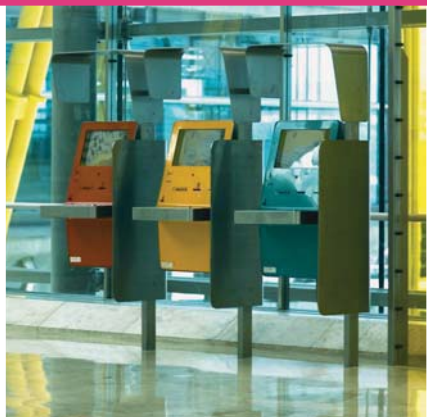
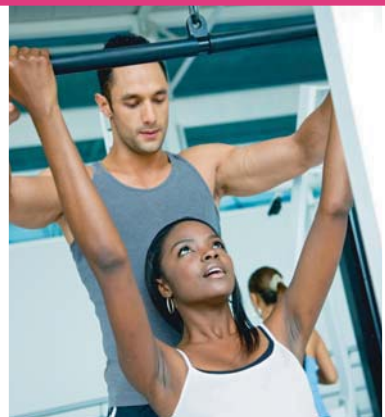


# SERVICES MARKETING

*People, Technology, Strategy*

SEVENTH EDITION



CHRISTOPHER LOVELOCK  
JOCHEN WIRTZ

# BRIEF CONTENTS

Contents xiii

Preface xvii

## **PART I Understanding Service Products, Consumers, and Markets 2**

**Chapter 1** New Perspectives on Marketing in the Service Economy 4

**Chapter 2** Consumer Behavior in a Services Context 35

**Chapter 3** Positioning Services in Competitive Markets 59

## **PART II Applying The 4 Ps Of Marketing to Services 80**

**Chapter 4** Developing Service Products: Core and Supplementary Elements 82

**Chapter 5** Distributing Services Through Physical and Electronic Channels 109

**Chapter 6** Setting Prices and Implementing Revenue Management 135

**Chapter 7** Promoting Services and Educating Customers 163

## **PART III Managing the Customer Interface 194**

**Chapter 8** Designing and Managing Service Processes 196

**Chapter 9** Balancing Demand and Productive Capacity 227

**Chapter 10** Crafting the Service Environment 253

**Chapter 11** Managing People for Service Advantage 278

**PART IV Implementing Profitable Service  
Strategies 312**

**Chapter 12** Managing Relationships and Building  
Loyalty **314**

**Chapter 13** Complaint Handling and Service  
Recovery **349**

**Chapter 14** Improving Service Quality and  
Productivity **379**

**Chapter 15** Striving for Service Leadership **416**

**CASES 440**

*Glossary 596*

*Credits 603*

*Name Index 604*

*Subject Index 612*

# CONTENTS

Preface xvii

## **Part I Understanding Service Products, Consumers, and Markets 2**

### **Chapter 1 New Perspectives on Marketing in the Service Economy 4**

Why Study Services? 5

What Are the Principal Industries of the Service Sector? 8

Powerful Forces Are Transforming Service Markets 10

What Are Services? 10

Four Broad Categories of Services—A Process Perspective 18

Services Pose Distinct Marketing Challenges 21

The Traditional Marketing Mix Applied to Services 22

The Extended Services Marketing Mix for Managing the Customer Interface 25

Marketing Must Be Integrated with Other Management Functions 27

A Framework for Developing Effective Service Marketing Strategies 28

### **Chapter 2 Consumer Behavior in a Services Context 35**

The Three-Stage Model of Service Consumption 36

Prepurchase Stage 37

Service Encounter Stage 45

Postencounter Stage 52

### **Chapter 3 Positioning Services in Competitive Markets 59**

What Is Required for Positioning Services Effectively? 61

Achieve Competitive Advantage Through Focus 61

Market Segmentation Forms the Basis for Focused Strategies 64

Service Attributes and Levels 66

Positioning Distinguishes a Brand from Its Competitors 68

Developing an Effective Positioning Strategy 68

Using Positioning Maps to Plot Competitive Strategy 72

Changing Competitive Positioning 76

## **Part II Applying The 4 Ps Of Marketing to Services 80**

### **Chapter 4 Developing Service Products: Core and Supplementary Elements 82**

Planning and Creating Service Products 83

The Flower of Service 86

Branding Service Products and Experiences 95

New Service Development 100

### **Chapter 5 Distributing Services Through Physical and Electronic Channels 109**

Distribution in a Services Context 110

Distribution Options for Serving Customers: Determining the Type of Contact 111

Place and Time Decisions 115

Delivering Services in Cyberspace 117

The Role of Intermediaries 121

The Challenge of Distribution in Large Domestic Markets 123

Distributing Services Internationally 124

### **Chapter 6 Setting Prices and Implementing Revenue Management 135**

Effective Pricing Is Central to Financial Success 136

Pricing Strategy Stands on Three Foundations 138

Revenue Management: What It Is and How It Works 145

Ethical Concerns in Service Pricing 149

Putting Service Pricing into Practice 155

### **Chapter 7 Promoting Services and Educating Customers 163**

The Role of Marketing Communications 164

Challenges of Services Communications 168

Marketing Communications Planning 169

The Marketing Communications Mix 173

The Role of Corporate Design 187

Integrating Marketing Communications 189

## **Part III Managing the Customer Interface 194**

### **Chapter 8 Designing and Managing Service Processes 196**

Flowcharting Customer Service Processes 197

Blueprinting Services to Create Valued Experiences and Productive Operations 200

Service Process Redesign 211

The Customer as Co-Producer 214

Self-Service Technologies 218

## **Chapter 9** **Balancing Demand and Productive Capacity** 227

Fluctuations in Demand Threaten Profitability 228

Managing Capacity 231

Analyze Patterns of Demand 232

Managing Demand 234

Inventory Demand Through Waiting Lines and Queuing Systems 238

Customer Perceptions of Waiting Time 243

Inventory Demand Through Reservations Systems 245

## **Chapter 10** **Crafting the Service Environment** 253

What Is the Purpose of Service Environments? 254

The Theory Behind Consumer Responses to Service Environments 258

Dimensions of the Service Environment 262

Putting It All Together 269

## **Chapter 11** **Managing People for Service Advantage** 278

Service Employees Are Crucially Important 280

Frontline Work Is Difficult and Stressful 282

Cycles of Failure, Mediocrity, and Success 285

Human Resources Management—How to Get It Right 290

Service Leadership and Culture 303

## **Part IV** **Implementing Profitable Service Strategies** 312

### **Chapter 12** **Managing Relationships and Building Loyalty** 314

The Search for Customer Loyalty 316

Understanding the Customer-Firm Relationship 320

The Wheel of Loyalty 323

Building a Foundation for Loyalty 324

Strategies for Developing Loyalty Bonds with Customers 331

Strategies for Reducing Customer Defections 336

CRM: Customer Relationship Management 339

### **Chapter 13** **Complaint Handling and Service Recovery** 349

Customer Complaining Behavior 350

Customer Responses to Effective Service Recovery 354

Principles of Effective Service Recovery Systems 355

Service Guarantees 359

Discouraging Abuse and Opportunistic Customer Behavior 365

## **Chapter 14** Improving Service Quality and Productivity **379**

Integrating Service Quality and Productivity Strategies **381**

What Is Service Quality? **383**

Identifying and Correcting Service Quality Problems **384**

Measuring and Improving Service Quality **386**

Learning from Customer Feedback **387**

Hard Measures of Service Quality **394**

Tools to Analyze and Address Service Quality Problems **396**

Defining and Measuring Productivity **400**

Improving Service Productivity **401**

## **Chapter 15** Striving for Service Leadership **416**

The Service-Profit Chain **417**

Integrating Marketing, Operations, and Human Resources **419**

Creating a Leading Service Organization **422**

In Search of Human Leadership **427**

## **Cases**

Case 1 Sullivan Ford Auto World **440**

Case 2 Four Customers in Search of Solutions **446**

Case 3 Dr. Beckett's Dental Office **448**

Case 4 Banyan Tree Hotels & Resorts **453**

Case 5 Giordano: Positioning for International Expansion **463**

Case 6 Distribution at American Airlines **475**

Case 7 The Accra Beach Hotel: Block Booking of Capacity During a Peak Period **484**

Case 8 Revenue Management of Gondolas: Maintaining the Balance Between Tradition and Revenue **490**

Case 9 Aussie Pooch Mobile **494**

Case 10 Shouldice Hospital Limited (Abridged) **507**

Case 11 Red Lobster **519**

Case 12 Menton Bank **521**

Case 13 Dr. Mahalee Goes to London: Global Client Management **531**

Case 14 Hilton HHonors Worldwide: Loyalty Wars **533**

Case 15 Massachusetts Audubon Society **547**

Case 16 TLContact: CarePages Service (A) **564**

Case 17 The Accellion Service Guarantee **577**

Case 18 Starbucks: Delivering Customer Service **580**

*Glossary* **596**

*Credits* **603**

*Name Index* **604**

*Subject Index* **612**

# PREFACE

Services dominate the expanding world economy as never before, and nothing stands still. Technology continues to evolve in dramatic ways. Established industries and their often famous and old companies decline and may even disappear as new business models and industries emerge. Competitive activity is fierce, with firms often employing new strategies and tactics in response to customers' ever-changing needs, expectations, and behaviors. Clearly, the skills in marketing and managing services have never been more important! This book has been written in response to the global transformation of our economies to services.

As the field of services marketing has evolved, so too has this book, with each successive edition representing a significant revision over its predecessor. The new 7th edition is no exception. You can be confident that it reflects the reality of today's world, incorporates recent academic and managerial thinking, and illustrates cutting-edge service concepts.

## WHAT'S NEW IN THIS EDITION?

The 7th edition represents a significant revision. Its contents reflect ongoing developments in the service economy, new research findings, and enhancements to the structure and presentation of the book in response to feedback from reviewers and adopters.

### New Structure, New Topics

- The chapter text is organized around a revised framework for developing effective service marketing strategies that seamlessly builds on topics learned in a principles or marketing management course. The framework is introduced in Figure I.1 and on pages 28–30. The four parts cover the following:
  - *Part I* explains the nature of services, how to understand services, how consumer behavior relates to services, and how to position services. It lays the building blocks for studying services and for learning how one can become an effective service marketer.
  - *Part II* covers the development of the service concept and its value proposition, and the product, distribution, pricing, and communications strategies that are needed for developing a successful business model. Part II revisits the 4 Ps of the traditional marketing mix (*P*roduct, *P*lace, *P*rice, and *P*romotion) and expands them to account for the specific characteristics of services that make them different from goods marketing.
  - *Part III* focuses on managing the interface between customers and the service organization. It covers the additional 3 Ps (*P*rocess, *P*hysical environment, and *P*eople) that are specific to services marketing.
  - *Part IV*, the longest and most challenging part of the text, addresses four key issues in implementing and managing effective services marketing. They are building customer loyalty, complaint handling and service recovery, improving service quality and productivity, and, finally, striving for service leadership.
- Each of the 15 chapters has been revised. All chapters incorporate new examples and references to recent research, and some have been re-titled to reflect important changes in emphasis.
- Based on reviewer feedback, the 7th edition no longer contains separate readings. Rather, the key issues from the readings and latest research were synthesized, conceptualized and integrated in the relevant chapters. Furthermore, removing the readings from the text allowed adding new topics and learning aids such as succinct but comprehensive chapter summaries in point format.
- Chapter 1, "New Perspectives on Marketing in the Service Economy," has been rewritten. It more deeply explores the nature of the modern service economy and



presents a crisp, new conceptualization of the nature of services, based upon award-winning research by one of the authors. In addition, it introduces the seven key elements of the services marketing mix (collectively referred to as the 7 Ps) and presents the organizing framework for the book.

- New applications of technology—from Internet-based strategies and biometrics, to search engine optimization, Twitter, and M-commerce—and the opportunities and challenges they pose for customers and service marketers alike, are woven into the text at relevant points across virtually all chapters, as well as illustrated in boxed inserts.
- You will also find that all chapters have been further streamlined, with minimum redundancies within and between chapters (with cross-referencing to other parts of the book where necessary). This has significantly enhanced the clarity and structure of the text.
- Many chapters are now structured around strong organizing frameworks such as the three-stage model of consumer behavior related to services (Chapter 2), the flower of service (Chapter 4), the service talent cycle (Chapter 11), the wheel of loyalty (Chapter 12), and the service-profit chain (Chapter 15).
- In rewriting and restructuring the chapters, we have worked hard to create a text that is clear, readable, and focused. Opening vignettes and boxed inserts within the chapters are designed to capture student interest and provide opportunities for in-class discussions. They describe significant research findings, illustrate practical applications of important service marketing concepts, and describe best practices by innovative service organizations from around the world.

### New and Updated Cases

- *Services Marketing, 7th edition* features an exceptional selection of 18 up-to-date, classroom-tested cases of varying lengths and levels of difficulty. We wrote a majority of the cases ourselves. Others are drawn from the case collections of Harvard, INSEAD, and Yale.
- Three cases are completely new to this edition (Banyan Tree Hotels & Resorts, Distribution at American Airlines, and Revenue Management of Gondolas). Ten of the remaining cases carried over from the previous edition have been updated. Copyright dates for most cases are 2008 or 2010.
- The new case selection provides even broader coverage of service marketing issues and application areas, with cases featuring a wide array of industries and organizations, ranging in size from multinational giants to small entrepreneurial start-ups, and from nonprofit organizations to professional service firms.

You'll find that this text takes a strongly managerial perspective, yet it is rooted in solid academic research, complemented by memorable frameworks. Our goal is to bridge the all-too-frequent gap between theory and the real world. Practical management applications are reinforced by numerous examples within the 15 chapters. Complementing the text are 18 outstanding classroom-tested cases.

Preparing this new edition has been an exciting challenge. Services marketing, once a tiny academic niche championed by just a handful of pioneering professors, has become a thriving area of activity for both research and teaching. There's growing student interest in taking courses in this field, which makes good sense from a career standpoint, because most business school graduates will go on to work in service industries. We designed this new edition to serve you as a practical resource during your education and career. We hope that you will enjoy reading this text as much as we enjoyed writing it!

### FOR WHAT TYPES OF COURSES CAN THIS BOOK BE USED?

This text is designed for advanced undergraduates, MBA students, and EMBA students. *Services Marketing, 7th edition* places marketing issues within a broader general management context. The book will appeal both to full-time students headed for a

career in management and to EMBA and executive program participants who are combining their studies with ongoing work in managerial positions.

Whatever a manager's specific job may be, we argue that he or she has to understand and acknowledge the close ties that link the marketing, operations, and human resource functions. With that perspective in mind, we've designed this book so that instructors can make selective use of chapters, readings, and cases to teach courses of different lengths and formats in either services marketing or service management.

## WHAT ARE THE BOOK'S DISTINGUISHING FEATURES?

Key features of this highly readable book include:

- A strong managerial focus supported by the latest academic research. It not only addresses the need for service marketers to understand customer needs and behavior, but also considers how to use these insights to develop effective strategies for competing in the marketplace.
- The text is organized around an integrated framework, which students immediately relate to as it seamlessly builds on topics covered in principles and marketing management courses.
- Use of memorable organizing frameworks for most chapters that have been classroom-tested for relevance and effectiveness. Examples include the three-stage model of consumer behavior related to services, the flower of service, the wheel of loyalty, the service talent cycle, and the service-profit chain.
- Each chapter takes a systematic learning approach that is clear and easy to follow. Each chapter has:
  - An opening vignette, which introduces the concepts taught in the chapter.
  - Clear learning objectives.
  - Chapter summaries in bullet form that condense the core concepts and messages of each chapter.
  - Interesting examples and illustrations from a wide range of industries and geographies that link theory to practice.
  - Review questions designed to consolidate understanding of key concepts through discussion and study.
  - Application exercises that extend understanding beyond the question-and-answer format and focus on application and internalization of the concepts, theories, and key messages of each chapter.
- Inclusion of 18 carefully selected American, European, and Asian cases that offer a global perspective.
- Extensive and up-to-date references at the end of each chapter.

We've designed *Services Marketing, 7th edition* to complement the materials found in traditional marketing management and principles texts. Recognizing that the service sector of the economy can best be characterized by its diversity, we believe that no single conceptual model suffices to cover marketing-relevant issues among organizations ranging from huge international corporations (in fields such as airlines, banking, insurance, telecommunications, freight transportation, and professional services) to locally owned and operated small businesses, such as restaurants, laundries, taxis, optometrists, and many business-to-business services. In response, the book offers a carefully designed "toolbox" for service managers, teaching students how different concepts, frameworks, and analytical procedures can best be used to examine and resolve the varied challenges faced by managers in different situations.

# Managing People for Service Advantage

*The old adage 'People are your most important asset' is wrong. The **right** people are your most important asset.*

JIM COLLINS

*Customer satisfaction results from the realization of high levels of value compared to competitors . . . Value is created by satisfied, committed, loyal, and productive employees.*

JAMES L. HESKETT, W. EARL SASSER, JR., AND LEONARD L. SCHLESINGER

## LEARNING OBJECTIVES (LOs)

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

- |  |  |
|--|--|
| <b>LO1</b> Explain why service employees are crucially important to the success of a firm.                           | <b>LO6</b> Explain the key areas in which service employees need training.   |
| <b>LO2</b> Understand the factors that make the work of frontline staff demanding, challenging, and often difficult. | <b>LO7</b> Understand why empowerment is so important in many frontline jobs.  |
| <b>LO3</b> Describe the cycles of failure, mediocrity, and success in HR for service firms.                          | <b>LO8</b> Explain how to build high-performance service delivery teams.   |
| <b>LO4</b> Understand the key elements of the Service Talent Cycle and know how to get HR right in service firms.    | <b>LO9</b> Know how to motivate and energize service employees so they will deliver service excellence and productivity. |
| <b>LO5</b> Know how to attract, select, and hire the right people for service jobs.                                  | <b>LO10</b> Understand the role of service leadership and culture in developing people for service advantage.            |

### Cora Griffith—The Outstanding Waitress<sup>1</sup>

Cora Griffith, a waitress for the Orchard Café at the Paper Valley Hotel in Appleton, Wisconsin, is superb in her role, appreciated by first-time customers, famous with her regular customers, and revered by her coworkers. Cora loves her work—and it shows. Comfortable in a role she believes is right for her, Cora follows nine rules of success:

1. **Treat Customers Like Family.** First-time customers are not allowed to feel like strangers. Cheerful and proactive, Cora smiles, chats, and includes everyone at the table in the conversation. She is as respectful to children as she is to adults and makes it a point to learn and use everyone's name. "I want people to feel like they're sitting down to dinner right at my house," she says. "I want them to feel they're welcome, that they can get comfortable, that they can relax. I don't just serve people, I pamper them."
2. **Listen First.** Cora has developed her listening skills to the point that she rarely writes down customers' orders. She listens carefully and provides a customized service: "Are they in a hurry?" "Do they have a special diet?" "Do they like their selection cooked in a certain way?"
3. **Anticipate Customers' Wants.** Cora replenishes beverages and brings extra bread and butter in a timely manner. One regular customer, who likes honey with her coffee, gets it without having to ask. "I don't want my customers to have to ask for anything," says Cora, "so I always try to anticipate what they might need."
4. **Simple Things Make the Difference.** Cora manages the details of her service, monitoring the cleanliness of the utensils and their correct placement. The fold for napkins must be just right. She inspects each plate in the kitchen before taking it to the table, and she provides crayons for small children to draw pictures while waiting for the meal. "It's the little things that please the customer," she says.
5. **Work Smart.** Cora scans all her tables at once, looking for opportunities to combine tasks. "Never do just one thing at a time," she advises. "And never go from the kitchen to the dining room empty-handed. Take coffee or iced tea or water with you." When she refills one water glass, she refills others. When clearing one plate, she clears others. "You have to be organized, and you have to keep in touch with the big picture."
6. **Keep Learning.** Cora makes an ongoing effort to improve existing skills and learn new ones.
7. **Success Is Where You Find It.** Cora is content with her work. She finds satisfaction in pleasing her customers, and she enjoys helping other people enjoy. Her optimistic attitude is a positive force in the restaurant. She is hard to ignore. "If customers come to the restaurant in a bad mood, I'll try to cheer them up before they leave," she says. Her definition of success: "To be happy in life."
8. **All for One, One for All.** Cora has been working with many of the same coworkers for more than eight years. The team supports one another on the crazy days when 300 conventioners come to the restaurant for breakfast at the same time. Everyone pitches in and helps. The wait staff cover for one another, the managers bus the tables, the chefs garnish the plates. "We are like a little family," Cora says. "We know each other very well and we

help each other out. If we have a crazy day, I'll go in the kitchen toward the end of the shift and say, 'Man, I'm just proud of us. We really worked hard today.'"

9. **Take Pride in Your Work.** Cora believes in the importance of her work and in the need to do it well: "I don't think of myself as 'just a waitress' . . . I've chosen to be a waitress. I'm doing this to my full potential, and I give it my best. I tell anyone who's starting out: 'take pride in what you do.' You're never just an anything, no matter what you do. You give it your all . . . and you do it with pride."



**FIGURE 11.1** A Waitress' Pride in Her Professionalism Earns Her Admiration and Respect from Customers and Co-Workers

Cora Griffith is a success story. She is loyal to her employer and dedicated to her customers and coworkers. A perfectionist who seeks continuous improvement, Cora's enthusiasm for her work and unflagging spirit creates an energy that radiates through the restaurant. She is proud of being a waitress, proud of "touching lives." Says Cora: "I have always wanted to do my best. However, the owners really are the ones who taught me how important it is to take care of the customer and who gave me the freedom to do it. The company always has listened to my concerns and followed up. Had I not worked for the Orchard Café, I would have been a good waitress, but I would not have been the same waitress."

*Source:* Leonard L. Berry, *Discovering the Soul of Service—The Nine Drivers of Sustainable Business Success*. New York: The Free Press, 1999, pp. 156–159.

## SERVICE EMPLOYEES ARE CRUCIALLY IMPORTANT

Among the most demanding jobs in service businesses are the so-called frontline jobs. Employees working in these customer-facing jobs span the boundary between inside and outside the organization. They are expected to be fast and efficient in executing operational tasks as well as courteous and helpful in dealing with customers. In fact, frontline employees are a key input for delivering service excellence and competitive advantage.

Therefore, behind most of today's successful service organizations stands a firm commitment to effective management of human resources (HR) including recruitment, selection, training, motivation, and retention of employees. Organizations that display this commitment understand the economic payoff from investing in their people. These firms are also characterized by a distinctive culture of service leadership and role modeling by top management. It is probably harder for competitors to duplicate high-performance human assets compared to any other corporate resource.

### Service Personnel as a Source of Customer Loyalty and Competitive Advantage

Almost everybody can recount some horror story of a dreadful experience they have had with a service business. If pressed, many of these same people can also recount a really good service experience. Service personnel usually feature prominently in such dramas. They either feature in roles as uncaring, incompetent villains or as heroes who went out of their way to help customers by anticipating their needs and resolving problems in a helpful and empathetic manner. You probably have your own set of favorite stories, featuring both villains and heroes—and if you're like most people, you probably talk more about the former than the latter.

From a customer's perspective, the encounter with service staff is probably the most important aspect of a service. From the firm's perspective, the service levels and the way service is delivered by the frontline personnel can be an important source of differentiation as well as competitive advantage. Service employees are so important to customers and the firm's competitive positioning because the frontline:

- **Is a core part of the product.** Often, the service employees is the most visible element of the service, delivers the service, and significantly determines service quality.
- **Is the service firm.** Frontline employees represent the service firm, and from a customer's perspective, they are the firm.
- **Is the brand.** Frontline employees and the service they provide often are a core part of the brand. The employees determine whether the brand promise is delivered.
- **Affects sales.** Service personnel often are crucially important for generating sales, cross-sales, and up-sales.
- **Determine productivity.** Frontline employees have heavy influence on the productivity of frontline operations.



Furthermore, frontline employees play a key role in anticipating customers' needs, customizing the service delivery, and building personalized relationships with customers.<sup>2</sup> Effective performance of these activities should ultimately lead to customer loyalty. How attentive employees can be in anticipating customers' needs was shown in the opening vignette citing Cora Griffith as an example. This and many other success stories of employees showing discretionary effort that made a difference have reinforced the truism that highly motivated people are at the core of service excellence.<sup>3</sup> They are increasingly a key variable for creating and maintaining competitive positioning and advantage.

The intuitive importance of the effect of service employees on customer loyalty was integrated and formalized by James Heskett and his colleagues in their pioneering research on what they call the *service profit chain* (Chapter 15 illustrates the chain in more detail). It demonstrates the chain of relationships among (1) employee satisfaction, retention, and productivity; (2) service value; (3) customer satisfaction and loyalty; and (4) revenue growth and profitability for the firm.<sup>4</sup> These themes were developed further in their book, *The Value Profit Chain: Treat Employees Like Customers and Customers like Employees*.<sup>5</sup> Unlike manufacturing, "shop-floor workers" in services (i.e., frontline staff) are in constant contact with customers, and solid evidence shows that employee satisfaction and customer satisfaction are highly correlated.<sup>6</sup> Therefore, this chapter focuses on how to retain satisfied, loyal, and productive service employees.

### The Frontline in Low-Contact Services

Most research in service management and many of the best practice examples featured in this chapter relate to high-contact services. This is not entirely surprising, of course, because the people in these jobs are so visible. They are the actors who appear front-stage in the service drama when they serve the customer. So, it is obvious why the frontline is so crucially important to customers and therefore to the competitive position of the firm. However, there's a growing trend across virtually all types of services toward low-contact delivery channels such as call centers and self-service options. Many routine transactions are now conducted without involving frontline staff at all. Examples include the many types of self-service technologies (SSTs) provided via websites, automatic teller machines (ATMs), and interactive voice response (IVR) systems (see Chapter 8 for a more detailed discussion of SSTs). In light of these trends, are frontline employees really all that important?

Although the quality of SSTs and their customer interface can reach very high levels—and SSTs' importance has been elevated drastically to the core engine for service delivery in many industries—the quality of frontline employees still remains imperative. Most people do not call the service hotline or visit the service center of their cell phone service provider, or their credit card company more than once or twice a year. However, these occasional service encounters are absolutely critical—they are the "moments of truth" that drive a customer's perceptions of the service firm (see Figure 11.2). Also, it is likely that these interactions are not about routine transactions, but about service problems and special requests. These very few contacts determine whether a customer thinks, "Customer service is excellent! When I need help, I can call you, and this is one important reason why I bank with you," or "Your service stinks. I don't like interacting with you, and I am going to spread the word about how bad your service is!"

Given that technology is relatively commoditized, the service delivered by the front line, whether it is face to face, "ear to ear," or via email, Twitter, or chat, is highly visible and important to customers, and therefore a critical component of a service firm's marketing strategy.



**FIGURE 11.2** A Friendly Employee at a San Diego Bank Delivering a 'Moment of Truth'

## FRONTLINE WORK IS DIFFICULT AND STRESSFUL

The service-profit chain requires high-performing, satisfied employees to achieve service excellence and customer loyalty. However, these customer-facing employees work in some of the most demanding jobs in service firms. Perhaps you have worked in one or more of such jobs, which are particularly common in the health care, hospitality, retailing, and travel industries. Let's discuss the main reasons why these jobs are so demanding (and you can relate these to your own experience, while recognizing there may be differences between working part-time for short periods and full-time as a career).

### Boundary Spanning

The organizational behavior literature refers to service employees as *boundary spanners*. They link the inside of an organization to the outside world, operating at the boundary of the company. Because of the position they occupy, boundary spanners often have conflicting roles. In particular, customer contact personnel must attend to both operational and marketing goals. This multiplicity of roles in service jobs often leads to role conflict and role stress among employees,<sup>7</sup> which we will discuss next.

### Sources of Conflict

There are three main causes of role stress in frontline positions: organization/client, person/role, and inter-client conflicts.

**ORGANIZATION/CLIENT CONFLICT.** Customer contact personnel must attend to both operational and marketing goals. They are expected to delight customers, which takes time, yet they have to be fast and efficient at operational tasks. On top of that, they often are expected to do selling, cross-selling, and up-selling, for instance, "Now would be a good time to open a separate account to save for your children's education" or "For only 25 dollars more per night, you can upgrade to the executive floor."

Finally, sometimes customer contact personnel are even responsible for enforcing rate integrity and pricing schedules that might be in direct conflict with customer satisfaction (e.g., "I am sorry, but we don't serve ice water in this restaurant, but we have an excellent selection of still and carbonated mineral waters" or "I am sorry, but we cannot waive the fee for the bounced check for the third time this quarter." This type of conflict is also called the two-bosses dilemma where service employees have the unpleasant choice of whether to enforce the company's rules or satisfy customer demands. The problem is especially acute in organizations that are not customer oriented. In these cases, staff frequently has to deal with customer needs and requests that are in conflict with organizational rules, procedures, and productivity requirements.

**PERSON/ROLE CONFLICT.** Service staff may have conflicts between what their job requires and their own personalities, self-perception, and beliefs. For example, the job may require staff to smile and be friendly even to rude customers (see the section on jaycustomers in Chapter 12). V. S. Mahesh and Anand Kasturi note from their consulting work with service organizations around the world that thousands of frontline staff consistently tend to describe customers with a pronounced negative flavor—frequently using phrases such as "overdemanding," "unreasonable," "refuse to listen," "always want everything their way, immediately," and "arrogant."<sup>8</sup>

Providing quality service requires an independent, warm, and friendly personality. These traits are most likely found in people with high self-esteem. However, many front-line jobs are often perceived as low-level jobs that require little education, offer low pay, and often lack prospects. If an organization is not able to “professionalize” their frontline jobs and move away from this image, these jobs may be inconsistent with staff’s self-perception and lead to person/role conflicts.

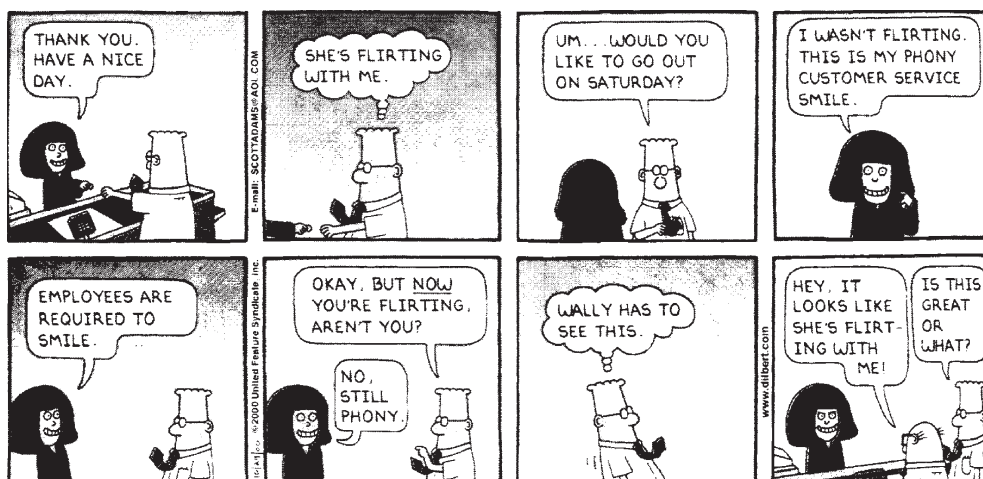
**INTER-CLIENT CONFLICT.** Conflicts between customers are not uncommon (e.g., smoking in nonsmoking sections, jumping queues, talking on a cell phone in a movie theater, or being excessively noisy in a restaurant), and it usually is the service staff that are summoned to call the offending customer to order. This is a stressful and unpleasant task, as it is difficult and often impossible to satisfy both sides.

In short, frontline employees may perform triple roles: satisfying customers, delivering productivity, and generating sales. In combination, playing such roles often leads to role conflict and role stress for employees.<sup>9</sup> Although employees may experience conflict and stress, they still are expected to have a pleasant disposition toward the customer. We call this emotional labor, which in itself is an important cause of stress. Let’s look at emotional labor in more detail in the next section.

### Emotional Labor

The term *emotional labor* was coined by Arlie Hochschild in her book *The Managed Heart*.<sup>10</sup> Emotional labor arises when a discrepancy exists between the way frontline staff feel inside and the emotions that management requires them to show in front of customers. Frontline staff are expected to be cheerful, genial, compassionate, sincere, or even self-effacing—emotions that can be conveyed through facial expressions, gestures, tone of voice, and words. Although some service firms make an effort to recruit employees with such characteristics, there will inevitably be situations when employees do not feel such positive emotions, yet are required to suppress their true feelings in order to conform to customer expectations. As Pannikkos Constanti and Paul Gibbs point out, “the power axis for emotional labor tends to favor both the management and the customer, with the front line employee . . . being subordinate,” thus creating a potentially exploitative situation.<sup>11</sup>

The stress of emotional labor is nicely illustrated in the following, probably apocryphal story: A flight attendant was approached by a passenger with: “Let’s have a smile.” She replied with: “Okay. I’ll tell you what. First you smile and then I’ll smile, okay?” He smiled. “Good,” she said. “Now hold that for 15 hours,” and walked away.<sup>12</sup> Figure 11.3 captures emotional labor with humor.



**FIGURE 11.3** Dilbert Encounters Emotional Labor at the Bank

Source: DILBERT: © Scott Adams/Dist. by permission of United Syndicate, Inc.



Firms need to be aware of ongoing emotional stress among their employees<sup>13</sup> and to devise ways of alleviating it, which should include training on how to deal with emotional stress and how to cope with pressure from customers. For example, because of Singapore Airlines' reputation for service excellence, its customers tend to have very high expectations and can be very demanding. This puts considerable pressure on its frontline employees. The commercial training manager of Singapore Airlines (SIA) explained,

We have recently undertaken an external survey and it appears that more of the "demanding customers" choose to fly with SIA. So the staff are really under a lot of pressure. We have a motto: "If SIA can't do it for you, no other airline can." So we encourage staff to try to sort things out, and to do as much as they can for the customer. Although they are very proud, and indeed protective of the company, we need to help them deal with the emotional turmoil of having to handle their customers well, and at the same time, feel they're not being taken advantage of. The challenge is to help our staff deal with difficult situations and take the brickbats. This will be the next thrust of our training programs.<sup>14</sup>

### Service Sweat Shops?

Rapid developments in information technology are permitting service businesses to make radical improvements in business processes and even completely reengineer their operations. These developments sometimes result in wrenching changes in the nature of work for existing employees. In some instances, deployment of new technology and methods can dramatically change the nature of the work environment (see Service Perspective 11.1). In other instances, face-to-face contact is replaced by use of the Internet or call center-provided services, and firms have redefined and relocated jobs, created new employee profiles for recruiting purposes, and sought to hire employees with a different set of qualifications.

As a result of the growing shift from high-contact to low-contact services, a large and increasing number of customer contact employees work by telephone or email, never meeting customers face to face.<sup>15</sup> For example, a remarkable 3 percent plus of the total U.S. workforce is now employed in call centers as "customer service representatives" or CSRs.

At best, when well designed, such jobs can be rewarding, and often offer parents and students flexible working hours and part-time jobs (some 50 percent of call center workers are single mothers or students). In fact, it has been shown that part-time workers are more satisfied with their work as CSRs than full-time staff, and perform just as well.<sup>16</sup> At worst, these jobs place employees in an electronic equivalent of the old-fashioned sweat shop. Even in the best managed call centers (also often called "customer contact centers"), the work is intense (see Figure 11.4), with CSRs expected to deal with up to two calls a minute (including trips to the restroom and breaks) and under a high level of monitoring. There is also significant stress from customers themselves, because many are irate at the time of contact.

