Chapter 6:
Setting Prices and Implementing Revenue Management

Overview Of Chapter 6

- **Effective Pricing is Central to Financial Success**

- **Pricing Strategy as Represented by the Pricing Tripod**

- **Revenue Management: What it is and How it Works**

- **Ethical Concerns in Service Pricing**

- **Putting Service Pricing into Practice**

Effective Pricing is
Central to Financial Success

What Makes Service Pricing Strategy Different and Difficult?

- **Harder to calculate financial costs of creating a service process or performance than a manufactured good**

- **Variability of inputs and outputs:**

  → **How can firms define a "unit of service" and establish basis for pricing?**

- **Importance of time factor – same service may have more value to customers when delivered faster**

- **Customers find service pricing difficult to understand, risky, and sometimes even unethical**

Objectives for Pricing of Services

- **Revenue and Profit Objectives**
  - ➔ **Seek profit**
  - ➔ **Cover costs**

- **Patronage and User-Based Objectives**
  - ➔ **Build demand**
    - - *Demand maximization*
    - - *Full capacity utilization*
  - ➔ **Build a user base**
    - - *Stimulate trial and adoption of new service*
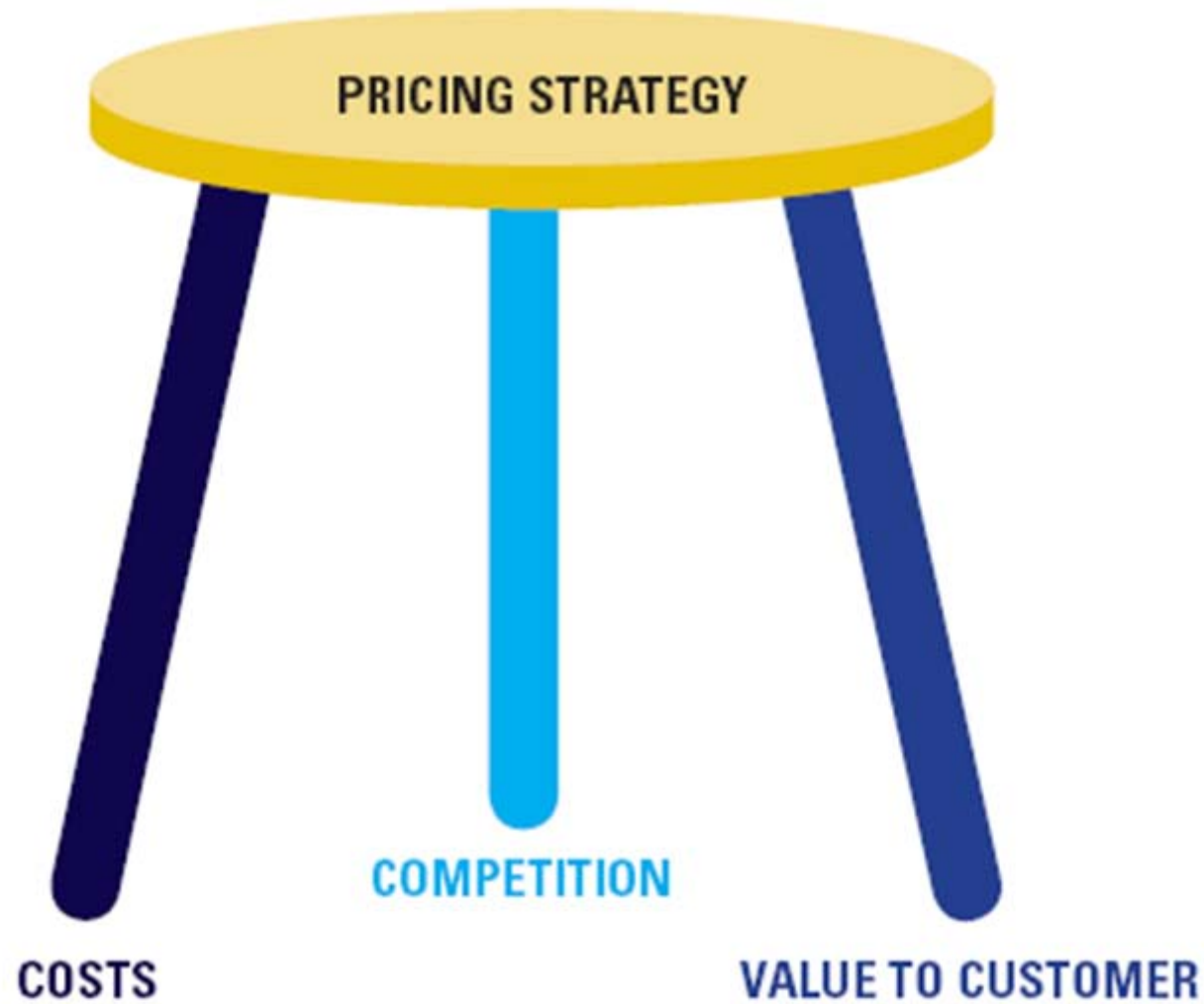   - - *Build market share/large user base*

Pricing Strategy
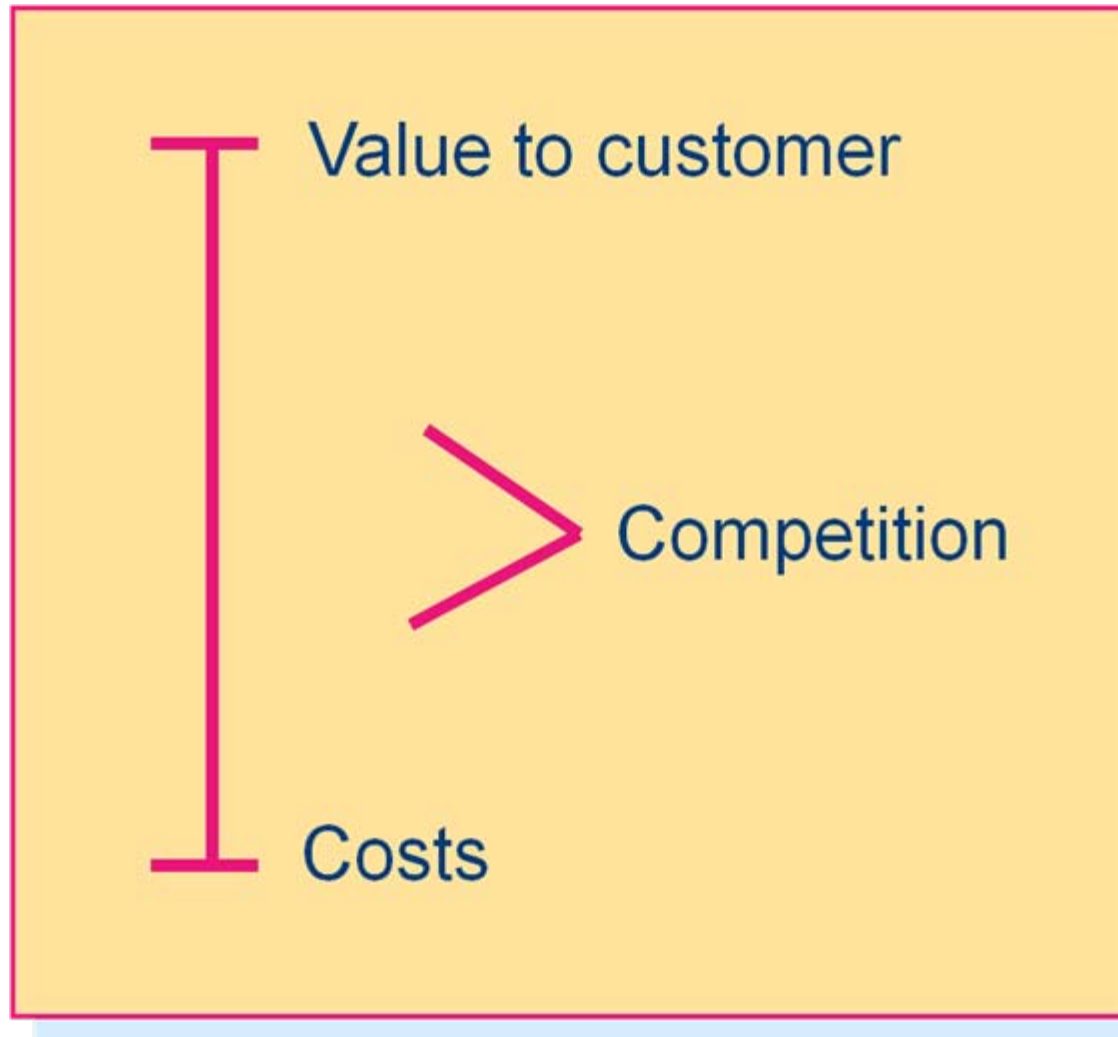# As Represented by the Pricing Tripod

The Pricing Tripod

Floor and Ceiling of Price

Three Main Approaches to Pricing

Cost-Based Pricing

- Set prices relative to financial costs

- Activity-Based Costing

- Pricing implications of cost analysis

Value-Based Pricing

- Relate price to value perceived by customer

Competition-Based Pricing

- Monitor competitors' pricing strategy

- Dependent on the price leader

Cost-Based Pricing: Traditional vs. Activity-Based Costing

- **Traditional costing approach**
    - ➔ Emphasizes expense categories (arbitrary overheads allocation)
    - ➔ May result in reducing value generated for customers

- **ABC management systems**
    - ➔ Link resource expenses to variety and complexity of goods/services produced
    - ➔ Yields accurate cost information

BUT, customers care about value to themselves, not what service production costs the firm

Value-Based Pricing: Understanding Net Value

- **Net Value = Perceived Benefits to Customer (Gross Value) minus All Perceived Outlays (Money, Time, Mental/Physical Effort)**

- **Consumer surplus: difference between price paid and amount customer would have been willing to pay in absence of other options**

- **Competing services are then evaluated via comparison of net value**

Value-Based Pricing:
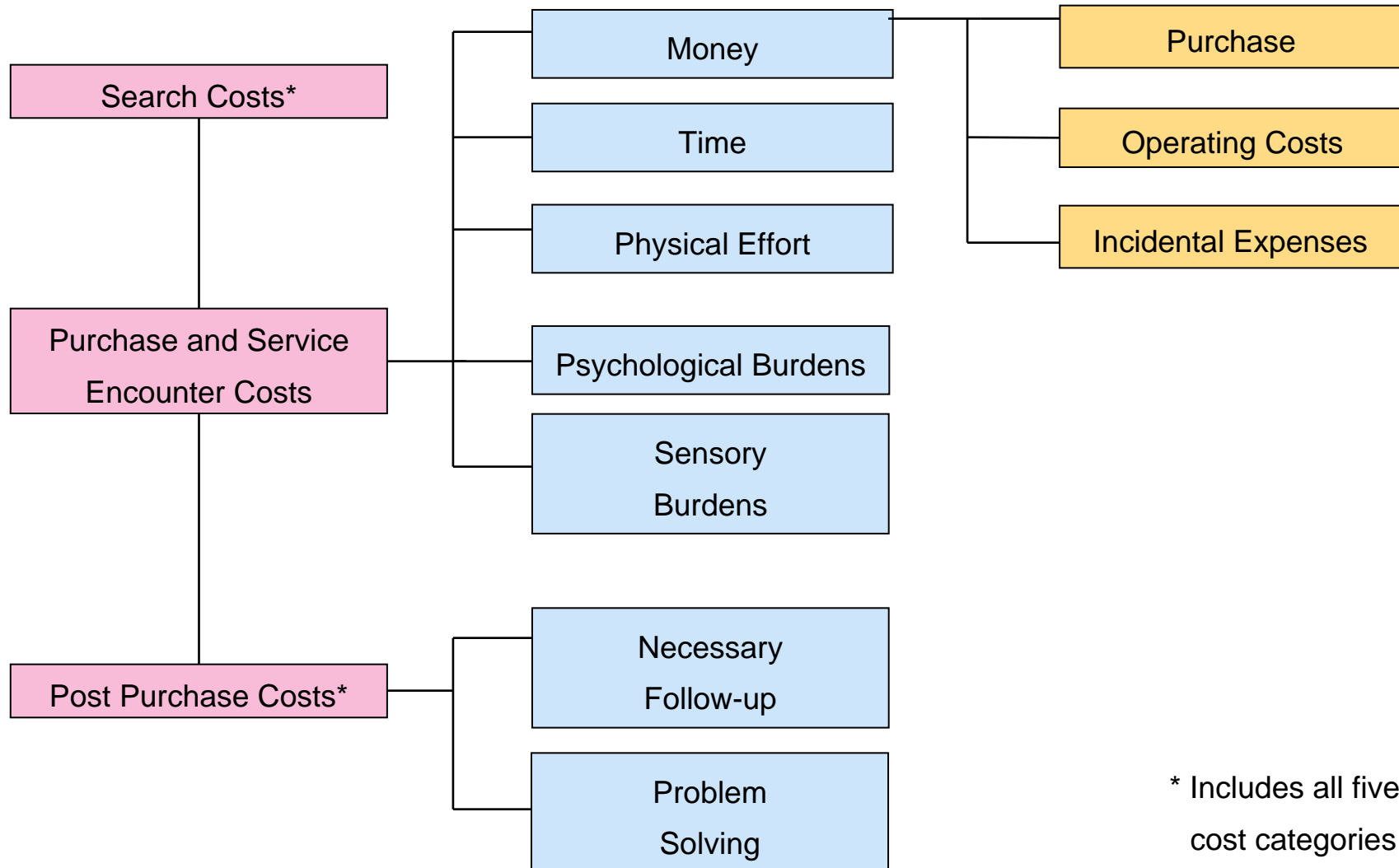# Strategies for Enhancing Net Value

● **Enhance gross value – benefits delivered**

➔ Add benefits to core product

➔ Enhance supplementary service

➔ Manage perceptions of benefits delivered

● **Reduce costs incurred by**

➔ Reducing monetary costs of acquisition and usage

➔ Cutting amount of time required to evaluate, buy, use service

➔ Lowering effort associated with purchase and use

Defining Total User Cost

```
Search Costs*
        |
        |                      Money ──────────────┐──── Purchase
        |                                          │
Purchase and Service          Time                ├──── Operating Costs
Encounter Costs ──────        Physical Effort      │
        |                                          └──── Incidental Expenses
        |                      Psychological Burdens
        |
        |                      Sensory
        |                      Burdens
        |
Post Purchase Costs* ──────    Necessary
                               Follow-up

                               Problem
                               Solving
```

* Includes all five

cost categories

Competition-Based Pricing

Price competition increases due to:

- Increasing competition
- Increase in substituting offers
- Wider distribution of competitor
- Increasing surplus capacity in the industry

However under these circumstances, price competition can decrease:

- High non-price-related costs of using alternatives
- Personal relationships matter
- Switching costs are high
- Time and location specificity reduces choice
- Managers should examine all related financial and non-monetary costs

Competitive-Based Pricing

Which clinic would you patronize if you needed a chest x-ray (assuming that all three clinics offer good technical quality)?

