Eighth Edition

SERVICES MARKETING

People Technology Strategy

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Services Marketing: People, Technology, Strategy

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PART 1

The Services Marketing Framework

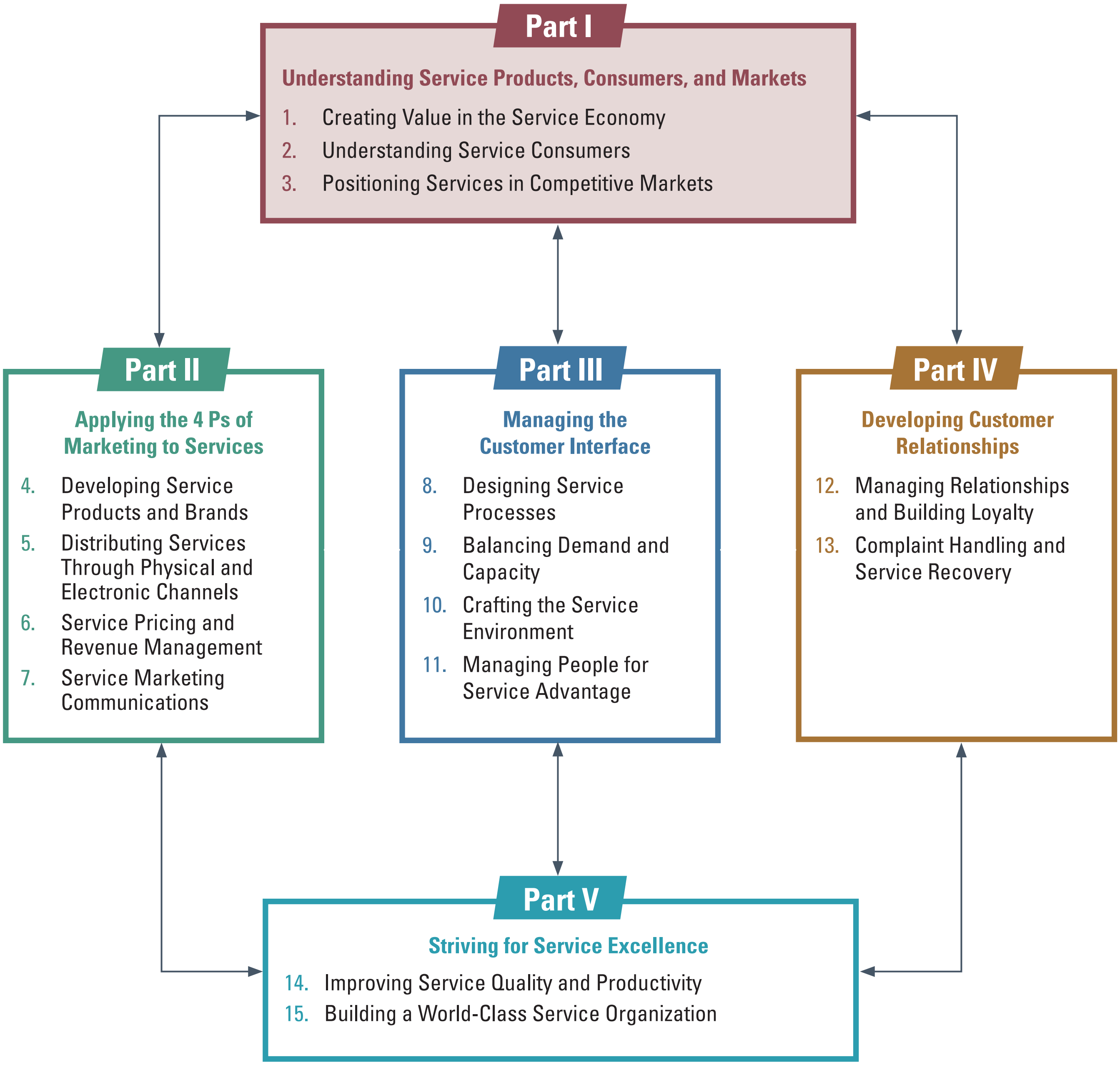


Figure I Organizing framework for services marketing

UNDERSTANDING SERVICE PRODUCTS, CONSUMERS, AND MARKETS

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

CHAPTER 1

Creating Value in the Service Economy

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

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

CHAPTER 2

Understanding Service Consumers

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

CHAPTER 3

Positioning Services in Competitive Markets

Discusses how to develop a customer-driven services marketing strategy and how a value proposition should be positioned in a way that creates competitive advantage for the firm. This chapter first links the customer, competitor, and company (commonly referred to as "3 C"s) analysis links to a firm's positioning strategy. The core of the chapter is then organized around the three key elements of positioning — *s*egmentation, *t*argeting, and *p*ositioning (commonly referred to as '**STP**') — and shows how firms can segment a service market, position their value proposition, and finally focus on attracting their target segment.

CHAPTER 01

Creating Value in the Service Economy

Ours is a service economy and has been for some time.

Karl Albrecht and Ron Zemke,
Thought leaders in business and service

In today's marketplace, consumers have the power to pick and choose as never before.

From the article "Crowned At Last",
published in **The Economist**, 31 March 2005

It's never enough to just tell people about some new insight... Instead of pouring knowledge into people's heads, you need to help them grind a new set of eyeglasses so that they can see the world in a new way. That involves challenging the implicit assumptions that have shaped the way people have historically looked at things.

John Seely Brown,
Thought leader on innovation

LEARNING OBJECTIVES (LOs)

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

- **LO 1** Understand how services contribute to a country's economy.
- **LO 2** Know the principal industries of the service sector.
- **LO 3** Identify the powerful forces that are transforming service markets.
- **LO 4** Understand how B2B services improve the productivity of individual firms and drive economic development.
- **LO 5** Be familiar with the difference between outsourcing and offshoring of services.
- **LO 6** Define services using the non-ownership service framework.
- **LO 7** Identify the four broad "processing" categories of services.
- **LO 8** Be familiar with the characteristics of services and the distinctive marketing challenges they pose.
- **LO 9** Understand the components of the traditional marketing mix applied to services.
- **LO 10** Describe the components of the extended marketing mix for managing the customer interface.
- **LO 11** Appreciate that the marketing, operations, and human resource management functions need to be closely integrated in service businesses.
- **LO 12** Understand the implications of the Service–Profit Chain for service management.
- **LO 13** Know the framework for developing effective service marketing strategies.

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

OPENING VIGNETTE

Introduction to the World of Services Marketing

Like every reader of this book, you're an experienced service consumer. You use an array of services every day, although some — such as talking on the phone, using a credit card, riding a bus, downloading music, using the Internet, or withdrawing money from an ATM — may be so routine that you hardly ever notice them unless something goes wrong. Other service purchases may involve more thought and be more memorable — for instance, booking a cruise vacation, getting financial advice, or having a medical examination. Enrolling in college or graduate school may be one of the biggest service purchases you will ever make. A typical university is a complex service organization that offers not only educational services, but also libraries, student accommodation, healthcare, athletic facilities, museums, security, counseling, and career services.

On campus you may find a bookstore, a bank, a post office, a photocopying shop, Internet cafes, a grocery store, entertainment, and more. Your use of these services is an example of service consumption at the individual or business-to-consumer (B2C) level.

Organizations use a wide array of business-to-business (B2B) services, which usually involve purchases on a much larger scale than those made by individuals or households.

Nowadays, organizations outsource more and more tasks to external service providers in order to focus on their core business. Without being able to buy these services at a good value, these organizations can't hope to succeed. Unfortunately, consumers aren't always happy with the quality and value of the services they receive. You too may not always be delighted with your service experiences; in fact, at times, you may be very disappointed.

Both individual and corporate consumers complain about broken promises, poor value for money, rude or incompetent personnel, inconvenient service hours, bureaucratic procedures, wasted time, malfunctioning self-service technologies (SSTs), complicated websites, a lack of understanding of their needs, and various other problems.

Suppliers of services, who often face stiff competition, appear to have a very different set of concerns. Many owners and managers complain about how difficult it is to find skilled and motivated employees, to keep costs down and make a profit, or to satisfy customers, who, they sometimes grumble, have become unreasonably demanding.

Fortunately, there are service companies that know how to please their customers while also running a productive and profitable operation, staffed by pleasant and competent employees, and accessible through user-friendly SSTs, websites, and apps.

You probably have a few favorite service firms you like to patronize. Have you ever stopped to think about the way they succeed in delivering services that meet and sometimes even exceed your expectations? This book will show you how service businesses can be managed to achieve customer satisfaction and profitability.

In addition to studying key concepts, organizing frameworks, and tools of services marketing, you will also be introduced to many examples from firms across the United States and around the world. From the experiences of other firms, you can draw important lessons on how to succeed in increasingly competitive service markets.

Figure 1.2 Happy people on a cruise vacation

Why Study Services

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

Definition of Services

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

Service Sector Industries

In order of contribution to US GDP:

- Government services
- Real estate
- Business and professional services
- Wholesale & retail trade
- Transport, utilities, & communications
- Finance & insurance
- Healthcare services
- Accommodation & food services
- Arts, entertainment, & recreation service
- Other private sector services

Categories of Services by Type of Processing

- People processing (e.g., passenger transport, hairstyling)
- Possession processing (e.g., freight transport, repair services)
- Mental stimulus processing (e.g., education)
- Information processing (e.g., accounting)

Key Trends

General Trends

- Government policies
- Social changes
- Business trends
- Advances in IT
- Globalization

B2B Services Growth

- Outsourcing
- Offshoring
- Firms increasing focus on core competencies
- Increasing specialization of economies
- Increasing productivity through R&D

Services Pose Distinct Marketing Challenges

Services tend to have four frequently cited characteristics: ***i***ntangibility, ***h***eterogeneity (variability of quality), ***i***nseparability of ***p***roduction and consumption, and perishability of output, or ***IHIP*** for short. Key implications of these features include the following:

- Most services cannot be inventoried (i.e., output is perishable).
- Intangible elements typically dominate value creation (i.e., services are physically intangible).
- Services are often difficult to understand (i.e., services are mentally intangible).
- Customers are often involved in co-production (i.e., if people processing is involved, the service in inseparable).
- People (service employees) may be part of the service product and experience.
- Operational inputs and outputs tend to vary more widely (i.e., services are heterogeneous).
- The time factor often assumes great importance (e.g., capacity management).
- Distribution may take place through nonphysical channels (e.g., information processing services).

Functions

Need to be tightly integrated as together they shape the customer experience, especially:

- Marketing
- Operations
- Human resources
- Information technology

Service–Profit Chain

Shows the tight links between

- Leadership
- Internal quality and IT
- Employee engagement
- Customer value, satisfaction, & loyalty
- Profitability & growth

Putting Service Strategy Into Action

This books is structured around an integrated model of services marketing and management that covers:

- Understanding Service Products, Consumers, & Markets
- Applying the 4 Ps of Marketing to Services
- Designing & Managing the Customer Interface using the additional 3 Ps of Services Marketing (Process, People, & Physical Environment)
- Developing Customer Relationships
- Striving for Service Excellence

Figure 1.3 Introduction to services marketing.

Figure 1.3 provides an overview of Chapter 1. In this chapter, we describe today's ever-changing service economy, define the nature of services, and highlight some challenges involved in marketing services. We conclude the chapter with a framework for developing and implementing service marketing strategies. This framework also establishes the structure for this book

WHY STUDY SERVICES?