Mahesh and Anand's research on call centers found that intrinsically motivated agents suffered less customer stress.<sup>17</sup> As we will discuss in this chapter, some of the keys to success in this area involve screening applicants to make sure they already know how to present themselves well on the telephone and have the potential to learn additional skills, training them carefully, and giving them a well-designed working environment.<sup>18</sup>

## SERVICE PERSPECTIVE 11.1

### COUNTING THE SECONDS—PERFORMANCE MEASUREMENT OF FRONTLINE EMPLOYEES

Retailers have come under tremendous pressure to cut costs, and labor is their biggest controllable expense. It is no wonder then that business is booming for the Operations Workforce Optimization (OWO) unit that was recently acquired by Accenture, the global consulting firm. The consulting and software company adapted time-motion concepts developed for manufacturing operations to service businesses, where it breaks down tasks such as working a cash register in a supermarket into quantifiable units and develops standard times to complete each unit or task. The firm then implements software to help its clients to monitor employee performance.

A spokesperson of a large retailer explained that they “expect employees to be at 100% performance to the standards, but we do not begin any formal counseling process until the performance falls below 95%.” If a staff falls below 95% of the baseline score too many times, he or she is likely to be bounced to a lower-paying job or be fired. Employee responses to this approach can be negative. Interviews with cashiers of that large retailer suggest that the system has spurred many to hurry up and experience increased stress levels. Hanning, 25 years old, took a job a cashier in one of the chain’s stores in Michigan for \$7.15 per hour in July 2007. She said she was “written up” three or four times for scores below 95% and was told that she had to move to another department at a lower pay if her performance did not improve. She recalled being told, “Make sure you’re just scanning, grabbing, bagging.” She resigned after almost one year on the job.

The customers’ experience can also be negatively affected. Gunter, 22 years old, says he recently told a longtime customer that he could not chat with her anymore as he was being timed. He said, “I was told to get people in and out.” Other cashiers said that they avoided eye contact with shoppers and hurried along those customers who may take longer to unload carts or make payment. A customer reported, “Everybody is under stress. They are not as friendly. I know elderly people have a hard time making change because you lose your ability to feel. They’re so rushed at checkout that they don’t want to come here.”

OWO recommends that retailers adjust time standards to account for customer service and other variables that can affect how long a particular task should take, but the interviews seem to suggest that quite a number of firms are focusing on productivity first. One clothing and footwear chain calculated that they could save \$15,000 per annum for every second cut from the checkout process, and another installed fingerprint readers directly at the cash registers so that cashiers can sign in directly at their individual workplaces and not at a central time clock, which saves minutes of wasted time according to a former director of a major retailer. OWO says that its methods can cut labor costs by 5 to 15%.

*Source:* Vanessa O’Connell, “Seconds Counts as Stores Trim Costs,” *The Wall Street Journal*, November 17, 2008, <http://www.nwanews.com/adg/Business/244489>, accessed June 5, 2009.

## CYCLES OF FAILURE, MEDIOCRITY, AND SUCCESS

Having discussed the importance of frontline employees and how difficult their work is, let’s look at the big picture—how poor, mediocre, and excellent firms set up their frontline employees for failure, mediocrity, or success. All too often, poor working environments translate into dreadful service, with employees treating customers the way their managers treat them. Businesses with high employee turnover frequently are stuck in what has been termed the *cycle of failure*. Others, which offer job security but little scope for personal initiative, may suffer from an



**FIGURE 11.4** Work in Customer Contact Centers Is Intense! Yet How Customer Service Representatives Perform Often Determines How a Firm's Service Quality Is Perceived by Customers

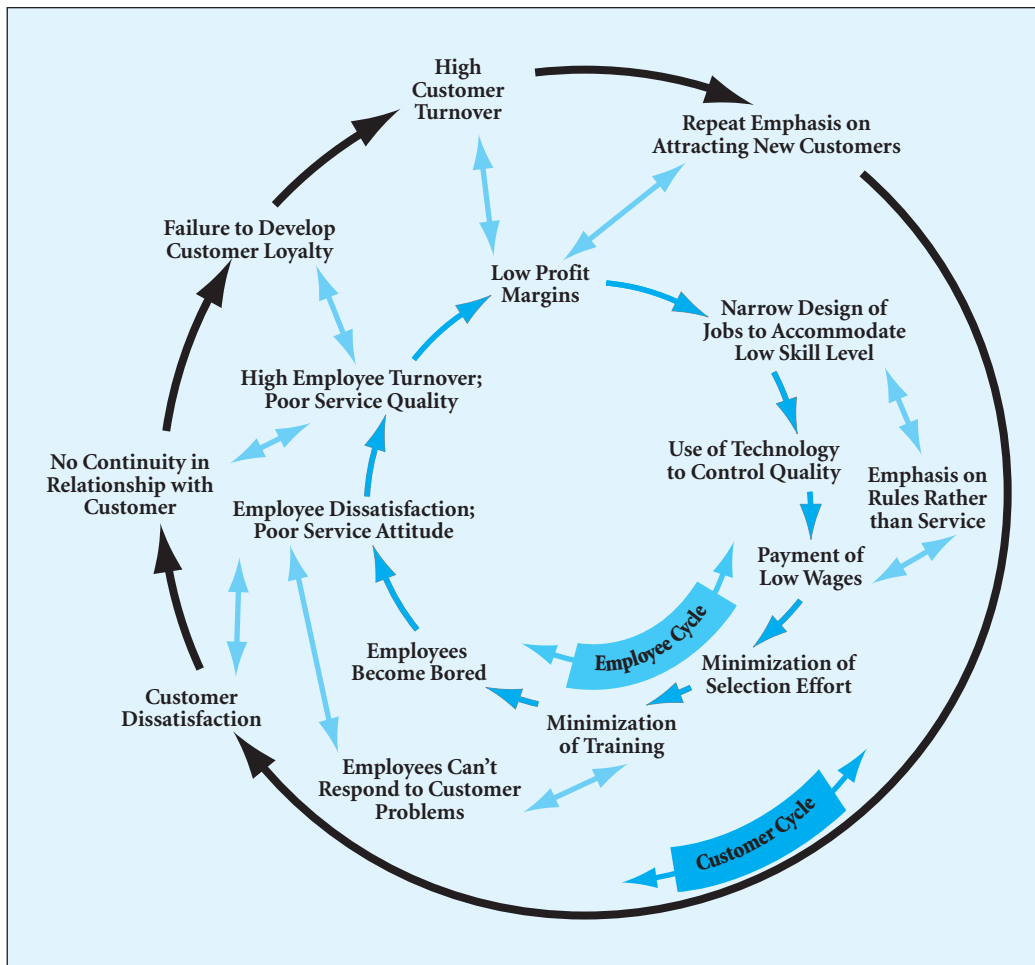
equally undesirable *cycle of mediocrity*. However, if the working environment is managed well, there is potential for a virtuous cycle in service employment, the *cycle of success*.<sup>19</sup>

### The Cycle of Failure

In many service industries, the search for productivity is carried out with a vengeance. One solution takes the form of simplifying work routines and hiring workers as cheaply as possible to perform repetitive work tasks that require little or no training. Among consumer services, department stores, fast-food restaurants, and call center operations often are cited as examples in which this problem abounds (although there are notable exceptions). The cycle of failure captures the implications of such a strategy, with its two concentric but interactive cycles: one involving failures with employees; the second, with customers (Figure 11.5).

The *employee cycle of failure* begins with a narrow design of jobs to accommodate low skill levels, an emphasis on rules rather than service, and the use of technology to control quality. A strategy of low wages is accompanied by minimal effort in selection or training. Consequences include bored employees who lack the ability to respond to customer problems, who become dissatisfied, and who develop a poor service attitude. Outcomes for the firm are low service quality and high employee turnover. Because of weak profit margins, the cycle repeats itself with the hiring of more low-paid employees to work in this unrewarding atmosphere. Some service firms can reach such low levels of employee morale that frontline staff become hostile toward customers and may even engage in “service sabotage” as described in Research Insights 11.1.

The *customer cycle of failure* begins with heavy organizational emphasis on attracting new customers who become dissatisfied with employee performance and the lack of continuity implicit in continually changing faces. These customers fail to develop any loyalty to the supplier and turn over as rapidly as the staff. This situation requires an ongoing search for new customers to maintain sales volume. The departure of discontented customers is especially disturbing in light of what we now know about the greater profitability of a loyal customer base.



**FIGURE 11.5** The Cycle of Failure

Source: Leonard L. Schlesinger and James L. Heskett "Breaking the Cycle of Failure in Services" *Sloan Management Review* 31 (Spring 1991): 17–28. Copyright © 1991 Massachusetts Institute of Technology. All rights reserved.

Managers' excuses and justifications for perpetuating the cycle of failure tend to focus on employees:

- You just can't get good people nowadays.
- People today just don't want to work.
- To get good people would cost too much and you can't pass on these cost increases to customers.
- It's not worth training our frontline people when they leave you so quickly.
- High turnover is simply an inevitable part of our business. You've got to learn to live with it.<sup>20</sup>

Too many managers ignore the long-term financial effects of low-pay/high turnover human resource strategies. James Heskett, Earl Sasser, and Leonard Schlesinger argue that companies need to measure employee lifetime value, just as they seek to calculate customer lifetime value.<sup>21</sup> Part of the problem is the failure to measure all relevant costs.

Three key cost variables often are omitted: (1) the cost of constant recruiting, hiring, and training (as much a time cost for managers as a financial cost); (2) the lower productivity of inexperienced new workers; and (3) the costs of constantly attracting new customers, which requires extensive advertising and promotional discounts. Also ignored are two revenue variables: (1) future revenue streams that might have continued for years but are lost when unhappy customers take their business elsewhere and (2) the potential income lost from prospective customers turned off by negative word of mouth. Finally, there are less easily quantifiable costs of disruptions to service while a job remains unfilled and loss of the departing employee's knowledge of the business (and potentially his or her customers as well).

## RESEARCH INSIGHTS 11.1

## SERVICE SABOTAGE BY THE FRONTLINE

The next time you are dissatisfied with the service provided by a service employee—in a restaurant, for example—it's worth pausing for a moment to think about the consequences of complaining about the service. You might just become the unknowing victim of a malicious case of service sabotage, such as having something unhygienic added to your food.

There actually is a fairly high incidence of service sabotage by frontline employees. Lloyd Harris and Emmanuel Ogbonna found that 90 percent of them accepted that frontline behavior with malicious intent to reduce or spoil the service—service sabotage is an everyday occurrence in their organizations.

Harris and Ogbonna classify service sabotage along two dimensions: covert-overt and routinized-intermittent behaviors. Covert behaviors are concealed from customers, whereas overt actions are purposefully displayed often to coworkers as well as customers. Routinized behaviors are ingrained into the culture, whereas intermittent actions are sporadic and less common. Some true examples of service sabotage classified along these two dimensions appear in Figure 11.6.

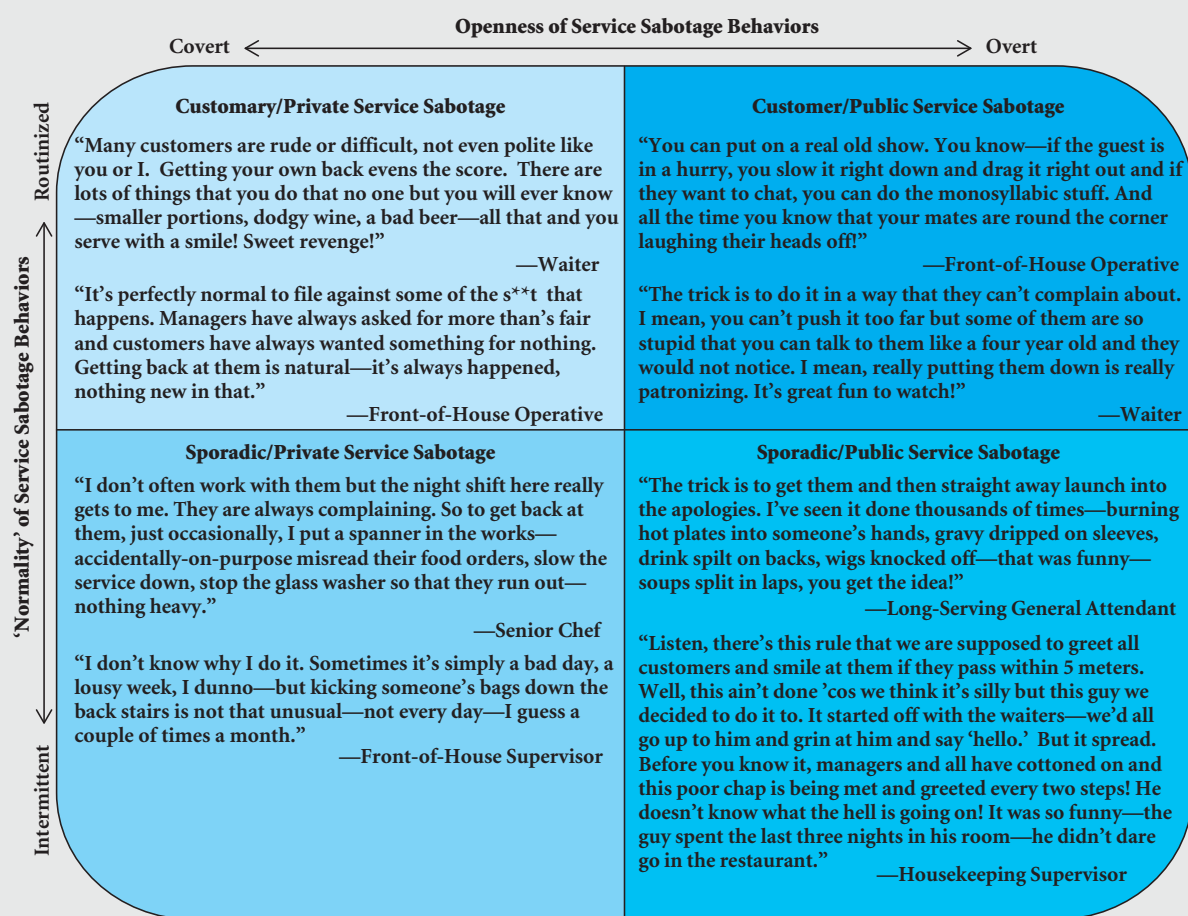


FIGURE 11.6 Examples of Services Sabotage

Source: Lloyd C. Harris and Emmanuel Ogbonna, "Exploring Service Sabotage: The Antecedents, Types and Consequences of Frontline, Deviant, Antiservice Behaviors," *Journal of Service Research*, Vol. 4, No. 3, 2002, pp. 163–183. Copyright © 2002 Sage Publications. Used with permission.

### The Cycle of Mediocrity

The cycle of mediocrity is another potentially vicious employment cycle (see Figure 11.7). You are most likely to find it in large, bureaucratic organizations. These often are typified by state monopolies, industrial cartels, or regulated oligopolies in which there's little market pressure from more agile competitors to improve performance and in which fear





**FIGURE 11.7** The Cycle of Mediocrity

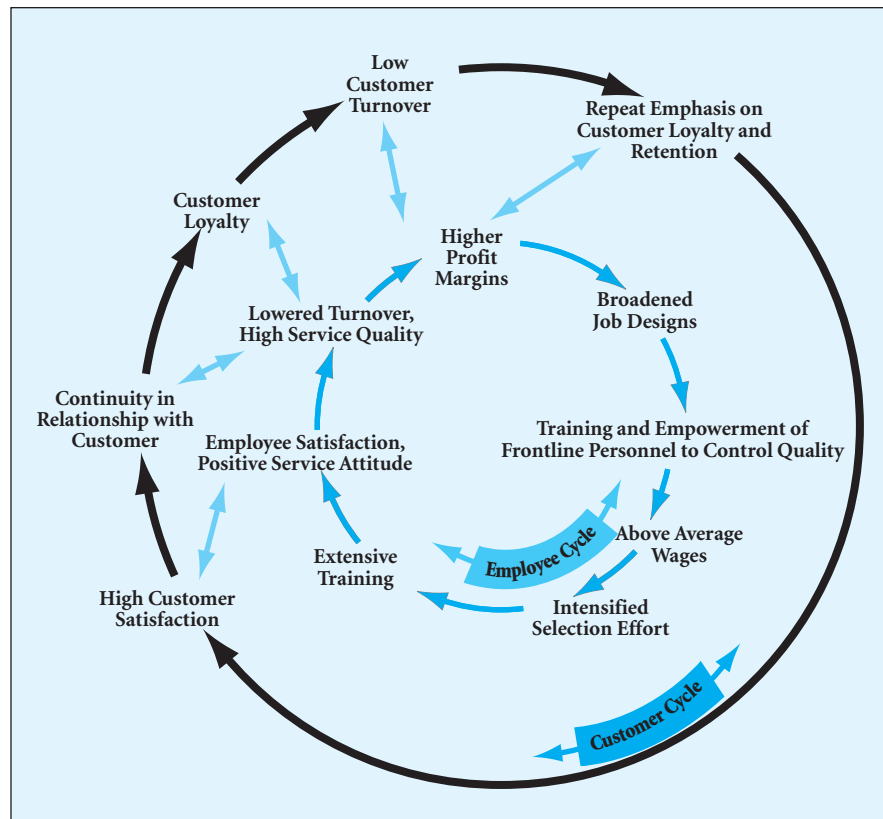
Source: Christopher Lovelock, "Managing Services: The Human Factor" in *Understanding Service Management*, ed. W.J. Glynn and J.G. Barnes (Chichester, UK John Wiley, 1995), 228.

of entrenched unions may discourage management from adopting more innovative labor practices.

In such environments, service delivery standards tend to be prescribed by rigid rule-books and oriented toward standardized service, operational efficiencies, and prevention of both employee fraud and favoritism toward specific customers. Job responsibilities tend to be narrowly and unimaginatively defined, tightly categorized by grade and scope of responsibilities, and further rigidified by union work rules. Salary increases and promotions are largely based on longevity. Successful performance in a job often is measured by absence of mistakes, rather than by high productivity or outstanding customer service. Training focuses on learning the rules and the technical aspects of the job, not on improving human interactions with customers and coworkers. Because there are minimal allowances for flexibility or employee initiative, jobs tend to be boring and repetitive. However, in contrast to the cycle of failure, most positions provide adequate pay and often good benefits combined with high security. Thus, employees are reluctant to leave. This lack of mobility is compounded by an absence of marketable skills that would be valued by organizations in other fields.

Customers find such organizations frustrating to deal with. Faced with bureaucratic hassles, lack of service flexibility, and unwillingness of employees to make an effort to serve them well, customers can become resentful. It's not surprising that dissatisfied customers sometimes display hostility toward service employees who feel trapped in their jobs and powerless to improve the situation. Perhaps you've been provoked by bad service and poor attitudes into reacting this way yourself. However, customers often continue to be "held hostage" by the organization because there is nowhere else for them to go, either because the service provider holds a monopoly, or because all other available players are perceived as equally bad or worse.

Employees may then protect themselves through such mechanisms as withdrawal into indifference, playing overtly by the rulebook, or countering rudeness with rudeness. The net result is a vicious cycle of mediocrity in which unhappy customers continually complain to sullen employees (and to other customers) about poor service and bad attitudes, generating greater defensiveness and lack of caring on the part of the



**FIGURE 11.8** The Cycle of Success

Source: Leonard L. Schlesinger and James L. Heskett. "Breaking the Cycle of Failure in Services" *Sloan Management Review* 31 (Spring 1991): 17-28. Copyright © 1991 Massachusetts Institute of Technology. All rights reserved.

staff. Under such circumstances, there's little incentive for customers to cooperate with the organization to achieve better service.

### The Cycle of Success

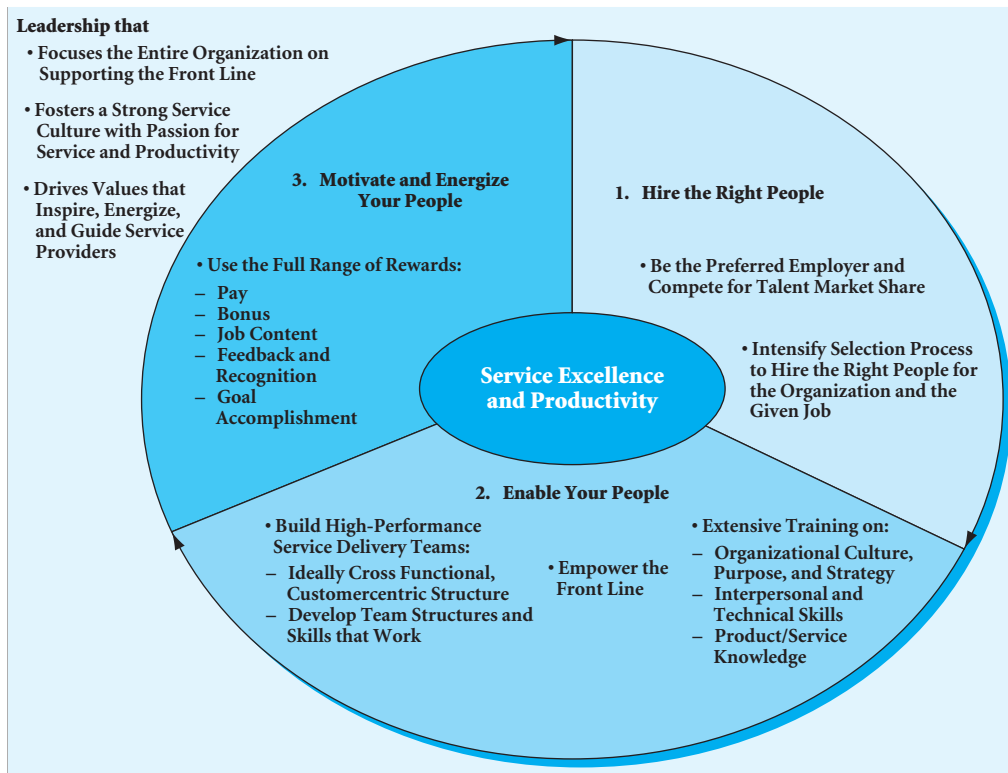
Some firms reject the assumptions underlying the cycles of failure or mediocrity. Instead, they take a longer term view of financial performance, seeking to prosper by investing in their people in order to create a cycle of success (Figure 11.8).

As with failure or mediocrity, success applies to both employees and customers. Attractive compensation packages are used to attract good quality staff. Broadened job designs are accompanied by training and empowerment practices that allow frontline staff to control quality. With more focused recruitment, intensive training, and better wages, employees are likely to be happier in their work and to provide higher quality, customer-pleasing service. Regular customers also appreciate the continuity in service relationships resulting from lower turnover and so are more likely to remain loyal. Profit margins tend to be higher, and the organization is free to focus its marketing efforts on reinforcing customer loyalty through customer retention strategies. These strategies usually are much more profitable than strategies for attracting new customers.

A powerful demonstration of a frontline employee working in the cycle of success is waitress Cora Griffin (featured in the opening vignette of this chapter). Even public service organizations in many countries are increasingly working toward creating their cycles of success, too, and offer their users good quality service at a lower cost to the public.<sup>22</sup>

### HUMAN RESOURCES MANAGEMENT—HOW TO GET IT RIGHT

Any rational manager would like to operate in the cycle of success. In this section, we'll discuss HR strategies that can help service firms to move toward that goal. Specifically, we'll discuss how firms can hire, motivate, and retain engaged service employees willing and able to deliver service excellence, productivity, and sales. Figure 11.9 shows the



**FIGURE 11.9** The Service Talent Cycle – Getting HR Right in Service Firms

service talent cycle that is our guiding framework for successful HR practices in service firms. We will then discuss the recommended practices one by one in this section.

### Hire the Right People

It is naïve to think that it's sufficient to satisfy employees. Employee satisfaction should be seen as necessary but not sufficient for having high performing staff. For instance, a recent study showed that employee effort was a strong driver of customer satisfaction over and above employee satisfaction.<sup>23</sup> As Jim Collins said, "The old adage 'People are the most important asset' is wrong. The *right* people are your most important asset." We would like to add to this: "...and the wrong people are a liability that is often difficult to get rid of." Getting it right starts with hiring the right people.

Hiring the right people includes competing for applications from the best employees in the labor market, then selecting from this pool the best candidates for the specific jobs to be filled.

**BE THE PREFERRED EMPLOYER.** To be able to select and hire the best people, they first have to apply for a job with you and then accept your job offer over others (the best people tend to be selected by several firms). That means a firm has to first compete for talent market share,<sup>24</sup> engaging in, as McKinsey & Company called it "the war for talent."<sup>25</sup> Competing in the labor market means having an attractive value proposition for prospective employees and includes factors such as having a good image in the community as a place to work for as well as delivering high-quality products and services that make employees feel proud to be part of the team.

Furthermore, the compensation package cannot be below average—top people expect above average packages. In our experience, it takes a salary in the range of the 60th to 80th percentile of the market to attract top performers to top companies. However, a firm does not have to be a top paymaster, if other important aspects of the value proposition are attractive. In short, understand the needs of your target-employees and get your value proposition right.

**SELECT THE RIGHT PEOPLE.** There's no such thing as the perfect employee (see Figure 11.10). Different positions often are best filled by people with different skill





**FIGURE 11.10** There's No Such Thing as a Perfect Employee

Source: © Randy Glasbergen

sets, styles, and personalities. For example, The Walt Disney Company assesses prospective employees in terms of their potential for on-stage or backstage work. On-stage workers, known as cast members, are assigned to those roles for which their appearance, personalities, and skills provide the best match.

What makes outstanding service performers so special? Often it is things that *cannot* be taught. It is the qualities intrinsic to the people and qualities they would bring with them to any employer. As one study of high performers observed:

Energy . . . cannot be taught, it has to be hired. The same is true for charm, for detail orientation, for work ethic, for neatness. Some of these things can be enhanced with on-the-job training . . . or incentives. . . . But by and large, such qualities are instilled early on.<sup>26</sup>

Also, HR managers have discovered that while good manners and the need to smile and make eye contact can be taught, warmth itself cannot. The only realistic solution is to ensure that the organization's recruitment criteria to favor candidates with naturally warm personalities. Jim Collins emphasizes that "the right people are those who would exhibit the desired behaviors anyway, as a natural extension of their character and attitude, regardless of any control and incentive system."<sup>27</sup>

The logical conclusion is that service firms should devote great care to attracting and hiring the right candidates. Let's next review tools that can help identify the right candidates for a given firm and job, and perhaps even more importantly, reject those candidates that don't fit.

### Tools to Identify the Best Candidates

Excellent service firms use a number of approaches to identify the best candidates in their applicant pool. These approaches include interviewing applicants, observing behavior, conducting personality tests, and providing applicants with a realistic job preview.<sup>28</sup>

**USE MULTIPLE, STRUCTURED INTERVIEWS.** To improve hiring decisions, successful recruiters like to employ structured interviews built around job requirements and to use more than one interviewer. People tend to be more careful in their judgments when they know that another individual is also evaluating the same applicant. Another advantage of using two or more interviewers is that it reduces the risk of "similar to me" biases—we all like people similar to ourselves.

**OBSERVE BEHAVIOR.** The hiring decision should be based on the behavior that recruiters observe, not just the words they hear. As John Wooden said: "Show me what you can do, don't tell me what you can do. Too often, the big talkers are the little doers."<sup>29</sup> Behavior can be directly or indirectly observed by using behavioral simulations or assessment center tests that use standardized situations in which applicants can be observed to see whether they display the kind of behaviors the firms' clients would expect. Also, past behavior is the best predictor of future behavior: Hire the person who has won service excellence awards, received many complimentary letters, and has great references from past employers.

**CONDUCT PERSONALITY TESTS.** Personality tests help to identify traits relevant for a particular job. For example, willingness to treat customers and colleagues with courtesy, consideration, and tact; perceptiveness of customer needs; and ability to communicate accurately and pleasantly are measurable traits. Hiring decisions based on such tests tend to be accurate.

For example, the Ritz-Carlton Hotels Group uses personality profiles on all job applicants. Employees are selected for their natural predisposition for working in a service context. Inherent traits such as a ready smile, a willingness to help others, and an affinity for multitasking enable them to go beyond learned skills. An applicant to Ritz-Carlton shared about her experience of going through the personality test for a job as a junior-level concierge at the Ritz-Carlton Millenia Singapore. Her best advice: “Tell the truth. These are experts; they will know if you are lying,” and then she added:

“On the big day, they asked if I liked helping people, if I was an organized person and if I liked to smile a lot.” Yes, yes and yes, I said. But I had to support it with real life examples. This, at times, felt rather intrusive. To answer the first question for instance, I had to say a bit about the person I had helped—why she needed help, for example. The test forced me to recall even insignificant things I had done, like learning how to say hello in different languages which helped to get a fix on my character.”<sup>30</sup>

It’s better to hire upbeat and happy people, because customers report higher satisfaction when served by more satisfied staff.<sup>31</sup> Apart from intensive interview-based psychological tests, cost-effective Internet-based testing kits are available. Here, applicants enter their test responses to a Web-based questionnaire, and the prospective employer receives the analysis, the suitability of the candidate, and a hiring recommendation. Developing and administering such tests has become a significant service industry in its own right. A leading global supplier of such assessment products, the SHL Group, serves some 15,500 organizations in 30 languages in over 50 countries. Have a look at its website at [www.shl.com](http://www.shl.com) to see the tests that are available.

**GIVE APPLICANTS A REALISTIC PREVIEW OF THE JOB.** During the recruitment process, service companies should let candidates know the reality of the job,<sup>32</sup> thereby giving them a chance to “try on the job” and assess whether it’s a good fit or not. At the same time, recruiters can observe how candidates respond to the job’s realities. This approach allows some candidates to withdraw if they determine the job is not suitable for them. At the same time, the company can manage new employees’ expectations of their job. Many service companies adopt this approach. For example, Au Bon Pain, a chain of French bakery cafes, lets applicants work for two paid days in a café prior to the final selection interview. Here, managers can observe candidates in action, and candidates can assess whether they like the job and the work environment.<sup>33</sup>

See Best Practice in Action 11.1 on how Southwest Airlines uses a combination of interviews and other selection tools to identify the right candidates with the right attitude and a personality that fits the Southwest culture from its vast pool of applicants.

### Train Service Employees Actively

If a firm has good people, investments in training can yield outstanding results. Service champions show a strong commitment to training in words, dollars, and action. As Benjamin Schneider and David Bowen put it, “The combination of attracting a diverse and competent applicant pool, utilizing effective techniques for hiring the

**BEST PRACTICE IN ACTION 11.1****Hiring at Southwest Airlines**

Southwest hires people with the right attitude and with personality that matches its corporate personality. Humor is the key. Herb Kelleher, Southwest's legendary former CEO and now chairman said, "I want flying to be a helluva lot of fun!" "We look for attitudes; people with a sense of humor who don't take themselves too seriously. We'll train you on whatever it is you have to do, but the one thing Southwest cannot change in people is inherent attitudes." Southwest has one fundamental, consistent principle—hire people with the right spirit. Southwest looks for people with other-oriented, outgoing personalities, individuals who become part of an extended family of people who work hard and have fun at the same time.

Southwest's painstaking approach to interviewing continues to evolve in the light of experience. It is perhaps at its most innovative in the selection of flight attendants. A day-long visit to the company usually begins with applicants gathered in a group. Recruiters watch how well they interact with each other (another chance for such observation will come at lunchtime).

Then comes a series of personal interviews. Each candidate has three one-on-one "behavioral-type" interviews during the course of the day. Based on input from supervisors and peers in a given job category, interviewers target 8 to 10 dimensions for each position. For a flight attendant, these might include a willingness to take initiative, compassion, flexibility, sensitivity, sincerity, a customer service orientation, and a predisposition to be a team player. Even humor is "tested." Prospective employees typically are asked, "Tell me how you recently used your sense of humor in a work environment. Tell me how you have used humor to defuse a difficult situation."

Southwest describes the ideal interview as "a conversation," in which the goal is to make candidates comfortable. "The first interview of the day tends to be a bit stiff, the second is more comfortable, and by the third they tell us a whole lot more. It's really hard to fake it under those circumstances." The three interviewers don't discuss candidates during the day but compare notes afterwards, so that it reduces the risk of bias.

To help select people with the right attitude, Southwest invites supervisors and peers (with whom future candidates will be working) to participate in the in-depth interviewing and selection process. In this way, existing employees buy into the recruitment process and feel a sense of responsibility for mentoring new recruits and helping them to become successful in the job (rather than wondering, as an interviewer put it, "who hired this turkey?"). More unusually, it invites its own frequent flyers to participate in the initial interviews for flight attendants and to tell the candidates what they, the passengers, value.

The interviewing team asks a group of potential employees to prepare a five-minute presentation about themselves and gives them plenty of time to prepare. As the presentations are delivered, the interviewers don't watch just the speakers. They watch the audience to see which applicants are using their time to work on their own presentations and which are enthusiastically cheering on and supporting their potential coworkers. Unselfish people who will support their teammates are the ones who catch Southwest's eyes, not the applicants who are tempted to polish their own presentations while others are speaking.

By hiring the right attitude, the company is able to foster the so-called Southwest spirit—an intangible quality in people that causes them to want to do whatever it takes and to want to go that extra mile whenever they need to. Southwest itself goes the extra mile for its employees and has never laid anyone off, even after it decided to close reservations centers in three cities in 2004 to cut costs. Management knows that the airline's culture is a key competitive advantage.

*Sources:* Kevin and Jackie Freiberg, *Nuts! Southwest Airlines' Crazy Recipe for Business and Personal Success*. New York: Broadway Books, 1997, 64–69; Christopher Lovelock, *Product Plus*. New York: McGraw-Hill, 1994, 323–326; Barney Gimbels, "Southwest's New Flight Plan," *Fortune*, May 16, 2005, 93–98.

most appropriate people from that pool, and then training the heck out of them would be gangbusters in any market."<sup>34</sup> Service employees need to learn:

- **The Organizational Culture, Purpose, and Strategy.** Start strong with new hires; focus on getting emotional commitment to the firm's core strategy; and promote core values such as commitment to service excellence, responsiveness, team spirit, mutual respect, honesty, and integrity. Use managers to teach, and

focus on “what”, “why” and “how” rather than on the specifics of the job.<sup>35</sup> For example, new recruits at Disneyland attend the “Disney University Orientation.” It starts with a detailed discussion of the company history and philosophy, the service standards expected of cast members, and a comprehensive tour of Disneyland’s operations.<sup>36</sup>

- **Interpersonal and Technical Skills.** Interpersonal skills tend to be generic across service jobs and include visual communications skills such as making eye contact, attentive listening, body language, and even facial expressions. Technical skills encompass all the required knowledge related to processes (e.g., how to handle a merchandise return), machines (e.g., how to operate the terminal), and rules and regulations related to customer service processes. Both technical and interpersonal skills are *necessary* but neither alone is *sufficient* for optimal job performance.<sup>37</sup>
- **Product/Service Knowledge.** Knowledgeable staff are a key aspect of service quality. They must be able to explain product features effectively and position the product correctly. For instance, in Best Practice in Action 11.2, Jennifer Grassano of Dial-A-Mattress coaches individual staff members on how to paint pictures in the customer’s mind.

