems in place to recover the service if the SST fails?

LO 12 ▶ Increasing the customers' participation level in a service process or shifting the process entirely to self-service or robot-delivered service requires the firm to change customer behavior. There are six steps to guide this process and reduce customer reluctance to change.

- o Develop customer trust.
- o Understand customers' habits and expectations.
- o Pre-test new procedures and equipment.
- o Publicize the benefits of changes.
- o Teach customers to use innovations and promote trial.
- o Monitor performance and continue to seek improvements.

LO 13 ▶ Service robots have the potential to bring unprecedented improvements in both service quality and productivity with profound implications for the design and management of customer service processes. Rapidly improving technologies are becoming smarter and more powerful, even as they get smaller, lighter, and cheaper.

LO 14 ▶ Service robots are system-based autonomous and adaptable interfaces that interact and communicate with and deliver services to an organization's customers. These abilities differentiate service robots from traditional SSTs. Service robots can handle unstructured interactions with customers and can guide them through the process. Across a range of services, customers can interact with service robots much as they do with service employees.

LO 15 ▶ Service robots are not equally suited to all types of services.

- o Service robots are good at delivering simple and repetitive tasks that tend to be low in terms of their emotional/social and cognitive/analytical complexity.
- o Services that require high cognitive and analytical skills, such as accounting and stock trading, can be delivered effectively by service robots.
- o It is difficult for robots to deal with complex and emotionally demanding tasks. These are best left to human service employees, who can respond better to the individual context and show understanding.
- o Tasks that require high cognitive and high emotional skills will increasingly be delivered by human–robot teams.

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balancing
DEMAND and
CAPACITY

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Know the different demand–supply situations that fixed capacity firms may face.

LO 2 Describe the building blocks of dealing with the problem of fluctuating demand.

LO 3 Understand what is meant by productive capacity in a service context.

LO 4 Be familiar with the basic ways to manage capacity.

LO 5 Recognize that demand patterns vary by segment, so that segment-specific variations in demand can be predicted.

LO 6 Be familiar with the four basic ways to manage demand.

LO 7 Understand how to use the marketing mix elements of price, product, place, and promotion to smooth out fluctuations in demand.

LO 8 Know how to use waiting lines and queuing systems to inventory demand.

LO 9 Understand how customers perceive waits and how to make waiting less burdensome for them.

LO 10 Know how to use reservation systems to inventory demand.

LO 11 Be familiar with strategic approaches to utilize residual surplus capacity even after all other options of matching demand and capacity have been exhausted.
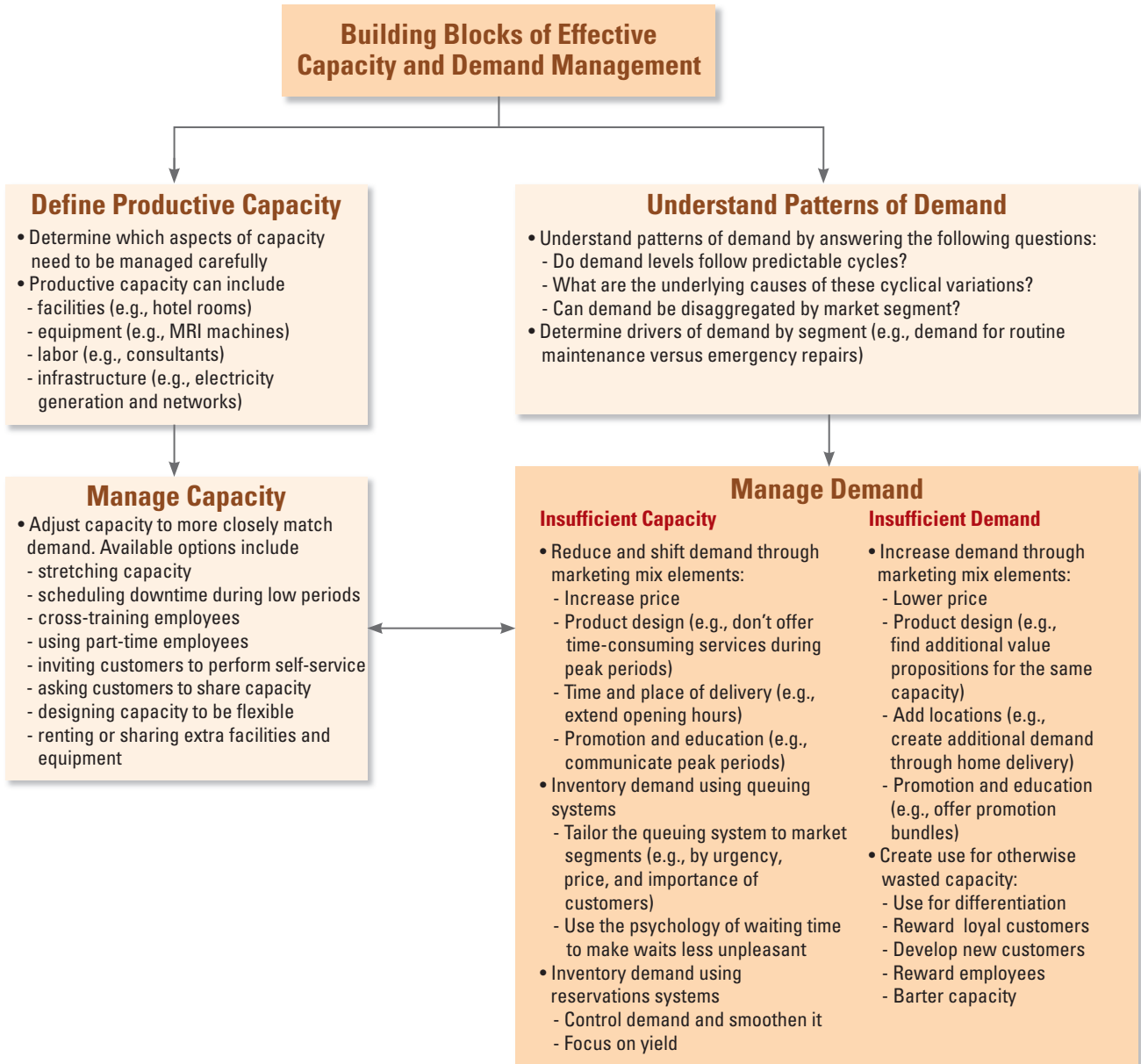
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Building Blocks of Effective Capacity and Demand Management

Define Productive Capacity

- Determine which aspects of capacity need to be managed carefully
- Productive capacity can include
  - facilities (e.g., hotel rooms)
  - equipment (e.g., MRI machines)
  - labor (e.g., consultants)
  - infrastructure (e.g., electricity generation and networks)

Understand Patterns of Demand

- Understand patterns of demand by answering the following questions:
  - Do demand levels follow predictable cycles?
  - What are the underlying causes of these cyclical variations?
  - Can demand be disaggregated by market segment?
- Determine drivers of demand by segment (e.g., demand for routine maintenance versus emergency repairs)

Manage Capacity

- Adjust capacity to more closely match demand. Available options include
  - stretching capacity
  - scheduling downtime during low periods
  - cross-training employees
  - using part-time employees
  - inviting customers to perform self-service
  - asking customers to share capacity
  - designing capacity to be flexible
  - renting or sharing extra facilities and equipment

Manage Demand

Insufficient Capacity

- Reduce and shift demand through marketing mix elements:
  - Increase price
  - Product design (e.g., don't offer time-consuming services during peak periods)
  - Time and place of delivery (e.g., extend opening hours)
  - Promotion and education (e.g., communicate peak periods)
- Inventory demand using queuing systems
  - Tailor the queuing system to market segments (e.g., by urgency, price, and importance of customers)
  - Use the psychology of waiting time to make waits less unpleasant
- Inventory demand using reservations systems
  - Control demand and smoothen it
  - Focus on yield

Insufficient Demand

- Increase demand through marketing mix elements:
  - Lower price
  - Product design (e.g., find additional value propositions for the same capacity)
  - Add locations (e.g., create additional demand through home delivery)
  - Promotion and education (e.g., offer promotion bundles)
- Create use for otherwise wasted capacity:
  - Use for differentiation
  - Reward loyal customers
  - Develop new customers
  - Reward employees
  - Barter capacity

Figure 9.3 Building blocks of effective capacity and demand management.

► **Reward employees.** In certain industries such as restaurants, beach resorts, or cruise lines, capacity can be used to reward employees and their families to build loyalty. This can improve employee satisfaction and provide employees with an understanding of the service as experienced from the customer's perspective and thereby raising performance.

► **Barter free capacity.** Service firms often can save costs and increase capacity utilization by bartering capacity with their own suppliers. Among the most widely bartered services are advertising space, airline seats, and hotel rooms.

CHAPTER SUMMARY

▶ **LO 1** ▶ At any one time, a firm with limited capacity can face different demand–supply situations:

- o Excess demand
- o Demand that exceeds ideal capacity
- o Well-balanced demand and supply
- o Excess capacity

When demand and supply are not in balance, firms will have idle capacity during low periods but will have to turn away customers during peak periods. This situation impedes the efficient use of productive assets and erodes profitability. Firms therefore need to try and balance demand and supply through adjusting capacity and/or demand.

▶ **LO 2** ▶ The building blocks for effective capacity and demand management are

- o Define productive capacity.
- o Use capacity management tools.
- o Understand demand patterns and drivers by customer segment.
- o Use demand management tools.

▶ **LO 3** ▶ When we refer to managing capacity, we implicitly mean productive capacity. There are several different forms of productive capacity in services:

- o Facilities for processing customers or goods
- o Equipment for processing people, possessions, or information
- o Labor
- o Infrastructure

▶ **LO 4** ▶ *Capacity* can be managed in a number of ways, including *stretching capacity* and *adjusting capacity*.

Stretching capacity means that some capacity is elastic and more people can be served with the same capacity through crowding (e.g., in a subway car), extending operating hours, or speeding up customer processing times.

Adjusting capacity involves to more closely match demand by

- o scheduling downtime during low periods
- o cross-training employees
- o using part-time employees
- o inviting customers to perform self-service
- o asking customers to share capacity
- o designing capacity to be flexible, and
- o renting or sharing extra facilities and equipment.

▶ **LO 5** ▶ To manage *demand* effectively, firms need to understand demand patterns and drivers by market segment. Different segments often exhibit different demand patterns (e.g., routine maintenance versus emergency repairs). Once firms have an understanding of the demand patterns of their market segments, they can use marketing strategies to reshape those patterns.

▶ **LO 6** ▶ Demand can be managed in the following four basic ways:

- o Take no action and leave demand to find its own levels.
- o Reduce demand during peak periods and increase demand during low periods.
- o Inventory demand through waiting lines and queuing systems.
- o Inventory demand through reservation systems.

▶ **LO 7** ▶ The following marketing mix elements can be used to help smooth out fluctuations in demand:

- o Use price and non-monetary customer costs to manage demand.

o Change product elements to attract different segments at different times.

o Modify the place and time of delivery (e.g., through extended opening hours).

o Promotion and education (e.g., "mail early for Christmas").