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

Consider this paradox: While we live in a service-driven economy, most business schools continue to teach marketing from a manufacturing perspective. If you have already taken a course in marketing, you would have most likely learned more about marketing manufactured products, especially consumer goods, rather than marketing services. Fortunately, a growing and enthusiastic group of scholars, consultants, and educators, including the authors of this book, has chosen to focus on services marketing and build on the extensive research conducted in this field over the past four decades. This book aims to provide you with the knowledge and skills that are necessary and relevant in tomorrow's business environment.

Services Dominate the Global Economy

The size of the service sector is increasing in almost all countries around the world. As an economy develops, the relative share of employment between agriculture, industry (including manufacturing and mining), and services changes dramatically[1]. Even in emerging economies, the service output is growing rapidly and often represents at least half of the Gross Domestic Product (GDP). *Figure 1.4* shows how the evolution to a service-dominated economy is likely to take place over time as the per capita income rises. In developed economies, knowledge-based services — defined as having intensive users of high technology or relatively skilled workforces — have been the most dynamic component[2]. *Figure 1.5* shows that the service sector already accounts for almost two-thirds of the value of the global GDP.

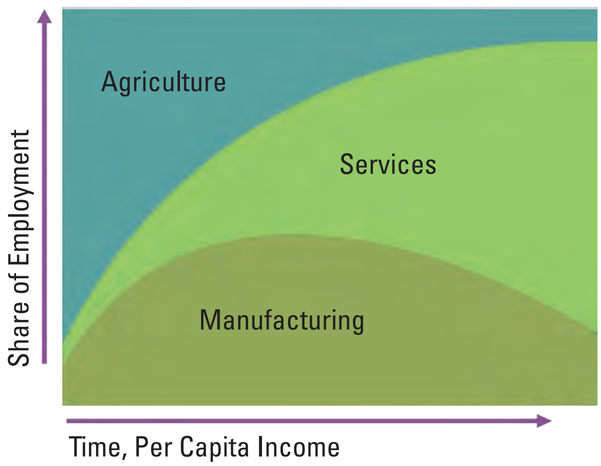


Figure 1.4 Changing structure of employment as an economy develops

Source
International Monetary Fund, 1997

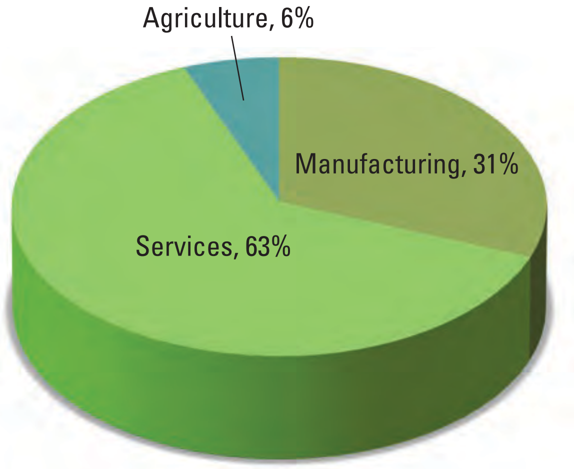


Figure 1.5 Contribution of services industries to GDP globally

Source
The World Factbook 2015, Central Intelligence Agency, www.cia.gov, accessed January 22, 2015.

Figure 1.6 shows the relative size of the service sector in various large and small economies. For most of the highly developed nations, services account for 65–80% of the GDP. One exception is South Korea, a manufacturing-oriented country with its service sector contributing only 58% to the GDP. Which are the world's most service-dominated economies? The answer would be Jersey, the Bahamas, and Bermuda — all small islands with a similar economic mix — which are equally service-dominated. Luxembourg (86%) has the most service-dominated economy in the European Union. Panama's strong showing (78%) reflects not only the operation of the Panama Canal, which is widely used by cruise ships as well as freight vessels, but also related services such as container ports, flagship registry, and a free port zone, as well as financial services, insurance, and tourism (*Figure 1.7*).

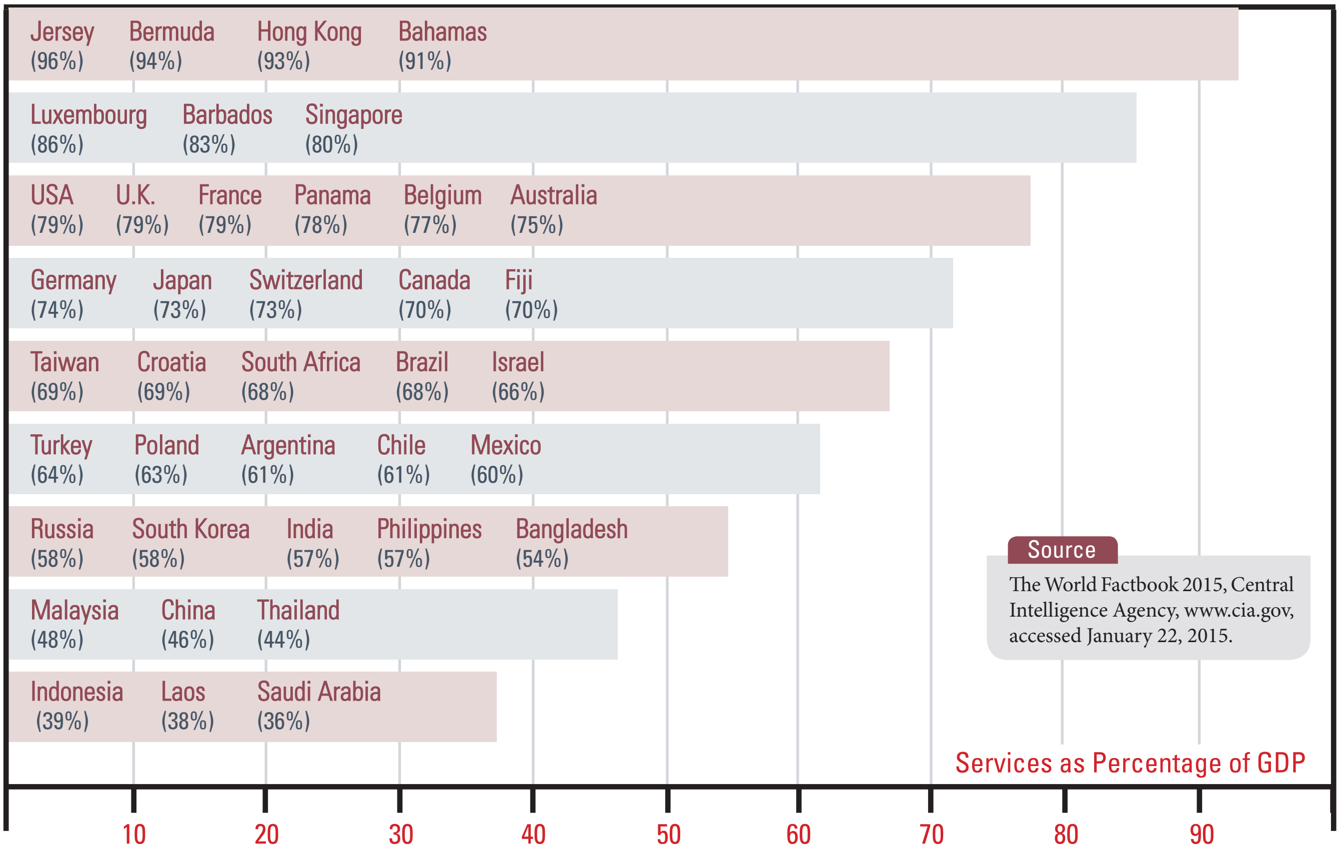


Figure 1.6 Estimated size of service sector in selected countries as a percentage of GDP

On the opposite end of the scale is China (46%), an emerging economy dominated by a substantial agricultural sector, booming manufacturing and construction industries. However, China's economic growth is now leading to an increase in demand for business and consumer services. China's government is investing heavily in service infrastructure, including shipping facilities and new airport terminals. Among the relatively affluent countries is Saudi Arabia with its oil-dominated economy, where services account for only 36% of the GDP.

Most New Jobs Are Generated by Services

Since the service sector is growing so rapidly in virtually all countries around the world, new job creation comes mainly from services. In fact, this shift in employment to the service sector has been seen as one of the longest and most stable of economic trends[3]. Service jobs do not just refer to relatively lowly paid frontline jobs such as in restaurants or call centers. Rather, some of the fastest economic growth is in knowledge-based industries — such as professional and business services, education, and healthcare[4]. These jobs tend to be well-paid, require good educational qualifications, and offer attractive careers.

Many manufacturing firms too have moved from just bundling supplementary services with their physical products to marketing certain elements as standalone services. See *Service Insights 1.1* to find out how Rolls-Royce achieved that transformation.

Just like Rolls-Royce, IBM was also previously known mainly as a manufacturer. The company made the transformation to a service provider and has become the world's largest business and technology services provider offering management consulting, systems integration, and application management services as part of IBM Global Services[5]. Not only has IBM moved into delivering services, it is also at the forefront of the movement to ensure that it trains workers for the service economy. Reflecting the ever tighter integration of value creation in the service economy, IBM coined the term Service Science, Management and Engineering (SSME), often called **service science** for short, which integrates key disciplines required to design, improve, and scale service systems. To be effective in today's service-driven economies, IBM believes future graduates should be 'T'-shaped. That is, they need a deep understanding of their own discipline such as business, engineering, or computer science (the vertical part of the T) as well as a basic understanding of service-related topics in other disciplines (the horizontal part of the T)[6].

Figure 1.7 The Panama Canal forms the backbone of Panama's service economy

SERVICE INSIGHTS 1.1

Rolls-Royce Sells Power by the Hour

Many manufacturing firms increase their competitive edge by providing superior value to their customers in the form of service. Rolls-Royce is one such example. Rolls-Royce, which makes world-class aircraft engines, is a successful company because it focuses on technical innovation. Rolls-Royce engines power about half of the latest wide-bodied passenger jets and a quarter of all single-aisle aircrafts in the world. A very important factor for its success has been the move from manufacturing to selling "power by the hour"— a bundle of goods and services that keeps the customers' engines running smoothly.

Imagine this — high above the Pacific, passengers doze on a long-haul flight from Tokyo to Los Angeles. Suddenly, there is a bolt of lightning. Passengers may not think much of it, but on the other side of the world in Derby, England, engineers at Rolls-Royce get busy. Lightning strikes on jets are common and usually harmless, but this one has caused some problems in one of the engines. The aircraft will still be able to land safely and could do so even with the affected engine shut down. The question is whether it will need a full engine inspection in Los Angeles, which would be normal practice but would also inconvenience hundreds of passengers waiting in the departure lounge.

A stream of data is beamed from the plane to Derby. Numbers dance across screens, graphs are drawn, and engineers scratch their heads. Before the aircraft lands, word comes that the engine is running smoothly, will not need a physical inspection, and the plane will be able to take off on time.

Industry experts estimate that manufacturers of jet engines can make about seven times the revenue from servicing and selling spare parts than they do from just selling the engines. Since it is so profitable, many independent servicing firms compete with companies like Rolls-Royce and offer spare parts for as low as one-third of the price charged by the original equipment manufacturers (OEMs). This is where Rolls-Royce has used a combination of technology and service to make it more difficult for competitors to steal its clients. Instead of selling engines first and parts and service later, Rolls-Royce has created an attractive bundle, which it branded TotalCare®. Customers are charged for every hour that an engine runs. Its website advertizes it as a solution ensuring "peace of mind" for the lifetime of an engine. Rolls-Royce promises to maintain the engine and replace it if it breaks down. The operations room in Derby continuously monitors the performance of some 3,500 engines, enabling it to predict when engines are likely to fail and let airlines schedule engine changes efficiently, reduce repairs and unhappy passengers. Today, about 80% of the engines shipped to its customers are covered by such contracts! Although Rolls-Royce had engines troubles on its A380, they fixed the problem quickly and bounced back from the incident with many more orders for their engines.