Of course, training has to result in tangible changes in behavior. If staff do not apply what they have learned, the investment is wasted. Learning is not only about becoming smarter, but about changing behaviors and improving decision making. To achieve this, practice and reinforcement are needed. Supervisors can play a

### BEST PRACTICE IN ACTION 11.2

#### Coaching at Dial-A-Mattress

Coaching is a common method employed by services leaders to train and develop staff. Dial-A-Mattress’ Jennifer Grassano is a bedding consultant (BC) for three days a week and a coach to other BCs for one day a week. She focuses on staff whose productivity and sales performance are slumping.

Her first step is to listen in on the BCs telephone calls with customers. She will listen for about an hour and take detailed notes on each call. The BCs understand that their calls may be monitored, but they receive no advance notice as that would defeat the purpose.

Grassano conducts a coaching session with the staff member, in which strengths and areas for improvements are reviewed. She knows how difficult it is to maintain a high energy level and convey enthusiasm when handling some 60 calls per shift. She likes to suggest new tactics and phrasings “to spark up their presentation.” One BC was not responding effectively when customers asked why one mattress was more expensive than another. Here, she stressed the need to paint a picture in the customer’s mind:

*Customers are at our mercy when buying bedding. They don’t know the difference between one coil system and another. It is just like buying a carburetor for my car. I don’t even know what a carburetor looks like. We have to use very descriptive words to help bedding customers make the decision that is right for them. Tell the customer that the more costly mattress has richer, finer padding with a blend of silk and wool. Don’t just say the mattress has more layers of padding.*

About two months after the initial coaching session, Grassano conducts a follow-up monitoring session with that BC. She then compares the BC’s performance before and after the coaching session to assess the effectiveness of the training.

Grassano’s experience and productivity as a BC give her the credibility as a coach. “If I am not doing well as a BC, then who am I to be a coach? I have to lead by example. I would be much less effective if I was a full-time trainer.” She clearly relishes the opportunity to share her knowledge and pass on her craft.

*Source:* Reprinted with the permission of The Free Press, a division of Simon & Schuster, Inc., from *Discovering the Soul of Service: The Nine Drives of Sustainable Business Success* by Leonard L. Berry. Copyright © 1999 by Leonard L. Berry. All rights reserved.



**FIGURE 11.11** Morning Briefings by a Supervisor Offer Effective Training Opportunities

crucial role by following up regularly on learning objectives, for instance, meeting with staff to reinforce key lessons from recent complaints and compliments (Figure 11.11).

Training and learning professionalizes the frontline, moving these individuals away from the common (self)-image of being in low-end jobs that have no significance. Well-trained employees feel and act like professionals. A waiter who knows about food, cooking, wines, dining etiquette, and how to effectively interact with customers (even complaining ones) feels professional, has a high self-esteem, and is respected by his customers. Training is therefore extremely effective in reducing person/role stress.

### Empower the Frontline

After selecting the right candidates and training them well, the next step is to empower the frontline.

Virtually all breakthrough service firms have legendary stories of employees who recovered failed service transactions or walked the extra mile to make a customer's day or avoid some kind of disaster for that client (for an example, see Best Practice in Action 11.3).<sup>38</sup> To allow this to happen, employees have to be empowered. Nordstrom trains and trusts its employees to do the right thing and empowers them to do so. Its employee handbook

#### BEST PRACTICE IN ACTION 11.3

##### Empowerment at Nordstrom

Van Mensah, a men's apparel sales associate at Nordstrom, received a disturbing letter from one of his loyal customers. The gentleman had purchased some \$2,000 worth of shirts and ties from Mensah and mistakenly washed the shirts in hot water. They all shrank. He was writing to ask Mensah's professional advice on how he should deal with his predicament (the gentleman did not complain and readily conceded the mistake was his).

Mensah immediately called the customer and offered to replace those shirts with new ones—at no charge. He asked the customer to mail the other shirts back to Nordstrom—at Nordstrom's expense. "I didn't have to ask for anyone's permission to do what I did for that customer," said Mensah. "Nordstrom would rather leave it up to me to decide what's best."

Middlemas, a Nordstrom's veteran, said to employees, "You will never be criticized for doing too much for a customer; you will only be criticized for doing too little. If you're ever in doubt as to what to do in a situation, always make a decision that favors the customer before the company." Nordstrom's Employee Handbook confirms this. It reads:

##### Welcome to Nordstrom

**We're glad to have you with our Company.**

**Our number one goal is to provide outstanding customer service.**

**Set both your personal and professional goals high.**

**We have great confidence in your ability to achieve them.**

##### Nordstrom Rules:

**Rule #1: Use your good judgment in all situations.**

**There will be no additional rules.**

**Please feel free to ask your department manager, store manager, or division general manager any question at any time.**

Source: Robert Spector and Patrick D. McCarthy, *The Nordstrom Way*. New York: John Wiley & Sons, Inc., 2000, 15–16, 95.



has only one rule: “Use good judgment in all situations.” Employee self-direction has become increasingly important, especially in service firms, because frontline staff frequently operate on their own, face to face with their customers, and it tends to be difficult for managers to closely monitor their behavior.<sup>39</sup> Research also linked high empowerment to higher customer satisfaction.<sup>40</sup>

For many services, providing employees with greater discretion (and training in how to use their judgment) enables them to provide superior service on the spot, rather than taking time to get permission from supervisors. Empowerment looks to frontline staff to find solutions to service problems and to make appropriate decisions about customizing service delivery.

**IS EMPOWERMENT ALWAYS APPROPRIATE?** Advocates claim that the empowerment approach is more likely to yield motivated employees and satisfied customers than the “production-line” alternative in which management designs a relatively standardized system and expects workers to execute tasks within narrow guidelines. However, David Bowen and Edward Lawler suggest that different situations may require different solutions, declaring that “both the empowerment and production-line approaches have their advantages . . . and . . . each fits certain situations. The key is to choose the management approach that best meets the needs of both employees and customers.” Not all employees are necessarily eager to be empowered, and many employees do not seek personal growth within their jobs and would prefer to work to specific directions rather than to use their own initiative. Research has shown that a strategy of empowerment is most likely appropriate when most of the following factors are present within the organization and its environment:

- The firm’s business strategy is based on competitive differentiation and on offering personalized, customized service.
- The approach to customers is based on extended relationships rather than on short-term transactions.
- The organization uses technologies that are complex and nonroutine in nature.
- The business environment is unpredictable, and surprises are to be expected.
- Existing managers are comfortable with letting employees work independently for the benefit of both the organization and its customers.
- Employees have a strong need to grow and deepen their skills in the work environment, are interested in working with others, and have good interpersonal and group process skills.<sup>41</sup>

**CONTROL VERSUS INVOLVEMENT.** The production-line approach to managing people is based on the well-established *control* model of organization design and management. There are clearly defined roles, top-down control systems, hierarchical pyramid structures, and an assumption that the management knows best. Empowerment, by contrast, is based on the *involvement* (or *commitment*) model, which assumes that employees can make good decisions and produce good ideas for operating the business if they are properly socialized, trained, and informed. This model also assumes that employees can be internally motivated to perform effectively and that they are capable of self-control and self-direction.

Schneider and Bowen emphasize that “empowerment isn’t just ‘setting the front-line free’ or ‘throwing away the policy manuals.’ It requires systematically redistributing four key ingredients throughout the organization, from the top downwards.”<sup>42</sup> The four features are:

- *Information* about organizational performance (e.g., operating results and measures of competitive performance).
- *Knowledge* that enables employees to understand and contribute to organizational performance (e.g., problem-solving skills).
- *Power* to make decisions that influence work procedures and organizational direction (e.g., through quality circles and self-managing teams).
- *Rewards* based on organizational performance such as bonuses, profit sharing, and stock options.

In the control model, the four features are concentrated at the top of the organization, while in the involvement model these features are pushed down through the organization.

**LEVELS OF EMPLOYEE INVOLVEMENT.** The empowerment and production-line approaches are at opposite ends of a spectrum that reflects increasing levels of employee involvement as additional information, knowledge, power, and rewards are pushed down to the front line. Empowerment can take place at several levels:

- *Suggestion Involvement* empowers employees to make recommendations through formalized programs. McDonald's, often portrayed as an archetype of the production-line approach, listens closely to its frontline. Did you know that innovations, ranging from Egg McMuffin to methods of wrapping burgers without leaving a thumbprint on the bun, were invented by employees?
- *Job Involvement* represents a dramatic opening up of job content. Jobs are redesigned to allow employees to use a wider array of skills. In complex service organizations such as airlines and hospitals, in which individual employees cannot offer all facets of a service, job involvement often is accomplished through the use of teams. To cope with the added demands accompanying this form of empowerment, employees require training, and supervisors need to be reoriented from directing the group to facilitating its performance in supportive ways.
- *High Involvement* gives even the lowest-level employees a sense of involvement in the company's overall performance. Information is shared. Employees develop skills in teamwork, problem solving, and business operations, and they participate in work-unit management decisions. There is profit sharing, often in the form of bonuses.

Southwest Airlines illustrates a high-involvement company, promoting common sense and flexibility. It trusts its employees and gives them the latitude, discretion, and authority they need to do their jobs. The airline has eliminated inflexible work rules and rigid job descriptions so its people can assume ownership for getting the job done and enabling flights to leave on time, regardless of whose "official" responsibility it is. This gives employees the flexibility to help each other when needed. As a result, they adopt a "whatever it takes" mentality.

Southwest mechanics and pilots feel free to help ramp agents load bags. When a flight is running late, it's not uncommon to see pilots helping passengers in wheelchairs to board the aircraft, assisting operations agents by taking boarding passes, or helping flight attendants clean the cabin between flights. All of these actions are their way of adapting to the situation and taking ownership for getting customers on board more quickly. In addition, Southwest employees apply common sense, not rules, when it's in the best interests for the customer.

Rod Jones, assistant chief pilot, recalls a captain who left the gate with a senior citizen who had boarded the wrong plane. The customer was confused and very upset. Southwest asks pilots not to go back to the gate with an incorrectly boarded customer. In this case, the captain was concerned about this individual's well-being. "So, he adapted to the situation," says Jones. "He came back in to the gate, deplaned the customer, pushed back out, and gave us an irregularity report. Even though he broke the rules, he used his judgment and did what he thought was best. And we said, 'Attaboy!'"<sup>43</sup>

### Build High-Performance Service-Delivery Teams

A team can be defined as "a small number of people with complementary skills committed to a common purpose, set of performance goals, and approach for which they hold themselves mutually accountable."<sup>44</sup> The nature of many services requires people to work in teams, often across functions, in order to offer seamless customer service processes.

Traditionally, many firms were organized by functional structures, under which, for example, one department is in charge of consulting and selling (e.g., selling a subscription contract with a cell phone), another, in charge of customer service (e.g., activation of value-added services, changes of subscription plans), and still a third is in charge of billing. This structure prevents internal service teams from viewing end customers as their own, and this structure can also mean poorer teamwork across functions, slower service, and more errors between functions. When customers have service problems, they easily fall between the cracks.

Empirical research has confirmed that frontline employees themselves regard lack of interdepartmental support as an important factor in hindering them from satisfying their customers.<sup>45</sup> Because of these problems, service organizations in many industries need to create cross-functional teams with the authority and responsibility to serve customers from beginning of the service encounter to the end. Such teams are also called self-managed teams.<sup>46</sup>

**THE POWER OF TEAMWORK IN SERVICES.** Teams, training, and empowerment go hand-in-hand. Teams facilitate communication among team members and the sharing of knowledge. By operating like a small, independent unit, service teams take on more responsibility and require less supervision than more traditional functionally organized customer service units. Furthermore, teams often set higher performance targets for themselves than supervisors would. Within a good team, pressure to perform is high.<sup>47</sup> Best Practice in Action 11.4 shows not only how Singapore Airlines uses teams to provide emotional support and to mentor its cabin crew, but also how the company effectively assesses, rewards, and promotes staff.

Some academics even feel that too much emphasis is placed on hiring “individual stars,” and too little attention is paid to hiring staff with good team abilities and motivation to work cooperatively. Stanford professors Charles O’Reilly and Jeffrey Pfeffer emphasize that how well people work in teams often is as important as how good people are, and that stars can be outperformed by others through superior teamwork.<sup>48</sup>

At Customer Research Inc. (CRI), a progressive and successful marketing research firm, team members’ feelings are illustrated in the following quotes:

- “I like being on the team. You feel like you belong. Everyone knows what’s going on.”
- “We take ownership. Everyone accepts responsibility and jumps in to help.”
- “When a client needs something in an hour, we work together to solve the problem.”
- “There are no slugs. Everyone pulls their weight.”<sup>49</sup>

Team ability and motivation are crucial for effective delivery of many types of services, especially those involving individuals who are each playing specialist roles. For example, health care services depend heavily on effective teamwork of many specialists (see Figure 11.12).

**CREATING SUCCESSFUL SERVICE-DELIVERY TEAMS.** It’s not easy to make teams function well. If people are not prepared for teamwork, and the team structure isn’t set up right, a firm risks having initially enthusiastic volunteers who lack the competencies that teamwork requires. The skills needed include not only cooperation, listening to others, coaching and encouraging one another, but also an understanding of how to air differences, tell one another hard truths, and ask tough questions. All these require training.<sup>50</sup> Management also needs to set up a structure that will steer the teams toward success. A good example is



**FIGURE 11.12** Surgical Teams Work under Particularly Demanding Conditions



**BEST PRACTICE IN ACTION 11.4****Singapore Airlines' Team Concept**

Singapore Airlines (SIA) understands the importance of teamwork in the delivery of service excellence and has been focusing on creating an *esprit de corps* among its cabin crew. This is made more difficult by the fact that many crew members are scattered around the world. SIA's answer is the "team concept."

Choo Poh Leong, Senior Manager Cabin Crew Performance, explained:

"In order to effectively manage our 6,600 crew, we divide them into teams, small units, with a team leader in charge of about 13 people. We will roster them to fly together as much as we can. Flying together, as a unit, allows them to build up camaraderie, and crew members feel like they are part of a team, not just a member. The team leader will get to know them well, their strengths and weaknesses, and will become their mentor and their counsel, and someone to whom they can turn if they need help or advice. The 'check trainers' oversee 12 or 13 teams and fly with them whenever possible, not only to inspect their performance, but also to help their team develop."

"The interaction within each of the teams is very strong. As a result, when a team leader does a staff appraisal, they really know the staff. You would be amazed how meticulous and detailed each staff record is. So, in this way, we have good control, and through the control, we can ensure that the crew delivers the promise. They know that they're being constantly monitored and so they deliver. If there are problems, we will know about them and we can send them for re-training. Those who are good will be selected for promotion."

According to Toh Giam Ming, Senior Manager Crew Performance, "What is good about the team concept is that despite the huge number of crew, people can relate to a team and have a sense of belonging. 'This is my team.' And they are put together for 1–2 years and they are rostered together for about 60–70 percent of the time, so they do fly together quite a fair bit . . . So especially for the new people, I think they find that they have less problems adjusting to the flying career, no matter what their background is. Because once you get familiar with the team, there is support and guidance on how to do things." Choo Poh Leong adds: "The individual, you see, is not a digit or a staff number, because if you don't have team-flying, you have 6,000 odd people, it can be difficult for you to really know a particular person."

SIA also has a lot of seemingly unrelated activities in the cabin crew division. For example, there is a committee called the Performing Arts Circle made up of talented employees with an interest in the arts. During a recent bi-annual Cabin Crew Gala Dinner, members of SIA raised over half a million dollars for charity. In addition to the "Performing Arts Circle," SIA also has a gourmet circle, language circles (such as a German and French speaking group), and even sports circles (such as football and tennis teams). As mentioned by Sim Kay Wee, "SIA believes that all these things really encourage camaraderie and teamwork."

*Sources:* Jochen Wirtz, Loizos Heracleous, and Nitin Pangarkar, "Managing Human Resources for Service Excellence and Cost Effectiveness at Singapore Airlines," *Managing Service Quality*, 18, No. 1, 2008, 4–19; Loizos Heracleous, Jochen Wirtz, and Nitin Pangarkar, *Flying High in a Competitive Industry: Secrets of the World's Leading Airline*. Singapore: McGraw-Hill, 2009.

American Express Latin America, which developed the following rules for making its teams work:

- Each team has an "owner"—a person who owns the team's problems.
- Each team has a leader who monitors team progress and team process. Team leaders are selected for their strong business knowledge and people skills.
- Each team has a quality facilitator—someone who knows how to make teams work and who can remove barriers to progress and train others to work together effectively.<sup>51</sup>

### Motivate and Energize People

Once a firm has hired the right people, trained them well, empowered them, and organized them into effective service delivery teams, how can it ensure that they will deliver? Staff performance is a function of ability and motivation.<sup>52</sup> Effective

hiring, training, empowerment, and teams give a firm able people; and reward systems are key to motivating them. Service staff must get the message that providing quality service holds the key for them to be rewarded. Motivating and rewarding strong service performers are some of the most effective ways of retaining them. Staff pick up quickly if those who get promoted are the truly outstanding service providers, and if those who get fired are those that do not deliver at the customer level.

A major way service businesses fail is not utilizing the full range of available rewards effectively. Many firms think in terms of money as reward, but it does not pass the test of an effective reward. Receiving a fair salary is a hygiene factor rather than a motivating factor. Paying more than what is seen as fair only has short-term motivating effects and wears off quickly. On the other hand, bonuses contingent on performance have to be earned again and again and therefore tend to be more lasting in their effectiveness. Other, more lasting rewards are the job content itself, recognition and feedback, and goal accomplishment.

**JOB CONTENT.** People are motivated and satisfied simply by knowing that they are doing a good job. They feel good about themselves and like to reinforce that feeling. This is true especially if the job also offers a variety of different activities, requires the completion of “whole” and identifiable pieces of work, is seen as significant in the sense that it has an impact on the lives of others, comes with autonomy, and provides direct and clear feedback about how well employees did their work (grateful customers and sales performance).

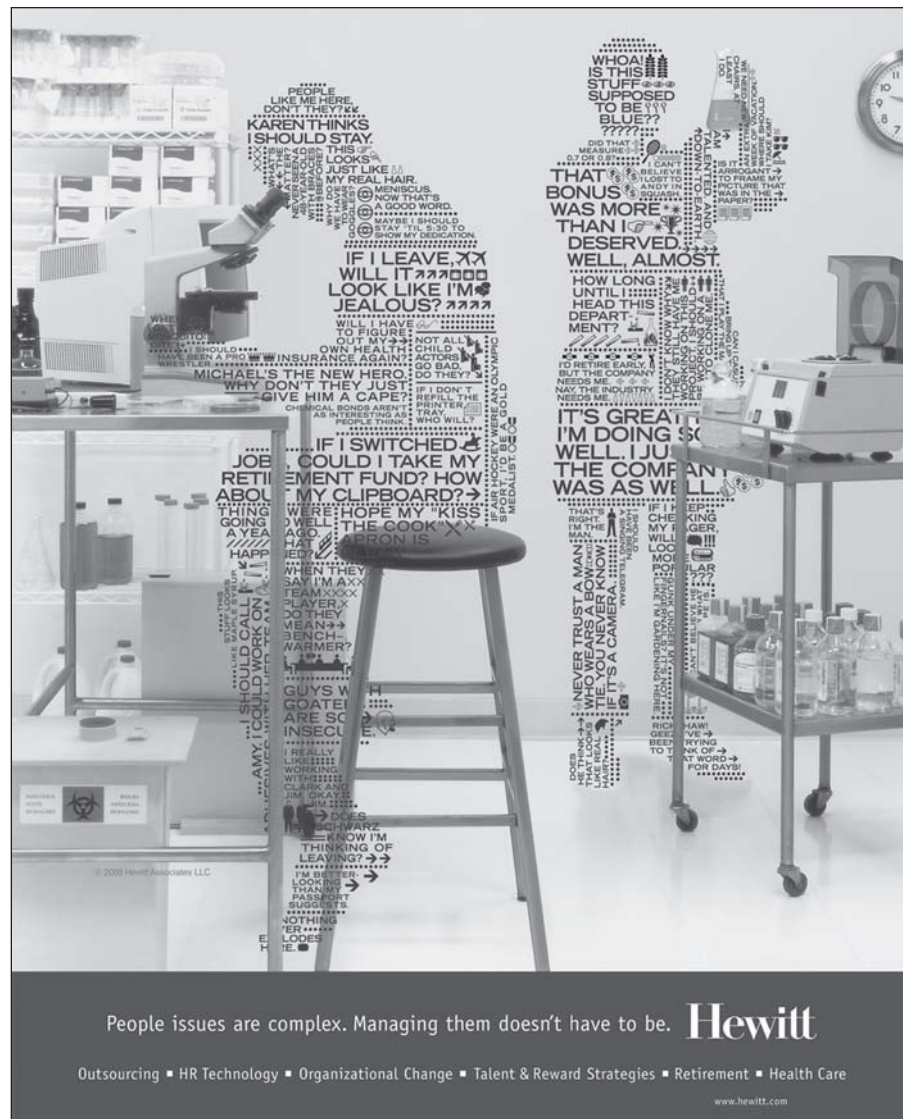
**FEEDBACK AND RECOGNITION.** Humans are social beings, and they derive a sense of identity and belonging to an organization from the recognition and feedback they receive from the people around them—their customers, colleagues, and bosses. If employees are recognized and thanked for service excellence, they will want to continue achieving it. If done well, star employee of the month-type of awards recognize excellent performances and can be highly motivating.

**GOAL ACCOMPLISHMENT.** Goals focus people’s energy. Goals that are specific, difficult but attainable, and accepted by the staff are strong motivators. They result in higher performance than no goals or vague goals (“do your best”) or goals impossible to achieve.<sup>53</sup> In short, goals are effective motivators.

The following are important points to note for effective goal setting:

- When goals are seen as important, achieving the goals is a reward in itself.
- Goal accomplishment can be used as a basis for giving rewards, including pay, feedback, and recognition. Feedback and recognition from peers can be given faster, more cheaply and effectively than pay, and have the additional benefit of gratifying an employee’s self-esteem.
- Service employee goals that are specific and difficult must be set publicly to be accepted. Although goals must be specific, they can be something intangible like improved employee courtesy ratings.
- Progress reports about goal accomplishment (feedback) and goal accomplishment itself must be public events (recognition) if they are to gratify employees’ esteem need.
- It is mostly unnecessary to specify the means to achieve goals. Feedback on progress while pursuing the goal serves as a corrective function. As long as the goal is specific, difficult but achievable, and accepted, goal pursuit will result in goal accomplishment, even in the absence of other rewards.

Successful firms recognize that people issues are complex. Hewitt Associates, a professional firm delivering human capital management services, captures the challenge of employee complexity in its advertising (Figure 11.13). Charles O’Reilly and Jeffrey Pfeffer conducted in-depth research on why some companies can succeed over long



**FIGURE 11.13** “People Issues Are Complex: Managing Them Doesn’t Have to Be” Declares Hewitt Associates

Source: Copyright © 2003 Hewitt Associates LLC

periods of time in highly competitive industries without having the usual sources of competitive advantage such as barriers of entry or proprietary technology. They concluded that these firms did not succeed by winning the war for talent (although these firms were hiring extremely carefully for fit), “but by fully using the talent and unlocking the motivation of the people” they already had in their organizations.<sup>54</sup>

### The Role of Labor Unions

Labor unions and service excellence do not seem to gel. The power of organized labor is widely cited as an excuse for not adopting new approaches in both service and manufacturing businesses. “We’d never get it past the unions,” managers say, wringing their hands and muttering darkly about restrictive work practices. Unions often are portrayed as villains in the press, especially when high-profile strikes inconvenience millions. Many managers seem to be rather antagonistic toward unions.

Contrary to the negative view presented above, many of the world’s most successful service businesses are highly unionized—Southwest Airlines is one example.

The presence of unions in a service company is not an automatic barrier to high performance and innovation, unless there is a long history of mistrust, acrimonious relationships, and confrontation.

Jeffrey Pfeffer has observed wryly that “the subject of unions and collective bargaining is...one that causes otherwise sensible people to lose their objectivity.”<sup>55</sup> He urges a pragmatic approach to this issue, emphasizing that “the effects of unions depend very much on what *management* does.” The higher wages, lower turnover, clearly established grievance procedures, and improved working conditions often found in highly unionized organizations can yield positive benefits in a well-managed service organization. Furthermore, management consultation and negotiation with union representatives are essential if employees are to accept new ideas (conditions equally valid in nonunionized firms). The challenge is to jointly work with unions, to reduce conflict, and to create a climate for service.<sup>56</sup>

## SERVICE LEADERSHIP AND CULTURE

So far, we have discussed the key strategies that help to move an organization toward service excellence. However, to truly get there, we need a strong service culture that is continuously reinforced and developed by management to achieve alignment with the firm’s strategy.<sup>57</sup> *Charismatic leadership*, also called *transformational leadership*, fundamentally changes the values, goals, and aspirations of the frontline to be consistent with that of the firms.’ With this kind of leadership, staff are more likely to perform their best and “above and beyond the call of duty,” because it is consistent with their own values, beliefs, and attitudes.<sup>58</sup>

Leonard Berry advocates a value-driven leadership that inspires and guides service providers. Leadership should bring out the passion for serving. It should also tap the creativity of service providers, nourish their energy and commitment, and give them a fulfilled working life. Some of the core values Berry found in excellent service firms included excellence, innovation, joy, teamwork, respect, integrity, and social profit.<sup>59</sup> These values are part of the firm’s culture. A *service culture* can be defined as:

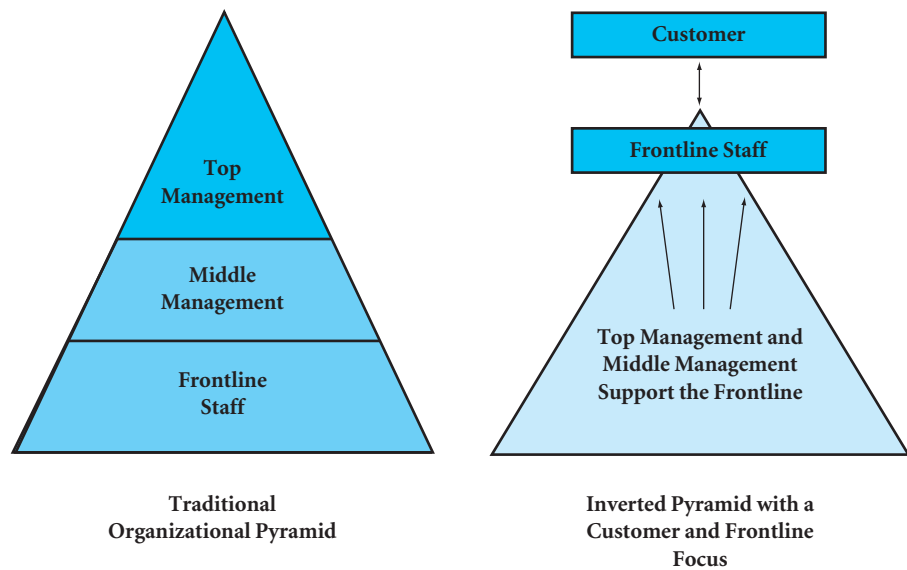
- Shared perceptions of *what* is important in an organization, and
- Shared values and beliefs of *why* those things are important.<sup>60</sup>

Employees rely heavily on their perceptions of what is important by noting what the company and their leaders do, not so much what they say. Employees gain their understanding of what is important through the daily experiences they have with the firm’s human resource, operations, and marketing practices and procedures.

A strong service culture is one where the entire organization focuses on the frontline, understanding that it is the lifeline of the business. The organization understands that today’s as well as tomorrow’s revenues are driven largely by what happens at the service encounter. Figure 11.14 shows the inverted pyramid, which highlights the importance of the frontline and shows that the role of top management and middle management is to support the frontline in their task of delivering service excellence to their customers.

In firms with a passion for service, top management show by their actions that what happens at the frontline is crucially important to them, by being informed and actively involved. They achieve this by regularly talking to and working with frontline staff and customers. Many actually spend significant amounts of time at the frontline serving customers. For example, Disney World’s management spends two weeks every year in frontline staff job such as sweeping streets, selling ice cream, or working as the ride attendant to gain a better appreciation and understanding of what really happens on the ground.<sup>61</sup>

Service leaders are not only interested in the big picture, but they focus on the details of service, they see opportunities in nuances that competitors might consider trivial, and they believe the way the firm handles little things sets the tone for how it handles everything else.



**FIGURE 11.14** The Inverted Organizational Pyramid

### Internal Marketing

In addition to a strong leadership that focuses on the frontline, it takes a strong communications effort to shape the culture and get the message to the troops. Service leaders use multiple tools to build their service culture, ranging from internal marketing and training to core principles and company events and celebrations.

Internal communications from senior managers to their employees play a vital role in maintaining and nurturing a corporate culture founded on specific service values. Well-planned internal marketing efforts are especially necessary in large service businesses that operate in widely dispersed sites, sometimes around the world. Even when employees are working far from the head office in the home country, they still need to be kept informed of new policies, changes in service features, and new quality initiatives. Communications may also be needed to nurture team spirit and support common corporate goals across national frontiers. Consider the challenge of maintaining a unified sense of purpose at the overseas offices of companies such as Citibank, Air Canada, Marriott, or Starbucks where people from different cultures who speak different languages must work together to create consistent levels of service.

Effective internal communications can help ensure efficient and satisfactory service delivery; achieve productive and harmonious working relationships; and build employee trust, respect, and loyalty. Commonly used media include internal newsletters and magazines, videos, private corporate television networks like those owned by FedEx and Merrill Lynch, Intranets (private networks of websites and email inaccessible to the general public), face-to-face briefings, and promotional campaigns using displays, prizes, and recognition programs.

For example, Ritz-Carlton translated the key product and service requirements of its customers into the Ritz-Carlton Gold Standards, which include a credo, motto, three steps of service, and 12 service values (see Best Practice in Action 11.5). An important aspect of the service values is their hierarchical structure. Service values 10, 11, and 12 represent functional values such as safety, security, and cleanliness. Ritz-Carlton refers to the next level of excellence as emotional engagement, which covers values 4 through 9. They relate to learning and professional growth of its employees, teamwork, service, problem solving and service recovery, innovation, and continuous improvement. Beyond the guests' functional needs and emotional engagement is the third level, which relates to values 1, 2, and 3 and is called “the Ritz-Carlton Mystique.” This level aims to create unique, memorable, and personal



**BEST PRACTICE IN ACTION 11.5****Ritz-Carlton's Gold Standards****Gold Standards**

Our Gold Standards are the foundation of The Ritz-Carlton Hotel Company, L.L.C. They encompass the values and philosophy by which we operate and include:

**The Credo**

The Ritz-Carlton Hotel is a place where the genuine care and comfort of our guests is our highest mission.

We pledge to provide the finest personal service and facilities for our guests who will always enjoy a warm, relaxed, yet refined ambience.

The Ritz-Carlton experience enlivens the senses, instills well-being, and fulfills even the unexpressed wishes and needs of our guests.

**Motto**

At The Ritz-Carlton Hotel Company, L.L.C., "We are Ladies and Gentlemen serving Ladies and Gentlemen." This motto exemplifies the anticipatory service provided by all staff members.

**Three Steps Of Service**

1. A warm and sincere greeting. Use the guest's name.
2. Anticipation and fulfillment of each guest's needs.
3. Fond farewell. Give a warm good-bye, and use the guest's name.

**Service Values: I Am Proud to Be Ritz-Carlton**

1. I build strong relationships and create Ritz-Carlton guests for life.
2. I am always responsive to the expressed and unexpressed wishes and needs of our guests.
3. I am empowered to create unique, memorable and personal experiences for our guests.
4. I understand my role in achieving the Key Success Factors, embracing Community Footprints and creating The Ritz-Carlton Mystique.
5. I continuously seek opportunities to innovate and improve The Ritz-Carlton experience.
6. I own and immediately resolve guest problems.
7. I create a work environment of teamwork and lateral service so that the needs of our guests and each other are met.
8. I have the opportunity to continuously learn and grow.
9. I am involved in the planning of the work that affects me.
10. I am proud of my professional appearance, language and behavior.
11. I protect the privacy and security of our guests, my fellow employees and the company's confidential information and assets.
12. I am responsible for uncompromising levels of cleanliness and creating a safe and accident-free environment.

**The 6th Diamond**

Mystique  
Emotional Engagement  
Functional

**The Employee Promise**

At The Ritz-Carlton, our Ladies and Gentlemen are the most important resource in our service commitment to our guests.

By applying the principles of trust, honesty, respect, integrity and commitment, we nurture and maximize talent to the benefit of each individual and the company.

The Ritz-Carlton fosters a work environment where diversity is valued, quality of life is enhanced, individual aspirations are fulfilled, and The Ritz-Carlton Mystique is strengthened.

*Source:* ©1992–2006 The Ritz-Carlton Hotel Company, L. L. C. All Rights Reserved. Reprinted with the permission of The Ritz-Carlton Hotel Company, L. L. C.

guest experiences that Ritz-Carlton believes can only occur when employees delivery on the guests' expressed and unexpressed wishes and needs and when they strive to build lifetime relationships between Ritz-Carlton and its guests.<sup>62</sup> The three levels are reflected in the Sixth Diamond in Ritz-Carlton's gold standards as "a new benchmark in the hospitality industry and the three levels for achieving both employee and customer engagement."<sup>63</sup>

Tim Kirkpatrick, Director of Training and Development of Ritz-Carlton's Boston Common Hotel said, "The Gold Standards are part of our uniform, just like your nametag. But remember, it's just a laminated card until you put it into action."<sup>64</sup> To reinforce these standards, every morning briefing includes a discussion directly related to the standards. The aim of these discussions is to keep the Ritz-Carlton philosophy at the center of its employees' minds.

Another great example of a firm with a strong culture is Southwest Airlines, which uses continuously new and creative ways to strengthen its culture. Southwest's Culture Committee members are zealots when it comes to the continuation of Southwest's family feel. The committee represents everyone from flight attendants and reservationists to top executives. As one participant observed, "The Culture Committee is not made up of Big Shots; it is a committee of Big Hearts." Culture Committee members are not out to gain power. They use the power of the Southwest spirit to better connect people to the cultural foundations of the company. The committee works behind the scenes to foster Southwest's commitment to its core values. The following are examples of events held to reinforce Southwest's cultures.

- **Walk a Mile in My Shoes.** This program helped Southwest employees gain an appreciation for other people's jobs. Employees were asked to visit a different department on their day off and to spend a minimum of six hours on the "walk." These participants were rewarded not only with transferable roundtrip passes, but also with goodwill and increased morale.
- **A Day in the Field.** This activity is practiced throughout the company all year long. Barri Tucker, then a senior communications representative in the executive office, for example, once joined three flight attendants working a three-day trip. Tucker gained by experiencing the company from a new angle and by hearing directly from customers. She was able to see how important it is for corporate headquarters to support Southwest's frontline employees.
- **Helping Hands.** Southwest sent out volunteers from around the system to lighten the load of employees in the cities where Southwest was in direct competition with United's Shuttle. This not only built momentum and strengthened the troops for the battle with United, it also helped rekindle the fighting spirit of Southwest employees.<sup>65</sup>

Empirical research in the hotel industry demonstrates why it is important for management to walk the talk. Judi McLean Park and Tony Simons conducted a study of 6,500 employees at 76 Holiday Inn hotels to determine whether workers perceived that hotel managers showed behavioral integrity using measures such as "My manager delivers on promises" and "My manager practices what he preached." These statements were correlated with employee responses to questions such as "I am proud to tell others I am part of this hotel," and "My coworkers go out of the way to accommodate guests' special requests," and then to revenues and profitability.