LO 8 ▶ *Waiting line and queuing systems* help firms inventory demand over short periods of time. There are different types of queues with their respective advantages and applications. Queuing systems include single line with single stage–single line with sequential stages, parallel lines to multiple servers, single line to multiple servers, designated lines, taking a number, and wait list.

Not all queuing systems are organized on a "first-come, first-served" basis. Rather, good systems often segment waiting customers by

o urgency of the job (e.g., hospital emergency units)

o duration of the service transaction (e.g., express lanes)

o premium service based on a premium price (e.g., first-class check-in counters)

o importance of the customer (e.g., frequent travelers get priority waitlisting)

LO 9 ▶ Customers don't like wasting their time waiting. Firms need to understand the *psychology of waiting* and take active steps to make waiting less frustrating:

o Keep customers occupied or entertained while waiting

o Minimize pre- and post-process waits

o Avoid perceptions of unfair waits

o Inform customers how long the wait is likely to be

o Provide customers with an explanation of why they have to wait

LO 10 ▶ Effective *reservation systems* inventory demand over a longer period of time and offer several benefits:

o Helping to reduce or even avoid customers waiting in queues and thereby avoid dissatisfaction due to excessive waits

o Allowing the firm to control demand and smooth it out

o Enabling the use of revenue management to focus on increasing yield by reserving scarce capacity for higher-paying segments, rather than just selling off capacity on a first-come first-serve basis

LO 11 ▶ Even after professional management of capacity and demand, most service firms will still experience periods of excess capacity. Firms can take a strategic approach to the use of surplus capacity, including the following:

o Use capacity for service differentiation. When capacity utilization is low, service employees can go all the way to truly wow their customers.

o Reward the firm's best customers and build loyalty (e.g., through special promotions as part of a loyalty program).

o Customer and channel development (e.g., provide free or heavily discounted trials).

o Reward employees (e.g., excess capacity in restaurants, beach resorts, or cruise lines can be used to reward loyal employees and their families).

o Barter free capacity (e.g., service firms can barter excess capacity for advertising space, airline seats, and hotel rooms).

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10

crafting the
SERVICE
ENVIRONMENT

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Recognize the four core purposes service environments fulfill.

LO 2 Know the theoretical underpinning from environmental psychology that helps us to understand how customers and employees respond to service environments.

LO 3 Be familiar with the integrative servicescape model.

LO 4 Know the three main dimensions of the service environment.

LO 5 Discuss the key ambient conditions and their effects on customers.

LO 6 Determine the roles of spatial layout and functionality.

LO 7 Understand the roles of signs, symbols, and artifacts.

LO 8 Know how service employees and other customers are part of the servicescape.

LO 9 Explain why designing an effective servicescape has to be done holistically and from the customer's perspective.

LO 10 Know the tools available to understand how customers use and respond to servicescapes.

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Figure 10.1 The contemporary curves of the Guggenheim have drawn in both praise and crowds in large quantities.

Main Purposes of Service Environments

- Shape customers' service experience and behaviors
- Signal quality, and position, differentiate, and strengthen the brand
- Is a core component of the value proposition
- Facilitate the service encounter and enhance productivity

Theories from Environmental Psychology That Explain Consumer Responses to Service Environments

The Stimulus-Organism-Response (SOR) Model

- Perceptions and interpretation of servicescapes influence how consumers feel
- These feelings then drive consumer responses to those environments

Valence and Intensity Model of Affect

- Customers' feelings (or emotions) can be modeled with two dimensions: Pleasure and Arousal
- Pleasure (i.e., valence) is subjective
- Arousal (i.e., intensity) largely depends on the information rate of an environment
- Pleasure and arousal interact on response behaviors, whereby arousal generally amplifies the effects of pleasure (or displeasure)

Servicescape Model

Key Dimensions of Service Environments

- Ambient conditions (e.g., music, scents, and colors)
- Spatial layout and functionality (including floor plan, size and shape of furnishing, counters, equipment)
- Signs, symbols, and artifacts
- Appearance of service employees and other customers

Response Moderators

- Customers (e.g., liking of servicescape, personal tolerance for stimulation through music, noise, and crowding)
- Employees (as moderators for customers)

Internal Responses

- Cognitive (e.g., beliefs, perceptions)
- Emotional (e.g., moods, attitudes)
- Physiological (e.g., comfort, pain)

Behavioral Responses

- Approach (e.g., explore, spend time, spend money in the environment)
- Avoidance (e.g., leave the environment)
- Interaction between customers and service employees

Design of Effective Service Environments

- Design with a holistic view
- Design from the customer's perspective
- Use design tools (ranging from keen observation and customer feedback to photo audits and field experiments)

Figure 10.3 Designing the service environment.

▶ ***Field experiments*** can be used to manipulate specific dimensions in an environment so that their effects can be observed. For instance, researchers can experiment with various types of music and scents and then measure the time and money customers spend in the environment. Laboratory experiments with pictures, videos, or other ways to simulate real-world service environments (such as virtual tours via computer) can be effectively used to examine the impact of changes in design elements that cannot be easily manipulated in a field experiment. Examples include testing of different color schemes, spatial layouts, or styles of furnishing.

▶ ***Blueprinting*** or flowcharting (described in Chapter 8) can be extended to include the physical evidence in the environment. Design elements and tangible cues can be documented as the customer moves through each step of the service delivery process. Photos can supplement the map to make it more vivid.

These tools allow an organization to examine how the different environmental elements at each step of the customer journey exceed or fail to meet expectations. The more a service company can see, understand, and experience the same things as its customers, the better equipped will it be to realize errors in the design of its environment and to improve what is already functioning well.

CHAPTER SUMMARY

LO 1 ▶ Service environments fulfill four core purposes. Specifically, they

- o shape customers' experiences and behaviors.
- o play an important role in determining customer perceptions of the firm and its image and positioning. Customers often use the service environment as an important quality signal.
- o can be a core part of the value proposition (such as for theme parks and resort hotels).
- o facilitate the service encounter and enhance productivity.

LO 2 ▶ Environmental psychology provides the theoretical underpinning for understanding the effects of service environments on customers and service employees. There are two key models:

- o The Stimulus-Organism-Response (SOR) model holds that environments influence peoples' affective state (or emotions and feelings), which in turn drives their behavior.
- o The valence and intensity model of affect holds that affect can be modeled with the two interacting dimensions of pleasure and arousal. Together, they determine whether people approach an environment and spend time and money in it or whether they avoid it.

LO 3 ▶ The servicescape model, which builds on the aforementioned theories, represents an integrative framework that explains how customers and service staff respond to key environmental dimensions.

LO 4 ▶ The servicescape model emphasizes three dimensions of the service environment:

- o Ambient conditions (including music, scents, and colors)
- o Spatial layout and functionality
- o Signs, symbols, and artifacts

CHAPTER SUMMARY

LO 5 ▶ Ambient conditions refer to those characteristics of the environment that pertain to our five senses. Even when not consciously perceived, they can still affect people's internal and behavioral responses. Important ambient dimensions include

- o *Music:* Its tempo, volume, harmony, and familiarity shape behavior by affecting emotions and moods. People tend to adjust their pace to match the tempo of the music.
- o *Scent:* Ambient scent can stir powerful emotions and relax or stimulate customers.
- o *Color:* Colors can have strong effects on people's feelings, with warm (e.g., red and orange) and cold colors (e.g., blue) having different impacts. Warm colors are associated with elated moods, while cold colors are linked to peacefulness and happiness.

LO 6 ▶ Effective spatial layout and functionality are important for making the service operation more efficient and enhancing its user friendliness.

- o Spatial layout refers to the floor plan; the size and shape of furnishings, counters, and potential machinery and equipment; and the ways in which they are arranged.
- o Functionality refers to the ability of these items to facilitate service operations.

LO 7 ▶ Signs, symbols, and artifacts help customers to draw meaning from the environment and guide them through the service process. They can be used to

- o label facilities, counters, or departments
- o show directions (e.g., to the entrance, exit, elevator, or toilet)
- o communicate the service script (e.g., take a queuing number and wait for it to be called)
- o reinforce behavioral rules (e.g., "please switch your cell phones to silent mode")

LO 8 ▶ The appearance and behavior of service employees and other customers in a servicescape can be part of the value proposition and can reinforce (or undermine) the positioning of the firm.

LO 9 ▶ Service environments are perceived holistically. Therefore, no individual aspect can be optimized without considering everything else. The process of designing service environments is an art rather than a science.

- o Due to this challenge, professional designers tend to specialize on specific types of environments, such as hotel lobbies, clubs, and health-care facilities.
- o The best service environments are designed not only on the basis of aesthetic considerations but, more importantly, with the customer's perspective in mind. The purpose is to guide customers smoothly through the service process.

LO 10 ▶ Tools that can be used to design and improve servicescapes include careful observation, feedback from employees and customers, photo audits, field experiments, and blueprinting.

◖ KNOW YOUR SERVICES MARKETING ◗

Review Questions

1. What are the four main purposes service environments fulfill?

2. Describe how the Stimulus-Organism-Response (SOR) model and the valence and intensity model of affect explain consumer responses to a service environment.

3. What is the relationship or link between the valence and intensity model of affect and the servicescape model?

4. Why do different customers and service staff respond very differently to the same service environment?

5. Explain the dimensions of ambient conditions and the ways in which each can influence customer responses to the service environment.

6. What are the roles of signs, symbols, and artifacts?

7. What are the implications of the fact that service environments are perceived holistically?

8. What tools are available for aiding our understanding of customer responses and for guiding the design and improvement of service environments?

◖ WORK YOUR SERVICES MARKETING ◗

Application Exercises

1. Identify firms from three different service industries where the service environment is a crucial part of the overall value proposition. Analyze and explain in detail the value that is being delivered by the service environment in each of the three industries.

2. Visit a service environment and have a detailed look around. Experience the environment and try to understand how the various design elements shape what you feel and how you behave in that setting.

3. Select a bad and a good waiting experience, and contrast the two situations with respect to the service environment and the other people waiting.

4. Visit a self-service environment and analyze how the design dimensions guide you through the service process. Which elements do you find most effective, and which seem least effective? How can the environment be improved to make the "way-finding" process easier for self-service customers?

5. Take a camera and conduct a photo audit of a specific servicescape. Photograph examples of excellent and very poor design features. Develop concrete suggestions on how this environment could be improved.

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11

managing people for
SERVICE
ADVANTAGE

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Explain why service employees are so important for the success of a firm.

LO 2 Understand the factors that make the work of front-line staff demanding and often difficult.

LO 3 Describe the cycles of failure, mediocrity, and success in human resources for service firms.

LO 4 Understand the key elements of the Service Talent Cycle for successful human resource management in service firms.

LO 5 Know how to attract, select, and hire the right people for service jobs.

LO 6 Explain the key areas in which service employees need training.

LO 7 Understand the role of internal marketing and communications.

LO 8 Understand why empowerment is so important in many front-line jobs.

LO 9 Explain how to build high-performance service delivery teams.

LO 10 Know how to integrate teams across departments and functional areas.

LO 11 Know how to motivate and energize service employees so that they will deliver service excellence and productivity.

LO 12 Understand what a service-oriented culture is.

LO 13 Know the difference between service climate and culture, and describe the determinants of a climate for service.

LO 14 Explain the qualities of effective leaders in service organizations.