Clinic A	Clinic B	Clinic C
• Price $65	• Price $125	• Price $185
• Located 1 hour away by car or transit	• Located 15 min away by car or transit	• Located next to your office building (or college)
• Next available appointment is in 3 weeks	• Next available appointment is in 1 week	• Next available appointment is in 1 day
• Hours: Monday – Friday, 9am – 5pm	• Hours: Monday – Friday, 8am – 10pm	• Hours: Monday – Saturday, 8am – 10pm
• Estimated wait at clinic is about 2 hours	• Estimated wait at clinic is about 30 to 45 minutes	• By appointment – estimated wait at clinic is about 0 to 15 minutes

Revenue Management:
What it is and How it works

Maximizing Revenue from Available Capacity at a Given Time

- **Most effective in the following conditions:**
  - ➔ **High fixed cost structure**
  - ➔ **Relatively fixed capacity**
  - ➔ **Perishable inventory**
  - ➔ **Variable and uncertain demand**
  - ➔ **Varying customer price sensitivity**

- **Revenue management (RM) is price customization**
  - ➔ **Charge different value segments different prices for same product based on price sensitivity**

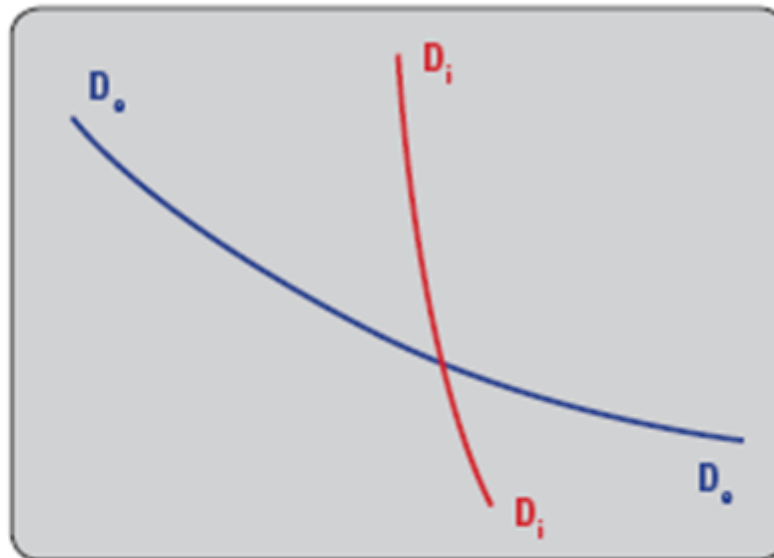# Maximizing Revenue from Available Capacity at a Given Time

- RM uses mathematical models to examine historical data and real time information to determine

  ➔ What prices to charge within each price bucket

  ➔ How many service units to allocate to each bucket

- Rate fences deter customers willing to pay more from trading down to lower prices (minimize consumer surplus)

Price Elasticity

PRICE PER UNIT OF SERVICE

QUANTITY OF UNITS DEMANDED

$$\text{Price Elasticity} = \frac{\text{Percentage change in demand}}{\text{Percentage change in price}}$$

D_e : Demand is *price elastic*. Small changes in price lead to big changes in demand

D_i : Demand for service is *price inelastic*. Big changes have little impact on demand

Key Categories of Rate Fences:
Physical (Product-Related) Fences

Product-Related Fences

Rate Fences	Examples
Basic Product	▪ Class of travel (Business/Economy class) ▪ Size and furnishing of a hotel room ▪ Seat location in a theater
Amenities	▪ Free breakfast at a hotel, airport pick up, etc. ▪ Free golf cart at a golf course
Service Level	▪ Priority wait listing ▪ Increase in baggage allowances ▪ Dedicated service hotlines ▪ Dedicated account management team

Key Categories of Rate Fences:
Non Physical Fences

Transaction Characteristics

Rate Fences	Examples
Time of booking or reservation	▪ Requirements for advance purchase ▪ Must pay full fare two weeks before departure
Location of booking or reservation	▪ Passengers booking air tickets for an identical route in different countries are charged different prices
Flexibility of ticket usage	▪ Fees/penalties for canceling or changing a reservation (up to loss of entire ticket price) ▪ Non-refundable reservation fees

Key Categories of Rate Fences:
Non Physical Fences

Consumption Characteristics

Rate Fences	Example
Time or duration of use	▪ Early bird special in restaurant before 6pm ▪ Must stay over on Sat for airline, hotel ▪ Must stay at least five days
Location of consumption	▪ Price depends on departure location, especially in international travel ▪ Prices vary by location (between cities, city centre vs. edges of city)

Key Categories of Rate Fences:
Non Physical Fences

Buyer Characteristics

Rate Fences	Examples
Frequency or volume of consumption	▪ Member of certain loyalty tier with the firm get priority pricing, discounts or loyalty benefits
Group membership	▪ Child, student, senior citizen discounts ▪ Affiliation with certain groups (e.g., Alumni)
Size of customer group	▪ Group discounts based on size of group

Relating Price Buckets and Fences to Demand Curve

PRICE PER SEAT (vertical axis)

- 1st Class
- Full Fare Economy (No Restrictions)
- 1-Week Advance Purchase
- 1-Week Advance Purchase, Saturday Night Stayover
- 3-Week Advance Purchase, Saturday Night Stayover
- 3-Week Advance Purchase, Saturday Night Stayover, $100 for changes
- Specified flights, book on Internet, no changes/ refunds
- Late Sales through Consolidators / Internet, no refunds

Capacity of 1st Class Cabin

NO. OF SEATS DEMANDED (horizontal axis)

Capacity of Aircraft

* Dark areas denote amount of consumer surplus (goal of segmented pricing is to reduce this)

Ethical Concerns in Service Pricing

Ethical Concerns in Pricing

● **Many services have complex pricing schedules**

➔ hard to understand

➔ difficult to calculate full costs in advance of service

● **Unfairness and misrepresentation in price promotions**

➔ misleading advertising

➔ hidden charges

● **Too many rules and regulations**

➔ customers feel constrained, exploited

➔ customers unfairly penalized when plans change

Designing Fairness into Revenue Management

- Design clear, logical, and fair price schedules and fences

- Use high published prices and present fences as opportunities for discounts

- Communicate consumer benefits of revenue management

- Use bundling to "hide" discounts

- Take care of loyal customers

- Use service recovery to compensate for overbooking

Putting Service Pricing into Practice

Pricing Issues:
Putting Strategy into Practice

1. How much to charge?

2. What basis for pricing?

3. Who should collect payment?

4. Where should payment be made?

5. When should payment be made?

6. How should payment be made?

7. How to communicate prices?

Putting Service Pricing into Practice

- **How much to charge?**

  ➔ **Pricing tripod provides a useful starting point**

  ➔ **A specific figure must be set for the price**

  ➔ **Need to consider the pros and cons, and ethical issues**

  > 1. How much to charge?

- **What basis for pricing?**

  ➔ **Completing a task**

  ➔ **Admission to a service performance**

  ➔ **Time based**

  ➔ **Monetary value of service delivered (e.g., commission)**

  ➔ **Consumption of physical resources (e.g., food and beverages)**

  > 2. What basis for pricing?

Putting Service Pricing into Practice

- **Who should collect payment?**
  - ➔ **Service provider or specialist intermediaries**
  - ➔ **Direct or non-direct channels**

- **Where should payment be made?**
  - ➔ **Conveniently located intermediaries**
  - ➔ **Mail/bank transfer**

- **When should payment be made?**
  - ➔ **In advance**
  - ➔ **Once service delivery has been completed**

3. Who should collect payment?

4. Where should payment be made?

5. When should payment be made?

Putting Service Pricing into Practice

- **How should payment be made?**

  - ➔ **Cash**

  - ➔ **Token**

  - ➔ **Stored value card**

  - ➔ **Electronic fund transfer**

  - ➔ **Charge Card (Debit/Credit)**

  - ➔ **Vouchers**

6. How should payment be made?

- **How to communicate prices?**

  - ➔ **Relate the price to that of competing products**

  - ➔ **Ensure price is accurate and intelligible**

7. How to communicate prices?

Summary

- **Pricing objectives can include**

  ➔ Generating revenues and profit, building demand, and developing user base

- **Three main foundations to pricing a service**

  ➔ Cost-based pricing

  ➔ Competition-based pricing

  ➔ Value-based pricing

- **Firm must be aware of competitive pricing but may be harder to compare for services than for goods**

Summary

- **Revenue management**

  ➔ **Maximizes revenue from a given capacity at a point in time**

  ➔ **Manage demand and set prices for each segment closer to perceived value**

  ➔ **Use of rate fences**

- **Ethical issues in pricing**

  ➔ **Complex pricing schedules**

  ➔ **Unfairness and misrepresentation in advertising**

  ➔ **Hidden charges**

  ➔ **Too many rules and regulations**

Chapter 8:
Designing and Managing Service Processes

Overview of Chapter 8

- **Flowcharting Customer Service Processes**

- **Blueprinting Services to Create Valued Experiences and Productive Operations**

- **Service Process Redesign**

- **The Customer as Co-Producer**

- **Self-Service Technologies**

Flowcharting Customer Service Processes

Flowcharting Service Delivery Helps to Clarify Product Elements

- Technique for displaying the nature and sequence of the different steps in delivery service to customers

- Offers way to understand total customer service experience

- Shows how nature of customer involvement with service organizations varies by type of service:

  ➔ People processing

  ➔ Possession processing

  ➔ Mental Stimulus processing

  ➔ Information processing

Flowcharts for People and Possession Processing Services

PEOPLE PROCESSING - STAY AT MOTEL

Park Car → Check In → **Spend night in room** → Breakfast → Check-out

- Maid makes up room (→ Check In)
- Breakfast prepared (→ Breakfast)

POSSESSION PROCESSING - REPAIR A DVD PLAYER

Travel to store → Technician examines player, diagnoses problem → Leave store → Return, pick up player and pay → **(Later) Play DVDs at home**
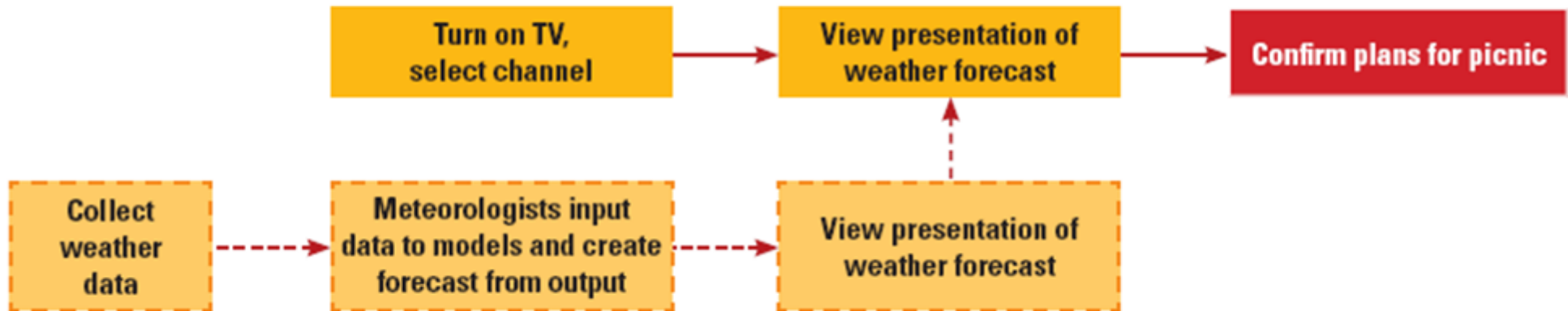
- Technician repairs player

Flowcharts for Mental Stimulus and Information Processing Services

MENTAL STIMULUS PROCESSING - WEATHER FORECAST

| Turn on TV, select channel | → | View presentation of weather forecast | → | Confirm plans for picnic |

| Collect weather data | ⇢ | Meteorologists input data to models and create forecast from output | ⇢ | View presentation of weather forecast |

INFORMATION PROCESSING - HEALTH INSURANCE

| Learn about options | → | Select plan, complete forms | → | Pay | → | Insurance coverage begins | → | Printed policy documents arrive |

| University and insurance company agree on terms of coverage | ⇢ | Customer information entered in database |

Blueprinting Services to Create Valued Experiences and Productive Operations

Developing a Blueprint

- **Developing a Blueprint**
  - ➔ **Identify key activities in creating and delivering service**
  - ➔ **Define "big picture" before "drilling down" to obtain a higher level of detail**
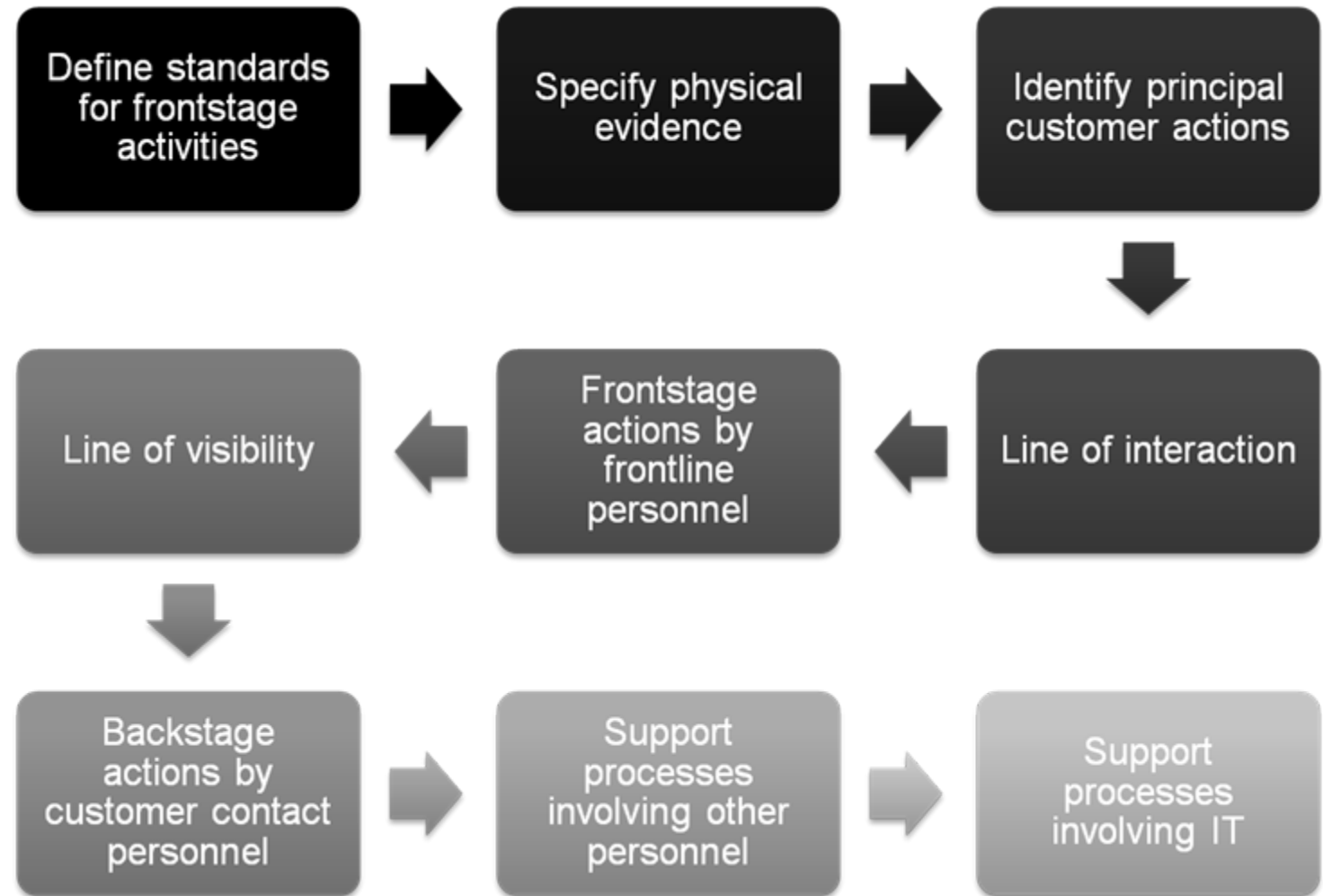
- **Advantages of Blueprinting**
  - ➔ **Distinguish between "frontstage" and "backstage"**
  - ➔ **Clarify interactions and support by backstage activities and systems**
  - ➔ **Identify potential fail points; take preventive measures; prepare contingency**
  - ➔ **Pinpoint stages where customers commonly have to wait**
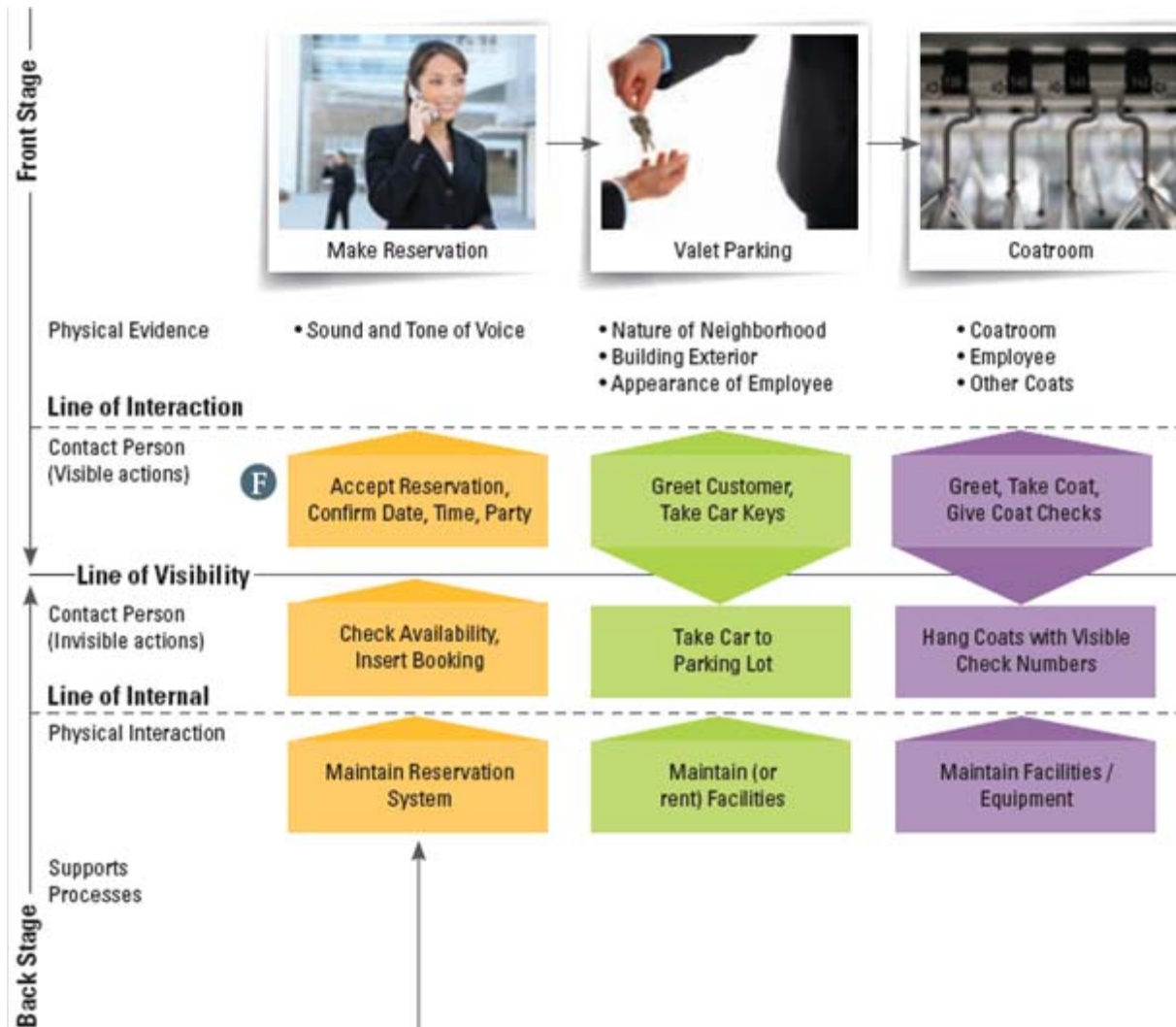
Key Components of a Service Blueprint