The results were stunning. They showed that behavioral integrity of a hotel's manager was highly correlated to employees' trust, commitment, and willingness to go the extra mile. Furthermore, of all manager behaviors measured, it was the single most important factor driving profitability. In fact, a mere one-eighth point increase in a hotel's overall behavioral integrity score on a five-point scale was associated with a 2.5 percent increase in revenue and a \$250,000 increase in profits per year per hotel.<sup>66</sup>

## CONCLUSION

The quality of a service firm's people—especially those working in customer-facing positions—plays a crucial role in determining market success and financial performance. That's why the *People* element of the 7 Ps is so important. Successful service organizations are committed to effective management of human resources and work closely with marketing and operations managers to balance what might otherwise prove to be conflicting goals. They recognize the value of investing in HR and understand the costs resulting from high levels of turnover. In the long run, offering better wages and benefits may be a more financially viable strategy than paying less to employees who have no loyalty and soon defect.

The market and financial results of managing people effectively for service advantage can be phenomenal. Good HR strategies allied with strong management leadership at all levels often lead to a sustainable competitive advantage. It is probably harder to duplicate high-performance human assets than any other corporate resource.

## Chapter Summary

**LO1** Service employees are extremely important to the success of a service firm because they are:

- A source of competitive positioning because they are (1) a core part of the service product, (2) they represent the service firm in the eyes of the customer, and (3) are a core part of the brand as they deliver the brand promise.
- Often crucially important for generating sales, cross-sales, and up-sales.
- A key driver of the productivity of the frontline operations.
- A source of customer loyalty.
- Even in low-contact services, frontline employees are the ones who leave an impression on the customer in those few but critical “moments of truth” encounters.

**LO2** The work of frontline employees is difficult and stressful because they are in boundary-spanning positions which often entail:

- Organization/client conflicts.
- Person/role conflict.
- Interclient conflicts.
- Emotional labor and emotional stress.

**LO3** We used three types of cycles involving frontline employees and customers to describe how firms can be set up for failure, mediocrity, and success:

- The *cycle of failure* involves a low-pay and high-employee turnover strategy and, as a consequence, results in high-customer dissatisfaction and defections that depress profit margins.
- The *cycle of mediocrity* typically is found in large bureaucracies, offering job security but not much scope in the job itself. There is no incentive to serve customers well.
- Successful service firms operate in the *cycle of success* where employees are satisfied with their jobs and are productive; as a consequence, customers

are satisfied and loyal. High profit margins allow investment in the recruitment, development, and motivation of the right frontline employees.

**LO4** The Service Talent Cycle is a guiding framework for successful HR strategies in service firms, helping them to move their firms into the cycle of success. Implementing the service talent cycle correctly will give firms highly motivated employees willing and able to deliver service excellence and go the extra mile for their customers and are highly productive at the same time. It has four key prescriptions:

- Hire the right people.
- Enable frontline employees.
- Motivate and energize them.
- Have a leadership team that emphasizes and supports the frontline.

**LO5** To hire the right people, firms need to attract, select, and hire the right people for their firm and any given service job. Best-practice HR strategies start with recognition that in many industries the labor market is highly competitive. Competing for talent by being the preferred employer requires:

- Work on being seen as a preferred employer, and as a result, receive a large number of applications from the best potential candidates in the labor market.
- Careful selection ensures that new employees fit both job requirements and the organization's culture. Select the best-suited candidates using screening methods such as observation, personality tests, structured interviews, and providing realistic job previews.

**LO6** To enable their frontline employees, firms need to:

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

- LO7** Empower the frontline so they can respond with flexibility to customer needs and nonroutine encounters and service failures. Empowerment and training will give employees the authority, skills, and self-confidence to use their own initiative in delivering service excellence.
- LO8** Organize frontline employees into effective service delivery teams (often cross-functional) that can serve their customers from end-to-end.
- LO9** Finally, energize and motivate employees with a full set of rewards, ranging from pay, satisfying job content, recognition, and feedback to goal accomplishment.
- LO10** Top and middle managers, including frontline supervisors, need to continuously reinforce a strong culture that emphasizes service excellence and productivity. Effective service leadership involves:
- Focusing the entire organization on supporting the front line.
  - Reinforcing a strong service culture that emphasizes service excellence and productivity and builds employee understanding and support for the organization's goals.
  - Driving values that inspire, energize, and guide service providers, and give them a fulfilled working life.

---

## Review Questions

1. Why are service personnel so important for service firms?
2. There is a trend of service delivery moving from high contact to low contact. Are service employees still important in low-contact services? Explain your answer.
3. What is emotional labor? Explain the ways in which it may cause stress for employees in specific jobs. Illustrate with suitable examples.
4. What are the key barriers for firms to break the cycle of failure and move into the cycle of success? And how should an organization trapped in the cycle of mediocrity proceed?
5. List five ways in which investment in hiring and selection, training, and ongoing motivation of employees will pay dividends in customer satisfaction for such organizations as (a) a restaurant, (b) an airline, (c) a hospital, and (d) a consulting firm.
6. Describe the key components of the service talent cycle.
7. What can a service firm do to become a preferred employer and, as a result, receive a large number of applications from the best potential candidates in the labor market?
8. How can a firm select the best-suited candidates from a large number of applicants?
9. What are the key types of training service firms should conduct?
10. What are the factors that favor a strategy of employee empowerment?
11. Identify the factors needed to make service teams successful in (a) an airline, (b) a restaurant, and (c) a customer contact center.
12. How can frontline employees be effectively motivated to deliver service excellence and productivity?
13. How can a service firm build a strong service culture that emphasizes service excellence and productivity?

---

## Application Exercises

1. An airline runs a recruiting advertisement for cabin crew that shows a picture of a small boy sitting in an airline seat and clutching a teddy bear. The headline reads: "His mom told him not to talk to strangers. So what's he having for lunch?" Describe the types of personalities you think would be (a) attracted to apply for the job by that ad and (b) discouraged from applying.
2. Consider the following jobs: emergency department nurse, bill collector, computer repair technician, supermarket cashier, dentist, kindergarten teacher, prosecuting attorney, server in a family restaurant, server in an expensive French restaurant, stockbroker, and undertaker. What type of emotions would you expect each of them to display to customers in the course of doing their job? What drives your expectations?
3. Use the service talent cycle as a diagnostic tool on a successful and an unsuccessful service firm you are familiar with. What recommendations would you prescribe to each of these two firms?

4. Think of two organizations you are familiar with, one that has a very good and one that has a very poor service culture. Describe the factors that contributed to shaping those organizational cultures. What factors do you think contributed most? Why?
5. As a human resources manager, which issues do you see as most likely to create boundary spanning

problems for employees in a customer contact center at a major Internet service provider? Select four issues and indicate how you would mediate between operations and marketing to create a satisfactory outcome for all three groups.

## Endnotes

1. Adapted from Leonard L. Berry, *Discovering the Soul of Service—The Nine Drivers of Sustainable Business Success*. New York: The Free Press, 1999, 156–159.
2. Liliana L. Bove, and Lester W. Johnson, “Customer Relationships with Service Personnel: Do We Measure Closeness, Quality or Strength?” *Journal of Business Research*, 54, 2001, 189–197; Magnus Söderlund and Sara Rosengren, “Revisiting the Smiling Service Worker and Customer Satisfaction,” *International Journal of Service Industry Management*, 19, No. 5, 2008, 552–574; Anat Rafaeli, Lital Ziklik, and Lorna Doucet, “The Impact of Call Center Employees’ Customer Orientation Behaviors and Service Quality,” *Journal of Service Research*, 10, No. 3, 2008, 239–255.
3. Recent research established the link between extra-role effort and customer satisfaction; e.g., Carmen Barroso Castro, Enrique Martín Armario, and David Martín Ruiz, “The Influence of Employee Organizational Citizenship Behavior on Customer Loyalty,” *International Journal of Service Industry Management*, 15, No. 1, 2004, 27–53.
4. James L. Heskett, Thomas O. Jones, Gary W. Loveman, W. Earl Sasser, Jr., and Leonard A. Schlesinger, “Putting the Service Profit Chain to Work,” *Harvard Business Review*, 72, March–April 1994, 164–174.
5. James L. Heskett, W. Earl Sasser, Jr., and Leonard L. Schlesinger, *The Value Profit Chain: Treat Employees Like Customers and Customers Like Employees*. New York: The Free Press, 2003.
6. Benjamin Schneider and David E. Bowen, “The Service Organization: Human Resources Management is Crucial,” *Organizational Dynamics*, 21, No. 4, Spring 1993, 39–52.
7. David E. Bowen and Benjamin Schneider, “Boundary-Spanning Role Employees and the Service Encounter: Some Guidelines for Management and Research.” In J. A. Czepiel, M. R. Solomon, and C. F. Surprenant, eds., *The Service Encounter*. Lexington, MA: Lexington Books, 1985, pp. 127–148.
8. Vaikalathur Shankar Mashesh and Anand Kasturi, “Improving Call Centre Agent Performance: A UK-India Study Based on the Agents’ Point of View,” *International Journal of Service Industry Management*, 17, No. 2, 2006, 136–157. On potentially conflicting goals see also Detelina Marinova, Jun Ye, and Jagdip Singh, “Do Frontline Mechanisms Matter? Impact of Quality and Productivity Orientations on Unit Revenue, Efficiency, and Customer Satisfaction,” *Journal of Marketing*, 72, No. 2, 2008, 28–45.
9. David E. Bowen and Benjamin Schneider, “Boundary-Spanning Role Employees and the Service Encounter: Some Guidelines for Management and Research,” in J. A. Czepiel, M. R. Solomon, and C. F. Surprenant, eds., *The Service Encounter*. Lexington, MA: Lexington Books, 1985, 127–148.
10. Arlie R. Hochschild, *The Managed Heart: Commercialization of Human Feeling*. Berkeley: University of California Press, 1983.
11. Panikkos Constanti and Paul Gibbs, “Emotional labor and Surplus Value: The Case of Holiday ‘Reps,’” *The Service Industries Journal*, 25, January 2005, 103–116.
12. Arlie Hochschild, “Emotional Labor in the Friendly Skies,” *Psychology Today*, June 1982, 13–15. Cited in Valarie A. Zeithaml, Mary Jo Bitner, and Dwayne D. Gremler, *Services Marketing: Integrating Customer Focus Across the Firm*, 4th ed. New York: McGraw-Hill, 2006, 359. See also Aviad E. Raz, “The Slanted Smile Factory: Emotion Management in Tokyo Disneyland,” *Studies in Symbolic Interaction*, 21, 1997, 201–217.
13. See also Michel Rod and Nicholas J. Ashill, “Symptoms of Burnout and Service Recovery Performance,” *Managing Service Quality*, 19, No. 1, 2009, 60–84; Jody L. Crosno, Shannon B. Rinaldo, Hulda G. Black, and Scott W. Kelley, “Half Full or Half Empty: The Role of Optimism in Boundary-Spanning Positions,” *Journal of Service Research*, 11, No. 3, 2009, 295–309.
14. Jochen Wirtz and Robert Johnston, “Singapore Airlines: What It Takes to Sustain Service Excellence - A Senior Management Perspective,” *Managing Service Quality*, 13, No. 1, 2003, 10–19; Loizos Heracleous, Jochen Wirtz, and Nitin Pangarkar, *Flying High in a Competitive Industry: Secrets of the World’s Leading Airline*. Singapore: McGraw-Hill, 2009.
15. “The Bangalore Paradox,” *The Economist*, April 23, 2005, 67–69.
16. Dan Moshavi and James R. Terbord, “The Job Satisfaction and Performance of Contingent and Regular Customer Service Representatives - A Human Capital Perspective,” *International Journal of Service Industry Management*, 13, No. 4, 2002, 333–347.
17. Vaikalathur Shankar Mahesh and Anand Kasturi, “Improving Call Centre Agent Performance,” *International Journal of Service Industry Management*, 17, No. 2, 2006, 136–157.
18. See also Vaikalathur Shankar Mahesh and Anand Kasturi, “Improving Call Centre Agent Performance,” *International Journal of Service Industry Management*, 17, No. 2, 2006, 136–157.
19. The terms “cycle of failure” and “cycle of success” were coined by Leonard L. Schlesinger and James L. Heskett,



- "Breaking the Cycle of Failure in Services," *Sloan Management Review* 32, Spring 1991, 17–28. The term, "cycle of mediocrity" comes from Christopher H. Lovelock, "Managing Services: The Human Factor," in W. J. Glynn and J. G. Barnes, eds. *Understanding Services Management*. Chichester, UK: John Wiley & Sons, 1995, 228.
20. Leonard Schlesinger and James L. Heskett, "Breaking the Cycle of Failure," *Sloan Management Review* 32, Spring 1991, 17–28.
21. James L. Heskett, W. Earl Sasser, Jr., and Leonard A. Schlesinger (2003), *The Value Profit Chain*, Free Press, pp. 75–94.
22. Reg Price and Roderick J. Brodie, "Transforming a Public Service Organization from Inside out to Outside in," *Journal of Service Research*, 4, No. 1, 2001, 50–59.
23. Mahn Hee Yoon, "The Effect of Work Climate on Critical Employee and Customer Outcomes," *International Journal of Service Industry Management*, 12, No. 5, 2001, 500–521.
24. Leonard L. Berry and A. Parasuraman, *Marketing Services—Competing Through Quality*. New York: The Free Press, 1991, 151–152.
25. Charles A. O'Reilly III and Jeffrey Pfeffer, *Hidden Value—How Great Companies Achieve Extraordinary Results with Ordinary People*. Boston, MA: Harvard Business School Press, 2000, 1.
26. Bill Fromm and Len Schlesinger, *The Real Heroes of Business*. New York: Currency Doubleday, 1994, 315–316.
27. Jim Collins, "Turning Goals into Results: The Power of Catalytic Mechanisms," *Harvard Business Review*, July–August 1999, 77.
28. This section was adapted from Benjamin Schneider and David E. Bowen, *Winning the Service Game*. Boston: Harvard Business School Press, 1995, 115–126.
29. John Wooden, *A Lifetime of Observations and Reflections On and Off the Court*. Chicago: Lincolnwood, 1997, 66.
30. Serene Goh, "All the Right Staff," and Arlina Arshad, "Putting Your Personality to the Test," *The Straits Times*, September 5, 2001, H1.
31. For a review of this literature, see Benjamin Schneider, "Service Quality and Profits: Can You Have Your Cake and Eat It, Too?" *Human Resource Planning*, 14, No. 2, 1991, 151–157.
32. This section was adapted from Leonard L. Berry, *On Great Service—A Framework for Action*. New York: The Free Press, 1995, 181–182.
33. Leonard Schlesinger and James L. Heskett, "Breaking the Cycle of Failure," *Sloan Management Review* 32, Spring 1991, 26.
34. Benjamin Schneider and David E. Bowen, *Winning the Service Game*. Boston, MA: Harvard Business School Press, 1995, 131.
35. Leonard L. Berry, *Discovering the Soul of Service—The Nine Drivers of Sustainable Business Success*. New York: The Free Press, 1999, 161.
36. Disney Institute, *Be Our Guest: Perfecting the Art of Customer Service*. Disney Enterprises, 2001.
37. David A. Tansik, "Managing Human Resource Issues for High Contact Service Personnel," in D. E. Bowen, R. B. Chase, T. G. Cummings, and Associates, eds. *Service Management Effectiveness*. San Francisco: Jossey-Bass, 1990, 152–176.
38. Parts of this section are based on David E. Bowen and Edward E. Lawler, III, "The Empowerment of Service Workers: What, Why, How and When," *Sloan Management Review* 33, Spring 1992, 32–39.
39. Dana Yagil, "The Relationship of Customer Satisfaction and Service Workers' Perceived Control—Examination of Three Models," *International Journal of Service Industry Management*, 13, No. 4, 2002, 382–398.
40. Graham L. Bradley and Beverley A. Sparks, "Customer Reactions to Staff Empowerment: Mediators and Moderators," *Journal of Applied Social Psychology*, 30, No. 5, 2000, 991–1012.
41. David E. Bowen and Edward E. Lawler, III, "The Empowerment of Service Workers: What, Why, How and When," *Sloan Management Review* 33, Spring 1992, 32–39.
42. Benjamin Schneider and David E. Bowen, *Winning the Service Game*. Boston, MA: Harvard Business School Press, 1995, 250.
43. This paragraph is based on Kevin Freiberg and Jackie Freiberg, *Nuts! Southwest Airlines' Crazy Recipe for Business and Personal Success*. New York: Broadway Books, 1997, 87–88.
44. Jon R. Katzenbach and Douglas K. Smith, "The Discipline of Teams," *Harvard Business Review* 71, March–April, 1993, 112.
45. Andrew Sergeant and Stephen Frenkel, "When Do Customer Contact Employees Satisfy Customers?" *Journal of Service Research*, 3, No. 1, August 2000, 18–34.
46. For a recent study that on self-managed team performance see Ad de Jong, Ko de Ruyter, and Jos Lemmink, "Antecedents and Consequences of the Service Climate in Boundary-Spanning Self-Managing Service Teams," *Journal of Marketing*, 68, April 2004, 18–35.
47. Leonard L. Berry, *On Great Service—A Framework for Action*. New York: The Free Press, 1995, 131.
48. Charles A. O'Reilly III and Jeffrey Pfeffer, *Hidden Value—How Great Companies Achieve Extraordinary Results with Ordinary People*. Boston, MA: Harvard Business School Press, 2000, 9.
49. Leonard L. Berry, *Discovering the Soul of Service—The Nine Drivers of Sustainable Business Success*. New York: The Free Press, 1999, 189.
50. Benjamin Schneider and David E. Bowen, *Winning the Service Game*. Boston, MA: Harvard Business School Press, 1995, 141; Leonard L. Berry, *On Great Service—A Framework for Action*. New York: The Free Press, 1995, 225.
51. Ron Zemke, "Experience Shows Intuition Isn't the Best Guide to Teamwork," *The Service Edge*, 7, No. 1 January 1994, 5.
52. This section is based on Benjamin Schneider and David E. Bowen, *Winning the Service Game*. Boston, MA: Harvard Business School Press, 1995, 145–173.
53. A good summary of goal setting and motivation at work can be found in Edwin A. Locke and Gary Latham, *A Theory of Goal Setting and Task Performance*. New Jersey: Englewood Cliffs, Prentice Hall, 1990.
54. Charles A. O'Reilly III and Jeffrey Pfeffer, *Hidden Value—How Great Companies Achieve Extraordinary Results with Ordinary People*, Boston, MA: Harvard Business School Press, 2000, 232.

55. Jeffrey Pfeffer, *Competitive Advantage Through People*. Boston: Harvard Business School Press, 1994, 160–163.
56. Jody Hoffer Gittel, Andrew von Nordenflycht, and Thomas A. Kochan, “Mutual Gains for Zero Sum? Labor Relations and Firm Performance in the Airline Industry,” *Industrial and Labor Relations Review*, 57, No. 2, 2004, 163–180.
57. The authors of the following paper emphasize the role of alignment between tradition, culture and strategy that together form the basis for the firms HR practices: Benjamin Schneider, Seth C. Hayes, Beng-Chong Lim, Jana L. Raver, Ellen G. Godfrey, Mina Huang, Lisa H. Nishii, and Jonathan C. Ziegert, “The Human Side of Strategy: Employee Experiences of a Strategic Alignment in a Service Organization,” *Organizational Dynamics*, 32, No. 2, 2003, 122–141.
58. Scott B. MacKenzie, Philip M. Podsakoff, and Gregory A. Rich, “Transformational and Transactional Leadership and Salesperson Performance,” *Journal of the Academy of Marketing Science*, 29, No. 2, 2001, 115–134.
59. Leonard L. Berry, *On Great Service – A Framework for Action*. New York: The Free Press, 1995, 236–237; Leonard L. Berry and Kent D. Seltman, *Management Lessons from Mayo Clinic: Inside One of the World's Most Admired Service Organization*. McGraw Hill, 2008. The following study emphasized the importance of the perceived ethical climate in driving service commitment of service employees: Charles H. Schwepker Jr. and Michael D. Hartline, “Managing the Ethical Climate of Customer-Contact Service Employees,” *Journal of Service Research*, 7, No. 4, 2005, 377–397.
60. Benjamin Schneider and David E. Bowen, *Winning the Service Game*. Boston, MA: Harvard Business School Press, 1995, 240.
61. Catherine DeVrye, *Good Service is Good Business*. Upper Saddle River, NJ: Prentice Hall, 2000, 11.
62. Joseph A. Mitchelli, *The New Gold Standard: 5 Leadership Principles for Creating a Legendary Customer Experience Courtesy of The Ritz-Carlton Hotel Company*. McGraw Hill, 2008, 61–66, 191–197.
63. <http://careers.ritzcarltonclub.com/standards.asp>, accessed June 3, 2009.
64. Paul Hemp, “My Week as a Room-Service Waiter at the Ritz,” *Harvard Business Review*, 80, June 2002, 8–11.
65. Adapted from Kevin Freiberg and Jackie Freiberg, *Nuts! Southwest Airlines' Crazy Recipe for Business and Personal Success*. New York: Broadway Books, 1997, 165–168.
66. Tony Simons, “The High Cost of Lost Trust,” *Harvard Business Review* 80, September 2002, 2–3.

# Managing Relationships and Building Loyalty

*The first step in managing a loyalty-based business system is finding and acquiring the right customers.*

FREDERICK F. REICHHELD

*Strategy first, then CRM.*

STEVEN S. RAMSEY

## LEARNING OBJECTIVES (LOs)

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

- |  |  |
|--|--|
| <b>LO1</b> Recognize the important role customer loyalty plays in driving a service firm's profitability.  | <b>LO8</b> Understand the relationship between customer satisfaction and loyalty.  |
| <b>LO2</b> Calculate the lifetime value (LTV) of a loyal customer.   | <b>LO9</b> Know how to deepen the relationship through cross-selling and bundling.   |
| <b>LO3</b> Understand why customers are loyal to a particular service firm.  | <b>LO10</b> Understand the role of financial and nonfinancial loyalty rewards in enhancing customer loyalty.                                     |
| <b>LO4</b> Explain the different types of marketing relating to the customer-firm relationship and understand how membership relationships can be created. | <b>LO11</b> Appreciate the power of social, customization, and structural bonds in enhancing loyalty.  |
| <b>LO5</b> Know the core strategies of the Wheel of Loyalty that explain how to develop a loyal customer base.   | <b>LO12</b> Understand what factors cause customers to switch to a competitor and how to reduce such switching.                                  |
| <b>LO6</b> Appreciate why it is so important for service firms to target the "right" customers.  | <b>LO13</b> Understand the part played by customer relationship management (CRM) systems in delivering customized services and building loyalty. |
| <b>LO7</b> Use service tiering to manage the customer base and build loyalty.  |  |

### Harrah's Entertainment's Customer Relationship Management<sup>1</sup>

Harrah's Entertainment, the world's largest gaming company with its three main brands—Harrah's, Caesar's, and Horseshoe—is a leader in the use of highly sophisticated loyalty programs. Harrah's was first to launch a tiered customer loyalty program in the gaming industry. Today, it has five tiers in its program: Gold, Platinum, Diamond, Seven Stars, and Chairman's Club. The program is integrated across all of its properties and services. Customers identify themselves (and earn points) at every touchpoint throughout the company, ranging from its gaming tables, restaurants, and hotels to the gift shops and shows. The points collected can be used to obtain cash, merchandise, lodging, show tickets, vacations, and events.

What is special about Harrah's is not its loyalty program, but what it does with the information gleaned about its customers when they use their cards to earn points. At the back-end, Harrah's has linked all of its databases from casino management, hotel reservations, and events to allow it to have a holistic view of each of its customers. Harrah's now has detailed data on over 42 million of its customers and knows their preferences and behaviors ranging from how much they spend on each type of game and their likes in food and drinks to entertainment and lodging preferences. All of this information about the customer is captured in real time.

Harrah's uses this data to drive its marketing and on-site customer service. For example, if a Diamond card holder on slot machine 278 signals for service, a Harrah's associate is able to ask, "The usual, Mr. Jones?" and then track the time it takes for a server to fill the guest's request. In another example, when a customer wins a jackpot, Harrah's can tailor a reward that celebrates that win. Harrah's also knows when a customer is approaching his maximum gaming limit on a particular evening and therefore when the customer is likely to stop playing. Just before the limit is reached, Harrah's can offer him a heavily discounted ticket in real time via text message for a show with available seats. This keeps the customer on the premises (and spending), makes him feel valued as he gets a very special deal just when he wanted to stop playing, and utilizes otherwise wasted capacity in its shows and restaurants.

Likewise, when a customer contacts a company's call center, the staff have detailed real-time information about a customer's preferences and spending habits and can then tailor promotions that cross-sell or up-sell its services. Harrah's does not do blanket promotions hitting all its customers at the same time, which is, according to Harrah's Chairman, President, and CEO Gary Loveman, "a margin eroding nightmare." Rather, it uses highly targeted promotions that create the right incentives for each of its different customers. And it uses control groups to measure the success of a promotion in dollars and cents and to further fine-tune its campaigns.

With its data-driven CRM, Harrah's is able to transform customer interactions into personal and differentiated ones. As a result, Harrah's increased the share-of-wallet of its Harrah's Total Rewards cardholders to over an impressive 50 percent, up from 34 percent before this customer relationship management program was implemented.



**FIGURE 12.1** Harrah's Hit the Jackpot with Its Technological Innovation in Developing Customer Relationships



## THE SEARCH FOR CUSTOMER LOYALTY

Targeting, acquiring, and retaining the “right” customers is at the core of many successful service firms. In Chapter 3, we discussed segmentation and positioning. In this chapter, we emphasize the importance of focusing carefully on desirable, loyal customers within the chosen segments and then taking pains to build and maintain their loyalty through well-conceived relationship marketing strategies. The objective is to build relationships and to develop loyal customers who will do a growing volume of business with the firm in the future.

Loyalty is an old-fashioned word traditionally used to describe fidelity and enthusiastic devotion to a country, a cause, or individual. More recently, it has been used in a business context, to describe a customer’s willingness to continue patronizing a firm over the long term, preferably on an exclusive basis, and recommending the firm’s products to friends and associates. Customer loyalty extends beyond behavior and includes preference, liking, and future intentions. Ask yourself: What service companies are you loyal to? And why are you loyal to these firms?

“Few companies think of customers as annuities,” says Frederick Reichheld, author of *The Loyalty Effect*, and a major researcher in the field of customer loyalty.<sup>2</sup> And yet that is precisely what a loyal customer can mean to a firm—a consistent source of revenue over a period of many years. The active management of the customer base and customer loyalty is also referred to as *customer asset management*.<sup>3</sup>

“Defector” was a nasty word during wartime. It describes disloyal people who sell out their own side and go over to the enemy. Even when they defected toward “our” side, rather than away from it, they are still suspect. Today, in a marketing context, the term defection is used to describe customers who drop off a company’s radar screen and transfer their brand loyalty to another supplier. Reichheld and Sasser popularized the term *zero defections*, which they describe as keeping every customer the company can serve profitably.<sup>4</sup> Not only does a rising defection rate indicate that something is wrong with quality (or that competitors offer better value), it may also be a leading indicator signaling a fall in profits. Big customers don’t necessarily disappear overnight; they often may signal their mounting dissatisfaction by steadily reducing their purchases and shifting part of their business elsewhere.

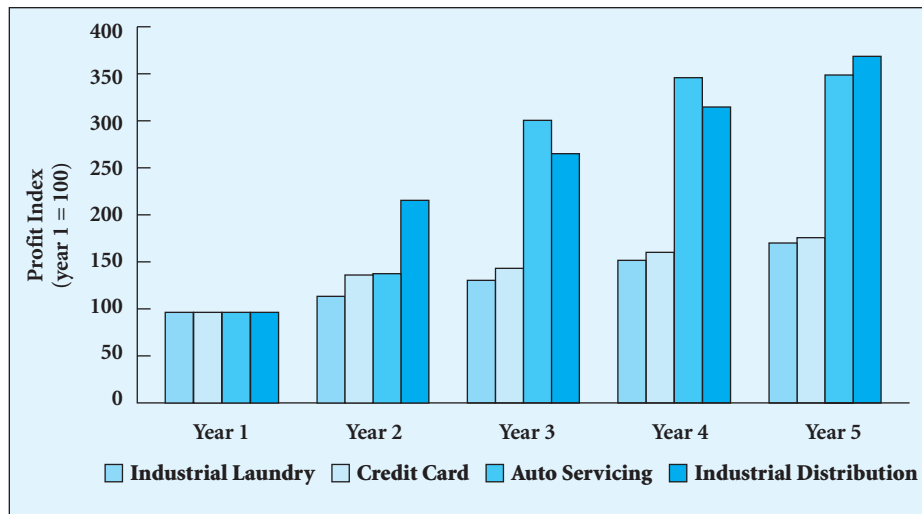
### Why Is Customer Loyalty Important to a Firm’s Profitability?

How much is a loyal customer worth in terms of profits? In a classic study, Reichheld and Sasser analyzed the profit per customer in different service businesses, as categorized by the number of years a customer had been with the firm.<sup>5</sup> They found that customers became more profitable the longer they remained with a firm in each of these industries. Annual profits per customer, indexed over a five-year period for easier comparison, are summarized in Figure 12.2. The industries studied (with average profits from a first-year customer shown in parentheses) were credit cards (\$30), industrial laundry (\$144), industrial distribution (\$45), and automobile servicing (\$25). A study of Internet firms showed similar loyalty effects. It took typically more than a year to recoup customer acquisition costs, and profits then increased as customers stayed longer with the firm.<sup>6</sup>

Underlying this profit growth, say Reichheld and Sasser, are four factors that work to the supplier’s advantage to create incremental profits. In order of magnitude at the end of seven years, these factors are:

1. *Profit derived from increased purchases (or, in a credit card and banking environment, higher account balances).* Over time, business customers often grow larger and so need to purchase in greater quantities. Individuals may also purchase more as their families grow or as they become more affluent. Both types of customers may be willing to consolidate their purchases with a single supplier who provides high-quality service.
2. *Profit from reduced operating costs.* As customers become more experienced, they make fewer demands on the supplier (for instance, they have less need for information and assistance and make more use of self-service options). They may





**FIGURE 12.2** How Much Profit a Customer Generates over Time

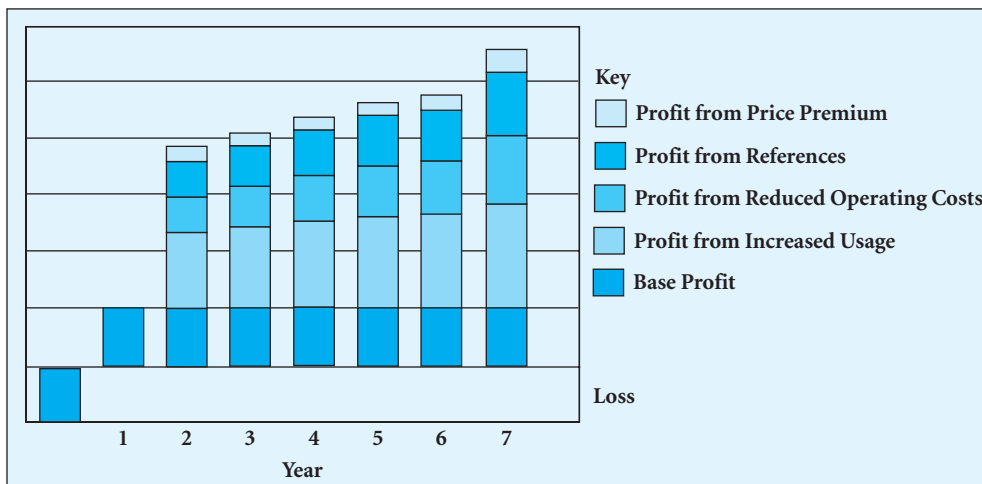
Source: Reprinted by permission of *Harvard Business Review* from Frederick J. Reichheld and W. Earl Sasser Jr. "Zero Defections: Quality Comes to Services" *Harvard Business Review* 73 (Sept-Oct 1990), p 108. Copyright © 1990 by the Harvard Business School Publishing Corporation. All rights reserved.

also make fewer mistakes when involved in operational processes, thus contributing to greater productivity.

3. **Profit from referrals to other customers.** Positive word-of-mouth recommendations are like free sales and advertising, saving the firm from having to invest as much money in these activities.
4. **Profit from price premium.** New customers often benefit from introductory promotional discounts; long-term customers are more likely to pay regular prices when they are highly satisfied and tend to be less price sensitive.<sup>7</sup> Moreover, customers who trust a supplier may be more willing to pay higher prices at peak periods or for express work.

Furthermore, the upfront costs of attracting these buyers can be amortized over many years. These customer acquisition costs can be substantial and can include sales commissions, advertising and promotions costs, administrative costs of setting up an account, and sending out welcome packages and sign-up gifts.

Figure 12.3 shows the relative contribution of each of these different factors over a seven-year period, based on an analysis of 19 different product categories (both goods and services). Reichheld argues that the economic benefits of customer loyalty noted above often explain why one firm is more profitable than a competitor.



**FIGURE 12.3** Why Customers Are More Profitable over Time

Source: Why Customers Are More Profitable Over Time from Frederick J. Reichheld and W. Earl Sasser Jr. "Zero Defections: Quality Comes to Services," *Harvard Business Review* 73 (Sep.-Oct. 1990): p. 108. Reprinted by permission of Harvard Business School.

### Assessing the Value of a Loyal Customer

It's a mistake to assume that loyal customers are always more profitable than those who make one-time transactions.<sup>8</sup> On the cost side, not all types of services incur heavy promotional expenditures to attract a new customer. Sometimes, it is more important to invest in a good retail location that will attract walk-in traffic. Unlike banks, insurance companies, and other "membership" organizations that incur costs for review of applications and account setup, many service firms face no such costs when a new customer first seeks to make a purchase. On the revenue side, loyal customers may not necessarily spend more than one-time buyers, and in some instances, they may even expect price discounts.

Finally, profits do not necessarily increase with time for all types of customers.<sup>9</sup> In most mass market B2C services—such as banking, cell phone services, or hospitality—customers can't negotiate prices. However, in many B2B contexts, large customers have significant bargaining power and therefore will nearly always try to negotiate lower prices when contracts come up for renewal, which forces suppliers to share the cost savings resulting from doing business with a large, loyal customer. DHL has found that although each of its major accounts generates significant business, they yield below average margins. In contrast, DHL's smaller, less powerful accounts, provide significantly higher profitability.<sup>10</sup>

Recent studies have also shown that the profit impact of a customer can vary dramatically depending on the stage of a service's product lifecycle. For instance, referrals by satisfied customers and negative word of mouth from "defected" customers have a much greater effect on profit impact in the early stages of the service product's lifecycle—when the name of the game is acquisition of new customers—than in later stages when the focus is on generating cash flow from the existing customer base.<sup>11</sup>

One of the challenges you will probably face in your work is determining the costs and revenues associated with serving customers to different market segments at different points in their customer lifecycles and predicting future profitability. For insights on how to calculate customer value, see "Worksheet for Calculating Customer Lifetime Value."<sup>12</sup>

### The Gap between Actual and Potential Customer Value

For profit-seeking firms, the potential profitability of a customer should be a key driver in marketing strategy. As Alan Grant and Leonard Schlesinger declare: "Achieving the full profit potential of each customer relationship should be the fundamental goal of every business.... Even using conservative estimates, the gap between most companies' current and full potential performance is enormous."<sup>13</sup> They suggest analysis of the following gaps between the actual and potential value of customers:

- What is the current purchasing behavior of customers in each target segment? What would be the impact on sales and profits if they exhibited the ideal behavior profile of (1) buying all services offered by the firm, (2) using these to the exclusion of any purchases from competitors, and (3) paying full price?
- How long, on average, do customers remain with the firm? What impact would it have if they remained customers for life?