LO 15 Understand different leadership styles and realize the importance of role modeling and focusing the entire organization on the front line.

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Figure 11.1 A waitress's pride in her professionalism earns her admiration and respect from customers and co-workers.

Front Line Employees Are Important

- Are a core part of the service product
- Are the service firm in the eyes of the customer
- Are a core part of the brand, delivering the brand promise
- Sell, cross-sell, and up-sell
- Are a key driver of customer loyalty
- Determine productivity

HR in Service Firms Is Challenging

Front Line Work Is Difficult and Stressful
- Boundary-spanning positions that link the inside of the organization to the outside world
- Have conflicting roles that cause role stress:
  - Organization/client conflict
  - Person/role conflict
  - Inter-client conflict
- Require emotional labor

Basic Models of HR in Service Firms
- Cycle of Failure
  - Low pay, low investment in people, high staff turnover
  - Result in customer dissatisfaction, defection, and low margins
- Cycle of Mediocrity
  - Large bureaucracies; offer job security but little scope in the job itself
  - No incentives to serve customers well
- Cycle of Success
  - Heavy investment in recruitment, development, and motivation of front line employees
  - Employees are engaged and productive
  - Customers are satisfied and loyal, margins are improved

How to Get HR Right: The Service Talent Cycle

Hire the Right People
- Be the preferred employer and compete for talent market share
- Intensify the selection process to identify the right people for the organization and given job
  - Filter out unsuitable candidates
  - Conduct multiple structured interviews
  - Observe candidate behavior
  - Use personality tests
  - Give applicants a realistic preview of the job

Enable the Front Line

Training and Development
- Conduct extensive training on
  - organizational culture, purpose, and strategy
  - interpersonal and technical skills
  - product/service knowledge
- Reinforce training to shape behaviors
- Professionalize the front line
- Use internal communications/marketing to shape the service culture and behaviors

Empower the Front Line
- Provide discretion to find solutions to service problems and customization of service delivery
- Set appropriate levels of empowerment depending on the business model and customer needs
- Empowerment requires (1) information about performance, (2) knowledge that enables contribution to performance, (3) power to make decisions, and (4) performance-based rewards

Organize Front Line Employees into Effective Service Delivery Teams
- Use cross-functional teams that can service customers from end to end
- Structure teams for success (including setting goals, carefully selecting members with the right skills)
- Integrate teams across departments and functional area (e.g., cross-postings, and internal campaigns such as "walk a mile in my shoes" and "a day in the field")

Motivate the Front Line
- Energize and motivate employees with a full set of rewards
- Rewards should include pay, performance bonuses, satisfying job content, feedback and recognition, and goal accomplishment

Service Culture, Climate, and Leadership

Service Culture
- Shared perceptions of what is important in an organization
- Shared values and beliefs of why those things are important

Climate for Service
- Climate is culture translated into policies, practices, and procedures
- Shared perception of practices and behaviors that get rewarded

Leadership
- Qualities of effective leaders
- Strong focus on front line

Figure 11.2 Organizing framework: Managing people for service advantage.

CHAPTER SUMMARY

LO 1 ▶ Service employees are extremely important for the success of a service firm because they
- o are a core part of the service product
- o represent the service firm in the eyes of the customer
- o are a core part of the brand as they deliver the brand promise
- o generate sales, cross-sales, and up-sales
- o are a source of customer loyalty
- o determine the productivity of front-line operations

LO 2 ▶ The work of front-line employees is difficult and stressful because they are in boundary-spanning positions that often entail
- o organization–client conflicts
- o person–role conflicts
- o inter-client conflicts
- o emotional labor and stress

LO 3 ▶ Three types of cycles involving front-line employees and customers describe how firms can be set up for failure, mediocrity, or success:
- o The Cycle of Failure involves a strategy of low pay and high employee turnover. It results in high customer dissatisfaction and defections, which in turn depress profit margins.
- o The Cycle of Mediocrity is typically found in large bureaucracies, offering job security but not much scope in the job itself. There is no incentive to serve customers well.
- o Successful service firms operate in the Cycle of Success, where employees are satisfied with their jobs and are productive. As a consequence, customers are satisfied and loyal. Higher profit margins allow investment in the recruitment, development, and motivation of the right front-line employees.

LO 4 ▶ The Service Talent Cycle is a guiding framework for successful HR in service firms, helping them to move their firms into the Cycle of Success. Implementing the Service Talent Cycle correctly will give firms highly motivated and productive employees who are willing and able to deliver service excellence and go the extra mile for their customers. It has four key prescriptions:
- o Hire the right people.
- o Enable front-line employees.
- o Motivate and energize them.
- o Have a leadership team that fosters a climate for service, walks the talk, and emphasizes and supports the front line.

LO 5 ▶ Firms need to attract, select, and hire the right people for their firm and any given service job. Best-practice HR strategies start with the recognition that the labor market is highly competitive in many industries. In order to compete for talent, a firm must do the following:
- o Work on being seen as a preferred employer, so that it can receive a large number of applications from the best potential candidates in the labor market.
- o Carefully select new employees so that they fit both job requirements and the organization's culture. The best suited candidates are gained by first sifting out unsuitable candidates and then identifying the most suitable ones using multiple methods such as structured interviews, observation, personality tests, and realistic job previews.

To enable their front-line employees, firms need to perform the following:

LO 6 ▶ Conduct extensive training on (1) the organizational culture, purpose, and strategy; (2) interpersonal and technical skills; and (3) product/service knowledge.

LO 7 ▶ Use internal communications (also referred to as "internal marketing") to reinforce the firm's service culture and convey the message to everyone in the company. An effective mix of internal communications tools should be used (e.g., e-mails; magazines; videos; briefings; and promotional campaigns using displays, prices, and recognition programs).

LO 8 ▶ Empower the front line so that they can respond with flexibility to customer needs, non-routine encounters, and service failures. Empowerment and training will give employees the authority, skills, and self-confidence to use their own initiative in delivering service excellence.
- o Empowerment needs to be set at the appropriate level for the business model and customer needs. It ranges from the low level of empowerment in the "production-line" approach for highly standardized services to a high level of decision authority for the front line in more complex and customized services.
- o Empowerment requires systematically distributing four key features: (1) information about organizational, team, and individual performance; (2) knowledge that enables employees to understand and contribute to performance; (3) power to make decisions; and (4) performance-based rewards.

LO 9 ▶
- o Organize front-line employees into effective (often cross-functional) service delivery teams that can serve their customers from end to end.

CHAPTER SUMMARY

LO 10 ▶
- Integrate service delivery teams across departments and functional areas. To be successful, the marketing, operations, human resources, and IT management functions need to be tightly integrated so that they can work together in well-coordinated ways. Integration means that the key deliverables and objectives of the various functions are not only compatible but also mutually reinforcing.
- Ways to improve integration include (1) internal transfers across functional areas; (2) cross-functional project teams; (3) cross-functional service delivery teams; (4) appointing individuals to integrate objective, processes, and activities between departments; (5) training, internal marketing, and campaigns (e.g., "walk a mile in my shoes" and "a day in the field"); and (6) management commitment to ensure that the overarching objectives of all functions are integrated.

LO 11 ▶
- Finally, energize and motivate employees with a full set of rewards such as pay, performance bonuses, satisfying job content, feedback, and recognition of goal accomplishment.

LO 12 ▶ A *service culture* describes the basic assumptions and values that guide organizational action. It can be boiled down to two points:
- shared perceptions of *what* is important in an organization, and
- shared values and beliefs about *why* those things are important.

An essential feature of a service-oriented culture is a strong belief in the importance of delivering superior value and service excellence. It builds employee understanding and support for the organization's goals that lead to those outcomes.

Exemplary leaders understand the powerful, unifying effect of focusing on customers and creating a service culture with values that inspire, energize, and guide service providers.

LO 13 ▶ A *service climate* is the surface layer on top of the culture. Climate is culture translated into the more concrete aspects that can be experienced by employees. It includes the policies, practices, and procedures of HR, operations, marketing, and IT. Climate also represents the shared perceptions of employees about the practices and behaviors that get rewarded in an organization.

LO 14 ▶ Service leaders should have the following qualities:
- Love for the business
- A set of core values related to service excellence and performance, which they pass on to the organization
- A strong belief in the people who work for them and recognition of the importance of the front line
- Ability to ask great questions and get answers from their teams
- Ability to role model the behaviors they expect from their teams
- Effective communication skills that allow leaders to inspire the organization to create success

LO 15 ▶ A leadership style that focuses on the basics and details creates a strong climate for service. Leaders should demonstrate a commitment to quality, set high standards, recognize and remove obstacles, and ensure the availability of the resources required to do it.

A strong service culture focuses on the front line. Leaders show by their actions that what happens at the front line is crucially important to them. The role of top and middle management is to support the front line in delivering service excellence to the firm's customers.

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THE *ESM* FRAMEWORK

PART I

Understanding Service Markets, Products, and Customers

- Introduction to Services Marketing
- Understanding Service Consumers
- Positioning Services in Competitive Markets

PART II

Applying the 4 Ps of Marketing to Services

- Developing Service Products and Brands
- Distributing Services through Physical and Electronic Channels
- Setting Prices and Implementing Revenue Management
- Promoting Services and Educating Customers

PART III

Managing the Customer Interface

- Designing Service Processes
- Balancing Demand and Capacity
- Crafting the Service Environment
- Managing People for Service Advantage

PART IV

Developing Customer Relationships

- Managing Relationships and Building Loyalty
- Complaint Handling and Service Recovery

PART V

Striving for Service Excellence

- Improving Service Quality and Productivity
- Building a World-Class Service Organization

Developing Customer Relationships

Part IV focuses on developing customer relationships through building loyalty and effective complaint handling and service recovery for long-term profitability. It consists of the following two chapters:

Chapter 12 Managing Relationships and Building Loyalty

Chapter 12 focuses on achieving profitability by creating relationships with customers from the right segments and then finding ways to build and reinforce their loyalty using the Wheel of Loyalty as an organizing framework. This chapter closes with a discussion of customer relationship management (CRM) systems.

Chapter 13 Complaint Handling and Service Recovery

Chapter 13 examines how effective complaint handling and professional service recovery can be implemented. It starts with a review of consumer complaining behavior and principles of effective service recovery. Service guarantees are discussed as a powerful way of institutionalizing effective service recovery and as an effective marketing tool signaling high-quality service. The chapter also discusses how to deal with jaycustomers who take advantage of service recovery policies and abuse the service in other ways.

12

managing
RELATIONSHIPS and
BUILDING LOYALTY

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Recognize the important role customer loyalty plays in driving a service firm's profitability.

LO 2 Calculate the lifetime value (LTV) of a loyal customer.

LO 3 Understand why customers are loyal to a particular service firm.

LO 4 Know the core strategies of the Wheel of Loyalty that explain how to develop a loyal customer base.

LO 5 Appreciate why it is so important for service firms to target the "right" customers.

LO 6 Use service tiering to manage the customer base and build loyalty.

LO 7 Understand the relationship between customer satisfaction and loyalty.

LO 8 Know how to deepen the relationship through cross-selling and bundling.

LO 9 Understand the role of financial and non-financial loyalty rewards in enhancing customer loyalty.