© Rolls-Royce plc

Leading research centers have followed IBM's call and have increasingly focused on the integration of key disciplines to better equip future service professionals. Some of the leading centers that have embraced service science include (in alphabetical order): the Center for Excellence in Service of Robert H. Smith School of Business at University of Maryland (www.rhsmith.umd.edu/ces), the Center for Services Leadership at the W. P. Carey School of Business at Arizona State University (http://wpcarey.asu.edu/csl), and The Service Research Center at Karlstad University in Sweden (www.ctf.kau.se). Recently, even an academic journal called *Service Science* has been launched to provide a publication outlet for service science research[7].

Understanding Services Offers Personal Competitive Advantage

This book is in response to the global transformation of our economies towards services. Learning about the distinctive characteristics of services and how they affect both customer behavior and marketing strategy will give you important insights and perhaps create a competitive advantage for your own career. Unless you are predestined to work in a family manufacturing or agricultural business, the probability is high that you will spend most of your working life in service organizations. You may also find yourself serving as a volunteer or board member for a nonprofit organization. The knowledge gained from studying this book may even encourage you to think about starting your own service business!

WHAT ARE THE PRINCIPAL INDUSTRIES OF THE SERVICE SECTOR?

LO 2
Know the principal industries of the service sector.

What industries make up the service sector and which are the biggest? The latter may not be the ones you would imagine at first, because this diverse sector includes many services targeted at business customers, some of which are not very visible unless you happen to work in that industry. National economic statistics are a useful starting point. To provide a better understanding of today's service-dominated economy, government statistical agencies have developed new ways to classify industries. In the United States, the manufacturing-oriented Standard Industrial Classification (SIC) system, developed in the 1930s, has been replaced by the new North American Industry Classification System (NAICS)[8], with Canada and Mexico adopting it too (*Service Insights 1.2*).

SERVICE INSIGHTS 1.2

NAICS: A New Way to Classify the Economies of North America

The North American Industry Classification System — developed jointly by the statistical agencies of Canada, Mexico, and the United States — offers a new approach to classifying industries in the economic statistics of the three North American Free Trade Agreement (NAFTA) countries. It replaces previous national systems, such as the SIC codes formerly used in the United States.

NAICS (pronounced "nakes") includes many new service industries that have emerged in recent decades and also reclassifies services as "auxiliary" establishments that provide services to manufacturing industries — examples include accounting, catering, and transportation. Every sector of the economy has been restructured and redefined. NAICS includes 358 new industries that the SIC did not identify, 390 that are revised from their SIC counterparts, and 422 that continue substantially unchanged. These industries are grouped into sectors and further subdivided into subsectors, industry groups, and establishments.

Among the new sectors and subsectors devoted to services are: *Information,* which recognizes the emergence and uniqueness of businesses in the "information economy"; *Health Care and Social Assistance; Professional, Scientific and Business Services; Educational Services;* and *Accommodation and Food Services; and Arts, Entertainment and Recreation* (which includes most businesses engaged in meeting consumers' cultural, leisure, or entertainment interests).

NAICS uses a consistent principle for classification, grouping businesses that use similar production processes. Its goal is to make economic statistics more useful and to capture developments that encompass applications of high technology (e.g., cellular telecommunications), new businesses that previously did not exist (e.g., environmental consulting), and changes in the way business is done (e.g., warehouse clubs).

NAICS codes are set up in such a way that researchers can drill down within broad industry sectors to obtain information on tightly defined types of service establishments. For instance, the NAICS code 71 designates arts, entertainment and recreation. Code 7112 designates spectator sports, and code 711211 designates sports teams and clubs. By looking at changes over time in "real" dollars (adjusted for inflation), it's possible to determine which industries have been growing and which have not. The NAICS codes are also being used to categorize employment statistics and numbers of establishments within a particular industry. And a new North American Product Classification System (NAPCS) thus defines thousands of service products. If you want to research service industries and service products, NAICS data is a great place to start.

Source

Economic Classification Policy Committee, "NAICS—North American Industry Classification System: New Data for a New Economy". Washington, DC: Bureau of the Census, October 1998; North American Industry Classification System, United States 2002 [Official NAICS manual], Washington, D.C.: National Technical Information Service, PB2002101430*SS, 2002. http://www.census.gov/eos/www/naics/, accessed January 22, 2015.

Contribution to Gross Domestic Product

To see how much value each of the major service industry groups contributes to the U.S. GDP, take a look at *Figure 1.8*. Would you have guessed that real estate and rental and leasing would be the largest for-profit service industry sector in the United States, accounting for 13% in 2013, almost one-eighth of GDP? Over 90% of this figure comes from activities such as renting residential or commercial property; managing properties on behalf of their owners; providing realty services to facilitate purchases, sales, and rentals; and appraising property to determine its condition and value. The balance is accounted for by renting or leasing a wide variety of other manufactured products, ranging from heavy construction equipment (with or without operators) to office furniture, tents, and party supplies. Another large cluster of services provides for distribution of physical products. Wholesale and retail trade accounts for about 11.8% of GDP.

Other substantial industry sectors or subsectors are professional and business services (11.8%), finance and insurance (7.2%), and healthcare (7.1%). Accommodation and food services constitute 2.7%, while the arts, entertainment, and recreation services — which includes high-profile consumer services such as spectator sports, fitness centers, skiing facilities, museums and zoos, performing arts, casinos, golf courses, marinas, and theme parks — collectively represent a mere 1.0% of GDP. Nevertheless, in an economy with an output of over $17.1 trillion, this last group of services was still valued at an impressive $164 billion in 2013.

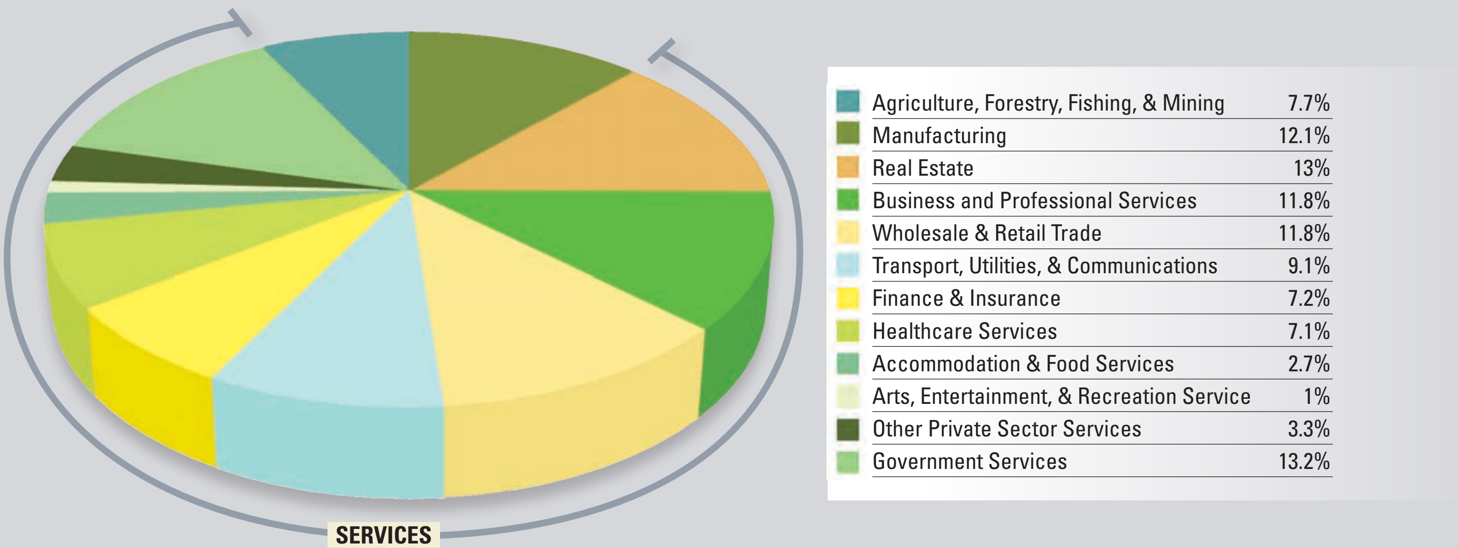


Figure 1.8 Value added by service industry categories to US GDP.

Source

Adapted from: U.S. Department of Commerce, Bureau of Economic Analysis, GDP by Industry Accounts for 2013, 2007, www.bea.gov; accessed January 22, 2015.

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

POWERFUL FORCES ARE TRANSFORMING SERVICE MARKETS

What are the factors causing this rapid growth of the service sector? Government policies, social changes, business trends, globalization, and advances in information technology (IT) and communications in particular, are among the powerful forces transforming today's service markets (*Figure 1.9*). Collectively, these forces reshape demand, supply, competitive landscape, and even the way customers buy and use services.

Of these forces, the dramatic development of IT and communications is perhaps the most important at the moment. Innovations in big data, cloud computing, user-generated content, mobile communications, networking technologies, artificial intelligence, and increasingly app-based SSTs bring their own service revolution. These technologies enable firms to deepen the relationships with their customers, offer multi-way information flow and more personalized services, improved analytics, and increase productivity and profitability[9]. More importantly, these new technologies also lead to a vast array of highly innovative business models, ranging from peer-to-peer services (e.g., Airbnb for short-term accommodation and Lending Club for personal loans), integrators (e.g., Uber connects passengers with independent drivers through apps), to crowd-based services (e.g., crowdSPRING, a leading provider of logo and graphic design services).

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

B2B SERVICES AS A CORE ENGINE OF ECONOMIC DEVELOPMENT[10]

A key driver of successful economies is their ecosystem of advanced, competitive, and innovative business services. You may ask, "Why would business services improve the productivity of a manufacturing firm and an economy as a whole?" Consider the following example: a large manufacturing firm runs its own canteen with 100 workers, who in the national statistics are classified as "manufacturing employees" producing "manufacturing output" (their output is captured in the added value created by their employer, i.e., the manufacturing firm). However, how good is a manufacturing firm in buying food ingredients, cooking, designing and running kitchen processes, supervising chefs, and controlling quality and costs in a canteen? The general answer is that the firm would probably not be capable of producing fantastic food. As the operations that take place in the canteen are low volume and of little importance to the overall business, they will justify neither greater management attention, nor significant investments in process improvements and R&D.

Many manufacturing firms have recognized this problem and outsourced their canteen operations, most likely via a tendering process with a renewal period of every few years. The winning bidder is likely to be a firm that specializes in running canteens and kitchens across many sites or branches. That company makes "operating canteens" its core competency. As such, the operation is managed with an emphasis on the quality of the services and food provided, and the efficiency of its cost structure. Branches can be benchmarked internally, and the overall operation has economies of scale, and is way down the learning curve.

