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Services Marketing

Maria Johann

Warsaw School of Economics
JUNE 2015

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87-800 Włocławek, ul. Toruńska 148

tel. 54 423 20 40, fax 54 423 20 80

e-mail: agencja.top@agencjatop.pl

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Preface

Services dominate today's world economy as a result of the considerable growth of the service sector over the last decades. The countries' economies depend nowadays on service industry, which contributes to a large extent to the national wealth and has become an important source of employment. Growing number of services has intensified competition among companies, which have to employ new strategies and tactics to respond to customers' changing needs and expectations. Services have come to be perceived as an important source of differentiation and a way of gaining competitive advantage in the market. Even manufacturers are turning to service aspects of their operations to build brand preference and increase market share. As a consequence of the emergence of service economy, profound knowledge and skills in marketing and managing services have become crucial for a business success of a company.

This book provides with a framework for understanding services marketing and is primarily designed for undergraduates, however, it is also recommended to students at any level of study who wish to expand their knowledge in the field of services marketing. Managers might also find concepts and analytical procedures described in this book helpful to overcome challenges they face and improve service performance. The text provides with knowledge about all aspects of the development of services marketing strategy and explains how to create the customer-focused services culture within a company. The book is divided into 10 chapters covering the material required for the services marketing course.

Chapter 1 presents an overview of the importance of the services sector to the global economy and provides an introduction to the services marketing. The nature of services is discussed with regards to services distinctive characteristics, their marketing implications and possible marketing responses. Service consumption model and the expanded marketing mix for services are also described in this chapter.

Chapter 2 focuses on marketing strategy formulation process. All steps involved in marketing strategy formulation process are described there, including firm and market analysis, segmentation process, target marketing, positioning, and marketing mix development. This chapter is crucial to acquire skills and knowledge necessary to develop a marketing strategy for services while the subsequent chapters present the components of the marketing mix.

Chapter 3 outlines the process of planning and creating service products with the emphasis put on the role of facilitating and enhancing supplementary services in creating value for customers. Different branding strategies for service products are described there, as well as main categories of new service developments are thoroughly discussed.

Chapter 4 describes a service delivery process and tools used to design new services and redesign existing ones. The importance of cooperation between marketers and operations managers is discussed in a context of enhancing customers' experience and increasing efficiency. Participation of customers in a service process, their impact on the service performance, and methods used to manage customers are also discussed in this chapter.

Chapter 5 discusses considerations of service pricing and presents three main foundations underlying pricing strategy: cost-based pricing, value-based pricing and competition-based pricing. Pricing strategies which communicate value to customers are discussed in this chapter; also the concept of revenue management, which aims at maximizing revenue through price adaptation, is explained in detail.

Chapter 6 considers the nature of service distribution and its marketing implications. Major distribution decisions are discussed with regards to place, time, and channels. The characteristics of different types of intermediaries are presented, especially in the context of benefits and challenges of various channels alternatives. Additionally, the implications of delivering through both physical and electronic channels are discussed.

Chapter 7 focuses on communication issues as they relate to service companies. Services communications challenges are discussed with regards to the nature of service products. The process of developing communications strategy is thoroughly described as well as main elements of the marketing communications mix. It is emphasized that building a strong brand identity requires integrated approach to communications strategy.

Chapter 8 discusses the role of physical evidence as an important component of the services marketing mix and its impact on consumer behavior. Two models developed by environmental psychologists explaining how consumers respond to service environments are presented in this chapter as well as dimensions of service environment. The holistic approach to servicescape design is highly recommended.

Chapter 9 presents an overview of the importance of frontline employees in services marketing. It is argued that human resources management should be closely linked to marketing management, since personnel has an impact on customer experience. The benefits of service oriented business strategy are described in this chapter, as well as the impact of employee satisfaction on customer satisfaction.

Chapter 10 considers factors crucial for building a customer-focused service company. The concepts of service quality and customer satisfaction are discussed. The measures of service quality are described and the role of customer satisfaction surveys is explained. Additionally, the importance of developing customer relationships is emphasized and the methods used to increase customer loyalty are outlined.

I hope that you will find this book and the services marketing course enjoyable, interesting, and helpful in extending your knowledge in services marketing and beneficial to your work and your career in services.

Maria Johann
Warsaw School of Economics

CHAPTER 1

Introduction to Services Marketing

Learning objectives

After reading this chapter, you should be able to:

- Understand the importance of the service sector in the global economy.
- Identify and describe the differences between goods and services.
- Be familiar with the characteristics of services and their implications for marketing.
- Understand the service consumption process and customer behavior in services.
- Identify and describe the components of the services marketing mix.

1.1 Services Sector in the Global Economy

The size of the service sector is increasing in many countries around the world. Most developed and emerging countries experience the growth of many service industries, which contribute considerably to the national economies. The service sector accounts for two-thirds of the value of the GDP globally, and it is an important source of employment and exports for many countries. Table 1.1 shows the relative size of the service sector in selected countries as a percentage of GDP. In the European Union, United States, and other developed countries service sector contributed to more than 70 percent of their GDPs. The same figures are recorded for employment in service sector. Moreover, employment is predicted to continue shrinking in manufacturing and agriculture while new jobs are expected to be created in many service industries. Knowledge-based industries such as professional and business services, healthcare, and education are considered to be the fastest growing service industries in the world¹. However, other service industries like travel, tourism, and hospitality have also considerable growth potential and have become the main industries in many developing countries. The growth of the service sector is not merely due to development of traditional services industries such as leisure and hospitality, healthcare and education, financial and insurance industries, professional and business services. Nowadays, many manufacturers are turning to the service aspects of their operations in order to gain competitive advantage in the market as well as generate additional revenue for their companies. They emphasize the service elements of their market offering such as extended warranties, low interest financing, free insurance, customer service, free shipping, and others².

¹ Ch. Lovelock, J. Wirtz, *Services Marketing. People, Technology, Strategy*, Prentice Hall, 7th edn., 2011, pp. 5-7.

² K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *Services Marketing: Concepts, Strategies and Cases*, South-Western Cengage Learning, 2009, pp. 4-5.

Table. 1.1. Estimated size of main sectors in selected countries as a percentage of GDP

	Agriculture	Industry	Services
World	6,0	30.9	63.2
European Union	1.8	25,0	73.1
The United States	1.1	22.1	76.8
China	10.2	46.9	43.0
Japan	1.4	24.9	73.8
Saudi Arabia	2.6	61.8	35.7
Nigeria	31.9	32.9	35.2

Source: *World Economic Outlook Database*, International Monetary Fund, 2011, *The World Factbook*, Central Intelligence Agency, www.cia.gov. Data for 2010.

The importance of the service sector in national economies is unquestionable. Moreover, as a consequence of the rapid development of service industry, world economy is experiencing a substantial change in its history causing many far-reaching effects. New service era is characterized by the dominance of service jobs, which require professional knowledge as well as new skills and qualifications, especially in the area of customer service. Traditional blue-collar work has been gradually replaced by professional, managerial, and administrative work performed in offices and service outlets. Since the frontline personnel is crucial for service performance and has a remarkable impact on customer satisfaction, employees started to be treated as a valuable asset for a company. Therefore, more emphasis has been put on suitable human resources policies including training and empowering staff. Other changes related to the development of service economy include application of new technologies that stimulate service products innovations and facilitate the provision of services as well as application of new systems such as customer relationship management and service quality information system in order to increase service quality and customer satisfaction.

1.2 The Nature of Services

The increasing interest in services sector has drawn the considerable attention to the discussions over what constitutes a service and whether services marketing is a distinctive subject to study. Many authors developed definitions of a service; however, given the diversity of services, it is hard to find any consistent definition which could be applied to all services. Most definitions focus on the fact that a service is intangible in nature and does not result in the ownership of anything.

According to A. Payne “a service is an activity which has some element of intangibility associated with it, which involves some interaction with customers or with property in their possession, and does not result in a transfer of ownership. A change in condition may occur and production of the service may or may not be closely associated with a physical product”³.

Ch. Lovelock and J. Wirtz stated that “services are economic activities offered by one party to another. Often time-based, performances bring about desired results to recipients, objects, or other assets for which purchasers have responsibility. In exchange for money, time, and effort,

³ A. Payne, *The Essence of Services Marketing*, Prentice Hall, 1993, p .6.

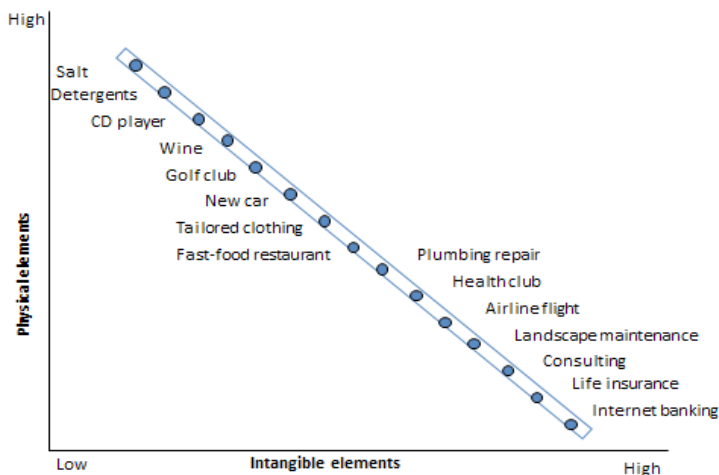
service customers expect value from access to goods, labor, professional skills, facilities, networks, and systems; but they do not normally take ownership of any of the physical elements involved⁴.

P. Kotler suggested that "a service is an activity or benefit that one party can offer to another that is essentially intangible and does not result in the ownership of anything. Its production may or may not be tied to a physical product". He has identified four categories of offer, varying from a 'pure' good to a 'pure service'⁵:

- a pure tangible good such as soap, sugar, tea,
- a tangible good with accompanying services like computers,
- a service with accompanying minor goods or services such as airline travel,
- a pure service like baby-sitting.

In practice, it can be very difficult to distinguish services from goods. A good is frequently purchased with some service component. Similarly, a service is augmented by tangible evidence added to the service. Thus, instead of analyzing product in terms of its subcategories, the more relevant concept is to consider "the offer" proposed to the customer, which might be either a good, a service or, in most circumstances, combination of both. An illustration of products depending upon the level of intangibility is shown in Figure 1.1. The concept of a continuum, ranging from tangible-dominant to intangible-dominant was first suggested by L. Shostack.

Figure 1.1 A continuum of products based on their intangibility



Source: G. Lynn Shostack, *Breaking Free from Product Marketing*, Journal of Marketing, April 1977.

Services have a number of distinctive characteristics which differentiate them from goods and have a number of important marketing implications. The four characteristics of services are: intangibility, inseparability, heterogeneity, and perishability⁶.

⁴ Ch. Lovelock, J. Wirtz, op.cit., p. 15.

⁵ P. Kotler, *Marketing Management: Analysis, Planning and Control*, Prentice Hall, Englewood Cliffs, 7th edn, 1991.

⁶ A. Palmer, *Principles of Services Marketing*, McGraw-Hill Book Company Europe, 1994, pp. 3-7.

Intangibility. To a large extent services cannot be experienced by physical senses. They cannot be seen, tasted, felt, or touched like tangible goods. In fact, many services are difficult to be examined before they are purchased. The lack of physical evidence increases the level of uncertainty when the customer is choosing among competing services. In some cases, even after the service has been delivered, the customer might not fully understand the service performance (e.g., diagnosis, treatment).

Inseparability. Whereas most goods are produced first, then sold and consumed, most services are sold first and then produced and consumed at the same time. In many cases customers are present when the service is being produced, so the producer and customers interact with each other during the service production process. This means that the service producers play an important role in the service experience for the customer (e.g., teaching, consulting).

Heterogeneity. Unlike tangible goods, services are highly variable. This is because services are performances, frequently produced by the service personnel, which means that the performed services will not be precisely alike. Thus, the variability of services might result in different levels of service quality. Another problem is that customers are usually involved in the service production process, so it can be difficult to carry out monitoring and control to ensure consistent standards (e.g., hairdressing, baby-sitting).

Perishability. Services differ from goods, as they cannot be saved, stored, resold, or returned. This is in contrast to goods that can be stored in inventory, resold, or returned if the customer is unhappy. An airline that offers the seats on a given flight, cannot sell those seats after the plane has left. Similarly, a hotel that offers rooms at a scheduled date, cannot sell them after that. Thus, the perishability of services results in a greater attention paid to the demand forecasting and capacity utilization.

Table 1.1 Implications of service characteristics and suggested marketing responses

Services characteristics	Implications	Responses
Intangibility	Difficulties with assessing quality Increased level of uncertainty Perceived high level of risk	Adding physical evidence Developing strong brands Facilitating recommendation Stressing tangible elements in advertising
Inseparability	Production process affects the service outcome Employees affect the service outcome Customers affect each other	Monitoring and controlling the service production process Management of consumer-producer interaction Precisely defining target market
Heterogeneity	Different levels of service quality Employees affect the service quality	Quality control procedures Selecting, training, motivating and controlling service personnel
Perishability	Services cannot be stored, resold, and returned	Management of demand Promotion and price policies

Source: Summarized from A. Palmer, *Principles of Services Marketing*, McGraw-Hill Company Book Company Europe, 1994, pp. 3-7.

Services tend to exhibit four described characteristics, yet any specific service displays a different combination of each of these factors. For example, a fast-food service is standardized, possesses tangible elements and is perishable. On the other hand, financial services are much less tangible, highly varied and can be performed away from the customer. An understanding of the degree to which a given service possesses any of the distinguished characteristics is crucial for identifying challenges and designing marketing programs. A service which is properly analyzed in terms of its characteristics and whose benefits are accurately assessed might be an important source of competitive advantage⁷.

1.3 Consumer Behavior in Services

The primary objective of marketers is to develop and provide offerings that satisfy consumer needs and expectations, thereby achieving organizational goals. To meet this objective service marketing managers need to understand how people make buying decisions and what determines their satisfaction. Undoubtedly, it is more difficult for customers to evaluate and choose services than goods, because services are intangible in nature and consumption is often intertwined with the production process. Specific features of services lead to some differences in consumer evaluation process for goods and services in all stages of the buying process⁸. Service consumption can be divided into three main stages: pre-purchase, service encounter, and post-encounter⁹.

Prepurchase stage. This stage begins with the identification of one's need and continues through information search, evaluation of alternatives to purchase decision. The decision to buy a service is triggered by a person's need or need arousal. Once a need is recognized, people usually start to look for information, what helps them better evaluate possible alternatives. While searching for information, they may rely on their past experience or use external sources such as advertising, online searches, and recommendations from service personnel, friends, and family. Then consumers select among acceptable options and decide whether to buy or not a particular service. When faced with several alternatives, customers compare different service offerings, basing on their attributes.

- **Search attributes** are tangible characteristics that a consumer can determine before buying a product. Search qualities include style, color, texture, smell, taste, and other tangible features. These attributes reduce the level of uncertainty while making a purchase decision. They mostly refer to goods, such as clothing, furniture, cars and food, which are tangible in nature, however, some search attributes can be found in services, too. For example, it is possible to assess many tangible features before visiting a particular hotel, restaurant, or a fitness club.
- **Experience attributes** are those that can be evaluated after purchase or during consumption. Customers must first experience the service and then they are able to assess such attributes as customer service, reliability, and atmosphere. Many services like entertain-

⁷ A. Payne, op.cit., p. 8.

⁸ V.A. Zeithaml, M.J. Bitner, *Services Marketing. Integrating Customer Focus across the Firm*, McGraw-Hill Higher Education, 2000, pp. 29-30.

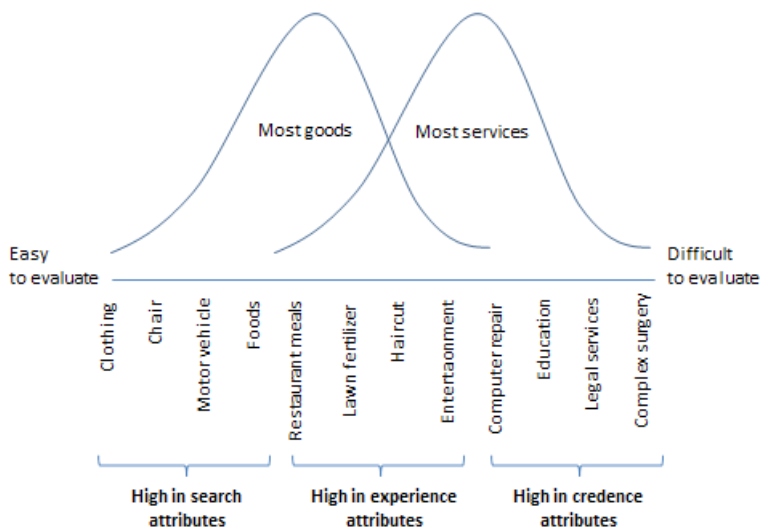
⁹ Ch. Lovelock, J. Wirtz, op.cit., pp. 36-55.

ment, restaurant meals and vacations are high in experience qualities. They are more difficult to evaluate than the products high in search qualities, because they have to be purchased and consumed before assessment.

- **Credence attributes** are characteristics that are hard or even impossible to evaluate after purchase and consumption. In comparison to products high in search or experience qualities, services with prevailing credence qualities are the most difficult to evaluate because customers may not have enough knowledge to assess the performance and level of quality of a specific service. Examples of offerings high in credence attributes include surgery, auto repair and legal services, since few customers possess medical, mechanical skills or legal knowledge.

As shown in figure 1.1, all products can be placed on a continuum of evaluation, ranging from those which are easy to evaluate to those which are difficult to evaluate, depending on their attributes. Because the experience and credence attributes dominate in services, customers have more difficulty in evaluating possible alternatives, so the perceived risk associated with purchase is higher. To reduce the level of risk and persuade customers to buy a particular service, suitable strategies can be implemented. Depending on the nature of a service, marketers may offer service guarantees and free trials, display credentials, use physical evidence, provide information using brochures, websites, videos, and other forms of advertising. These efforts may influence a purchase decision when a customer is considering different alternatives. The prepurchase stage ends once a purchase decision is made.

Figure 1.1 Customers evaluations of different types of products



Source: Adapted from V.A. Zeithaml, *How Consumers Evaluation Processes Differ Between Goods and Services*, in J.H. Donnelly and W.R. George, *Marketing of Services* (Chicago: American Marketing Association, 1981).

Service encounter stage. After making a purchase decision, customers move on to the next stage of service consumption – the service encounter stage. This stage involves a series of contacts with the service firms which cause certain consumers' reactions. Additionally, the decision to buy a specific service is accompanied by a set of expectations about the service performance. So, in the case of services the service encounter stage is more complex and complicated, because marketers have also to be aware of customers' expectations, understand their feelings and reactions during the service delivery process and be able to deal with them. This means that besides professional performance of a service, the ability to influence people's moods and emotions in positive ways is crucial for customers' perception and evaluation of their service experience. Moreover, as some customers receiving service at the same time may have an impact on the satisfaction and dissatisfaction of other customers, marketers should understand how to cope with a number of customers, resolve problems within a group, and be sensitive to cultural differences. In general, since a service encounter consists of a series of events and interactions between a service provider and customers, firms need to carefully design a service process and manage those operations that have an effect on customer satisfaction. Marketers may use different strategies and policies aimed at improvement of service performance and increasing customer satisfaction. They include a proper selection of service personnel, providing training in specific skills related to service delivery, creation of service environment adequate to a character of a service, deciding which aspects of the service should be performed in the presence of the customer and which should be performed in the backstage.

Postencounter stage. In the postencounter stage customers evaluate the service performance by comparing the service they perceive they have received with their expectations. As satisfaction is a key outcome of the marketing process, marketers need to understand the sources of customers' satisfaction or dissatisfaction. Furthermore, there is an evidence of links between the level of customer satisfaction and the firm's overall performance, which means that by creating more value for customers, the firm creates more value for its owners. The reasons why customers might be satisfied or not, differ depending on their expectations based on personal needs and preferences, level of knowledge, previous experience, word of mouth communications, and promises given by a service firm. During the decision-making process, customers assess the attributes and risks related to a service offering and develop their expectations. When it comes to the experience, customers are generally pleased when service performance perceptions approach or exceed desired levels. In such situations they are more likely to make repeat purchases, remain loyal to the service supplier, and express their positive opinions about their experience. On the other hand, when customers are disappointed because the perceived service performance does not meet their expectations, they are more likely to complain and share their negative opinions with others.

1.4 The Services Marketing Mix

One of the basic concepts in marketing is the marketing mix, defined as "the elements an organization controls that can be used to satisfy or communicate with customers"¹⁰. The traditional marketing mix is composed of four basic strategic elements: product, price, place (or distribution) and promotion (or communication), often referred to as the "4 Ps"¹¹. Additionally, each of these elements has its own mix of ingredients. All the distinguished variables are also interrelated and, to some extent, they depend on each other.

Initial analysis of the marketing mix components were limited to a study of manufacturing industry, since, at that time, the significance of services to the economy was considered to be relatively unimportant¹². However, the increasing role of services over the years caused a rising interest in the way they should be marketed. The analysis of the nature of services showed that the traditional marketing mix is not sufficient and requires some modifications when applied to services. A number of analysts redefined the marketing mix adding additional variables which in practice enable services marketers to better communicate with and satisfy their customers. The extended marketing mix is composed of 7 Ps, which includes the traditional 4 Ps, as well as process associated with service delivery, physical environment and people¹³.

A brief overview of the marketing mix elements for services is given below with a more detailed description presented in the subsequent chapters¹⁴.

Product. Products are the means by which organizations seek to satisfy their customers. In this sense, a product is an offer which consists of any elements - tangible and intangible ones. A service product is composed of a core product that respond to the customers' primary needs and supplementary services which constitute value-added enhancements. Planning the marketing mix begins with creating a service concept which involves product-mix decisions aimed at offering value to customers which would satisfy their needs better than competing offers. Typically, product-mix decisions focus on quality, brand image, design, and reliability. One important implication for service products' decisions is that new services cannot be protected by patents or copyrights.

¹⁰ V.A. Zeithaml, M.J. Bitner, op.cit., p. 18.

¹¹ The concept of marketing mix was first proposed by Borden in 1965 who described the marketing executive as a "mixer of ingredients ...who is constantly engaged in fashioning creatively a mix of marketing procedures and policies...to produce a profitable enterprise". He initially identified 12 elements of the marketing mix of manufacturers, which were later simplified by other authors. The 4Ps classification was created by E.J. Mc Carthy, *Basic Marketing: A Managerial Approach*, Homewood, IL: Richard D. Irwin, Inc., 1960. R.F. Lauterborn proposed a 4 Cs classification in 1993, stating that 4Cs model is more consumer-oriented. In the Lauterborn's model Product is replaced by 'Consumer', Price by 'Cost', Distribution by 'Convenience', and Promotion by 'Communication'.

¹² A. Palmer, op.cit, p. 31.

¹³ The concept of 7 Ps was developed by B.H. Booms and M.J Bitner, *Marketing Strategies and Organization Structures for Service Firms*, in J.H. Donnelly and W.R. George, eds. *Marketing of Services*, Chicago: American Marketing Association, 1981, pp.47-51.

¹⁴ Lovelock, J. Wirtz, op.cit, pp. 22-26.

Place. Place decisions refer to the ease of access that customers have to a service. Service distribution involves physical location decisions, decisions about which intermediaries to use, and what channels to choose - physical or electronic ones. In many cases service firms offer customers a choice of distribution channels, which may include visiting a branch, dealing with an agent, using the Internet, call center or self-service machines like ATMs. Nowadays, speed and convenience of place and time have become important determinants of service delivery. To ensure effective distribution, firms offer extended hours (e.g. 24/7), use more distribution channels, and develop their websites to enable customers to get detailed information and online help, make reservations, orders and payments.

Promotion. No marketing program can succeed without communications, which involves different methods and techniques used to deliver information about an offer, persuade the target customers of the benefits of a specific brand, and encourage them to take action at specific times. The traditional promotion mix includes advertising, personal selling, sales promotion and public relations. In the case of services marketing these elements are also important, but because services are produced and consumed at the same time, service personnel can become an important component of promotional activities as well as tangible elements of service environment. Also, because of services intangibility, the role of services communications is to create confidence in the firm's capabilities and reduce the perceived risk of purchase.

Price. Pricing is an important strategic issue because it is a significant indicator of products' quality. In services marketing the role of pricing is even more important, as many services are intangible in nature, so customers rely mostly on price while assessing the level of their quality. In general, pricing decisions involve choices regarding the level of prices to be charged, discounts, terms of payment and the extent to which price differentiation is to be pursued. These decisions are similar to the issues facing a good marketer, however some differences occur. Most services are perishable and they cannot be stocked in inventory. If there is no demand, the unused capacity is wasted. On the other hand, when the demand exceeds the capacity, a number of customers may not buy a product. Thus, a key issue for services marketers is to smooth demand using dynamic pricing strategies.