LO 10 Appreciate the power of social, customization, and structural bonds in enhancing loyalty.

LO 11 Understand what factors cause customers to switch to a competitor and how to reduce such switching.

LO 12 Know why loyalty programs and customer relationship management (CRM) systems are important enablers of delivering loyalty strategies.

LO 13 Understand the part played by CRM systems in delivering customized services and building loyalty.

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Importance of Customer Loyalty to Firm Profitability

- Higher purchases, share-of-wallet, and cross-buying
- Reduced customer service costs
- Positive word-of-mouth and referrals
- Lower price sensitivity
- Amortization of acquisition costs over a longer period

Value Analysis and Loyalty Drivers

Value Analysis
- Lifetime value computation
- Gap analysis between actual and potential customer value

Loyalty Drivers
- Confidence benefits
- Social benefits
- Special treatment benefits

Customer Loyalty Strategies: The Wheel of Loyalty

Foundation for Loyalty
- Target the right customers, match firm capabilities with customer requirements
- Search for value, not just volume
- Use tiering of the customer base to focus resources and attention on the firm's most valuable customers
- Deliver service quality to win behavioral loyalty (share-of-wallet) and attitudinal loyalty (share-of-heart)

Loyalty Bonds
- Deepen the relationship through bundling and cross-selling
- Offer loyalty rewards
  - Financial rewards (hard benefits); e.g., points, frequent flyer miles, free upgrades
  - Non-financial rewards (soft benefits); e.g., priority waitlisting, upgrading, and early check-in; special recognition and appreciation; implicit service guarantee
- Higher-level loyalty bonds
  - Social bonds
  - Customization bonds
  - Structural bonds

Reduce Customer Churn
- Churn analysis
- Address key churn drivers
- Effective complaint handling and service recovery
- Increase switching costs
  - Positive switching costs (soft lock-in strategies) through adding value (see loyalty bonds)
  - Contractual and other hard lock-in strategies (e.g., early cancellation fees)

Enablers of Customer Loyalty Strategies: Frontline Employees and Account Managers

Frontline Employees

Account Managers

Membership-type Relationships
- Achieved through loyalty programs even for transaction-type services
- Loyalty programs provide a unique identifier of the customer that facilitates an integrated view of the customer across all channels, branches, and product lines

CRM Systems
- Strategy development (e.g., customer strategy, including target segments, tiering of customers, design of loyalty bonds)
- Value creation for customers (e.g., through customization and priority service)
- Value creation for the firm (e.g., through higher share-of-wallet and lower servicing costs)
- Multi-channel integration (e.g., provide a unified customer interface)
- Information management (e.g., deliver customer data to all touchpoints)
- Performance assessment of strategy

Figure 12.3 Organizing framework for managing relationships and building loyalty.

CHAPTER SUMMARY

LO 1 ▶ Customer loyalty is an important driver of a service firm's profitability. The profits derived from loyal customers come from (1) increased purchases, (2) reduced operation costs, (3) referral of new customers, and (4) price premiums. In addition, customer acquisition costs can be amortized over a longer period of time.

LO 2 ▶ To understand the profit impact of the customers, firms should calculate the lifetime value (LTV) of their customers. LTV calculations need to include (1) acquisition costs, (2) revenue streams, (3) account-specific servicing costs, (4) the expected number of years the customer will stay with the firm, and (5) the discount rate for future cash flows.

LO 3 ▶ Customers are only loyal if they benefit in some way. Common benefits customers see in being loyal include

- o *confidence benefits*, including the feeling that there is less risk of something going wrong and the ability to trust the provider
- o *social benefits*, including being known by name, being on friendly terms with the service provider, and enjoying certain social aspects of the relationship
- o *special treatment benefits*, including better prices, extra services, and higher priority

LO 4 ▶ It is not easy to build customer loyalty. The *Wheel of Loyalty* offers a systematic framework that guides firms on how to do so. The framework has three components that follow a sequence.

- o First, firms need to build a *foundation for loyalty*, without which loyalty cannot be achieved. The foundation delivers confidence benefits to its loyal customers.
- o Once the foundation has been laid, firms can create *loyalty bonds* to strengthen the relationship. These bonds should deliver social and special treatment benefits.
- o Finally, firms also have to work on reducing *customer churn*.

To build the foundation for loyalty, firms need to

LO 5 ▶ Segment the market and *target the "right" customers*. A firm needs to choose its target segments carefully and match them to its own capabilities. It also needs to focus on customer value and fit rather than only on customer volume.

LO 6 ▶ Manage the customer base via *service tiering*, which divides the customer base into different value tiers (e.g., platinum, gold, iron, and lead). It helps the firm to tailor strategies to the different service tiers. The higher tiers offer higher value for the firm but also expect higher service levels. For the lower tiers, the focus should be on increasing profitability by building volume, increasing prices, cutting service costs, and sometimes even ending unprofitable relationships.

LO 7 ▶ The foundation for loyalty lies in customer satisfaction. The satisfaction–loyalty relationship can be divided into three main zones: defection, indifference, and affection. Only highly satisfied or delighted customers who are in the zone of affection will be truly loyal. True loyalty covers both behavioral loyalty (share of wallet and referral behavior) and attitudinal loyalty (share of heart).

Loyalty bonds are used to build relationships with customers. There are three different types of customer bonds:

LO 8 ▶ The relationship bonds with customers can be deepened through cross-selling and bundling, which make switching more difficult and increase convenience through one-stop shopping.

LO 9 ▶ Reward-based loyalty programs aim at building share of wallet through financial rewards (e.g., loyalty points) and non-financial rewards (e.g., higher-tier service levels, priority service, recognition, and appreciation).

LO 10 ▶ Higher level bonds include social, customization, and structural bonds. Competing firms usually find these bonds more difficult to copy than reward-based bonds.

LO 11 ▶ The final step in the Wheel of Loyalty is to understand what causes customers to leave and then systematically reduce these *churn drivers*.

- o Common causes for customers to switch include core service failures and dissatisfaction, deceptive and unfair pricing, inconvenience, poor response to service failures, and the overall perception that the provider has an inferior performance on key attributes compared to the best alternative provider.
- o To prevent customers from switching, firms should (1) analyze and address the key reasons why their customers leave them, (2) have good complaint-handling and service-recovery processes in place, and (3) increase "positive" customer switching costs.

LO 12 ▶ Most strategies discussed in the Wheel of Loyalty require an in-depth understanding of customers to actively improve loyalty. For example, unless a firm knows the consumption behavior of individual customers, it cannot apply tiering of service, customization, personalization, and churn management. In such cases, "membership-type" relationships are needed. These can be created even for transaction-type services through loyalty programs, apps, and CRM systems.

▶ LO 13 ▶ Finally, CRM systems should be seen as enabling the successful implementation of the Wheel of Loyalty. CRM systems are particularly useful when firms have to serve large numbers of customers across many service delivery channels. An effective CRM strategy includes five key processes:

- o Strategy development, including choice of target segments, tiering of service, and design of loyalty rewards

- o Value creation, including delivering benefits to customers through tiered services and loyalty programs (e.g., priority wait listing and upgrades)

- o Multi-channel integration to provide a unified customer interface across many different service delivery channels (e.g., from the website and app to the branch office)

- o Information management, which includes the data repository, analytical tools (e.g., campaign management analysis and churn-alert systems), and front- and back-office applications.

- o Performance assessment, which has to address three questions:

  (1) Is the CRM creating value for the customers and the firm?

  (2) Are its marketing objectives being achieved?

  (3) Is the CRM system itself performing according to expectations?

- o Performance assessment should lead to the continuous improvement of the CRM strategy and system.

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complaint handling and
SERVICE
RECOVERY

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Recognize the actions that customers may take in response to service failures.

LO 2 Understand why customers complain.

LO 3 Know what customers expect from the firm when they complain.

LO 4 Understand how customers respond to effective service recovery.

LO 5 Explain the service recovery paradox.

LO 6 Know the principles of effective service recovery systems.

LO 7 Be familiar with the guidelines for front-line employees on how to handle complaining customers and recover from a service failure.

LO 8 Recognize the power of service guarantees.

LO 9 Understand how to design effective service guarantees.

LO 10 Know when firms should not offer service guarantees.

LO 11 Be familiar with the seven groups of jaycustomers and understand how to manage them effectively.

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Customer Responses to Service Failure
- Take public action (complain to the firm, to a third party, and/or take legal action)
- Take private action (switch provider, spread negative word-of-mouth)
- Take no action

Customer Expectations Once a Complaint Is Made
Customers expect fair treatment along three dimensions:
- Procedural justice: Customers expect a convenient, responsive, and flexible service recovery process.
- Interactional justice: The recovery effort must be seen as genuine, honest, and polite.
- Outcome justice: The restitution has to reflect the customer's loss and inconveniences suffered.

Customer Complaining
Why do customers complain?
- Obtain restitution or compensation
- Vent anger
- Help to improve the service
- For altruistic reasons

What proportion of unhappy customers complains?
- 5–10% complain
- For low-value, low-involvement services, the complaint rate can be much lower

Why don't unhappy customers complain?
- It takes time and effort
- The payoff is uncertain
- Complaining can be unpleasant

Who is most likely to complain?
- Higher socio-economic class customers
- Customers with more product knowledge

Where do customers complain?
- The vast majority of complaints are made at the point-of-service provision (face to face, over the phone, and chat)
- Only a small proportion of complaints is sent via email, social media, websites, or letters

Customer Responses to an Effective Service Recovery
- Avoids switching, restores confidence in the firm
- The Service Recovery Paradox: An excellent recovery can even result in higher satisfaction and loyalty than if a service was delivered as promised

Principles of Effective Service Recovery Systems
- Make it easy for customers to provide feedback and reduce complaint barriers
- Enable effective service recovery: Make it (1) proactive, (2) planned, (3) trained, and (4) empowered
- Establish appropriate compensation levels: Set based on the (1) positioning of the firm, (2) severity of the service failure, and (3) importance of the customer. Target for "well-dosed generosity"
  - Dealing with complaining customers:
    - Act fast
    - Acknowledge customer's feelings
    - Don't argue
    - Show understanding
    - Clarify the facts
    - Give customer the benefit of the doubt
    - Propose steps to solve the problem
    - Keep the customer informed
    - Consider compensation
    - Persevere to regain customer goodwill
    - Improve the service system

Service Guarantees
- Institutionalize professional complaint handling and service recovery
- Drive improvement of processes
- Design: (1) unconditional, (2) easy to understand, (3) meaningful, (4) easy to invoke, (5) easy to collect on, and (6) credible
- Unsuitable for firms with (1) a reputation for excellence, (2) poor quality service, and (3) uncontrollable quality due to external factors (e.g., weather)

Jaycustomers
There are 7 types of jaycustomers:
1. The Cheat
2. The Thief
3. The Rule Breaker
4. The Belligerent
5. The Family Feuders
6. The Vandal
7. The Deadbeat

- Jaycustomers cause problems for firms and can spoil the service experience of other customers
- Firms need to keep track and manage their behavior, including, as a last resort, blacklisting them from using the firm's facilities

Figure 13.3 Organizing framework for managing complaints and service recovery.