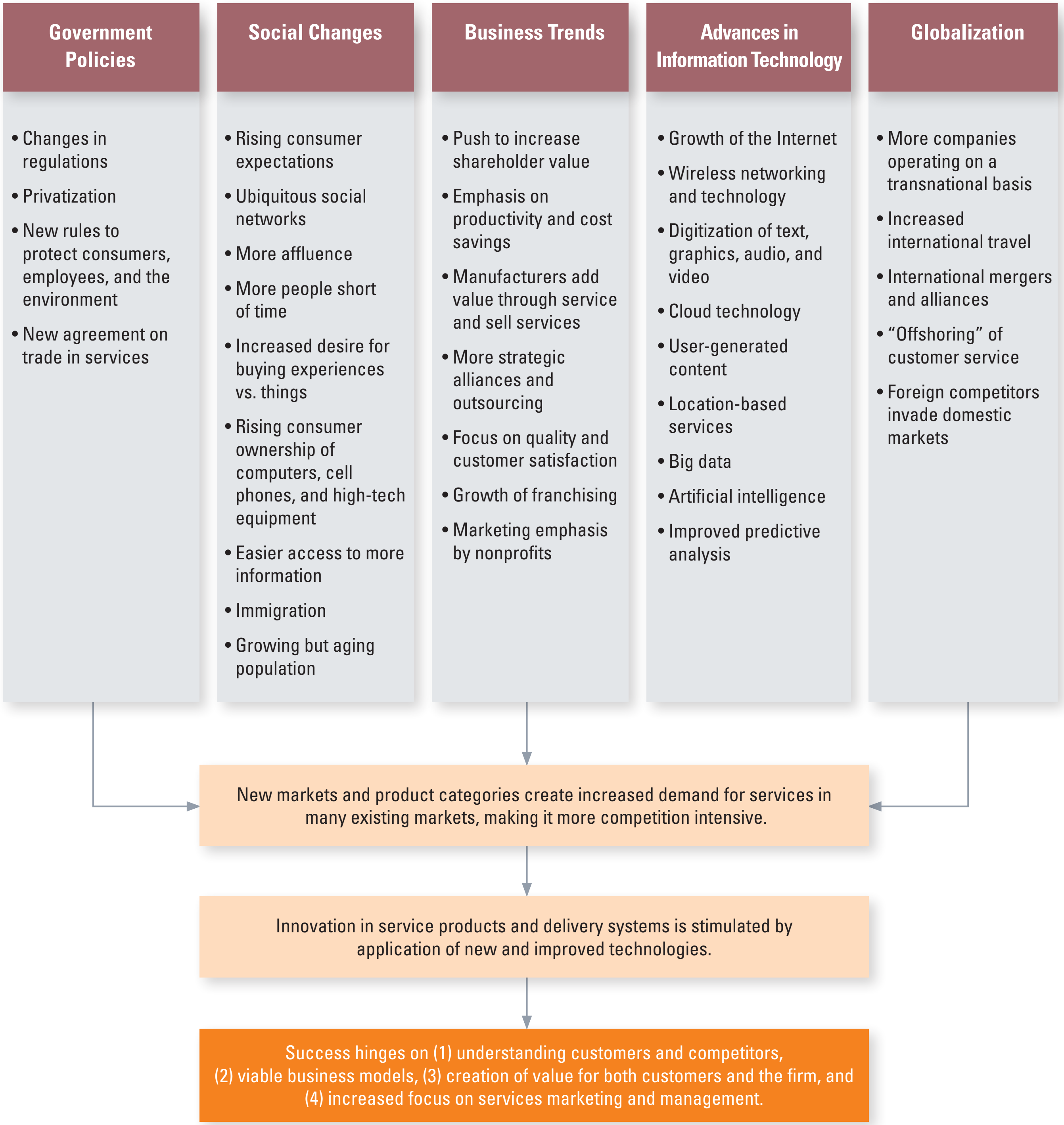


Figure 1.9 Factors stimulating the transformation of the service economy

It also makes sense for the firm to invest in process improvements and R&D as the benefits can be reaped across multiple sites. What used to be a neglected support activity within a manufacturing firm has become a management focus and core competency of an independent service provider. The same logic applies to almost all non-core activities, assets, goods, and services a company can source more cost-effectively from third-party providers (*Figure 1.10*). McKinsey estimates that such service inputs to manufacturing output are about 20–25%, offering much potential for further outsourcing[11]. This development leads to an increasing specialization of our economies with significant gains in overall productivity and living standards.

LO 5
Be familiar with the difference between outsourcing and offshoring of services.

OUTSOURCING AND OFFSHORING OFTEN WORK IN TANDEM

Will service jobs be lost to low-wage countries? New communications technologies mean that some service work can be carried out far from where customers are located[12]. Offshoring here refers to services that are **conducted** in one country and **consumed** in another (*Figure 1.11*). Prior to the turn of the century, offshoring was mostly confined to the manufacturing sector, offshore services have since emerged as a dynamic global sector over the past two decades, driven by the rise of information and communication technologies, the international tradability of services, and the evolution of global business services models.

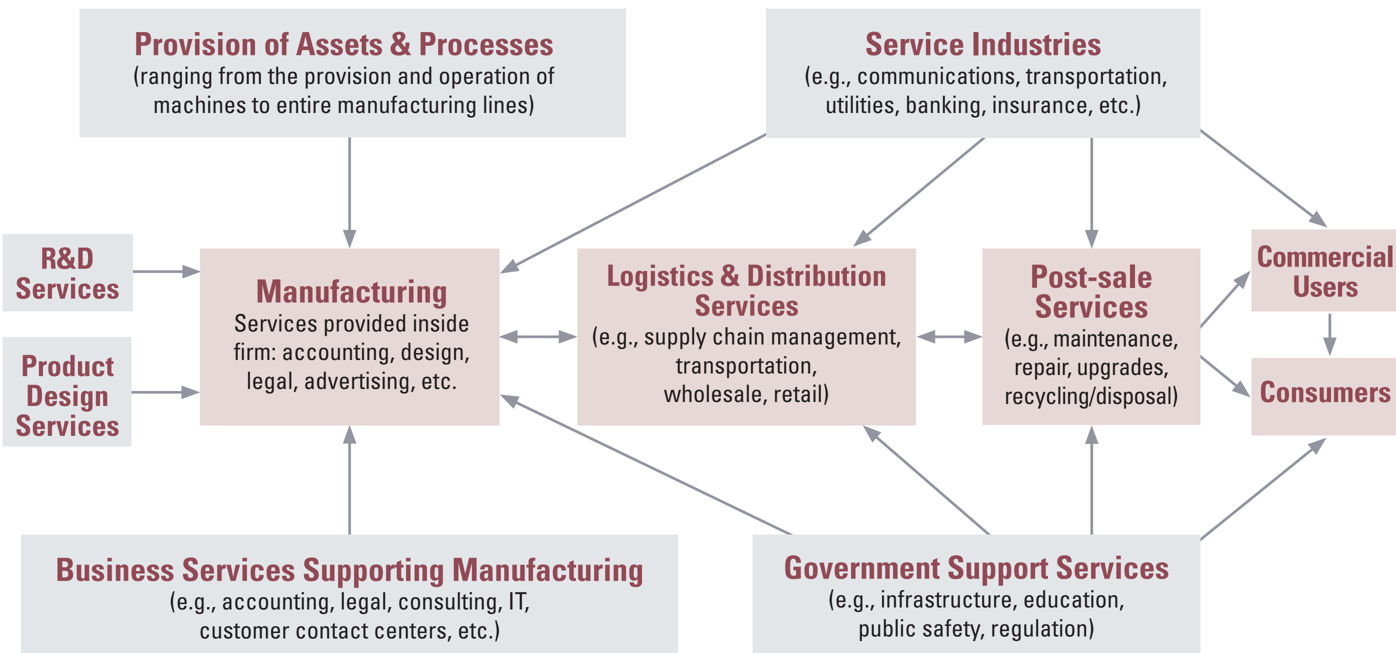


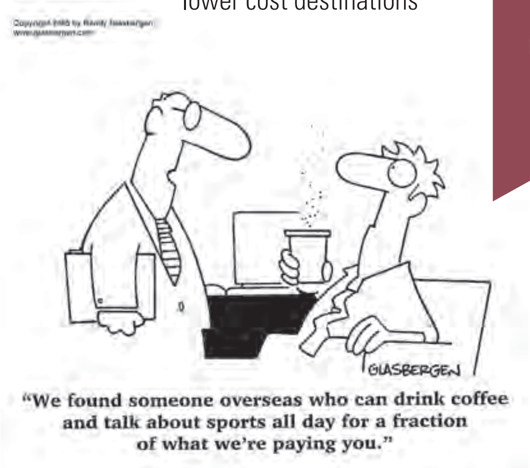
Figure 1.10 Outsourcing is an important driver for the growth of the service sector.

Source
Jochen Wirtz and Michael Ehret, "Service-Based Business Models: Transforming Businesses, Industries and Economies," in Raymond P. Fisk, Rebekah Russell-Bennett, and Lloyd C. Harris, eds. *Serving Customers: Global Services Marketing Perspectives* (Tilde University Press, Melbourne, Australia), 28–46.

Figure 1.12 shows different business models that can develop in the outsourcing and offshoring of services[13]. The first scenario (**Arrow 1**) describes a firm's decision to outsource services domestically. **Arrow 2** describes a situation where a firm switches from a domestic supplier to a foreign supplier. In some cases, firms make the decision to outsource and to offshore to a foreign supplier simultaneously (**Arrow 3**). The fourth scenario is when firms source from foreign locations by establishing a subsidiary abroad (**Arrow 4**). This is often referred to as "captive offshoring." Finally, combining outsourcing and offshoring implies shifting the service provision from a foreign affiliate to a foreign-owned supplier (**Arrow 5**).

A study by the international consulting firm McKinsey & Company estimated that 11% of service jobs around the world could be carried out remotely. In practice, however, McKinsey predicted that the percentage of service jobs that could actually be "offshored" will prove to be much more limited — only 1% of the total service employment in developed countries[14]. Of course, loss of even that small percentage can affect a large number of workers, including some well-paid professionals whose work can be performed much more cost-effectively by, say, highly qualified engineers working in India, the Philippines, or Belarus[15].