As we showed earlier, the profitability of a customer often increases over time. Management's task is to design and implement marketing programs that increase loyalty—including share-of-wallet, up-selling, and cross-selling—and to identify the reasons why customers defect and then take corrective action.

### Why Are Customers Loyal?

After understanding how important loyal customers can be for the bottom line of a service firm, let's explore what makes a customer loyal. Customers are not inherently loyal to any one firm! Rather, we need to give our customers a reason to consolidate their buying with us and then stay with us. We need to create value for them to become and remain loyal. Research has shown that relationships can create value for individual consumers through such factors as inspiring greater confidence, offering social benefits, and providing special treatment (see Research Insights 12.1).

## WORKSHEET

### CALCULATING CUSTOMER LIFETIME VALUE

Calculating customer value is an inexact science that is subject to a variety of assumptions. You may want to try varying these assumptions to see how it affects the final figures. Generally speaking, revenues per customer are easier to track on an individualized basis than are the associated costs of serving a customer, unless (1) no individual records are kept and/or (2) the accounts served are very large and all account-related costs are individually documented and assigned.

#### Acquisition Revenues Less Costs

If individual account records are kept, the initial application fee paid and initial purchase (if relevant) should be found in these records. Costs, by contrast, may have to be based on average data. For instance, the marketing cost of acquiring a new client can be calculated by dividing the total marketing costs (advertising, promotions, selling, etc.) devoted toward acquiring new customers by the total number of new customers acquired during the same period. If each acquisition takes place over an extended period of time, you may want to build in a lagged effect between when marketing expenditures are incurred and when new customers come on board. The cost of credit checks—where relevant—must be divided by the number of new customers, not the total number of applicants, because some applicants will probably fail this hurdle. Account set-up costs will also be an average figure in most organizations.

#### Annual Revenues and Costs

If annual sales, account fees, and service fees are documented on an individual-account basis, account

revenue streams (except referrals) can be easily identified. The first priority is to segment your customer base by the length of its relationship with your firm. Depending on the sophistication and precision of your firm's records, annual costs in each category may be directly assigned to an individual account holder or averaged for all account holders in that age category.

#### Value of Referrals

Computing the value of referrals requires a variety of assumptions. To get started, you may need to conduct surveys to determine (1) what percentage of new customers claim that they were influenced by a recommendation from another customer and (2) what other marketing activities also drew the firm to that individual's attention. From these two items, estimates can be made of what percentage of the credit for all new customers should be assigned to referrals. Additional research may be needed to clarify whether "older" customers are more likely to be effective recommenders than "younger" ones.

#### Net Present Value

Calculating net present value (NPV) from a future profit stream will require choice of an appropriate annual discount figure. (This could reflect estimates of future inflation rates.) It also requires assessment of how long the average relationship lasts. The NPV of a customer, then, is the sum of the anticipated annual profit on each customer for the projected relationship lifetime, suitably discounted each year into the future.

ACQUISITION			YEAR 1	YEAR 2	YEAR 3	YEAR n
<i>Initial Revenue</i>		<i>Annual Revenues</i>				
Application fee <sup>a</sup>	_____	Annual account fee <sup>a</sup>	_____	_____	_____	_____
Initial purchase <sup>a</sup>	_____	Sales	_____	_____	_____	_____
		Service fees <sup>a</sup>	_____	_____	_____	_____
		Value of referrals <sup>b</sup>	_____	_____	_____	_____
<i>Total Revenues</i>	_____		_____	_____	_____	_____
<i>Initial Costs</i>	_____	<i>Annual Costs</i>				
Marketing	_____	Account management	_____	_____	_____	_____
Credit check <sup>a</sup>	_____	Cost of sales	_____	_____	_____	_____
Account setup <sup>a</sup>	_____	Write-offs (e.g., bad debts)	_____	_____	_____	_____
Less total costs	_____		_____	_____	_____	_____
Net Profit (Loss)	_____		_____	_____	_____	_____

<sup>a</sup>If applicable.

<sup>b</sup>Anticipated profits from each new customer referred (could be limited to the first year or expressed as the net present value of the estimated future stream of profits through year n); this value could be negative if an unhappy customer starts to spread negative word of mouth that causes existing customers to defect.

## RESEARCH INSIGHTS 12.1

### HOW CUSTOMERS SEE RELATIONAL BENEFITS IN SERVICE INDUSTRIES

What benefits do customers see themselves receiving from an extended relationship with a service firm? Researchers seeking answers to this question conducted two studies. The first consisted of in-depth interviews with 21 respondents from a broad cross-section of backgrounds. Respondents were asked to identify service providers they used on a regular basis and were invited to identify and discuss any benefits they received as a result of being a regular customer. Among the comments were:

- I like him [hair stylist]... He's really funny and always has lots of good jokes. He's kind of like a friend now.
- I know what I'm getting—I know that if I go to a restaurant that I regularly go to, rather than taking a chance on all of the new restaurants, the food will be good.
- I often get price breaks. The little bakery that I go to in the morning, every once in a while, they'll give me a free muffin and say, "You're a good customer, it's on us today."
- You can get better service than drop-in customers... We continue to go to the same automobile repair shop because we have gotten to know the owner on a kind of personal basis, and he... can always work us in.
- Once people feel comfortable, they don't want to switch to another dentist. They don't want to train or break a new dentist in.

After evaluating and categorizing the comments, the researchers designed a second study in which they collected 299 survey questionnaires. The respondents were told to select a specific service provider with whom they had a strong, established relationship. Then the questionnaire asked them to assess the extent to which they received each of 21 benefits (derived from analysis of the first study) as a result of their relationship with the specific provider they had identified. Finally, they were asked to assess the importance of these benefits for them.

A factor analysis of the results showed that most of the benefits that customers derived from relationships could be grouped into three categories. The first, and most important, group involved what the researchers labeled confidence benefits, followed by social benefits and special treatment.

- *Confidence benefits* included feelings by customers that in an established relationship there was less risk of something going wrong, confidence in correct performance, ability to trust the provider, lowered anxiety when purchasing, knowing what to expect, and receipt of the firm's highest level of service.
- *Social benefits* embraced mutual recognition between customers and employees, being known by name, friendship with the service provider, and enjoyment of certain social aspects of the relationship.
- *Special treatment benefits* included better prices, discounts on special deals that were unavailable to most customers, extra services, higher priority when there was a wait, and faster service than most customers.

Source: Kevin P. Gwinner, Dwayne D. Gremler, and Mary Jo Bitner, "Relational Benefits in Services Industries: The Customer's Perspective," *Journal of the Academy of Marketing Science*, 26, No. 2, 1998, 101–114.

## UNDERSTANDING THE CUSTOMER-FIRM RELATIONSHIP

Before exploring how we can actively improve customer loyalty, let's understand the different types of relationships customers can have with their service providers. There's a fundamental distinction between strategies intended to produce a single transaction and those designed to create extended relationships with customers.

### Transactional Marketing

A *transaction* is an event during which an exchange of value takes place between two parties. One transaction or even a series of transactions don't necessarily constitute a relationship, which requires mutual recognition and knowledge between the parties. When each transaction between a customer and a supplier is essentially discrete and anonymous, with

no long-term record kept of a customer's purchasing history, and little or no mutual recognition between the customer and employees, then no meaningful marketing relationship can be said to exist. This is true for many services, ranging from passenger transport to food service or visits to a movie theater, in which each purchase and use is a separate event.

### Relationship Marketing

The term *relationship marketing* has been widely used to describe the type of marketing activity designed to create extended relationships with customers, but until recently it was only loosely defined. Research by Nicole Coviello, Rod Brodie, and Hugh Munro suggests at least three distinct categories of what they call relational marketing: *database marketing*, *interaction marketing*, and *network marketing*.<sup>14</sup>

**DATABASE MARKETING.** In database marketing, the focus is still on the market transaction but now it includes information exchange. Marketers rely on information technology, usually in the form of a database, to form a relationship with targeted customers and retain their patronage over time. However, the nature of these relationships often is not a close one, with communication driven and managed by the seller. Technology is used to (1) identify and build a database of current and potential customers, (2) deliver differentiated messages based on consumers' characteristics and preferences, and (3) track each relationship to monitor the cost of acquiring the consumer and the lifetime value of the resulting purchases.<sup>15</sup> Although technology can be used to personalize the relationship, relations often remain somewhat distant. Utility services such as electricity, gas, and cable TV are good examples.

**INTERACTION MARKETING.** A close relationship often exists in face-to-face interactions between customers and representatives of the supplier (or "ear-to-ear" interaction by phone). Although the service itself remains important, value is added by people and social processes. Interactions may include negotiations and sharing of insights in both directions. This type of relationship exists in many local service markets, ranging from community banks to dentistry, in which buyer and seller know and trust each other. It is also commonly found in many B2B services. Both the firm and the customer are prepared to invest resources to develop a mutually beneficial relationship. This investment may include time spent sharing and recording information.

As service companies grow larger and make increasing use of technologies such as interactive websites and self-service technology, maintaining meaningful relationships with customers becomes a significant marketing challenge. Firms with large customer bases find it increasingly difficult to build and maintain meaningful relationships through call centers, websites, and other mass-delivery channels (see Figure 12.4).

**NETWORK MARKETING.** We often say that someone is a "good networker" because he or she is able to put individuals in touch with others who have a mutual interest. In a B2B context, marketers work to develop a network of relationships with customers, distributors, suppliers, the media, consultants, trade associations, government agencies, competitors, and even their customers' customers. Often, a team of individuals within the supplier's firm collaborate to provide effective service to a parallel team within the customer's organization.

The four types of marketing of transactional, database, interaction, and network marketing are not necessarily mutually exclusive. A firm may have transactions with some customers who have neither the desire nor the need to make future purchases, while working hard to move others up the loyalty ladder.<sup>16</sup> Evert Gummesson identified no fewer than 30 types of relationships. He advocates *total relationship marketing*, describing it as:

. . . marketing based on relationships, networks, and interaction, recognizing that marketing is embedded in the total management of the networks of the selling organization, the market, and society. It is directed to long-term, win-win relationships with individual customers, and value is jointly created between the parties involved.<sup>17</sup>





**FIGURE 12.4** Building and Maintaining Relationships through Call Centers Is a Challenge

**Creating “Membership” Relationships**

The nature of the current relationship with customers can be analyzed by asking first: Does the supplier enter into a formal “membership” relationship with customers, as with telephone subscriptions, banking, and the family doctor? Or is there no defined relationship? Second: Is the service delivered on a continuous basis, as in insurance, broadcasting, and police protection? Or is each transaction recorded and charged separately? Table 12.1 shows the matrix resulting from this categorization, with examples in each category. A *membership relationship* is a formalized relationship between the firm and an identifiable customer that often provides special benefits to both parties.

Discrete transactions, in which each use involves a payment to the service supplier by an essentially “anonymous” consumer, are typical of services like transport, restaurants, cinemas, and

shoe repairs. The problem for marketers of such services is that they tend to be less informed than their counterparts in membership-type organizations about who their customers are and how each customer uses the service. Managers in businesses that sell discrete transactions have to work a little harder to establish relationships.

In small businesses such as hair salons, frequent customers are (or should be) welcomed as “regulars” whose needs and preferences are remembered. Keeping formal records of customers’ needs, preferences, and purchasing behavior is useful even for small firms, because it helps employees avoid having to ask the same questions on each service occasion, allows them to personalize the service given to each customer, and enables the firm to anticipate future needs.

In large companies with substantial customer bases, transactions can still be transformed into relationships by offering extra benefits to customers who choose to register with the firm (loyalty programs for hotels, airlines, and car rental firms fall into this category). Having a loyalty program in place enables a firm to know who its current customers are and to capture their service transactions and preferences. This is valuable information for service delivery, for allowing customization and personalization, and for segmentation purposes. For transaction-type businesses,

**TABLE 12.1** Relationships with Customers

Nature of Service Delivery	Type of Relationship Between the Service Organization and Its Customers	
	Membership Relationship	No Formal Relationship
Continuous delivery of service	Insurance	Radio station
	Cable TV subscription	Police protection
	College enrollment	Lighthouse
	Banking	Public highway
Discrete transactions	Long-distance calls from subscriber phone	Car rental
	Theater series subscription	Mail service
	Travel on commuter ticket	Toll highway
	Repair under warranty	Pay phone
	Health treatment for HMO member	Movie theater
		Public transportation
		Restaurant

loyalty reward programs become a necessary enabler for implementing the strategies in the Wheel of Loyalty (discussed in the next section).

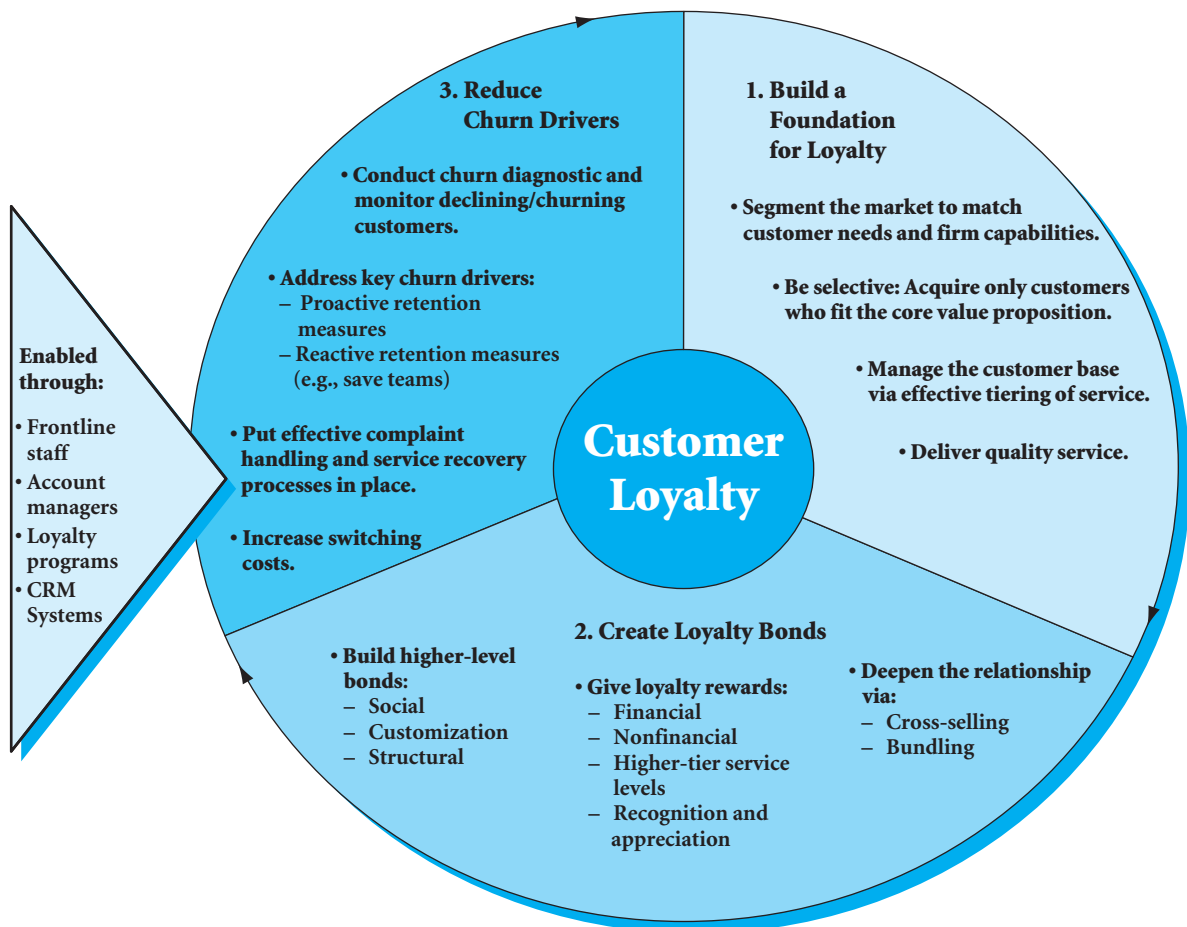
In addition to using loyalty programs, selling the service in bulk (for instance, a theater series subscription or a commuter ticket on public transport) can also transform discrete transactions into membership relationships. We will next discuss how we can systematically think about creating value propositions for our customers to become loyal.

## THE WHEEL OF LOYALTY

Building customer loyalty is difficult. Just try to think of all the service firms you are loyal to. Most people cannot think of more than perhaps a handful of firms they truly like (i.e., give a high share-of-heart) and to whom they are committed to going back (i.e., give a high share-of-wallet). This shows that although firms put enormous amounts of money and effort into loyalty initiatives, they often are not successful in building true customer loyalty. We use the Wheel of Loyalty shown in Figure 12.5 as an organizing framework for thinking about how to build customer loyalty. It comprises three sequential strategies.

- First, the firm needs a solid foundation for creating customer loyalty that includes targeting the right portfolio of customer segments, attracting the right customers, tiering the service, and delivering high levels of satisfaction.
- Second, to truly build loyalty, a firm needs to develop close bonds with its customers that either deepen the relationship through cross-selling and bundling or add value to the customer through loyalty rewards and higher level bonds.
- Third, the firm needs to identify and eliminate the factors that result in “churn”—the loss of existing customers and the need to replace them with new ones.

We discuss each of the components of the Wheel of Loyalty in the sections that follow.



**FIGURE 12.5** The Wheel of Loyalty

## BUILDING A FOUNDATION FOR LOYALTY

Many elements are involved in creating long-term customer relationships and loyalty. In Chapter 3, we discussed segmentation and positioning. In this section, we emphasize the importance of focusing on serving a portfolio of several desirable customer segments, and then taking pains to build and maintain their loyalty through well-conceived relationship marketing strategies.

### Targeting the Right Customers

Loyalty management starts with segmenting the market to match customer needs and firm capabilities, in short, identify and target the right customers. “Who should we be serving?” is a question that every service business needs to raise periodically. Customers often differ widely in terms of needs. They also differ in terms of the value they can contribute to a company. Not all customers offer a good fit with the organization’s capabilities, delivery technologies, and strategic direction.

Companies need to be selective about the segments they target if they want to build successful customer relationships. This means focusing on acquiring customers who fit the core value proposition! Matching customers to the firm’s capabilities is vital. Managers must think carefully about how customer needs relate to such operational elements as speed and quality, the times when service is available, the firm’s capacity to serve many customers simultaneously, and the physical features and appearance of service facilities. They also need to consider how well their service personnel can meet the expectations of specific types of customers, in terms of both personal style and technical competence.<sup>18</sup> Finally, they need to ask themselves whether their company can match or exceed competing services directed at the same types of customers.

The result of carefully targeting customers by matching the company capabilities and strengths with customer needs should be a superior service offering in the eyes of those customers who value what the firm has to offer. As Frederick Reichheld said, “the result should be a win-win situation, where profits are earned through the success and satisfaction of customers, and not at their expense.”<sup>19</sup>

### Searching for Value, Not Just Volume

Too many service firms still focus on the *number* of customers they serve without giving sufficient attention to the *value* of each customer.<sup>20</sup> Generally speaking, heavy users who buy more frequently and in larger volumes are more profitable than occasional users. Roger Hallowell makes this point nicely in a discussion of banking:

A bank’s population of customers undoubtedly contains individuals who either cannot be satisfied, given the service levels and pricing the bank is capable of offering, or will never be profitable, given their banking activity (their use of resources relative to the revenue they supply). Any bank would be wise to target and serve only those customers whose needs it can meet better than its competitors in a profitable manner. These are the customers who are most likely to remain with that bank for long periods, who will purchase multiple products and services, who will recommend that bank to their friends and relations, and who may be the source of superior returns to the bank’s shareholders.<sup>21</sup>

Relationship customers are by definition not buying commodity services. Service customers who buy strictly based on lowest price (a minority in most markets) are not good target customers for relationship marketing in the first place. They are deal prone, continuously seek the lowest price on offer, and switch easily.

Loyalty leaders are picky about acquiring only the right customers, which are those for whom their firms have been designed to deliver truly special value. Acquiring the right customers can bring in long-term revenues, continued growth from referrals, and

enhanced satisfaction from employees whose daily jobs are improved when they can deal with appreciative customers. Attracting the wrong customers typically results in costly churn, a diminished company reputation, and disillusioned employees. Ironically, it is often the firms that are highly focused and selective in their acquisition—rather than those that focus on unbridled acquisition—that grow fast over long periods.<sup>22</sup> Best Practice in

### BEST PRACTICE IN ACTION 12.1

#### Vanguard Discourages the Acquisition of “Wrong” Customers

The Vanguard Group is a growth leader in the mutual fund industry that built its \$1 trillion in managed assets by painstakingly targeting the right customers for its business model. Its share of new sales, which was around 25 percent, reflected its share of assets or market share. However, it had a far lower share of redemptions, which gave it a market share of net cash flows of 55 percent (new sales minus redemptions), and made it the fastest-growing mutual fund in its industry.

How did Vanguard achieve such low redemption rates? The secret was in its careful acquisition, and its product and pricing strategies, which encouraged the acquisition of the “right” customers.

John Bogle, Vanguard’s founder, believed in the superiority of index funds and that their lower management fees would lead to higher returns over the long run. He offered Vanguard’s clients unparalleled low management fees through a policy of not trading (its index funds hold the market they are designed to track), not having a sales force, and spending only a fraction of what its competitors did on advertising. Another important part of keeping its costs low was its aim to discourage the acquisition of customers who were not long-term index holders.

Bogle attributes the high customer loyalty Vanguard has achieved to a great deal of focus on customer defections, which are called redemptions in the fund context. “I watched them like a hawk,” he explained, and analyzed them more carefully than new sales to ensure that Vanguard’s customer acquisition strategy was on course. Low redemption rates meant that the firm was attracting the right kind of loyal, long-term investors. The inherent stability of its loyal customer base has been key to Vanguard’s cost advantage. Bogle’s pickiness became legendary. He scrutinized individual redemptions with a fine-tooth comb to see who let the wrong kind of customers on board. When an institutional investor redeemed \$25 million from an index fund bought only nine months earlier, he regarded the acquisition of this customer a failure of the system. He explained, “We don’t want short-term investors. They muck up the game at the expense of the long-term investor.” At the end of his chairman’s letter to the Vanguard Index Trust, Bogle reiterated: “We urge them [short-term investors] to look elsewhere for their investment opportunities.”

This care and attention to acquiring the right customers became legendary. For example, Vanguard turned away an institutional investor who wanted to invest \$40 million because Vanguard suspected that the customer would churn the investment within the next few weeks, creating extra costs for existing customers. The potential customer complained to Vanguard’s CEO, who not only supported the decision, but also used it as an opportunity to reinforce to his teams why they needed to be selective about the customers they accept.

Furthermore, Vanguard introduced a number of changes to industry practices that discouraged active traders from buying its funds. For example, Vanguard did not allow telephone transfers for index funds, redemption fees were added to some funds, and the standard practice subsidizing new accounts at the expense of existing customers was rejected because the practice was considered disloyal to its core investor base. These product and pricing policies in effect turned away heavy traders, but made the fund unequivocally attractive for the long-term investor.

Finally, Vanguard’s pricing was set up to reward loyal customers. For many of its funds, investors pay a one-time fee upfront, which goes into the funds to compensate all current investors for the administrative costs of selling new shares. In essence, this fee subsidizes long-term investors and penalizes short-term investors. Another novel pricing approach was the creation of its Admiral shares for loyal investors, which carried an expense fee of one-third less than ordinary shares (0.12 percent per year instead of 0.18 percent).



Source: © 2009 Vanguard Inc.

Source: Adapted from Frederick F. Reichheld, *Loyalty Rules! How Today’s Leaders Build Lasting Relationships*. Boston, MA: Harvard Business School Press, 2001, 24–29, 84–87, 144–145; [www.vanguard.com](http://www.vanguard.com), accessed June 10, 2009.

Action 12.1 shows how Vanguard Group, a leader in the mutual funds industry, designed its products and pricing to attract and retain the right customers for its business model.

Different segments offer different value for a service firm. Like investments, some types of customers may be more profitable than others in the short term, but others may have greater potential for long-term growth. Similarly, the spending patterns of some customers may be stable over time, while those of others may be more cyclical, spending heavily in boom times but cutting back sharply in recessions. A wise marketer seeks a mix of segments in order to reduce the risks associated with volatility.<sup>23</sup>

In many cases, David Maister emphasizes, marketing is about getting *better* business, not just *more* business.<sup>24</sup> For instance, the caliber of a professional firm is measured by the type of clients it serves and the nature of the tasks on which it works. Volume alone is no measure of excellence, sustainability, or profitability. In professional services, such as consulting firms or legal partnerships, the mix of business attracted may play an important role in both defining the firm and in providing a suitable mix of assignments for staff members at different levels in the organization.

Finally, managers shouldn't assume the "right customers" are always big spenders. Depending on the service business model, the right customers may come from a large group of people that no other supplier is doing a good job of serving. Many firms have built successful strategies on serving customers segments that had been neglected by established players, which didn't perceive them as sufficiently "valuable." Examples include: Enterprise Rent-A-Car, which targets customers who need a temporary replacement car, avoiding the more traditional segment of business travelers who are pursued by its principal competitors; Charles Schwab, which focuses on retail stock buyers; and Paychex, which provides small businesses with payroll and human resource services.<sup>25</sup>

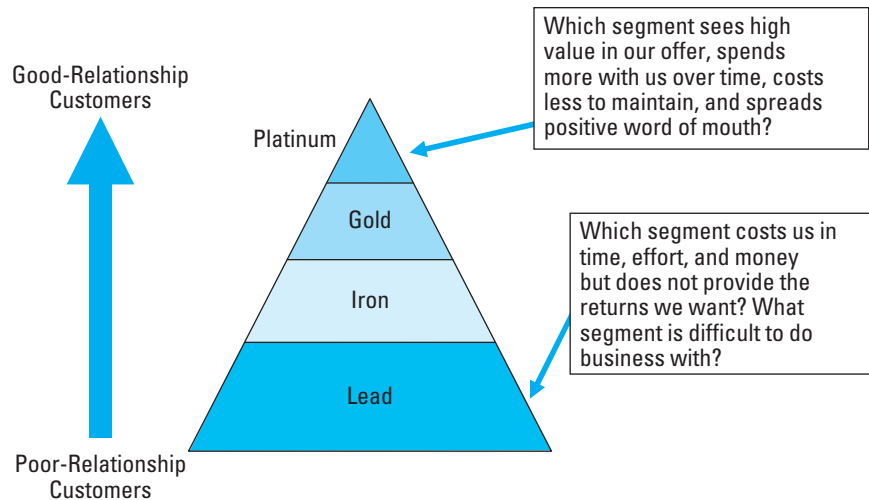
### Managing the Customer Base through Effective Tiering of Service

Marketers should adopt a strategic approach to retaining, upgrading, and even ending relationships with customers. Customer retention involves developing long-term, cost-effective links with customers for the mutual benefit of both parties, but these efforts need not necessarily target all the customers in a firm with the same level of intensity. Research has confirmed that customer profitability and return on sales can be increased by focusing a firm's resources on top-tier customers.<sup>26</sup> Furthermore, different customer tiers often have quite different service expectations and needs. According to Valarie Zeithaml, Roland Rust, and Katharine Lemon, it's critical for service firms to understand the needs of customers within different profitability tiers and adjust their service levels accordingly.<sup>27</sup>

Just as service product categories can be tiered to reflect the level of value included (e.g., first, business, and economy class in air travel; see Chapter 4, pp. 80) so can groups of customers. In the latter instance, service tiers can be developed around different levels of profit contribution of different groups of customers and their needs (including sensitivities to variables such as price, comfort, and speed) and identifiable personal profiles such as demographics. Zeithaml, Rust, and Lemon illustrate this principle through a four-level pyramid (Figure 12.6).

- *Platinum.* These customers constitute a very small percentage of a firm's customer base, but they are heavy users and contribute a large share of the firm's profits. This segment typically is less price sensitive but expects highest service levels, and it is likely to be willing to invest in and try new services.
- *Gold.* The gold-tier includes a larger percentage of customers than the platinum, but individual customers contribute less profit than platinum customers. They tend to be slightly more price sensitive and less committed to the firm.
- *Iron.* These customers provide the bulk of the customer base. Their numbers give the firm economies of scale. Hence, they often are important so that a firm can build and





**FIGURE 12.6** The Customer Pyramid

Source: Valerie A. Zeithaml, Roland T. Rust & Katharine N. Lemon "The Customer Pyramid: Creating and Serving Profitable Customers" California Management Review 43, no. 4, Summer 2001, Figure 1, pp. 118–142. Copyright © 2001 by The Regents of the University of California. Reprinted by permission of The Regents for electronic posting add "All rights reserved. This article is for personal viewing by individuals accessing this site. It is not to be copied, reproduced, or otherwise disseminated without written permission from the California Management Review. By viewing this document, you hereby agree to these terms. For permission or reprints, contact: cmr@haas.berkeley.edu.

maintain a certain capacity level and infrastructure, which often is needed for serving gold and platinum customers well. However, iron customers often are only marginally profitable. Their level of business is not sufficient to warrant special treatment.

- *Lead*. Customers in this tier tend to generate low revenues for a firm but often require the same level of service as iron customers, turning them into a loss-making segment from a firm's perspective.

The precise characteristics of customer tiers vary, of course, from one type of business to another and even from one firm to another. Service Perspective 12.1 provides an illustration from the marketing research industry.

Customer tiers typically are based on profitability and their service needs. Rather than providing the same level of service to all customers, each segment receives a service level that is customized based on its requirements and value to the firm. For example, the platinum tier is provided some exclusive benefits not available to other segments. The benefit levels for platinum and gold customers often are designed with retention in mind, because these customers are the ones competitors would like to entice to switch.

Marketing efforts can be used to encourage an increased volume of purchases, upgrading the type of service used, or cross-selling additional services to any of the four tiers. However, these efforts have different thrusts for the different tiers, as their needs, usage behaviors, and spending patterns usually are very different. Among segments for which the firm already has a high share-of-wallet, the focus should be on nurturing, defending, and retaining these customers, possibly by use of loyalty programs.<sup>28</sup>

For lead-tier customers, the options are to either migrate them to the iron segment or to terminate them. Migration can be achieved via a combination of strategies, including up-selling, cross-selling, and setting base fees and price increases. For example, imposing a minimum fee that is waived when a certain level of revenue is generated may encourage customers who use several suppliers to consolidate their transactions with a single provider. There may also be opportunities to cut service costs to those customers. Customer behavior can be shaped in ways that reduce the cost of serving them; for instance, transaction charges for electronic channels may be priced lower

## SERVICE PERSPECTIVE 12.1

### TIERING THE CUSTOMERS OF A MARKET RESEARCH AGENCY

Tiering its clients helped a leading U.S. market research agency understand its customers better. The agency defined *platinum clients* as large accounts that were not only willing to plan a certain amount of research work during the year, but were also able to commit to the timing, scope, and nature of their projects, which made capacity management and project planning much easier for the research firm. The acquisition costs for projects sold to these clients were only 2–5 percent of project values (as compared to as much as 25 percent for clients who required extensive proposal work and project-by-project bidding). Platinum accounts were also more willing to try new services and to buy a wider range of services from their preferred provider. These customers generally were very satisfied with the research agency's work and were willing to act as references for potential new clients.

*Gold accounts* had a similar profile to platinum clients, except that they were more price sensitive and were more inclined to spread their budgets across several firms. Although these accounts had been clients for many years, they were not willing to commit their research work for a year in advance even though the research firm would have been able to offer them better quality and priority in capacity allocation.

*Iron accounts* spent moderate amounts on research and commissioned work on a project basis. Selling costs were high, as these firms tended to send out requests-for-proposals (RFPs) to a number of firms for all their projects. They sought the lowest price and often did not allow for sufficient time for the research firm to perform a quality job.

*Lead accounts* sought only isolated, low-cost projects that tended to be “quick and dirty” in nature, with little opportunity for the research firm to add value or to apply its skill sets appropriately. Sales costs were high as the client typically invited several firms to quote. Furthermore, because these firms were inexperienced in conducting research and in working with research agencies, selling a project often took several meetings and required multiple revisions to the proposal. Lead accounts also tended to be high maintenance because they did not understand research work well; they often changed project parameters, scope, and deliverables midstream and then expected the research agency to absorb the cost of any rework, thus further reducing the profitability of the engagement.

*Source:* Adapted Valarie A. Zeithaml, Roland T. Rust, and Katharine N. Lemon, “The Customer Pyramid: Creating and Serving Profitable Customers,” *California Management Review*, Berkeley, 43, No. 4, Summer 2001, 127–128.

than for people-intensive channels. Another option is to create an attractively priced, low-cost platform. In the cell phone industry, for example, low-use mobile users are directed to prepaid packages that do not require the firm to send out bills and collect payments, which also eliminates the risk of bad debts on such accounts.

Divesting, or terminating, customers comes as a logical consequence of the realization that not all existing customer relationships are worth keeping.<sup>29</sup> Some relationships may no longer be profitable for the firm, because they may cost more to maintain than the contributions they generate. Some customers no longer fit the firm's strategy either, because that strategy has changed or because the customers' behavior and needs have changed.

Occasionally customers are “fired” outright (although concern for due process is still important). ING Direct is the fast-food model of consumer banking—it is about as no-frills as it gets. It only has a handful of basic products, and it lures low-maintenance customers with high-interest rates (its Orange savings account paid 3.8 percent in January 2006—several times the industry average) (see Figure 12.7). To offset that generosity, its business model pushes its customers toward online transactions, and the bank routinely fires customers who don't fit its business model. When a customer calls too often (the average customer phone call

costs the bank \$5.25 to handle) or wants too many exceptions to the rule, the bank's sales associates basically say: "Look, this doesn't fit you. You need to go back to your community bank and get the kind of contact you're comfortable with." As a result, ING Direct's cost per account is only one-third of the industry average.<sup>30</sup>

Other examples where customers get fired include students caught cheating in examinations or country club members who consistently abuse the facilities or other people. In some instances, termination may be less confrontational. Banks wishing to divest themselves of certain types of accounts that no longer fit with corporate priorities have been known to sell them to other banks (one example is credit card holders who receive a letter in the mail telling them that their account has been transferred to another card issuer).

Just as investors need to dispose of poor investments and banks may have to write off bad loans, each service firm needs to regularly evaluate its customer portfolio and consider ending unsuccessful relationships. Legal and ethical considerations, of course, will determine how to take such actions. For example, a bank may introduce a minimum monthly fee for accounts with a low balance (e.g., below \$1,000), but for social responsibility considerations waive this fee for customers on social security.