CHAPTER SUMMARY

▶ **LO 1** ▶ When customers are dissatisfied, they have several alternatives:

- o Take some form of public action (e.g., complain to the firm or a third party or even take legal action).
- o Take some form of private action (e.g., switch to another provider and/or spread negative word of mouth).
- o Take no action.

▶ **LO 2** ▶ To effectively recover from a service failure, firms need to understand customer complaining behavior and motivations as well as what customers expect in response.

- o Customers typically complain for any combination of the following four reasons: (1) to obtain restitution or compensation, (2) to vent their anger, (3) to help to improve the service, and (4) to spare other customers from experiencing the same problems (i.e., they complain for altruistic reasons).
- o In practice, most dissatisfied customers do not complain as (1) they may not know where to complain, (2) they think it requires too much effort and is unpleasant, and (3) they perceive the payoffs of their effort as uncertain.
- o The people who are most likely to complain tend to be better educated, have higher income, are more socially involved, and have more knowledge about the product.
- o Customers are most likely to complain at the point of service provision (face to face and over the phone). Only a small proportion of complaints is made via other channels such as e-mail, social media, websites, or letters.

▶ **LO 3** ▶ Once customers make a complaint, they expect firms to deal with it in a fair manner along three dimensions of fairness:

- o Procedural fairness: Customers expect the firm to have a convenient, responsive, and flexible service recovery process.
- o Interactional justice: Customers expect an honest explanation, a genuine effort to solve the problem, and polite treatment.
- o Outcome justice: Customers expect compensation that reflects the loss and inconvenience suffered as a result of the service failure.

▶ **LO 4** ▶ Effective service recovery can, in many cases, avoid customer switching and restore confidence in the firm. When customers complain, they give the firm a chance to correct problems, restore the relationship with the complainer, and improve future satisfaction. Service recovery is therefore an important opportunity to retain a valued customer.

▶ **LO 5** ▶ The *service recovery paradox* describes the phenomenon where customers who experience an excellent service recovery after a failure feel even more satisfied than customers who had no problem in the first place. However, it is important to note that this paradox does not always apply. It is best to get the service right the first time rather than provide expensive service recovery.

▶ **LO 6** ▶ Effective service recovery systems should

- o make it easy for customers to give feedback (e.g., provide hotline numbers, e-mail addresses, and social media channels on all communications materials) and encourage them to provide feedback
- o enable effective service recovery by making it (1) proactive, (2) pre-planned, (3) trained, and (4) empowered
- o establish appropriate compensation levels—compensation should be higher if (1) a firm is known for service excellence, (2) the service failure is serious, and (3) the customer is important to the firm.

CHAPTER SUMMARY

LO 7 ▶ The guidelines that front-line employees should follow to handle customer complaints and recover the service effectively include: (1) act fast; (2) acknowledge the customer's feelings; (3) don't argue with the customer; (4) show that you understand the problem from the customer's point of view; (5) clarify the truth and sort out the cause; (6) give customers the benefit of the doubt; (7) propose the steps needed to solve the problem; (8) keep customers informed of progress; (9) consider compensation; (10) persevere to regain customer goodwill; and (11) self-check the service delivery system and improve it.

LO 8 ▶ Service guarantees are a powerful way to institutionalize professional complaint handling and service recovery. Service guarantees set clear standards for the firm. They also reduce customers' risk perceptions and can build long-term loyalty.

LO 9 ▶ Service guarantees should be designed to be (1) unconditional, (2) easy to understand and communicate, (3) meaningful to the customer, (4) easy to invoke, (5) easy to collect on, and (6) credible.

LO 10 ▶ Not all firms stand to gain from service guarantees. Specifically, firms should be careful offering service guarantees when (1) they already have a reputation for service excellence, (2) service quality is too low and has to be improved first, (3) aspects of service quality are uncontrollable because of external factors (e.g., the weather), and (4) customers perceive low risk when buying the service.

LO 11 ▶ Not all customers are honest, polite, and reasonable. Some may want to take advantage of service recovery situations, while others may inconvenience and stress front-line employees and other customers. Such customers are called jaycustomers.

o There are seven groups of jaycustomers: (1) the Cheat, (2) the Thief, (3) the Rulebreaker, (4) the Belligerent, (5) the Family Feuders, (6) the Vandal, and (7) the Deadbeat.

o Different types of jaycustomers cause different problems for firms and may spoil the service experience of other customers. Hence, firms need to manage their behavior, even if that means keeping track of how often a customer invokes a service guarantee or (as a last resort) black-listing them from using the firm's facilities.

KNOW YOUR SERVICES MARKETING

Review Questions

1. How do customers typically respond to service failures?

2. Why don't many more unhappy customers complain? What do customers expect the firm to do once they have filed a complaint?

3. Why would a firm prefer its unhappy customers to come forward and complain?

4. What is the service recovery paradox? Under what conditions is this paradox most likely to hold? Why is it best to deliver the service as planned, even if the paradox does hold in a specific context?

5. How can a firm make it easy for dissatisfied customers to complain?

6. Why should a service recovery strategy be proactive, planned, trained, and empowered?

7. How generous should compensations related to service recovery be?

8. How should service guarantees be designed? What are the benefits of service guarantees over and above a good complaint handling and service recovery system?

9. Under what conditions is it not suitable to introduce a service guarantee?

10. What are the different types of jaycustomers? How can a service firm deal with such customers?

WORK YOUR SERVICES MARKETING

Application Exercises

1. Think about the last time you experienced a less-than-satisfactory service experience. Did you complain? Why? If you did not complain, explain why not.

2. When was the last time you were truly satisfied with an organization's response to your complaint? Describe in detail what happened and what made you satisfied.

3. What would be an appropriate service recovery policy for a wrongly bounced check for (a) your local savings bank, (b) a major national bank, and (c) a private bank for high net-worth individuals? Please explain your rationale and also compute the economic costs of the alternative service recovery policies.

4. Design an effective service guarantee for a service with high perceived risk. Explain (a) why and how your guarantee would reduce perceived risk of potential customers and (b) why current customers would appreciate being offered this guarantee although they are already a customer of that firm and therefore are likely to perceive lower levels of risk.

5. How generous should compensation be? Review the following incident and comment. Then evaluate the available options, comment on each, select the one you recommend, and defend your decision.

"The shrimp cocktail was half frozen. The waitress apologized and didn't charge me for my dinner," was the response of a very satisfied customer about the service recovery he received. Consider the following range of service recovery policies a restaurant chain could set, and try to establish the costs for each policy:

Option 1: Smile and apologize, defrost the prawn cocktail, return it, and smile and apologize again.

Option 2: Smile and apologize, replace the prawn cocktail with a new one, and smile and apologize again.

Option 3: Smile and apologize, replace the prawn cocktail, and offer a free coffee or dessert.

Option 4: Smile and apologize, replace the prawn cocktail, and waive the bill of $80 for the entire meal.

Option 5: Smile and apologize, replace the prawn cocktail, and offer a voucher of $80 for another dinner to be redeemed within three months.

6. Identify the possible behavior of jaycustomers for a service of your choice. How can the service process be designed to minimize or control the behavior of jaycustomers?

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THE *ESM* FRAMEWORK

PART I

Understanding Service Markets, Products, and Customers

- Introduction to Services Marketing
- Understanding Service Consumers
- Positioning Services in Competitive Markets

PART II

Applying the 4 Ps of Marketing to Services

- Developing Service Products and Brands
- Distributing Services through Physical and Electronic Channels
- Setting Prices and Implementing Revenue Management
- Promoting Services and Educating Customers

PART III

Managing the Customer Interface

- Designing Service Processes
- Balancing Demand and Capacity
- Crafting the Service Environment
- Managing People for Service Advantage

PART IV

Developing Customer Relationships

- Managing Relationships and Building Loyalty
- Complaint Handling and Service Recovery

PART V

Striving for Service Excellence

- Improving Service Quality and Productivity
- Building a World-Class Service Organization

Striving for Service Excellence

Part V focuses on service quality and productivity as well as how firms can achieve service leadership. It consists of the following two chapters:

Chapter 14   Improving Service Quality and Productivity

Both productivity and quality are necessary and related to financial success in services. Chapter 14 covers diagnosing quality shortfalls using the gaps model and reviewing strategies to close quality gaps. Customer feedback systems are introduced as an effective tool for systematically listening to and learning from customers. Productivity is concerned with bringing down costs, and key approaches for increasing productivity are discussed.

Chapter 15   Building a Service Organization That Wins

Chapter 15 opens with a discussion on the impact of customer satisfaction on financial performance and shareholder value. Furthermore, it covers the characteristics of world-class service organizations and introduces four levels of service performance (i.e., service loser, nonentity, professional, and service leader). An audit tool is provided that helps to assess the performance level of an organization. We discuss how to move a service organization to higher levels of performance. The chapter closes with a discussion of the three strategic pathways toward achieving cost-effective service excellence.

14

improving
SERVICE
QUALITY and
PRODUCTIVITY

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

▶ **LO 1** Explain the relationships between service quality, productivity, and profitability.

▶ **LO 2** Be familiar with the different perspectives of service quality.

▶ **LO 3** Demonstrate how to use the Gaps Model for diagnosing and addressing service quality problems.

▶ **LO 4** Differentiate between hard and soft measures of service quality.

▶ **LO 5** Explain the common objectives of effective customer feedback systems.

▶ **LO 6** Describe key customer feedback collection tools.

▶ **LO 7** Be familiar with hard measures of service quality and control charts.

▶ **LO 8** Select suitable tools to analyze service problems.

▶ **LO 9** Understand return on quality and determine the optimal level of reliability.

▶ **LO 10** Define and measure service productivity.

▶ **LO 11** Understand the difference between productivity, efficiency, and effectiveness.

▶ **LO 12** Recommend the key methods to improve service productivity.

▶ **LO 13** Know how productivity improvements impact quality and value.

▶ **LO 14** Understand how to integrate all the tools to improve the quality and productivity of customer service processes.

▶ **LO 15** Explain how TQM, ISO 9000, Six Sigma, and the Malcolm Baldrige and EFQM approaches relate to managing and improving service quality and productivity.

Integrating Service Quality and Productivity

- Quality and productivity are twin paths to creating value for customers and firms.
- Service quality and productivity can reinforce, be independent or even counter each other's impact on profitability.

The Gaps Model

The model helps to identify the causes of quality problems at the macro level through a gap analysis:
- Gap 1: The Knowledge Gap
- Gap 2: The Policy Gap
- Gap 3: The Delivery Gap
- Gap 4: The Communications Gap
- Gap 5: The Perceptions Gap
- Gap 6: The Service Quality Gap

Each of the gaps has distinct causes. Prescriptions are provided on how to address the causes of each gap.

What Is Service Quality?

- Customer defined
- Consistently meeting or exceeding customer expectations

Measuring Service Quality

Customer Feedback

- Referred to as "soft measures"

Objectives:
- Assess and benchmark performance.
- Improve performance by cementing strengths and improving weaknesses.
- Create a customer centric service culture and a culture for change.