Figure 1.11 Many services today can be outsourced to lower cost destinations



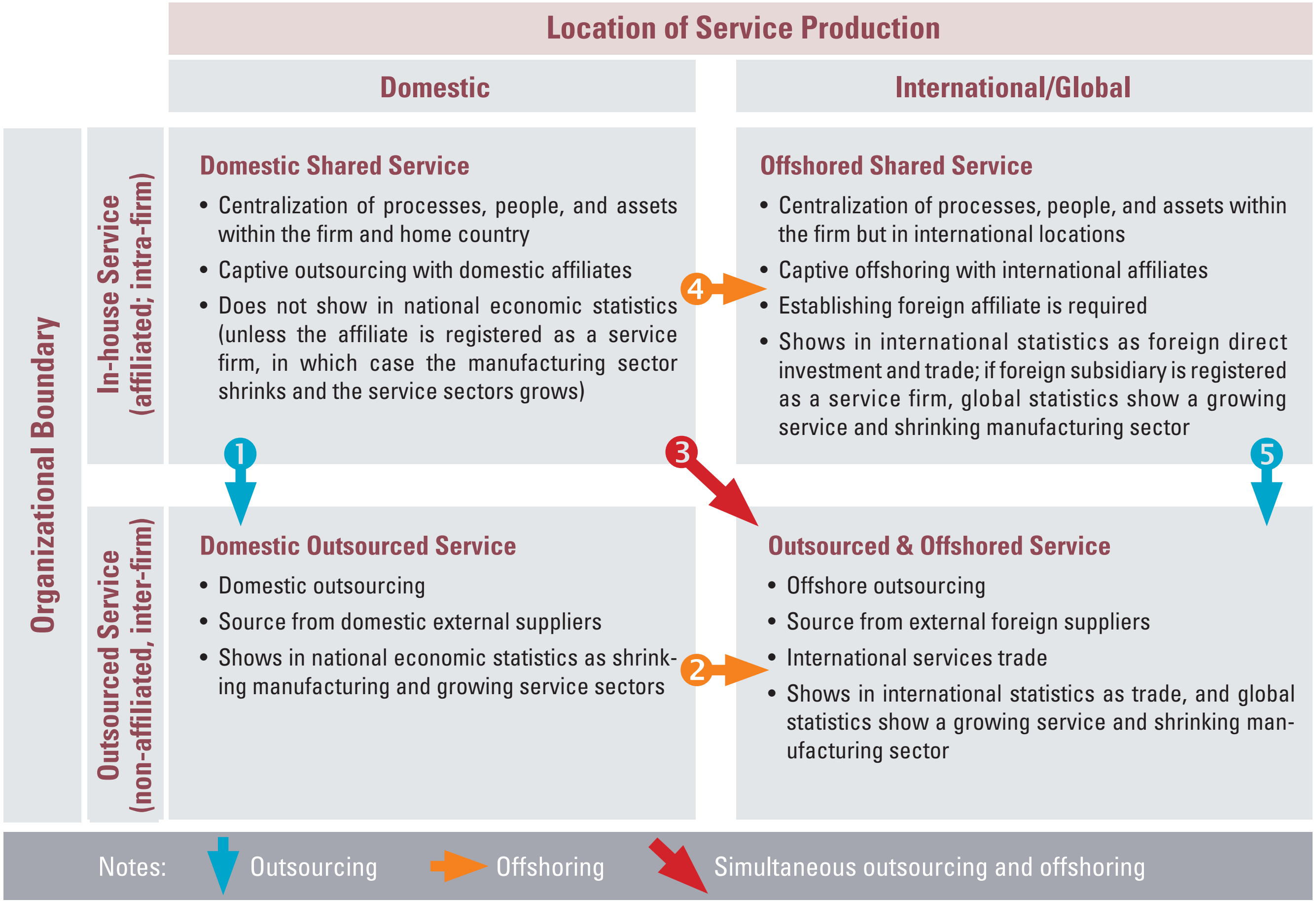


Figure 1.12 Outsourcing and offshoring are independent, but often work in tandem.

Source

Jochen Wirtz, Sven Tuzovic, and Michael Ehret (2015), "Global Business Services: Increasing Specialization and Integration of the World Economy as Drivers of Economic Growth," *Journal of Service Management*, Vol. 26, No.4, pp. 565--587.

WHAT ARE SERVICES?

Thus far, our discussion of services has focused on different types of service industries and their development. But now it's time to ask the question: What exactly is a service?

The Historical View

Attempts to describe and define services go back more than two centuries. In the late eighteenth and early nineteenth centuries, classical economists focused on the creation and possession of wealth. They contended that goods (initially referred to as "commodities") were objects of value over which ownership rights could be established and exchanged. Ownership implied tangible possession of an object that had been acquired through purchase, barter, or gift from the producer or a previous owner, and was legally identifiable as the property of the current owner.

Adam Smith's famous book *The Wealth of Nations,* published in Great Britain in 1776, distinguished between the outputs of what he termed "productive" and "unproductive" labor[16]. The former, he stated, produced goods that could be stored after production and subsequently exchanged for money or other items of value. Unproductive labor, however "honorable, useful, or necessary," created services that **perished** at the time of production and therefore didn't contribute to wealth. Building on this theme, the French economist Jean-Baptiste Say argued that production and consumption were inseparable in services, coining the term "immaterial products" to describe them[17].

Today, we know that production and consumption are indeed *separable* for many services (think of dry cleaning, lawn mowing, and weather forecasting)[18] and that not all service performances are perishable (consider video recordings of concert performances and sports events). Very significantly, many services are designed to create **durable value** for their recipients (your own education being a case in point). But the distinction between ownership and **non-ownership**, which we will discuss in the next section, remains a valid one, emphasized by several leading service marketing scholars[19].

LO 6

Define services using the non-ownership service framework.

BENEFITS WITHOUT OWNERSHIP

Services cover a huge variety of different and often very complex activities, making them difficult to define[20]. The word **service** was originally associated with the work that servants did for their masters. In time, a broader association emerged, captured in the dictionary definition of "the action of serving, helping, or benefiting; conduct tending to the welfare or advantage of another"[21]. Early marketing definitions of services contrasted them against goods and described services as "acts, deeds, performances, or efforts" and argued that they had different characteristics from goods — defined as "articles, devices, materials, objects, or things"[22]. But we believe that services need to be defined in their own right, not in relation to goods. A short and snappy definition, like the oft-repeated "something which can be bought and sold but which cannot be dropped on your foot"[23] is amusing and memorable, but may not be particularly helpful as a guide to marketing strategy. Today, our thinking has advanced and focuses on the lack of transfer of ownership when buying a service.

Consider this: you didn't acquire ownership of the hotel room where you stayed last weekend, you didn't have ownership over the physical therapist who worked on your injured knee, and you didn't receive ownership of the concert you just attended. None of these purchases resulted in actual ownership. If you didn't receive a transfer of ownership the last time you purchased a service, then what did you buy?

Christopher Lovelock and Evert Gummesson argue that services involve a form of **rental** through which customers can obtain benefits[24]. What customers value and are willing to pay for are desired experiences and solutions. We use the term **rent** as a general term to describe payment made for use of something or access to skills and expertise, facilities or networks (usually for a defined period of time), instead of buying it outright (which may not even be possible in many instances).

We can identify five broad categories within the non-ownership framework that focus on (1) use of labor, skills, and expertise, (2–4) various degrees of use of goods and facilities (exclusive, defined, or shared), and (5) access and use of networks and systems:

1. **Labor, skills, and expertise rentals.** Here, other people are hired to perform work that customers either cannot or choose not to do themselves. Some of these include:
    - Car repair
    - Medical check-up
    - Management consulting

2. **Rented goods services**. These services allow customers to obtain the exclusive temporary right to use a physical object that they prefer not to own. Examples include:
    - Boats
    - Fancy dress costumes
    - Construction and excavation equipment

3. **Defined space and facility rentals**. This is when customers obtain the use of a certain portion of a larger facility such as a building, vehicle, or area. They usually share this facility with other customers. Examples of this kind of rental include:
    - A seat in an aircraft
    - A suite in an office building
    - A storage container in a warehouse

4. **Access to shared facilities.** Customers rent the right to share the use of the facility. The facilities may be a combination of indoors, outdoors, and virtual. Examples include:
   - Theme parks
   - Golf clubs
   - Toll roads *(Figure 1.13)*

5. **Access and use of networks and systems.** Customers rent the right to participate in a specified network. Service providers offer a variety of terms for access and use, depending on customer needs. Examples include:
   - Telecommunications
   - Utilities and banking
   - Social online networks and games (e.g., League of Legends)

The difference between ownership and non-ownership affects the nature of marketing tasks and strategy. For example, the criteria for a customer's choice of service differ when something is being rented instead of owned. For a rental car to be used on vacation in Hawaii, for example, customers may focus on the ease of making reservations, the rental location and hours, the attitudes and performance of service personnel, the cleanliness and maintenance of vehicles, etc. If the customers are looking to own a car, then they are more likely to consider price, brand image, ease of maintenance, running costs, design, color, upholstery, etc.

Figure 1.13 Customers rent the right to use toll roads

Defining Services

Based on the non-ownership perspective of services, we offer the following comprehensive definition of services:

DEFINITION OF SERVICES

Services are economic activities performed by one party to another. Often time-based, these performances bring about desired results to recipients, objects, or other assets.

In exchange for money, time, and effort, service customers expect value from access to labor, skills, expertise, goods, facilities, networks, and systems. However, they do not normally take ownership of the physical elements involved[25].

Note that we define services as **economic activities** between two parties, implying an exchange of value between the seller and buyer in the marketplace. We describe services as **performances** that are most commonly **time-based**. We emphasize that purchasers buy services because they are looking for **desired results**. In fact, many firms explicitly market their services as "solutions" to prospective customers' needs. And finally, our definition emphasizes that while customers *expect to obtain value* from their service purchases *in exchange for their money, time, and effort,* this value comes from *access to a variety of value-creating elements rather than transfer of ownership.* (Spare parts installed during repairs and restaurant-prepared food and beverages are among the few exceptions, but the value added by these items is usually less than that of the accompanying service elements).

Service Products versus Customer Service and After-Sales Service

With the growth of the service economy, and the emphasis on adding value-enhancing services to manufactured goods, the line between services and manufacturing increasingly becomes blurred. Many manufacturing firms — from carmakers Toyota, aerospace engine producers GE and Rolls-Royce to high-tech equipment manufacturers Samsung and Siemens — are moving aggressively into service businesses[26]. Quite a few firms have transitioned from simply bundling supplementary services with their physical products to reformulating and enhancing certain elements so that they can be marketed as standalone services (see the example of Gulfstream in *Figure 1.14*)[27]. Another success story is Rolls-Royce featured in *Service Insights 1.1*.

The principles and tools discussed in services marketing (e.g., how to price a service, manage capacity in a call center, improve service quality or manage service employees) are equally applicable to manufacturing firms that increase the service component of their offering. As Theodore Levitt long ago observed, "There are no such things as service industries. There are only industries whose service components are greater or less than those

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Figure 1.14 Gulfstream advertises its award-winning maintenance and support services of other industries. Everybody is in service[28]." More recently, Roland Rust and Ming-Hui Huang suggested that "the 'product versus services' conceptualization is out-of-date and that service is everywhere, not just in the service sector[29]." An even more radical view has been advanced by Stephen Vargo and Robert Lusch in their award-winning article on a new mindset, the **service-dominant (S-D) logic**. S-D logic suggests that all products are valued for the service they provide, and that the value derived from a physical good, for example, is not the good itself, but the service it provides during consumption (which they termed "**value-in-use**"[30]).

FOUR BROAD CATEGORIES OF SERVICES — A PROCESS PERSPECTIVE

LO 7
Identify the four broad "processing" categories of services.

Did you notice that the definition of services emphasizes not only value creation through rental and access, but also the desired results that can be brought about to recipients of the service, objects, and other assets? There are major differences among services depending on what is being processed. Services can "process" people, physical objects, and data, and the nature of the processing can be tangible or intangible. Tangible actions are performed on people's bodies or to their physical possessions. Intangible actions are performed on people's minds or to their intangible assets. This gives rise to the classification of services into four broad categories. They are **people-processing, possession-processing, mental stimulus processing,** and **information processing** (*Figure 1.15*)[31]. Although the industries within each category may appear at first sight to be very different, analysis will show that they do, in fact, share important process-related characteristics. As a result, managers from different industries within the same category may obtain useful insights by studying another to generate useful innovations for their own organization. Let's examine why these four different types of processes often have distinctive implications for marketing, operations, and human resource management.