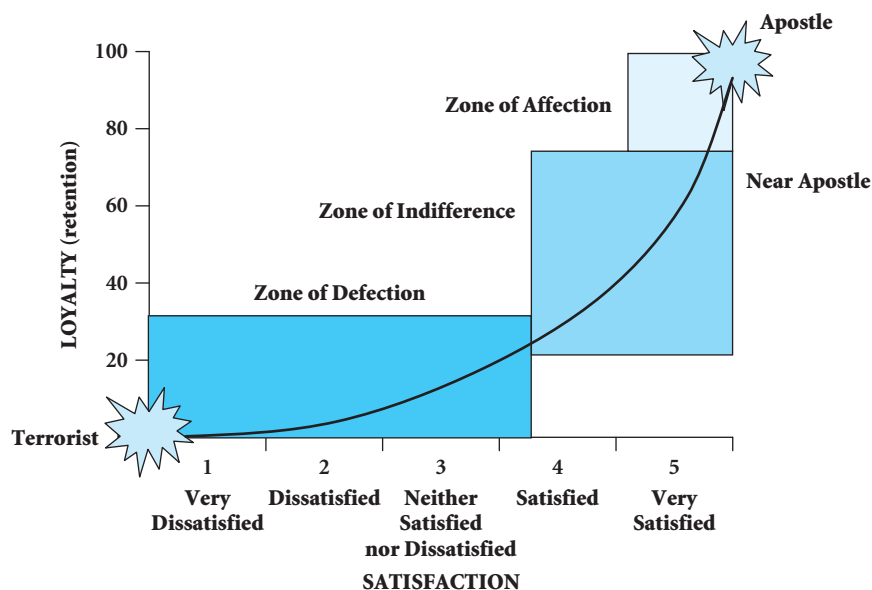
**FIGURE 12.7** ING Direct Can Offer High Interest Rates Because Its Costs to Service Customers Are Kept Low

Source: Courtesy of ING Bank.

### Customer Satisfaction and Service Quality Are Prerequisites for Loyalty

The foundation for true loyalty lies in customer satisfaction, for which service quality is a key input. Highly satisfied or even delighted customers are more likely to become loyal apostles of a firm,<sup>31</sup> consolidate their buying with one supplier, and spread positive word of mouth. Dissatisfaction, in contrast, drives customers away and is a key factor in switching behavior. Recent research has even demonstrated that increases in customer satisfaction lead to increases in stock prices (see Research Insights 12.2).

The satisfaction-loyalty relationship can be divided into three main zones: Defection, indifference, and affection (see Figure 12.8). The *zone of defection* occurs at low satisfaction levels. Customers will switch unless switching costs are high or



**FIGURE 12.8** The Customer Satisfaction-Loyalty Relationship

Source: Reprinted by permission of Harvard Business Review from Thomas O. Jones and W. Earl Sasser, Jr., "Why Satisfied Customers Defect," Harvard Business Review, November-December 1995, p. 91. Copyright © 1995 by the Harvard Business School Publishing Corporation. All rights reserved.

## RESEARCH INSIGHTS 12.2

## CUSTOMER SATISFACTION AND WALL STREET—HIGH RETURNS AND LOW RISK!

Does a firm's customer satisfaction levels have anything to do with its stock price? This was the intriguing research question Claes Fornell and his colleagues wanted to answer. More specifically, they examined whether investments in customer satisfaction lead to excess stock returns (see Figure 12.9), and if so, whether these returns were associated with higher risks as would be predicted by finance theory.

The researchers built two stock portfolios, one hypothetical back-dated portfolio and a real-world portfolio. Both portfolios exclusively consisted of firms that did well in terms of their customer satisfaction ratings (as measured by the American Customer Satisfaction Index (ACSI)). The ACSI-based portfolios were rebalanced once a year on the day when the annual ACSI results were announced. Only firms in the top 20 percent in terms of customer satisfaction ratings were included (firms were either retained if they already were in the top 20 percent last year, or firms that improved their satisfaction ranking into the top 20 percent were added to the portfolio). Firms that fell below the 20 percent cut-off were sold.

The return and risk of both portfolios were measured and their risk-adjusted returns were then compared to broad market indices such as the S&P 500 and NASDAQ. The findings were striking for managers and investors alike. Fornell and his colleagues discovered that the ACSI-based portfolio generated significantly higher risk-adjusted returns than their market benchmark indices. Changes in the ACSI ratings of individual firms were significantly related to their future stock price movement. However, simply publishing the latest data on the ACSI index did not immediately move share prices as efficient market theory would have predicted. Rather, share prices seemed to adjust slowly over time as firms published other results (perhaps earnings data or other "hard" facts that may lag customer satisfaction), and excess stock returns were generated as a result. This return represents a stock market imperfection, but it is consistent with research in marketing, which holds that satisfied customers improve the level and the stability of cash flow.

In a later study, Lerzan Aksoy and her colleagues build on these findings and confirmed that a portfolio based on ACSI data outperformed the S&P 500 index over a 10-year period and delivered risk-adjusted abnormal returns.

For marketing managers, the findings of both studies confirm that investments (or "expenses"—if you talk to accountants) in managing customer relationships and the cash flows they produce are fundamental to the firm's and therefore shareholders' value creation.



**FIGURE 12.9** Can Customer Satisfaction Data Help to Outperform the Market?

Although the results are convincing, be careful should you want to exploit this apparent market inefficiency and invest in firms that show high increases in customer satisfaction in future ACSI releases—your finance friends will tell you that efficient markets learn fast! You will know this has happened when you see stock prices move as a response of future ACSI releases. You can learn more about the ACSI at [www.theacsi.org](http://www.theacsi.org).

*Sources:* Claes Fornell, Sunil Mithas, Forrest V. Morgeson III, and M. S. Krishnan, "Customer Satisfaction and Stock Prices: High Returns, Low Risk," *Journal of Marketing*, 70, January 2006, 3–14; Lerzan Aksoy, Bruce Cooil, Christopher Groening, Timothy L. Keiningham, and Atakan Yalçın, "The Long-Term Stock Market Valuation of Customer Satisfaction," *Journal of Marketing*, 72, No. 4, 2008, 105–122.

there are no viable or convenient alternatives. Extremely dissatisfied customers can turn into “terrorists,” providing an abundance of negative feedback about the service provider.<sup>32</sup> The *zone of indifference* is found at intermediate satisfaction levels. Here, customers are willing to switch if they find a better alternative. Finally, the *zone of affection* is located at very high satisfaction levels, where customers may have such high attitudinal loyalty that they do not look for alternative service providers. Customers who praise the firm in public and refer others to the firm are described as “apostles.” High satisfaction levels lead to improved future business performance.<sup>33</sup>

## STRATEGIES FOR DEVELOPING LOYALTY BONDS WITH CUSTOMERS

Having the right portfolio of customer segments, attracting the right customers, tiering the service, and delivering high levels of satisfaction are a solid foundation for creating customer loyalty as shown in the Wheel of Loyalty in Figure 12.5. However, firms can do more to “bond” closely with their customers. Specific strategies include (1) deepening the relationship through cross-selling and bundling; (2) creating loyalty rewards; and (3) building higher level bonds such as social, customization, and structural bonds.<sup>34</sup> We will discuss each of these three strategies next.

### Deepening the Relationship

To tie customers closer to the firm, deepening the relationship through bundling and/or cross-selling services is an effective strategy. For example, banks like to sell as many financial products as possible into an account or household. Sophisticated analytical software makes it possible to adopt microsegmentation strategies targeted at small groups of customers who share certain relevant characteristics at a specific point in time and who are seen as potential targets for cross-selling or up-selling campaigns (note the strategy employed by the Royal Bank of Canada, as described in Best Practice in Action 12.2). Once a family has a checking account, credit card, savings account, safe deposit box, car loan, mortgage, and so on with the same bank, the relationship is so deep that switching becomes a major exercise and is unlikely, unless of course, customers are extremely dissatisfied with the bank.

Customers can benefit from consolidating their purchasing of various services from the same provider. One-stop shopping typically is more convenient and less hassle than buying individual services from different providers. When having many services with the same firm, the customer may achieve a higher service tier and receive better service, and sometimes service bundles do come with price discounts.

### Encouraging Loyalty through Financial and Nonfinancial Rewards

Few customers buy from only one supplier. This is especially true in situations where service delivery involves separate transactions (such as a car rental) rather than being continuous in nature (as with insurance coverage). In many instances, consumers are loyal to several brands (sometimes described as “polygamous loyalty”) but avoid others. In such instances, the marketing goal becomes strengthening the customer’s preference for one brand over the others and gaining a greater share of the customer’s spending on that service category (also referred to as increasing share-of-wallet). Well-designed loyalty programs can achieve increased share-of-wallet, reward-based bonds.<sup>35</sup> Incentives that offer rewards based on the frequency of purchase, value of purchase, or a combination of both represent a basic level of customer bonding. Rewards can be *financial* or *nonfinancial* in nature.

**FINANCIAL REWARDS.** Financial rewards are customer incentives that have a financial value (also called “hard benefits”), such as discounts on purchases and loyalty program rewards such as frequent flier miles or the cash-back programs provided by some credit card issuers.



**BEST PRACTICE IN ACTION 12.2****Database Marketing at the Royal Bank of Canada**

At least once a month, Toronto-based analysts at the Royal Bank of Canada (the country's largest bank) use data modeling to segment its base of 10 million customers. The segmentation variables include credit risk profile, current and projected profitability, life stage, likelihood of leaving the bank, channel preference (i.e., whether customers like to use a branch, self-service machines, the call center, or online banking), product activation (how quickly customers actually use a product they have bought), and propensity to purchase another product (i.e., cross-selling potential). Says a senior vice president, "Gone are the days when we had mass buckets of customers that would receive the same treatment or same offer on a monthly basis. Our marketing strategy is [now] much more personalized. Of course, it's the technology that allows us to do that."

The main source of data is the marketing information file, which records what products customers hold with the bank, the channels they use, their responses to past campaigns, transactional data, and details of any restrictions on soliciting customers. Another source is the enterprise data warehouse, which stores billing records and information from every document a new or existing customer fills out.

Royal Bank analysts run models based on complex algorithms that can slice the bank's massive customer database into tightly profiled microsegments that are based on simultaneous use of several variables, including the probability that target customers will respond positively to a particular offer. Customized marketing programs can then be developed for each of these microsegments, giving the appearance of a highly personalized offer. The data can also be used to improve the bank's performance on unprofitable accounts by identifying these customers and offering them incentives to use lower-cost channels.

An important goal of Royal Bank's segmentation analysis is to maintain and enhance profitable relationships. The bank has found that customers who hold packages of several services are more profitable than those who don't. These customers also stay with the bank an average of three years longer. As a result of the sophisticated segmentation practices at Royal Bank, the response rates to its direct marketing programs have jumped from an industry average of only 3 percent to as high as 30 percent.

---

*Source:* Meredith Levinson, "Slices of Lives," *CIO Magazine*, August 15, 2000.

Besides airlines and hotels, more and more service firms ranging from retailers (such as department stores, supermarkets, book shops, and petrol stations), telecommunications providers, and café chains to courier services and cinema chains have or are launching similar rewards programs in response to the increasing competitiveness of their markets. Although some provide their own rewards—such as free merchandise, vehicle upgrades, or free hotel rooms at vacation resorts—many firms denominate their awards in miles that can be credited to a selected frequent flyer program. In short, air miles have become a form of promotional currency in the service sector.<sup>36</sup>

Recent research in the credit card industry suggests that financial rewards-based loyalty programs strengthen the customers' perception of the value proposition and lead to increased revenues due to fewer defections and higher usage levels.<sup>37</sup> To assess the potential of a loyalty program to alter normal patterns of behavior, Grahame Dowling and Mark Uncles argue that marketers need to examine three psychological effects:<sup>38</sup>

- *Brand loyalty versus deal loyalty.* To what extent are customers loyal to the core service (or brand) rather than to the loyalty program itself? Marketers should focus on loyalty programs that directly support the value proposition and positioning of the product in question.
- *How buyers value rewards.* Several elements determine a loyalty program's value to customers: (1) the cash value of the redemption rewards (if customers had to purchase them); (2) the range of choice among rewards—for instance, a selection of gifts rather than just a single gift; (3) the aspirational value of the rewards—something exotic that the consumer would not normally purchase may have greater appeal than a cash-back offer; (4) whether the amount of usage required

to obtain an award places it within the realm of possibility for any given consumer; (5) the ease of using the program and making claims for redemption; and (6) the psychological benefits of belonging to the program and accumulating points.

- *Timing.* How soon can benefits from participating in the rewards program be obtained by customers? Deferred gratification tends to weaken the appeal of a loyalty program. One solution is to send customers periodic statements of their account status, indicating progress toward reaching a particular milestone and promoting the rewards that might be forthcoming when that point is reached.

Of course, well-designed rewards programs alone will not suffice to retain a firm's most desirable customers. If you and other customers are dissatisfied with the quality of service or believe better value can be obtained from a less expensive service, you may quickly become disloyal. No service business that has instituted a rewards program for frequent users can ever afford to lose sight of its broader goals of offering high-service quality and good value relative to the price and other costs incurred by customers.<sup>39</sup> Furthermore, one of the risks associated with a focus on strengthening relationships with high-value customers is that a firm may allow service to other customers to deteriorate.

Finally, customers can even get frustrated especially with financial rewards-based programs, so that rather than creating loyalty and goodwill they then breed dissatisfaction! Examples include when customers feel they are excluded from a reward program because of low balances or volume of business, if they cannot redeem their loyalty points because of black-out dates during high demand periods, if the rewards are seen as having little or no value, and if redemption processes are too cumbersome and time consuming.<sup>40</sup> And some customers already have so many loyalty cards in their wallet that they simply are not interested in adding more cards to that pile, especially if customers see them as only marginally valuable.

**NONFINANCIAL REWARDS.** Nonfinancial rewards (also called “soft benefits”) provide benefits that cannot be translated directly into monetary terms. Examples include giving priority to loyalty program members on reservations waitlists and virtual queues in call centers. Some airlines provide benefits such as higher baggage allowances, priority upgrading, access to airport lounges, and the like to its frequent flyers, even when they are only flying in economy class. Informal loyalty rewards, sometimes found in small businesses, may take the form of periodically giving regular customers a small treat as a way of thanking them.

Important intangible rewards include special recognition and appreciation. Customers tend to value the extra attention given to their needs and appreciate the implicit service guarantee offered by high-tier loyalty program memberships, including efforts to meet their occasional special requests. Many loyalty programs also deliver significant status benefits to customers in the top-tiers who feel part of an elite group (e.g., the Chairman's Club cardholders at Harrah's Entertainment in our opening vignette) and enjoy special treatment.<sup>41</sup> Tiered loyalty programs in particular can provide powerful incentives and motivation for customers to achieve the next higher level of membership that often leads to higher share-of-wallet for the preferred provider.

Nonfinancial rewards, especially if linked to higher tier service levels, are typically more powerful than financial ones as the former can create tremendous value for customers. Unlike financial rewards, nonfinancial rewards directly relate to the firm's core service and directly enhance the customers' experience and value perception. In the hotel context, for example, redeeming loyalty points for free gifts does nothing to enhance the guest experience. However, getting priority for reservations, early check-in, late check-out, upgrades, and receiving special attention and appreciation make your stay more pleasant, leave you with the fuzzy warm feeling that this firm appreciates your business, and makes you want to come back.

Best Practice in Action 12.3 describes how British Airways has designed its Executive Club effectively by combining financial and nonfinancial loyalty rewards.

### Building Higher-Level Bonds

One objective of loyalty rewards is to motivate customers to consolidate their purchases with one provider or at least make it the preferred provider. However, reward-based loyalty programs are relatively easy for other suppliers to copy and rarely provide a sustained competitive advantage. In contrast, higher level bonds tend to offer a more sustained competitive advantage. We discuss next the three main types of higher level bonds: (1) social, (2) customization, and (3) structural.

**SOCIAL BONDS.** Have you ever noticed how your favorite hairdresser addresses you by name when you go for a haircut or how she asks why she hasn't seen you for a long time and hopes everything went well while you were away on a long business trip? Social bonds typically are based on personal relationships between providers and customers. Alternatively, they may reflect pride or satisfaction in holding membership in an organization (e.g., a prestigious university alumni club). Although social bonds are more difficult to build than financial bonds and may require considerable time to achieve, for that same reason they are also harder for competitors to replicate for that same customer. A firm that has created strong social bonds with its customers has a better chance of retaining them for the long term. When social bonds extend to shared relationships or experiences between customers, such as in country clubs or educational settings, they can be a major loyalty driver for the organization.<sup>42</sup>

**CUSTOMIZATION BONDS.** Customization bonds are built when the service provider succeeds in providing customized service to its loyal customers. For example, Starbucks' employees are encouraged to learn their regular customers' preferences and customize

#### BEST PRACTICE IN ACTION 12.3

##### Rewarding Value of Use, Not Just Frequency, at British Airways

Unlike some frequent flyer programs, in which customer usage is measured simply in miles, British Airways' (BA) Executive Club members receive both *air miles* toward redemption of air travel awards and *points* toward silver or gold tier status for travel on BA. With the creation of the OneWorld airline alliance with American Airlines, Qantas, Cathay Pacific, and other carriers, Executive Club members have been able to earn miles (and sometimes points) by flying these partner airlines, too.

As shown in Table 12.2, silver and gold cardholders are entitled to special benefits, such as priority reservations and a superior level of on-the-ground service. For instance, even if a gold cardholder is only traveling in economy class, he or she will be entitled to first-class standards of treatment at check-in and in the airport lounges. However, whereas miles can be accumulated for up to three years (after which they expire), tier status is valid for only 12 months beyond the membership year in which it was earned. In short, the right to special privileges must be re-earned each year. The objective of awarding tier status is to encourage passengers who have a choice of airlines to concentrate their travel on British Airways, rather than to join several frequent flyer programs and collect mileage awards from all of them. Few passengers travel with such frequency that they will be able to obtain the benefits of gold tier status (or its equivalent) on more than one airline.

Points given also vary according to the class of service. Longer trips earn more points than shorter ones (a domestic or short haul European trip in economy class generates 15 points, a transatlantic trip 60 points, and a trip from the UK to Australia earns 100 points.) However, tickets at deeply discounted prices may earn fewer miles and no points at all.

To reward purchase of higher-priced tickets, passengers earn points at double the economy rate if they travel in club (business class) and at triple the rate in first class. To encourage gold and silver cardholders to remain loyal, BA offers incentives for Executive Club members to retain their current tier status (or to move up from silver to gold). Silver cardholders receive a 25 percent bonus on all air miles, regardless of class of service, and gold cardholders receive a 50 percent bonus. In other words, it doesn't pay to spread the miles among several frequent-flyer programs!

**TABLE 12.2** Benefits Offered by British Airways to Its Most Valued Passengers

Benefit	Silver Tier Members	Gold Tier Members
Reservations	Dedicated silver phone line	Dedicated gold phone line
Reservation assurance	If flight is full, guaranteed seat in economy when booking full fare ticket at least 24 hours in advance and checking in at least one hour in advance	If flight is full, guaranteed seat in economy when booking full fare ticket at least 24 hours in advance, and checking in at least one hour in advance
Priority waitlist and standby	Higher priority	Highest priority
Advance notification of delays over 4 hours from US or Canada	Yes	Yes
Check-in desk	Club (regardless of travel class)	First (regardless of travel class)
Lounge access	Club departure lounges for passenger and one guest regardless of class of travel	First class departure lounge for passenger and one guest, regardless of travel class; use of arrivals lounges; lounge access anytime, and allowing use of lounges even when not flying BA intercontinental flights
Preferred boarding	Board aircraft at leisure	Board aircraft at leisure
Special services assistance		Problem solving beyond that accorded to other BA travelers
Bonus air miles	+25%	+50%
Upgrade for two		Free upgrade to next cabin for member and companion after earning 2,500 tier points in one year, another upgrade for two after 3,500 points in same year. Award someone else with a Silver Partner card on reaching 4,500 points within membership year

Although the airline makes no promises about complimentary upgrades, members of BA's Executive Club are more likely to receive such invitations than other passengers. Tier status is an important consideration. Unlike many airlines, BA tends to limit upgrades to situations in which a lower class of cabin is overbooked. They do not want frequent travelers to believe that they can plan on buying a less expensive ticket and then automatically receive an upgraded seat.

*Source:* British Airways Executive Club, [www.britishairways.com/travel/ecbenftgold/public/en\\_us](http://www.britishairways.com/travel/ecbenftgold/public/en_us) accessed April 27, 2009.

their service accordingly (see Figure 12.10). One-to-one marketing is a specialized form of customization in which each individual is treated as a segment by itself.<sup>43</sup> Many large hotel chains capture the preferences of their customers through their loyalty program databases, so that when customers arrive at their hotel, they find their individual needs have already been anticipated—from preferred drinks and snacks in the minibar to the kind of pillow they like and the newspaper they want to read in the morning. When a



**FIGURE 12.10** Starbucks' Employees Are Encouraged to Learn Their Customers' Preferences

customer becomes used to this special service, he or she may find it difficult to adjust to another service provider who is not able to customize the service (at least not immediately, as it takes time for the new provider to learn someone's needs).<sup>44</sup>

**STRUCTURAL BONDS.** Structural bonds are frequently seen in B2B settings and aim to stimulate loyalty through structural relationships between the provider and the customer. Examples include joint investments in projects and sharing of information, processes, and equipment. Structural bonds can be created in a B2C environment, too. For instance, some airlines have introduced short message service (SMS) check-in, and SMS or email alerts for flight arrival and departure times so that travelers do not have to waste time waiting at the airport in the case of delays. Some car rental companies offer travelers the opportunity to create customized pages on the firm's website where they

can retrieve details of past trips, including pick-up and return locations, types of cars, insurance coverage, billing address, credit card details, and so forth. This simplifies and speeds the task of making new bookings. Once customers have integrated their way of doing things with the firm's processes, structural bonds are created that link the customer to the firm and make it more difficult for competition to draw them away.

Have you noticed that while all these bonds tie a customer closer to the firm, combined they also deliver the confidence, social, and special treatment benefits customers desire (refer back to Research Insights 12.1)? In general, bonds will not work well unless they also generate value for the customer!

## STRATEGIES FOR REDUCING CUSTOMER DEFECTIONS

So far, we discussed drivers of loyalty and strategies to tie customers more closely to the firm. A complementary approach is to understand the drivers for customer defections, or customer churn, and work on eliminating or reducing those drivers.

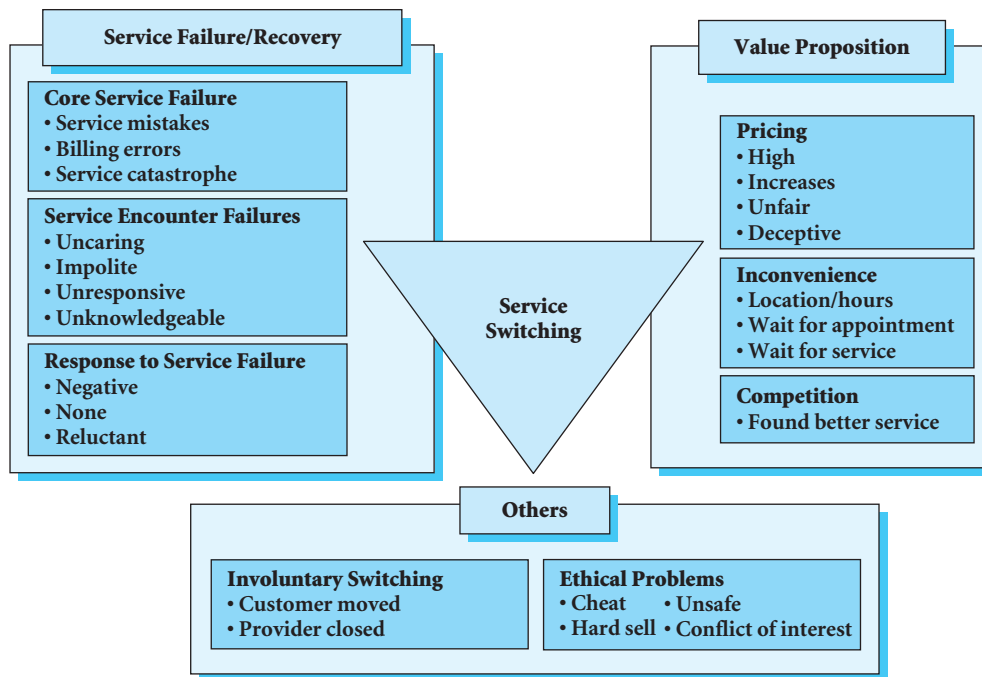
### Analyze Customer Defections and Monitor Declining Accounts

The first step is to understand the reasons for customer switching. Susan Keveaney conducted a large-scale study across a range of services and found several key reasons why customers switch to another provider<sup>45</sup> (Figure 12.11). Core service failures were mentioned by 44 percent of respondents as a reason for switching; dissatisfactory service encounters by 34 percent; high, deceptive, or unfair pricing by 30 percent; inconvenience in terms of time, location, or delays by 21 percent, and poor response to service failure by 17 percent. Many respondents described a decision to switch as resulting from interrelated incidents, such as a service failure followed by an unsatisfactory service recovery.

Many service firms regularly conduct *churn diagnostics*. This includes the analysis of data on churned and declining customers, exit interviews (call center staff often have a short set of questions they ask when a customer cancels an account to gain a better understanding of why customers defect), and in-depth interviews of former customers by a third-party research agency that typically yield a more detailed understanding of churn drivers.<sup>46</sup>

Some firms even try to predict churn of individual accounts. For example, cell phone service providers use *churn alert systems* that monitor the activity in individual customer accounts with the objective of predicting impending customer switching.





**FIGURE 12.11** What Drives Customers to Switch Away from a Service Firm?

Source: Adapted from Susan M. Keaveney, "Customer Switching Behavior in Service Industries: An Exploratory Study," *Journal of Marketing* 59 (April 1995), 71-82. Copyright © 1995. Reprinted with permission from *Journal of Marketing*. Published by the American Marketing Association.

Important accounts at risk are flagged and trigger proactive retention efforts such as sending a voucher and/or having a customer service representative call the customer to check on the health of the customer relationship and initiate corrective action if needed.

### Address Key Churn Drivers

Keaveney's findings underscore the importance of addressing some generic churn drivers by delivering quality service (see Chapter 14), minimizing inconvenience and other nonmonetary costs, and offering fair and transparent pricing (Chapter 6). In addition to these generic drivers, industry-specific drivers exist as well. For example, handset replacement is a common reason for cell phone service subscribers to discontinue an existing relationship, as new subscription plans typically come with heavily subsidized, brand-new handsets. To prevent handset-related churn, many providers now offer proactive handset replacement programs in which their current subscribers are offered heavily discounted handsets at regular intervals. Some providers even provide handsets for free to high-value customers or against redemption of loyalty points.

In addition to such proactive retention measures, many firms use reactive measure as well. These include specially trained call center staff, so-called *save teams*, who deal with customers who intend to cancel their accounts. The main job of save team employees is to listen to customer needs and issues and to try to address them with the key focus of retaining the customer. However, save teams should be rewarded carefully—see Service Perspective 12.2.

### Implement Effective Complaint Handling and Service Recovery Procedures

Effective complaint handling and excellent service recovery are crucial to keeping unhappy customers from switching providers. That includes making it easy for customers to voice their problems with the firm and then responding with a strong service recovery. We will discuss in depth on how to do this effectively in Chapter 13.

## SERVICE PERSPECTIVE 12.2

### CHURN MANAGEMENT GONE WRONG

America Online (AOL) agreed to pay \$1.25 million in penalties and costs and to change some of its customer service practices to settle an investigation by the State of New York. In complaints filed with the state's attorney general's office, some 300 subscribers accused AOL of ignoring their demands to cancel the service and stop billing them.

What went wrong? AOL had been rewarding its call center employees for "saving" customers who called in to cancel their service. Employees could earn high bonuses if they were able to dissuade half or more of such customers to stay with the firm. As claimed by the attorney general's office, this may have led AOL's employees to make it difficult to cancel service. As a response, AOL agreed in a settlement to record service cancellations requests recorded and verified by a third-party monitor, and it agreed to provide up to four months' worth of refunds to all New York subscribers who claim their cancellations had been ignored (AOL did not admit to any wrongdoing in that settlement).



As a response, AOL agreed in a settlement to record service cancellations requests recorded and verified by a third-party monitor, and it agreed to provide up to four months' worth of refunds to all New York subscribers who claim their cancellations had been ignored (AOL did not admit to any wrongdoing in that settlement).

Eliot Spitzer, New York's Attorney General at the time, said: "This agreement helps to ensure that AOL will strive to keep its customers through quality service, not stealth retention programs."

Source: *The Associated Press*, "AOL to Pay \$1.25M to Settle Spitzer Probe," *USA Today*, August 25, 2005, 5B.

### Increase Switching Costs

Another way to reduce churn is to increase switching barriers.<sup>47</sup> Many services have natural switching costs (e.g., it is a lot of work for customers to change their primary banking account, especially when many direct debits, credits, and other related banking services are tied to that account, plus many customers are reluctant to learn about the products and processes of a new provider).<sup>48</sup>

Switching costs can also be created by instituting contractual penalties for switching, such as the transfer fees levied by some brokerage firms for moving shares and bonds to another financial institution. However, firms need to be cautious so they are not perceived as holding their customers hostage. A firm with high switching barriers and poor service quality is likely to generate negative attitudes and bad word of mouth. "At some point, the last straw is reached and a previously inert customer will have had enough" and switch the service provider.<sup>49</sup>

## CRM: CUSTOMER RELATIONSHIP MANAGEMENT

Service marketers have understood for some time the power of customer relationship management, and certain industries have applied it for decades. Examples include the corner grocery store, the neighborhood car repair shop, and providers of banking services to high net-worth clients. Mention the term CRM, however, and costly, complex IT systems and infrastructure, and CRM vendors such as SAP and Siebel immediately come to mind. But CRM actually signifies the whole process by which relations with customers are built and maintained.<sup>50</sup> It should be seen as an enabler of the successful implementation of the Wheel of Loyalty. Let's first look at CRM systems before we move to a more strategic perspective.

### Common Objectives of CRM Systems

Many firms have large numbers of customers (sometimes millions), many different touchpoints (for instance, tellers, call-center staff, self-service machines, and websites), at multiple geographic locations. At a single large facility, it's unlikely that a customer will be served by the same frontline staff on two consecutive visits. In such situations, managers historically lacked the tools to practice relationship marketing. Today however, CRM systems act as an enabler, capturing customer information and delivering it to the various touchpoints.

From a customer perspective, well-implemented CRM systems can offer a unified customer interface that delivers customization and personalization. This means that at each transaction, the relevant account details, knowledge of customer preferences and past transactions, or history of a service problem are at the fingertips of the person serving the customer. This can result in a vast service improvement and increased customer value.

From a company perspective, CRM systems allow the company to better understand, segment, and tier its customer base, better target promotions and cross-selling, and even implement churn alert systems that signal if a customer is in danger of defecting.<sup>51</sup> Service Perspective 12.3 highlights some common CRM applications.

## SERVICE PERSPECTIVE 12.3

### COMMON CRM APPLICATIONS

- **Data collection**—The system captures customer data such as contact details, demographics, purchasing history, service preferences, and the like.
- **Data analysis**—The data captured is analyzed and categorized by the system according to criteria set by firm. This is used to tier the customer base and tailor service delivery accordingly.
- **Sales force automation**—Sales leads, cross-sell and up-sell opportunities can be effectively identified and processed, and the entire sales cycle from lead generation to close of sales and after sales service can be tracked and facilitated through the CRM system.
- **Marketing automation**—Mining of customer data enables the firm to target its market. A good CRM system enables the firm to achieve one-to-one marketing and cost savings, often in the context of loyalty and retention programs. This results in increasing the ROI on its marketing expenditure. CRM systems also enable the assessment of the effectiveness of marketing campaigns through the analysis of responses.
- **Call center automation**—Call center staff have customer information at their fingertips and can improve their service levels to all customers. Furthermore, caller ID and account numbers allow call centers to identify the customer tier the caller belongs to and to tailor the service accordingly. For example, platinum callers get priority in waiting loops.

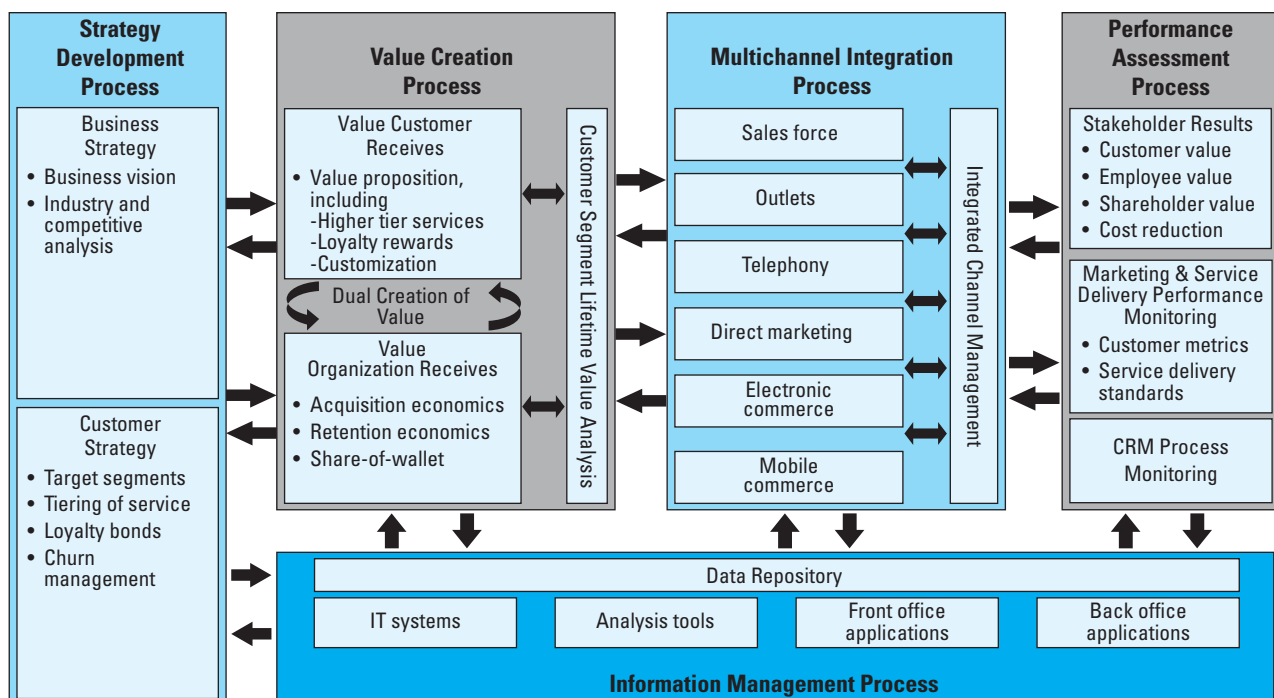
### What Does a Comprehensive CRM Strategy Encompass?<sup>52</sup>

Rather than viewing CRM as a technology, we subscribe to a more strategic view of CRM that focuses on the profitable development and management of customer relationships. Figure 12.12 provides an integrated framework of five key processes involved in a CRM strategy:

1. **Strategy development** involves the assessment of business strategy (including articulation of the company's vision, industry trends, and competition). The business strategy typically is the responsibility of top management. Once determined, the business strategy should be guiding the development for the customer strategy, including the choice of target segments, customer base tiering, the design of loyalty bonds, and churn management (as discussed in the Wheel of Loyalty; see Figure 12.5).
2. **Value creation** translates the business and customer strategies into specific value propositions for customers and the firm. The value created for customers includes all the benefits delivered through priority-tiered services, loyalty rewards, and customization and personalization. The value created for the firm needs to include reduced customer acquisition and retention costs and increased share-of-wallet.