Use a mix of tools to obtain reliable and actionable feedback, such as
- surveys, feedback cards and online/ mobile messages, complaints, and compliments
- mystery shopping
- focus groups and service reviews
- online reviews and discussions

Operational Measures

- Referred to as "hard measures"
- Process and outcome measures
- Relate to process activities and outcomes that can be counted, timed, or measured (e.g., system uptime, on-time departure, service response time, and failure rates)

Analysis and Reporting

- Daily morning briefings to the frontline
- Monthly service performance updates to process owners and service teams
- Quarterly service performance reviews to middle management and process owners
- Annual service performance reports to top management and the entire firm

Analyzing Service Quality Problems

Analytical tools:
- Fishbone diagram to conduct root-cause analysis
- Pareto charts to identify key fail points and root causes
- Blueprinting

Return on quality:
- Assess costs and benefits of quality initiatives
- Importance-performance matrix
- Optimal level of reliability depends on cost of service recovery

Systematic Approaches to Improving Service Quality and Productivity

Nine-step approach to service process improvement:
1. Determine priority processes for improvement
2. Set targets for (a) customer satisfaction, (b) defects, (c) cycle-time, and (d) productivity improvements
3. Identify key elements of quality
4. Assess process performance
5. Identify quality gaps
6. Identify root causes of gaps
7. Improve process performance
8. Control and fine-tune
9. Start again; the journey is the destination…

Widely used organization-wide systematic approaches:
- Total Quality Management (TQM)
- ISO 9000 certification
- Six Sigma (including DMAIC)
- Malcolm Baldrige and EFQM approaches

Defining, Measuring, and Improving Service Productivity

Defining and measuring productivity:
- Productivity: output/input
- Efficiency: compared to a standard (i.e., "do things right")
- Effectiveness: compared to a goal (i.e., "do the right things")
- All three have to be balanced

Productivity improvement strategies:
- Generic productivity strategies (i.e., "doing the same things better, faster, cheaper," and deployment of technology, incl. intelligent automation)
- Customer-driven approaches (e.g., shifting time of demand, using lower-cost delivery channels and self-service)
- Outsourcing to third parties
- Monitor potential customer implications of productivity enhancement

Figure 14.1 Improving service quality and productivity.

CHAPTER SUMMARY

LO 1 ▶ Quality and productivity are twin paths for creating value for customers and the firm. However, the relationship between productivity and customer satisfaction (and the net effects on profitability) can be positive, neutral, or negative and therefore needs to be managed carefully.

LO 2 ▶ There are different definitions of service quality. In this book, we adopt the customer-focused definition of service quality as consistently meeting or exceeding customer expectations.

LO 3 ▶ The Gaps Model is an important tool to diagnose and address service quality problems. We identified six gaps that can be the cause of quality shortfalls:

1. Gap 1—the knowledge gap
2. Gap 2—the policy gap
3. Gap 3—the delivery gap
4. Gap 4—the communications gap
5. Gap 5—the perceptions gap
6. Gap 6—the service quality gap (this is the most important gap; in order to close Gap 6, the other five gaps have to be closed first)

We summarized a series of potential causes for each of the gaps and provided generic prescriptions for addressing these causes and thereby closing the gaps. These prescriptions take a holistic organization perspective.

LO 4 ▶ There are both soft and hard measures of service quality. *Soft measures* are usually based on perceptions of and feedback from customers and employees. *Hard measures* relate to processes and their outcomes.

LO 5 ▶ Feedback from customers (i.e., mostly soft measures) should be systematically collected via a customer feedback system (CFS). The key objectives of a CFS include

1. assessment and benchmarking of service quality and performance
2. customer-driven learning and improvement
3. creating a customer-oriented service culture and a culture of change

LO 6 ▶ o Firms can use a variety of tools to collect customer feedback, including (1) total market surveys, (2) annual customer satisfaction surveys, (3) transactional surveys, (4) automated rating systems such as those based on apps and messaging, (5) unsolicited customer feedback (e.g., compliments and complaints), (6) online reviews and discussions on third-party (social) media, (7) mystery shopping, (8) focus group discussions, and (9) service reviews.

o A reporting system is needed to channel feedback and its analysis to the relevant parties so that they may take action.

LO 7 ▶ *Hard measures* relate to operational processes and outcomes and can be counted, timed, or observed. *Control charts* are a simple method of displaying performance on hard measures over time against specific quality standards.

LO 8 ▶ Key tools to analyze and address service quality problems include the following:

1. *Fishbone diagrams* to identify the root causes of quality problems
2. *Pareto analysis* to assess the frequency of quality problems and identify the most common causes
3. *Blueprinting* to determine the exact location of fail points in a customer service journey and then help to redesign the process

LO 9 ▶ There are financial implications of service quality improvements. A return-on-quality (ROQ) approach assesses the costs and benefits of specific quality initiatives. Firms should increase service reliability up to the point at which the incremental improvement equals the cost of service recovery (which is the actual cost of failure). When a service failure occurs, customers should receive a satisfying service recovery.

LO 10 ▶ Productivity measures the amount of output produced relative to the amount of inputs used. An improvement in this ratio can be achieved by cutting the resources required to create a given volume of output or by increasing the output obtained from a given level of input. Key inputs vary according to the industry and can include labor, materials, energy, and assets.

LO 11 ▶ It is important to differentiate between these three concepts:

1. Productivity involves the amount of outputs based on a given level of inputs (e.g., input/output ratio).
2. Efficiency is usually time-based and compared to a standard such as industry average (e.g., speed of delivery).
3. Effectiveness refers to the degree to which a firm meets its goals (such as customer satisfaction).

Productivity and efficiency cannot be separated from effectiveness. Firms that strive to be more productive, efficient, and effective in consistently delivering customer satisfaction will be more successful.

LO 12 ▶ Generic methods to improve productivity include

1. controlling costs in every step of the process
2. reducing waste of materials and labor
3. training employees to work more productively
4. broadening the job scope of employees to reduce bottlenecks and downtime

5. redesigning customer service processes to be more productive and effective (e.g., through lean Six Sigma)

6. using machines, equipment, technology, intelligent automation, and analytics that enable employees to work faster or to a higher level of quality

7. installing expert systems so that paraprofessionals can do the work previously done by higher-paid experts

8. replacing service employees with machines, intelligent automation, service robots, and customer-operated self-service technologies (SSTs)

9. tiering service levels to allocate resources better to more important customers.

10. improving capacity utilization

11. outsourcing non-core activities that can be provided more cost-effectively by third parties

Customer-driven methods to improve productivity include

1. changing the timing of customer demand to better match demand to capacity

2. encouraging the use of lower-cost service delivery channels and replacing labor with machines, service robots, and SSTs

3. getting customers to use more cost-effective third parties for parts of the service delivery

LO 13 ▶ While making improvements to productivity, firms need to bear in mind that both front-stage and back-stage improvements can have an impact on service quality and the customer experience.

LO 14 ▶ A nine-step approach can be used to improve customer service processes:

1. Determine priority processes for improvement (e.g., through a frequency count of process occurrence and number of complaints and the use of the prioritization matrix).

2. Set targets for customer satisfaction, defects, cycle time, and productivity improvements (e.g., through benchmarking and a project charter).

3. Identify key elements of quality (e.g., through blueprinting to identify touch points and the use of the five dimensions of quality together with customer and employee feedback to understand what quality means in the eyes of the customer).

4. Assess process performance (e.g., through hard operational measures and soft customer feedback measures).

5. Identify performance shortfalls and quality gaps (e.g., map customer needs and wants against process performance; map frequency count of service failures on service blueprints to understand where exactly service processes fail).

6. Identify root causes of gaps (e.g., use the Gaps Model to capture all possible sources of gaps; use TQM tools such as the fishbone diagram, Pareto charts, and service blueprints to drill down to specific gaps).

7. Improve process performance (e.g., use the prescriptions of the Gaps Model to close quality shortfalls; use customer service process redesign tools as discussed in Chapter 8 and plans for service recovery as covered in Chapter 13).

8. Control and fine tune (i.e., monitor the performance of the redesigned process and fine tune it further).

9. Start again, the journey is the destination...

LO 15 ▶ TQM, ISO 9000, Six Sigma, Malcolm Baldrige, and European Foundation for Quality Management (EFQM) are systematic and complementary approaches to managing and improving service quality and productivity. They integrate many of the tools discussed in this chapter.

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15

building a world-class
SERVICE
ORGANIZATION

LEARNING OBJECTIVES (LOs)

By the end of this chapter, the reader should be able to:

LO 1 Know the long-term impact of customer-centricity on profitability and shareholder value.

LO 2 Know the relationship between relative customer satisfaction and share-of-wallet, and be familiar with the Wallet Allocation Rule.

LO 3 Know the characteristics of world-class service organizations and be familiar with the four levels of service performance.

LO 4 Understand what is required for transforming a service firm from a service loser to a service leader.

LO 5 Be familiar with the three strategic pathways that allow organizations to achieve cost-effective service excellence (CESE).

LO 6 Know the dual-culture strategy of CESE and its implementation challenges.

LO 7 Be familiar with the operations management approach for achieving CESE.

LO 8 Appreciate the focused service factory strategy that allows a relatively easy way of implementing CESE.

LO 9 Understand business model considerations related to the pathways toward CESE.

INTRODUCTION

You are almost at the end of this book and presumably also at the tail end of your services marketing course. In this final chapter, we integrate many of the topics you have studied and provide you with a summary of what a world-class service organization looks like. We also discuss the financial impact of being a service leader and three strategic pathways towards achieving cost-effective service excellence. See Figure 15.1 for an overview. The chapter closes with a call to action on your part!

Customer Satisfaction Leads to Superior Financial Performance

- Empirical evidence for the satisfaction-financial performance link
- Relative satisfaction compared to competitors is key for capturing a customer's share-of-wallet

Four Levels of Service Performance

- Performance in marketing, operations, and HR determines the service performance level
- Service firms can be categorized into four performance levels:
  1. Service loser
  2. Service nonentity
  3. Service professionals
  4. Service leader

Two Common Strategies

- Low-Cost Strategy: good standardized quality and value-for-money
- Service Excellence Strategy: high quality, customized services offered at a price premium
- Difficult to combine both, but a few breakthrough organizations have achieved the combined strategy of cost-effective service excellence

Three Pathways toward Cost-Effective Service Excellence (CESE)

Dual-Culture Strategy

- Leadership ambidexterity using a "both/and" logic, focus, and role modeling, reinforced by communications, training, and reward systems
- Contextual ambidexterity guides individual employee decision-making
- Employee buy-in can be difficult and requires a credible "rallying-cry"

Operations Management Approach

- Uses three tools to reduce (often customer-induced) process variability so that systems and technology can be deployed. They include
  1. buffering and industrializing the back office, and shifting activities from the expensive front office to the industrialized back office.
  2. modularizing service through reduced customer choice, interaction flexibility and contact. This allows deployment of systems and technology also in the front office.
  3. deploying SST, robotics, and AI.
- The three tools each build on another, whereby each step eases the implementation of the next.

Focused Service Factory Strategy

- Tailors a single solution to meet the exact needs of a specific customer segment combined with a culture for service excellence
- Reduces customer-induced variability to a minimum and provides customers a single, highly standardized, and excellent service offering
- Is relatively easy to implement

Figure 15.1 Paths toward becoming a breakthrough service organization.