People. Many services require direct interaction between customers and the firm's personnel, that is why people often become an important part of the service experience. The appearance, attitude, behavior and skills of the service personnel influence the customer's perception of the service. Therefore, recruiting, training, motivating and rewarding service employees cannot be only regarded as human resources decisions, but also marketing decisions. To achieve specified quality standards, marketing department and human resources department need to work closely together. Another issue that causes implications for marketing decisions is that customers themselves can affect the service experience, service quality and their own satisfaction. Service marketers need to carefully select target market, choosing the right customers, educate them and shape their behavior.

Physical evidence. The intangible nature of services and the fact that services are produced and consumed at the same time mean that it is difficult to judge a service before purchase. Customers perceive greater risk and uncertainty while taking buying decisions and

choosing among competing services. To reduce this risk and persuade customers to a specific service, marketers may use environment in which the service is delivered. The elements of this environment are tangible, so they can serve as an important indicator of service quality. The physical evidence includes such elements as brochures, business cards, signage, equipment and staff uniforms. In many cases it also includes the physical environment of a service outlet where customers make purchase decisions. So, landscaping, the appearance of buildings, vehicles, interior furnishing, stationery and other visible components of environment are also significant and marketers should design them carefully.

Process. Manufactured goods are produced in a factory, where quality standards are under control and customers themselves are not involved in the production process. Thus, production is of little concern to the consumers of manufactured goods, whereas in services customers participate in the production process and are often involved in co-production. As flow of activities within the service delivery provide customers with evidence on which to judge a service, creating and delivering services requires design and implementation of effective processes. For these reasons, marketing managers and operations managers need to work closely together to ensure reliable delivery, high quality and productivity. The key issue is to reduce variability, which can be achieved by various means, such as designing customer service processes, training employees, implementing service quality management and standardized operating procedures.

Table 1.2 Expanded marketing mix for services

Product	Place	Promotion	Price	People	Physical evidence	Process
Physical good features Quality level Accessories Packaging Warranties Product lines Branding	Channel type Exposure Intermediaries Outlet locations Transportation Storage Managing channels	Promotion blend Sales people - number - selection - training - incentives Advertising - targets - media types - types of ads - copy thrust Sales promotion Publicity	Flexibility Price level Terms Differentiation Discounts Allowances	Employees - recruiting - training - motivation - rewards - teamwork Customers - education - training	Facility design Equipment Signage Employee dress Other tangibles - reports - business cards - statements - guarantees	Flow of activities - standardized - customized Number of steps - simple - complex Customer involvement

Source: V.A. Zeithaml, M.J. Bitner, *Services Marketing. Integrating Customer Focus Across the Firm*, McGraw-Hill Higher Education, 2000, p. 19.

Questions

1. What are the reasons for the growing share of the service sector in national economies?
2. Describe the marketing implications of services characteristics and suggested marketing responses.
3. Choose a service company you are familiar with, and describe marketing challenges related to services characteristics and discuss possible marketing responses.
4. Explain the three-stage model of service consumption.
5. Describe search, experience, and credence attributes, and give examples of each.
6. Explain why the expanded marketing mix is used in a services context.
7. Discuss the 7 Ps marketing mix concept on the example of a selected service company.

CHAPTER 2

Services Marketing Strategy

Learning objectives

After reading this chapter, you should be able to:

- Identify the main stages of marketing strategy formulation process.
- Understand the relationship between strategic planning and marketing planning.
- Be familiar with the methods used to analyze marketing environment and a company's current market position.
- Understand the segmentation process, target marketing, differentiation, and positioning in the services context.
- Learn how to identify and select target segments on the basis of different variables.
- Understand how to develop an effective positioning strategy.
- Know the framework for developing the services marketing mix strategy.

2.1 Marketing Strategy Formulation Process

Marketing strategy refers to the policies and key decisions in the field of marketing adopted by management that have impact on company's performance. Marketing strategy focuses primarily on products, markets, and the relationships with customers. Unlike corporate strategy which is concerned with the decisions made in an organization comprising many business units, marketing strategy is concerned with a particular business unit strategy¹⁵. The marketing strategy is based on the marketing concept which holds that the key to achieving company's organizational goals is being more effective than competitors in creating, delivering, and communicating superior customer value to target customers, and thereby ensuring profits through customer satisfaction¹⁶. When developing marketing strategy, it is necessary to consider the following factors: the strategic objectives, demand forecast, preferences of customers, macroenvironmental trends, competitive environment, the competitors' strategies, the company's main resources and core competencies.

Marketing strategy formulation process can be divided into several stages. As shown in figure 2.1, first, it is important to conduct internal and external analysis to gather information which establishes bases for marketing decisions. The firm needs to identify its strengths and weaknesses as well as core competencies, analyze trends in the macroenvironment, and conduct market and competitor analysis. Then, it should specify the market and customer

¹⁵ R. Brenan, P Baines, P Garneau, Contemporary Strategic Marketing, Palgrave Macmillan, 2003, p. 16.

¹⁶ Kotler P, Marketing Management, Prentice Hall, 2003, p. 19.

preferences within this market, identify and select the best bases for segmentation, and decide which segment or segments to target. After selecting target customers, it is necessary to differentiate a company's market offering from competing offerings and develop the best positioning strategy. Implementation of positioning requires the careful design of the marketing mix elements, which are crucial in creating customer value. When developing marketing strategy, existing interdependencies among the marketing mix elements should be considered, thereby each of them can be used to support each other in order to reinforce the positioning of market offering and deliver high service quality to achieve competitive advantage.

Figure 2.1 Marketing strategy formulation process



2.2 Firm and Market Analysis

Firm analysis. To design an effective marketing strategy, it is necessary to consider the strategic context of a company including its mission statement, growth strategy, competitive strategy, strategic objectives, as well as organizational resources.

- **Mission statement** is a statement that provides information about company's goals, major policies, values, and competitive advantage. A mission statement is often based on a vision which describes a desired outcome of the company's performance in the future. Service companies stress different competitive advantages than manufacturers. Service mission statements are generally less comprehensive, they put less emphasis on technology, philosophy, location, and self-concept and they are mostly focused on customers and a public image¹⁷. Mission statement is crucial for development

¹⁷ F.R. David, How companies define their mission, Long Range Planning, vol. 22, no. 1, 1989, pp.90-97.

of marketing strategy and designing a marketing program, which should reflect company's values and competitive advantage.

- **Growth strategy** is a strategy aimed at winning larger market share. There are four ways in which a company can develop its products and markets. Market penetration strategy is focused on existing markets and the same products, which means that the company can use a wide range of promotional activities or develop distribution network to increase sales. A firm pursuing a product development strategy introduces new products and sells them into current markets usually through existing channels, taking advantage of gained experience, and often of brand awareness and brand loyalty. Market development strategy means that a company enters new markets and offers the same products. In this case it needs to conduct market research, then design promotional campaign, and develop distribution network. Diversification strategy is a high risk strategy, since a company enters new markets and sells new products, thus it cannot benefit from any experience¹⁸.
- **Competitive strategy** is a strategy which is focused on gaining competitive advantage in the market. There are three generic competitive strategies which are aimed at winning competitive advantage: overall cost leadership, differentiation and focus¹⁹. The first option for a firm to build a sustainable competitive advantage over its rivals is overall cost leadership. Here, the main effort is put on lowering the production and distribution cost, so that a company can gain competitive advantage by charging lower prices. A firm can also pursue a differentiation strategy which means that it delivers something valuable to customers and charges a higher price for added value. There are many ways of differentiation the market offering. It is possible to achieve an excellence in service quality, speed of delivery, customer service, brand exclusivity, and other factors. A company may focus on the whole market or on a narrow segment. A focus strategy means that a company concentrates on a small segment and it gains competitive advantage either through cost leadership or through differentiation.
- **Strategic objectives** specify what a company expects to achieve as a result of the implementation of its strategy. Strategic objectives are long-term and can be classified into a number of categories, including financial objectives which focus on improving a company's profitability, sales and market share objectives aiming at growing market share and increasing sales, human resources objectives which concentrate on the selection and development of the workforce, and internal processes objectives putting stress on enhancing operational efficiency²⁰.

¹⁸ I. Ansoff, *Corporate Strategy*, revised edn., Harmondsworth, Penguin Books, 1987.

¹⁹ M.E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance*, New York, Free Press, 1985.

²⁰ There are numerous classifications of strategic objectives. Peter Drucker distinguished eight major categories: market standing, innovation, human resources, financial resources, physical resources, productivity, social responsibility, and profit requirements.

- **Organizational resources** are used to accomplish company's goals. They include market resources like products, brands, distribution channels; human resources which are the people within a company; physical resources, such as buildings, vehicles, and equipment; and financial resources, for example cash, loans and equity. The analysis of the organizational resources compared with the resources of competitors results in the identification of the company's strengths and weaknesses²¹.

Market analysis. The analysis of the marketing environment is considered with the identification of the circumstances outside the company which have an impact on its performance. Each company is affected by a wide range of external factors, however, some of them are of relatively high importance and may considerably influence the achievement of company's marketing objectives, and some are less significant or of little importance. The key objective of the marketing environment analysis is to distinguish those factors which are crucial, thus because of its complexity, it is reasonable to reduce the market analysis to two main categories: the macroenvironment and the competitive environment.

- **Macroenvironment** comprises factors outside the competitive environment that may influence the company's performance and achievement of its objectives. The macroenvironmental trends may lead to new opportunities and threats and for this reason they should be carefully examined. Typically, they can be classified into six main groups: demographic, economic, political-legal, social-cultural, technological, and natural²². Demographic analysis refers to the monitoring of population, its size, growth rate, age distribution, ethnic groups, as well as household patterns, and educational levels. Unlike other environmental factors, demographic changes take effect gradually, so they can be forecast quite precisely. Economic environment can be considered in two dimensions: macroeconomic and microeconomic. Macroeconomic conditions, such as economic growth, inflation, exchange rates, and interest rates provide information about major economic trends, whereas microeconomic conditions refer to the factors that influence consumer expenditures including income, savings, debt, and credit availability. Marketers should also monitor technological trends, as new technologies may have a considerable impact on consumption patterns and even change customers' habits. Political and legal environment, which is composed of laws, government agencies, and pressure groups, may also affect marketing decisions. Marketers should possess knowledge about laws regulating business and pay attention to the special-interest groups. Social and cultural factors, like core beliefs, values, subcultures, and shifts in values over time affect consumption patterns and provide important marketing implications. The environmental trends related to the deterioration of the natural environment and the shortage of raw materials need also to be examined carefully, since they can be sources of many opportunities and threats.

²¹ R. Brenan, P. Baines, P. Garneau, *Contemporary Strategic Marketing*, Palgrave Macmillan, 2003, p. 94.

²² P. Kotler, *op.cit*, pp. 162-178.

- **Competitive environment** consists of those factors with which the company comes into closest contact and which have direct impact on its success. The competitive environment is divided into five groups: competitors, potential entrants, substitutes, buyers, and suppliers²³. The Porter five forces' analysis is used to determine the long-run profit attractiveness of a market or a specific segment. A segment is perceived unattractive and expensive to compete if it already contains numerous and strong competitors. Firms that may enter the market cause also potential threat. The higher the entry barriers are, the more difficult is to enter the market and do business within a given industry. Beyond the companies that compete directly, and those which may enter the market, there are actual or potential substitutes for the product. If the competition from substitutes intensifies, it has an impact on prices and profits in the market. Buyers possess a significant bargaining power and might considerably affect the attractiveness of a segment. When buyers become concentrated or organized, their bargaining power grows. Another threat comes from suppliers who also influence the competition within an industry. A segment is considered unattractive when suppliers are powerful and switching costs are high. After conducting competitive environment analysis, it is necessary to identify primary competitors, their objectives, strengths, weaknesses, and strategies.

SWOT analysis. The purpose of SWOT analysis, which is the overall evaluation of a company's strengths, weaknesses, opportunities and threats, is to identify the key information from data gathered by the marketing audit. Strengths and weaknesses are the outcome of internal analysis of company's resources in the field of marketing, personnel, finance and organization, and should be compared with the competitors' resources. Opportunities and threats are identified on the basis of the analysis of the company's external environment. The essence of the SWOT analysis is usually presented in a table under four headings in order to highlight the external opportunities and threats and weigh them against a company's strengths and weaknesses. SWOT analysis provides the basis for setting objectives and developing marketing strategies.

2.3 Segmentation and Target Marketing

The segmentation process starts with the definition of the market and identification of customer needs. The choice of the market refers to the specification of customers to which the firm intends to market its services, as well as understanding customer preferences and attitudes. Once the market has been identified, alternative approaches to segmentation should be examined in order to select the best bases for segmentation. There are many ways by which a service firm can approach market segmentation. As shown in figure 2.2, these approaches fall into two main groups; one is based on customer characteristics and the other on customer responses²⁴.

²³ M.E. Porter, *Competitive Strategy*, New York, Free Press, 1980.

²⁴ A. Payne, *op.cit.*, pp. 71-82.

Customer characteristics. This category includes descriptors of the customers who are buying services what enables to understand who the customers are. Using this approach, markets can be segmented on the basis of the following characteristics:

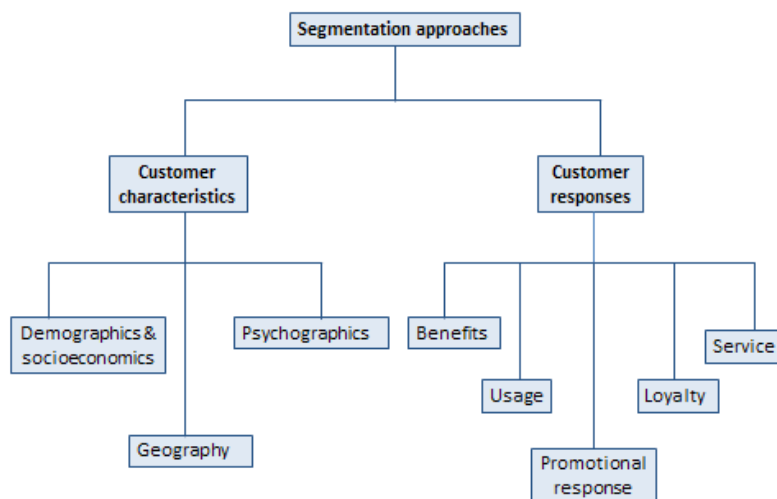
- **Demographics and socio-economics** variables are very commonly used descriptors of customers. In consumer service markets demographic segmentation refers to such factors as sex, age, family size, while in business markets the typical demographic characteristics include the company size, organizational form and the type of services offered. Socio-economic factors can include income, occupation, education, social class and ethnic origins.
- **Psychographics** is a more developed form of segmentation and is concerned with people's behavior and lifestyles. People differ in attitudes, personality types, interests, values, and these affect the services they purchase. As customers within the same demographics group can exhibit different psychographic profiles, it is necessary to consider psychographic variables in conjunction with demographic characteristics.
- **Geography** refers to dividing customers according to where they work or live. Dividing market into geographical units, such as countries, states or cities helps to identify local and regional trends. Other factors like population density or climate related factors can be useful in determining sales potential in different regions. Geographic segmentation is typically considered as a first base for segmentation, yet it should be examined in correlation with other variables.

Customer responses. This category includes descriptors of the customers' behavior which enables to understand what and why customers buy. Using this approach, segmentation can be carried out on the basis of the following characteristics:

- **Benefits** are related to the reasons why customers buy products. However, people vary regarding their preferences and the benefits they seek from the same market offering. Thus, the key issue is to identify the segment which desires a common set of benefits and design a service providing these benefits.
- **Usage** refers to the type and extent of usage patterns. Using this variable, customers are typically divided into heavy, medium, occasional and non-users of the service. By concentrating on usage patterns of a particular service, a company can develop loyalty programs and reinforce relationships with current users.
- **Promotional response** considers how customers respond to various types of promotional activities, such as advertising, sales promotion, exhibitions, and others. This information can be used to ensure that a particular segment receives an adequate form of communications or adjust promotional activities to customer preferences.
- **Loyalty** means commitment to re-buy a preferred product or service in the future. Customers can be characterized by their degree of loyalty and thereby classified into four groups: "hard-core loyals" – those who buy one brand all the time, "split loyals" – remain loyal most of the time, "shifting loyals" – shift from one brand to another, and "switchers" – showing little or no loyalty.

- **Service** itself and consideration of how customers respond to various service offerings can also serve as a basis for segmentation. Measuring the importance of various service elements to particular customer groups, enables a service company to design service packages appropriate to different market segments.

Figure 2.2 Major approaches to services market segmentation



Source: A. Payne, *The Essence of Services Marketing*, Prentice Hall International, 1993, p. 72.

Selection of the base for segmentation involves an evaluation of alternative bases in order to identify the best approach. Several options can be examined using the characteristics described above, as well as segment profitability and attractiveness criteria, such as market growth, competitive intensity, market access, degree of risk, and others.

After evaluating different segments, the service company should decide which and how many segments it will target; using one of the following approaches to target market selection, shown in figure 2.3.

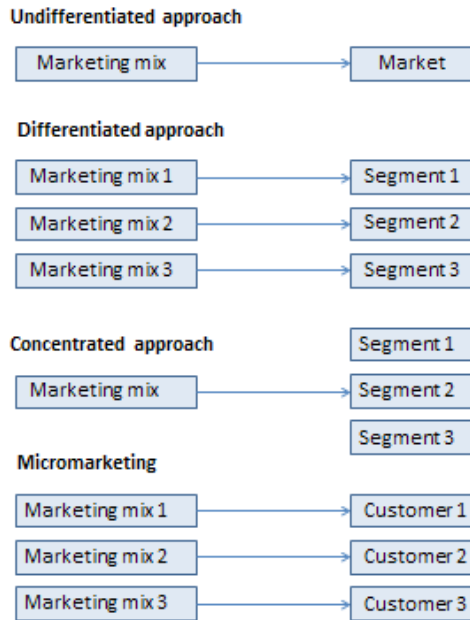
Undifferentiated marketing. In mass marketing there is no recognition of distinct segments in the market. A service company targets the whole market and develops one marketing-mix strategy, focusing on what is common in the needs of customers. Such an approach creates a large market potential; however, it does not lead to satisfying particular needs of customers.

Differentiated marketing. A service company identifies several segments and designs separate marketing programs for them. By using a differentiated approach, it is possible to increase customer satisfaction; thereby a service company can build a stronger position within each market segment. On the other hand, focusing on many segments may considerably increase the cost of doing business and lead to lower profits.

Concentrated marketing. Using a concentrated marketing approach, a service company recognizes that there are number of segments in the market; however, it decides to target one specific segment or a niche. By concentrating on a selected segment, a company can achieve a strong market position, because it possesses broad knowledge about customers and knows how to meet their specific needs and requirements.

Micromarketing. In a micromarketing approach, a service company focuses on local customer groups, such as trading areas, neighborhoods, stores, and also on individuals. Marketers see the individual in every customer, assuming that each of them has a unique set of wants and preferences. Thus, service providers customize their strategies to local markets and individuals to meet each customer's needs more precisely and effectively.

Figure 2.3 Major approaches to services target market selection



The segmentation process should result in the decision about which and how many segments the service company will target. Moreover, selected segments should be capable of description and large enough to make it worthwhile for the company to invest its own resources²⁵. After selecting target markets, the service company needs to position the services offered to those markets in the minds of customers.

²⁵ M. McDonald, A. Payne, *Marketing Planning for Services*, Butterworth-Heineman, 1996, p. 87.

2.4 Positioning and Differentiation of Services

Positioning of services is even more important than positioning of goods because services tend to be intangible, so differentiation becomes a key issue in making the service distinctive in the perception of customers. Positioning is concerned with the identification, development and communication of the attributes which a service company intends to use to make its market offering recognizable and superior to the competing services²⁶. The final result of positioning is the creation of a value proposition, which is a cogent reason why target customers should buy a particular service. The key issue for the company is to differentiate its market offering from its competitors in order to provide superior value to customers. As shown in table 2.1, a service company can use different differentiation variables, which enable to create customer value and thereby a distinctive company's image. Positioning highly depends on the company's ability to differentiate its market offering from the services offered by its competitors.

Table 2.1 Differentiation Variables for Services

Service	Personnel	Channel	Image
Ordering ease	Competence	Coverage	Symbols
Delivery	Courtesy	Expertise	Media
Installation	Credibility	Performance	Atmosphere
Customer training	Reliability		Events
Customer consulting	Responsiveness		
Maintenance and repair	Communication		
Miscellaneous			

Source: Adapted from P. Kotler, *Marketing Management*, Prentice Hall, 2003, p. 318.

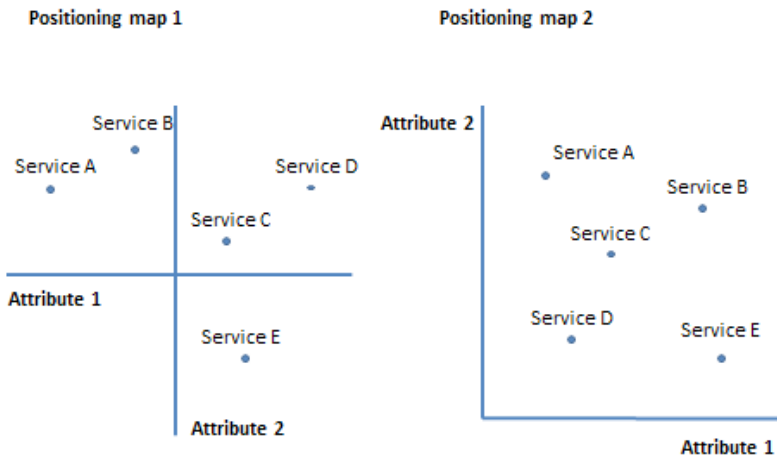
Development of service positioning is a process which involves the following steps: determining levels of positioning, identifying the key attributes of differentiation, locating selected attributes on positioning maps, evaluating other positioning alternatives, and implementing the best positioning strategy²⁷. Determining the level of positioning refers to the decision on what organizational level the positioning strategy is to be considered: industry as a whole, organization as a whole, the range of services offered by a specific company, or individual service. Once the positioning level has been determined, the next step involves the identification of various attributes important to target customers and the assessment of the relative importance of each of them. Then, it is necessary to locate the various companies' services for these attributes on positioning maps. A positioning map, referred to as a perceptual map, usually contains two features, as shown in figure 2.4. Those features reflect key customer preferences. A map is a useful way of representing consumers' perceptions of alternative services, which shows the existing competitive situation on the market. Basing on the information from the map, a service company can use one of the strategies: it can strengthen the current

²⁶ A. Payne, op.cit, p. 95.

²⁷ M. McDonald, A. Payne, *Marketing Planning for Services*, Butterworth-Heineman, 1996, pp. 99-103.

position against competitors, identify an unoccupied position on the map, or reposition the competition²⁸. When positioning a service, a company should decide how many attributes to convey to target customers. Some marketers claim that promoting one benefit gives a company the best opportunity to create an image of a leader for that particular attribute. Single-benefit positioning means being “number one” and offering the “best service”, “lowest price” or “fastest delivery”. Other marketers suggest that promoting more than one benefit may be more distinctive and more difficult to be imitated by competitors; however, by increasing the number of benefits, it is possible to cause a loss of a company’s clear image. After selecting the attributes necessary for differentiation of a market offering and making decision about overall positioning strategy, the next step involves the implementation of the developed ideas. The marketing mix is crucial for implementing the positioning strategy. The design of each of the marketing mix element should be consistent with the positioning strategy and reflect its main idea.

Figure 2.4 Positioning maps



2.5 The Marketing Mix Strategy

Segmentation and positioning provide opportunity to tailor the service offering to meet the needs of specific segments. When developing strategies for different customer groups, marketers use various elements to create consistent marketing programs. Traditionally, they consider four basic elements, such as product, price, place and promotion, which are referred to as 4 Ps of the marketing mix. However, in services marketing, as explained earlier, the traditional marketing mix needs to be extended by adding new elements. Regarding the characteristics of services, much more appropriate is to use 7 Ps model, which consists of the tra-

²⁸ A. Ries, J. Trout, Positioning: The Battle for Your Mind, Warner Books, New York, 1981.

ditional components of the marketing mix and three additional elements – people, physical evidence, and process. People are an essential element in the service delivery process; thereby they become an important part of the differentiation strategy by which a company can gain competitive advantage. The process is associated with service delivery and has an impact on customer satisfaction, thus process management is crucial for service quality improvement. Physical evidence needs to be emphasized as an important marketing mix component, as many services are intangible, so customers make their judgment about service quality basing on the tangible elements. All of the marketing mix elements represent a potential for value creation and thus require special attention from marketers.

When developing the marketing mix strategy, it is necessary to consider how much time it will take to design or introduce the changes to the marketing mix components. The service company can change its price, sales force and advertising expenditure in the short run; however, it can develop new service offerings and distribution channels only in the long run. Therefore, the strategy framework should be established to ensure the implementation of all planned activities. Moreover, it is necessary to analyze the character of each of the marketing mix component as well as their interdependencies. For example, a new service development may require modifications to the distribution system, pricing strategy or the type of promotional activities used to stimulate buying. As complementary and substitution effects may occur among the marketing mix elements, they should be also examined by the marketers. Substitution of the marketing mix ingredients enables a service company to design various combinations of the marketing mixes, whereas complementary effects require consideration of correlations among the marketing mix components, e.g. high quality of a service offering demands high quality of customer service. Since the marketing mix decisions are crucial for overall success of the marketing strategy, they need to be carefully analyzed, what will be presented in the subsequent chapters.