Core of CRM is the concept of dual creation of value—customers need to participate in CRM (e.g., through volunteering information) so they can reap value from the firm's CRM initiatives. For instance, only if your driver's license, billing address, credit card details, and car and insurance preferences are stored in a car rental's CRM system, then you benefit from the increased convenience of not having to provide those data for each reservation.

Firms can even create value through information drawn from one customer for others (e.g., Amazon's analysis of which other books customers have bought with a profile similar to yours and customer ratings of books). CRM seems most successful when there is a win-win situation for the firm and its customers.<sup>53</sup>



**FIGURE 12.12** An Integrated Framework for CRM Strategy

Source: Adapted from Adrian Payne and Paine Frow "A Strategic Framework for Customer Relationship Management." *Journal of marketing* 69 (October 2005), 167–176. Copyright © 2005 Journal of Marketing. Reprinted with permission from the American Marketing Association.

3. **Multichannel integration.** Most service firms interact with their customers through a multitude of channels, and it has become a challenge to serve customers well across these many potential interfaces and offer a unified customer interface that delivers customization and personalization. CRM's channel integration addresses this challenge.
4. **Information management.** Service delivery across many channels relies on the firm's ability to collect customer information from all channels, integrate it with other relevant information, and make the relevant information available to the front line (or to the customer in a self-service context) at the various touchpoints. The information management process encompasses the data repository (which contains all the customer data), IT systems (which encompasses the IT hardware and software), analytical tools (which include data mining software, and more specific application packages such as campaign management analysis, credit assessment, customer profiling, churn alert systems, and even customer fraud detection and management), front office applications (which support activities that involve direct customer contact, including sales force automation and call centre management applications), and back office applications (which support internal customer related processes including logistics, procurement, and financial processing).
5. **Performance assessment** must address three critical questions. First, is the CRM strategy creating value for its key stakeholders (i.e., customers, employees, and shareholders)? Second, are the marketing objectives (ranging from customer acquisition, share-of-wallet, retention to customer satisfaction) and service delivery performance objectives (e.g., call center service standards such as call waiting and first-time resolution rates) being achieved? Third, is the CRM process itself performing up to expectations (e.g., are the relevant strategies being set, is customer and firm value being created, is the information management process working effectively, and is integration across customer service channels being achieved effectively)? The performance assessment process should drive the continuous improvement of the CRM strategy itself.

### Common Failures in CRM Implementation

Unfortunately, the majority of CRM implementations have failed in the past. According to the Gartner Group, the implementation failure rate is 55 percent, and Accenture claims it is around 60 percent. A key reason for this high failure rate is that firms often equate installing CRM systems with having a customer relationship strategy. They forget that the system is just a tool to enhance the firm's customer servicing capabilities and is not the strategy itself.

Furthermore, CRM cuts across many departments and functions (e.g., from customer contact centers, online services, and distributions to branch operations, employee training, and IT departments), programs (ranging from sales and loyalty programs to launching of new services and cross-selling initiatives), and processes (e.g., from credit-line authorization all the way to complaint handling and service recovery). The wide-ranging scope of CRM implementation and the unfortunate reality that it is often the weakest link that determines the success of an implementation, shows the challenge of getting it right. Common reasons for CRM failures include:<sup>54</sup>

- **Viewing CRM as a technology initiative.** It's easy to let the focus shift toward technology and its features, with the result that the IT department—rather than top management or marketing—takes the lead in devising CRM strategy. This often results in a lack of strategic direction and understanding of customers and markets during implementation.
- **Lack of customer focus.** Many firms implement CRM without the ultimate goal to enable consistent service delivery for valued customers across all customer service processes and delivery channels.
- **Insufficient appreciation of customer lifetime value (LTV).** The marketing of many firms is not sufficiently structured around the vastly different profitability of different customers. Furthermore, servicing costs for different customer



segments are often not captured well (e.g., using activity-based costing as discussed in Chapter 6).

- **Inadequate support from top management.** Without ownership and active involvement of top management, the CRM strategic intent will not survive the implementation intact.
- **Failing to re-engineer business processes.** It is virtually impossible to implement CRM successfully without redesigning customer service and back-office processes. Many implementations fail because CRM is fitted into existing processes rather than redesigning the processes to fit a customer-centric CRM implementation. Redesigning also requires effective change management and employee engagement and support, which often are lacking.
- **Underestimating the challenges in data integration.** Firms frequently fail to integrate customer data, which often are scattered all over the organization. A key to unlocking the full potential of CRM is to make customer knowledge available in real time to all employees who need it.

In the long run, firms can put their CRM strategies at substantial risk if customers believe that CRM is used in a way detrimental to them.<sup>55</sup> Examples include perceptions of not being treated fairly (including existing customers who are not offered attractive pricing or promotions that are offered, for example, to new accounts) and potential privacy concerns (see Service Perspective 12.4). Being aware and actively avoiding these pitfalls is a first step toward a successful CRM implementation.

### How to Get CRM Implementation Right

In spite of the many horror stories of millions of dollars sunk into unsuccessful CRM projects, more and more firms are getting it right. “No longer a black hole, CRM is becoming a basic building block of corporate success,” argue Darrell Rigby and Dianne Ledingham.<sup>56</sup> Even CRM systems that have been implemented but have not yet shown results can be well positioned for future success. Seasoned McKinsey consultants recommend taking a step back and studying how to build customer loyalty, rather than focusing on the technology itself.<sup>57</sup> Instead of using CRM to transform entire businesses through the wholesale implementation of the CRM model advanced in Figure 12.12, successful implementations focus on clearly defined problems within their customer relationship cycle. These narrow CRM strategies often reveal additional opportunities for further improvements that, taken together, can evolve into broad CRM implementation extending across the entire company.<sup>58</sup> Likewise, Rigby, Reichheld, and Schefter recommend focusing on the customer strategy and not the technology, posing the question:

If your best customers knew that you planned to invest \$130 million to increase their loyalty...how would they tell you to spend it? Would they want you to create a loyalty card or would they ask you to open more cash registers and keep enough milk in stock? The answer depends on the kind of company you are and the kinds of relationships you and your customers want to have with one another.<sup>59</sup>

Among the key issues managers should debate when defining their customer relationship strategy for a potential CRM system implementation are:

1. How should our value proposition change to increase customer loyalty?
2. How much customization or one-to-one marketing and service delivery is appropriate and profitable?
3. What is the incremental profit potential of increasing the share-of-wallet with our current customers? How much does this vary by customer tier and/or segment?
4. How much time and resources can we allocate to CRM right now?

## SERVICE PERSPECTIVE 12.4

### CRM EXTREME—A GLIMPSE INTO ORDERING PIZZA IN 2015?

**Operator:** "Thank you for calling Pizza Delight. Linda speaking. How may I help you?"

**Customer:** "Good evening, can I order..."

**Operator:** "Sir, before taking your order, could I please have the number of your multi-purpose smart card?"

**Customer:** "Hold on... it's... um... 4555 1000 9831 3213."

**Operator:** "Thank you! Can I please confirm you're Mr. Thompson, calling from 10940 Wilford Boulevard? You are calling from your home number 432-3876, your cell phone number is 992-4566, and your office number is 432-9377."

**Customer:** "How in the world did you get my address and all my numbers?"

**Operator:** "Sir, we are connected to the Integrated Customer Intimacy System."

**Customer:** "I would like to order a large seafood pizza..."

**Operator:** "Sir, that's not a good idea."

**Customer:** "Why?!?"

**Operator:** "According to your medical records, you have very high blood pressure and a far too high cholesterol level, Sir."

**Customer:** "What?... What do you recommend then?"

**Operator:** "Try our Low Fat Soybean Yoghurt Pizza. You'll like it."

**Customer:** "How do you know?"

**Operator:** "You borrowed the book *Popular Soybean Dishes* from the City Library last week, Sir."

**Customer:** "OK, I give up... Get me three large ones then. How much will that be?"

**Operator:** "That should be enough for your family of 8, Sir. The total is \$47.85."

**Customer:** "Can I pay by credit card?"

**Operator:** "I'm afraid you'll have to pay us cash, Sir. Your credit card is over the limit and your checking account has an overdue balance of \$2,435.88. That's excluding the late payment charges on your home equity loan, Sir."

**Customer:** "I guess I'll have to run to the ATM and withdraw some cash before your guy arrives."

**Operator:** "You can't do that, Sir. Based on the records, you've reached your daily machine withdrawals limit for today."

**Customer:** "Never mind. Just send the pizzas, I'll have the cash ready. How long is it gonna take?"

**Operator:** "About 45 minutes Sir, but if you don't want to wait you can always come and collect it on your Harley, registration number L.A.6468..."

**Customer:** "#@\$#%^%#@!"

**Operator:** "Sir, please watch your language. Remember, on April 28, 2014, you were convicted of using abusive language at a traffic warden..."

**Customer:** (speechless)

**Operator:** "Is there anything else, Sir?"

**Source:** This story was adapted from various sources, including [www.lawdebt.com/gazette/nov2004/nov2004.pdf](http://www.lawdebt.com/gazette/nov2004/nov2004.pdf) (accessed January 2006) and a video created by the American Civil Liberties Union (ACLU), available at [www.aclu.org/pizza](http://www.aclu.org/pizza). This video aims to communicate the privacy threats that CRM poses to consumers. The ACLU is a nonprofit organization that campaigns against government's and corporations' aggressive collection of information on people's personal life and habits.

5. If we believe in customer relationship management, why haven't we taken more steps in that direction in the past? What can we do today to develop customer relationships without spending a lot on technology?<sup>60</sup>

Answering these questions may lead to the conclusion that a CRM system may currently not be the best investment or highest priority, or that a scaled down version may suffice to deliver the intended customer strategy. In any case, we emphasize that the system is merely a tool to drive the strategy and thus must be tailored to deliver that strategy.

## CONCLUSION

Many elements are involved in gaining market share, increasing share-of-wallet, cross-selling other products and services to existing customers, and creating long-term loyalty. We used the Wheel of Loyalty as an organizing framework, which starts with identifying and targeting the right customers, then learning about their needs, including their preferences for various forms of service delivery. Translating this knowledge into service delivery, tiered service levels, and customer relationship strategies are the key steps toward achieving customer loyalty.

Marketers need to pay special attention to those customers who offer the firm the greatest value, as they purchase its products with the greatest frequency and spend the most on premium services. Loyalty programs provide rewards to high-value customers and facilitate tiered service delivery. These programs also enable marketers to track the behavior of high-value customers in terms of where and when they use the service, what service classes or types of product they buy, and how much they spend.

Customer relationship management is a key enabler for the strategies discussed in the Wheel of Loyalty and often is integrated with loyalty programs. From a customer perspective, CRM can result in vast service improvements and increased customer value (e.g., through customization and increased convenience).

## Chapter Summary

- LO1** Customer loyalty is an important driver of a service firm's profitability. The profits derived from loyal customers come from (1) increased purchases, (2) reduced operation costs, (3) referral of new customers, and (4) price premiums. Also, customer acquisition costs can be amortized over a longer period of time.
- LO2** However, it is not true that loyal customers are always more profitable. They may expect price discounts for staying loyal. To truly understand the profit impact of the customers, firms need to learn how to calculate the *LTV* of their customers. *LTV* calculations need to include (1) acquisition costs, (2) revenue streams, (3) account-specific servicing costs, (4) expected number of years the customer will stay with the firm, and (5) discount rate for future cash flows.
- LO3** Customers are only loyal if it benefits them. Common benefits customers see include:
  - *Confidence benefits*, including feeling that there is less risk of something going wrong, ability to trust the provider, and receipt of the firm's highest level of service.
  - *Social benefits*, including being known by name, friendship with the service provider, and enjoyment of certain social aspects of the relationship.
  - *Special treatment benefits*, including better prices, extra services, and higher priority.
- LO4** There is a fundamental difference between relationship marketing and transactional marketing.
- *Relationship marketing* includes the not mutually exclusive approaches of (1) database marketing, (2) interaction marketing, and (3) network marketing.
- Businesses that sell *discrete transactions* have to work harder to build relationships. Offering loyalty programs that track customer purchases across outlets and time are an effective tool for many of such firms.
- LO5** It is not easy to build customer loyalty. The *Wheel of Loyalty* offers a systematic framework that guides firms on how to do so. The framework has three components that follow a sequence:
  - First, firms need to build a *foundation for loyalty* without which loyalty cannot be achieved. The foundation delivers confidence benefits to its loyal customers.
  - Once the foundation is laid, firms can then create *loyalty bonds* to strengthen the relationship. Loyalty benefits deliver social and special treatment benefits.
  - Finally, besides focusing on loyalty, firms also have to work on reducing *customer churn*.
- To build the foundation for loyalty, firms need to:
  - LO6** Segment the market and *target the "right" customers*. Firms need to choose their target segments carefully and match them to what the firm can do best. Firms need to focus on customer value, instead of just going for customer volume.
  - LO7** Manage the customer base via *service tiering*, which divides the customer base into different value tiers

(e.g., platinum, gold, iron, and lead). It helps to tailor strategies to the different service tiers. The higher tiers offer higher value for the firm, but also expect higher service levels. For the lower tiers, the focus should be on increasing profitability through building volume, increasing prices, cutting servicing costs, and as a last resort even ending unprofitable relationships.

- LO8** Understand that the foundation for loyalty lies in *customer satisfaction*. The satisfaction loyalty relationship can be divided into three main zones: defection, indifference, and affection. Only highly satisfied or delighted customers in the zone of affection will be truly loyal.
- Loyalty bonds are used to build relationships with customers. There are three different types of customer bonds:
- LO9** Cross-selling and bundling *deepen relationships* that make switching more difficult and often increase convenience through one-stop shopping.
- LO10** Loyalty programs aim at building share-of-wallet through *financial rewards* (e.g., loyalty points) and *nonfinancial rewards* (e.g., higher-tier service levels and recognition and appreciation).
- LO11** Higher level bonds include *social, customization, and structural bonds*. These bonds tend to be more difficult to copy by competition than reward-based bonds.
- LO12** The final step in the Wheel of Loyalty is to understand what causes customers to leave and then systematically reduce these *churn drivers*.
- Common causes for customers to switch include core service failures and dissatisfaction, perceptions that pricing is deceptive and unfair, inconvenience, and poor response to service failures.
  - To prevent customers from switching, firms should analyze and address key reasons why their customers leave them, have good complaint handling and service recovery processes in place, and potentially increase customers' switching costs.
- LO13** Finally, *CRM systems* should be seen as enabling the successful implementation of the Wheel of Loyalty. CRM systems are particularly useful when firms have to serve large numbers of customers across many service delivery channels. An effective CRM strategy includes five key processes:
- Strategy development, including choice of target segments, tiering of service, and design of loyalty rewards.
  - Value creation, including delivering benefits to customers through tiered services and loyalty programs (e.g., priority waitlisting and upgrades).
  - Multichannel integration to provide a unified customer interface across many different service delivery channels (e.g., from the website to the branch office).
  - Information management, which includes the data repository, analytical tools (e.g., campaign management analysis and churn alert systems), and front and back office applications.
  - Performance assessment, which has to address the three questions of:
    - (1) Is the CRM creating value for customers and the firm?
    - (2) Are its marketing objectives being achieved?
    - (3) Is the CRM system itself performing according to expectations?
  - Performance assessment should lead to continuous improvement of the CRM strategy and system.

## Review Questions

1. Why is customer loyalty an important driver of profitability for service firms?
2. Why is targeting the "right customers" so important for successful customer relationship management?
3. How can you estimate a customer's lifetime value (LTV)?
4. Explain what is meant by a customer portfolio. How should a firm decide the most appropriate mix of customers to have?
5. What is tiering of services? Explain why it is used and its implications for firms and their customers.
6. How do the various strategies described in the Wheel of Loyalty relate to one another?
7. Identify some key measures that can be used to create customer bonds and encourage long-term relationships with customers?
8. What are the arguments for spending money to keep existing customers loyal?
9. What is the role of CRM in delivering a customer relationship strategy?



## Application Exercises

1. Identify three service businesses you patronize on a regular basis. For each business, complete the following sentence: "I am loyal to this business because..."
2. What conclusions do you draw about (a) yourself as a consumer and (b) the performance of each of the businesses in Exercise 1? Assess whether any of these businesses managed to develop a sustainable competitive advantage through the way it won your loyalty.
3. Identify two service businesses you used several times but have now ceased to patronize (or plan to stop patronizing soon) because you were dissatisfied. Complete the sentence: "I stopped using (or will soon stop using) this organization as a customer because..."
4. Again, what conclusions do you draw about yourself and the firms in Exercise 3? How would each of these firms potentially avoid your defection? What could each of these firms do to avoid defections in the future of customers with a profile similar to yours?
5. Evaluate the strengths and weaknesses of two frequent user programs, each one from a different service industry. Assess how each program could be improved further.
6. Design a questionnaire and conduct a survey asking about two loyalty programs. The first is about a membership/loyalty program your classmates or their families like best and keep them loyal to that firm. The second should be about a loyalty program that is not well perceived and does not seem to add value to the customer. Use open-ended questions such as "What motivated you to sign up in the first place?" "Why are you using this program?" "Has participating in the program changed your purchasing/usage behavior in any way?" "Has it made you less likely to use competing suppliers?" "What do you think of the rewards available?" "Did membership in the program lead to any immediate benefits in the use of the service?" "What are the three things you like best about this loyalty membership program?" "What did you like least?" and "What are some suggested improvements?" Analyze what features make loyalty/membership programs successful and what features do not achieve the desired results. Use frameworks such as the Wheel of Loyalty to guide your analysis and presentation.
7. Approach service employees in two or three firms with implemented CRM systems. Ask the employees about their experience interfacing with these systems and whether or not the CRM systems (a) help them understand their customers better and/or (b) lead to improved service experiences for their customers. Ask them about potential concerns and improvement suggestions they may have about their organizations' CRM systems.

## Endnotes

1. T. Stanley, "High Stakes Analytics. Optimize: Business Strategy & Execution for CIOs," February 2006, [www.cognos.com/company/success/harrahs.html](http://www.cognos.com/company/success/harrahs.html), accessed April 28, 2009; J. Voight, "Total Rewards Pays Off for Harrah's," *Brandweek.com*, 17, September 2007, [www.brandweek.com/bw/news/recent\\_display.jsp?vnu\\_content\\_id=1003641351](http://www.brandweek.com/bw/news/recent_display.jsp?vnu_content_id=1003641351), accessed April 28, 2009; J. N. Hoover, "2007 Chief of The Year: Tim Stanley," *Information Week*, December 8, 2007, [www.informationweek.com/story/showArticle.jhtml?articleID=204702770](http://www.informationweek.com/story/showArticle.jhtml?articleID=204702770), accessed April 28, 2009; James L. Heskett, W. Earl Sasser, and Joe Wheeler, *The Ownership Quotient*. Boston: Harvard Business Press, 2008, 9–13; [www.harrahs.com](http://www.harrahs.com), accessed June 6, 2009.
2. Frederick F. Reichheld and Thomas Teal, *The Loyalty Effect*. Boston: Harvard Business School Press, 1996.
3. Ruth Bolton, Katherine N. Lemon, and Peter C. Verhoef, "The Theoretical Underpinnings of Customer Asset Management: A Framework and Propositions for Future Research," *Journal of the Academy of Marketing Science*, 32, No. 3, 2004, 271–292.
4. Frederick F. Reichheld and W. Earl Sasser, Jr., "Zero Defections: Quality Comes to Services," *Harvard Business Review*, October 1990, 105–111.
5. Ibid.
6. Frederick F. Reichheld and Phil Schefter, "E-Loyalty—Your Secret Weapon on the Web," *Harvard Business Review*, July–August 2002, 105–113.
7. Christian Homburg, Nicole Koschate, and Wayne D. Hoyer, "Do Satisfied Customers Really Pay More? A Study of the Relationship Between Customer Satisfaction and Willingness to Pay," *Journal of Marketing*, 69, April 2005, 84–96.
8. Grahame R. Dowling and Mark Uncles, "Do Customer Loyalty Programs Really Work?" *Sloan Management Review*, Summer 1997, 71–81; Werner Reinartz and V. Kumar, "The Mismanagement of Customer Loyalty," *Harvard Business Review*, July 2002, 86–94.
9. Werner J. Reinartz and V. Kumar, "On the Profitability of Long-Life Customers in a Noncontractual Setting: An Empirical Investigation and Implications for Marketing," *Journal of Marketing*, 64, October 2000, 17–35.
10. Jochen Wirtz, Indranil Sen, and Sanjay Singh, "Customer Asset Management at DHL in Asia," in Jochen Wirtz and Christopher Lovelock, eds., *Services Marketing in Asia—A Case Book*. Singapore: Prentice Hall, 2005, 379–396.



11. John E. Hogan, Katherine N. Lemon, and Barak Libai, "What is the True Cost of a Lost Customer?" *Journal of Services Research*, 5, No. 3, 2003, 196–208.
12. For a discussion on how to evaluate the customer base of a firm, see Sunil Gupta, Donald R. Lehmann, and Jennifer Ames Stuart, "Valuing Customers," *Journal of Marketing Research*, 41, No. 1, 2004, 7–18.
13. Alan W. H. Grant and Leonard H. Schlesinger, "Realize Your Customer's Full Profit Potential," *Harvard Business Review*, 73, September–October 1995, 59–75. See also Nicolas Glady and Christophe Croux, "Predicting Customer Wallet Without Survey Data," *Journal of Service Research*, 11, No. 3, 2009, 219–231.
14. Nicole E. Coviello, Roderick J. Brodie, and Hugh J. Munro, "Understanding Contemporary Marketing: Development of a Classification Scheme," *Journal of Marketing Management*, 13, No. 6, 501–522.
15. J. R. Copulsky and M. J. Wolf, "Relationship Marketing: Positioning for the Future," *Journal of Business Strategy*, 11, No. 4, 1990, 16–20.
16. Johnson and Selnes proposed a typology of exchange relationships that included "strangers," "acquaintances," "friends," and "partners" and derived implications for customer portfolio management. For details see Michael D. Johnson and Fred Selnes, "Customer Portfolio Management: Towards a Dynamic Theory of Exchange Relationships," *Journal of Marketing*, 68, No. 2, 2004, 1–17.
17. Evert Gummesson, *Total Relationship Marketing*. Oxford: Butterworth-Heinemann, 1999, 24.
18. It has even been suggested to let "chronically dissatisfied customer go to allow front-line staff focus on satisfying the 'right' customers," see Ka-shing Woo and Henry K. Y. Fock, "Retaining and Divesting Customers: An Exploratory Study of Right Customers, 'At-Risk' Right Customers, and Wrong Customers," *Journal of Services Marketing*, 18, No. 3, 2004, 187–197.
19. Frederick F. Reichheld, *Loyalty Rules—How Today's Leaders Build Lasting Relationships*. Boston, MA: Harvard Business School Press, 2001, 45.
20. Yuping Liu, "The Long-Term Impact of Loyalty Programs on Consumer Purchase Behavior and Loyalty," *Journal of Marketing*, 71, No. 4, October 2007, 19–35.
21. Roger Hallowell, "The Relationships of Customer Satisfaction, Customer Loyalty, and Profitability: An Empirical Study," *International Journal of Service Industry Management*, 7, No. 4, 1996, 27–42.
22. Frederick F. Reichheld, *Loyalty Rules – How Today's Leaders Build Lasting Relationships*. Boston, MA: Harvard Business School Press, 2001, 43, 84–85.
23. Ravi Dhar and Rashi Glazer, "Hedging Customers," *Harvard Business Review*, 81, May 2003, 86–92.
24. David H. Maister, *True Professionalism*. New York: The Free Press, 1997 (see especially Chapter 20).
25. David Rosenblum, Doug Tomlinson, and Larry Scott, "Bottom-Feeding for Blockbuster Business," *Harvard Business Review*, March 2003, 52–59.
26. Christian Homburg, Mathias Droll, and Dirk Totzek, "Customer Prioritization: Does it Pay Off, and How Should It Be Implemented?" *Journal of Marketing*, 72, No. 5, 2008, 110–130.
27. Valarie A. Zeithaml, Roland T. Rust, and Katharine N. Lemon, "The Customer Pyramid: Creating and Serving Profitable Customers," *California Management Review*, 43, No. 4, Summer 2001, 118–142.
28. Werner J. Reinartz and V. Kumar, "The Impact of Customer Relationship Characteristics on Profitable Lifetime Duration," *Journal of Marketing*, 67, No. 1, 2003, 77–99.
29. Vikras Mittal, Matthew Sarkees, and Feisal Murshed, "The Right Way to Manage Unprofitable Customers," *Harvard Business Review*, April 2008, 95–102.
30. Elizabeth Esfahani, "How to Get Tough with Bad Customers," *ING Direct*, October 2004, and <http://home.ingdirect.com>, accessed January 19, 2006.
31. Not only is there a positive relationship between satisfaction and share of wallet, but the greatest positive impact is seen at the upper extreme levels of satisfaction. For details, refer to Timothy L. Keiningham, Tiffany Perkins-Munn, and Heather Evans, "The Impact of Customer Satisfaction on Share of Wallet in a Business-to-Business Environment," *Journal of Service Research*, 6, No. 1, 2003, 37–50.
32. Florian v. Wangenheim, "Postswitching Negative Word of Mouth," *Journal of Service Research*, 8, No. 1, 2005, 67–78.
33. Neil A. Morgan and Lopo Leotte Rego, "The Value of Different Customer Satisfaction and Loyalty Metrics in Predicting Business Performance," *Marketing Science*, 25, No. 5, September–October 2006, 426–439.
34. Leonard L. Berry and A. Parasuraman, "Three Levels of Relationship Marketing," *Marketing Services - Competing through Quality*. New York: The Free Press, 1991, 136–142; Valarie A. Zeithaml, Mary Jo Bitner, and Dwayne D. Gremler, *Services Marketing*, 4th edn. New York: McGraw-Hill, 2006, 196–201.
35. Michael Lewis, "The Influence of Loyalty Programs and Short-Term Promotions on Customer Retention," *Journal of Marketing Research*, 41, August 2004, 281–292; Jochen Wirtz, Anna S. Mattila, and May Oo Lwin, "How Effective are Loyalty Reward Programs in Driving Share of Wallet?" *Journal of Service Research*, 9, No. 4, 2007, 327–334.
36. Katherine N. Lemon and Florian V. Wangenheim, "The Reinforcing Effects of Loyalty Program Partnerships and Core Service Usage," *Journal of Service Research*, 11, No. 4, 2009, 357–370.
37. Ruth N. Bolton, P. K. Kannan, and Matthew D. Bramlett, "Implications of Loyalty Program Membership and Service Experience for Customer Retention and Value," *Journal of the Academy of Marketing Science*, 28, No. 1, 2000, 95–108; Michael Lewis, "The Influence of Loyalty Programs and Short-Term Promotions on Customer Retention," *Journal of Marketing Research*, 41, No. 3, 2004, 281–292.
38. Grahame R. Dowling and Mark Uncles, "Do Customer Loyalty Programs Really Work?" *Sloan Management Review* 38, Summer 1997, 71–82.
39. See for example Iselin Skogland and Judy Siguaw, "Are Your Satisfied Customers Loyal?" *Cornell Hotel and Restaurant Administration Quarterly*, 45, No. 3, 2004, 221–234.
40. Bernd Stauss, Maxie Schmidt, and Adreas Schoeler, "Customer Frustration in Loyalty Programs," *International Journal of Service Industry Management*, 16, No. 3, 2005, 229–252.
41. On the perception of design of loyalty tiers see Xavier Drèze and Joseph C. Nunes, "Feeling Superior: The Impact of Loyalty Program Structure on Consumers'

- Perceptions of Status," *Journal of Consumer Research*, 35, No. 6, 2009, 890–905.
42. Mark S. Rosenbaum, Amy L. Ostrom, and Ronald Kuntze, "Loyalty Programs and a Sense of Community," *Journal of Services Marketing*, 19, No. 4, 2005, 222–233; Isabelle Szmigin, Louise Canning, and Alexander E. Reppel, "Online Community: Enhancing the Relationship Marketing Concept Through Customer Bonding," *International Journal of Service Industry Management*, 16, No. 5, 2005, 480–496; Inger Roos, Anders Gustafsson, and Bo Edvardsson, "The Role of Customer Clubs in Recent Telecom Relationships," *International Journal of Service Industry Management*, 16, No. 5, 2005, 436–454; Dennis Pitta, Frank Franzak, and Danielle Fowler, "A Strategic Approach to Building Online Customer Loyalty: Integrating Customer Profitability Tiers," *Journal of Consumer Marketing*, 23, No. 7, 2006, 421–429.
  43. Don Peppers and Martha Rogers, *The One-to-One Manager*. New York: Currency/Doubleday, 1999.
  44. Rick Ferguson and Kelly Hlavinka, "The Long Tail of Loyalty: How Personalized Dialogue and Customized Rewards Will Change Marketing Forever," *Journal of Consumer Marketing*, 23, No. 6, 2006, 357–361.
  45. Susan M. Keaveney, "Customer Switching Behavior in Service Industries: An Exploratory Study," *Journal of Marketing*, 59, April 1995, 71–82.
  46. For a more detailed discussion of situation-specific switching behavior, refer to Inger Roos, Bo Edvardsson, and Anders Gustafsson, "Customer Switching Patterns in Competitive and Noncompetitive Service Industries," *Journal of Service Research*, 6, No. 3, 2004, 256–271.
  47. Jonathan Lee, Janghyuk Lee, and Lawrence Feick, "The Impact of Switching Costs on the Consumer Satisfaction-Loyalty Link: Mobile Phone Service in France," *Journal of Services Marketing*, 15, No. 1, 2001, 35–48; Shun Yin Lam, Venkatesh Shankar, M. Krishna Erramilli, and Bvsn Murthy, "Customer Value, Satisfaction, Loyalty, and Switching Costs: An Illustration from a Business-to-Business Service Context," *Journal of the Academy of Marketing Science*, 32, No. 3, 2004, 293–311; Michael A. Jones, Kristy E. Reynolds, David L. Mothersbaugh, and Sharon Beatty, "The Positive and Negative Effects of Switching Costs on Relational Outcomes," *Journal of Service Research*, 9, No. 4, 2007, 335–355.
  48. Moonkyu Lee and Lawrence F. Cunningham, "A Cost/Benefit Approach to Understanding Loyalty," *Journal of Services Marketing*, 15, No. 2, 2001, 113–130; Simon J. Bell, Seigyoung Auh, and Karen Smalley, "Customer Relationship Dynamics: Service Quality and Customer Loyalty in the Context of Varying Levels of Customer Expertise and Switching Costs," *Journal of the Academy of Marketing Science*, 33, No. 2, 2005, 169–183.
  49. Lesley White and Venkat Yanamandram, "Why Customers Stay: Reasons and Consequences of Inertia in Financial Services," *International Journal of Service Industry Management*, 14, No. 3, 2004, 183–194.
  50. For an excellent book on CRM see V. Kumar and Werner J. Reinartz, *Customer Relationship Management: A Database Approach*. Hoboken, NJ: John Wiley & Sons, 2006.
  51. Kevin N. Quiring and Nancy K. Mullen, "More Than Data Warehousing: An Integrated View of the Customer," in: John G. Freeland, ed., *The Ultimate CRM Handbook—Strategies & Concepts for Building Enduring Customer Loyalty & Profitability*. New York: McGraw-Hill, 2002, 102–108.
  52. This section is adapted from Adrian Payne and Pennie Frow, "A Strategic Framework for Customer Relationship Management," *Journal of Marketing*, 69, October 2005, 167–176.
  53. William Boulding, Richard Staelin, Michael Ehret, and Wesley J. Johnston, "A Customer Relationship Management Roadmap: What is Known, Potential Pitfalls, and Where to Go," *Journal of Marketing*, 69, No. 4, 2005, 155–166.
  54. This section is largely based on Sudhir H. Kale, "CRM Failure and the Seven Deadly Sins," *Marketing Management*, September/October 2004, 42–46.
  55. William Boulding, Richard Staelin, Michael Ehret, and Wesley J. Johnston, "A Customer Relationship Management Roadmap: What is Known, Potential Pitfalls, and Where to Go," *Journal of Marketing*, 69, No. 4, 2005, 155–166.
  56. Darrell K. Rigby and Dianne Ledingham, "CRM Done Right," *Harvard Business Review*, November 2004, 118–129.
  57. Manuel Ebner, Arthur Hu, Daniel Levitt, and Jim McCrory, "How to Rescue CRM?" *The McKinsey Quarterly*, 4, Technology, 2002.
  58. Darrell K. Rigby and Dianne Ledingham, "CRM Done Right," *Harvard Business Review*, November 2004, 118–129.
  59. Darrell K. Rigby, Frederick F. Reichheld, and Phil Scheffer, "Avoid the Four Perils of CRM," *Harvard Business Review*, February 2002, 108.
  60. Darrell K. Rigby, Frederick F. Reichheld, and Phil Scheffer, "Avoid the Four Perils of CRM," *Harvard Business Review*, February 2002, 108.

## CASE 4 Banyan Tree Hotels & Resorts

JOCHEN WIRTZ

*Banyan Tree Hotels and Resorts had become a leading player in the luxury resort and spa market in Asia. As part of its growth strategy, Banyan Tree had launched new brands and brand extensions that included resorts, spas, residences, destination club memberships, retail outlets, and even museum shops. Now, the company was preparing to aggressively grow its global footprint in the Americas, Caribbean, Europe and the Middle East while preserving its distinctive Asian identity and strong brand image of Banyan Tree.*

A brand synonymous with private villas, tropical garden spas, and retail galleries promoting traditional craft, Banyan Tree Hotels and Resorts received its first guest in 1994 in Phuket, Thailand. Since then, it had grown into a leading manager and developer of niche and premium resorts, hotels and spas in Asia Pacific. Despite having minimal advertising, Banyan Tree achieved global exposure and a high level of brand awareness through the company's public relations and global marketing programs. Much interest was also generated by the company's socially responsible business values and practices caring for the social and natural environments. With a firm foothold in the medium-sized luxury resorts market, the company introduced a new and contemporary brand Angsana in 2000 to gain a wider customer base. As the resorts market became increasingly crowded with similar competitive offerings, lured by the success of Banyan Tree, the company had to contemplate about expanding its business and preserving its distinct identity. Banyan Tree and Angsana resorts were expanding geographically outside of Asia and also into the urban hotel market in major cities throughout the world. With around 34 hotels and resorts scheduled to open over the next three years, Banyan Tree faced the challenge of translating and maintaining the success of a niche Asian hospitality brand into various market segments on a global scale.