Objectives:

➢ **Identify fail points & risks of excessive waits**

➢ **Set service standards**

➢ **Fail-proof process**

```
Define standards        →   Specify physical      →   Identify principal
for frontstage              evidence                  customer actions
activities
                                                           ↓
Line of visibility     ←   Frontstage            ←   Line of interaction
                            actions by
                            frontline
                            personnel
      ↓
Backstage              →   Support               →   Support
actions by                 processes                 processes
customer contact           involving other           involving IT
personnel                  personnel
```

Blueprinting the Restaurant Experience: Act 1

Make Reservation · Valet Parking · Coatroom

Physical Evidence
- Sound and Tone of Voice
- Nature of Neighborhood / Building Exterior / Appearance of Employee
- Coatroom / Employee / Other Coats

Line of Interaction

Contact Person (Visible actions)
- Accept Reservation, Confirm Date, Time, Party
- Greet Customer, Take Car Keys
- Greet, Take Coat, Give Coat Checks

Line of Visibility

Contact Person (Invisible actions)
- Check Availability, Insert Booking
- Take Car to Parking Lot
- Hang Coats with Visible Check Numbers

Line of Internal

Physical Interaction
- Maintain Reservation System
- Maintain (or rent) Facilities
- Maintain Facilities / Equipment

Supports Processes

- **Act 1: Prologue and Introductory Scenes**

- **Act 2: Delivery of Core Product**
  - ➔ Cocktails, seating, order food and wine, wine service
  - ➔ Potential fail points: Menu information complete? Menu intelligible? Everything on the menu actually available?
  - ➔ Mistakes in transmitting information a common cause of quality failure
  - ➔ Customers may not only evaluate quality of food and drink, but how promptly it is served or serving staff attitudes

- **Act 3: The Drama Concludes**
  - ➔ Remaining actions should move quickly and smoothly, with no surprises at the end
  - ➔ Customer expectations: accurate, intelligible and prompt bill, payment handled politely, guest are thanked for their patronage

Improving Reliability of Processes Through Fail-Proofing

- **Identify fail points**

- **Analysis of reasons for failure reveals opportunities for failure-proofing to reduce/eliminate future errors**

- **Need fail-safe methods for both employees and customers**

Setting Service Standards and Targets

- **Service providers set standards for each step sufficiently high to satisfy and even delight customers**

  ➔ Include time parameters, script and prescriptions for appropriate style and demeanor

  ➔ Must be expressed in ways that permit objective measurement

- **Performance targets – specific process and team performance targets for which staff are responsible for**
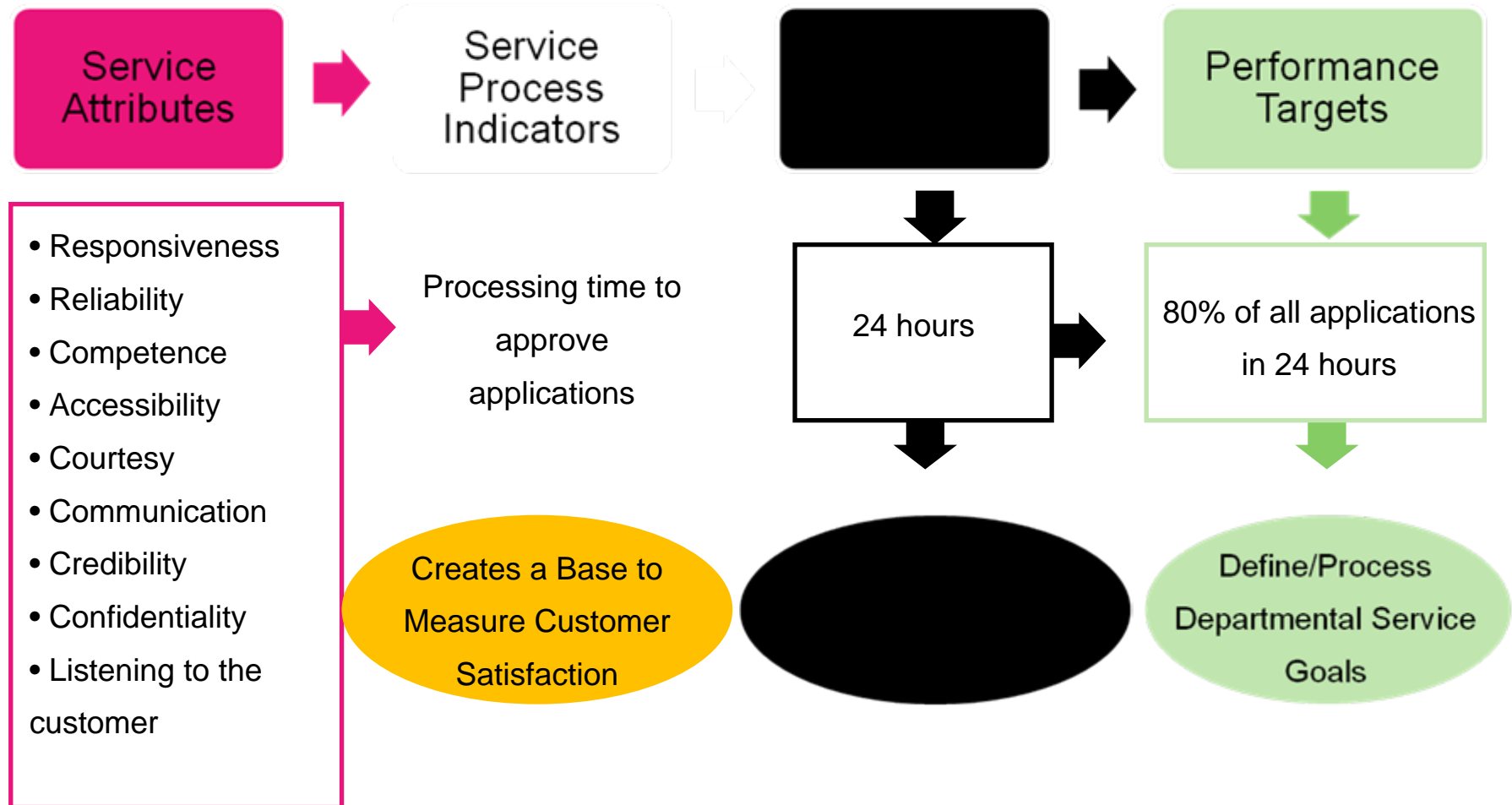
- **Evaluated based on distinction between standards and targets**

Setting Service Standards and Targets

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- **First impression is important**
  - ➔ **Affects customer's evaluations of quality during later stages of service delivery as customer perceptions of service experiences tend to be cumulative**

- **For low-contact service, a single failure committed front stage is relatively more serious than in a high-contact service**

Setting Standards and Targets for Customer Service Processes

Service Attributes → **Service Process Indicators** ⇨ [ ] → **Performance Targets**

- Responsiveness
- Reliability
- Competence
- Accessibility
- Courtesy
- Communication
- Credibility
- Confidentiality
- Listening to the customer

→ Processing time to approve applications

24 hours → 80% of all applications in 24 hours

Creates a Base to Measure Customer Satisfaction

Define/Process Departmental Service Goals

Redesigning Service Processes

Why Redesign?

- **Revitalizes process that has become outdated**

- **Changes in external environment make existing practices obsolete and require redesign of underlying processes**

- **Rusting occurs internally**

  ➜ Natural deterioration of internal processes; creeping bureaucracy; evolution of spurious, unofficial standards

  ➜ Symptoms:
    - *Extensive information exchange*
    - *Data that is not useful*
    - *High ratio of checking control activities to value-adding activities*

Why Redesign?

"Institutions are like steel beams—they tend to rust. What was once smooth and shiny and nice tends to become rusty."

Mitchell T. Rabkin, MD,
former president of Boston's Beth Israel Hospital

Why Redesign?

● **Redesign aims to achieve these performance measures:**

➔ **Reduced number of service failures**

➔ **Reduced cycle time from customer initiation of a service process to its completion**

➔ **Enhanced productivity**

➔ **Increased customer satisfaction**

Process Redesign: Approaches and Potential Benefits

Eliminating non-value-adding steps
- Streamline front-end and back-end processes of services
- Improve productivity and customer satisfaction

Shifting to self-service
- Increase in productivity and service quality
- Lower costs and perhaps prices
- Enhance technology reputation
- Differentiates company

Delivering direct service
- Improve convenience for customers
- Productivity can be improved by eliminating expensive retail locations
- Increase customer base

Process Redesign: Approaches and Potential Benefits

Bundling services

- Involves grouping multiple services into one offer, focusing on a well-defined customer group
- A better fit to the needs of target segment
- Increase productivity with customized service
- Increase per capita service use

Redesigning physical aspects of service process

- Focus on tangible elements of service process (facilities and equipment)
- Increase convenience
- Enhance satisfaction and productivity of frontline staff
- Cultivate interest in customers

The Customer as Co-Producer

Levels of Customer Participation

High – Customer works actively with provider to co-produce the service

- Service cannot be created without customer's active participation
- Customer can jeopardize quality of service outcome

Medium – Customer inputs required to assist provider

- Provide needed information and instructions
- Make some personal effort; share physical possessions

Low – Employees and systems do all the work

- Involves standardized work

Customers as Partial Employees

- **Customers can influence productivity and quality of service processes and outputs**

- **Customers not only bring expectations and needs but also need to have relevant service production competencies**

- **For the relationship to last, both parties need to cooperate with each other**

Managing Customers

Recruitment and Selection	• Recruit customers that possess the competency to perform the necessary tasks
Job Analysis	• Are customers aware of their roles and equipped with the required skills?
Education and Training	• Information required for them to perform their roles via instructions or video demonstration
Motivate	• Ensure that they will be rewarded for good performance
Appraise	• For sub-par performances, improve customer training or change the role or process
Ending	• Last resort: if customer is non compliant consider termination of the relationship

Self-Service Technologies

Self-Service Technologies (SSTs)

- **SSTs are the ultimate form of customer involvement where customers undertake specific activities using facilities or systems provided by service supplier**

  ➔ **Customer's time and effort replace those of employees**

- **Information-based services lend selves particularly well to SSTs**

  ➔ **Used in both supplementary services and delivery of core product**

Self-Service Technologies (SSTs)

Many companies and government organizations seek to divert customers from employee contact to Internet-based self-service

Advantages:

➜ **Time and Cost savings**

➜ **Flexibility**

➜ **Convenience of location**

➜ **Greater control over service delivery**

➜ **High perceived level of customization**

Disadvantages:

➜ **Anxiety and stress experienced by customers who are uncomfortable with using them**

➜ **Some see service encounters as social experiences and prefer to deal with people**

What Aspects Of SSTs Please Or Annoy Customers?

• SST machines are conveniently located and accessible 24/7– often as close as the nearest computer!

• Obtaining detailed information and completing transactions can be done faster than through face-to-face or telephone contact

• SSTs fail – system is down, PIN numbers not accepted, etc.

• Customers themselves mess up – forgetting passwords; failing to provide information as requested; simply hitting wrong buttons

Key weakness: Few firms incorporate service recovery systems such that customers are still forced to make telephone calls or personal visits

Putting SSTs to Test by Asking a Few Simple Questions

- **Does the SST work reliably?**
  - ➔ Firms must ensure that SSTs are dependable and user-friendly

- **Is the SST better than interpersonal alternatives?**
  - ➔ Customers will stick to conventional methods if SST doesn't create benefits for them

- **If it fails, what systems are in place to recover?**
  - ➔ Always provide systems, structures, and technologies that will enable prompt service recovery when things fail

Managing Customer's Reluctance to Change

- Increasing customer's participation level in a service can be difficult

- Marketing communications to be used to:

  ➔ Prepare customer for change

  ➔ Explain the rationale and benefits

  ➔ What customers need to do differently in the future

Summary

- Service blueprinting can be used to design a service and create a satisfying experience for customers. Key components of the blueprint include:

- Blueprinting a restaurant (or other service) can be a three-act performance

  ➔ Prologue and introductory scenes

  ➔ Delivery of the core product

  ➔ Conclusion of the drama

Summary

- **Service standards and targets are different and can be used to evaluate performance**

- **Service process redesign reduces service failure and enhances productivity**

- **When the customer is a co-producer, issues to consider are**

  - ➔ **Levels of customer participation**

  - ➔ **Self-service technologies (SST)**

  - ➔ **Psychological factors in customer co-production**

  - ➔ **Aspects of SST that please or annoy customers**

Chapter 10:
Crafting the Service Environment

Overview of Chapter 10

- **What is the Purpose of Service Environments?**

- **Understanding Consumer Responses to Service Environments**

- **Dimensions of the Service Environment**

- **Putting It All Together**

What is the Purpose of Service Environments?