	Name of the Service Act	
Name of the Service Act	**People**	**Possessions**
Tangible Actions	**People processing** (services directed at people's bodies): • Hairstylist • Passenger Transportation • Healthcare	**Possession processing** (services directed at physical possessions): • Freight Transportation • Laundry and Dry Cleaning • Repair and Maintenance
Intangible Actions	**Mental stimulus processing** (services directed at people's mind): • Education • Advertising/PR • Psychotherapy	**Information processing** (services directed at intangible assets): • Accounting • Banking • Legal Services

Figure 1.15 Four broad categories of services

Figure 1.16 A customer getting treated to a luxurious manicure

People Processing

From ancient times, people have sought out services directed at themselves, including transportation, food, lodging, health restoration, or beautification (*Figure 1.16*). To receive these types of services, customers must physically enter the service system. Why? Because they are an integral part of the process and cannot obtain the desired benefits by dealing at arm's length with service suppliers. In short, they must enter the **service factory**, a physical location where people or machines (or both) create and deliver service benefits to customers. Of course, service providers are sometimes willing to come to customers, bringing the necessary tools of their trade to create the desired benefits at the customers' preferred location. Implications of people processing services include:

- Service production and consumption are simultaneous, which means that the customers typically must be present in the physical location (service factory). This requires planning about the location of the service operation, careful design of service processes and the service environment, and demand and capacity management.
- Active cooperation of the customer is needed in the service delivery process. For example, for a manicure service, you would have to cooperate with the manicurist by specifying what you want, sitting still, and presenting each finger for treatment when requested.
- There is a need for managers to think carefully about the location of the service operation, the design of service processes and the service environment, demand and capacity management, and output from the customer's point of view. Apart from financial costs, non-financial costs such as time, mental and physical effort need to be taken into account.

Possession Processing

Often, customers ask a service organization to provide tangible treatment for some physical possession — a house that has been invaded by insects, a hedge that has grown too high, a malfunctioning elevator (*Figure 1.17*), a broken screen of a smartphone, a parcel that needs to be sent to another city, or a sick pet. The implications of such services are:

- Unlike for people-processing services, production and consumption are not necessarily simultaneous, giving more flexibility to the service firm in designing such services for cost-efficiency.
- Customers tend to be less involved in these services, compared to people-processing services. The involvement may be limited to just dropping off or collecting the item. In such instances, production and consumption can be described as **separable**. However, in some instances, the customer may prefer to be present during service delivery, perhaps wishing to supervise cutting of the hedge or comfort the family dog while it receives an injection at the veterinary clinic.

Figure 1.17 Elevator repair is a possession processing service

Mental Stimulus Processing

These services touch people's minds and have the power to shape attitudes and influence behavior. Mental stimulus processing services include education, news and information, professional advice, and some religious activities. Obtaining the full benefit of such services requires an investment of time and a degree of mental effort on the customer's part. However, recipients don't necessarily have to be physically present in a service factory — just mentally in communication with the information being presented. There's an interesting contrast here with people-processing services. Passengers can sleep through a flight and still arrive at their desired destination. But if you fall asleep during an online lecture, you won't be any wiser at the end than at the beginning!

Because the core content of services in this category is information-based (whether text, speech, music, visual images, or video), it can be digitized and made available via downloads, YouTube, and the like. For instance, the Boston Symphony Orchestra's concerts can be attended live, viewed or heard live, pre-recorded on TV, or sold as digital recordings (*Figure 1.18*). Services in this category can thus be "inventoried," for consumption at a later date than their production. In fact, the same performance can be consumed repeatedly. For some students, accessing a lecture online and perhaps viewing key parts repeatedly may be a better solution than taking a physical class. Key implications that arise from these kinds of services are as follows:

- Customers do not have to be physically present in the service factory. They only access the information remotely when they need it.
- Services in this category can be "inventoried" for consumption at a later date, or consumed repeatedly.

Figure 1.18 Orchestral concerts provide mental stimulation and pleasure

Information Processing

Information can be processed by information and communications technology (often referred to as ICT), and/or by professionals who use their brains to perform information processing and packaging. Information is the most intangible form of service output. However, it can be transformed into more permanent and tangible forms like letters, reports, books, or files in any type of format. Some services that are highly dependent on the effective collection and processing of information are financial and professional services such as accounting (*Figure 1.19*), law, marketing research, management consulting, and medical diagnosis.

It is sometimes difficult to tell the difference between information processing and mental stimulus processing services. For example, if a stockbroker performs an analysis of a client's brokerage transactions, it seems like information processing. However, when the results of the analysis are used to make a recommendation about the most suitable type of investment strategy for the future, it would seem like mental stimulus processing. Therefore, for simplicity, we will periodically combine our coverage of mental stimulus and information processing services under the umbrella term of **information-based services**.

Figure 1.19 A young couple getting financial advice on buying a new home looking at insurance.

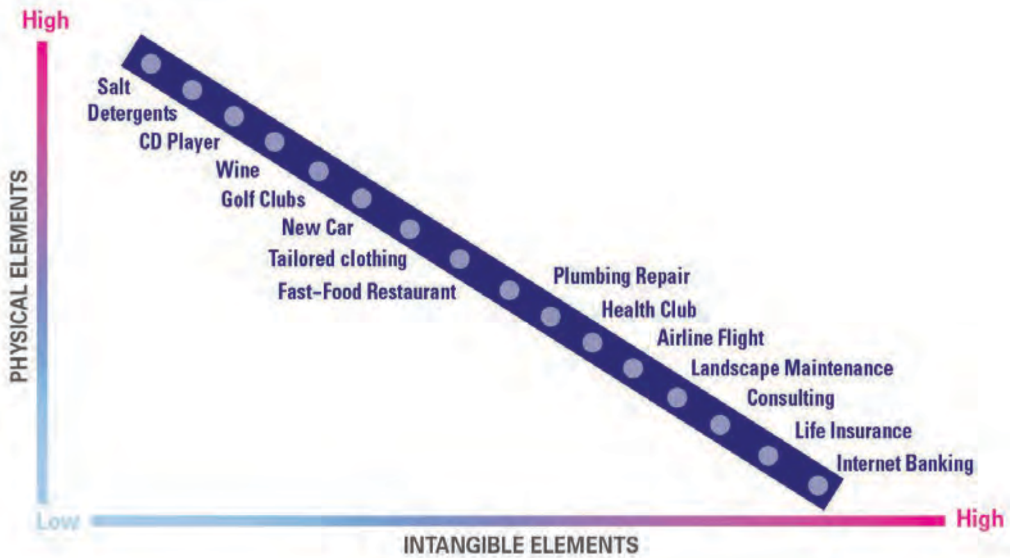
LO 8
Be familiar with the characteristics of services and the distinctive marketing challenges they pose.

SERVICES POSE DISTINCT MARKETING CHALLENGES

Can the marketing concepts and practices developed in manufacturing companies be directly transferred to service organizations where no transfer of ownership takes place? The answer is often "no." Services tend to have different features from goods, including the frequently cited four characteristics of ***i***ntangibility, ***h***eterogeneity (variability of quality), ***i***nseparability of production and consumption, and ***p***erishability of output[32], or **IHIP** for short[33]. *Table 1.1* explains these characteristics, and other common differences between services and goods. Together, these differences cause the marketing of services to differ from that of manufactured goods in several important respects.

Table 1.1 Managerial implications of eight common features of service

Differences	Implications	Marketing-related Topics
Most service products cannot be inventoried (i.e., output is perishable)	• Customers may be turned away or have to wait	• Smooth demand through promotions, dynamic pricing, and reservations • Work with operations to adjust capacity
Intangible elements usually dominate value creation (i.e., service is physically intangible)	• Customers cannot taste, smell, or touch these elements and may not be able to see or hear them • Harder to evaluate service and distinguish from competitors	• Make services tangible through emphasis on physical clues • Employ concrete metaphors and vivid images in advertising and branding
Services are often difficult to visualize and understand (i.e., service is mentally intangible)	• Customers perceive greater risk and uncertainty	• Educate customers to make good choices, explain what to look for, document performance, offer guarantees
Customers may be involved in co-production (i.e., if people processing is involved, the service is inseparable)	• Customers interact with providers' equipment, facilities, and systems • Poor task execution by customers may hurt productivity, spoil the service experience, and curtail benefits	• Educate customers to make good choices, explain what to look for, document performance, offer guarantees
People may be part of the service experience	• Appearance, attitude, and behavior of service personnel and other customers can shape the experience and affect satisfaction	• Recruit, train, and reward employees to reinforce the planned service concept • Target the right customers at right times; shape their behavior
Operational inputs and outputs tend to vary more widely (i.e., services are heterogeneous)	• Harder to maintain consistency, reliability, and service quality or to lower costs through higher productivity • Difficult to shield customers from results of service failures	• Set quality standards based on customer expectations; redesign product elements for simplicity and failure-proofing • Institute good service recovery procedures • Automate customer–provider interactions; perform work while customers are absent
The time factor often assumes great importance	• Customers see time as a scarce resource to be spent wisely, dislike wasting time waiting, want service at times that are convenient	• Find ways to compete on speed of delivery, minimize burden of waiting, offer extended service hours
Distribution may take place through non-physical channels	• Information-based services can be delivered through electronic channels such as the Internet or voice telecommunications, but core products involving physical activities or products cannot • Channel integration is a challenge; that is to ensure consistent delivery of service through diverse channels, including branches, call centers and websites.	• Seek to create user-friendly, secure websites and free access by telephone • Ensure that all information-based service elements are delivered effectively and reliably through all key channels



Source
Adapted from Lynn Shostack

Figure 1.20 Relative value added by physical versus intangible elements in goods and services

It is important to recognize that these differences, while useful generalizations, **do not apply equally to all services**. Intangibility for example, ranges from tangible-dominant to intangible-dominant (see *Figure 1.20* for a scale that presents a variety of examples)[34]. Large differences also exist between the four categories of services we discussed in the previous section. For example, people tend to be part of the service experience only if the customer has direct contact with service employees. This is usually the case for people-processing services but not for many information-processing service transactions such as online banking. You will recognize these differences as we discuss the marketing mix for services throughout this book.

THE 7 PS OF SERVICES MARKETING

When developing strategies to market manufactured goods, marketers usually address four basic strategic elements: ***p***roduct, ***p***rice, ***p***lace (or distribution), and ***p***romotion (or communication). As a group, these are usually referred to as the "4 Ps" of the marketing mix[35]. As is evident from *Table 1.1,* the nature of services poses distinct marketing challenges. Hence, the **4 Ps** of goods marketing are not adequate to deal with the issues arising from marketing services and have to be adapted and extended. We will therefore revisit the traditional **4 Ps** of the marketing mix in this book to focus on service-specific issues.

Furthermore, the traditional marketing mix does not cover the customer interface. We therefore need to extend the marketing mix by adding three Ps associated with service delivery — **process, physical environment,** and **people**[36]. Collectively, these seven elements are referred to as the "7 Ps" of services marketing. You can think of these elements as the seven strategic levers of services marketing used to develop strategies for meeting customer needs profitably in competitive marketplaces. Now, let's look briefly at each of the **7 Ps**.

THE TRADITIONAL MARKETING MIX APPLIED TO SERVICES

LO 9
Understand the components of the traditional marketing mix applied to services.

Product Elements

Service products lie at the heart of a firm's marketing strategy. If a product is poorly designed, it won't create meaningful value for customers, even if the rest of the **7 Ps** are well executed. Planning the marketing mix begins with creating a service product that will offer value to target customers and satisfy their needs better than competing alternatives. Service products consist of a core product that meets the customers' primary need and a variety of supplementary service elements that are mutually reinforcing, and add value to help customers to use the core product more effectively. Supplementary service elements include providing information, consultation, order taking, hospitality, handling exceptions, etc.