CHAPTER SUMMARY

LO 1 ▶ A service leader's adoption of a long-term perspective and customer-centricity pays off financially. There is solid empirical evidence that high customer satisfaction (compared to an organization's peer group) leads to superior financial returns.

LO 2 ▶ It is not the absolute satisfaction score but the relative rating that determines a customer's share-of-wallet.

o Specifically, a customer's share-of-wallet can be predicted by (1) the relative satisfaction rank of a brand used by a customer, and (2) the number of brands used by that customer. Combining these two pieces of information in the Wallet Allocation Rule (WAR), one can calculate a reliable and accurate prediction of share-of-wallet.

o One important implication of the WAR is that simply increasing a firm's satisfaction score does not increase its share-of-wallet if it does not also achieve a change in ranking vis-à-vis competitors.

LO 3 ▶ There are four levels of service performance, and only the last two follow the key lessons from this book:

(1) *Service losers*. They are poor performers in marketing, operations, and HRM. Service losers survive because monopoly situations give customers little choice other than to buy from them.

(2) *Service non-entities*. Their performance leaves much to be desired, but they have eliminated the worst features of service losers.

(3) *Service professionals*. They have a clear market position, and customers in target segments seek them out on the basis of their sustained reputation for meeting expectations. They are solid performers in marketing, operations, and HR, and the functions are tightly integrated.

(4) *Service leaders*. They are the breakthrough service champions that are regarded as the crème de la crème of their respective industries. Their company names are synonymous with service excellence and an ability to delight customers.

We contrasted the description and actions of a service leader against professionals, non-entities, and losers along the three functional areas in Table 15.1. Service leadership requires high performance across a number of dimensions. These may include the use of sophisticated marketing, the management and motivation of employees, and the continuous improvement of service quality and productivity.

LO 4 ▶ Human leaders at all levels of an organization are needed for a service firm to be taken in the right direction and to ensure that the relevant strategies are implemented throughout the organization.

(1) The various chapters throughout this book discuss exactly how to do that. You now have the tools, concepts, and theories that will help you become an agent of change in your organization.

(2) At the strategic level, the two most common strategies are either a cost or a service excellence focus.

o A low-cost strategy aims to minimize costs by running centralized, standardized, and automated processes while building volume. Customers can be satisfied with good quality standard services that provide excellent value for money.

o A service excellence strategy is based on a deep understanding of customers, responsiveness to their needs and requests, high quality, and customized services that are offered at a price premium and are typically for smaller target segments.

o It is difficult to combine both strategies. Nevertheless, there are a few breakthrough service organizations that have achieved such a combined strategy of cost-effective service excellence.

LO 5 ▶ There are three strategic pathways organizations have taken to achieve cost-effective service excellence (CESE):

(1) Dual-culture strategy,

(2) Operations management approach, and

(3) Focused service factory strategy.

These strategies can be used in combination.

LO 6 ▶ The dual-culture strategy focuses an entire organization on the simultaneous pursuit of service excellence and productivity and makes both of them integral parts of its culture. This approach uses ambidextrous organizational approaches:

o *Leadership ambidexterity* involves leaders who rally their organizations to internalize a "both/and" rather than an "either/or" logic. This allows leaders to put systems in place to focus and energize the organization on the potentially conflicting demands of cost-effectiveness and service excellence, to role model ambidextrous behaviors, and to reinforce them with internal communication, training, rewards, and recognition.

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o *Contextual ambidexterity* governs the thinking and decision making of individual employees about when to focus on service excellence, when to emphasize cost-effectiveness, and ideally, how to integrate both objectives synergistically.

o A *dual-culture strategy* is difficult to execute as it can strain employees; it may seem counterintuitive to offer great service externally but be stingy internally at the same time. Organizations require a credible "rallying cry," or rationale, to get employee buy-in (e.g., "we make Michelin-starred food affordable" or "we support a charitable cause").

LO 7 ▶ The operations management approach deploys a combination of tools to reduce process variability so that systems and technology can be deployed. The tools include

(1) buffering and industrializing the back office, and shifting activities from the expensive front office to an industrialized back office. A buffered back office is easier to industrialize.

(2) modularizing service through reduced customer choice, interaction flexibility, and contact, which allows an increased deployment of systems and technologies also in the front office.

(3) the deployment of self-service technologies (SSTs), robotics, and AI—which becomes easier after processes and products have been modularized and have low complexity.

These three tools build on one another, whereby the implementation of each step eases the implementation of the next.

LO 8 ▶ The focused service factory strategy tailors a single solution to meet the exact needs of a specific customer segment combined with a culture for service excellence. It reduces customer-induced variability to a minimum, and customers receive a single, highly standardized, and excellent service offering. This strategy is a relatively easy way to achieve CESE.

LO 9 ▶ Of the three core strategies, the dual-culture strategy is the hardest to execute. Service excellence is a natural focus of service employees, but cost-effectiveness is a harder sell.

The operations management approach and focused service factory strategy hardwire productivity and cost-effectiveness into the business model, and employees can focus on service excellence without having to focus so heavily on cost and incremental productivity gains. This makes the operations management approach and focused service factory strategy easier to implement.

An accelerated shift toward operations management and focused service factory–based business models is likely to occur with increasing deployment of service robots and AI.

Uber's Unintended Burdens

Christopher S. Tang and Jochen Wirtz

On August 13, 2020, Uber CEO Dara Khosrowshahi explained that Uber was backing Proposition 22, which would exempt it from Assembly Bill 5 (AB5), a California law that would require Uber to treat its drivers as employees with benefits effectively on January 1, 2020.[1] To win over California voters, Uber and Lyft were considering shutting down their services "temporarily" in California as a means to appeal to those who vote on Proposition 22 in the November 2020 ballot. This case looks at Uber's position as it awaited this decision.

Uber lost over $8 billion in 2019 and was expected to lose $6 billion by October 2020. California Assembly Bill 5, a state statute, was expected to increase Uber's operating cost dramatically. It would also be a major blow to Uber and other gig economy firms (e.g., Uber Eats, Grubhub, Deliveroo) if other states in the United States and other countries were to follow suit and propose labor laws similar to AB5. If so, Chief Executive Dara Khosrowshahi's premonition back in 2019, when it filed for IPO, that Uber might never be profitable would indeed come true.[2] Was this law to become the beginning of the end for Uber?

THE BEGINNING

Uber was hailed as a disruptive force in transportation that could put taxi services out of business. Ever since Travis Kalanick and Garrett Camp founded Uber in 2009, this multinational ride-hailing company had expanded its services from ride-hailing (UberX, Uber Black, Uber Pool) to food delivery (Uber Eats), to freight transportation (Uber Freight), to electric bikes and motorized scooter rental (through a partnership with Lime).

Uber's smartphone app was well designed. By downloading the app and by linking it with a credit card, a customer, or rider, could immediately hail a ride by specifying the destination and pick-up location. The app provided the estimated price, and once the price was accepted, the app would match the rider with nearby drivers and then provide the name of their driver; their customer rating; the make, model, and license plate number of the car; the estimated time for the pickup; as well as real-time tracking information about the location of the driver. At the end of the ride, the rider could leave a

tip and rate the driver. This seamless service had been well received by riders.

Uber operated in a two-sided market. Its success hinged upon massive rider and driver participation. To reduce waiting time for riders, Uber needed many drivers. At the same time, to reduce idle time and increase earnings for drivers, Uber needed many riders. To entice both riders and drivers to participate, Uber was able to use venture capital funds[3] to capture market share in many markets by heavily subsidizing drivers and riders, getting them to switch from taxis to Uber (Exhibit 1). Investors gave Uber a valuation of over $70 billion even though it had lost billions of dollars every year except in 2018, the year before it filed for IPO (Table 1).

The IPO

Uber celebrated its IPO in May 2019 with huge fanfare, but many investors were nervous about Uber's profitability in the near future. To calm nervous investors, Khosrowshahi provided some assurance by emphasizing that (1) Uber was well positioned to penetrate a $12 trillion addressable market, (2) Uber's platform was poised to become the "Amazon of transportation," and (3) other companies like Amazon and Facebook also had rocky IPOs. Uber debuted on New York Stock Exchange at $42 per share, which was lower than its expected price at $45. After its IPO in 2019, the share price was hovering around $30 per share in 2020. Was this a reflection of investors' doubts about Uber's long-term success?

ROCKY ROAD

One of the promises of Uber was that it could grow and capture markets worldwide. As an online platform, Uber's asset-light model enabled the firm to scale its operations in many markets without a huge setup cost. However, Uber

Service Robots in the Frontline: How Will Aarion Bank's Customers Respond?

Jochen Wirtz, Stefanie Paluch, and Werner Kunz

The top management at Aarion Bank was pushing for a rapid digital transformation and intelligent automation. That included customer service with the aim of moving almost all routine transactions, services, and enquiries to cost-effective but high-quality, cutting-edge digital delivery channels. These included smart AI-powered self-service technologies and service robots. Nikita Jones, the Vice President of Customer Service, was worried about how some customer segments would respond to this strategic direction the bank was to embark upon and how she could prepare her team and its various customer segments for this digital transformation.

"I'm concerned about the speed and scope top management pushes in our digital transformation," said Nikita Jones to Antony Lee, her deputy head of customer service. She and Lee were having a follow-up discussion after a board meeting where the CEO had outlined the bank's aggressive push toward rapid digitization of its retail banking division. The board and top management expected significant cost savings, better service quality, higher compliance, and easy scalability of its operations. However, Jones worried how the bank's customers, many of them being wealthy Baby Boomers and Gen-Xers, would respond. After the meeting, the CEO had sent an email to share his vision; it clearly shows his enthusiasm for this accelerated push. It included the following:

> Central for almost all businesses to survive is the digital and technological revolution we are all currently living through. I am convinced that the service sector is at an inflection point with regard to productivity gains and service industrialization, similar to the industrial revolution in manufacturing that started in the 18th century. Virtually all service sectors will be transformed by rapidly developing technologies that become better, smarter, smaller, and cheaper. This applies especially to technologies that are relevant in retail banking, such as AI, chatbots,

analytics, machine learning, mobile technologies, apps, geo-tagging, biometrics, and text processing, speech processing, image processing, and so much more.[1]

In combination, these technologies and service innovations have the potential to dramatically improve the customer experience and productivity all at the same time. Furthermore, many of these technologies have almost zero incremental cost. For example, AI and virtual service robots (e.g., voice-based chatbots) require significant investments for their development, but then can be scaled. Serving more customers has almost zero incremental costs.

Have a look at the case study of a leading bank that is already in the advanced stages of digitization and intelligent automation [see the section "Understanding the Power of IA through an Example" in this case]. This is where I envisage we will go, too. Thankfully, this bank is in a different geography and we are not competing with it!

By going faster than our local competitors, we may have the opportunity to gain significant market share! Let's be proactive and make this our number one strategic direction. We want to become one of the world's best digital banks taking full advantage of intelligent automation... but of course, with a personal touch, where needed and where it adds real value!