Purpose of Service Environments

- Shape customers' experience and their behaviors

- Support image, positioning, and differentiation

- Part of the value proposition

- Facilitate service encounter and enhance productivity

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Shape customers' experience and their behaviors

- **Message-creating medium**
  - ➔ symbolic cues to communicate the distinctive nature and quality of the service experience

- **Attention-creating medium**
  - ➔ make servicescape stand out from competition and attract customers from target segments

- **Effect-creating medium**
  - ➔ use colors, textures, sounds, scents, and spatial design to enhance desired service experience

Support Image, Position, and Differentiation

Orbit Hotel and Hostel, Los Angeles

Four Seasons Hotel, New York

Servicescape as Part of Value Proposition

- **Physical surroundings help shape appropriate feelings and reactions in customers and employees**

  ➔ **e.g., Disneyland, Denmark's Legoland**

- **Servicescapes form a core part of the value proposition**

  ➔ **Las Vegas: repositioned itself to a somewhat more wholesome fun resort, visually striking entertainment center**

  ➔ **Florida-based Muvico: builds extravagant movie theatres and offers plush amenities.** *"What sets you apart is how you package it."* *(Muvico's CEO, Hamid Hashemi)*
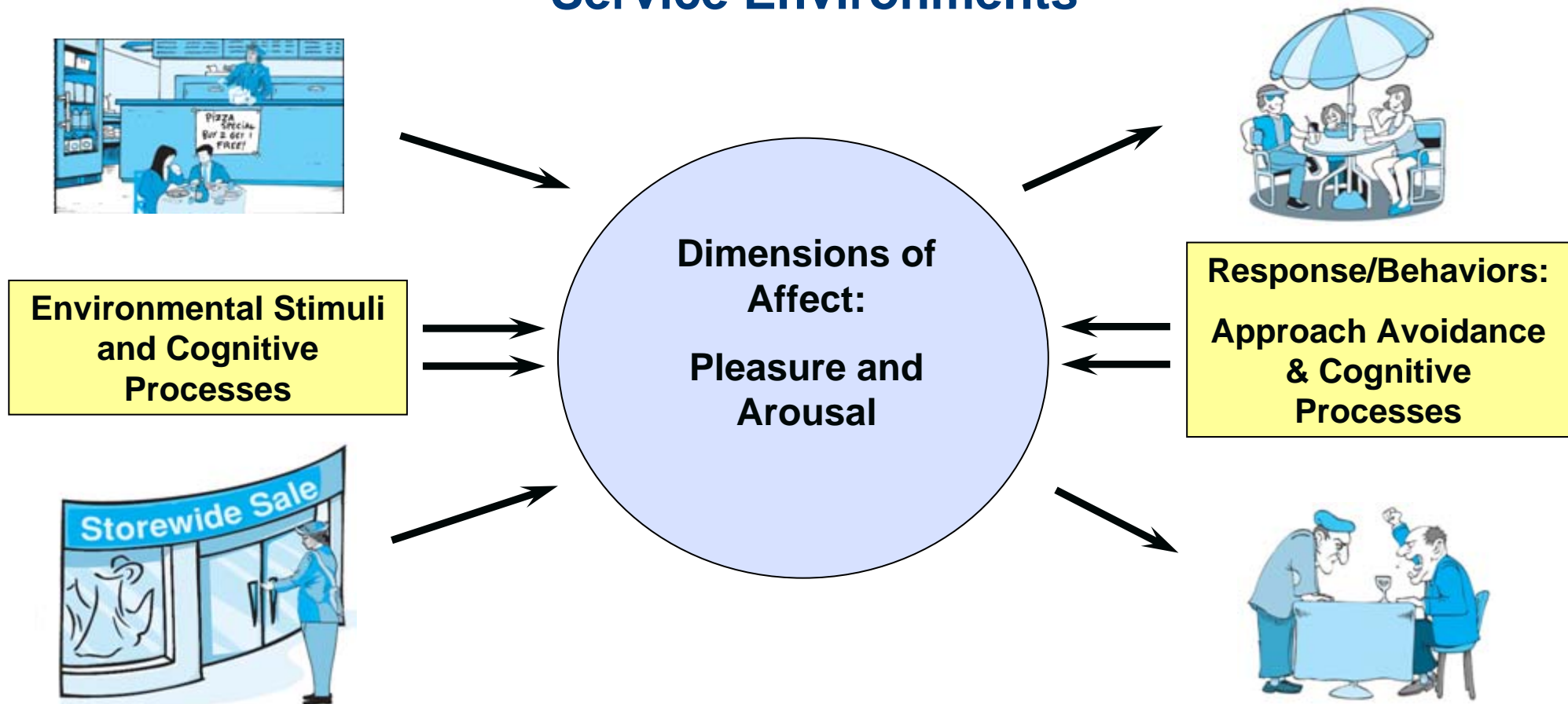
  The power of servicescapes is being discovered

Understanding Consumer Reponses to Service Environments

The Mehrabian-Russell Stimulus-Response Model

Feelings Are a Key Driver of Customer Responses to Service Environments

Environmental Stimuli and Cognitive Processes

Dimensions of Affect:

Pleasure and Arousal

Response/Behaviors:

Approach Avoidance & Cognitive Processes

Insights from Mehrabian-Russell Stimulus-Response Model

It is a simple yet fundamental model of how people respond to environments that illustrates:

- **The environment, its conscious and unconscious perceptions, and interpretation influence how people feel in that environment**

- **Feelings, rather than perceptions/thoughts drive behavior**

- **Typical outcome variable is 'approach' or 'avoidance' of an environment, but other possible outcomes can be added to model**

The Russell Model of Affect

Insights from Russell's Model of Affect

- Emotional responses to environments can be described along two main dimensions:

  ➔ Pleasure: subjective, depending on how much individual likes or dislikes environment

  ➔ Arousal: how stimulated individual feels, depends largely on information rate or load of an environment

- Separates cognitive emotions from emotional dimensions

- Advantage: simple, direct approach to customers' feelings

  ➔ Firms can set targets for affective states

Drivers of Affect

- **Caused by perceptions and cognitive processes of any degree of complexity**

- **Determines how people feel in a service setting**

- **If higher levels of cognitive processes are triggered, the interpretation of this process determines people's feelings**

- **The more complex a cognitive process becomes, the more powerful its potential impact on affect**
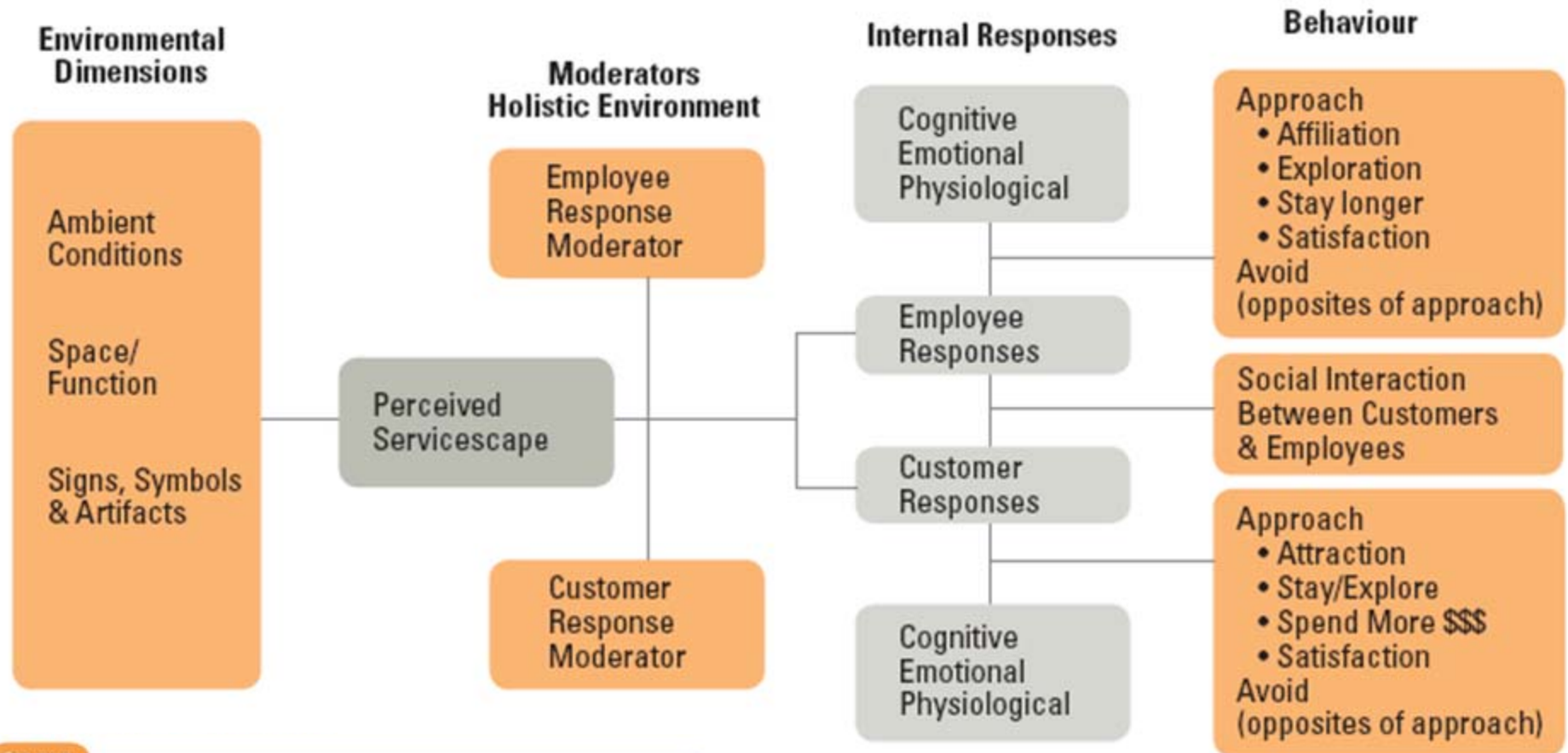
Behavioral Consequence of Affect

- **Pleasant environments result in approach, whereas unpleasant ones result in avoidance**

- **Arousal amplifies the basic effect of pleasure on behavior**

  ➔ **If environment is pleasant, increasing arousal can generate excitement, leading to a stronger positive consumer response**

  ➔ **If environment is unpleasant, increasing arousal level will move customers into the "distressed" region**

- **Feelings during service encounters are an important driver of customer loyalty**

An Integrative Framework: The Servicescape Model

Environmental Dimensions
- Ambient Conditions
- Space/Function
- Signs, Symbols & Artifacts

Moderators Holistic Environment
- Employee Response Moderator
- Perceived Servicescape
- Customer Response Moderator

Internal Responses
- Cognitive Emotional Physiological
- Employee Responses
- Customer Responses
- Cognitive Emotional Physiological

Behaviour
- Approach
  - Affiliation
  - Exploration
  - Stay longer
  - Satisfaction
- Avoid (opposites of approach)
- Social Interaction Between Customers & Employees
- Approach
  - Attraction
  - Stay/Explore
  - Spend More $$$
  - Satisfaction
- Avoid (opposites of approach)

SOURCE
Bitner, M.J. (1992) Servicescapes: The impact of physical surroundings on customers and employees. *Journal of Marketing*, 56 (April), pp. 57–71.

An Integrative Framework: The Servicescape Model

- Identifies the main dimensions in a service environment and views them holistically

- Internal customer and employee responses can be categorized into cognitive, emotional, and psychological responses, which lead to overt behavioral responses towards the environment

- Key to effective design is how well each individual dimension fits together with everything else

Dimensions of the Service Environment

Main Dimensions in Servicescape Model

- **Ambient Conditions**

  ➔ **Characteristics of environment pertaining to our five senses**

- **Spatial Layout and Functionality**

  ➔ **Spatial layout:**
    - *floorplan*
    - *size and shape of furnishings*

  ➔ **Functionality: ability of those items to facilitate performance**

- **Signs, Symbols, and Artifacts**

  ➔ **Explicit or implicit signals to:**
    - *help consumers find their way*

Ambient Conditions

- Ambient conditions are perceived both separately and holistically, and include:

  ➔ Lighting and color schemes

  ➔ Size and shape perceptions

  ➔ Sounds such as noise and music

  ➔ Temperature

  ➔ Scents

- Clever design of these conditions can elicit desired behavioral responses among consumers

Music

- **In service settings, music can have powerful effect on perceptions and behaviors, even if played at barely audible levels**

- **Structural characteristics of music－such as tempo, volume, and harmony－are perceived holistically**
  - ➔ **Fast tempo music and high volume music increase arousal levels**
  - ➔ **People tend to adjust their pace, either voluntarily or involuntarily, to match tempo of music**

- **Careful selection of music can deter wrong type of customers**

Scent

- **An ambient smell is one that pervades an environment**

  ➔ May or may not be consciously perceived by customers

  ➔ Not related to any particular product

- **Scents have distinct characteristics and can be used to solicit emotional, physiological, and behavioral responses**

- **In service settings, research has shown that scents can have significant effect on customer perceptions, attitudes, and behaviors**

Aromatherapy: Effects of Selected Fragrances on People

Fragrance	Aroma Type	Aromatherapy Class	Traditional Use	Potential Psychological Effect on People
Eucalyptus	Camphoraceous	Toning, stimulating	Deodorant, antiseptic, soothing agent	Stimulating and energizing
Lavender	Herbaceous	Calming, balancing, soothing	Muscle relaxant, soothing agent, astringent	Relaxing and calming
Lemon	Citrus	Energizing, uplifting	Antiseptic, soothing agent	Soothing energy levels
Black pepper	Spicy	Balancing, soothing	Muscle relaxant, aphrodisiac	Balancing people's emotions

Color

- ● **Colors can be defined into three dimensions:**

  - ➔ **Hue is the pigment of the color**

  - ➔ **Value is the degree of lightness or darkness of the color**

  - ➔ **Chroma refers to hue-intensity, saturation, or brilliance**

- ● **People are generally drawn to warm color environments**

  - ➔ **Warm colors encourage fast decision making and are good for low-involvement decisions or impulse buys**

  - ➔ **Cool colors are preferred for high-involvement decisions**

Common Associations and Human Responses to Colors

Color	Degree of Warmth	Nature Symbol	Common Association and Human Responses to Color
Red	Warm	Earth	High energy and passion; can excite and stimulate emotions, expressions, and warmth
Orange	Warmest	Sunset	Emotions, expressions, and warmth
Yellow	Warm	Sun	Optimism, clarity, intellect, and mood-enchancing
Green	Cool	Growth, grass and trees	Nurturing, healing and unconditional love
Blue	Coolest	Sky and Ocean	Relaxation, serenity and loyality
Indigo	Cool	Sunset	Mediation and spirituality
Violet	Cool	Violet flower	Spirituality, reduces stress, can create an inner feeling of calm

Signs, Symbols, and Artifacts

- **Communicates the firm's image and helps customers find their way**

  ➔ **First time customers will automatically try to draw meaning from the signs, symbols, and artifacts**

- **Challenge is to guide customer through the delivery process**

  ➔ **Unclear signals from a servicescape can result in anxiety and uncertainty about how to proceed and obtain the desired service**

Putting It All Together

Selection of Environmental Design Elements

- **Consumers perceive service environments holistically**
  - ➔ **No dimension of design can be optimized in isolation, because everything depends on everything else**
  - ➔ **Holistic characteristic of environments makes designing service environment an art**

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Tools to Guide Servicescape Design

- **Keen observation of customers' behavior and responses**

- **Feedback and ideas from frontline staff and customers**

- **Photo audit – Mystery Shopper to take photographs of service experience**

- **Field experiments can be used to manipulate specific dimensions in an environment and the effects observed**

- **Blueprinting or service mapping – extended to include physical evidence in the environment**

Summary

- **Service environment:**
  - ➔ **Shapes customers' experiences and behavior**
  - ➔ **Facilitates service encounters and enhances productivity**

- **Mehrabian-Russell stimulus-response model and Russell's model of affect help us understand customer responses to service environments**

- **Main dimensions of servicescape model:**
  - ➔ **Ambient conditions – music, scent, color, etc.**
  - ➔ **Spatial layout and functionality**
  - ➔ **Signs, symbols, and artifacts**