Place and Time

Service distribution may take place through physical or electronic channels (or both), depending on the nature of the service (*Table 1.1*). For example, today's banks offer customers a wide range of distribution channels, including visiting a bank branch, using a network of ATMs, doing business by telephone, online banking on a desktop, and using apps on a smartphone. In particular, many information-based services can be delivered almost instantaneously to any location in the world that has Internet access. Furthermore, firms may also deliver their services directly to end-users or through intermediary organizations such as retail outlets that receive a fee or commission to perform certain tasks associated with sales, service, and customer-contact. To deliver service elements to customers, companies need to decide where and when these services are delivered, as well as the methods and channels used[37].

Distribution of Core versus Supplementary Services. The Internet is reshaping distribution strategy for numerous industries. However, we need to distinguish between its potential for delivering information-based **core products** (those that respond to customers' primary requirements) and simply providing **supplementary services** that facilitate purchase and use of physical goods. Examples of information-based core products include online educational programs offered by the Khan Academy and Coursera, and automobile insurance coverage from Progressive Casualty Co.

In contrast, if you buy an outdoor gear or book a flight online, the delivery of the core product itself must still take place through physical channels. The tent and sleeping bag that you bought from REI (Recreational Equipment Inc.) will be delivered to your home. And you'll have to go to the airport in person to board your United Airlines flight. Much e-commerce activity concerns supplementary services that are based on **transfer of information, making reservations and payments,** as opposed to downloading the core product itself.

Importance of the Time Factor. Speed and convenience of place and time have become important determinants of effective distribution and delivery of services (*Table 1.1*). Many services are delivered in real time while customers are physically present. Today's customers are highly time-sensitive, mostly in a hurry, and see wasted time as a cost to avoid[38]. You probably do, too. They may be willing to pay extra to save time, such as taking a taxi when a city bus serves the same route (*Figure 1.21*), or to get a needed task performed faster. Increasingly, busy customers expect service to be available when it suits them, rather than when it suits the supplier. If one firm responds by offering extended hours, its competitors often feel obliged to follow suit. Nowadays, a growing number of services are available 24/7, and via more delivery channels.

Figure 1.21 Taking a taxi can save time for busy commuters

Price and Other User Outlays

Like product value, payment is very important in allowing a value exchange to take place. For firms, the pricing strategy affects how much income is generated. Pricing strategy is often highly dynamic, with price levels adjusted over time according to factors like customer segment, time and place of delivery, level of demand, and available capacity.

For customers, price is a key part of the costs they must incur to obtain desired benefits. To calculate whether a particular service is "worth it," they may go beyond just money and assess how much time and effort are involved (*Figure 1.22*). Service marketers, therefore, must not set only prices that target customers are willing and able to pay, but also understand — and seek to minimize, where possible — other burdensome outlays that customers incur in using the service. These outlays may include additional monetary costs (such as travel expenses to a service location), time spent, unwanted mental and physical effort, and exposure to negative sensory experiences.

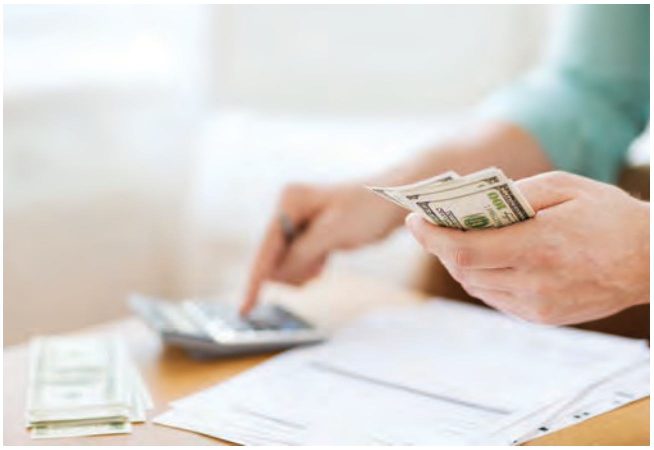


Figure 1.22 Money is not the only consideration when measuring the cost of a service

Most Service Products Cannot be Inventoried. Since services involve actions or performances, they are temporary and perishable. Therefore, they usually cannot be stocked as inventory for future use (*Table 1.1*). Although facilities, equipment, and labor can be held in readiness to create the service, each represents productive capacity, not the product itself. If there is no demand, unused capacity is wasted and the firm loses the chance to create value from these assets. During periods when demand exceeds capacity, customers may be turned away or asked to wait until later. A key task for service marketers, therefore, is to find ways of smoothing demand levels to match available capacity using dynamic pricing strategies.

Promotion and Education

What should we tell customers and prospects about our services? Few marketing programs can succeed without effective communications. This component plays three vital roles: providing needed information and advice, persuading target customers to buy the service product, and encouraging them to take action at specific times. In services marketing, much communication is educational in nature, especially for new customers. Suppliers need to teach their customers about the benefits of the service, where and when to obtain it, and how to participate in service processes to get the best results.

Services are Often Difficult to Visualize and Understand as Intangible Elements Tend to Dominate Value Creation. Intangibility can consist of both mental and physical dimensions. Mental intangibility means that it is difficult for customers to visualize the experience in advance of purchase and to understand the value and benefits they will be getting, while physical intangibility is that which cannot be touched or experienced by the other senses[39]. It is often the intangible elements — such as processes, Internet-based transactions, and the expertise and attitudes of service personnel — that create the most value in service performances. When customers can't taste, smell, or touch these elements and may not be able to see or hear these elements (i.e., they are physically intangible), it may be more difficult for them to assess important service features in advance of purchase and evaluate the quality of the service performance itself (Table 1.1).

Therefore, an important role of a service firm's communications is to create confidence in the firm's experience, credentials, and expertise of its employees. For example, firms can use physical images and metaphors to promote service benefits and demonstrate the firm's competencies (*Figure 1.23*). In personal interactions, the role of well-trained service employees in communications is crucial in reducing the perceived risk of purchase by helping prospective customers to make good choices, by educating them on what to expect both during and after service delivery, and by helping them to move smoothly through the service process. Documenting performance, explaining what was done and why, and offering guarantees are additional ways to reassure customers and reduce anxiety. Service firms have much to gain from helping customers to appreciate the service offering, become more competent and productive[40]. After all, if you know how to use a service well, you'll not only have a better service experience and outcome, but your greater efficiency may boost the firm's productivity, lower its costs, and even enable it to reduce the price you pay.

Customer–Customer Interactions Affect the Service Experience. When you encounter other customers at a service facility, they too can affect your satisfaction. How they're dressed, who they are, and how they behave can reinforce or negate the image a firm is trying to project and the experience it is trying to create. The implications are clear: we need to use marketing communications to attract the right customer segments to the service facility, and once there, also to educate them on the proper behavior.

Figure 1.23 A customer is co-producing the service when working out at the gym under the direction of a personal trainer

LO 10

Describe the components of the extended marketing mix for managing the customer interface.

THE EXTENDED SERVICES MARKETING MIX FOR MANAGING THE CUSTOMER INTERFACE

Process

Smart managers know that where services are concerned, **how** a firm does things is as important as **what** it does. Therefore, creating and delivering product elements requires design and implementation of effective processes. Badly designed service processes lead to slow, bureaucratic, and ineffective service delivery, wasted time, and a disappointing experience for customers. Poor service process design also makes it difficult for frontline employees to do their jobs well, resulting in low productivity and employee dissatisfaction.

Operational Inputs and Outputs Can Vary Widely. Operational inputs and outputs tend to vary more widely for services, and can make customer service process management a challenge (*Table 1.1*). When a service is delivered face to face and consumed as it is produced, final "assembly" must take place in real time. However, operations are often distributed across thousands of sites or branches. When operations are distributed (rather than centralized in a factory), it is difficult for service organizations to ensure reliable delivery, control quality, and improve productivity. As a former packaged goods marketer once observed after moving to a new position at Holiday Inn:

> *We can't control the quality of our product as well as a Procter and Gamble control engineer on a production line can…When you buy a box of Tide, you can reasonably be 99 and 44/100 percent sure that it will work to get your clothes clean. When you reserve a Holiday Inn room, you're sure at some lesser percentage that it will work to give you a good night's sleep without any hassle, or people banging on the walls and all the bad things that can happen in a hotel*[41].

Nevertheless, the best service firms have made significant progress in reducing variability by carefully designing customer service processes, adopting standardized procedures and equipment, implementing rigorous management of service quality, training employees more carefully, and automating tasks previously performed by humans.

Customers Are Often Involved in Co-production. Some services require customers to participate actively in co-producing the service product (*Table 1.1*). For example, you're expected to help the investment banker understand what your needs are, how much you want to invest financially, the kind of risks you are willing to take, and the expected returns. This will enable the banker to advise you on what to invest in. In fact, service scholars argue that customers often function as **partial employees**[42]. Increasingly, your involvement takes the form of self-service, often using SSTs facilitated by smart machines, telecommunications, and the Internet[43]. Whether customers co-produce or use SSTs, well-designed customer service processes are needed to facilitate service delivery.

Demand and Capacity Need to be Balanced. Manufacturing can ensure a smooth process flow by having an inventory of materials and parts ready for use. For services, such buffering means having customers wait in the service process! Therefore, areas closely related to service process management involve the balancing of demand and capacity, design of waiting and queuing systems, and management of the impact of waiting on the customer's psychology.

Physical Environment

If your job is in a service business that requires customers to enter the service factory, you'll also have to spend time thinking about the design of the physical environment or servicescape[44]. The appearance of buildings, landscaping, vehicles, interior furnishings, equipment, staff members' uniforms, signs, printed materials, and other visible cues provide tangible evidence of a firm's service quality. The servicescape also facilitates service delivery, and guides customers through the service process. Service firms need to manage servicescapes carefully, since they can have a profound impact on customer satisfaction[45] and service productivity.

People

Despite advances in technology, many services will always need direct interaction between customers and service employees (*Table 1.1*). You must have noticed many times how the difference between one service supplier and another lies in the attitude and skills of their employees. Service firms need to work closely with their human resources (HR) departments and devote special care in selecting, training, and motivating their service employees (*Figure 1.24*). In addition to possessing the technical skills required by the job, these individuals also need good interpersonal skills and a positive attitude. HR managers who think strategically recognize that having loyal, skilled, motivated employees who can work well independently or together in teams represent a key competitive advantage.

Figure 1.24 Hospitality is shown through employees wearing a ready smile and being ready to serve customers

LO 11
Appreciate that the marketing, operations, and human resource management functions need to be closely integrated in service businesses.

MARKETING MUST BE INTEGRATED WITH OTHER MANAGEMENT FUNCTIONS

In the previous section, we described the **7 Ps** as the strategic levers of services marketing. As you think about these different elements, it should quickly become clear that marketers working in a service business cannot expect to operate successfully in isolation from managers in other functions. In fact, four management functions play central and interrelated roles in meeting the needs of service customers: marketing, operations, HR, and IT. *Figure 1.25* illustrates this interdependency. One of the top management's responsibilities is to ensure that managers and other employees in each of these functions don't operate in departmental silos.