Questions

1. Describe the main stages of the marketing strategy formulation process.
2. Examine the strategic alternatives for a selected service company and identify its competitive strategy.
3. Identify main macroenvironmental trends and carry out the Porter's 5 forces analysis and SWOT analysis for a service company you are familiar with.
4. Describe major approaches to services market segmentation as well as approaches to services target market selection.
5. What are the implications for developing an effective positioning strategy?
6. Choose the industry you are familiar with and create a perceptual map showing the competitive positions of major service providers within this industry.
7. What are the main considerations for the services marketing mix strategy?

CHAPTER 3

The Service Product

Learning objectives

After reading this chapter, you should be able to:

- Understand what constitute a service product.
- Be familiar with the Flower of Service concept.
- Describe facilitating and enhancing supplementary services.
- Describe different branding strategies for service products.
- Discuss the categories of new service development.

3.1 Planning and Creating Service Products

Goods can be defined as objects, devices, or things, whereas services can be defined as deeds, efforts, or performances²⁹, however, the distinction between goods and services is not always that clear. In reality, many services contain some goods elements and most goods offer at least a service delivery. Products are usually a bundle of tangible and intangible elements. Moreover, the tangible aspects of a service product and the intangible aspects of a tangible product can be an important source of product differentiation and the way to gain competitive advantage in the market. If a company offering tangible goods forgets about the intangible components of its market offering, it overlooks an important aspect of its business facing marketing myopia³⁰. Similarly, a company offering services cannot ignore the tangible elements which surround the core benefit of a product. By defining its business too narrowly, a company can lose a chance to use some important value added components to create better experience for its customers.

A useful way of presenting the relationship between tangible and intangible elements of a firm's operations was suggested by L. Shostack³¹. A molecular model which she proposed is an illustration of the benefits that a product offers to customers. Figure 3.1 applies the molecular model to the cinema visit. The cinema experience is determined by many factors, including intangible elements, such as entertainment, customer service, atmosphere and payment options as well as tangible elements, like cinema building, screen size, food and drink, and toilet facilities. Developing molecular models enables managers to identify all tangible and intangible elements that comprise most products. Understanding the service experience components is very important to manage them more effectively and thereby be able to better meet customer needs³².

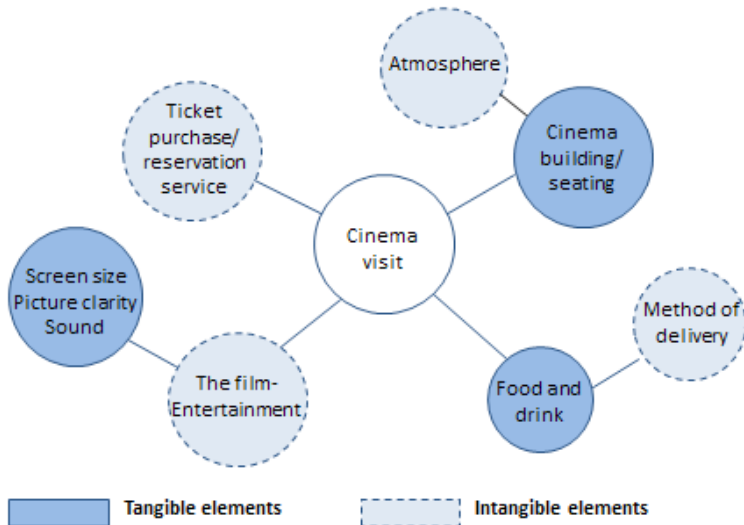
²⁹ L.L. Berry, Services Marketing is Different, Business Magazine, May-June 1980, pp. 24-29.

³⁰ T. Levitt, Marketing Myopia, Harvard Business Review, 38, July-August, 1960, pp. 24-47.

³¹ G.L. Shostack, Breaking Free from Product Marketing, Journal of Marketing, April 1977.

³² K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, op.cit., pp. 7-8.

Figure 3.1 The molecular model for the cinema visit



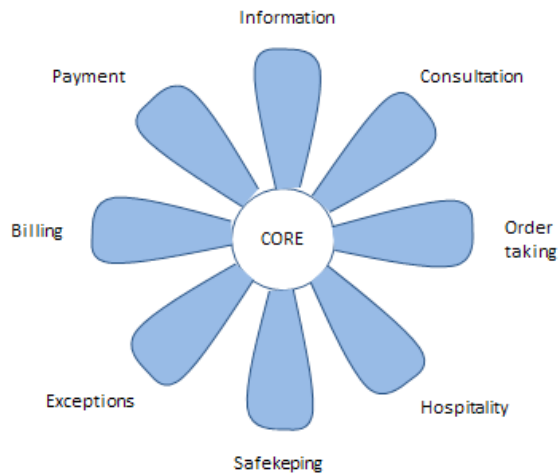
Source: K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *Services Marketing: Concepts, Strategies and Cases*, South-Western Cengage Learning, 2009, p. 8.

Designing a service product requires an understanding of how the product elements, physical and intangible ones, should be combined and delivered to create value for customers that meets their expectations. The physical elements of a market offering and services processes will be discussed in the subsequent chapters and here the main focus is put on the core and supplementary services. The core product delivers problem-solving benefits for customers, whereas supplementary services augment the core product and enhance its value. As shown in figure 3.2, supplementary services can be classified into one of the eight clusters which are displayed as petals surrounding the center of a flower called the *Flower of Service*³³. The petals appear in a clockwise sequence which is likely to be encountered by customers. There are two groups of supplementary services: facilitating supplementary services, which are necessary for effective service delivery and enhancing supplementary services designed to add extra value for customers³⁴.

³³ The Flower of Service concept was introduced in Ch. Lovelock, *Cultivating the Flower of Service: New Ways of Looking at Core and Supplementary Services*, in P. Eiglier and E. Langeard, eds. *Marketing, Operations, and Human Resources: Insights into Services*, Aix-en-Provence, France: IAE, Université d'Aix-Marseille III, 1992, pp. 296-316.

³⁴ Ch. Lovelock C, J. Wirtz, op.cit., Prentice Hall, 2011, pp. 86-93.

Figure 3.2 The flower of service



Source: Ch. Lovelock C, J. Wirtz, *Services Marketing. People, Technology, Strategy*, Prentice Hall, 2011, p. 86.

Facilitating supplementary services. These are supplementary services which are essential for service delivery or they enable the use of a core product. They include the following services: information, order-taking, billing, and payment.

- **Information** is crucial to obtain full value from a service product. It can be provided by front-line employees, brochures, displays, websites, and other sources. The types of information vary depending on the nature of a service and may include schedules, directions to a service site, conditions of sale, confirmation of reservations, instructions, receipts and tickets, and warnings.
- **Order-taking** is a service which is offered to a customer once they make a purchase decision and are ready to buy a product. Some service companies such as banks and insurance companies require that a customer goes through application process which is designed to gather essential information. In other cases, making reservations will be considered a typical form of order-taking. Order entry can be received through sales personnel, mail, e-mail, or online.
- **Billing** is common to many services. Customers expect bills to be accurate, complete, clear, informative, and timely. There are different procedures of billing which range from verbal statements, handwritten invoices, machine display to self-billing and others. Billing is usually associated with payment.
- **Payment** is typically expected after a customer gets a bill. The most typical form of payment is cash or credit cards; however other options can be used. They include coupons, vouchers, checks, and others.

- **Enhancing supplementary services.** These are supplementary services that may add extra value for customers. They include services such as consultation, hospitality, safekeeping, and exceptions.
- **Consultation** involves a dialog between a service person and a customer focused on finding the best solution to the problem. Consultation can take a form of advice which requires understanding of customer's special needs and wishes. It can also be counseling which helps understand customers their situation and find their own solutions. Training in product use is another form of consultation which involves detailed description of product application and might be adjusted to customer's individual needs.
- **Hospitality** is especially important in face-to-face encounters. It is associated with welcoming customers, showing them interest and willingness to understand and meet their needs. Since hospitality can have a considerable impact on customers' satisfaction, careful selection of service personnel is required. People who are naturally warm, open and friendly create much more hospitable atmosphere than others.
- **Safekeeping** refers to caring for customers' personal possessions. It involves coat rooms, parking for vehicles, safekeeping of valuables, child care and pet care. Some customers would not come to buy a product, if such services were not provided. Safekeeping can also refer to services aimed at caring for products that customers bought and they include packaging, transportation, delivery, installation, and others.
- **Exceptions** are supplementary services which are out of routine. They involve special requests which may relate to personal needs such as diets, children care, and medical or disability needs. Other types of exceptions include problem solving when service delivery fails, handling of customers' complains, and compensation for failures.

Supplementary services provide many possibilities for adding value to a core product. Marketers can use combination of them depending on the nature of a service product and a company's market positioning strategy. A strategy which is focused on delivering high quality services requires more enhancing supplementary services than a strategy which aims at competing on low prices.

3.2 Branding Service Products

Branding is concerned with identification and development of the added values associated with products, aiming at building a company or product image. The creation of successful brands requires defining products' functional and discriminating benefits to distinguish them in a competitive environment and to ensure brand uniqueness. There are three main objectives of branding: to conform to the legal patent protection, to guarantee quality and homogeneity in markets, and to differentiate products and services from competitors³⁵. However, the services are not easily patentable. For example, human labor and processes are not patented,

³⁵ F. Bradley, *Strategic Marketing in the Customer Driven Organization*, John Wiley & Sons Ltd, England, 2003, pp. 111-113.

so, in the case of services, developing a distinguished brand seems to be even more important. In general, a brand is a name, symbol or design, or a combination of them intended to identify the company's products and differentiate them from competitors by providing functional benefits and added values. An important term related to branding is brand equity which refers to the amount of money that customers are willing to pay for a particular brand. Brand equity is an important intangible asset of a company and makes it more valuable over time.

While many tangible products are branded, the service offerings are less likely to be branded and the main effort is usually put on developing the corporate image of the service provider³⁶. Thus, as a result of the development and implementation of branding strategy, the services offered by a company should be associated with its brand name. Service companies usually offer a wide range of services rather than a single product. For this reason, they can choose one of the following branding alternatives: branded house, sub-brands, house of brands, and endorsed brands³⁷.

Branded house. One of the branding strategies is to use a single brand for all products and services offered often in unrelated fields. Creating a branded house is on one hand efficient because it allows to considerably reduce costs. Moreover, a well-known brand guarantees an acceptable level of sales for a new product introduced into the market. Starbucks successfully has extended its brand from coffee to tea, fruit juices, ice-cream and sandwiches. On the other hand, if the product categories are too far apart, using branded house strategy can result in diluting the original brand. The Virgin Group is an example of a company which has extremely diverse market offerings including air travel, train travel, travel packages, soft drinks, financial services, telephones, entertainment, and others.

Sub-brands. A company can decide to use sub-brands what means that a new product or service introduced into the market gets its own distinctive name and visual identity to differentiate it from the parent brand. Sub-branding can be used when a company intends to enter new market segments or launch new product categories. This strategy can be especially effective when a company decides to move a brand upscale or downscale or when the core brand does not resonate well enough with a new target market. However, launching a new brand requires moving resources from the core brand to a new sub-brand which might either affect the sales of the core brand or a company's image. Sub-branding is a common strategy in the airline industry. A number of major airlines introduced express shuttle products such as Delta Express, Shuttle by United or Air France's La Navette, as well as other sub-branded services such as premium cabins like Raffle Class at Singapore Airlines or Club World at British Airways.

Endorsed brands. This strategy is used when a company decides to introduce a new product or service under its own name, but the corporate brand is still featured to support the new product brand name and to ensure its credibility. The parent brand communicates value that strengthens the promise of the endorsed brand, but at the same time the endorsed brand can develop its own personality and usually dominates the core brand. Developing endorsed

³⁶ A. Palmer, op.cit., p. 130.

³⁷ J. Devlin, Brand Architecture in Services. The Example of Retail Financial Services, "Journal of Marketing Management", 19, 2003, pp. 1043-1065.

brands is a common practice among hotel corporations. Starwood Hotels and Resorts Worldwide endorsed several hotel brands targeted at different segments. Westin, Sheraton, St. Regis, and other brands offer distinctive value propositions and a loyalty program developed under the Starwood brand name and it is an additional benefit for the customers. Another example of using endorsed brands is McDonald's with its products, such as Big Mac, McNuggets, McChicken, and McMuffin. By adding Mc or Mac to the names of the products, the relationship between the parent brand and the endorsed brands is stressed.

House of brands. This strategy focuses on introducing products under their own brand names while the core brand gets little or no attention, which means that the parent brand is not significant and does not add much credibility to the promoted products. House of brands strategy lets the company develop many unrelated brands which are aimed at reaching different market segments. Additionally, it enables to distinguish new market offerings and avoid incompatible brand associations. However, this strategy can be costly for a company, since the separate budgets are necessary to develop each new brand and introduce it into the market. Many global companies providing consumer products, like Procter & Gamble, Johnson & Johnson, Unilever, and Colgate-Palmolive, use the house of brands strategy. In the service sector Yum! Brands Inc. is an example of the global company that successfully adopted this strategy. The company's brands, such as Pizza Hut, KFC and Taco Bell are the world's leading chains of restaurants.

The branding decisions are crucial for a company's success and they are very important when introducing new services into the market. Having a number of options a company has to decide whether to use an existing brand and apply it to a new market offering or to develop a new brand name for a product, or to use a combination of those. If a product is launched under its own name, another important decision refers to defining the relationship between a parent brand and a new brand and deciding which of those will be dominant. While choosing the branding strategy it is important to examine the company's overall brand strategy, consider available financial resources, conduct market analysis and assess the advantages and disadvantages of different branding options.

3.3 Developing New Service Product

The success of a service company highly depends of its ability to introduce new market offerings. New service developments are essential for company's competitiveness and are considered an important strategic option for growth. Service products which are launched into the market go through several stages from introduction to growth, maturity and decline. Introduction is preceded by the product development stage during which new service ideas are assessed and decisions about possible service improvements are made. If new services introduced into the market are major service innovations, they require support of advertising and other types of promotional activities. Minor service improvements can be introduced without getting any media coverage. During the growth stage sales start to increase, as many customers become aware of the benefits than can be gained by using a new service offering. Competitors enter the market or make adjustments to their offerings to be more competitive. For the same reason, they can also cut prices on their existing services. The maturity stage is marked by a slow sales growth

and over time the market becomes saturated for all competitors. Marketers might appeal to new customers by adjusting advertising messages. They can also modify their service offerings or any other element of the marketing mix. During the decline period sales and profits decline, thus marketers withdraw unprofitable services from their range.

New service developments are crucial for developing and maintaining market position, therefore service companies put much effort in improving existing services and introducing technological innovations. New services launched into the market can vary and may be anything from a minor adaptation to an existing service such as offering coffee at a hairdressing salon to a major development which might be revolutionary like air travels offered to customers for the first time. New service developments can be classified into seven main categories, ranging from major service innovations to style changes³⁸.

Major service innovations. This category includes the services which are introduced into the market for the first time. For this reason they need more promotional support than other types of new service developments. Promotion is primarily focused on informing customers about new service offering, its characteristics, and benefits. Major service innovations may bring new solutions to customers and may be revolutionary in character. Skype, Facebook and eBay are the examples of major service innovations.

Major process innovations. In many cases the core product remains the same, yet the service delivery is changed. Major process innovations involve new ways of delivering the product which are beneficial for customers. The general idea of process innovations is to facilitate customers' access to service offering and attract those who were unable to buy a service using traditional ways of delivery. E-learning is an example of major process innovation which gives an opportunity to study through the Internet. It can be performed via on-screen lectures, interactive workshops, and chats.

Product-line extensions. Besides major service and process innovations there are many minor improvements which are designed to better meet customers' needs. Product-line extensions refer to introducing additions to current product lines. By extending their product-line, service firms offer broader range of services to existing customers and attract new customers. Tour operators introduce new travel destinations offering their customers' wider choice which additionally enables them to create an image of an innovative company.

Process-line extensions. Service companies can also introduce new process delivery methods to existing ones. Process-line extensions are less innovative than major process innovations, thus they require less time to be introduced. They usually involve adding additional distribution channel which is another possibility for customers to buy a product. Creating self-service options such as self-scanning fast lane checkouts or using call center or Internet as an alternative to traditional methods of selling products are the examples of process-line extensions.

Supplementary service innovations. This type of innovations occurs regularly and refers to adding new facilitating or enhancing service elements to the existing core service. Supplementary service innovations are introduced to create a better experience for customers. They

³⁸ Ch. Lovelock C, J. Wirtz, op.cit. pp. 100-101.

may involve offering customers free access to the Internet, which might be used in the hotels, restaurants, and shopping centers.

Service improvements. The most common type of service innovations are service improvements. They involve minor changes added to either the core product or to supplementary services. For example, the restaurants can use their service personnel to welcome customers and escort them to a table.

Style changes. Many innovations are designed to change the style of the service environment and they do not require any improvements to the core product or supplementary services. Style changes include simple innovations to existing styles such as introducing new uniforms, designs, color schemes, repainting the interior, using new stationery, and others.

Service companies need to have a systematic approach to monitoring the marketplace, planning and implementing new services. Additionally, it is important to create an environment that encourages creativity and idea generation coming from different sources, such as staff, customers, suppliers, and others. The organizational activities which are aimed at stimulating innovativeness include involving employees in the decision making process, empowering them and encouraging to make their own contributions to service improvements. Building and maintaining relationships with customers is another important aspect of creating pro-innovative climate. Customers who are encouraged to play an active role in the service process and come up with the service improvements ideas might be also more satisfied with the services they receive. Similarly, developing good relationships with suppliers and involving them in the service development process might be beneficial to both sides. Through cooperation in strategic alliances with partners who may be competitors service companies can develop innovative projects and introduce new market offerings. Information coming from other sources as well as environmental trends should also be considered if they are relevant to the development of company's innovativeness.

Questions

1. Using a molecular model, analyze a selected service product.
2. Explain the *Flower of Service* concept and identify each of its petals.
3. What is the distinction between enhancing and facilitating supplementary services?
4. Choose a service product you are familiar with and identify its core product and supplementary services.
5. Describe branding strategies used by service companies. Illustrate your answer with examples of branding in services.
6. Identify and explain the main dimensions of service innovations.
7. Choose a service company you are familiar with and describe its innovative activities.
8. What activities might be recommended to encourage and stimulate innovation and creativity?

CHAPTER 4

The Service Process

Learning objectives

After reading this chapter, you should be able to:

- Be familiar with flowcharting and blueprinting.
- Develop a blueprint for a service delivery process.
- Explain how service redesign can help improve service quality and productivity.
- Be familiar with the service process redesign methods.
- Understand the role of customers in service delivery process.
- Know how to manage customers' behavior in service delivery process.

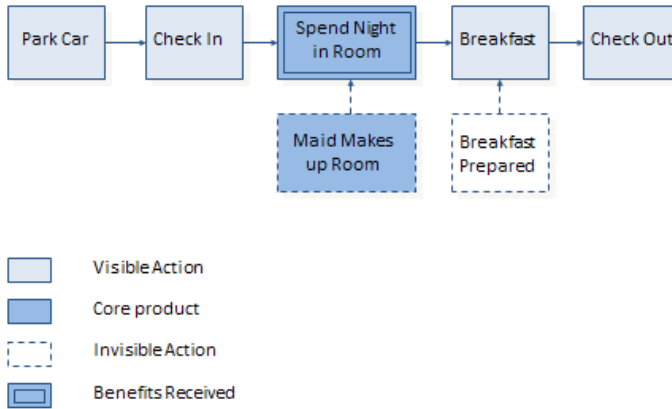
4.1. Designing Service Process

From the customer's perspective a service is an experience, but from the service company's perspective a service is a process which should be designed and managed to create a desired customer's experience. Additionally, it can be an important component of a company's competitive strategy and a way to differentiate it from competitors. Service process is also linked with service quality evaluations and service outcome is linked with customer satisfaction evaluations³⁹. For all of these reasons, a service process should be examined in detail as well as the techniques used to display all elements of service delivery. A very simple form of describing a service process is a **flowchart**. It is a tool, which shows a sequence of encounters that customers have with a service company. Figure 4.1 presents a flowchart for delivery of a service - stay at a motel. It involves several steps such as parking a car, checking-in, spending night in a room, having breakfast, and checking-out. Flowcharting helps to distinguish service elements like the core product and supplementary services and enables to assess the level of customer involvement in the service delivery process⁴⁰.

³⁹ P.A. Dabholkar, J.W. Overby, Linking process and outcome to service quality and customer satisfaction evaluations, *International Journal of Service Industry Management*, 16(1), 2005, pp. 10-27.

⁴⁰ Ch. Lovelock, J. Wirtz, op.cit., pp. 197-198.

Figure 4.1 A flowchart for delivery of a service – stay at a motel



Source: Ch. Lovelock, J. Wirtz, *Services Marketing. People, Technology, Strategy*, Prentice Hall, 2011, p. 199.

A more sophisticated form than a flowchart and one of the most common techniques used to design new services or redesign existing ones is blueprinting⁴¹. A **blueprint** specifies how a service process should be constructed and includes detailed description of all activities visible and invisible to customers showing the linkages between them. When developing a blueprint, first it's necessary to identify key activities involved in a service process, distinguishing those which are experienced by customers and those which are other actions and support processes essential for service delivery. Between the front-stage and back-stage activities there is a line of visibility. For companies which take into account the customers' perspective, a very important aspect of designing a blueprint is identifying the interactions between customers and employees. Operationally oriented businesses would rather focus on managing the back-stage activities⁴². However, two perspectives are important and blueprinting might be a useful tool for operations managers as well as marketing managers⁴³. A blueprint enables managers to identify potential fail points in the service process and modify the procedures to enhance the customers' experience and increase productivity. It is usually presented as a sequence of actions involving several stages and is similar to a theatrical script. Figure 4.2 illustrates a part of the experience of dinner at a restaurant⁴⁴. It shows first interactions between customers and a service company, beginning with making a reservation, then parking a car, to leaving coats in the coatroom. For each of these activities scripts should be prepared to ensure that customers' expectations are met. Below the line of visibility all actions essential for perform-

⁴¹ Blueprinting was first proposed by L.G. Shostack, *Designing Services that Deliver*, Harvard Business Review, January-February, 1984, pp.133-9.

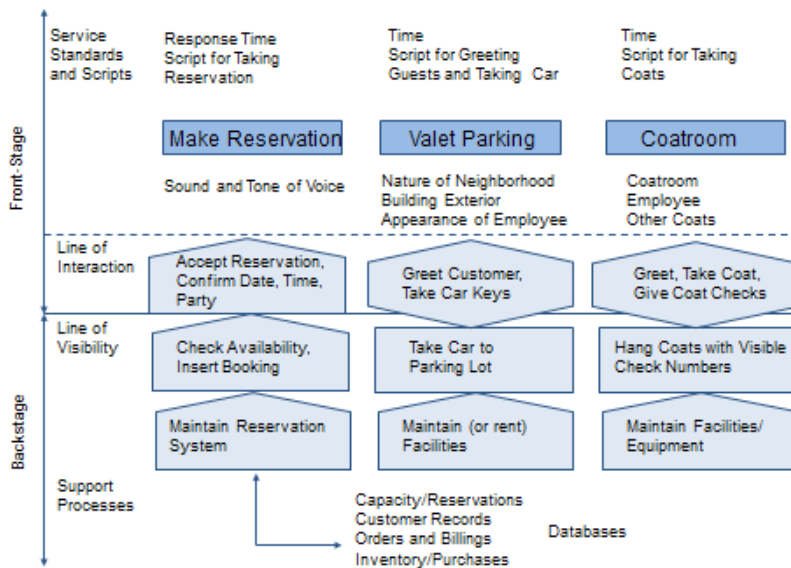
⁴² Ch. Lovelock, J. Wirtz, *op.cit.*, pp.200-201.

⁴³ G.L. Shostack, *Service positioning through structural change*, Journal of Marketing, 51, January 1987, pp. 34-43.

⁴⁴ A three-act performance illustrating the whole restaurant experience was presented in the Ch. Lovelock, J. Wirtz, *Services Marketing. People, Technology, Strategy*, Prentice Hall, 2011, pp. 204-207. It was based on the experience of dinner for two at Chez Jean upscale restaurant.

ing front-stage activities are presented as well as supporting processes. Service environment represents a stage, which includes the exterior and interior of the restaurant with such elements as furnishings, staff uniforms, lighting, music, and table settings.

Figure 4.2 A blueprint for a restaurant experience – act 1



Source: Lovelock Ch., Wirtz J., *Services Marketing. People, Technology, Strategy*, Prentice Hall, 2011, p. 204.