Summary

- **When putting it all together, firms should**

  ➔ **Design with a holistic view**

  ➔ **Design from a customer's perspective**

  ➔ **Use tools to guide servicescape design**

Chapter 12: Managing Customer Relationships & Building Loyalty

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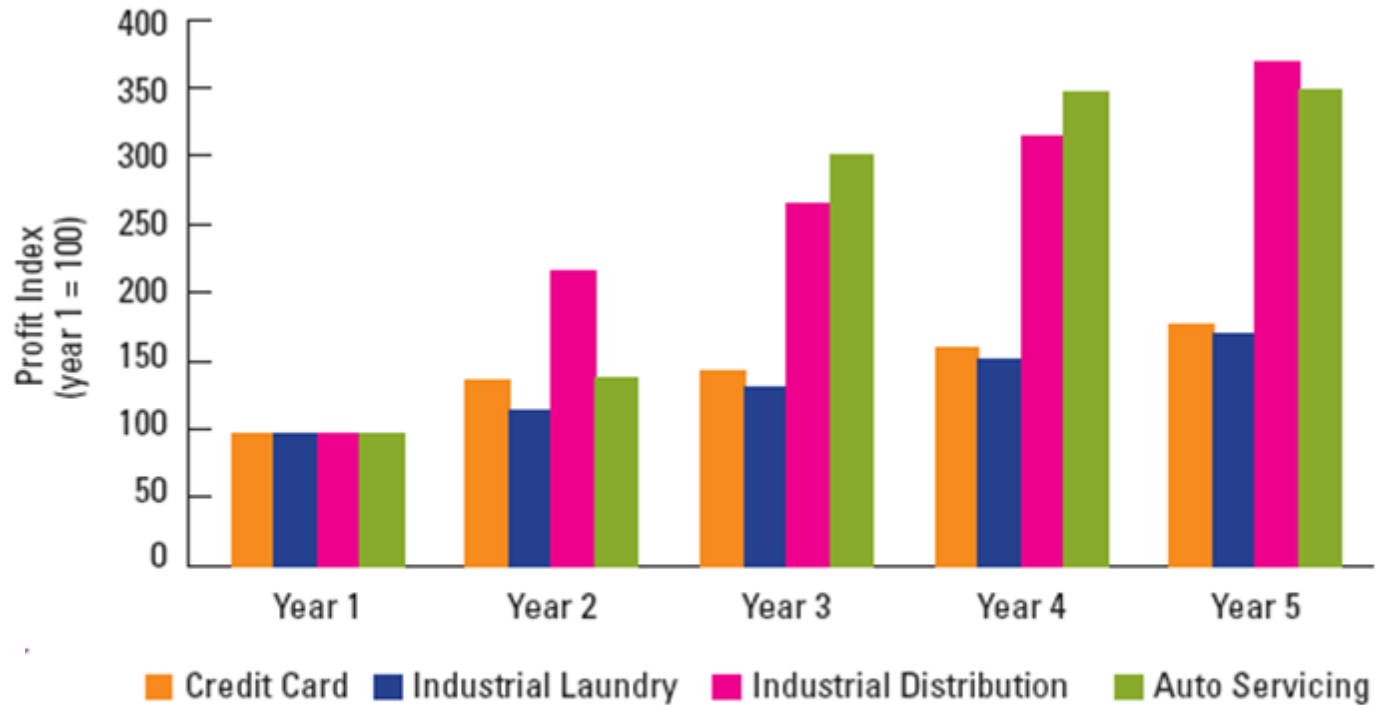
Overview of Chapter 12

- **The Search for Customer Loyalty**

- **Understanding the Customer-Firm Relationship**

- **The Wheel of Loyalty**

- **Building a Foundation for Loyalty**

- **Strategies for Building Loyalty Bonds with Customers and Reducing Customers' Defections**

- **CRM: Customer Relationship Management**

The Search for Customer Loyalty

How Much Profit a Customer Generates Over Time

Profit Index (year 1 = 100) for Credit Card, Industrial Laundry, Industrial Distribution, and Auto Servicing across Year 1 through Year 5.

SOURCE

Based on reanalysis of data from Reichheld, F.R., Sasser Jr., W.E., (1990). Zero defections: quality comes from services. *Harvard Business Review*, 68 (September–October), pp. 105–111.
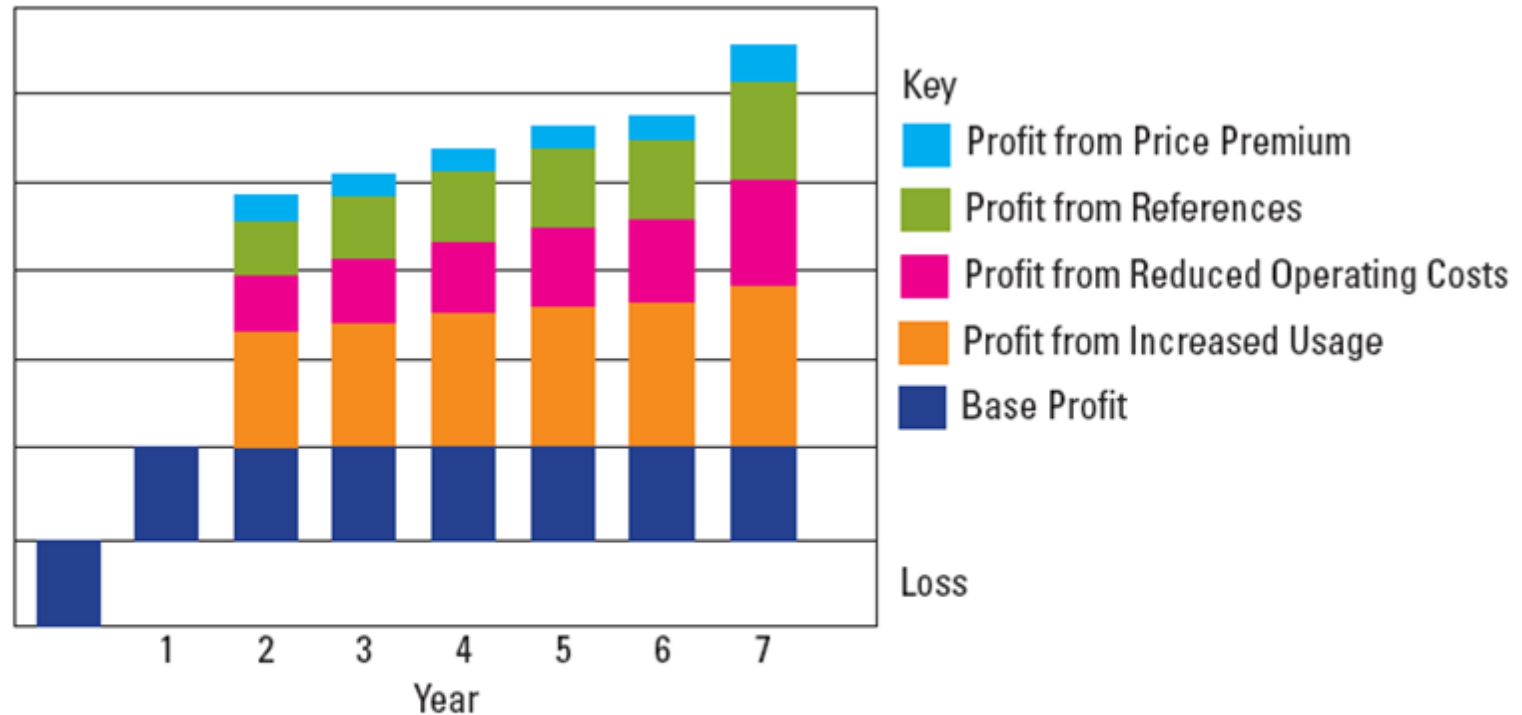
Why Customers Are More Profitable Over Time

Figure 12.3 Why customers become profitable over time.

Key
- Profit from Price Premium
- Profit from References
- Profit from Reduced Operating Costs
- Profit from Increased Usage
- Base Profit

SOURCE

Reprinted by permission of *Harvard Business Review*. From Zero defections: quality comes from services. By Reichheld, F.R. & Sasser Jr., W.E.(September-October), p.108. Copyright © 1990 by the Harvard Business School Publishing Corporation; all rights reserved.

Why is Customer Loyalty Important to a Firm's Profitability?

- **Customers become more profitable the longer they remain with a firm:**

  ➔ **Increased purchases and/or account balances**
  - Customers/families purchase in greater quantities as they grow

  ➔ **Reduced operating costs**
  - Fewer demands from suppliers and operating mistakes as customer becomes experienced

  ➔ **Referrals to other customers**
  - Positive word-of-mouth saves firm from investing money in sales and advertising

  ➔ **Price premiums**
  - Long-term customers willing to pay regular price
  - Willing to pay higher price during peak periods

Assessing the Value of a Loyal Customer

● **Must not assume that loyal customers are always more profitable than those making one-time transactions**

➔ **Costs**
  - Not all types of services incur heavy promotional expenditures to attract a new customer
  - Walk-in traffic more important at times

➔ **Revenue**
  - Large customers may expect price discounts in return for loyalty
  - Revenues don't necessarily increase with time for all types of customers

Assessing the Value of a Loyal Customer

- **Profit impact of a customer varies according to stage of service in product life cycle**

  ➔ **e.g., referrals and negative word-of-mouth have a higher impact in early stages**

- **Tasks:**

  ➔ **determine costs and revenues for customers from different market segments at different points in their customer lifecycles**

  ➔ **predict future profitability**

Measuring Customer Equity: Lifetime Value of Each Customer

- **Acquisition revenues less costs**

  ➔ **Revenues (application fee + initial purchase)**

  ➔ **Costs (marketing + credit check + account set up)**

- **Projected annual revenues and costs**

  ➔ **Revenues (annual fee + sales + service fees + value of referrals)**

  ➔ **Costs (account management + cost of sales + write-offs)**

Measuring Customer Equity: Lifetime Value of Each Customer

- **Value of referrals**

  ➔ Percentage of customers influenced by other customers

  ➔ Other marketing activities that drew the firm to an individual's attention

- **Net Present Value**

  ➔ Sum anticipated annual values (future profits)

  ➔ Suitably discounted each year into the future

Gap Between Actual and Potential Customer Value

- **What is current purchasing behavior of customers in each target segment?**

- **What would be impact on sales and profits if they:**
  - ➔ **buy all services offered by the firm,**
  - ➔ **use these to the exclusion of any purchases from competitors,**
  - ➔ **pay full price?**

- **How long, on average, do customers remain with firm?**

- **What impact would it have if they remained customers for life?**

Why are Customers Loyal? (Service Insights 12.1)

● **Customers stay loyal when we create value for them**

● **Value can be created for customers through:**

➔ **Confidence benefits**
  - Confidence in correct performance
  - Ability to trust the provider
  - Lower anxiety when purchasing
  - Knowing what to expect and receive

➔ **Social benefits**
  - Mutual recognition and friendship

➔ **Special treatment**
  - Better price
  - Discounts not available to most customers
  - Extra services
  - Higher priority when there is a wait

Understanding the Customer-Firm Relationship

Transactional Marketing

- **Transactional Marketing**

  ➔ **One transaction or a series of transactions does not necessarily constitute a relationship**

  ➔ **Requires mutual recognition and knowledge between the parties**

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Relationship Marketing

- **Marketing that creates extended relationships with customers**

- **Database Marketing:**

  → **Includes market transaction and information exchange**

  → **Technology is used to**
    - (1) Identify and build database of current and potential customers
    - (2) Deliver differentiated messages based on customers' characteristics
    - (3) Track each relationship to monitor cost of acquiring that customer and lifetime value of resulting purchases

Relationship Marketing

- **Interaction Marketing:**

  ➔ **Face-to-face interaction between customers and supplier's representatives**

  ➔ **Value is added by people and social processes**

  ➔ **Increasing use of technologies make maintaining relationships with customers a challenge**
     e.g., self service technology, interactive website, call centers

- **Network Marketing:**

  ➔ **Common in B2B context**

  ➔ **Companies commit resources to develop positions in a network**

Relationships with Customers

Type of Relationship Between the Service Organization and its Customers

Nature of Service Delivery	Membership Relationship	No Formal Relationship
Continuous	• Cable TV • Insurance Policy • College enrollment	• Radio Station • Police • Lighthouse
Discrete Transactions	• Subscriber phone • Theater subscription • Warranty repair	• Pay Phone • Movie Theatre • Public Transport

The Wheel of Loyalty

The Wheel of Loyalty

3. Reduce Churn Drivers

- Conduct churn diagnostic and monitor declining/churning customers.
- Address key churn drivers:
  - Proactive retention measures
  - Reactive retention measures (e.g., save teams)
- Put effective complaint handling and service recovery processes in place.
- Increase switching costs.

1. Build A Foundation For Loyalty

- Segment the market to match customer needs and firm capabilities.
- Be selective: Acquire customers who fit the core value proposition.
- Manage the customer base via effective tiering of service.
- Deliver quality service.

2. Create Loyalty Bonds

- Build higher-level bonds:
  - Social
  - Customization
  - Structural
- Give loyalty rewards:
  - Financial
  - Nonfinancial
  - Higher-tier service levels
  - Recognition and appreciation
- Deepen the relationship via:
  - Cross-selling
  - Bundling

CUSTOMER LOYALTY

Enabled through:

- Frontline staff
- Account managers
- Membership programs
- CRM Systems

Building a
Foundation for Loyalty

Targeting the Right Customers
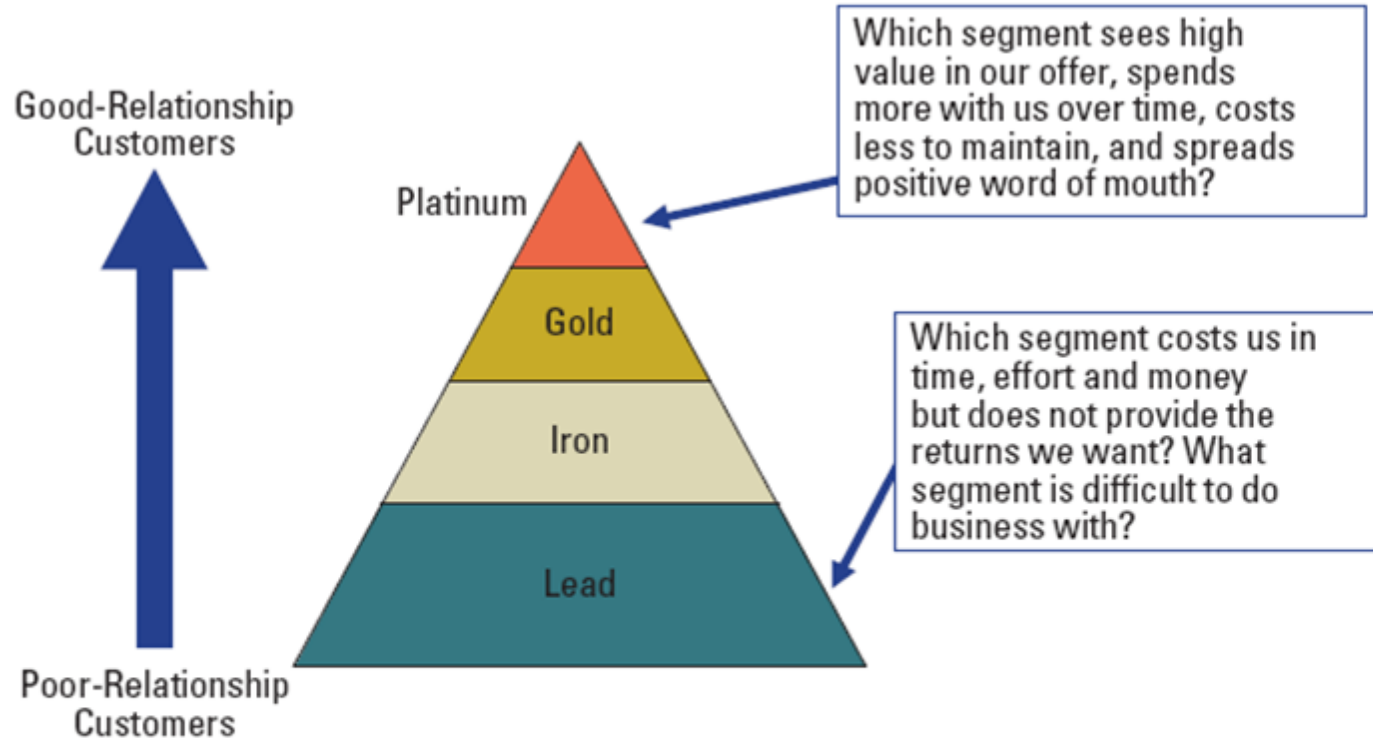
- **Target the right customer**

  ➔ How do customer needs relate to operations elements?

  ➔ How can service personnel meet expectations of different customers?

  ➔ Can company match or exceed competing services that are directed at same types of customers?

- **Focus on number of customers served and value of each customer**

  ➔ Some customers more profitable than others in the short term

  ➔ Others may have room for long-term growth

- **"Right customers" are not always high spenders**

  ➔ Can be a large group of people that no other supplier is serving well

Effective Tiering of Service
The Customer Pyramid

Good-Relationship Customers

Poor-Relationship Customers

Platinum

Gold

Iron

Lead

Which segment sees high value in our offer, spends more with us over time, costs less to maintain, and spreads positive word of mouth?

Which segment costs us in time, effort and money but does not provide the returns we want? What segment is difficult to do business with?

SOURCE

Zeithaml, V. A., Rust, R. T., & Lemon, K. N. (2001). The customer pyramid: Creating and serving profitable customers. *California Management Review*, 43(4), (Summer), pp. 118–142.