### Company Background

By early 2009, Banyan Tree Hotels and Resorts (BTHR) managed and/or had ownership interests in 25 resorts and hotels, 68 spas, 65 retail galleries, and two golf courses in 55 locations in 23 countries. Since its establishment in 1994, the company's flagship brand, Banyan Tree, had won some four hundred international tourism, hospitality, design, and marketing awards, some of which included the "Best Resort Hotel in Asia-Pacific" (Phuket) for four consecutive years from Business Traveller Awards since 2002, "Seychelles' Best Resort" and "Seychelles' Best Spa" from World Travel Awards (2003), "Best Hotels for Rooms" (Bangkok) from UK Conde Nast Traveller (2006), "Best Hotel (Luxury)" (Lijiang) from Hospitality Design Awards (2007), and "PATA Gold Award—Ecotourism Project Category" (Bintan) from Pacific Asia Travel Association Gold Awards (2008).<sup>1</sup>

BTHR was founded by Ho Kwon Ping, a travel enthusiast and former journalist, and his wife Claire Chang, a strong advocate of corporate social responsibility. Prior to entering the hotels and resorts business, Ho spent some 15 years managing the family business, which was into everything imaginable, such as commodities, food products, consumer electronics, and property development, competing mainly on cost, and was

© 2010 by Jochen Wirtz.

Jochen Wirtz is Associate Professor of Marketing and Academic Director of the UCLA—NUS Executive MBA Program at the National University of Singapore.

The support and feedback of the management of Banyan Tree Hotels & Resorts in the writing of this case is gratefully acknowledged.

<sup>1</sup>The complete list of awards won by Banyan Tree can be found on the company's website at [www.banyantree.com](http://www.banyantree.com).

not dominant in any particular country or industry, while Chang was deeply involved in sociology and social issues. The closing of a factory in Thailand one year after its opening—because it lost out to other low-cost producers in Indonesia—was the last straw for Ho, who then realized that a low-cost strategy was not only difficult to follow but would also lead nowhere. Determined to craft out something proprietary that would allow the company to become a price maker rather than a price taker, Ho decided that building a strong brand was the only way for him to maintain a sustainable competitive advantage.

The idea of entering the luxury resorts market was inspired by the gap in the hotel industry that giant chains such as the Hilton and Shangri-La could not fill. There existed a market segment that wanted private and intimate accommodation without the expectation of glitzy chain hotels. This was fueled by the sharp price gap between the luxurious Aman Resorts and other resorts in the luxury resorts market. For example, the Amanpuri in Thailand, one of Aman's resorts, charged in 2004 a rack rate for its villas ranging from \$650 to more than \$7,000 a night, whereas the prices of other luxury resorts, such as the Shangri-La Hotel and Phuket Arcadia Beach Resort by Hilton in Thailand, were priced below \$350. Noticing the big difference in prices between Aman Resorts and the other resorts in the luxury resorts market, Ho saw potential for offering an innovative niche product that could also bridge the price gap in this market. Seasoned travelers themselves, Ho and Chang backpacked throughout the world in their youth. Their extensive experiences are evident in their nonconforming beliefs that resorts should provide more than just accommodation. Ho and Chang hit upon the idea of building a resort comprising individual villas, local-inspired architectural design, and positioned as a romantic and intimate escapade for guests. Banyan Tree had moved up its positioning into the higher end of the luxury market, and by 2008 its rack rates were typically between \$1,200 and \$7,000 for the resort in Phuket, and between Euros 1,500 and Euro 4,200 for the resort in the Seychelles.

Operations at Banyan Tree began with only one resort in Phuket, situated on a former mining site once deemed too severely ravaged to sustain any form of development by a United Nations Development Program planning unit and the Tourism Authority of Thailand. It was a bold decision, but the company, together with Ho, Chang, and Ho's brother Ho Kwon Cjan, restored it after extensive rehabilitation works costing a total of \$250 million. So successful was Banyan Tree Phuket when it was finally launched that the company worked quickly to build two other resorts, one at Bintan Island in Indonesia and the other at Vabbinfaru Island in the Maldives. The company never looked back. Even though Asia's travel industry experienced periodic meltdowns such as the Asian Economic Crisis in 1997–1998, the September 11 attacks on the World Trade Center in 2001, the dot.com crisis in 2001–2002, severe acute respiratory syndrome (SARS) in 2003, and the Tsunami on December 26, 2004, no employee was retrenched and room rates at Banyan Tree rose steadily.

### Brand Origins

Known as Yung Shue Wan in the local dialect, Banyan Tree Bay was a fishing village on Lamma Island in Hong Kong, where Ho and his wife Chang lived for three idyllic years before he joined the family business. Despite the village's modest and rustic setting, they remember it to be a sanctuary of romance and intimacy. The large canopies of the Banyan Tree also showed semblance of the shelter afforded by Asia's tropical rainforests. Ho and Chang thus decided to name their resort Banyan Tree and position it as a sanctuary for the senses.

### The Service Offering

Unlike most other resorts then, Banyan Tree resorts comprised individual villas that came with a private pool or spa treatment room, each designed to offer guests exclusivity and utmost privacy. For example, a guest could skinny-dip in the private pool within his villa without being seen by other guests, putting him in a world of his own (see Exhibit 1).





**EXHIBIT 1:** World of Privacy in a Double Pool Villa at Banyan Tree Phuket

All Banyan Tree hotels and resorts were designed around the concept of providing “a sense of place” to reflect and enhance the culture and heritage of the destination. This is reflected in the architecture, furnishings, landscape, vegetation, and service offers. To create a sense of exotic sensuality and ensure the privacy of its guests, the resorts are designed to blend into the natural landscape of the surrounding environment and use the natural foliage and boulders as the privacy screen (see Exhibit 2 showing Banyan Tree Seychelles). The furnishings of Banyan Tree villas were deliberately native to convey the exoticism of the destination with its rich local flavor and luxurious feel. The spa pavilions in Seychelles were constructed around the large granite boulders and lush foliage to offer an outdoor spa experience in complete privacy. The resorts’ local flavor was also reflected in the services offered, some of which were unique to certain resorts. Employees were allowed to vary the service delivery process according to local culture and practices, as long as these were consistent with the brand promise of romance and intimacy. Thus, in Phuket, for instance, a couple could enjoy dinner on a traditional Thai long tail boat accompanied by private Thai musicians while cruising instead of dining in a restaurant. Banyan Tree Phuket also offered wedding packages in which couples were blessed by Buddhist monks. In the Maldives, wedding ceremonies could be conducted underwater among the corals. Guests could also choose to dine in a castaway sandbank with only their private chefs and the stars for company and watch the sunset toasting champagne on a Turkish gullet returning from a trip watching a school of spinner dolphins.

Products and services were conceived with the desired customer experience in mind. One such product was the “Intimate Moments” package, specially created for couples. This was presented as a surprise when guests returned to find their villas



**EXHIBIT 2:** Banyan Tree Seychelles Blends Well into Its Natural Environment





**EXHIBIT 3:** Banyan Tree Spa Pavilion with a View

the “body, mind, and soul,” and was mainly targeted at couples who would enjoy their treatments together.

In line with Banyan Tree’s ethos of conserving local culture and heritage and promoting cottage crafts, Chiang founded the Banyan Tree Gallery, a retail outlet showcasing indigenous crafts. Banyan Tree Gallery outlets were set up in each resort. Items sold were made by local artisans and included traditionally woven handmade fabrics, garments, jewelery, handicrafts, tribal art, and spa accessories such as incense candles and massage oils that guests could use at home to recreate the Banyan Tree experience.

Embarking on projects to support the various communities in the locations Banyan Tree resorts are situated, Banyan Tree Gallery worked closely with village cooperatives and nonprofit craft marketing agents to provide gainful employment to the artisans. While acting as a marketing channel for Asian crafts like basket weaving, hill tribe cross-stitching and lacquerware, Banyan Tree Gallery also educated its customers about the crafts with an accompanying write-up. In the course of Banyan Tree Gallery’s operations, the community outreach extended from across Thailand to Laos, Cambodia, India, Nepal, Sri Lanka, Indonesia, Malaysia, and Singapore.



**EXHIBIT 4:** A Contemporary Asian Shopping Experience with a Strong Sense of Corporate Responsibility at Banyan Tree Gallery

decorated with lit candles, incense oil lamps burning, flower petals spread throughout the room, satin sheets on the decorated bed, a chilled bottle of champagne or wine, and tidbits placed next to the outdoor bath which is decorated with flowers, candles, and bath oils. The couple was presented with a variety of aromatic massage oils to further inspire those intimate moments.

Another draw of the resorts was the Banyan Tree Spa, found at every Banyan Tree property. The pioneer of the tropical garden spas concept, Banyan Tree Spas offered a variety of aromatic oil massages, and face and body beauty treatments using traditional Asian therapies, with a choice of indoors or outdoors treatment. The spa products used were natural, indigenous products, made from local herbs and spices. Nonclinical in concept, Banyan Tree Spas relied mainly on the “human touch” instead of energy-consuming, high-tech equipment. The spa experience was promoted as a sensorial, intimate experience that would rejuvenate

The result of Banyan Tree’s efforts was “a very exclusive, private holiday feeling,” as described by one guest. Another guest commented, “It’s a treat for all the special occasions like honeymoons and wedding anniversaries. It’s the architecture, the sense of place, and the promise of romance.”

### Marketing Banyan Tree

In the first two years after Banyan Tree was launched, the company’s marketing communications was managed by an international advertising agency. The agency also designed the Banyan Tree

logo (shown in Exhibit 5), and together with the management came up with the marketing tagline: “Sanctuary for the Senses.”

Though furnished luxuriously, Banyan Tree resorts were promoted as providing romantic and intimate “smallish” hotel experiences, rather than luxurious accommodation as touted by most competitors then. “Banyan Tree Experiences” was marketed as intimate private moments. The resorts saw themselves as setting the stage for guests to create those unforgettable memories.

When Banyan Tree was first launched, extensive advertising was carried out for a short period of time to gain recognition in the industry. Subsequently, the company scaled down on advertising and kept it minimal, mainly in high-end travel magazines in key markets. The advertisements were visual in nature with succinct copy or showcased the awards and accolades won. Exhibit 6 shows a Banyan Tree advertisement highlighting the award-winning Banyan Tree Spa.

Brand awareness for Banyan Tree was generated largely through public relations and global marketing programs. For example, relationships with travel editors and writers were cultivated to encourage visits to the resorts. This helped increase editorial coverage on Banyan Tree, which management felt was more effective in conveying the “Banyan Tree Experience” from an impartial third-party perspective. Its website, [www.banyantree.com](http://www.banyantree.com), increasingly drove online bookings and provided vivid information about the latest offerings of Banyan Tree’s fast growing portfolio.

The management of marketing activities was centralized at the Singapore headquarters for consistency in brand building. BTHR appointed a few key wholesalers in each targeted market and worked closely with them to promote sales. Rather than selling through wholesale and retail agents that catered to the general market, BTHR chose to work only with agents specializing in exclusive luxury holidays targeted at wealthy customers. Global exposure was also achieved through Banyan Tree’s membership in the Small Luxury Hotels and Leading Hotels of the World. Targeting high-end consumers, they represent various independent exclusive hotels and have sales offices in major cities around the world.

The end of 2007 marked a new stage of Banyan Tree’s global expansion, with the launch of its own GDS code “BY.” GDS is a global distribution system used by travel providers to process airline, hotel, and car rental reservations across 640,000 terminals of travel agents and other distribution partners around the world. Prior to BY, Banyan Tree was represented by its marketing partners, Leading Hotels of the World (LW) and Small Luxury Hotels (LX). Now, Banyan Tree had its unique identity on the GDS, further strengthening its brand presence and customer ownership. Banyan Tree now has enough critical mass to ensure the economic feasibility of a GDS private label. The acquisition of its own GDS code meant that Banyan Tree was transitioning from a relatively small regional player to a global brand in the eyes of the travel industry.

### Brand Values

Banyan Tree embraced certain values, such as actively caring for the natural and human environment and revitalizing local communities, which in turn



EXHIBIT 5: Banyan Tree Logo



EXHIBIT 6: Advertisement Showcasing “Spa of the Year” Award from Condé Nast Traveller

created pride and respect among staff. The company hoped to build the brand on values that employees and customers could identify with and support as part of their own life values. A dedicated corporate social responsibility committee, headed by Chang and featuring general managers and valued associates from each resort, was formed to focus on these issues simultaneously with both a regional overview and local perspectives. Thus, the company worked actively to preserve, protect, and promote the natural and human environments in which Banyan Tree resorts were located.

### Preserving the Environment

Resorts were built using local materials as much as possible and at the same time minimizing the impact on the environment. At Banyan Tree Bintan, for example, the 70 villas located in a rainforest were constructed around existing trees, cutting down as few trees as possible, to minimize the impact the resort had on the natural environment. The villas were built on stilts and platforms to avoid cutting trees and possible soil erosion. At Banyan Tree Maldives Vabbinfaru and Banyan Tree Seychelles, fresh water supply was obtained by the more expensive method of desalination, instead of extracting water from the underground water table, which risked long-term disruption of the ecological system. Toiletries such as shampoo, hair conditioner, bath foam, and body lotion provided by the resorts were nontoxic and biodegradable and filled in reusable containers made from celadon or ceramic. Refuse was recycled where possible and treated through an in-house incinerator system. Wastewater was also treated and recycled in the irrigation of resort landscapes.

Through the retail arm Banyan Tree Gallery, the human environment efforts were evident in the active sourcing of traditional crafts from indigenous tribes to provide gainful employment. These employment opportunities provided a source of income for the tribes and, at the same time, preserved their unique heritage.

In line with the Banyan Tree Group's Green Imperative initiative, Banyan Tree Gallery constantly used ecofriendly and recycled materials in the development of its merchandise. Examples included photo frames made using discarded telephone directories, elephant dung paper stationary, and lead-free celadon and ceramic spa amenities. Unique collections like the black resin turtles stationary range and leaf-inspired merchandise were created to promote environmental awareness and were accompanied by a write-up to educate the consumer on the targeted conservation campaign. In support of animal rights, the galleries did not carry products made from shell or ivory.

Besides trying to conduct business in an environmentally responsible manner, BTHR actively pursued a number of key initiatives, including its Greening Communities program. Greening Communities was launched as a challenge to seven participating resorts. It planted 28,321 trees in the first two years of the program. Banyan Tree Lijiang, for example, planted some 20,000 fruit trees to create additional income for families of the supporting community. While trees will absorb carbon and improve the quality of the environment, the main goal of this program was to engage local communities, associates, and guests to share the causes of climate change and actions that can reduce our collective carbon footprint.

### Creating Brand Ownership Among Employees

All employees were trained in the basic standards of five-star service establishments, which included greeting guests, remembering their first names, and anticipating their needs. In addition, some employees got a taste of the "Banyan Tree Experience" as part of their training. The management believed that the stay would help employees better understand what guests will experience, and, in return, enhance their delivery of special experiences for the guests.

Although management imposed strict rules in the administration of the resorts, employees were empowered to exercise creativity and sensitivity. For example, the housekeeping teams were not restricted by a standard bed decoration. Rather, they



were given room for creativity although they had general guidelines for turning the bed to keep in line with the standards of a premium resort. Banyan Tree invested liberally in staff welfare: employees were taken to and from work in air-conditioned buses and had access to various amenities, including high-quality canteens, medical services, and child care facilities. Staff dormitories had televisions, telephones, refrigerators, and attached bathrooms. The company's generous staff welfare policies apparently paid off. Ho said, "The most gratifying response is the sense of ownership that our staff began to have. It's not a sense of financial ownership, but they actually care about the property. In our business, service and service standards do not always mean the same thing as in a developed country, where standards are measured by efficiency and productivity, by people who are already quite well-versed in a service culture. We operate in places that, sometimes, have not seen hotels. People come from villages. What we need—more than exact standards—is for them to have a sense of hospitality, a sense that the guest is an honored person who, by virtue of being there, is able to give a decent livelihood to the people who work. This creates a culture in which everybody is friendly and helpful.

### Involving Guests in Environmental Conservation

Part of the company's corporate social responsibility initiatives were designed to encourage environmental conservation and help ecological restoration. To create greater environmental awareness, Banyan Tree organized activities that involved interested guests in their research and environmental preservation work. In the Maldives, for instance, guests were invited to take part in the coral transplantation program (see Exhibit 7 for a picture of guest involvement in the long-running coral planting program). Guests who participated in the program were then encouraged to return several years later to see the progress of their efforts. Guests were also offered free marine biology sessions allowing them to learn more about the fascinating marine life and its conservation. Guests also had an opportunity to take part in the Green Sea Turtle Headstarting Projects. The response from guests was tremendously positive.

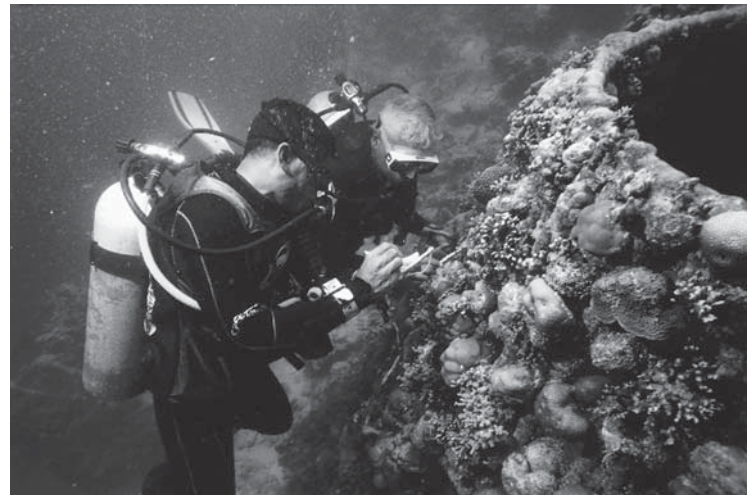
In 2002, Banyan Tree established the Green Imperative Fund (GIF) to further support community-based and environmental initiatives in the regions where it has a presence. Guests were billed \$2 per room night at Banyan Tree properties and \$1 at Angsana properties (of which they could opt out if they wished) and the company matched dollar for dollar. Details of the program were communicated to guests through various methods, including sand-filled turtles and in-villa turndown gifts.

Guests generally were happy to know that their patronage contributed to meaningful causes, like the construction of new schools for the local community, the restoration of coral reefs, and the longevity of local village crafts.

### Involving the Local Community

In addition to engaging local craftsmen to produce indigenous art and handicrafts for sale at its galleries, Banyan Tree also involved the local community in all aspects of its business, even as the resorts were being built. Villas were constructed with as much indigenous material as possible, most of which was supplied by local traders. Traditional arts and handicrafts that complemented the villas' aesthetics were also purchased from local artisans.

The company believed in building profitable resorts that would benefit the surrounding environment and contribute to local economies through the creation of employment and community



**EXHIBIT 7:** Guests Participate in Planting Corals at Banyan Tree Maldives and Angsana Ihuru

development projects. Thus, besides providing employment for the local community, the company brought business to the local farmers and traders by making it a point to purchase fresh produce from them. Whenever possible, the company supported other regional tourism ventures that would benefit the wider local community and enhance the visitor's experience. The Banyan Tree Maldives Marine Laboratory is a prime example: it is the first fully equipped private research facility to be fully funded and operated by a resort. The lab seeks to lead conservation efforts in the Maldives to protect and regenerate coral and marine life for the future of the tourism industry as well as to promote awareness and education of this field to the local community.

Recognizing that the disparity in lifestyles and living standards between guests and the local community might create a sense of alienation within the local community, a community relations department was set up to develop and manage community outreach programs. After consultations with community stakeholders, a number of funding scholarships for needy children were given, a school and child care center were built, lunches and parties for the elderly were hosted, and local cultural and religious activities were supported.

One of BTHR's formalized programs was Seedlings, which aimed to help young adults from local communities and motivate them and provide the means for completing their education to successfully enter the labor force as adults. This program benefited the community at large as it provided the next generation with educational opportunities and to break the poverty cycle.<sup>2</sup>

### Growing Banyan Tree

In 2002, BTHR took over the management of a city hotel in the heart of Bangkok from Westin Hotel Company. The hotel was rebranded as Banyan Tree Bangkok, after extensive renovation works were completed to upgrade the hotel's facilities and build new additional spa amenities and a Banyan Tree Gallery. This was the first Banyan Tree hotel to be located in the city, unlike the other beachfront Banyan Tree properties. Banyan Tree planned to open city hotels in Seoul, Beijing, Shanghai, and Hangzhou, and Angsana expanded into Dubai and London.

As the Banyan Tree brand became established, the company began expanding its network of spas and retail outlets. Stand-alone Banyan Tree Spas and Banyan Tree Galleries were set up as separate ventures, independent of Banyan Tree hotels and resorts, in various places such as Singapore, Shanghai, Sydney, India, and Dubai, operating either in other hotels or as stand-alone outlets. Its most recent spa was The World Spa by Banyan Tree, located on board of the *ResidenSea*, a residential cruise ship, offering Banyan Tree signature spa treatments to the world's only resort community travelling the globe.

In addition to the Spa Academy in Phuket opened in 2001, and to support its fast-growing spa business, in 2007 Banyan Tree opened two new spa academies in Lijiang, China and Bangkok, Thailand.

After establishing a foothold in the luxury resorts market, BTHR introduced the Angsana brand in response to demand from hotel operators in Asia that were keen to introduce spa services in their hotels. As the positioning of these hotels did not fit that of Banyan Tree, the company decided to launch a



**EXHIBIT 8:** Extending the Banyan Tree Maldives Experience Onboard the Banyan Velaa

<sup>2</sup>Detailed information on BTHR's CSR activities can be found at <http://www.banyantree.com/csr>.



new brand, Angsana, a more contemporary and affordable brand than Banyan Tree, to run as stand-alone spa businesses in other hotels.

The first Angsana Spa was opened in 1999 at Dusit Laguna, one of several hotels at Laguna Phuket, an integrated resort development with shared facilities located at Bang Tao Bay in Thailand. The Angsana Spa was so well received that the company quickly set up five other such spas in various hotels in Thailand. In 2000, BTHR opened its first Angsana Resort & Spa, complete with an Angsana Gallery, located less than one kilometer away from Banyan Tree Bintan in Indonesia.

In 2003, Banyan Tree launched The Museum Shop by Banyan Tree—a joint partnership with Singapore’s National Heritage Board to showcase Asia’s rich and diverse cultural heritage through unique museum-inspired merchandise. Designed to inspire and educate shoppers, The Museum Shop by Banyan Tree makes history more accessible and approachable to the layperson. By 2008, Banyan Tree had in total 65 retail outlets, ranging from Banyan Tree Galleries, Banyan Tree Spa Galleries, The Museum Shop by Banyan Tree, Elements Jewelry by Banyan Tree, and Angsana Galleries to Angsana Spa Galleries.

Banyan Tree Galleries are the retail outlets supporting the hotels, while Banyan Tree Spa Galleries support the spa outlets, selling more spa-focused merchandise such as signature aromatherapy amenities, essential oils, candles, and body care products. The Museum Shop by Banyan Tree is located in various museums in Singapore and the merchandise sold will be inspired by the artifacts exhibited in the respective museums. The Elements Jewelry by Banyan Tree sells specialized merchandise such as jewelry and fashion items.

### The Road Ahead

To diversify its geographic spread, Ho had started to venture into locations in South America (the first resort in Mexico opened in 2009), Southern Europe, and the Middle East where he hoped to replicate Banyan Tree’s rapid success. However, given the higher costs of doing business in the Americas and Europe, would the same strategy that had brought fame and success to Banyan Tree in Asia be workable in the rest of the world? Ho’s ultimate vision was “to string a necklace of Banyan Tree Resorts around the world; not quantity, but a number of jewels that form a chain around the world.” In 2008 alone, Banyan Tree had signed management contracts that would expand its operations to at least an additional 50 Banyan Tree and Angsana properties by 2011. Of the properties under development, the majority were resorts and/or integrated resorts, and approximately 10 were city hotels.

While expanding the company’s network of hotels and resorts, spas, and retail outlets, Ho had to be mindful of the brands’ focus and be careful not to dilute the brands. He also had to consider the strategic fit of the company’s portfolio of brands, which comprised Banyan Tree and Angsana.

Banyan Tree certainly stood out among its competitors in the resorts industry when it was first launched. Since then, its success had attracted various competitors



**EXHIBIT 9:** Angsana Maldives Ihuru

who offer similar products and services. Thus, it was imperative that Banyan Tree retained its competitive advantage to prevent losing its distinctive position in the market.

### Study Questions

1. What are the main factors that contributed to Banyan Tree's success?
  2. Evaluate Banyan Tree's brand positioning and communications strategies. Can Banyan Tree maintain its unique positioning in an increasingly overcrowded resorts market?
  3. Discuss whether the brand portfolio of Banyan Tree and Angsana, as well as the product portfolio of beach resorts and city hotels, spas, galleries, and museum shops fit as a family. What are your recommendations to Banyan Tree for managing these brands and products in future?
  4. What effect does the practice of corporate social responsibility have on brand equity?
  5. What potential problems do you foresee bringing Banyan Tree to the Americas, Europe, and the Middle East? How could Banyan Tree address those issues?
-

## ABOUT THE AUTHORS



As a team, Christopher Lovelock and Jochen Wirtz provide a blend of skills and experience that's ideally suited to writing an authoritative and engaging services marketing text. Since first meeting in 1992, they've worked together on a variety of projects, including cases, articles, conference papers, two Asian adaptations of earlier editions of *Services Marketing*, and the new text book *Essentials of Services Marketing*. In 2005, both were actively involved in planning the American

Marketing Association's biennial Service Research Conference, hosted by the National University of Singapore and attended by participants from 22 countries on five continents.

The late **Christopher Lovelock** was one of the pioneers of services marketing. He consulted and gave seminars and workshops for managers around the world, with a particular focus on strategic planning in services and managing the customer experience. From 2001 to 2008, he had been an adjunct professor at the Yale School of Management, where he taught services marketing in the MBA program.

After obtaining a BCom and an MA in economics from the University of Edinburgh, he worked in advertising with the London office of J. Walter Thompson Co. and then in corporate planning with Canadian Industries Ltd. in Montreal. Later, he obtained an MBA from Harvard and a PhD from Stanford, where he was also a postdoctoral fellow.

Professor Lovelock's distinguished academic career included 11 years on the faculty of the Harvard Business School and two years as a visiting professor at IMD in Switzerland. He has held faculty appointments at Berkeley, Stanford, and the Sloan School at MIT as well as visiting professorships at INSEAD in France and The University of Queensland in Australia.

Author or co-author of over 60 articles, more than 100 teaching cases, and 27 books, Professor Lovelock has seen his work translated into 14 languages. He served on the editorial review boards of the *Journal of Service Management*, *Journal of Service Research*, *Service Industries Journal*, *Cornell Hospitality Quarterly*, and *Marketing Management*, and served as an ad hoc reviewer for the *Journal of Marketing*.

Widely acknowledged as a thought leader in services, Christopher Lovelock has been honored with the American Marketing Association's prestigious Award for Career Contributions in the Services Discipline. His article with Evert Gummesson, "Whither Services Marketing? In Search of a New Paradigm and Fresh Perspectives" won the AMA's Best Services Article Award in 2005. Earlier, he received a best article award from the *Journal of Marketing*. Recognized many times for excellence in case writing, he has twice won top honors in the *BusinessWeek* European Case of the Year award. For further information, see [www.lovelock.com](http://www.lovelock.com).



**Jochen Wirtz** holds a Ph.D. in services marketing from the London Business School and has worked in the field of services for over 20 years. He is a tenured associate professor at the National University of Singapore (NUS) where he teaches services marketing in executive, MBA, and undergraduate programs. He is also the founding director of the dual degree UCLA—NUS Executive MBA Program, a Fellow of the NUS Teaching Academy, and an Associate Fellow of Executive Education at Saïd Business School, University of Oxford.



Professor Wirtz's research focuses on service marketing and has been published in over 80 academic journal articles, 100 conference presentations, and some 30 book chapters. He is a co-author of more than 10 books, including his latest—*Essentials of Services Marketing* (Prentice Hall, 2009) and *Flying High in a Competitive Industry: Secrets of the World's Leading Airline* (McGraw Hill, 2009).

In recognition of his excellence in teaching and research, Professor Wirtz has received 20 awards, including the prestigious, university-wide Outstanding Educator Award at the National University of Singapore and the 2009 Best Practical Implications Award by Emerald Group Publications. He serves on the editorial review boards of 10 academic journals, including the *Journal of Service Management*, *Journal of Service Research*, *Journal of Service Science* and *Cornell Hospitality Quarterly* and is an ad hoc reviewer for the *Journal of Consumer Research*, and *Journal of Marketing*. Professor Wirtz chaired the American Marketing Association's biennial Service Research Conference in 2005 when it was held for the first time in Asia.

Professor Wirtz has been an active management consultant, working with international consulting firms, including Accenture, Arthur D. Little, and KPMG and major service firms in the areas of strategy, business development, and customer feedback systems. Originally from Germany, Professor Wirtz spent seven years in London before moving to Asia. For further information, see [www.JochenWirtz.com](http://www.JochenWirtz.com).

## ABOUT THE CONTRIBUTORS OF THE CASES

**Benjamin Edelman** is an assistant professor at Harvard Business School

**Lorelle Frazer** is a professor at Griffith University, Australia

**James L. Heskett** is Baker Foundation Professor at Harvard Business School

**Roger Hallowell** is an affiliated professor of strategy at HEC Paris and a former professor at Harvard Business School

**Sheryl E. Kimes** is a professor at the School of Hotel Administration, Cornell University

**Jill Klein** is an associate professor of marketing, INSEAD, France

**Youngme Moon** is Donald K. David Professor of Business Administration at Harvard Business School

**John A. Quelch** is Senior Associate Dean and Lincoln Filene Professor of Business Administration at Harvard Business School

**Stowe Shoemaker** is Associate Dean of Research and Donald Hubbs Distinguished Professor at Conrad Hilton College of Hotel and Restaurant Management, University of Houston

**Lauren Wright** is a professor of marketing, California State College, Chico



## ACKNOWLEDGMENTS

Over the years, many colleagues in both the academic and business worlds have provided us with valued insights into the management and marketing of services through their publications, in conference or seminar discussions, and through stimulating individual conversations. In addition, both of us have benefited enormously from in-class and after-class discussions with our students and executive program participants.

We're much indebted to those researchers and teachers who helped to pioneer the study of services marketing and management, and from whose work we continue to draw inspiration. Among them are John Bateson of SHL Group; Leonard Berry of Texas A&M University; Mary Jo Bitner and Stephen Brown of Arizona State University; Richard Chase of the University of Southern California; Pierre Eiglier of Université d'Aix-Marseille III; Raymond Fisk of the University of New Orleans; Christian Grönroos of the Swedish School of Economics in Finland; Stephen Grove of Clemson University; Evert Gummesson of Stockholm University; James Heskett and Earl Sasser of Harvard University; and Benjamin Schneider of the University of Maryland. We salute, too, the contributions of the late Eric Langeard and Daryl Wyckoff.

A particular acknowledgment is due to six individuals who have made exceptional contributions to the field, not only in their role as researchers and teachers but also as journal editors, in which capacity they facilitated publication of many of the important articles cited in this book. They are Bo Edvardsson, University of Karlstad and editor, *Journal of Service Management (JOSM)*; Robert Johnston, University of Warwick and founding editor of *JOSM*; Jos Lemmink, Maastricht University and former editor, *JOSM*; Roland Rust of the University of Maryland, founding editor, *Journal of Service Research (JSR)*; A. "Parsu" Parasuraman, University of Miami and former editor *JSR*; and Katherine Lemon, Boston College, current editor of *JSR*.

Although it's impossible to mention everyone who has influenced our thinking, we particularly want to express our appreciation to the following: Tor Andreassen, Norwegian School of Management; David Bowen of Thunderbird Graduate School of Management; John Deighton, Theodore Levitt, and Leonard Schlesinger, all currently or formerly of Harvard Business School; Loizos Heracleous of University of Warwick; Douglas Hoffmann of Colorado State University; Sheryl Kimes of Cornell University; Jean-Claude Larréché of INSEAD; David Maister of Maister Associates; Anna Mattila of Pennsylvania State University; Anat Rafaeli of Technion-Israeli Institute of Technology; Frederick Reichheld of Bain & Co; Bernd Stauss of Katholische Universität Eichstätt; Charles Weinberg of the University of British Columbia; Lauren Wright of California State University, Chico; George Yip of London Business School; and Valarie Zeithaml of the University of North Carolina.

We've also gained important insights from our co-authors on international adaptations of *Services Marketing*, and we are grateful for the friendship and collaboration of Guillermo D'Andrea of Universidad Austral, Argentina; Harvir Singh Bansal of Wilfrid Laurier University, Canada; Jayanta Chatterjee of Indian Institute of Technology at Kanpur, India; Patricia Chew of UniSIM, Singapore; Luis Huete of IESE Business School, Spain; Keh Hean Tat of Peking University, China; Laura Iacovone of Università Bocconi, Italy; Denis Lapert of INT-Management, France; Barbara Lewis of Manchester School of Management, UK; Lu Xiongwen of Fudan University, China; Annie Munos of Euromed Marseille École de Management, France; Javier Reynoso of Tec de Monterrey, Mexico; Paul Patterson of the University of New South Wales, Australia; Sandra Vandermerwe of Imperial College, UK; Rhett Walker of LaTrobe University, Australia; and Shirai Yoshio of Takasaki City University of Economics, Japan.

IBM Cooperation has been a major catalyst in developing the new field of service science, and we would like to especially thank James Spohrer, Paul Maglio, and Wendy Murphy of the IBM's Almaden Research Center for advancing services thinking across functional and disciplinary boundaries.

It's a pleasure to acknowledge the insightful and helpful comments of reviewers of this and previous editions: David M. Andrus of Kansas State University; Charlene Bebeko of Indiana University of Pennsylvania; Michael L. Capella of Villanova University; Susan Carder of Northern Arizona University; Frederick Crane of the University of New Hampshire; Harry Domicone of California Lutheran University; Lukas P. Forbes of Western Kentucky University; Bill Hess of Golden Gate University; Ben Judd of the University of New Haven; P. Sergius Koku of Florida Atlantic University; Robert P. Lambert of Belmont University; Martin J. Lattman of Johns Hopkins University; Daryl McKee of Louisiana State University; Terri Rittenburg of the University of Wyoming; Cynthia Rodriguez Cano of Augusta State University; and Lisa Simon of California Polytechnic State University. They challenged our thinking and encouraged us to include many substantial changes. In addition, we benefited from the valued advice of Sharon Beatty of the University of Alabama and Karen Fox of Santa Clara University, who provided thoughtful suggestions for improvement.

It takes more than authors to create a book and its supplements. Warm thanks are due to our three research assistants, Valerie Phay, Lisa Tran, and Nicole Wong, who provided excellent support with various aspects of writing this book. And we're very appreciative of all the hard work put in by the editing and production staff who worked to transform our manuscript into a handsome published text. They include James Heine, Acquisitions Editor; Kierra Kashickey, Editorial Project Manager; Karin Williams, Editorial Assistant; Judy Leale, Senior Managing Editor; Clara Bartunek, Production Project Manager; and Emily Winders of Elm Street Publishing Services. Thanks also to Gavin Fox of Texas Tech University, author of the Seventh Edition test bank.

Finally, we'd like to thank you, our reader for your interest in this exciting and fast-evolving field of services marketing. If you have interesting research, examples, stories, cases, videos, or any other materials that would look good in the next edition of this book, or any feedback, please do contact us via [www.JochenWirtz.com](http://www.JochenWirtz.com). We'd love to hear from you!

*Christopher Lovelock*  
*Jochen Wirtz*