When designing a blueprint it is also important to consider the type of a service encounter that a customer has with a service company, since it causes several implications for the service delivery process. The service encounter is a period during which a consumer directly interacts with a service⁴⁵, including its personnel, tangible elements and other aspects of the service environment. From the customer's perspective, the encounter differs depending on two factors: the level of tangibility of the service and the recipient of the service who might be either a customer or his or her possessions⁴⁶. High-contact encounters, such as hairdressing, healthcare, fitness and beauty services, require physical presence of a customer and are highly tangible. As this type of encounter is the most intense, all elements of blueprint, including front-stage and back-stage activities, support processes, scripts and stage itself, should be carefully designed. The services which are based on low contact with customers, like broadcasting and telephone services do not need to have scripts prepared as well as other stage elements. This is because customers are not present during an encounter with a service provider. Another type of a service encounter in-

⁴⁵ G.L. Shostack, Planning the Service Encounter, in J.A. Czepiel, M.R. Solomon, C.F. Suprenant (eds.), *The Service Encounter*, Lexington Books, Lexington, MA, 1985, pp. 243-54.

⁴⁶ A. Palmer, op.cit., p. 150.

cludes those services which are performed on customers' objects, for example appliances repair services or transportation of goods services. In such cases customers do not have to be involved in the service delivery process. Although the technical skills of staff and timing seem to be of high importance, the manner in which service personnel deals with customers during pre- and after- service stages is also significant and has an impact on overall customer satisfaction. The last category of service encounters is made up of services performed on customers' intangible assets such as banking, insurance and consulting services. Here, customers mostly judge the service on its outcome, however, professionalism of the service personnel and the image of a service company also play an important role in the assessment of a service.

4.2 Service Process Redesign

Service process design requires involvement of marketing managers and operations managers. However, preparing a blueprint which is satisfactory for both parties does not complete their work. After having a service process designed marketers and operations managers should focus their attention on possible improvements which at the same time would enhance customers' experience and increase efficiency. This is mostly because customer needs change over time, new service elements are added to existing service offerings and new technologies are applied for better performance of services. Sometimes, the need for a process redesign comes from the changes which occur in the external environment such as new law regulations, and sometimes it is caused by the internal factors which might be related to the introduced service improvements. Examining blueprints is also important because it gives an opportunity to find new solutions for the service delivery which might optimize the service process and be beneficial for customers.

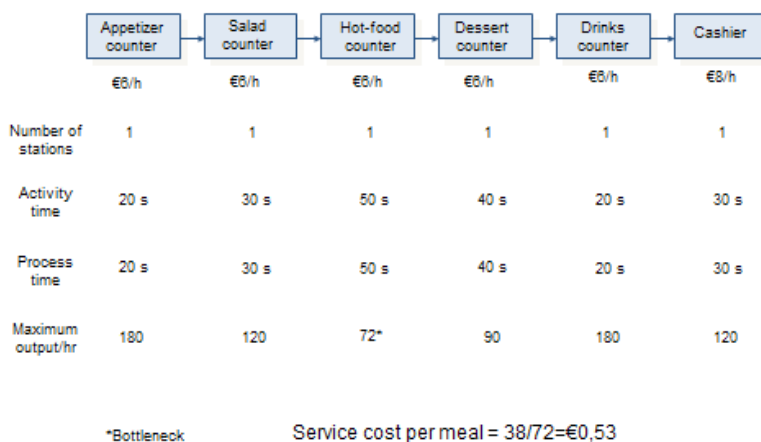
Figure 4.1 shows a blueprint for a cafeteria restaurant⁴⁷. A cafeteria is a type of a fast-food restaurant with a long chain of food-serving counters. Customers take selected food as they walk along and place it on a tray. Such restaurants require few employees and they are usually located in big institutions such as schools, colleges, department stores, and office buildings. Conversely to the restaurants in which service personnel is crucial to service delivery, in cafeterias service process is of high importance and is closely linked to the efficiency and customer satisfaction. In this example the cost calculation refers to the cost of providing service personnel to each counter. The process time is calculated by dividing the activity time by the number of stations performing a given activity. Maximum output per hour is considered as the number of people that can be served at each station within an hour. In order to calculate the service cost per meal, it is necessary to calculate the total labor cost per hour and divide it by the maximum output per hour.

When examining the blueprint to improve service delivery, it is important to identify the bottlenecks in the system. Bottlenecks are the points at which customers wait the longest period of time. In figure 4.1 hot-food counter is a place where process lasts the longest, so it is necessary to focus on this stage of service delivery. There are some possible solutions to this

⁴⁷ The example of a blueprint for a cafeteria restaurant with its modified versions was described in K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *Services Marketing: Concepts, Strategies and Cases*, South-Western Cengage Learning, 2009, pp.185-7.

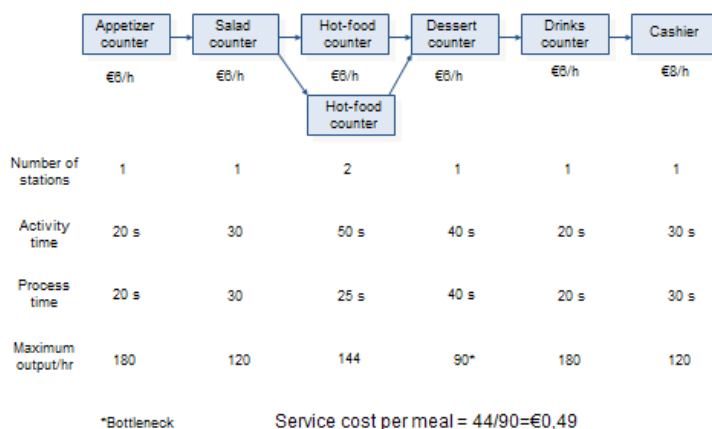
problem, which involve considering the alternate versions of service process redesign. One possible improvement of service delivery process is presented in figure 4.2. The blueprint for cafeteria restaurant was modified by adding one more hot-food counter. As a result of this change, the process time of serving customers taking hot food is shorter. And even though the labor costs associated with providing a meal are higher, the service cost per meal goes down. Thus, on one hand customers benefit from faster service delivery and on the other hand the process efficiency is increased which improves operational efficiency of the system.

Figure 4.1 Blueprint for a cafeteria restaurant



Source: Based on K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *Services Marketing: Concepts, Strategies and Cases*, South-Western Cengage Learning, 2009, p.185.

Figure 4.2 Modified blueprint for a cafeteria restaurant



Source: Based on K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *Services Marketing: Concepts, Strategies and Cases*, South-Western Cengage Learning, 2009, p.187.

Service process redesign should improve productivity and service quality at the same time. For this reason, the cooperation between marketing and operations managers is so important. There are a number of types of service process redesign, which might be classified into five groups, including eliminating non value-adding steps, introducing self-service, delivering direct service, offering bundling services, and redesigning the physical aspects of a service process⁴⁸.

Eliminating non value-adding steps. The service process may include many stages and long procedures which are not really essential for the outcome. In such cases, service redesign should be focused on eliminating non value-adding steps such as filling out forms, processing payment or dealing with service personnel. As a result of reducing unnecessary activities or shifting tasks from customers to service firm, the service delivery process should be easier and faster. Potential benefits for company include increased efficiency and ability to customize service; however, the implementation of changes requires customer education and employee training.

Introducing self-service. A very common method of reducing costs is shifting to self-service. Since more and more customers become familiar with the Internet and are able to exploit information available on the web, shifting the transactions from call centers to websites is a way to lower costs and improve productivity. Self-service facilitates customers the access to a service and increases the speed of a service process, which results in greater customer satisfaction and higher retention rates. However, one of the limitations related to self-service is that it reduces interactions between customers and service staff, and consequently customer feedback and opportunities to build relationships.

Delivering direct service. This type of service redesign involves delivering service directly to a customer instead of bringing a customer to a service company. It is also possible to use a direct service delivery as one of the alternatives of providing a service, which gives customers more buying options and increases an access to a service offering. If a company shifts to direct service, it can expand customer base and reduce costs by eliminating store locations. Delivering a service directly is more convenient for customers, but it requires more credibility and trust.

Offering bundling services. Bundling services involves combining multiple services into one package. Bundled services are focused on well-defined market segments and they are precisely tailored to customers' needs. Additionally, bundled services are attractive and convenient for customers which might enhance their loyalty. Thus, customers are less likely to switch service provider which results in higher retention rates. Bundling is also beneficial for a service company, because it increases sales and productivity. The transactions are faster and bundled billing reduces the number of bills increasing convenience for service personnel.

Redesigning the physical aspects of a service process. This type of service redesign is focused on tangible elements of a service process such as equipment, tools, service accessories and facilities. It can also involve changes to service environment like furniture, uniforms, stationery, new designs, and décor. Introducing such changes, in spite of the costs incurred, can result in increased satisfaction of frontline employees as well as higher productivity. Customers also benefit from redesigning the physical aspects of a service process. The changes generate interest and the new service experience is enhanced and improved.

⁴⁸ L.L. Berry, S.K. Lampo, Teaching an Old Service New Tricks: the Promise of Service Redesign, *Journal of Service Research*, 2 no. 3, 2000, pp. 265-275.

4.3 Customers in Service Process

The service experience is shaped by many factors, including service environment, service personnel, organizations and systems, and other customers. Blueprinting helps to identify all of these elements to manage them more effectively. Service environment represents the stage where front-stage actions take place, frontline employees play their roles basing on carefully prepared scripts to meet customers' needs, and the invisible systems involve all support processes and back-stage activities essential for service delivery. Whereas those aspects of the service experience might be designed and controlled to a large extent, it is more difficult to have a control over other customers. The presence of other people and the way they behave can enhance or detract from one's service experience⁴⁹. Examples of a negative influence may include children crying during a flight, people talking during a performance or customers behaving aggressively in a night club. Since a service company's clientele has a profound impact on an individual's experience, a blueprint should also specify the role of customers in a service process and the extent to which they influence each other. Identification of customers' impact on service delivery and their possible behaviors helps to find ways to minimize potential conflicts and respond appropriately so that customers coexist peacefully.

Participation of customers in a service process refers to their involvement in creating and producing a service which usually causes some uncertainties and challenges for managers. Depending upon the extent of participation, it is possible to distinguish three broad levels: low, moderate and high participation level⁵⁰.

Low participation level. Some services do not require active involvement of customers and even their passive role might be limited. In such case products and processes are usually standardized. The examples of services falling into this category include possession-processing services such as car wash services, mechanical repairs, cleaning, maintenance, transport of goods and others. Here, the activities involving customers are limited to providing access to their possessions and making payment. Services in which a customer is primarily a passive recipient include public transportation or entertainment services like visiting a movie theater.

Moderate participation level. The role of customers in delivering many services cannot be minimized because the final outcome depends on the cooperation between a service provider and recipient. Services which need to be customized and tailored to an individual's needs require active involvement of customers. These inputs typically include provision of information regarding their preferences and specific needs. Hair cutting, styling and beauty services are the examples of services with a moderate participation level of customers.

High participation level. Sometimes customers have to work actively with a service provider, because otherwise the final result will be unsatisfactory. In such cases customers become co-producers of a service and the quality depends to a large extent of their involvement

⁴⁹ S.J. Grove, R.P. Fisk, The Impact of Other Customers on Service Experiences: a Critical Incident Examination of Getting Along, *Journal of Retailing* 73 (1), 1997, pp. 63-85.

⁵⁰ M.J. Bitner, W.T. Faranda, A.R. Hubbert, V.A. Zeithaml, Customer Contributions and Roles in Service Delivery, *International Journal of Service Industry Management*, 8, No 3, 1997, pp. 193-205.

and cooperation. Education and health care services cannot be performed without active participation of customers. For example, patients who are overweight will not lose extra weight unless they actively get involved and follow a diet decided by a doctor. Similarly, students will not achieve good results unless they work hard and follow the instructor's rules.

The participation of customers in a service process and the degree to which they might influence each other pose some implications for managers. By using various methods, it is possible to manage service encounters more effectively in order to remove adverse elements and strengthen positive ones. Selecting customers on the basis of their ability to interact with other customers is used to minimize potential conflicts within a group because of certain similarities that people share. Specifying age limits, imposing dress code requirements, setting price on different levels, and using other selection criteria ensure that customers are more likely to have the same lifestyle, attitudes and preferences. An important aspect of the management of customer participation is determining rules of behavior expected from customers. Since certain types of behavior might significantly influence an individual's service experience, it is important to create a set of rules and guidelines to follow, and then familiarize customers with them. If the rules are not obeyed, some measures should be undertaken. Service personnel intervention can have a form of a gentle reminder; however, sometimes more serious actions might be required. Written rules and regulations, codes of conducts, signs such as "no smoking", "no cellphones" or "no drinking and eating" are used in many service organizations like schools, hospitals, restaurants and others. Service staff can also facilitate interactions among customers by introducing individuals to each other, arranging social events, cultural programs or any other form of socializing.

Questions

1. Identify methods used to describe service delivery process.
2. Develop a blueprint for a service with which you are familiar.
3. Explain how blueprinting help in designing and redesigning service process.
4. Explain how service process redesign might improve service quality and productivity.
5. Describe different methods used to redesign service process.
6. What methods might be used to manage customers effectively? Illustrate your answer with examples of specific services.

CHAPTER 5

The Pricing of Services

Learning objectives

After reading this chapter, you should be able to:

- Understand the considerations of service pricing.
- Explain cost-based pricing, value-based pricing, and competition-based pricing.
- Describe satisfaction-based relationship, and efficiency approaches to pricing.
- Understand revenue management and describe how it works.
- Explain the role of rate fences in effective revenue management.

5.1 Considerations of Service Pricing

When a service company develops a new product, it must consider many factors including setting a right price for its market offering. Price is a very important component of the marketing mix strategy, because it brings revenue for a company while other elements represent costs. Price is also a very flexible element and can be used as an important tactical tool. Unlike other marketing mix elements, such as product features, distribution network, and advertising, price can be changed quickly and adopted to market conditions. Given the intangible nature of services, pricing decisions are particularly important. Service customers expect a certain level of quality basing mostly on price and are more likely to use price as a cue to quality⁵¹. Thus, a service company should use quality and price as the base for its positioning strategy and sets its price in relation to the value delivered and perceived by customers⁵². Designing and implementing a pricing strategy requires consideration many internal and external factors and using a systematic approach to setting, adapting, and changing prices. Setting price policy involves several steps, such as selecting the pricing objective, determining demand, estimating costs, analyzing competitors' prices and strategies, selecting a pricing method and setting the final price⁵³.

Setting the right price is a difficult task since many factors should be considered at the same time. The most important considerations of serving pricing are shown in figure 5.1 Customers' assessment of service features resulting in their perception of value sets the ceiling for price. The costs set a minimum price or price floor for a serving offering. Between these two extremes, a service company has to consider other internal and external factors, such as

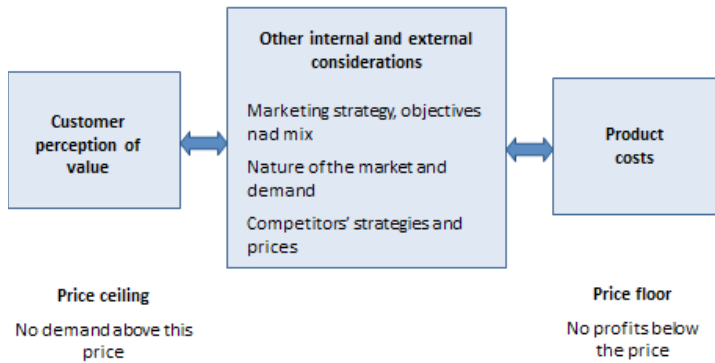
⁵¹ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, op.cit., p. 214.

⁵² Positioning the product on quality and price enables to distinguish nine price-quality strategies, which are described in P. Kotler, Marketing Management, Prentice Hall, 2003, p. 472.

⁵³ P. Kotler, K.L. Keller, A Framework for Marketing Management, Pearson Prentice Hall, 2007, p. 219.

marketing strategy and objectives, the nature of the market and demand, and competitors' strategies and prices. Price decisions should be based on company's pricing objectives which are related to revenues and profits as well as building and increasing market share. Moreover, pricing decisions should be coordinated with other marketing-mix elements to form an effective marketing program. When setting a price, it is also important to analyze the relationship between alternative prices and the resulting demand for a company's product. Thus, knowledge about factors affecting price sensitivity is necessary and crucial for pricing decisions. The price charged by competitors is another important factor to be considered by a service company when setting its own price. Since the prices of competing services are set between price ceiling and floor, they can serve as a point of reference for a company and customers.

Figure 5.1 Considerations of service pricing



Source: P. Kotler, G. Armstrong, *Principles of Marketing*, 13th edition, Pearson Education, 2010, p. 315.

The three main foundations underlying pricing strategy, including costs, customer's perceived value, and competitors' pricing, require more detailed analysis⁵⁴.

Cost-based pricing. As costs set the minimum price, a service company should charge a price which covers the cost of producing, distributing, and selling the product. However, it's more difficult to determine costs of creating service performance than it is to identify costs associated with producing a physical good. Additionally, many service companies need to develop infrastructure to create performances, which results in a very high ratio of fixed costs to variable costs. The examples of service organizations with relatively high fixed costs include schools, hospitals, colleges, hotels, airlines, and others. In such cases perishability causes many problems and greatly affects pricing strategy and tactics. Pricing becomes also much more complex than in companies with significant variable costs. Thus, many service companies develop activity-based cost (ABC) accounting instead of using traditional cost accounting approach⁵⁵. Whereas traditional accounting focuses on using fixed, semi-variable, and variable costs as well as break-even

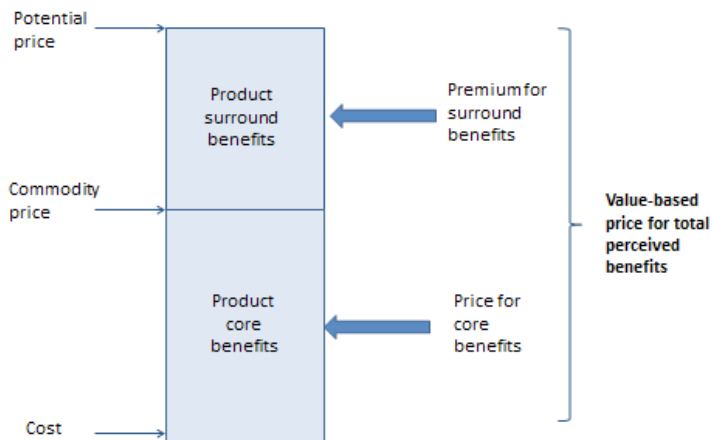
⁵⁴ Ch. Lovelock, J. Wirtz, op.cit., pp.138-145.

⁵⁵ R. Cooper, R.S. Kaplan, Profit Priorities from Activity-Based Costing, Harvard Business Review, May-June 1991, pp.130-135.

analysis to estimate service costs and make pricing decisions, ABC accounting tries to assess the cost of serving each customer by identifying all activities that are directly and indirectly associated with production, distribution, and selling products. This approach enables to estimate real profitability of different services, channels, market segments, and individual customers.

Value-based pricing. The customer's perceived value sets a ceiling on the price that a company can charge for its products, which means that customers will not pay more for a service than they believe it is worth. Therefore, the knowledge about value perception is essential for setting the right price. First, it is important to create value proposition which is an essential part of marketing strategy. Then, a service company communicates value to its customers usually by using different tools, such as advertising, public relations, personal selling, and others. Perceived value is made up of various elements including the customer's image of the product performance, company's reputation, customer service, ease of delivery, warranties offered as well as elements of service environment. When customers buy a product, they typically weigh the benefits related to a service offering against the costs of the purchase. For this reason, price should be considered along with other marketing mix variables and cannot be simply the result of cost calculation. The key to value-based pricing is to deliver more value than competitors, which is possible by adding more benefits to the core product and more supplementary services. As shown in figure 5.2, value-based pricing approach reflects the fact that customers are willing to pay more for perceived benefits related to the core product as well as to surrounding services.

Figure 5.2 Value-based pricing



Source: A. Payne, *The Essence of Services Marketing*, Prentice Hall International (UK) Ltd, 1993, p. 143.

Competition-based pricing. Competitors set prices for services within the floor-to-ceiling range; however they use different strategies to achieve their objectives. The knowledge about competitors' costs, prices, and market offerings is crucial for a company when setting

its own prices. When competing services are relatively undifferentiated, the price becomes an important factor influencing buying decisions, so offering competitive prices makes sense. Similarly, with a large number of competing services and wide availability of substitutes, price competition usually intensifies; however, there are several circumstances which might reduce the tendency to compete on price. When non-price factors, such as time of delivery, service site location and service features, are crucial to customers and influence their buying decisions, there is no reason to fight price wars. It is much better to focus on those factors instead of introducing price reductions. Many services are highly personalized and service performance as well as relationships with the service provider are more important for a customer than price itself. In such cases the service company should put an effort in enhancing service experience rather than in offering discounts and other price related incentives. Customers are also less likely to change service providers when switching costs are high, so offering competitive prices might not bring expected results.

Given all the factors influencing pricing decisions, some additional remarks should be made with regards to the nature and characteristics of services. Due to higher risk associated with the service purchase, consumers are more likely to pay higher prices what reduces the level of perceived risk. Additionally, customers assess the intangible services basing on prices and use price as a cue to quality, which gives more flexibility to a service provider when setting prices. Furthermore, customers experience more difficulties when comparing the prices of competing services and need more time and effort to get information about them. Demand is usually more inelastic in the case of services and is influenced by the prices of other goods related to a particular service purchase. For this reason, cross-price elasticity should be analyzed when making pricing decisions. Perishability, on the other hand, implies that services must be produced and consumed at the same time. Since many services cannot be stored for later use, price adaptation strategies should be used to decrease the problem of low capacity utilization. Another reason for charging customers different prices for the same service is due to fluctuations in demand for services. Adapting the price can result in creating new demand during off-peak periods and flattening the existing peaks by encouraging customers to use a service in less busy times. Service companies typically offer wide range of services, which enables using price bundling to increase sales and profits. As it was stated, intangibility of services results in higher level of risk associated with a service purchase, and additionally perishability increases this risk. In such services as medical treatment or legal proceedings it is very difficult to assess all costs because of unpredictable number of services involved in the service process to achieve an expected result. Another difficulty in cost estimating is a high fixed/variable cost ratio. Moreover, fluctuations in demand for services result in employing part-time workforce, thereby many service companies face relatively high staff turnover, which makes costs even more difficult to estimate. Due to inseparability and perishability, the advantages associated with the economies of scale are also of limited significance⁵⁶.

⁵⁶ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *op.cit.*, pp. 201-220.

5.2 Service Pricing Strategies

After considering all factors that might influence pricing decisions, it is important to decide which pricing strategy to choose so that organizational objectives can be met. There are three alternative pricing strategies which might be used by service companies to communicate value to customers: satisfaction-based pricing, relationship pricing, and efficiency pricing⁵⁷.

Satisfaction-based pricing. This pricing strategy provides value by recognizing and reducing customers' perceptions of uncertainty related to the intangible nature of services. Since a certain level of risk is often associated with a service purchase, different solutions might be implemented in order to increase certainty and build confidence and trust, including service guarantees, benefit-driven pricing, and flat-rate pricing.

- **Service guarantees** are a popular way of appealing to customers that value certainty and quality and who accept higher prices to get those benefits. Service guarantees can be used by companies that offer services perceived as high-risk, that are focused on delivering high quality services or that need to differentiate from their competitors when entering the market. Dental clinics can offer guarantees on many services and use the terms of guarantee as an important factor that differentiates one clinic from another.
- **Benefit-driven pricing** is based on pricing the benefits that customers receive. Thus, it is important to identify what customers value in a service, and then, when charging customers for a service, communicate an association between the price and the attributes of service valuable for them. As price is related to the benefits, customers usually feel more satisfied and less uncertain. A hairdresser, for example, can charge for a service depending on its components like level of stylist, men's or ladies haircut, type of highlights, and wash and style.
- **Flat-rate pricing** reduces perceived risk associated with a service purchase by agreeing on a fixed price before the transaction occurs. In effect, the risk of cost changes, which cannot be controlled by the company, falls on the service provider. Flat-rate pricing is effective when the price is competitive, the company controls its costs, and there are opportunities to develop relationships with customers. Consultants, attorneys, and other professionals can offer fixed prices for their services especially with regard to business clients.

Relationship pricing. The concept of relationship pricing is based on using price as an effective tool in building, maintaining, and developing relationships with customers. When developing pricing strategy which is focused on encouraging customers to expand their dealings with a service company, marketers need to understand customers' needs and their reasons for developing long-term relationship with a company.

- **Long-term contracts** offer price and non-price incentives to strengthen the existing relationships with customers and to develop new ones. Customers benefit from dealing with the same service provider over years. They pay lower prices and get more

⁵⁷ L.L. Berry, M.S. Yadav, Capture and Communicate Value in the Pricing of Services, Sloan Management Review, 1996, pp. 41-51.

privileges. Long-term contracts facilitate communication and information exchange, which has a positive effect on service quality and performance. For a service company, the steady flow of revenue ensures more financial stability. Additionally, long-term commitments reduce switching between service providers. Fitness, golf, and medical memberships are examples of long-term contracts.

- **Price bundling** aims at enhancing relationships with customers by offering two or more services in a single package. This practice is very common among service providers because many of them offer broad range of services, so different combinations of bundled offerings are possible. Price bundling is beneficial for both sides. A service company can increase sales and reduce costs, whereas customers can save time and money purchasing related services from one service provider. Tour operators offer holidays which include transport, accommodation, meals, and other attractions and sell them in one package. However, some companies introduce mixed bundling, which enables customers to buy services in a package or separately.