The Customer Satisfaction Loyalty Relationship

Strategies for Building Loyalty Bonds with Customers

Strategies for Developing Loyalty Bonds with Customers

- **Deepening the relationship**

  ➔ **Bundling/Cross-selling services makes switching a major effort that customer is unwilling to undertake**

  ➔ **Customers benefit from consolidating their purchasing of various services from the same provider**

  - *One-stop-shopping, potentially higher service levels*
  - *Higher service tiers, etc.*

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Strategies for Developing Loyalty Bonds with Customers

- **Reward Based Bonds: Incentives that offer rewards based on frequency of purchase, value of purchase, or combination of both**

  ➔ **Financial bonds**
    - Discounts on purchases, loyalty program rewards (e.g., frequent flyer miles), cash-back programs

  ➔ **Non-financial rewards**
    - Priority to loyalty program members for waitlists and queues in call centers; higher baggage allowances, priority upgrading

  ➔ **Intangible rewards**
    - Special recognition and appreciation, tiered loyalty programs

- **Reward-based loyalty programs are relatively easy to copy and rarely provide a sustained competitive advantage**

Strategies for Developing Loyalty Bonds with Customers

- **Social Bonds**

  ➔ Based on personal relationships between providers and customers

  ➔ Harder to build and imitate and thus, better chance of retention in the long term

- **Customization Bonds**

  ➔ Customized service for loyal customers
       e.g., Starbucks

  ➔ Customers may find it hard to adjust to another service provider who cannot customize service

Strategies for Developing Loyalty Bonds with Customers

- **Structural Bonds**

  - ➔ **Mostly seen in B2B settings**

  - ➔ **Align customers' way of doing things with supplier's own processes**
    - *Joint investments in projects and sharing of information, processes and equipment*

  - ➔ **Can be seen in B2C environment too**
    - *Airlines - SMS check-in, SMS e-mail alerts for flight arrival and departure times*

  - ➔ **Difficult for competition to draw customers away when they have integrated their way of doing things with existing supplier**

Strategies for Reducing Customer Defections

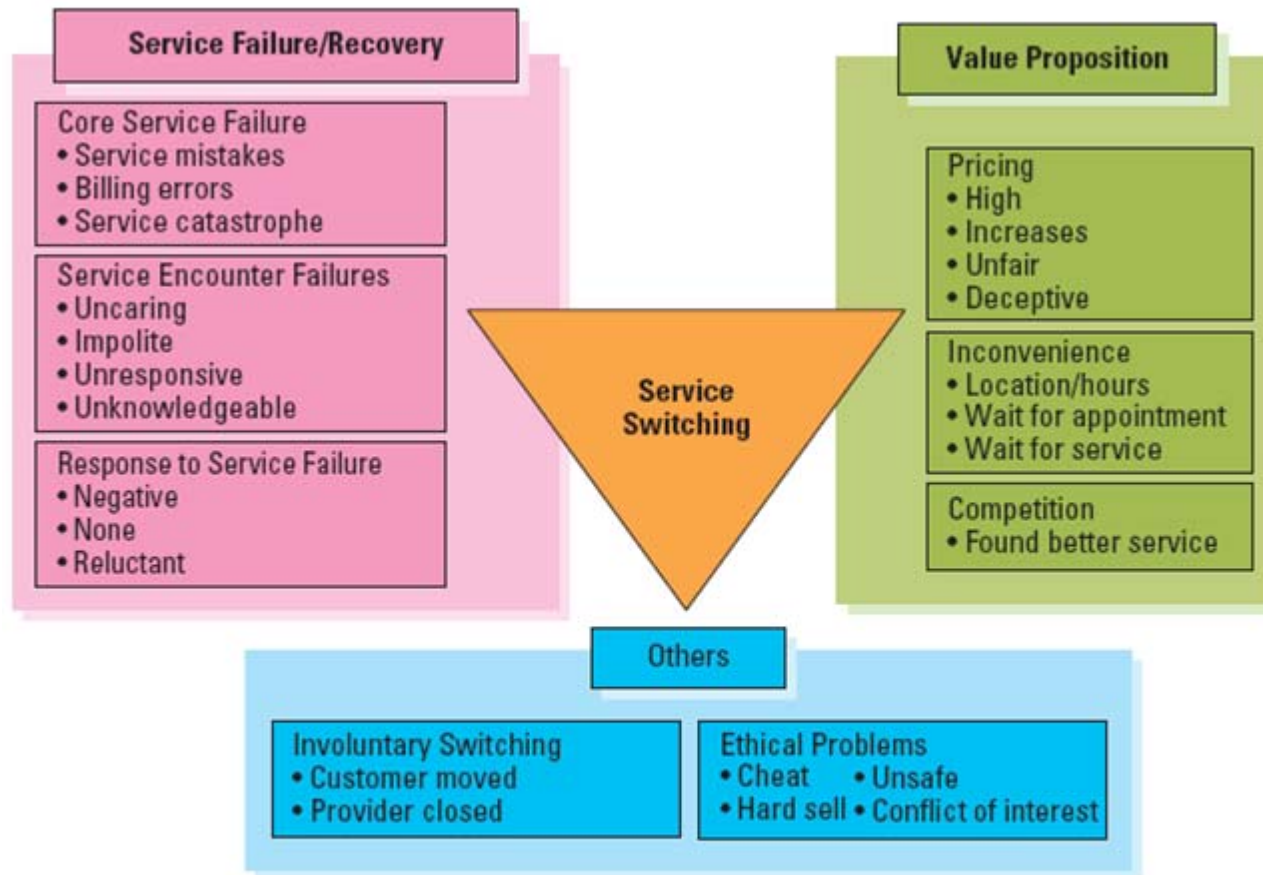# Analyze Customer Defections and Monitor Declining Accounts

- **Understand reasons for customer switching**

- **Churn Diagnostics**

  ➔ **Analysis of data warehouse information on churned and declining customers**

  ➔ **Exit interviews:**
    - Ask a short set of questions when customer cancels account; in-depth interviews of former customers by third party agency

  ➔ **Churn Alert Systems:**
    - Monitor activity in individual customer accounts to predict impending customer switching
    - Proactive detention efforts – send voucher, customer service representative calls customer

What Drives Customers to Switch?

Service Failure/Recovery

Core Service Failure
- Service mistakes
- Billing errors
- Service catastrophe

Service Encounter Failures
- Uncaring
- Impolite
- Unresponsive
- Unknowledgeable

Response to Service Failure
- Negative
- None
- Reluctant

Value Proposition

Pricing
- High
- Increases
- Unfair
- Deceptive

Inconvenience
- Location/hours
- Wait for appointment
- Wait for service

Competition
- Found better service

Service Switching

Others

Involuntary Switching
- Customer moved
- Provider closed

Ethical Problems
- Cheat • Unsafe
- Hard sell • Conflict of interest

SOURCE

Adapted from Keaveney, S. M. (1995). Customer switching behavior in service industries: An exploratory study, *Journal of Marketing*, 59(April), pp. 71–82.

Addressing Key Churn Drivers

● **Delivery quality**

● **Minimize inconvenience and non-monetary costs**

● **Fair and transparent pricing**

● **Industry specific drivers**

   ➔ Cellular phone industry: handset replacement a common reason for subscribers discontinuing services – offer proactive handset replacement programs

● **Reactive measures**

   ➔ Save teams

Other Ways to Reduce Churn

- **Implement Effective Complaint Handling and Service Recovery Procedures**

- **Increase Switching Costs**
  - ➔ **Natural switching costs**
    - *- e.g., Changing primary bank account – many related services tied to account*
  - ➔ **Can be created by instituting contractual penalties for switching**
    - *- Must be careful not to be perceived as holding customers hostage*
    - *- High switching barriers and poor service quality likely to generate negative attitudes and word of mouth*

CRM: Customer Relationship Management

Objectives of CRM Systems

- **Data collection**
  - ➔ Customer data such as contact details, demographics, purchasing history, service preferences

- **Data analysis**
  - ➔ Data captured is analyzed and categorized
  - ➔ Used to tier customer base and tailor service delivery accordingly

- **Sales force automation**
  - ➔ Sales leads, cross-sell and up-sell opportunities effectively identified and processed
  - ➔ Track and facilitate entire sales cycle

Objectives of CRM Systems

- **Marketing automation**

  ➔ Mining of customer data enables the firm to target its market

  ➔ Goal to achieve one-to-one marketing and cost savings

  ➔ Results in increasing the ROI on its marketing expenditure

  ➔ Enables the assessment of the effectiveness of marketing campaigns through the analysis of responses
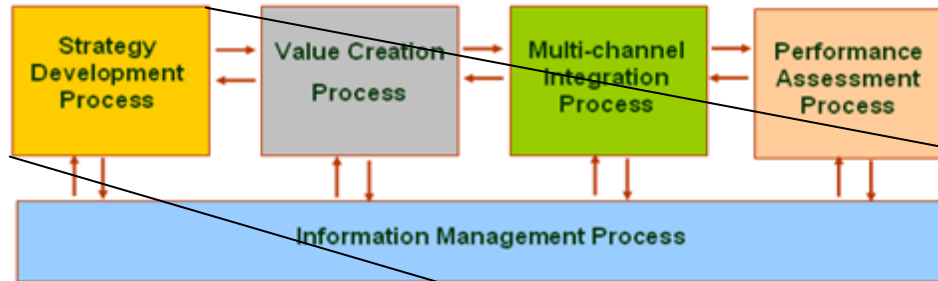
- **Call center automation**

  ➔ Call center staff have customer information at their fingertips resulting in improved service levels to customers.

  ➔ Caller ID and account numbers allow call centers to identify the customer tier the caller belongs to, and to tailor the service accordingly.

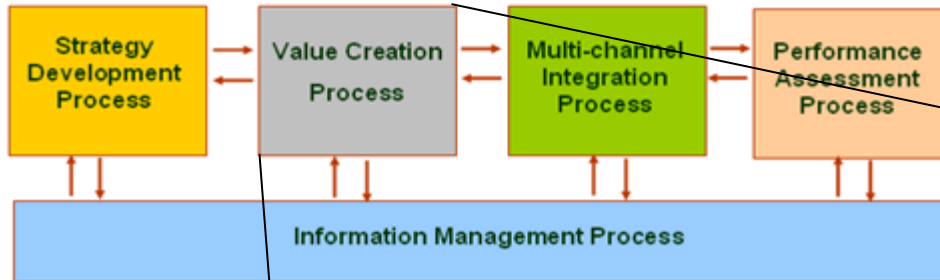# Integrated Framework for CRM Strategy

```
┌──────────────┐      ┌──────────────┐      ┌──────────────┐      ┌──────────────┐
│   Strategy   │ ───> │ Value Creation│ ───> │ Multi-channel │ ───> │ Performance  │
│ Development  │ <─── │    Process    │ <─── │  Integration  │ <─── │  Assessment  │
│   Process    │      │               │      │    Process    │      │   Process    │
└──────────────┘      └──────────────┘      └──────────────┘      └──────────────┘
```

Information Management Process

Source: Adapted from: Adrian Payne and Pennie Frow, "A Strategic Framework for Customer Relationship Management," *Journal of Marketing* 69 (October 2005): 167-176.

CRM: Strategy Development

- ● **Strategy Development**
    - ➔ **Responsibility of top management**
    - ➔ **Used to guide the development for the customer strategy**
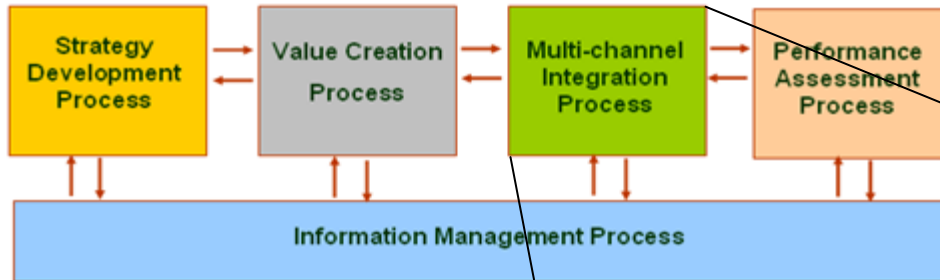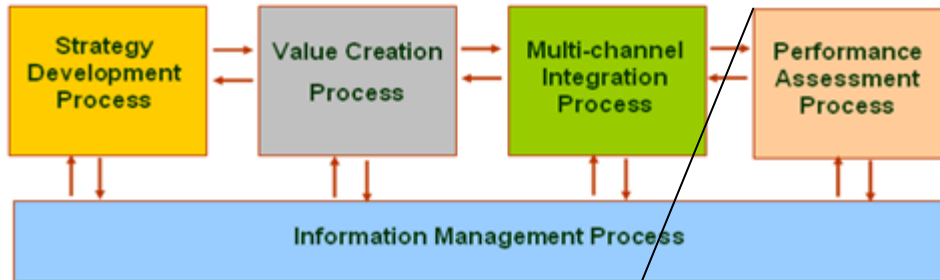   - ➔ **Assessment of business strategy**

CRM: Value Creation

```
[Strategy Development Process] → [Value Creation Process] → [Multi-channel Integration Process] → [Performance Assessment Process]
[Information Management Process]
```

- **Value Creation**

  ➔ **Translates business and customer strategies into specific value propositions for both customers and firm**

    - *Customers benefit from priority, tiered services, loyalty rewards, and customization*

    - *Company benefits from reduced customer acquisition and retention costs, and increased share-of-wallet*

  ➔ **Dual creation of value: customers need to participate in CRM to reap value from firm's CRM initiatives**

CRM: Multi-Channel Integration

- ● **Multi-Channel Integration**

  - ➔ **Serve customers well across many potential interfaces**

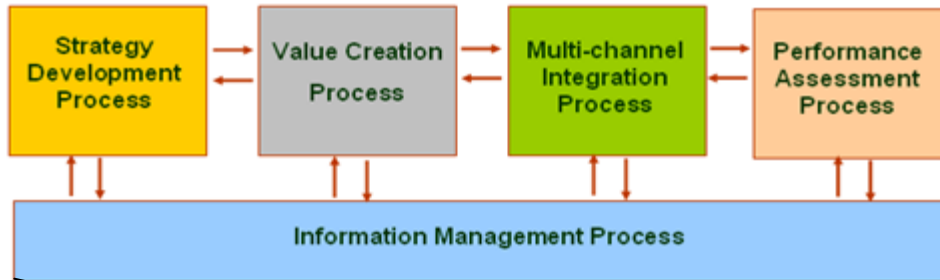 - ➔ **Offer a unified interface that delivers customization and personalization**
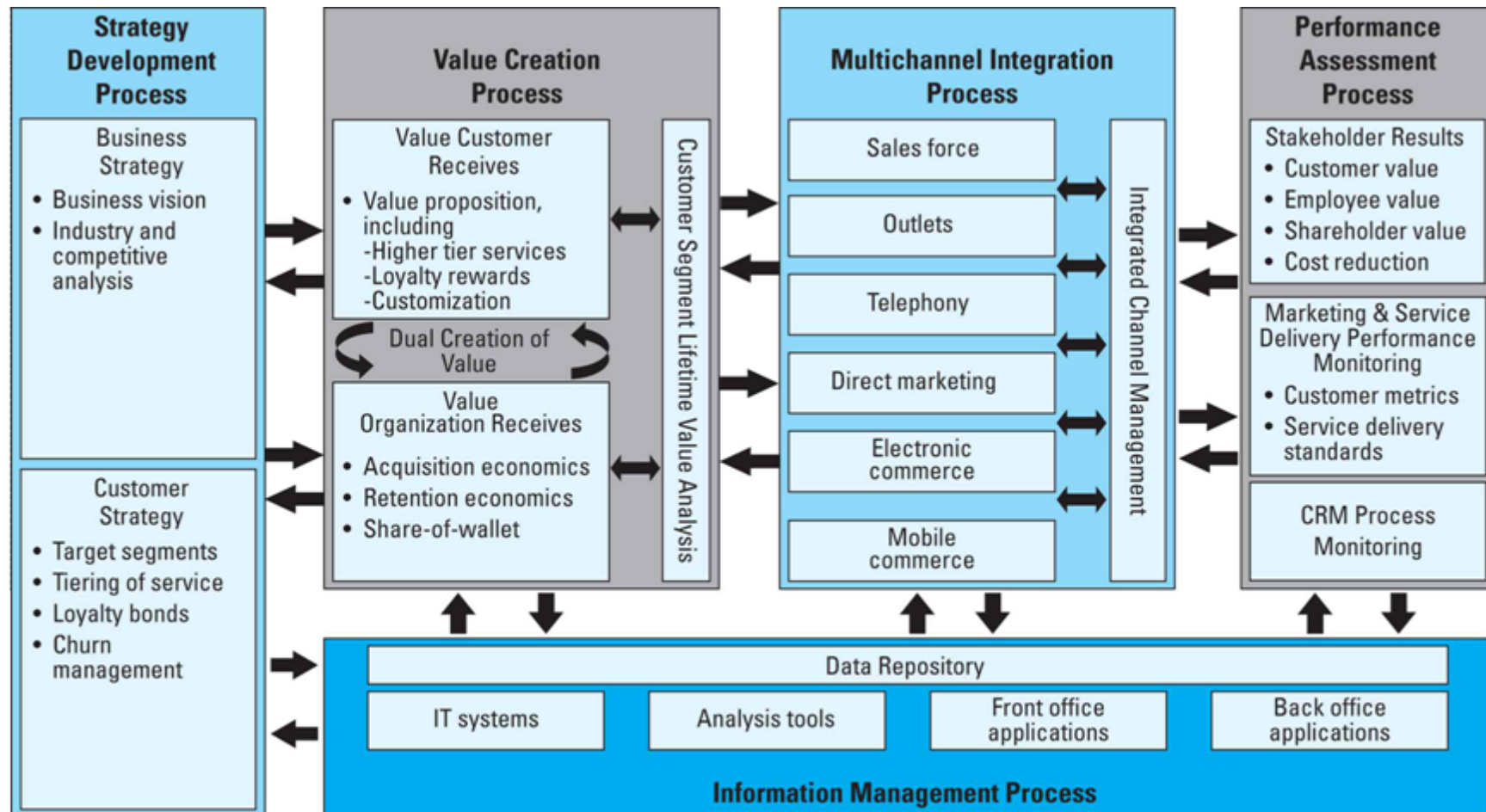
CRM: Performance Assessment

| Strategy Development Process | → | Value Creation Process | → | Multi-channel Integration Process | → | Performance Assessment Process |