Jones shook her head and wondered, "How can we develop an implementation strategy that will be embraced by our customers? Do we need to structure our implementation by types of services, customers, profitability? What else do we need to worry about?" Then Jones recalled the customer survey a marketing agency had recently conducted. Jones and Lee looked through the findings of the focus groups and the representative quotes the research agency had pulled out

Digital Luxury Services: Tradition versus Innovation in Luxury Fashion

Jonas Holmqvist, Jochen Wirtz, and Martin P. Fritze

The world of luxury is undergoing rapid changes as many classic luxury brands embark on markedly different strategies to deal with an increasingly digital economy. Some luxury brands such as Chanel and Bottega Veneta have deliberately chosen to minimize the impact of digitization and instead focus even more heavily on the traditional service encounter in their boutiques. Other luxury brands like Dior, Saint Laurent, and Hermès follow a different strategy as they push innovative new digital services, which has led to rapidly growing online sales. At their core, all these brands continue to sell luxury fashion, yet their approach to digitization of the service encounter could not be more different even as they seek to preserve their exclusivity. How can luxury fashion brands develop their digital service strategy and at the same time retain the exclusive and personalized service their customers expect?

The luxury sector is in many ways remarkably different from most other business fields, not least as its focus remains solidly on exclusivity rather than trying to reach as many customers as possible. Luxury brands are well aware of the inverted price–demand curve: contrary to other brands, luxury brands often see increased demand for their products as prices go up. A key definition of luxury is *exclusivity that combines with quality in order to become something desirable for many customers*. Well aware of the importance of exclusivity, many luxury brands actively want to keep the number of customers limited. In the words of Patrick Thomas, former CEO of French luxury brand Hermès: "The luxury industry is built on a paradox: the more desirable a brand becomes, the more it sells, but the more it sells, the less desirable it becomes."

In line with this paradox, most luxury brands are only available in a few selected places; their flagship stores are often found in the fashion capitals, and customers from all over the world travel to visit them. The servicescape in these boutiques is carefully and exquisitely designed to appeal to all senses to reinforce the desired brand positioning. The service encounter itself should match the high expectations of the customer. As part of the service experience, customers are often served champagne or other beverages and receive personalized and attentive service.

However, the world of luxury is changing, and it is changing rapidly. Millennials and younger generations who have

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Note: This case is based on expert interviews, media reports, and the following publications: Jonas Holmqvist, Jochen Wirtz, and Martin P. Fritze, "Luxury in the Digital Age: A Multi-Actor Service Encounter Perspective," *Journal of Business Research* 121 (December 2020): 907–931; Jochen Wirtz, Jonas Holmqvist, and Martin P. Fritze, "Luxury Services," *Journal of Service Management* 31(4): 665–691.

Mike Goldwater/Alamy Stock Photo

Singapore Airlines: Managing Human Resources for Cost-Effective Service Excellence

Jochen Wirtz and Loizos Heracleous

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SIA's brand campaign, "The Lengths We Go To"

Platform versus Pipeline Business Models: Are Airbnb and Marriott Right to Move into Each Other's Turf?

Jochen Wirtz

To continue its fast growth, Airbnb diverted from its pure peer-to-peer (P2P) strategy and has been adding owned-room capacity. Meanwhile, Marriott has added P2P platform-sourced rooms to its marketing and distribution channels. The question the senior management of both companies need to address is what it takes for them to be successful in each other's turf.

It has become fashionable to show tables of the market valuations of supposed legacy companies like Marriott International (referred to here as pipeline businesses) and compare them to their peer-to-peer (P2P) platform business model counterparts such as Airbnb. Indeed, these asset-light platform businesses often approach or even exceed the market capitalization of their "old economy" counterparts, although they often have no physical assets to speak of. Over the past 10 years, P2P platforms have enjoyed explosive growth. Consumers around the world have become familiar with the sharing economy and many are happy to use what it offers, such as the peer-provided accommodation on Airbnb.

Exhibit 1: For Airbnb, maintaining the pace of expansion meant going beyond the gig economy.

Anna Berkut/Alamy Stock Photo

AIRBNB'S MOVE INTO PIPELINE BUSINESSES

To sustain its rapid growth, Airbnb acquired last-minute hotel booking platform HotelTonight, which enabled it to offer HotelTonight's independent and boutique hotel offerings directly on the Airbnb platform. Thanks to the acquisition, instead of having to work individually and directly with boutique hotels and bed and breakfast owners to list their properties, Airbnb could integrate a large amount of hotel inventory onto the Airbnb platform at a lower cost. This was achieved through technology integration at the back-end between HotelTonight and Airbnb. Offering these hotels and vacation rentals on one platform allowed Airbnb to enjoy marketing-related synergies associated with cross-selling. In particular, Airbnb found that guests who first booked a hotel on Airbnb were highly likely to return and also book peer-provided rooms in the future.

Furthermore, Airbnb started pipeline-like product innovation with an emphasis on standardizing products. For example, it launched Airbnb Plus, which listed quality-inspected homes that include everyday essentials. While these homes commanded a price premium over regular Airbnb listings, they offered the traveler more hotel-like consistency with a specified minimum level of comfort, amenities, and design.

Airbnb Luxe was another sub-brand that offered "extraordinary homes with five-star everything." These homes had to adhere to over 300 brand standards, including design features such as high-vaulted ceilings, attractive art, and closets with matching hangers, thus enabling Airbnb to develop branded

What Drives Share of Streaming for Streaming Video Services? The Launch of HBO Max

Alexander Buoye, Luke Williams, Timothy Keiningham, and Lerzan Aksoy

HBO Max launched its streaming service in May 2020. At the time of the launch, streaming services were already well established and dominated by a few large, well-established competitors (e.g., Netflix, Amazon Prime, Disney+, Hulu, etc.). In the face of intense competition, HBO Max's initial launch was widely characterized as "underwhelming" despite its large content library and a rise in streaming due to the COVID-19 pandemic.

A survey of streaming service customers demonstrated why HBO Max's launch was largely deemed underwhelming. HBO Max's Net Promoter Score (NPS), a measure of customers' satisfaction with the brand, was well below its two largest competitors, Amazon Prime and Netflix.

Despite the low NPS, however, HBO Max's share of streaming by its customers was a respectable 38%. One of the big issues for HBO Max post-launch was finding a way to increase its share of streaming. NPS, however, provides little guidance in improving share as the results of the survey found it to be very weakly correlated to share of streaming.

By using wallet allocation rule analysis, however, data regarding customers perceptions of HBO Max and competitors is strongly linked to customers' share of streaming. As a result, it was possible to identify what HBO Max must do to gain share in the competitive video streaming market.

INTRODUCTION

Video streaming services are a major entertainment delivery platform. Across the world, the rise in streaming services often came at the expense of traditional cable and broadcast delivery platforms. As a result, traditional video content providers had to adapt to the streaming environment or risk becoming obsolete.

The subscription streaming video market was dominated by only a few major players. Netflix and Amazon Prime had been the acknowledged leaders in the vertical, with media giant Disney competing on a robust but more fragmented basis through its family of subsidiary content offerings (Disney+ and Hulu as well as the sports specialty service, ESPN+). In May 2020, AT&T's WarnerMedia introduced its HBO Max streaming service as another alternative, replacing or enhancing previous incarnations (e.g., HBO Go, HBO Now) of their streaming platform. This case examines the launch of HBO Max.

At the time of the HBO Max launch, the legacy HBO streaming services (HBO Go, HBO Now) claimed only about 8 million subscribers. However, when including all traditional

HBO cable/satellite subscribers, the combined number reached 35 million. By comparison, Netflix boasted 183 million subscribers; Amazon Prime, 150 million; Disney+, 50 million; Apple TV+, 33 million; and Hulu 30, million.[1] YouTube, a more general, non-subscription-based streaming video platform, claimed well over 1.6 billion users globally.[2] YouTube's premium subscription service, YouTube Premium (formerly YouTube Red), however, claimed only about 20 million subscribers.[3] Sling TV (a subsidiary of Dish Network) was a minor player, with fewer than 2.5 million subscribers in May 2020.[4]

The launch of HBO Max was expected to bring the HBO streaming active user numbers more in line with leading competitors. According to AT&T's WarnerMedia third quarter earnings report, the number of HBO and HBO Max U.S. subscribers exceeded company targets (38 million vs a 37 million target by the end of 2020) and reached 57 million globally.[5] However, fewer than half of eligible subscribers had actually activated the service.[6] The low activation rate was credited in large part to technical issues, as the HBO Max app was not readily available on major platforms like Roku and Amazon Fire TV.[7] By October 2020, the general consensus about the HBO Max launch was "underwhelming,"[8] despite a strong content library and increased overall viewership of streaming video due to the COVID-19 global pandemic.[9]

LUX*: Staging a Service Revolution in a Resort Chain

Jochen Wirtz and Ron Kaufman

LUX* is a successful hospitality group operating in the Indian Ocean as well as other locations. In its previous incarnation, the company suffered from poor financial performance, poor service quality, and a weak brand. A change in the leadership of the company prompted a transformation that showed positive results within 12 months. This case study describes a service revolution that led to rapid improvements in service culture and guest experience, which in turn led to sustained financial improvements on a quarter-on-quarter basis and long-term growth.

INTRODUCTION

With its headquarters in Mauritius, the LUX* hospitality group operates a portfolio of eight resorts and a private island in the Indian Ocean (Exhibit 1). The brand promises guests a celebration of life through its new value proposition—luxury resort hospitality that is "Lighter.Brighter."

What is the "Lighter.Brighter" hospitality? Established luxury hotels had come to be associated with stiff-upper-lipped service and stuffy opulence. Lighter hospitality meant breaking away from these precedents to offer a more effervescent experience without compromising on the hotel's upscale sensibilities. At the same time, LUX* wanted to brighten up guest experiences. For example, the company significantly lowered the prices of items in the mini-bar to encourage guests to just take what they fancied and enjoy themselves. Such measures allowed LUX* to ensure that both guests and business would benefit from its operations.

The group's resorts have been doing exceptionally well since its launch in 2011. Within a short span of time, LUX*

has successfully transformed its service culture. The group has seen 16 consecutive quarter-on-quarter improvements in its financial performance. The group's resorts also enjoy a higher occupancy rate than the industry average in the destinations where they operate (measured quarterly by the Market Penetration Index, which compares the hotel's occupancy against its competitive set). The group's financial performance is reflected in the multiple accolades it has won for service excellence. These include the "Indian Ocean Leading Hotel" award for LUX* Maldives from World Travel Awards, the "Best Resort Hotel Mauritius" award for LUX* Belle Mare from International Hospitality Awards, and the "Reunion Island's Leading Hotel" award for LUX* Ile de la Réunion from World Travel Awards.

THE DARK AGES

However, things were not always this rosy. Before LUX* was launched in 2011, the group was known as Naiade Resorts, and the company suffered from poor financial health. None of its hotels were on the list of top 10 hotels on TripAdvisor in their geographic competitive sets. To top it off, the Naiade brand lacked clarity. Its brand name was used for nine different properties ranging from three to five stars, creating an unclear positioning in the minds of consumers. The problems in its positioning became apparent when the global financial crisis struck in 2008–2009, causing a large drop in occupancy and room rates (Exhibit 2). The group's troubles culminated in 2011 with a criminal case involving the high-profile murder of an Irish hotel guest.

Having witnessed prolonged economic turmoil and a criminal case, the motivation and morale of hotel employees were unprecedentedly low. Financially, the impact of these

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