Efficiency pricing. The primary objective of efficiency pricing is to deliver the most cost-effective service to customers. With this strategy, a service company is focused on attracting economically minded customers. Understanding, managing and reducing costs are the fundamentals of efficiency pricing. One possibility to reduce costs is to introduce innovations and apply new methods and business practices aimed at efficiency increase. Cost reduction efforts can be also focused on eliminating these activities that do not add enough value for customers. Therefore, the understanding of relationship between value perceived by customers and the costs incurred to receive this value is crucial for this strategy. Southwest Airlines, Ryanair, and other low cost airlines offer competitive prices, which is possible as a result of using less expensive airports and limiting supplementary services typically associated with air travelling.

5.3 Revenue Management

Many service companies face the problem of insufficient capacity utilization and uncertainty related to demand fluctuations, which result in lower sales and profits. Even though different methods might be used to increase sales, numerous firms are more likely to use a more complex approach called revenue management. First, the concept was developed as yield management mostly referring to the airlines industry, and then it started to be applied in the broader range of service industries as revenue management. Revenue management is the application of strategies and tactics to maximize the revenue through adaptation of prices to different segments at different times of a day, week, month, or season⁵⁸. The application of revenue management is most effective when service industries possess several distinct characteristics. First, the companies are able to divide market into clear segments with regards to their price sensitivity. They have relatively fixed capacity and perishable inventory. The de-

⁵⁸ Ch. Lovelock, J. Wirtz, *op.cit.*, p. 145.

mand for services tends to fluctuate over time, but can be influenced by price. It is possible to adjust price quickly to reflect supply and demand variations. Companies experience problems of high marginal production costs, yet they have low marginal sales costs⁵⁹. Revenue management approach is used by companies that meet those criteria and is typical for such industries as airlines, tourism, transportation and health care. However, recently many other companies have developed systems aimed at increasing capacity utilization. The revenue management process involves several steps. It begins with data collection regarding products, their prices, and customer behavior. After collecting and analyzing data, it is important to divide market into segments basing on customers price sensitiveness to certain products at given time and place. Market segmentation is essential to the next step, which is forecasting demand for each distinguished customer segment. Forecasting is used to project future quantities of demand as well as forecast demand as a function of the marketing mix variables such as price and promotion. Forecasts are crucial for developing price optimization strategies, which are crucial to increase revenue. The service company should re-evaluate prices, products, and processes and adjust revenue ,management strategy and tactics to changing market conditions⁶⁰.

The key issue in implementing revenue management is designing proper rate fences, which allow customers to select the market offering on the basis of service characteristics and the amount of money they are willing to pay. Key categories of fences are shown in table 5.1. The physical fences refer to product features, whereas non-physical fences enable to distinguish services with regards to transaction, consumption or buyer characteristics⁶¹. Product characteristics related to setting different prices include the quality of physical attributes, the number of services included in a market offering, and the level of services provided. Such fences might be used for example in the tourism, recreation, entertainment, and airlines industries. Transaction characteristics involve charging different prices depending on time and location of booking or making reservation. Customers can get discounts for advance purchase or pay lower price when making reservation online. Fences are also used with regards to consumption characteristics. Service companies, such as restaurants, hotels, and fitness clubs can charge customers lower prices for using a service in a specified period of time. Another category of rate fences, which is commonly used by many service providers, refers to buyer characteristics. For example, discounts are offered to customers who belong to certain groups like children, students, and senior citizens as well as loyalty card users. Described fences can be used by companies as an important tool when distinguishing segments of customers with regard to the perceived value and the price they are willing to pay, however, a good understanding of customer preferences and behavior are crucial for revenue management approach.

⁵⁹ S.E. Kimes, Yield management: A tool for capacity-constrained service firms, *Journal of Operations Management*, vol.8(4), 1989, pp. 348-63.

⁶⁰ R. Cross, *Revenue Management: Hard-Core Tactics for Market Domination*. New York, NY: Broadway Books, 1997.

⁶¹ Ch. Lovelock, J. Wirtz , *op.cit.*, pp.147-149.

Table 5.1 Key categories of rate fences

Rate fences	Examples
Service characteristics	Class of travel (business/economy class), seat location in a theater or stadium
Basic product	Free meal on flight, free sauna and jacuzzi in a swimming pool
Amenities	
Service level	Separate check-in counters, hospitality desk in a hotel
Transaction characteristics	Discounts for advance purchase (package holidays)
Time of booking and reservation	Making reservation on line (airline tickets)
Location of booking or reservation	Fees for changing reservations (airline tickets)
Flexibility of ticket usage	
Consumption characteristics	Happy hours in a restaurant, hotel weekend prices
Time or duration of use	Prices vary by location (between cities, city center, outskirts)
Location of consumption	
Buyer characteristics	Loyalty benefits (silver, gold, and platinum cards)
Frequency of volume of consumption	Child, student, and senior citizen discounts
Group membership	Group discounts based on size of a group
Size of consumer group	Tourists are charged higher prices than local customers
Geographic location	

Source: Based on Ch. Lovelock, J. Wirtz, *Services Marketing. People, Technology, Strategy*, Prentice Hall, 2011, p. 148.

Although pricing of services is a difficult task, some guidelines might be helpful in designing an overall pricing strategy⁶². First of all, price should be easy to understand for customers. In practice, pricing schedules are often too complex and hard to understand. Some service companies have a wide variety of different plans and schemes, which are confusing for customers. Instead of using complicated pricing systems, it is much better to distinguish the company's main market offerings and price them adequately to their value. Another impor-

⁶² L.L. Berry, M.S. Yadav, Capture and Communicate Value in the Pricing of Services, *Sloan Management Review*, 1996, pp. 41-51.

tant aspect of a good pricing strategy is a properly designed relation between value and price. Not only price should represent value to a customer, but it also should reflect the expected amount of value. Price should also reduce customer uncertainty and reinforce customer trust. Customers often perceive a certain level of risk associated with buying services, therefore a company should put an effort in ensuring customers that they are paying the right price. Additionally, price should enhance customer loyalty and facilitate the relationship between customers and a service provider. By using an appropriate pricing strategy and price incentives, it is possible to increase customer retention and build long-term relationships.

Questions

1. What are the main considerations of service pricing?
2. Discuss the main foundations underlying pricing strategy, including costs, customer's perceived value, and competitor's pricing.
3. Discuss the concepts of satisfaction-based, relationship, and efficiency pricing.
4. Select a service company of your choice and discuss its pricing strategy.
5. Explain the concept of revenue management and describe how it works.
6. Describe key categories of rate fences and give examples of specific rate fences used by service companies.

CHAPTER 6

Distributing services

Learning objectives

After reading this chapter, you should be able to:

- Understand the nature and challenges of service distribution.
- Distinguish between distributing core and supplementary services.
- Be familiar with the types of interactions between a service provider and customers.
- Describe place and time decisions of physical channels.
- Be familiar with steps involved in channel design decisions.
- Discuss advantages and disadvantages of using different types of intermediaries.

6.1. The Nature of Service Distribution

Traditionally, distribution is viewed as a set of activities concerned with movement of finished goods from producers to customers. Since most producers do not sell their goods directly to customers, they need intermediaries to resell the merchandise. These intermediaries constitute a marketing channel⁶³. Marketing channels are sets of organizations involved in the process of making products available for use or consumption⁶⁴. They partner with each other to improve the performance of the system in delivering customer value. Members of marketing channel perform different functions including gathering information about customers, competitors and other actors of marketing environment; developing communications to stimulate selling; reaching agreement on price and other terms of transaction; providing transport and storage, acquiring funds, assuming risks of ownership, providing payment and others⁶⁵.

The distribution of services differs considerably from the distribution of goods. Due to intangibility, services cannot be stored, transported or inventoried. They cannot be either separated from the service provider because of the inseparable nature of services, therefore they must be created and distributed simultaneously. Because there are no physical products, traditional wholesalers and retailers rarely operate in such markets. Many services are provided directly to customers without the use of intermediaries. For example, personal services like hairdressing or massaging are performed directly. Depending on their nature, information-processing services can be delivered either directly or through electronic channels. The

⁶³ P. Kotler, op.cit, p. 504.

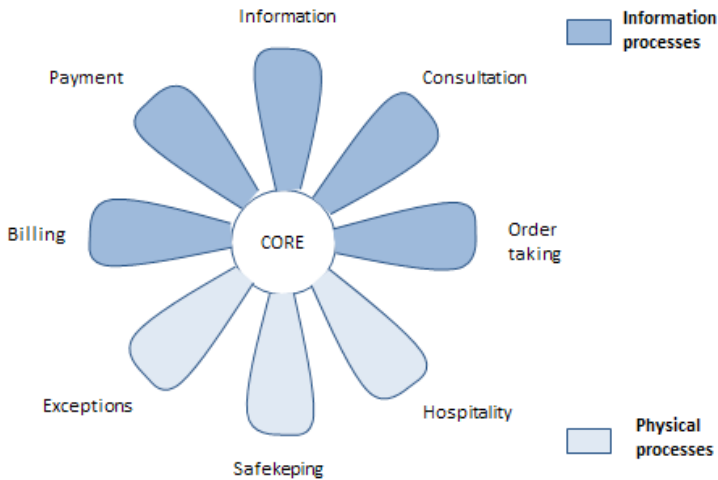
⁶⁴ L.W. Stern, A.I. El-Ansary, Marketing Channels, 5th ed., Upper Saddle River, NJ: Prentice Hall, 1996.

⁶⁵ P. Kotler, K.L. Keller, op.cit, p. 243.

only traditional indirect channel used to distribute services involves an agent and is typical for such services as insurance, securities, and real estate. Franchising can also be used as a way to develop distribution network, however, not all service companies can apply this business model.

In a services context, distribution embraces three interrelated flows: information and promotion flow, negotiating flow, and product flow. Distribution of promotional materials is aimed at getting customers interested in buying a service. Negotiations are essential for reaching an agreement on the terms of the offer and service features. Distributing services involves location decisions and development of the network of service sites. As shown in Figure 6.1, the *Flower of service* concept, which illustrates the core product and supplementary services, can be used in a distribution context as well. Information flow refers to the information and consultation petals; negotiations flow to the order-taking, billing, and payment; and product flow to the core service and remaining petals. Many core services as well as enhancing supplementary services like hospitality, safekeeping and exceptions require a physical location. However, information based supplementary services, such as information, consultation, order-taking, billing, and payment, can be either provided face-to-face or via electronic channels⁶⁶.

Figure 6.1 Information and physical processes of the service product



Source: Ch. Lovelock, J. Wirtz, *Services Marketing. People, Technology, Strategy*, Prentice Hall, 2011, p. 111.

The location of a service site and channels used to deliver services are key distribution decisions. Because customers are often involved in a service process as co-producers, the time and place at which they are expected to participate in a process should be considered along with other service components as an important value creation factor. Unlike manufacturers who can produce goods in the most economic locations, service providers cannot take loca-

⁶⁶ Ch. Lovelock, J. Wirtz, op.cit., pp. 110-111.

tion decisions in isolation from the customers' needs. Therefore, usually a trade-off is required between producer requirements and customers' needs⁶⁷. Service providers should also decide what channels to use to distribute their services. They can either use direct sales or deliver services by intermediaries. However, many service companies outsource certain tasks. In such cases, the core product with some supplementary elements is delivered by the originating supplier, whereas other supplementary services are delivered by the intermediary. This system requires supervision to ensure that services offered to customers fit the overall service concept⁶⁸.

6.2. Place and Time Decisions

Place and time decisions are crucial for service delivery. When deciding on where and how services should be offered to customers, it is important to consider the nature of the interaction between a service company and customers, and whether the firm should maintain a single outlet or multi-site locations. Possible options for service delivery, with regards to the type of interaction between a service provider and customers, and availability of service sites, are shown in Table 6.1⁶⁹.

Table 6.1 Types of interaction between a service company and customers

	Single site	Multiple sites
Customers come to a service company	Hairdresser, theater, fitness club, country club, café	Fast-food chain, motel chain, car rental, bank
A service company comes to customers	House cleaning, maintenance services, repairs	Mail delivery, road service, pizza delivery
Customers and a service company transact remotely	Local TV station	Telephone, broadcast network, electricity

Source: Based on Ch. Lovelock, J. Wirtz, *Services Marketing, People, Technology, Strategy*, Prentice Hall, 2011, p. 112.

Customers come to a service company. When customers visit a service site, location decisions become very important. In such services as restaurants, cafes, pubs and clubs they can be even critical to success of a business. Service companies which maintain a number of sites like fast-food chains, hotels, car rentals and banks should develop a location strategy. It involves identifying company's needs and objectives, formulating requirements with regards to prospective locations, considering different sites basing on costs and benefits offered by each location, and selecting locations that satisfy these criteria and meet company's needs.

A service company comes to customers. Site location becomes less important when a service company comes to customers. Wide range of maintenance services as well as cleaning and repairs services are delivered at a customer's site. Service providers come with their equipment, products, and personnel to the customers' premises such as offices, schools, hos-

⁶⁷ A. Palmer, op.cit, p.215.

⁶⁸ Ch. Lovelock, J. Wirtz, op.cit., p. 121.

⁶⁹ Ch. Lovelock, J. Wirtz, op.cit., pp. 111-115.

pitals, stadiums and others. In many cases service providers can decide whether they visit their customers or require customers to come to a service site. Doctors, hairdressers, and beauty and massage specialists can build their business around visiting individuals in their homes.

Customers and a service company transact remotely. When the service transaction is conducted remotely, customers never see service facilities and personnel. In such cases, customers deal with a service provider via Internet, phone or mail. Suppliers of electricity, gas, and telephone do not have to be concerned with location of their service sites. Some services offered by a service provider require physical presence of a customer, whereas others can be provided through remote transactions. For example, routine banking services are delivered online, but more complicated transactions like arranging a mortgage or credit need to be provided at the bank premises.

Location decisions require the understanding of customers' needs and expectations, the nature of the service, and the competitive activities. However, the key issue is to develop the strategy that meet company's needs and helps to achieve its objectives. For this reason, cost, productivity, and access to labor are also important determinants of the location strategy, especially with regards to the back-stage elements. Locating front-stage activities depends on different factors such as outlet availability, safety, parking access, consumer shopping habits, and nature of the service. For example, customers should have an easy access to frequently purchased services, whereas locations of specialty services do not have to meet this requirement. When selecting the service site for high quality or professional services, prestigious locations would fit the best overall service concept. Typically, services should be located close to where customers live and work, on transportation routes, in shopping malls, bus, rail, and airports terminals, and other places convenient for customers. Location decisions must be complemented by defining when service should be delivered. This refers to how many days a week and how many hours a day service will be available to customers. Some supplementary services might be available at extended hours, whereas the core service and other supplementary services can be provided 40-50 hours a week. The present trend is towards extended operating hours and seven-day operations. In some cases, services are available 24 hours a day, 7 days a week, all year long. Time at which the service is available as well as the location of a service site might be an important source of company's competitive advantage.

6.3. Channel-Design Decisions

Channel-design decisions involve several steps including analyzing customer needs, setting channel objectives, identifying major channel alternatives, and evaluating major alternatives⁷⁰. As it was already stated, distribution decisions require a trade-off between customers' needs and producer needs, so that organizational goals can be achieved as well as customer satisfaction. Typically, services can be distributed to customers directly through company-

⁷⁰ P. Kotler, K.L. Keller, op.cit, p. 245.

owned channels or through intermediaries such as agents, brokers, franchisees, and electronic channels. When evaluating major channel alternatives, it is necessary to take into account the advantages and disadvantages of different types of intermediaries as well as competitors' channels and environmental conditions.

Direct sale. Many services are distributed directly to customers. Direct sale is a typical form of distribution of local services such as cafes, pubs, medical and dental clinics, and beauty and hairdressing salons, however, service providers which maintain a number of sites use direct channels as well. Moreover, many multinational chains set up their own outlets which are completely run and managed by a company. Among the main advantages of the company-owned service sites are: control of the distribution system, ensuring the consistency of service, and maintenance of brand image. The major benefit of distributing services through direct channels is having control over the outlets. A company can implement a coherent system of recruiting, training and motivating employees, establish its own standards, and monitor the service provision to maintain its consistency. As a result, customers can expect the same quality and service experience in each outlet, what decreases the purchase risk and helps maintain a clear brand image. Additionally, a direct contact with customers facilitates communications and getting feedback about service performance. This enables service provider to react quickly and implement improvements to existing services and develop new ones. One more benefit is that a company has a complete control over the customer relationship. In spite of numerous advantages of company-owned channels, such a system has several disadvantages. First of all, the company must bear all the financial risk and find capital when planning on expanding its business. Another problem is that multinational companies are not experts in local markets and might be unaware of adjustments which should be made. For this reason, partnerships or joint ventures are preferred to company-owned channels when expanding into other cultures and countries⁷¹.

Agents and brokers. Agents are intermediaries who handle negotiations and signs agreements on behalf of a service supplier, whereas brokers assist in negotiations between buyers and sellers. Agents and brokers do not have title to services, but deliver rights to them and perform different marketing functions. Among the major benefits of using these types of intermediaries is reducing selling and distribution costs. Moreover, a service producer can expand its business and increase sales without bearing unnecessary financial risk. Agents and brokers are usually paid by commission and get rewards and incentives for reaching certain sales levels, which is a good way to motivate them to achieve better results. Additionally, they have much better and broader knowledge about local market and their customers. Since they understand customers' preferences, they know how to adapt the market offering to match their needs and persuade them to buy a service. For the same reasons, they can easily develop and maintain the relationships with their customers. However, there are some challenges of delivering service through agents and brokers. In many cases agents represent multiple service suppliers. While customers benefit from having a choice of buying a market offering

⁷¹ V.A. Zeithaml, M.J. Bitner, op.cit., pp. 345-347.

most suitable for them, the agents, in fact, are selling competing services, which decreases the chance of selling a service of a particular service provider. Another problem is loss of control over pricing and other marketing activities. As service supplier's representatives, agents can configure services and charge customers different prices which might be perceived unethical and affect a company's brand image⁷².

Franchising. Franchising has become a popular way to expand business and increase revenues and has been widely used by service companies. This is a practice of using another firm's business model, which has been already successfully implemented. A company (the franchisor) enters into contractual relationship with other firms (franchisees) operating under the franchisor's trade name. Both parties sign a franchise agreement which specifies the following terms: the nature of the product, the geographic territory of franchisee's business operations, the fee for the franchise, the amount of revenue to be paid to the franchisor, the instructions how to operate the business, the length of the agreement, the promotional, administrative, and technical support provided by the franchisor, and the way the agreement can be terminated⁷³. Franchising is a strategy which works best when the business concept is relatively easy and services can be standardized and easily duplicated. The major benefit for the franchisor is the ability to develop wider distribution network with a recognizable brand name without bearing unnecessary financial risk. Additionally, they can maintain service consistency in outlets, due to provided training, equipment, and promotional support, as well as implemented control procedures in all areas of business operations. However, some franchisors delegate the responsibility for recruiting, training, and supporting franchisees within a given geographic area. This strategy, known as "master franchising", allows the company to operate efficiently in local markets. Master franchisees are usually individuals who have already succeeded as operators of franchise outlets, so they can share their knowledge and provide support to less experienced franchisees⁷⁴. Challenges for franchisors include: difficulty in motivating franchisees, potential conflict with franchisees as they gain more experience, and decreased control over service quality and customer relationships. In spite of some problems associated with franchising, this model of business has been implemented by many companies. Some of the most popular franchises include fast-food restaurants, however, the fastest-growing chains developed through franchising relate to health and fitness, publications, security, and consumer services⁷⁵.

Electronic channels. Developments in computer technology and telecommunications have caused changes in the distribution of services. Many companies started to use electronic channels to distribute services, which do not require direct contact with customer. This form of distribution includes service delivery through computer, telephone, interactive, multimedia, and television. Electronic channels can be used as a complement or alternative

⁷² V.A. Zeithaml, M.J. Bitner, *op.cit.*, pp. 355-357.

⁷³ *Ibidem*, p. 350.

⁷⁴ Ch. Lovelock, J. Wirtz, *op.cit.*, p. 123.

⁷⁵ International Franchise Association Educational Foundation, *Franchise Industry Gains 300 Concepts in One Year*, November 19, 2007.

to traditional physical channels for delivering information-based services and supplementary services such as information, consultation, order-taking, billing, and payment. Particularly, the Internet revolutionized service delivery and changed the traditional relationships between customers and the company. Additionally, the Internet enables to collect data on consumer behavior, advertise services, obtain feedback quickly from customers, and create online communities to market services⁷⁶. Adding an Internet channel to already established physical channels requires high capital, however, multichannel strategy is beneficial for service provider due to increased market coverage, lower selling costs, and more customized selling. Distribution of services through electronic channels brings substantial benefits, but at the same time poses some challenges for companies. The major benefit of using electronic media is lower cost and effort to deal with customers than the costs to perform different activities with personal channels. Moreover, this form of distribution allows the service provider to maximize market coverage, interact with a large numbers of customers, and thereby increase sales. With electronic channels, customers have an easy and convenient access to services, and can react quickly in case of problems or when they want to share their opinions about services. Rapid customer feedback enables the company to make necessary adjustments, enhance customer relationships, and increase service quality. Challenges of distributing services through electronic channels involve lack of control of the electronic environment and security of information which undermine customer trust, increased price competition, consumer reluctance to change buying patterns, and inability to deliver and customize many services due to lack of personal contact⁷⁷. Although this form of distribution creates some problems, electronic channels have become very popular among many service companies due to its cost-effectiveness and efficiency.

Service providers have a wide choice of channel alternatives, however, they have to evaluate each option carefully to choose the best and most suitable way to distribute their services to customers. First, it is important to assess costs of selling through different channels and benefits such as expected level of sales as well as the impact of using each channel option on value delivered to customers. Typically, lower-cost channels like Internet produce less customer value than company-owned channels or franchise outlets. This is because some supplementary services can be provided only in direct contact. However, customers with higher confidence and broader knowledge about a service are more likely to use impersonal channels, which is time saving and convenient. Thus, in some cases, service companies can switch their customers to lower-cost channels without losing sale or customer value and thereby gain channel advantage⁷⁸. When evaluating channel alternatives, it is also necessary to consider control issues and adaptive criteria along with economic criteria. In general, it is better for a service company to have much control over channels, because it enables to maintain consistency of services, which has a positive impact on customer satisfaction and mutual re-

⁷⁶ Ch. Lovelock, J. Wirtz, *op.cit.*, p. 119.

⁷⁷ V.A. Zeithaml, M.J. Bitner, *op.cit.*, pp. 357-361.

⁷⁸ L.G. Friedman, T.R. Furey, *The Channel Advantage: Going to Marketing with Multiple Sales Channels*, Boston, Butterworth-Heinemann, 1999.

relationships. With regard to adaptive criteria, long-term commitments with channel members reduce the service provider's ability to respond to changing environment. In today's uncertain marketplace, it is better to have commitments which provide more flexibility and ensure higher adaptability.

After choosing the best channel alternative, a service company needs to select intermediaries and decide how to train and motivate them as well as what measures to use to evaluate their performance. Service providers should start with determining the characteristics and formulating requirements for potential channel members, which serve as a base for selecting intermediaries. Depending on the type of intermediary, these characteristics usually include location, sales potential, financial strength, experience in the market, size and quality of sales force, cooperativeness, and others. Then, the service company should design and implement training programs for intermediaries to improve their performance. Typical training for sales personnel involves product knowledge, customer service, and sales techniques and might be also used as a way to differentiate a service. Channel members need to be motivated to achieve better results, so service providers should understand intermediaries' needs and offer them adequate financial and non-financial incentives. However, system of rewards should be linked to evaluation standards set by the company. These include sales-quota attainment, customer service performance, ability to use sales techniques, time delivery, involvement in performing some marketing functions such as sales, promotion and others. Periodically, it is necessary to review channel arrangements and modify channel structure by adding or dropping particular channel or individual intermediaries to increase channel effectiveness.

Questions

1. What are the distinctive challenges of distributing services?
2. Why is it important to distinguish between distributing core and supplementary services?
3. How the type of interaction between a service provider and customers might affect distribution decisions?
4. What are the key factors driving place and time decisions?
5. Discuss advantages and disadvantages of major channels alternatives.
6. What are the implications for a service company of delivering through both physical and electronic channels?
7. Select a service company you are familiar with and discuss its distribution strategy with regards to place, time, and channels decisions.

CHAPTER 7

The Services Communications

Learning objectives

After reading this chapter, you should be able to:

- Understand the challenges of services communications.
- Be familiar with the steps involved in developing communications strategy.
- Identify main types of communications channels.
- Understand the importance of integrating marketing communications.
- Describe the elements of marketing communications mix.