Information Management Process

Performance Assessment

● **Is CRM system creating value for key stakeholders?**

● **Are marketing and service standard objectives being achieved?**

● **Is CRM system meeting performance standards?**

CRM: Information Management

Strategy Development Process → Value Creation Process → Multi-channel Integration Process → Performance Assessment Process

Information Management Process

- ● **Information Management**

  - ➔ **Collect customer information from all channels**

  - ➔ **Integrate it with other relevant information**

  - ➔ **Make useful information available to the frontline**

  - ➔ **Create and manage data repository, IT systems, analytical tools, specific application packages**

Integrated Framework for CRM Strategy

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Common Failures in CRM Implementation

- Service firms often equate installing CRM systems with having a customer relationship strategy

- Common reasons for failures

  ➔ Viewing CRM as a technology initiative

  ➔ Lack of customer focus

  ➔ Insufficient appreciation of customer lifetime value (CLV)

  ➔ Inadequate support from top management

  ➔ Failure to reengineer business processes

  ➔ Underestimating the challenges in date integration

Defining a CRM Strategy

- How should our value proposition change to increase customer loyalty?

- How much customization or one-to-one marketing and service delivery is appropriate and profitable?

- What is incremental profit potential of increasing share-of-wallet with current customers? How much does this vary by customer tier and/or segment?

- How much time and resources can we allocate to CRM right now?

- If we believe in customer relationship management, why haven't we taken more steps in that direction in the past?

- What can we do today to develop customer relationships without spending on technology?

Summary

- **Customer loyalty is an important driver of profitability so firms need to assess lifetime customer value and narrow gap between actual and potential value**

- **Building a foundation of loyalty involves**

  - **Good fit between customer needs and capabilities**

  - **Tiering services effectively**

  - **Obtaining customer satisfaction through service quality**

- **Customer loyalty bonds include**

  - **Reward-based, social, customization, and structural bonds**

  - **Created through membership and loyalty programs**

Summary

- **Strategies for reducing customer defections include**
  - ➔ **Analyzing customer defections and monitoring declining accounts**
  - ➔ **Addressing key churn drivers, increasing switching costs**
  - ➔ **Implementing effective complaint-handling and service recovery procedures**

- **A successful CRM program requires understanding of common failures while including the following processes**
  - ➔ **Strategy development process**
  - ➔ **Value creation process**
  - ➔ **Multichannel integration process**
  - ➔ **Performance assessment process**

Chapter 14: Improving Service Quality and Productivity

Overview of Chapter 14

- **Integrating Service Quality and Productivity Strategies**

- **What is Service Quality?**

- **The Gaps Model**

- **Measuring and improving service quality**

- **Learning from Customer Feedback**

- **Hard Measures of Service Quality**

- **Tools to Analyze and Address Service Quality Problems**

- **Defining and Measuring Quality**

- **Improving Service Productivity**

Integrating Service Quality and Productivity Strategies

Integrating Service Quality and Productivity Strategies

- **Quality and productivity create value for customers and companies**

- **Quality focuses on the benefits created for customers; productivity addresses financial costs incurred by firm**

- **Importance of productivity:**

  ➔ **Keep costs down to improve profits and/or reduce prices**

  ➔ **Enable firms to spend more on improving customer service and supplementary services**

  ➔ **Secure firm's future through increased spending on R&D**

  ➔ **May impact service experience**

What is Service Quality?

Different Perspectives of Service Quality

Transcendent:

- Quality = Excellence. Recognized only through experience

User-based:

- Quality lies in the eyes of the beholder

Value-based:

- Quality is a trade-off between price and value

Dimensions of Service Quality

Tangibles
- Appearance of physical elements

Reliability
- Dependable and accurate performance

Responsiveness
- Promptness; helpfulness

Assurance
- Competence, courtesy, credibility, security

Empathy
- Easy access, good communication, understanding of customer

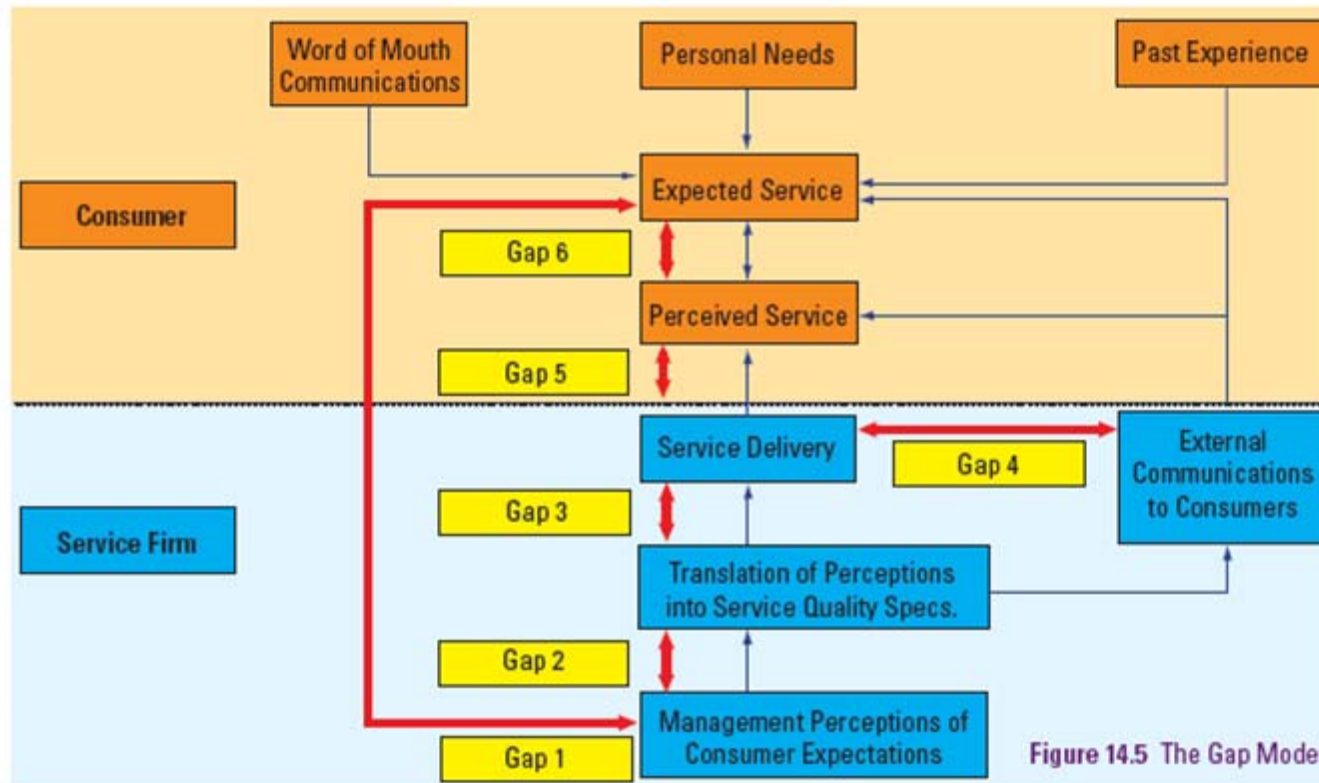# The Gaps Model

Six Service Quality Gaps

Figure 14.5 The Gap Model.

SOURCE

Adapted from the original 5-gaps model developed by Parasuraman, A., Zeithaml, V. A., & Berry, L. L. (1985). A conceptual model of service quality and its implications for future research. *Journal of Marketing* 49, (Fall), pp. 41–50; Zeithaml, V. A., Bitner, M. J., & Gremler, D. (2006). *Services Marketing: Integrating Customer Focus Across the Firm* (p. 46.). NY: McGraw Hill/Irwin. A further gap (Gap 5) was added by Christoper Lovelock (1994), *Product Plus* (p. 112). NY: McGraw Hill.

Suggestions for Closing the Six Service Quality Gaps

Types of Quality Gap	Proposed Solutions
Gap 1—The Knowledge Gap	*Educate Management About What Customers Expect* • Sharpen market research procedures, including questionnaire and interview design, sampling, and field implementation, and repeat research studies once in a while • Implement an effective customer feedback system that includes satisfaction research, complaint content analysis and customer panels • Increase interactions between customers and management • Facilitate and encourage communication between front-line employees and management

Gap 2—The Policy Gap	*Establish the Right Service Processes and Specify Standards*
	
	• Get the customer service processes right:
	  o Use a rigorous, systematic, and customer-centric process for designing and redesigning customer service processes.
	  o Standardize repetitive work tasks to ensure consistency and reliability by substituting hard technology for human contact and improving work methods (soft technology).
	
	• Develop tiered service products that meet customer expectations:
	  o Consider premium, standard and economy-level products to allow customers to self-segment according to their needs, or
	  o Offer customers different levels of service at different prices
	
	• Set, communicate and reinforce measurable customer-oriented service standards for all work units:
	  o Establish for each step in service delivery a set of clear service quality goals that are challenging, realistic and explicitly designed to meet customer expectations.
	  o Ensure that employees understand and accept goals, standards, and priorities

Types of Quality Gap	Proposed Solutions

Gap 3—The Delivery Gap	*Ensure that Performance Meets Standards and that Customers Understand the Quality Level Delivered*
	
	• Ensure that customer service teams are motivated and able to meet service standards:
	  o Improve recruitment with a focus on employee-job fit; select employees for the abilities and skills needed to perform their job well.
	  o Train employees on the technical and soft skills needed to perform their assigned tasks effectively, including interpersonal skills, especially for dealing with customers under stressful conditions.
	  o Clarify employee roles and ensure that employees understand how their jobs contribute to customer satisfaction; teach them about customer expectations, perceptions and problems.
	  o Build cross-functional service teams that can offer customer-centric service delivery and problem resolution.
	  o Empower managers and employees in the field by pushing decision-making power down the organization.
	  o Measure performance; provide regular feedback and reward customer service team performance as well as individual employees and managers on attaining quality goals.
	• Install the right technology, equipment, support processes and capacity:
	  o Select the most appropriate technologies and equipment for enhanced performance.
	  o Ensure that employees working on internal support jobs provide good service to their own internal customer, the front-line personnel.
	  o Balance demand against productive capacity.
	• Manage customers for service quality:
	  o Educate customers so that they can perform their roles and responsibilities in service delivery effectively.

Types of Quality Gap	Suggest Solutions

Gap 4—The Communications Gap	*Close the Internal Communications Gap by ensuring that Communications Promises are Realistic and Correctly understood by Customers*
	
	• Educate managers responsible for sales and marketing communications about operational capabilities:
	  o Seek inputs from front-line employees and operations personnel when new communications programs are being developed.
	  o Let service providers preview advertisements and other communications before customers are exposed to them.
	  o Get sales staff to involve operations staff in face-to-face meetings with customers.
	  o Develop internal educational and motivational advertising campaigns to strengthen understanding and integration among the marketing, operations, and human resource functions, and to standardize service delivery across different locations.
	• Ensure that communications content sets realistic customer expectations.
	• Be specific with promises and manage customers' understanding of communication content:
	  o Pretest all advertising, brochures, telephone scripts and web site content prior to external release to see if target audience interpret them as the firm intends (if not, revise and retest). Make sure that the advertising content reflects those service characteristics that are most important to customers. Let them know what is not possible and why.
	  o Identify and explain in real time the reasons for shortcomings in service performance, highlighting those that cannot be controlled by the firm.
	  o Document beforehand the tasks and performance guarantees that are included in an agreement or contract. After the completion of the work, explain what work was performed in relation to a specific billing statement.

Suggestions for Closing the Six Service Quality Gaps

Types of Quality Gap	Suggest Solutions

Gap 5—The Perception Gap	*Tangibilize and Communicate the Service Quality Delivered*
	• Make service quality tangible and communicate the service quality delivered:
	  o Develop service environments and physical evidence cues that are consistent with the level of service provided.
	  o For complex and credence services, keep customers informed during service delivery on what is being done, and give briefings after the delivery so that customers can appreciate the quality of service they received.
	  o Provide physical evidence (e.g. for repairs, show customers the damaged components that were removed).

Gap 6—The Service Gap	Close Gaps 1 to 5 to consistently meet Customer Expectations Gap 6 is the accumulated outcome of all the preceding gaps. It will be closed when Gaps 1 to 5 have been addressed.