7.1. Services Communications Challenges

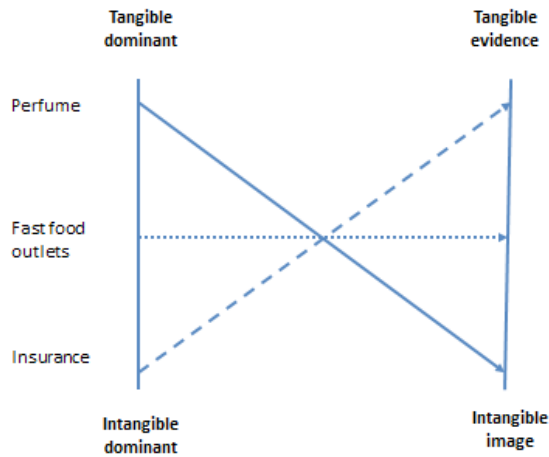
Marketing communications are the means by which marketers promote the value proposition offered by their company. They inform existing and prospective customers about product features and benefits, price and other costs, channels through which product is delivered, and when and where it is available. Moreover, they attempt to persuade customers that their product offers the best solution to meet customers' needs, and remind them about the product's benefits relative to competing offerings. Communications efforts are also focused on building and developing the relationships with customers and other groups of stakeholders. In recent decades, the approach to marketing communications has changed due to growing number of communication channels, and more fragmented audiences made up of sophisticated consumers. Many companies moved toward integrated marketing communication, instead of using selected communication tools to achieve their communications objectives. Integrated marketing communications is the concept that recognizes the added value gained through integration and coordination of all marketing communication tools, functions, and sources within a company into a consistent program. This program is designed to bring together advertising, direct marketing, sales promotion, public relations, and other communication tools to maximize impact on consumers and other stakeholders⁷⁹.

Traditional marketing communications strategies were designed to promote manufactured goods, however, services differ considerably from goods. For this reason, it is necessary to consider those differences when developing services communications programs, rather than base on the ways typical for physical products communications. Unlike goods, services are performances and cannot be assessed before they are bought. Due to high level of uncertainty related to purchase decision, customers search for any signs of the service quality. Therefore, marketers should make

⁷⁹ K.E. Clow, D. Baack, *Integrated Advertising, Promotion, and Marketing Communications* 3rd edition. Pearson Education, 2007, pp. 9–10.

efforts to “tangibilize the intangible” and focus on physical service attributes when creating a communications message⁸⁰. As shown in Figure 7.1, they should use tangible evidence to promote their market offering, whereas physical product marketers are challenged to enhance their message with abstract ideas⁸¹. To overcome the challenges of intangibility, marketers can use various advertising techniques including showing physical components of service and service environment, presenting service delivery process, displaying benefits gained from the service, presenting customer testimonials, using metaphors tangible in nature, citing independent sources, documenting and citing statistics regarding service performance, and presenting company’s achievements⁸². Providing documentation about the company’s performance additionally reduces customer’s uncertainty and minimizes the perception of service heterogeneity. As service delivery is a process which requires an interaction between a customer and service provider, it is appropriate to show front line employees and customers interacting in a friendly manner. Advertising that illustrates services inseparability is also a good way to present professionalism of service staff, especially when the company’s differentiation is based on customer service. Service companies often face a problem of perishability, which means that services cannot be stored and sell at later time. In this case, advertising and sales promotion can help to encourage customers to change the timing of service use, and thus enable a company to match the demand with capacity available at specific time.

Figure 7.1 The impact of intangibility on communications strategies



Source: Adapted from G.L. Shostack, *Breaking Free from Product Marketing*, The Journal of Marketing, April 1977.

⁸⁰ T. Levitt, Marketing Intangible Products and Product Intangibles, Harvard Business Review, May-June 1981, pp. 94-102.

⁸¹ G.L. Shostack, *Breaking Free from Product Marketing*, The Journal of Marketing, April 1977.

⁸² B. Mittal, J. Baker, Advertising Strategies for Hospitality Services, Cornell Hotel and Restaurant Administration Quarterly, 43, April 2002, pp. 51-63.

Services communications should be viewed more broadly than as a set of tools and techniques used to influence target audience to achieve company's communications objectives. There are also different ways to communicate with customers and other groups of stakeholders. The location of a service site, service environment and atmosphere in which service is delivered, behavior and outlook of personnel, corporate design, and other visual and non-visual elements contribute to a perception of a service in customers' minds that might enhance the formal communications message⁸³. When developing a communications strategy, marketers should integrate various elements appealing to a target audience to create a clear and consistent message. Thus, integrated marketing communications has a broader context in services, thereby causing many challenges to marketers. Not only they have to deal with problems related to services communications, but they also have to identify all elements communicative in nature and synchronize them into an integrated marketing communications program.

7.2. Developing a Communications Strategy

Planning and designing effective communications requires the following steps: defining the target audience, determining the objectives, designing the communications, selecting channels, establishing the budget, deciding on the communications mix, measuring the results, and managing integrated marketing communications⁸⁴.

Defining the target audience. The process of developing communications strategy should start with the identification of a target audience. Typically, a company communicates with many groups at the same time, including potential buyers, current users, employees, influential groups, and general public. However, different promotional tools are used to communicate with specific audiences. If a service company intends to reach prospective buyers, it would rather use traditional media, direct marketing, and public relations. Targeting users requires more efforts put on selling techniques like cross- and up-selling, direct marketing, and loyalty programs as well as other point-of-sale promotions. Communications directed at employees is a part of internal marketing campaign, which is mostly based on public relations techniques. Public relations are also effective in creating a brand image which appeals to described audiences as well as influential groups and general public.

Determining the objectives. After defining target audience, marketers should specify communications objectives the service company wants to achieve. The communications objectives relate to the stages within the product life cycle and can be categorized under three broad headings: to inform, to persuade, and to remind. The major communications objectives within the introduction stage are focused on informing customers about a new service offering and creating brand awareness. During the growth stage communications efforts should be put on building customer preference and enhancing the firm's image by promoting the benefits of a specific brand. Communications objectives within the maturity and decline stages tend to encourage repeated purchases and reinforce previous promotional activities.

⁸³ Ch. Lovelock, J. Wirtz, *op.cit.*, pp. 164-165.

⁸⁴ P. Kotler, *op.cit.*, p. 566.

Designing the communications. Developing effective message involves searching for ideas that help communicate the value proposition offered by a company in the most appealing way. Marketers can either use informational appeals elaborating on the market offering's attributes and benefits or transformational appeals emphasizing non-product related benefits and the ways in which a product provides customer satisfaction⁸⁵. Examples of informational appeals in advertising include problem-solution ads, service process demonstration ads, comparison ads, and testimonials. They focus on the individuals' practical and functional need for a product and use rational arguments to build brand preference and persuade customers to make a purchase decision. Unlike informational appeals, transformational appeals attempt to affect customers' emotions and feelings. They stress the experience that results from using a particular brand or depict a person who uses this brand. When designing the message, it is also important to remember that intangible services require communications emphasizing their physical attributes, rather than based on abstract ideas.

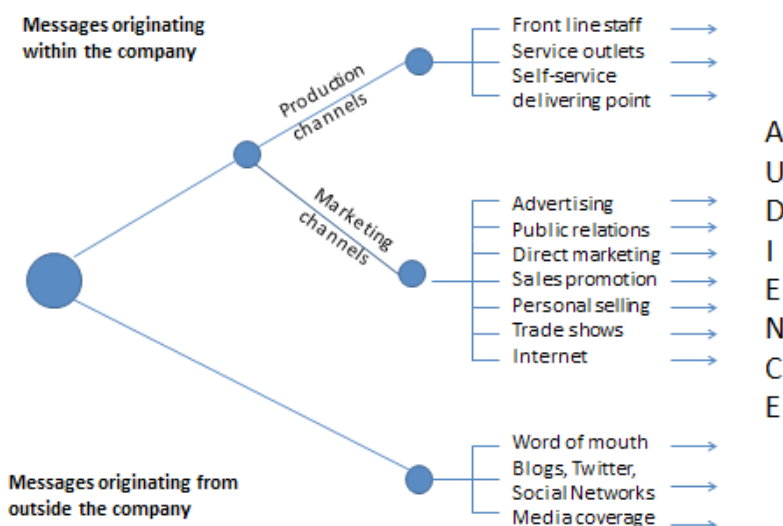
Selecting the channels. After designing the message, marketers must select most suitable channels to reach the target audience. Communications channels can be categorized into two main groups: personal and non-personal channels. Personal communications channels are those in which two or more persons communicate with each. They involve person-to-person and person-to-audience contact, as well as communication over the telephone or through e-mail. Non-personal communications channels include broadcast media (television, radio), print media (newspapers, magazines), display media (billboards, posters, signs), electronic media (web page, CD-ROM, videotape), sales promotion, events, and publicity⁸⁶. It is also possible to categorize communications channels into those which are controlled by a company and those that are not. As shown in Figure 7.1, messages originating within the company can be transmitted through marketing channels and production channels. Marketing channels include traditional media and Internet, while production channels are the company's service delivery channels which enable communications through service outlets and service staff. Other messages originate from outside the company and involve media coverage, word of mouth, blogs, and social networks⁸⁷.

⁸⁵ B.D. Cutler, E.G. Thomas, S.R. Rao, Informational/Transformational Advertising: Differences in Usage Across Media Types, Product Categories, and National Cultures, *Journal of International Consumer Marketing*, Volume 12, Issue 3, 2000, pp. 69-83.

⁸⁶ P. Kotler, K.L. Keller, *op.cit.*, pp. 285-287.

⁸⁷ A. Palmer, *op.cit.*, p. 397.

Figure 7.1 Sources of messages received by a target audience



Source: Adapted from A. Palmer, *Principles of Services Marketing*, London, McGraw-Hill, 4th ed., 2005, p. 397.

Establishing the budget. One of the most difficult decisions is determining the communications budget. Expenditures vary greatly across industries: in the cosmetic industry communications budgets fall between 30-50 percent of sales revenue, whereas in the industrial-equipment industry spending amount to 5-10 percent. Marketers use four common methods when deciding on a budget⁸⁸.

- **Affordable method.** Marketers set the promotion budget based on what a company can afford. Even though this approach ignores the impact of promotion on sales volume and is not effective in long-term planning, many small companies use this method.
- **Percentage-of-sales method.** Many companies set the promotion budget at a certain percentage of current or anticipated sales. This method is simple to use and links sales to promotion expenditures, however, it views sales as the cause of promotion rather than as the result.
- **Competitive-parity method.** Some companies monitor competitors' expenditures and set the promotion budget based on industry average. Although competitors' budgets represent the collective wisdom of the industry, companies differ greatly in terms of their needs, objectives and resources.
- **Objective-and-task method.** Marketers set the promotion budget by determining objectives and tasks needed to achieve these objectives, and estimating costs of performing specified tasks. The sum of these costs constitutes the budget. This method is logical and rational, since it links spending to promotion results.

⁸⁸ P. Kotler, K.L. Keller, op.cit., pp. 287-288.

Deciding on the communications mix. Marketers must allocate the communications budget over major promotional tools, however, they have to consider several factors when developing their communications mix. First, communications tools differ in terms of their characteristics and costs. Additionally, they might be more or less effective depending on which market or target audience a company tries to reach. For example, advertising is commonly used in consumer markets, whereas business markets require many promotional efforts put on personal selling. Moreover, promotional tools vary in their effectiveness at different stages of buyer readiness. Advertising and publicity are most effective in the awareness building and comprehension stages and then their role is decreasing. Conversely, sales promotion and personal selling are most important in the conviction and order stages. When deciding about promotional tools, it is also necessary to consider a stage of the product within the product life-cycle. In the introduction stage advertising and publicity dominate, then in the growth stage the demand is built through word of mouth. Sales promotion, personal selling, and advertising are important in the maturity stage. In the decline stage the promotional activities besides sales promotion are limited.

Measuring the results. After implementing the communications plan, it is necessary to measure its impact on the target audience. The sales generated by a promotional campaign is the most important effect of undertaken activities, however, different methods are used for measuring the effectiveness of various promotional tools. Advertising effectiveness requires measuring message recognition and recall, previous and current attitudes toward the brand, as well as purchase behavior and customer satisfaction. Sales promotion measures include the number of new customers, repeat purchases and attitude changes. The effectiveness of personal selling is measured in terms of the ability of sales staff to perform sales tasks and use sales techniques, which is linked to the achievement of sales targets. The methods used for studying effectiveness of public relations involve media content analysis, trade show and event measurement, and public opinion polls and surveys.

Managing integrated marketing communications. The last step of developing effective communications is to determine the ways in which the marketing communications process will be managed. Marketing communications program should be designed jointly, which means that all communication tools and messages must be coordinated, so that they produce a consistent and clear brand image. This means that agencies, firms, and company's units involved in the development of communications program should work together rather than focus on individual tasks and parts of a program. Thus, firms should appoint a marketing communications director who is responsible for all of the company's communications and coordinates all undertaken activities.

7.3. The Marketing Communications Mix

The marketing communications mix, often called promotion mix, refers to a combination of marketing tools used to communicate the marketer's message to achieve the company's communications objectives. Services marketers have a wide range of communication tools to

promote their company's value proposition and influence target audience. The most important communication tools are briefly described below.

Personal selling. The sales personnel plays a very important role in the communications strategy of many service companies. This is because firms typically have a control over service delivery channels including service outlets, which gives cost-effective and powerful communications opportunities⁸⁹. Personal selling is a unique communications tool because it allows for personal interactions between sales staff and customers. Due to its face-to-face character, customers get a relatively high degree of personal attention, the message can be highly customized, and sales force can deliver detailed and precise information. Moreover, the service provider can get quickly a feedback from their customers about their opinions and preferences, and measure the results of selling activities. Personal selling is also effective in building and maintaining the relationship with customers. The typical tasks of salespeople include providing information, taking reservations, receiving payments, solving problems, and handling complaints. When the service supplier offers several products, frontline employees additionally are encouraged to cross-sell services, up-sell them to higher value, and promote new ones. Service companies need to carefully consider all issues regarding their sales force, such as objectives, size, structure, and compensation, as well as selection criteria, training, motivating, supervising, and evaluating.

Advertising. Marketers have a wide range of advertising media which might be used to deliver the message to target audience, including broadcast (television, radio), print (magazines, newspapers), outdoor (billboards, posters, exteriors of buses, vehicles, buildings) and other types. Advertising is especially effective in building brand awareness and brand preference and remains the most popular form of communication in consumer markets. When it comes to making a choice about which media to select, marketers should consider many factors, such as target audience media habits, product characteristics, message characteristics, and cost. Television is an expensive and powerful medium with broad market coverage, thereby it is effective in promoting services addressed to wide target markets, such as financial, telecommunications, entertainment, tourism and fast-food services. Since radio offers only audio presentation and attracts lower attention than television, it can be used for announcing sales promotions and other events. Magazines, due to their high selectivity, credibility, and prestige, are effective in advertising services addressed to selected target audiences. Newspapers are the most effective medium in advertising local services and enable to deliver informative messages, but poor quality of ads limits substantially their visual appearance. Outdoor ads can support other media activities and might be used to inform about new performances, events, movies, as well as current sales promotions. Analyzing the content of ads, research shows that ads for services contain more factual information on price, warranties, documentation of performance, and availability than ads for goods⁹⁰.

⁸⁹ Ch. Lovelock, J. Wirtz, *op.cit.*, p. 181.

⁹⁰ S.J. Grove, G.M. Pickett, D.N. Laband, An Empirical Examination of Factual Information Content among Service Advertisements, *The Service Industries Journal*, 15, April 1995, pp. 216-233.

Direct marketing. This category of communications includes direct mail, catalogs, telemarketing, e-mail, and mobile telecommunications. These channels enable to send personalized and informative messages to highly selected target markets at reasonable cost. Marketers need to have a detailed database with information about customers and their preferences, when they want to employ this strategy. Direct marketing is growing in importance, since it is measurable, has significant impact on sales, and is effective in building customer relationship. The growth of Internet and mobile phones along with improvements in technology has made product selection and ordering easier and faster. On the other hand, marketers turned to direct marketing, due to rising costs of traditional media and sales force. They use different types of channels to achieve their objectives. Direct mail is a very popular medium because it enables to define precisely target audience, personalize the message, and measure the effectiveness of campaign. Catalogs are also quite common and serve as a very important communications tool in some industries like tourism. Another direct marketing tool telemarketing involves is the use of the telephone and call centers to communicate with customers, take orders, and answer their questions. It helps reduce selling costs and improve customer satisfaction.

Sales promotion. Service companies often use sales promotion as a very important ingredient of their communications strategy. Conversely to advertising which gives a reason to buy a product, sales promotion offers an incentive to buy it. This category of communications embraces a diverse collection of tools such as samples, coupons, discounts, gifts, and competitions with prices. They can be used in consumer markets and in business markets. Sales promotion tools are designed to stimulate purchase of particular products in a given time, however, they might vary in their specific objectives. Whereas samples stimulate consumer trial, competitions with rewards contribute to a long-term relationship. Sales promotions have a number of benefits. They add value to the market offering, encourage customers to make buying decisions, and increase sales during periods when demand would be otherwise low. However, sales promotion does not have a long lasting effect and customers acquired through sales promotion campaigns may have lower repurchase rates and lower lifetime value⁹¹. For this reason, sales promotion incentives should be used with great care.

Public relations. Besides communication tools which are typically designed to attract target market customers, service companies must use also tools that allows communications with all groups of stakeholders and general public. Public relations involve techniques aimed at promoting a company's image or its individual products. They include press releases, press conferences, obtaining testimonials from public figures, community involvement, fundraising, and sponsorship of sporting events and other activities. PR specialists present information about a company, promote the understanding of a company through external and internal communications, organize special events, influence key decision makers to promote favorable legislation and regulation, educate and train important target markets, advise management about public issues, and sponsor particular activities to publicize specific products. All of these activities help a service company build its image, reputation and credibility. Public

⁹¹ M. Lewis, Customer Acquisition Promotions and Customer Asset Value, *Journal of Marketing Research*, XLIII, May 2006, pp. 196-203.

relations enables to create positive publicity about a company and increases its brand awareness, however, lack of control over presented information can lead also to transmitting negative news and opinions.

Internet. The role of e-marketing tools is growing in importance since they can complement or even supplement conventional communications channels. The Internet provides opportunities for a greater interaction with customers and personalization of message at a reasonable cost. The typical forms of e-marketing communications include company's own websites and online advertising. Marketers can use their own websites for various tasks, such as providing information about a company and its products, building company's image, building and maintaining relationships with customers, facilitating communications through email and chat rooms, enabling customers to place orders and make payments, and gathering information about customers, their preferences, and opinions. Internet advertising uses different techniques like banner advertising, pop-ups and click through, and search engines. Many companies place banner ads on portals or other firm's websites to attract customers to the advertiser's own site, whereas pop-up ads are intended to draw web traffic and capture e-mail addresses through windows containing advertisements. Search engine advertising on the other hand increases the visibility of websites in search engine result pages through the use of paid placement.

Word of mouth. This form of communication involves recommendations from other customers and is more credible than promotional activities initiated by a company. When the perceived risk associated with the service purchase is relatively high, customers are more likely to rely on the word of mouth communication⁹². As many services tend to have credence attributes, the perceived purchase risk is high and customers seek information from reliable sources. For this reason positive word of mouth is very important for service companies. It is possible to stimulate positive comments and recommendations from customers by employing various strategies. For example, service firms can present testimonials and references from satisfied customers, offer incentives to existing customers for persuading new customers to buy a service, and create exciting promotions to make people talk to each other about the services provided by a company. Word of mouth can also spread out in Internet and is known as viral marketing. Viral messages are created by companies to increase brand awareness and take the form of text, images, interactive games, and video clips. In addition to messages sent by e-mail, word of mouth can be distributed by social networks and online communities.

Corporate design. Corporate visual identity plays an important role in the way a company is perceived by customers and other stakeholders. It provides a firm with visibility, expresses its values and contributes to the brand image. Corporate design includes such features as logo, uniforms, corporate colors, stationary, equipment, and building interior. It helps to ensure a consistent message which is communicated through all communications channels used by a company. Corporate design along with corporate communication and corporate behavior make up corporate identity which is a key to promote a company and distinguish it from its competitors.

⁹² H.S. Bansal, P.A. Voyer, Word of Mouth Processes Within a Services Purchase Decision Context, *Journal of Service Research*, 3, No. 2, November 2000, pp. 166-177.

Having so many communications channels and a number of target audiences to reach, it is important to integrate all communication tools that a company is willing to use to deliver a consistent and clear message. Integrating marketing communications enables firms to be more effective in terms of reaching target audiences with the messages, which has a significant impact on sales, but most importantly, it helps to create a strong brand identity.

Questions

1. What are the challenges of services communications and how can they be overcome?
2. What are the types of communications channels used to deliver messages to target audience?
3. Describe the process of developing communications strategy.
4. Explain the benefits of integrating communications mix elements.
5. Why personal selling is considered an important tool in services communications?
6. What communications tools are most effective in (a) creating brand awareness, (b) increasing sales, (c) building customer loyalty.
7. What are the sources of messages originating from outside the company received by a target audience and how a company can stimulate positive word of mouth?
8. Discuss the problems related to the effectiveness of communications strategy. Illustrate your answer with relevant examples.

CHAPTER 8

The Company's Physical Evidence

Learning objectives

After reading this chapter, you should be able to:

- Understand the role of physical evidence in customers' experience.
- Be familiar with the models explaining how people respond to service environment.
- Know and discuss the dimensions of service environment.
- Understand how ambient conditions influence customers' behaviors.
- Understand the role of spatial layout and functionality, signs, symbols and artifacts.

8.1. The Role of Physical Evidence

The physical environment affects customers' experience during the service encounter enhancing or undermining customer satisfaction. In some services such as theme parks, restaurants, cafes, and hotels service environment might even be a key to customer satisfaction, making great impression and leaving long-lasting memories. Thus, physical evidence is an important component of a service company marketing-mix strategy and overall value proposition. Due to the intangibility of services, customers rely on physical evidence when assessing the expected quality level, so careful design of all tangible elements can increase perceived value of the market offering.

Physical evidence can fall into three main categories: facility exterior, facility interior, and other tangibles⁹³. The facility exterior includes the surrounding environment, parking facilities, the firm's entrance, and signage. When deciding about a location of the service company, especially with regard to high-contact services, it is important to consider the accessibility, safety, visibility and compatibility of the service site and market offering with the surrounding environment. The facility interior is composed of such elements as interior design, signage, equipment and other devices necessary for service performance which are complemented by ambient conditions like music, scents, temperature, and colors. Some of these elements are visible to customers and play an important role in the service delivery process, but other ones are much more subtle and they are essential in creating certain mood and atmosphere of the service outlet. Other tangible elements include stationery, business cards, billing statements, personnel uniforms, promotional material and are a part of visual identity of a company. Since customers perceive all service elements holistically, it is important to ensure that they are carefully designed to create a consistent image and a unique brand experience.

⁹³ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, op.cit., p. 264.

The company's physical evidence may serve different purposes. It differentiates the firm from its competitors, communicates its image through tangible clues, facilitate the performance of the service, and socialize customers and employees⁹⁴. The servicescape can be used as a part of the company's value proposition enhancing customer experience. Nicely designed interiors along with equipment of good quality and well-dressed personnel make good impression on customers. Such service environments, conversely to poorly designed interiors, are more likely to attract customers and offered services are usually perceived as professional. However, service companies which offer low-price services can emphasize the functional aspect of their outlets. For example, fast-food restaurants are designed to ensure convenience and fast service delivery. Therefore, all restaurants are visible, offer parking space, are equipped in all necessary facilities, and their personnel is dressed in practical uniforms. Additionally, the firm's exterior, interior, and other tangibles create a packaging of a service, which adds value to the market offering and communicates a company's image to customers. Many elements of physical evidence are essential for service delivery and play an important role in facilitating the flow of service activities. Service companies design servicescapes and use suitable equipment, as well as signs and symbols to ensure that service process goes smoothly. Another use of the physical evidence is to facilitate the socialization of customers and employees. Uniforms, for example, help identify the firm's personnel while name tags are useful in creating friendly atmosphere and familiarize customers with employees.

8.2. Consumer Responses to Service Environments

Physical evidence plays an important role in marketing programs of many services companies because it can greatly influence people's emotions and behaviors. Thus, knowledge about how customers behave in different service settings is essential for making decisions about the development of servicescape. Since people respond to specific environments, marketers should be aware of factors which have impact on customers' behaviors and design service environment that stimulates positive feelings and reactions. Two models developed by environmental psychologists help understand the effects of the service environment on consumer behavior.

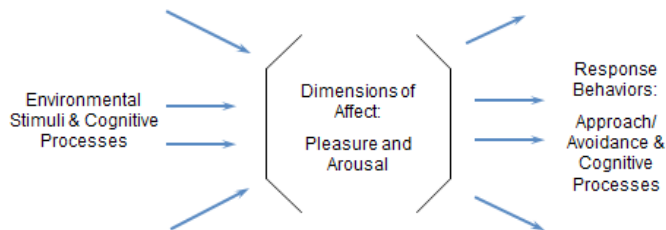
The Mehrabian-Russell stimulus-response model presented in Figure 8.1 holds that people's feelings are crucial to how they respond to service environments⁹⁵. The responses of customers to the firm' physical evidence are influenced by three emotional states: pleasure-displeasure, arousal-nonarousal, and dominance-submissiveness. The pleasure-displeasure emotional state reflects the degree to which the individuals like or dislike the environment. The arousal-nonarousal state refers to how excited and stimulated people are by environmental stimuli, whereas the dominance-submissiveness state shows the extent to which customers can act freely within the service environment. Service companies should design environments

⁹⁴ M.J. Bitner, *The Servicescape*, in T.A. Swartz, D. Iacobucci, *Handbook of Services Marketing and Management*, California, Sage Publications, 2000, pp. 37-51.

⁹⁵ A. Mehrabian, J.A. Russell, *An Approach to Environmental Psychology*, Cambridge, MA: MIT Press, 1974.

which stimulate feelings of pleasure and excitement that would lead customers to stay longer and explore the environment. However, some services such as dental clinics, beauty salons, spas, and elegant hotels and restaurants require calmer and more relaxing servicescapes. Consumer responses to the set of environmental stimuli can be characterized by a certain type of behavior. Customers can either wish to interact with the service environment (approach behavior) or feel disappointed and wish to leave it (avoidance behavior).

Figure 8.1. The Mehrabian-Russell stimulus-response model

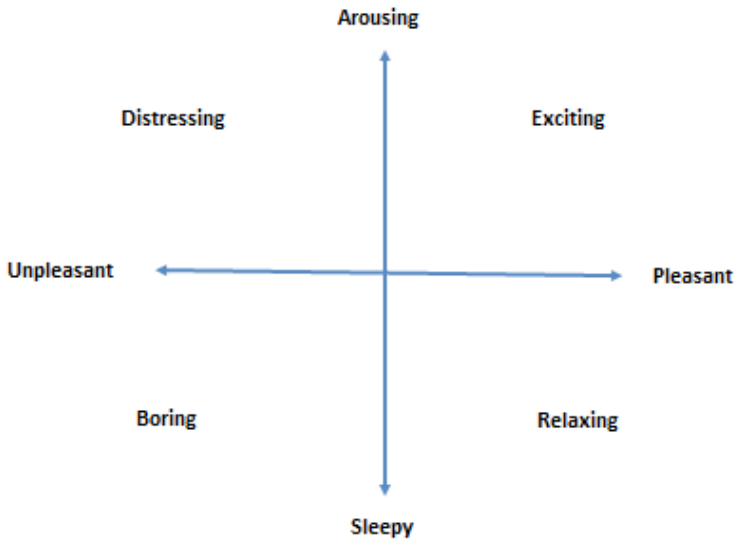


Source: Based on A. Mehrabian, J.A. Russell, *An Approach to Environmental Psychology*, Cambridge, MA: MIT Press, 1974.

In addition to the stimulus-response model, Russell developed model of affect, which explains feelings and emotions in more detail. The Russell model of affect, shown in Figure 8.2, is used to help marketers understand individuals' feelings in service environments⁹⁶. Customers' responses to various elements of the physical environment can be described along two dimensions: pleasure/displeasure and arousal/sleepiness. The pleasure/displeasure dimension refers to the degree to which customers are satisfied with the service environment, ranging from very high to very low satisfaction level. The arousal/sleepiness dimension refers to how stimulated people are by the physical environment, ranging from highest levels of excitement to highest levels of calmness. Marketers can use Russell's model of affect when they design service environment to stimulate certain reactions. Similarly, it is possible to use this model to assess how customers feel in the service environment. Since services are performances and experience is crucial to customer satisfaction, marketers should carefully plan all elements of physical environment to ensure they create desirable atmosphere. For example, the theme parks should be designed so that customers feel happy and excited, whereas yoga centers require environment that stimulates meditation and relaxation.

⁹⁶ J.A. Russell, A circumplex model of affect, *Journal of Personality and Social Psychology*, 39 (6), 1980, pp. 1161-1178.

Figure 8.2. The Russell model of affect



Source: J.A. Russell, *A circumplex model of affect*, *Journal of Personality and Social Psychology*, 39 (6), 1980, pp. 1161-1178.

When developing a concept of the service environment, it is important to understand customers' expectations and design all elements of firm's physical evidence that meet their needs and lead to positive consumer responses. Generally speaking, pleasant environments, which might be either exciting or relaxing tend to draw people in, while unpleasant environments perceived as boring or distressing discourage individuals to interact with them.

8.3. Dimensions of the Service Environment

Service environments are very complex and are made up of many elements. The main dimensions of the servicescapes include ambient conditions, space and functionality, and signs, symbols, and artifacts⁹⁷.

Ambient conditions. These are environmental conditions that pertain to individuals' five senses. They have psychological and physical impact on how people feel and behave. For this reason, all elements of ambient conditions should be designed carefully to stimulate desired responses. Thus, marketers can utilize the senses of sight, sound, scent, touch, and taste to create sensory appeal that influences customers' and employees' well-being and behaviors. Ambient conditions include size and shape perceptions, colors, temperature, air quality, scent, music, noise, smell, lightning, and others.

⁹⁷ M.J. Bitner, *Servicescapes: The Impact of Physical Surroundings on Customers and Employees*, *Journal of Marketing*, 56, April 1992, pp. 57-71.

- **Sight** appeals refer to visual aspects of service environment that individuals perceive. The primary visual stimuli appealing to customers include size, shape, and colors⁹⁸. The size of a company and its facilities is often associated with its power, stability, and security. Many customers believe that large firms are more reliable and competent than the smaller ones. However, other customers may perceive large firms as impersonal and are more likely to choose smaller companies with more intimate and friendly atmosphere. Shape perceptions are related to the design and placement of furniture and other parts of equipment which helps to create harmony within the service environment. Color of the firm's physical evidence has a strong impact on how people feel and often makes first impression on customers. Psychological impact of colors might be considered in three dimensions: hue, value, and chroma⁹⁹. Hue refers to the name of the color, such as red, yellow, green, or blue. Value defines the degree of lightness and darkness of the color, and chroma refers to intensity and defines brightness or dullness of the color. Colors can be classified into warm and cool colors, which symbolize different things and evoke different feelings. The typical associations and human responses to colors are presented in Table 8.1. In general, people prefer warm color environments, which also encourage making fast decisions, however, cool colors are more appropriate when it comes to high involvement purchases.

Table 8.1. The associations and human responses to colors

Color	Degree of Warmth	Association and response to color
Red	Warm	Increases enthusiasm, stimulates energy, passion, and excitement, encourages action and confidence, increase arousal levels, blood pressure, and pulse rate
Orange	Warmest	Stimulates emotions, expression, warmth, activity and appetite, encourages socialization, noted for its ability to encourage verbal expression of emotions
Yellow	Warm	Mentally stimulating, activates memory, and encourages communication, instill optimism, clarity, and intellect, bright yellow often noticed for its mood-enhancing ability
Green	Cool	Nurturing, healing, relaxing mentally and physically, helps alleviate depression, nervousness, and anxiety, second to blue as favorite color
Purple	Cool	Calms the mind and nerves, reduces stress and can create an inner feeling of calm, offers the sense of spirituality, encourages creativity
Blue	Coolest	Calming, cooling and relaxing, lowers blood pressure, healing color for nervous disorders and for relieving headaches, blue is the overwhelming favorite color

Source: www.sensationalcolor.com

⁹⁸ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, op.cit., pp. 279-280.

⁹⁹ A.H. Munsell, A Munsell Color Product, New York: Kollmorgen Corporation, 1996.

- **Sound** is a very important element of ambient conditions and is associated with music, noise, announcements, and other sounds noticed by customers. Background music helps to create certain mood and atmosphere within the service outlet, while announcements are used to deliver messages and inform about market offerings and current promotions. However, some sounds like noise are undesirable and might considerably distract customers' attention, therefore marketers should eliminate them or prevent their occurrence. Music is an important mood-setter, yet research studies have shown that besides creating positive mood, music can additionally influence people buying behavior. For example, fast tempo music increases the pace of consumer various behaviors and reactions, while slow music has the opposite effect¹⁰⁰. When deciding about background music, it is also important to remember about customers' preferences. Younger people tend to like different type of music than older ones and therefore their reactions to music might differ considerably¹⁰¹. Additionally, background music should be carefully selected so that it goes well with the company's market offering and other elements of ambient conditions. While music enhances customers' experience, announcements are rather informative in nature, so their role is to deliver suitable information to target audience. They should be transmitted professionally to make good impression on customers and influence positively their perception of the company. Marketers should also ensure that noise and other unwanted sounds do not disturb customers and deteriorate their service experience.
- **Scent** appeals are associated with certain smells that pervade an environment. The presence of scent influences people's mood and atmosphere of the service outlet, so marketers should pay attention to ensure pleasurable experience for customers in this regard. Some scents like odors are undesirable, so good ventilation systems should be installed and smell avoidance tactics should be employed. Besides smells that have a negative impact on customers, some scents evoke very positive feelings and stimulate certain reactions. Aromatherapy uses aromatic oils to alter people's mind, mood, and health, which might be also used to influence customers within a service outlet. Table 8.2 shows the effects of selected fragrances on people. Some smells like orange or lemon are energizing and stimulating while other ones such as lavender or sandalwood promote relaxation and homely and comfortable feel. Smells, in addition to creating certain mood and atmosphere, can also alter buying decisions and thereby contribute to the sales growth. For example, smell of fresh bread coming from a bakery might considerably increase sales, as well as other smells stimulating hunger. Experts in scent creation claim that firms should have a certain scent associated with their products and recognized by customers, which is an important part of brand experience.

¹⁰⁰ R.E. Milliman, The Influences of Background Music on the Behavior of Restaurant Patrons, *Journal of Consumer Research* 13, September 1986, p.288. R.E. Millman, Using Background Music to Affect the Behavior of Supermarket Shopper, *Journal of Marketing*, Summer 1982, pp. 86.

¹⁰¹ S. Oakes, The Influence of the Musicscape Within Service Environments, *Journal of Service Marketing*, 14, No7, 2000, pp. 539-556.

Table 8.2. The effects of selected fragrances on people

Fragrance	Potential psychological effect on people
Eucalyptus	Stimulating and energizing, helps to create balance and the feeling of cleanliness and hygiene
Lavender	Stress reducing, relaxing and calming, helps to create a homely and comfortable feel
Lemon	Refreshing, stimulating, uplifting, boosts energy levels and helps to make people feel happy and rejuvenated
Orange	Refreshing, uplifting, rejuvenating, energizing, stimulating, and cheering, helps to relief stress, anxiety, and insomnia
Sandalwood	Promotes relaxation and spiritual harmony, helps to calm the nerves, enhances immunity
Black pepper	Boosts endurance, increases circulation, and tones muscles, reduces fear and motivates change

Source: www.essentialaura.com

- Touch** stimuli refer to the ability of touching physical evidence of a service. Customers are more likely to buy products when they have a possibility to handle them. As touch appeals might influence buying decision as well as service experience, it is important to deliver samples and promotional material to customers and use other elements of physical evidence in the service outlet to improve service performance. Marketers should pay attention on those elements that customers usually touch like furniture, carpets, and other facilities, and ensure that they evoke positive reactions. It is also possible to enhance service experience by involving customers in a service process and encouraging them to touch physical components of a service. For example, museums can utilize some of their exhibits, so that visitors can touch and experience them more profoundly. Touch appeals can also be developed through shaking hands with the service personnel, which additionally might be perceived as a friendly and caring manner of dealing with customers.
- Taste** appeals refer to the ability of trying service samples or any treats offered by service providers. Similarly to other sensory appeals, taste stimuli can influence buying decision and enhance service experience. Typically, service providers can offer candies or a cup of tea or coffee at a service outlet. When customers are involved in a service process or they are waiting to receive a service, offering treats creates the perception of care and hospitality. Some services such as restaurants are associated with taste and taste stimuli are of prime importance to customer satisfaction. It is even possible to enhance service experience in the restaurants by serving free beverages, bread, and other specialties. In tourism, image of many countries might be associated with taste as well. Providing free samples of products typical for any country during tourism fairs might be an effective promotional tool.

Space and functionality. In addition to ambient conditions which stimulate customers' senses and contribute to service experience, service process serves specific purposes. For this reason marketers should also concentrate on functional aspect of the service environment and ensure that service is delivered properly. Thus, service outlet should meet requirements with regard to space and functionality. Spatial layout refers to the floor plan including location of toilets, cloakroom and waiting room, size and space of furnishing, equipment and devices necessary for service delivery, handicapped facilities, and the ways in which they are arranged, whereas functionality refers to the ability of those items to facilitate service performance and improve service experience.

Signs, symbols and artifacts. Service environments should be adjusted to customers' needs and enable them to go smoothly through service process. Thus, servicescape designers should ensure that customers get precise and visible information on where service facilities are located and how to proceed to get a desired service. Signs, symbols, and artifacts play a very important role as a communication tool during service delivery. Signs can be used to indicate the name of the service facility, communicate the service script, and to teach the rules in the service settings. In public buildings, at the airports, in hospitals, at stadiums, in schools, in shopping centers and other places that attract many people such signs are required to ensure order and deliver important information about directions, service facilities, codes of conduct and imposed rules and regulations.

The service environment plays an important role in creating service experience and shaping customers' perception about a company. All elements of the physical evidence including the facility exterior, facility interior, and other tangibles contribute to the individuals' experience, however, customers tend to perceive servicescapes holistically. This means that although they notice particular elements of the service environment, their final assessment is based on the overall impression. Therefore, servicescape designers should put their efforts into creating a unique atmosphere within a service outlet, rather than being focused on individual aspect of the physical evidence. Such a holistic approach helps ensure that service encounter would be a memorable and exceptional experience, resulting in higher customer satisfaction and better mutual relationships.

Questions

1. Why is physical evidence so important in a service company marketing strategy?
2. What models are used to explain consumer responses to environment?
3. How can customers respond to service environment?
4. What is the impact of ambient conditions on customers' behavior?
5. What are the roles of spatial layout and functionality, signs, symbols, and artifacts?
6. Develop a strategy for a chosen service company that would enhance the firm's sight, sound, scent, touch, and taste appeals.
7. Choose a service company you are familiar with and discuss its service environment in terms of its space arrangements and functionality.

CHAPTER 9

Managing Services Employees

Learning objectives

After reading this chapter, you should be able to:

- Understand the role of service personnel in the service delivery process.
- Know how to attract, select, train, and motivate the service personnel.
- Understand the importance of empowerment in a services context.
- Be familiar with the benefits of service oriented business strategy.
- Understand how employee satisfaction is related to customer satisfaction.

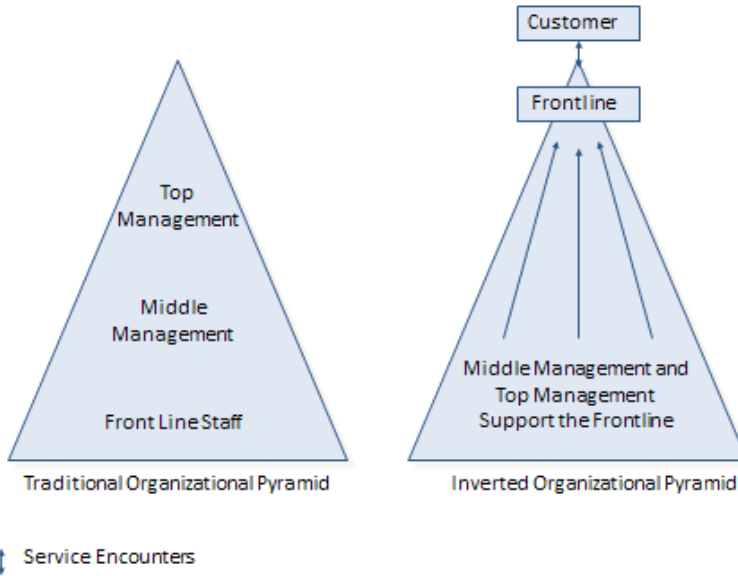
9.1. The Importance of Service Personnel

Service personnel plays a very important role in the success and profitability of the company, it can also be an important source of differentiation as well as a competitive advantage. It is a challenge for service companies to differentiate from other similar companies since they tend to offer the same bundle of benefits. Service employees and the way they deal with customers are harder to be duplicated comparing to other service features, therefore they can be used to distinguish one company from another. Frontline staff is also crucial for creating customer's satisfaction and delivering service excellence. A number of studies have shown that employee satisfaction and customer satisfaction are clearly related, therefore service companies should employ effective human resources policies, which would result in high satisfaction of employees. Thus, in the services context, human resources management should be linked to the marketing management in order to meet customers' needs as well as company's objectives.

Service personnel perform many tasks and is expected to achieve both operational and marketing goals. The sales people have to be fast and efficient and delight customers at the same time. Additionally, they are involved in selling, cross-selling, and up-selling and company's promotional activities. Since the first-line employees perform different functions including representing the company, creating service quality, improving productivity, and making sales, they are vital for business success. For this reason, the entire company should focus on the front line and support them in their tasks of delivering services. Thus, in the services context, it is better to invert the traditional organizational pyramid with the management at the top and staff at the bottom. Instead, the frontline staff should be placed at the top of the pyramid, followed by middle management, and top management. Figure 9.1 shows the inverted organizational pyramid, in contrast to the traditional pyramid, which highlights a customer and frontline focus¹⁰².

¹⁰² Ch. Lovelock, J. Wirtz, op.cit., pp.280-282, 303-304.

Figure 9.1 The traditional organizational pyramid versus inverted pyramid



Source: Ch. Lovelock, J. Wirtz, *Services Marketing. People, Technology, Strategy*, Prentice Hall, 2011, p. 304.

9.2. Human Resources Management

The main objective of marketing is to achieve organizational goals by satisfying customers' needs. In service companies first line employees are usually involved in a service delivery process, which means that customer satisfaction is related to professionalism of service staff. For this reason, in market oriented companies, human resources management should be closely linked to marketing management. Human resources management is concerned with the decisions regarding personnel such as hiring, managing, developing, and controlling people who work in a company. Effective human resources management enables employees to contribute to the accomplishment of firm's objectives and its overall success. In services context, human resources policies should support marketing efforts aimed at satisfying customers. Therefore, it is important that information about a customer's profile, as well as data coming from customer satisfaction surveys is available to human resources managers. They can use this data to develop recruitment and training programs, so that employees are able to meet customers' needs and deliver high quality service. In practice, all human resources practices are interrelated and influence service excellence and productivity.

Recruitment. The first important task for human resources managers is to attract the right people for the right job within a company. Hiring personnel involves competing for the applications from the best candidates and selecting those who seem to be the best for the specific positions. Competing in the labor market for prospective employees requires having an attractive

value proposition, which includes such elements as having a good image, delivering high quality products, and offering a competitive compensation package¹⁰³. The prestige and market success of an employer are key factors for attracting career-seekers, however, companies providing best perks to their employees are usually highly ranked among the best companies to work for.

In order to select the right personnel, it is necessary to follow the recruitment procedure, which starts with the development of a job description and person specification. Employers use a number of methods to advertise their job vacancies and promote job opportunities, like placing adverts in newspapers and magazines, using recruitment agencies and professional associations, putting information on their websites, using the Internet job boards, and accepting resumes from candidates even when a position was not advertised. Next steps of the recruitment process include the pre-interview selection based on the received CVs and application forms, shortlisting candidates, inviting them for interview, interviewing and testing, choosing the best applicant, and offering the employment¹⁰⁴.

Service companies can use several approaches to identify the best candidates. For example, during the interview managers can observe if the candidates have the right attitude and a personality that fits the company's culture. It is believed that some qualities such as warmth, energy, charm, detail orientation, and neatness cannot be taught, so careful observation of behavior might be helpful to notice these features¹⁰⁵. Personality tests and other psychological tests can also help to identify traits relevant for a particular position as well as references from past employers. After interviewing all candidates, managers should make the right hiring decisions. A good recruitment procedure should result in the appointment of candidates who are best qualified and suitable for the job.

Training. Employees should possess specific knowledge and skills to perform their job effectively. For this reason, service companies need to develop training strategy related to their objectives and needs of employees. Typically, training of service staff involves the organizational strategy, interpersonal and technical skills, and product knowledge¹⁰⁶.

- **The organizational strategy** is necessary to be learned by new employees; however, some companies provide training in this area to their staff to constantly promote firm's core values. The knowledge about company's history, culture, philosophy, and objectives is crucial to the development of mutual respect, team spirit and integrity, as well as service excellence.
- **Interpersonal and technical skills** are essential to service delivery. Developing interpersonal skills, such as appropriate body language, attentive listening, and making eye contact, facilitates communication with customers and improves customer service. Technical skills on the other hand include knowledge of specific field, rules and regulations, procedures, and the ability to use equipment and operate machines necessary for service performance.

¹⁰³ Ch. Lovelock, J. Wirtz, *op.cit.*, p. 291.

¹⁰⁴ G. Cole, *Personnel Management*, DP Publications, London, 1988.

¹⁰⁵ B. Fromm, L. Schlesinger, *The Real Heroes of Business*, New York, Currency Doubleday, 1994, pp. 315-316.

¹⁰⁶ Ch. Lovelock, J. Wirtz, *op.cit.*, pp. 294-295.

- **Product knowledge** is a crucial component of service quality. Employees should possess an extensive knowledge about a company's market offering in order to deliver information, explain product features and answer customers' questions. Additionally, the service personnel should be able to give recommendations and suggest the best service solutions tailored to customers' needs.

Managing. Managing employees involves decisions about the degree of the empowerment of the frontline employees. Service companies can adopt one of two main approaches to managing people in a company: the production-line approach or empowerment.

- **The production-line approach** is based on a control model of organization design and management in which roles in a company are clearly defined and decision-making process is centralized. This model assumes that service operations might be more efficient when tasks are simplified and employees perform them following the specified procedures. The employees are not empowered and cannot make their own decisions. Managers can only take action and solve customers' problems. Additionally, it is recommended to replace people by equipment and systems, since they are believed to be more reliable and easier to control. The production-line approach gives a company control over interactions with customers and ensures uniformity of customer service and other firm's operations¹⁰⁷.
- **Empowerment** is based on the involvement model in which employees play crucial role in satisfying customers' needs. First-line staff is encouraged and rewarded for showing initiative and solving customers' problems. Employees are asked to make suggestions for service improvements and flexibly interact with customers. Empowered employees respond quicker to customer needs, feel better about their jobs, become more involved in work, perform their tasks with more enthusiasm, and come up with ideas about how to best serve customers. Empowering service personnel brings many benefits, however, it also produces costs including a greater investment in selection and training, higher labor costs, and the threat of inconsistent service delivery and making bad decisions¹⁰⁸. Therefore, service companies can adopt one of the following empowerment approaches: suggestion involvement, job involvement or high involvement. Suggestion involvement empowers employees to make suggestions for service improvements, but they cannot implement their own ideas and solutions. In job involvement approach employees work usually in teams, have more freedom and are encouraged to use their skills, however, higher level decisions remain the responsibility of management. The goal of high involvement is to give people extensive training to develop their various skills and involve them in participating in management decisions¹⁰⁹. Both approaches have their advantages and each of them is

¹⁰⁷ T. Levitt, Production-Line Approach to Service, Harvard Business Review, September-October, 1972, pp. 41-52, T. Levitt, Industrialization of Service, Harvard Business Review, September-October, 1976, pp. 63-74.

¹⁰⁸ D.E. Bowen, E.E. Lawler III, Facing the Customer: Empowerment or Production Line?, Center for Effective Organizations, CEO Publication, G 91-5 (190), 1991.

¹⁰⁹ E.E. Lawler III, Choosing an Involvement Strategy, Academy of Management Executive, 2, 1988, pp.197-204.

suitable for different type of business environment. Empowerment is more appropriate when a service company offers personalized and customized service, and when it is focused on the development of long-term relationships with customers, performed tasks are non-routine in nature, and employees are qualified, have good interpersonal skills, and seek personal growth within a company¹¹⁰.

Motivating. Whereas effective hiring, training, and empowerment leads to the possession of qualified and skilled service personnel, motivating and rewarding are crucial to retaining them. Motivation of employees falls into two categories: maintainers and motivators.

- **Maintainers** include such factors as salary, fringe benefits, working conditions, job security, organizational policies, and supervision and should be kept at a satisfactory level. A number of methods might be used to reward financially employees. Typically, service personnel gets a regular salary or wages based on their work performance. Additionally, they can receive sales commission or bonuses for good work and achievement of specified targets. Fringe benefits are compensations provided to employees in addition to their regular salary. They contribute to the well-being of service personnel and might take different forms including sick-leave, paid vacation, health insurance, paid continuing education, use of a company car, subsidized meals, discounted or free health club membership, and other club memberships. Other maintainers include creating friendly working environment and good and trustful cooperation, meeting health and safety standards at work, and other policies facilitating work within a company.
- **Motivators** include such factors as job content and recognition, job position and responsibility, career development, and goal accomplishment. People are satisfied by knowing that they are doing a good job. They feel good and motivated when they get a positive feedback from their bosses, colleagues, and customers. Another tool used to motivate service staff is a clearly defined career pathway. It shows how employees' working life might develop within a particular company providing they perform all duties effectively and meet performance standards and expectations. Precisely defined duties and responsibilities related to the specific position as well as difficult but attainable goals might be also good motivators.