Measuring and Improving Service Quality

Measures of Service Quality

Soft Measures

- Not easily observed, must be collected by talking to customers, employees or others

- Provide direction, guidance and feedback to employees on ways to achieve customer satisfaction

- Can be quantified by measuring customer perceptions and beliefs

- e.g., SERVQUAL, surveys, and customer advisory panel

Hard Measures

- Can be counted, timed, or measured through audits

- Typically operational processes or outcomes

- Standards often set with reference to percentage of occasions on which a particular measure is achieved

Learning from Customer Feedback

Key Objectives of Customer Feedback Systems

- **Assessment and benchmarking of service quality and performance**

- **Customer-driven learning and improvements**

- **Creating a customer-oriented service culture**

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Customer Feedback Collection Tools

Total market surveys	Post-transaction surveys	Ongoing customer surveys
Customer advisory panels	Employee surveys/panels	Focus groups
Mystery shopping		

Strengths and Weaknesses of Customer Feedback Collection Tools

COLLECTION TOOLS	LEVEL OF MEASUREMENT			ACTIONABLE	REPRESENTATIVE/ RELIABLE	POTENTIAL FOR SERVICE RECOVERY	FIRST HAND LEARNING	COST EFFECTIVENESS
	FIRM	PROCESS	TRANSACTION SPECIFIC					
Total Market Survey (Incl. Competitors)	●	○	○	○	●	○	○	○
Annual Survey on Overall Satisfaction	●	◐	○	○	●	○	○	○
Transactional Survey	●	●	◐	◐	●	○	○	○
Service Feedback Cards	◐	●	●	◐	◐	●	◐	●
Mystery Shopping	○	◐	●	●	○	○	◐	○
Unsolicited Feedback (e.g., complaints)	○	◐	●	●	○	●	◐	●
Focus Group Discussions	○	◐	●	●	○	◐	●	◐
Service Reviews	○	◐	●	●	○	●	●	◐

Analysis, Reporting, and Dissemination of Customer Feedback

- Relevant feedback tools and collecting customer feedback should be channeled back to the relevant parties to take action

- Three common types of performance reports:

  ➔ Monthly Service Performance Update

  ➔ Quarterly Service Performance Review

  ➔ Annual Service Performance Report

Hard Measures of Service Quality

Hard Measures of Service Quality

- **Service quality indexes**

  ➔ Embrace key activities that have an impact on customers

- **Control charts to monitor a single variable**

  ➔ Offer a simple method of displaying performance over time against specific quality standards

  ➔ Enable easy identification of trends

  ➔ Are only good if data on which they are based are accurate

- **FedEx: One of the first service companies to understand the need for an index of service quality that embraced all the key activities that affect customers**

Control Chart for Departure Delays

Flights Departing Within 15 Minutes of Schedule

Tools to Analyze and Address Service Quality Problems

Tools to Analyze and Address Service Quality Problems

- **Fishbone diagram**

  ➔ **Cause-and-effect diagram to identify potential causes of problems**

- **Pareto Chart**

  ➔ **Separating the trivial from the important. Often, a majority of problems are caused by a minority of causes (i.e., the 80/20 rule)**
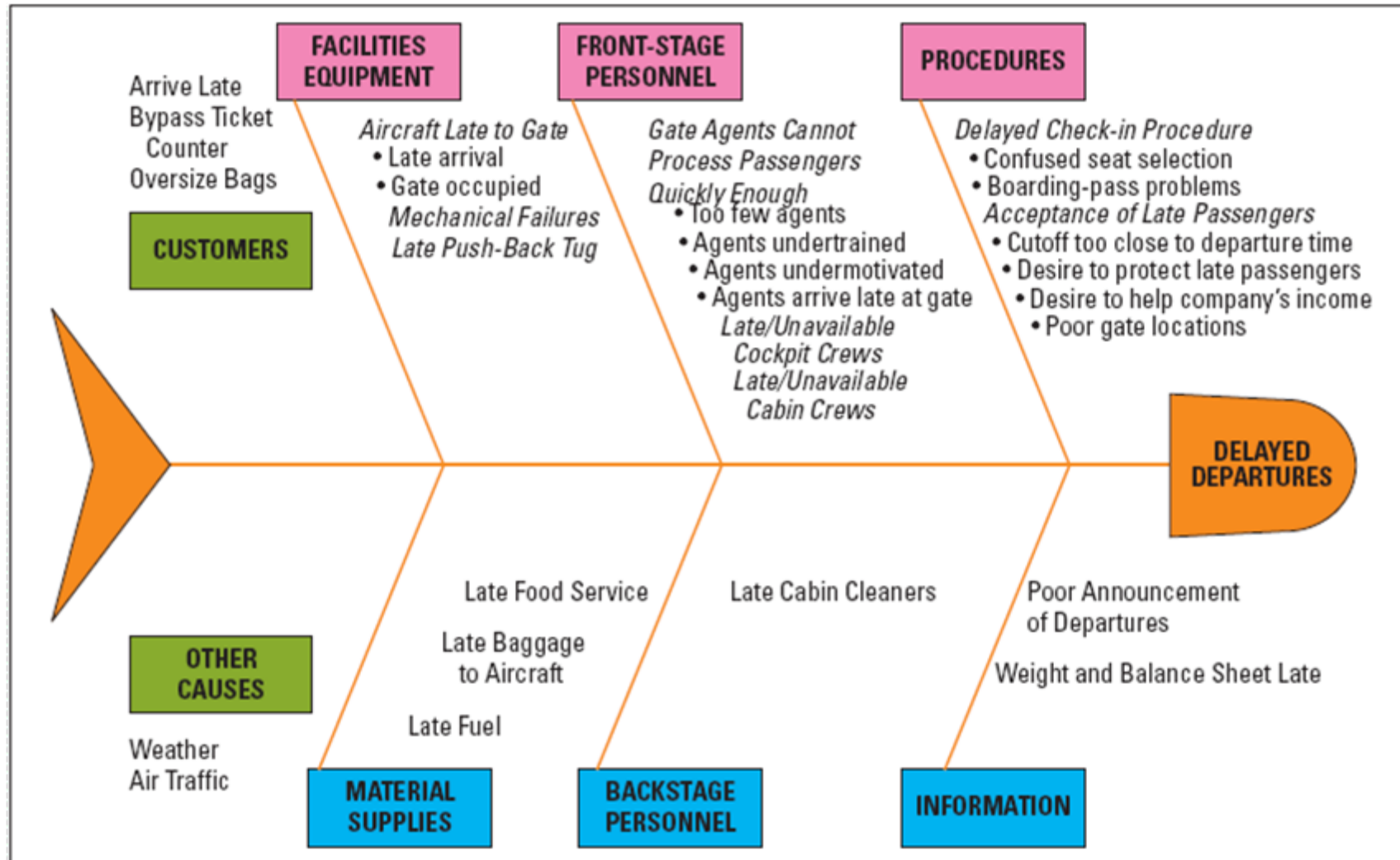
- **Blueprinting**

  ➔ **Visualization of service delivery, identifying points where failures are most likely to occur**

Cause-and-Effect Chart for Flight Departure Delays

CUSTOMERS

Arrive Late
Bypass Ticket Counter
Oversize Bags

FACILITIES EQUIPMENT

Aircraft Late to Gate
• Late arrival
• Gate occupied
Mechanical Failures
Late Push-Back Tug

FRONT-STAGE PERSONNEL

Gate Agents Cannot Process Passengers Quickly Enough
• Too few agents
• Agents undertrained
• Agents undermotivated
• Agents arrive late at gate
Late/Unavailable Cockpit Crews
Late/Unavailable Cabin Crews

PROCEDURES

Delayed Check-in Procedure
• Confused seat selection
• Boarding-pass problems
Acceptance of Late Passengers
• Cutoff too close to departure time
• Desire to protect late passengers
• Desire to help company's income
• Poor gate locations

DELAYED DEPARTURES

OTHER CAUSES

Weather
Air Traffic

MATERIAL SUPPLIES

Late Food Service

Late Baggage to Aircraft

Late Fuel

BACKSTAGE PERSONNEL

Late Cabin Cleaners

INFORMATION

Poor Announcement of Departures

Weight and Balance Sheet Late

Analysis of Causes of Flight Departure Delays

Newark
- 15.3%
- 23.1%
- 15.4%
- 23.1%
- 23.1%

All stations, excluding Chicago–Midway Hub
- 11.7%
- 8.7%
- 11.3%
- 53.3%
- 15%

Washington National
- 4.9%
- 19%
- 33.3%
- 9.5%
- 33.3%

Key
- Late Passengers
- Waiting for Pushback
- Waiting for Fueling
- Late Weight and Balance Sheet
- Late Cabin Cleaning/Supplies
- Other

Blueprinting

- **Depicts sequence of front-stage interactions experienced by customers plus supporting backstage activities**

- **Used to identify potential fail points**

  ➔ **where failures are most likely to appear**

- **Shows how failures at one point can have a ripple effect**

- **Managers can identify points which need urgent attention**

  ➔ **Important first step in preventing service quality problems**

Return On Quality (ROQ)

- **Assess costs and benefits of quality initiatives**

  ➔ **ROQ approach is based on four assumptions:**
    - *quality is an investment*
    - *quality efforts must be financially accountable*
    - *it's possible to spend too much on quality*
    - *not all quality expenditures are equally valid*

  ➔ **Implication: Quality improvement efforts may benefit from being related to productivity improvement programs**
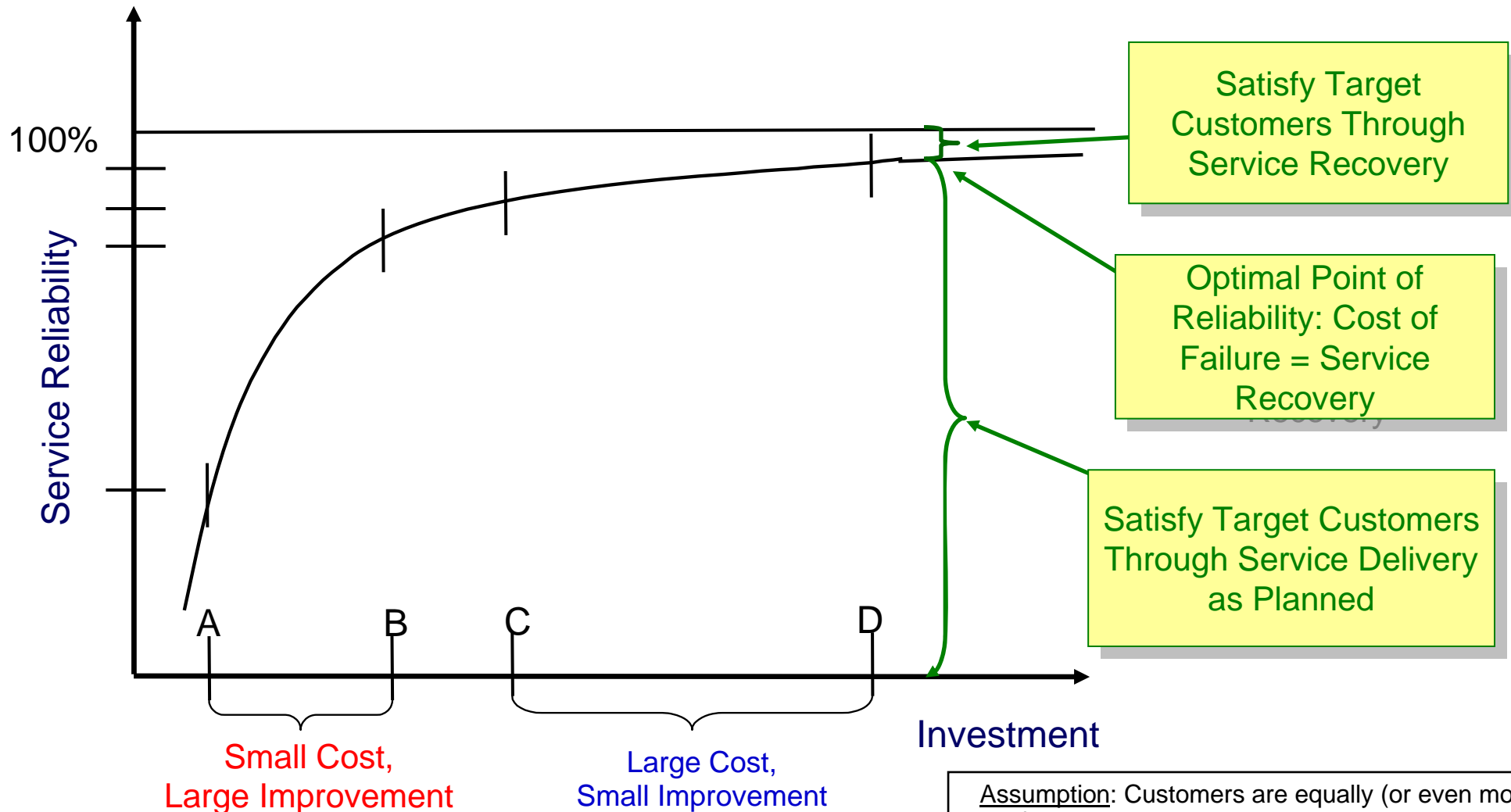
  ➔ **To determine feasibility of new quality improvement efforts, determine costs and then relate to anticipated customer response**

- **Determine optimal level of reliability**

  ➔ **Diminishing returns set in as improvements require higher investments**

  ➔ **Know when improving service reliability becomes uneconomical**

When Does Improving Service Reliability Become Uneconomical?

Y-axis: Service Reliability (100%)
X-axis: Investment

Points along x-axis: A, B, C, D

Satisfy Target Customers Through Service Recovery

Optimal Point of Reliability: Cost of Failure = Service Recovery

Satisfy Target Customers Through Service Delivery as Planned

Small Cost, Large Improvement

Large Cost, Small Improvement

Assumption: Customers are equally (or even more) satisfied with the service recovery than with a service that is delivered as planned.

Productivity in a Service Context

- **Productivity: amount of output produced relative to amount of inputs**

    ➔ **Improvement in productivity means an improvement in the ratio of outputs to inputs.**

- **Intangible nature of service makes it hard to measure productivity of service firms, especially for information-based services**

    ➔ **Both input and output are hard to define**

    ➔ **Relatively simpler in possession-processing services, as compared to information- and people-processing services**

Service Efficiency, Productivity, and Effectiveness

- **Efficiency: involves comparison to a standard, usually time-based (e.g., how long employee takes to perform specific task)**

  ➔ **Focus on inputs rather than outcomes and may ignore variations in service quality/value**

- **Productivity: involves financial valuation of outputs to inputs**

  ➔ **Consistent delivery of outcomes desired by customers should command higher prices**

- **Effectiveness: degree to which firm meets goals**

  ➔ **Cannot divorce productivity from quality and customer satisfaction**

Improving Service Productivity

Generic Productivity Improvement Strategies

- **Typical strategies to improve service productivity:**

  - ➔ Careful control of costs

  - ➔ Efforts to reduce wasteful use of materials or labor

  - ➔ Matching productive capacity to average demand levels

  - ➔ Replacing workers by automated machines or self-service technologies

  - ➔ Teaching employees how to work more productively

  - ➔ Broadening variety of tasks that service worker can perform

  - ➔ Installing expert systems that allow paraprofessionals to take on work previously performed by professionals

- **Although improving productivity can be approached incrementally, major gains often require redesigning entire processes**

Customer-Driven Strategies to Improve Productivity

- **Change timing of customer demand**
  - ➔ By shifting demand away from peaks, managers can make better use of firm's productive assets and provide better service

- **Involve customers more in production**
  - ➔ Get customers to self-serve
  - ➔ Encourage customers to obtain information and buy from firm's corporate websites

- **Ask customers to use third parties**
  - ➔ Delegate delivery of supplementary service elements to intermediary organizations

Implications of Backstage and Front-Stage Changes for Customers

- **Backstage changes may impact customers**
  - ➔ **Keep track of proposed backstage changes, and prepare customers for them**
    - *e.g., new printing peripherals may affect appearance of bank statements*

- **Front-stage productivity enhancements are especially visible in high contact services**
  - ➔ **Some improvements only require passive acceptance, while others require customers to change behavior**
  - ➔ **Must consider impact on customers and address customer resistance to changes**

A Note of Caution on Mere Cost Reduction Strategies

- Without new technology, firms improve service productivity by eliminating waste and reducing labor costs

- Multitasking can reduce productivity

- Excessive pressure breeds discontent and frustration among customer contact personnel

- It is often better to search for service process redesign opportunities that lead to quantum leaps in improvements in productivity and service quality at the same time

Summary

- Service quality has five key dimensions: Tangibles, Reliability, Responsiveness, Competence, Courtesy

- GAPS model can be used to diagnose and address service quality problems:
  - 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

- Customer feedback systems are used to:
  - Assess and benchmark service quality and performance
  - Institutionalize customer-driven learning and improvements
  - Create a customer-oriented service culture

Summary

- **Efficiency, productivity, and effectiveness need to be distinguished when measuring service quality**

- **Customer-driven approaches to improving productivity include**
  - ➔ **Changing timing of customer demand**
  - ➔ **Involving customers more in production**
  - ➔ **Asking customers to use third parties**
  - ➔ **Use cost-reduction strategies with caution if they are not driven by new technology or process redesign - they may reduce service quality!**

Appendix

SERVQUAL

- **Survey research instrument based on premise that customers evaluate firm's service quality by comparing:**

  - ➔ their perceptions of service quality actually received with
  - ➔ their prior expectations of companies in a particular industry
  - ➔ Poor Quality: Perceived performance ratings < expectations
  - ➔ Good Quality: Perceived performance ratings > expectations

- **Developed primarily in context of face-to-face service encounters**

- **Scale contains 22 items reflecting five dimensions of service quality**

- **Scale may have to be customized to the research context as recent research suggests that it is not generalizable**

Tools to Analyze and Address Service Quality Problems

- **Total Quality Management (TQM)**

- **ISO 9000**
  - ➔ Comprises requirements, definitions, guidelines, and related standards to provide an independent assessment and certification of a firm's quality management system

- **Malcolm Baldrige Model Applied to Services**
  - ➔ To promote best practices in quality management, and recognizing, and publicizing quality achievements among U.S. firms
  - ➔ Many countries around the world have adapted the Malcolm Baldrige Model

- **Six Sigma & Lean Six Sigma**
  - ➔ Statistically, only 3.4 defects per million opportunities (1/294,000)
  - ➔ Has evolved from defect-reduction approach to an overall business-improvement approach