Monitoring and controlling. Since a service personnel plays usually an important role in service delivery, the control of the workforce becomes crucial for controlling service quality. Control systems should be related to reward systems, so that employees are motivated to perform their job according to specified standards. Service companies can employ different control systems including self-control or informal control from the peer group, direct personal supervision of personnel, technical control built into the service production process to monitor individuals' performance, and bureaucratic control requiring employees to document their performance¹¹¹. Moreover, it is possible to use other control methods like mystery shopping to assess whether frontline staff display desired behaviors or get feedback from customers using satisfaction surveys and evaluations.

¹¹⁰ D.E. Bowen, E.E. Lawler III, The Empowerment of Service Workers: What, Why, How, and When, Sloan Management Review 33, Spring 1992, pp. 32-39.

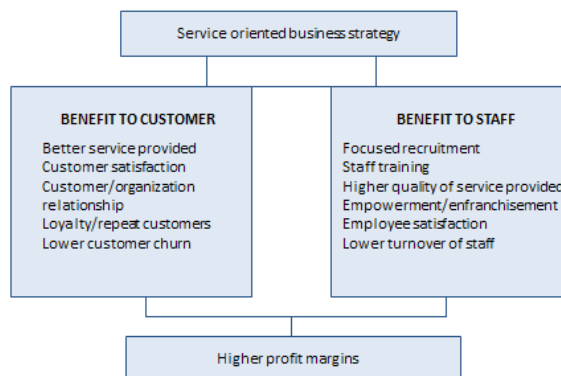
¹¹¹ A. Palmer, op.cit., p. 206.

9.3. Service Oriented Business Strategy

Service companies that recognize the role of personnel in generating customer satisfaction and sustainable profits are more likely to employ the market-focused management approach rather than the industrial management approach¹¹². Firms that follow the traditional industrial management model believe that location strategies, advertising, and sales promotion are the key to sales revenues, whereas labor costs and other operating costs should be kept as low as possible. They ignore the role of personnel as an important factor contributing to a company's success. Employees are believed to be indifferent and unskilled, so they should work to specific directions and perform simplified tasks. Additionally, followers of this approach prefer to rely on technology, machines, and systems rather than on human beings.

In contrast to firms that adopted the industrial management approach, many service companies turned to the market-focused management approach and concentrated their activities on serving customers. Proponents of this approach believe that employee turnover and customer satisfaction are related. They emphasize the role of recruitment and training of front line employees as well as performance based payment as the ways to improve retention rates. Better-trained and qualified personnel provide better service and are less likely to switch their jobs. As a result, customers are more satisfied and make more purchases. Another benefit of training and motivating employees better than competitors is lower labor costs expressed as a percentage of sales. Besides described characteristics, new measures are used to examine the firm's performance in the market-focused management approach. These measures include the value of customer retention, the costs of employee turnover, the value of employee training, and the monetary benefits associated with service recovery¹¹³. All benefits of service oriented business strategy gained by customers, employees, and a company are shown in Figure 9.2.

Figure 9.2 Benefits of service oriented business strategy



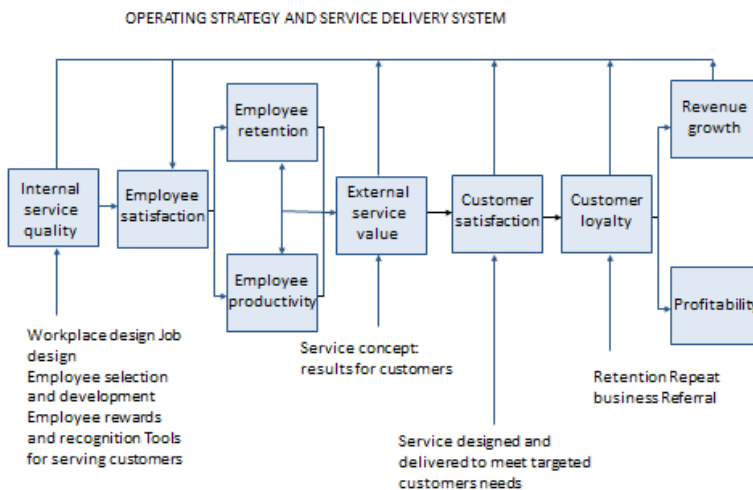
Source: K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *Services Marketing: Concepts, Strategies and Cases*, South-Western Cengage Learning, 2009, p. 315.

¹¹² L.A. Schlesinger, J.L. Heskett, The Service-Driven Service Company, *Harvard Business Review*, September-October 1991, pp. 71-75.

¹¹³ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *op.cit.*, pp. 18-22.

The benefits of the market-focused management model are also displayed in the service-profit chain presented in Figure 9.3¹¹⁴. The service-profit chains show a series of links in a managerial process that leads a service company to a success. Additionally, these links show that customer satisfaction and employee satisfaction are related. Since employee satisfaction is derived from a workplace, it is important that managers understand employees' needs and adapt human resources practices contributing to employee satisfaction. Thus, hiring, training, and motivating personnel have an impact on internal service quality which is crucial to employee satisfaction. Satisfied employees are more productive and more loyal, what means that employee satisfaction is linked with the company's productivity and employee retention. Due to higher employee retention rates, the costs of recruitment and training are reduced, which additionally contributes to higher productivity. Moreover, satisfied employees perform their tasks better, are more involved and have positive attitudes which are reflected in their behaviors. All these enhance external service value and are noticed by customers who are ultimately more satisfied. Customer satisfaction is related to customer loyalty, which is demonstrated by repeated purchases and favorable word of mouth. Customer satisfaction leads to increased profitability and revenue growth. The links between employee satisfaction and customer satisfaction displayed in the service-profit chain model lead to the conclusion that service companies should put their efforts to ensure internal service quality to achieve their objectives. Thus, the cooperation between marketers and human resources managers is essential to the success of a service firm.

Figure 9.3 The service-profit chain



Source: J.L. Heskett, T.O. Jones, G.W. Loveman, W.E. Sasser Jr., and L.A. Schlesinger, *Putting the Service-Profit Chain to Work*, Harvard Business Review, March-April 1994, pp. 164-174.

¹¹⁴ J.L. Heskett, T.O. Jones, G.W. Loveman, W.E. Sasser Jr., and L.A. Schlesinger, *Putting the Service-Profit Chain to Work*, Harvard Business Review, March-April 1994, pp. 164-174.

Questions

1. Explain the role of frontline personnel in a service company.
2. How can a service company become a preferred employer? Give examples of companies, which have proven to be excellent employers.
3. How can a service company select the best candidates from a number of applicants?
4. What are the types of training service companies should conduct to ensure that employees perform their jobs effectively?
5. What are the main methods used to motivate service personnel?
6. Explain the concept and benefits of empowerment and give examples of companies that have successfully empowered their service staff.
7. Discuss the benefits of service oriented business strategy.
8. Using the service-profit chain, explain how employee satisfaction is related to customer satisfaction.

CHAPTER 10

The Customer-Focused Service Company

Learning objectives

After reading this chapter, you should be able to:

- Understand the importance of service quality.
- Know how to use the gaps model for diagnosing quality problems.
- Be familiar with the measures of service quality.
- Know how to define and measure customer satisfaction.
- Understand the importance of developing relationships with customers.
- Discuss the methods used to develop and manage customer relationships.

10.1. Improving Service Quality

Service quality is an important element of differentiation and is crucial to customer satisfaction. The two concepts of service quality and customer satisfaction are intertwined, however, they differ in meaning. Whereas customer satisfaction is a short-term transaction-specific measure, service quality is related to the long-term evaluation of the service performance¹¹⁵. Companies delivering services of high quality experience a number of benefits including higher customer satisfaction, positive word of mouth, good publicity, repeated purchases, and increases in market share. However, they also face several challenges related to quality management. To achieve high quality levels for services, it is necessary to accurately understand customers' needs, specify quality standards in order to meet those needs, design service delivery systems and procedures to ensure that high quality services are provided, implement suitable human resources policies to ensure that personnel perform high quality services, and develop a service quality information system to assess the firm's overall performance.

Since service quality is quite complex in meaning, defining this term may cause some difficulties. Research studies conducted by A. Parasuraman, V.A. Zeithaml, L.L. Berry have shown that they are different dimensions of service quality including tangibles (appearance of physical elements), reliability (ability to perform the service dependably and accurately), responsiveness (willingness to help customers and provide prompt service), assurance (credibility, security, competence, and courtesy), and empathy (easy access, good communications, and customer understanding)¹¹⁶. Additionally, researchers identified four potential gaps within a service company, which might lead to the service gap – the difference between customers' expectations and their perceptions of what was delivered¹¹⁷.

¹¹⁵ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, op.cit., p. 399.

¹¹⁶ V.A. Zeithaml, A. Parasuraman, L.L. Berry, *Delivering Quality Service*, New York, The Free Press, 1990.

¹¹⁷ A. Parasuraman, V.A. Zeithaml, L.L. Berry, A Conceptual Model of Service Quality and Its Implications for Future Research, *Journal of Marketing*, 49, Fall 1985, pp. 41-50; V.A. Zeithaml, L.L. Berry, A. Parasuraman, Communication and Control Processes in the Delivery of Services, *Journal of marketing*, 52, April 1988, pp. 36-58.

The knowledge gap. This gap refers to the difference between management perceptions of customers' expectations and customers' actual expectations. The size of the knowledge gap depends on several factors, such as the company's research orientation, communication between the first-line employees and management, and the complexity of the organizational structure. The knowledge gap tends to decrease when the consumer research is conducted regularly, the information flow within a company is ensured, and the appropriate organizational structure and procedures that promote communication are employed.

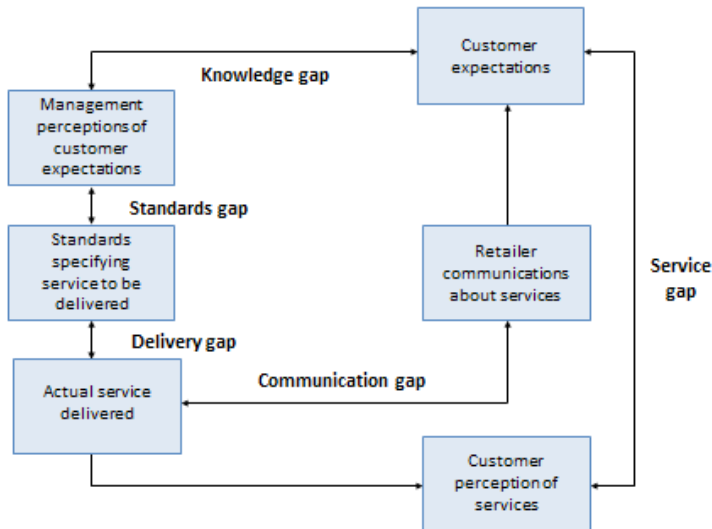
The standards gap. Even if management accurately identified customers' expectations, there might be a gap between management understanding of customers' expectations and the standards set for service delivery. To minimize this gap, management should use a flow-chart with detailed description of all firm's operations and specification of the way the system should operate and desired behavior of frontline staff. However, the standards gap can also appear as a consequence of cost reduction decisions and a company's focus on operational effectiveness.

The delivery gap. This gap occurs when there is a noticeable difference between the actual performance of the service and specified standards. The existence and the size of the delivery gap depend on the desire and ability of service staff to perform service according to standards set by management. This aspect of service quality is intertwined with human resources policies employed by the company. Proper selection of candidates, good training and motivation system as well as implemented control procedures help to minimize the delivery gap.

The communications gap. The expectations regarding service quality might be also influenced by messages delivered through communications channels to customers. The communications gap might be caused by the difference between the quality of service described in the external communications and the quality of service actually delivered. Thus, marketing managers need to cooperate with other managers responsible for advertising and sales personnel to ensure that messages sent through communications channels would be understandable and realistic.

The service gap. This gap appears as a consequence of other gaps and is actually perceived by customers. The service gap is a difference between customers' expectations about service quality and their perceptions of the service quality that is delivered.

Figure 10.1 Conceptual model of service quality



Source: A. Parasuraman, V.A. Zeithaml, L.L. Berry, *A Conceptual Model of Service Quality and Its Implications for Future Research*, Journal of Marketing, 49, Fall 1985, pp. 41-50.

The original 5-gap model developed by A. Parasurman, V.A. Zeithaml and L.L. Berry was extended to 6-gap model by Ch. Lovelock. The 6th gap refers to the perceptions gap – the difference between the service which is delivered to customers and their perceptions of what was delivered. In this model, the knowledge gap, the perceptions gap and the service quality gap represent external gaps occurring between customers and a service company, and the policy gap (the standards gap), the delivery gap, and the communications gap are internal gaps occurring within a company between its departments and sections¹¹⁸.

After identifying possible quality gaps, it is important to measure quality of delivered services in order to assess if service quality gaps exist and whether any corrective actions should be taken to improve service quality. Quality measures can be grouped into two categories: soft and hard. Soft measures are not easily observed and can be collected by talking to employees, customers, and others, whereas hard measures refer to activities which can be counted such as service response times or failure rates¹¹⁹. Companies focused on delivering high quality services should implement a service quality information system, which utilizes various measures to assess a company's performance. Main components of such a system include customer research and non-customer research¹²⁰.

¹¹⁸ Ch. Lovelock, *Product Plus: How Product + Service = Competitive Advantage*, New York, McGraw-Hill, 1994, p.218.

¹¹⁹ Ch. Lovelock, J. Wirtz, op.cit., p. 387.

¹²⁰ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, op.cit., pp. 410-422.

SERVQUAL. It is a common measure of service quality. A 44-item scale, which is used to measure customers' expectations and perceptions with regards to five service quality dimensions¹²¹. The scale consists of two sections: a 22-item section that shows customers' expectations of an excellent firm within a specific industry and a 22-item section that shows customers' perceptions of a particular company. Customers' expectations and perceptions are measured on a 7-point scale. Then, the results from two sections are compared and service gaps are identified. The following dimensions of service quality are examined:

- **The tangibles dimension** refers to the assessment of a company's ability to manage its physical environment, which is composed of various elements, such as interior design, furniture, wall colors, equipment, lightning, stationery, promotional materials, personnel appearance as well as other tangibles.
- **The reliability dimension** compares customers' expectations and a company's performance with regards to consistency and dependability of its operations. The firm is considered reliable when its promises are kept, service is performed correctly, and problems are resolved quickly.
- **The responsiveness dimension** reflects a company's ability to provide service in a timely manner. Employees who are responsive inform customers when service will be performed, deliver prompt and accurate service, and are eager to help customers and resolve their problems.
- **The assurance dimension** refers to a company's commitment to perform service professionally in terms of competence, courtesy to customers, and security of its operations. Employees of an excellent company are competent, knowledgeable, polite and friendly, so customers trust them and feel safe in their transactions.
- **The empathy dimension** reflects a company's ability to understand customers' needs and feelings. Empathetic firms give their customers individualized attention, tailor their offering to specific customers' needs, and have operating hours convenient to all customers.

Customer research is focused on the examining of customers' perceptions of a firm's performance and includes such measures as customer complaints, after-sales surveys, customer focus groups interviews, and others.

- **Customer complaints** are a useful tool to identify weaknesses of a company's service delivery system. If the same problem appears in customer complaints, managers should take corrective actions to eliminate service deficiencies and reinforce excellent performance.
- **After-sales surveys** are carried out to assess customer satisfaction as soon as the service transaction has been completed. The after-sales surveys give a real picture of a service performance since they are addressed to all customers and deliver information for service improvements.
- **Customer focus group interviews** are also a commonly used research method. A focus group consists usually of eight to twelve customers who are asked their opinions in a group interview guided by a moderator. The information gathered in a focus group

¹²¹ A. Parasuraman, L.L. Berry, V.A. Zeithaml, SERVQUAL: a Multiple-Item Scale for Measuring Customer Perceptions of Service Quality, *Journal of Retailing*, 67 (Winter), 1988, pp. 420-450.

interview is richer than data obtained from individual customers, however, other research methods should be used to confirm group's opinions.

Non-customer research refers to the assessment of competitors' performance as well as employees' perceptions of a company's performance and includes such measures as employee surveys, mystery shopping, total market quality surveys, and others.

- **Employee surveys** are an important tool used to identify obstacles related to the provision of quality services noticed by service staff. Since employees are able to assess internal service quality, information gathered from them can be useful. Additionally, employee surveys examine personnel attitudes, morale, and overall work satisfaction, which might have an impact on service delivery.
- **Mystery shopping** is a research method used to measure quality of service provided by employees. Mystery shoppers are trained individuals who pose as customers and evaluate service staff. They measure personnel performance with regards to quality of customer service, ability to use sales techniques, possessed knowledge, as well as their appearance, and others required features.
- **Total market quality surveys** measure the quality of services provided by a company sponsoring a survey as well as the quality of services offered by competing firms. Total market quality surveys deliver information needed for service improvements and give a realistic picture of firms' performance within an industry.

10.2. Improving Customer Satisfaction

Customer satisfaction is a measure of how products offered by a company meet customers' expectations and is often used as a key element of business strategy. As it was already stated, customer satisfaction is a short-term transaction-specific measure and an important service performance indicator. Although customer satisfaction and service quality are both measured by comparing perceptions to expectations, customer satisfaction compares customers' perceptions to their expectations from any service company with regards to actual service encounter. Service quality, on the other hand, compares customers' perceptions to their expectations from a company offering high quality services and refers to overall company's performance over time¹²². Customer satisfaction surveys provide a number of benefits. First of all, they convey the message to customers that a company cares about their comfort and well-being and takes into account their opinions and suggestions in order to make service improvements. They are also an important source of information about service performance and might be used as a tool in evaluating and rewarding service personnel. Providing the results of surveys are favorable, firms can utilize them when communicating with customers. Moreover, the companies with high customer satisfaction ratings are more likely to create positive work environment, what results in greater involvement and satisfaction of employees and consequently better relationships with customers.

¹²² K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, op.cit., p. 410.

Methods used to monitor customer satisfaction involve indirect and direct measures. Indirect measures include examining changes in company’s sales and profits as well as analyzing customer complaints, whereas direct measures come from customer satisfaction surveys. Customer satisfaction surveys are not standardized among service companies. They might vary from very general to very detailed. The questions and the scales used to collect data also vary. Many companies use both open and closed questions, and some use a 100-scale, some a 10-point scale, and some a 5-point scale. The most common is a 5-point scale with five possible answer options: very satisfied, somewhat satisfied, neutral, somewhat dissatisfied, and very dissatisfied. An example of customer satisfaction survey with very general questions and a 5-point scale is shown in Figure 10.2. Service companies can use different methods of collecting data including personal interviews, phone surveys, mail questionnaires, online surveys, and others. Customer satisfaction surveys that collect quantitative and qualitative data are most useful. The quantitative rating enables comparing company’s results over time and against its competitors, whereas qualitative data shows weak points and areas for improvements¹²³.

Figure 10.2 Customer satisfaction survey

	Satisfied	Somewhat satisfied	Neutral	Somewhat dissatisfied	Dissatisfied
Products	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Customer service	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Ordering billing	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Delivery	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Employees	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

Customer satisfaction surveys are helpful to better understand customers’ expectations with regards to provided services, however, the results of such surveys and information obtained do not necessarily reflect real customers’ opinions. There are several factors that might influence customer satisfaction ratings. Customers who buy services from a particular service provider are generally satisfied and those who are not usually switch to competitors. As a consequence, the company gets a feedback from satisfied customers and do not often have

¹²³ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, op.cit., pp. 373-376.

a chance to hear from those who are dissatisfied. Another problem is that responses are received only from limited number of customers, so the errors appear in the results of surveys. The data collection method can also influence the results of the surveys. Higher satisfaction rates are usually obtained via personal interviews and phone surveys compared to other methods. Moreover, the way questions are asked and the question context may considerably affect the satisfaction rating as well as timing of survey relative to the date of purchase. Customers tend to be most satisfied just after they buy a product and their satisfaction decrease over time. Additionally, respondents are more likely to express opinions, which are considered socially appropriate and to some extent their mood while completing the survey might influence satisfaction scores¹²⁴. Despite all problems related to the accuracy of results obtained via customer satisfaction surveys, they are undoubtedly a useful tool for managers to improve service delivery as well as company's results.

10.3. Developing Relationships with Customers

Creating, developing, and managing relationships with customers is an important aspect of marketing strategy. The concept of relationship marketing was introduced in the 80s and initially referred to as attraction, maintaining, and enhancing customer relationships¹²⁵. Later, the definition was extended and a broader view towards relationships was taken. In addition to customer markets, it is also important to develop relationships with other markets with which a company interacts, including suppliers, recruitment, referral and influence, as well as internal markets¹²⁶. However, customer markets remain of prime importance for marketing activities of a company. Relationship marketing changed the marketing perspective from a transaction-based approach to an emphasis put on customer retention. Customers who are loyal and purchase more frequently are perceived more valuable for a company. Every customer represents a potential lifetime value, so marketing efforts should be directed towards existing customers, their needs, and preferences. In order to develop long-term relationships, it is necessary to build customer involvement, commitment, and trust. In service companies focused on building loyalty, customer service plays an important role in their marketing strategies and is an essential element in creating service quality and customer satisfaction.

Building customer loyalty involves offering them an attractive value proposition, which is usually extended with the increased degree of loyalty. Since the aim of relationship marketing is to enhance relationships with customers, it is necessary to move them up to higher levels of loyalty. The ladder of loyalty developed by A. Payne is a good illustration of this process. First, the emphasis is put on gaining prospective customers. As soon as prospects become customers, the efforts are directed at developing relationships. Through repeated purchases

¹²⁴ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *op.cit.*, pp. 377-380.

¹²⁵ L. Berry, Relationship Marketing, in L. Berry, G.L. Shostack and G.D. Upah, *Emerging Perspectives on Services Marketing*, American Marketing Association, Chicago, 1983, pp.25-8.

¹²⁶ M. Christopher, A.F.T. Payne and D. Ballantyne, *Relationship Marketing: Bringing Quality, Customer Service and Marketing Together*, Butterworth-Heinemann, Oxford, 1991.

and greater involvement customers become regular clients. As the relationship deepens, clients might turn into supporters, and eventually they become advocates for the company and its products¹²⁷. Loyalty can be developed through various measures and companies can use different approaches towards building relationships. They can base their strategy on rational reasons or appeal to customers' feelings. Instrumental loyalty focuses on services benefits such as fast delivery, high quality, low price, whereas emotional loyalty stresses other reasons for attachment like tradition or memories. It is more difficult to develop emotional loyalty, however, it appears to be stronger and long-lasting. The best strategies involve building instrumental and emotional loyalty¹²⁸.

Service companies can use a number of measures to enhance relationships with their customers and to develop their loyalty. It is possible to tie customers closer to the company through bundling and cross-selling services. Customers save their time when dealing with one service provider and get price discounts and better service. As a consequence, they are less likely to switch to competing firms providing they are satisfied with delivered services. In many cases customers purchase services offered by different firms and are loyal to several brands at the same time. In such instances, service companies can develop loyalty programs in order to strengthen the customers' preference for their brands and build a greater share of the customers' spending. Incentives are mostly based on the frequency of purchase and value of purchase, and involve financial and non-financial rewards. Financial rewards take usually a form of discounts on purchases and other rewards such as free services and free gifts. Non-financial rewards include benefits, which represent certain value for customers like recognition and appreciation, extra attention given to their needs, and status benefits. Some companies encourage their employees to learn their customers' preferences in order to build social bonds based on personal relationships between service personnel and customers. Other ones use loyalty program databases to collect information about customers in order to customize services to individual needs¹²⁹.

Many service companies aiming at developing relationships with their customers use a customer database or CRM system. Data collection involves capturing information on customers' characteristics, purchasing history, service preferences, and others. Data analysis is used to categorize gathered information according to criteria set by a company, which facilitates service customization. Sales process can be tracked through the system and effectiveness of marketing campaign can be measured. Additionally, sales personnel and call center staff can use information available at the database to better tailor services to customers' needs. Customers benefit from the system, as a result of service improvements, increased convenience and better customization of services. Benefits for the company are also noticeable, although implementing a CRM system may involve considerable time and expenses. Better relationships with customers due to effective targeting and more personal approach, can lead to enhanced customer satisfaction, increased sales, and higher retention rates.

¹²⁷ A. Payne, *op.cit.*, p. 33.

¹²⁸ K.D. Hoffman, J.E.G. Bateson, E.H. Wood, A.J. Kenyon, *op.cit.*, p. 355.

¹²⁹ Ch. Lovelock, J. Wirtz, *op.cit.*, pp. 331-336.

Questions

1. Contrast service quality as it compares to customer satisfaction.
2. Using the gaps model, identify the gaps that influence customer perceptions of service quality.
3. Consider your own experience as a customer and give examples of quality gaps, which might occur as a result of the difference between expectations and perceptions of the service performance.
4. Describe the components of a service quality information system and the methods used to measure service quality.
5. Explain why it is important to measure customer satisfaction and what measures are typically used to assess customer satisfaction.
6. What are the factors that might influence customer satisfaction ratings?
7. Explain the concept of relationship marketing and the importance of developing relationships with customers.
8. Identify the measures used to build relationships with customers. Illustrate your answer with an example of a service company that has successfully developed a loyalty program.

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