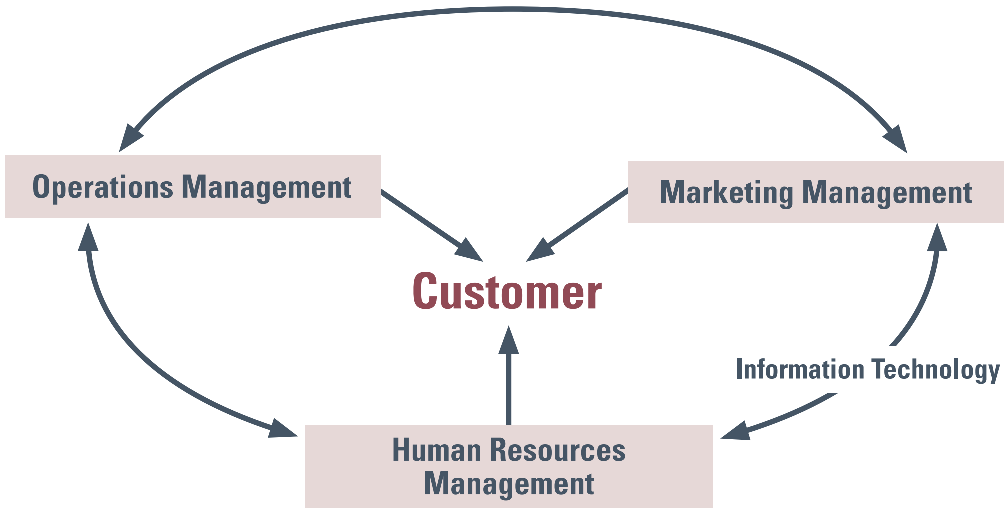


Figure 1.25 Marketing, Operations, Human Resources, and IT departments must collaborate to serve the customer

Operations is the primary line function in a service business, responsible for managing service delivery through equipment, facilities, systems, and many tasks performed by customer-contact employees. In most service organizations, you can also expect to see operations managers actively involved in product and process design, many aspects of the physical environment, and implementation of productivity and quality improvement programs.

HR is often seen as a staff function, responsible for job definition, recruitment, training, reward systems, and quality of work life — all of which are, of course, central to the people element. But in a well-managed service business, HR managers view these activities from a strategic perspective. They understand that the quality and commitment of the front line have become a major source of competitive advantage. Service organizations cannot afford to have HR specialists who do not understand customers. When employees understand and support the goals of their organization, have the skills and training needed to succeed in their jobs, and recognize the importance of creating and maintaining customer satisfaction, both marketing and operations activities are easier to manage and are more likely to be successful.

IT is a key function as service processes are information-heavy — at almost every customer touch point, real-time information is needed (from customer data to prices and available capacity). Operations, HR, and marketing are critically dependent on IT to manage their functions and create value for the organization's customers.

For these reasons, we don't limit our coverage exclusively to marketing in this book. In many of the chapters you'll also find us referring to service operations, human resource management, and IT. Some firms deliberately rotate their managers among different job functions, especially between marketing and operations positions, precisely so that they will be able to appreciate different perspectives. Your own career in services might follow a similar path.

Imagine yourself as the manager of a small hotel. Or, if you like, think big and picture yourself as the chief executive officer (CEO) of a major bank. In both instances, you need to be concerned about satisfying your customers on a daily basis, about operational systems running smoothly and efficiently, and about making sure that your employees are not only working productively, but are also delivering good service. In short, integration of activities between these functions is the name of the game in services. Problems in any one of these areas can negatively affect the execution of tasks in other functions and might result in dissatisfied customers. Only a minority of people who work in a service firm are employed in formal marketing positions. However, Evert Gummesson argues that all those whose work affects the customer in some way — either through direct contact or the design of processes, IT systems, and policies that shape customers' experiences — need to think of themselves as **part-time marketers**[46].

THE SERVICE–PROFIT CHAIN

LO 12
Understand the implications of the Service–Profit Chain for service management.

A conceptual framework that shows how marketing, operations, HR, and IT are integrated in high-performance service organizations is the Service–Profit Chain. James Heskett and his colleagues at Harvard argue that when service companies put employees and customers first, there is a big change in the way they manage and measure success. They relate profitability, customer loyalty, and customer satisfaction to the value created by satisfied, loyal, and productive employees, and supported by customer- and employee-centric operations and technology:

> *Top-level executives of outstanding service organizations spend little time setting profit goals or focusing on market share… Instead they understand that in the new economics of service, frontline workers and customers need to be the center of management concern. Successful service managers pay attention to the factors that drive profitability… investment in people, technology that supports frontline workers, revamped recruiting and training practices, and compensation linked to performance for employees at every level.*

The service–profit chain, developed from analyses of successful service organizations, puts "hard" values on "soft" measures. It helps managers target new investments to develop service and satisfaction levels for maximum competitive impact, widening the gap between service leaders and their merely good competitors[47].

The Service–Profit Chain (*Figure 1.26*), shows the links in a managerial process that are proposed to lead to success in service businesses.

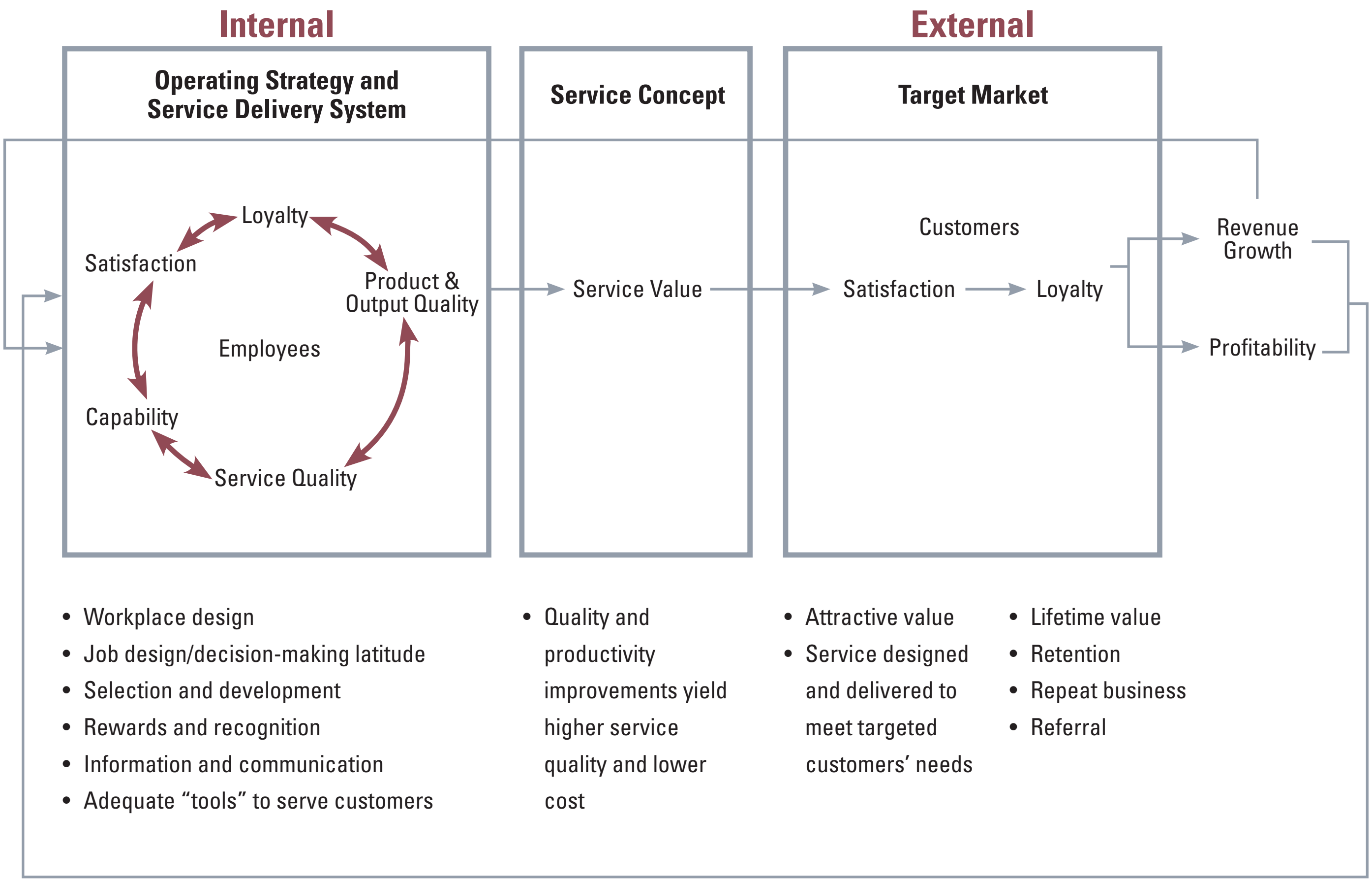


Figure 1.26 The Service–Profit Chain

Source

Reprinted by permission of Harvard Business Review: Heskett, JL., Jones, T.O., Loveman, G.W., Sasser Jr., W.E., and Schlesinger, L.A. (March–April 1994), "Putting the Service–Profit Chain to Work," *Harvard Business Review*, p.166. Copyright © 1994 by the Harvard Business School Publishing Corporation; all rights reserved.

Table 1.2 provides a useful summary, highlighting the behaviors required of service leaders in order to manage their organizations effectively. Working backwards, from the desired end results of revenue growth and profitability, links 1 and 2 focus on customers. The links include an emphasis on identifying and understanding customer needs, making investments to ensure customer retention, and having a commitment to adopt new performance measures that track such variables as satisfaction and loyalty among both customers and employees. Link 3 focuses on the value for customers created by the service concept and highlights the need for investments to continually improve both service quality and productivity.

Another set of service leadership behaviors (links 4–7) relate to employees and include organizational focus on the front line. The design of jobs should offer greater freedom for employees. Managers with potential should be developed. This category also stressed the idea that paying higher wages can actually decrease labor costs because of reduced turnover, higher productivity, and higher quality. Underlying the chain's success (link 8) is top management leadership. The Service–Profit Chain is an important guiding philosophy for this book, with core chapters explaining how to successfully implement the Service–Profit Chain.

Table 1.2 Links in the Service–Profit Chain

1. Customer loyalty drives profitability and growth
2. Customer satisfaction drives customer loyalty
3. Value drives customer satisfaction
4. Quality and productivity drive value
5. Employee loyalty drives service quality and productivity
6. Employee satisfaction drives employee loyalty
7. Internal quality as delivered by operations and IT drives employee satisfaction
8. Top management leadership underlies the chain's success.

Source

Heskett, JL., Jones, T.O., Loveman, G.W., Sasser Jr., W.E., and Schlesinger, L.A., (March-April 1994), "Putting the Service–Profit Chain to Work," *Harvard Business Review*; James L. Heskett, W. Earl Sasser, and Leonard L. Schlesinger, *The Service Profit Chain* (Boston: Harvard Business School Press, 1997).

LO 13
Know the framework for developing effective service marketing strategies.

A FRAMEWORK FOR DEVELOPING EFFECTIVE SERVICE MARKETING STRATEGIES

The **7 Ps** and the Service–Profit Chain are integrated into the wider organizing framework of this book. It shows how each of the chapters fits together with the others as they address related topics and issues. *Figure 1.27* presents the organizing framework for this book, which is divided into five parts: (1) understanding service products, consumers, and markets; (2) applying the **4 Ps** of marketing to services; (3) designing and managing the customer interface (i.e., the additional **3 Ps** of services marketing); (4) developing customer relationships; and (5) striving for service excellence. Note that the arrows link the different boxes in the model: They stress the interdependences between the different parts. Decisions made in one area must be consistent with those taken in another, so that each strategic element will mutually reinforce the rest.

PART 1

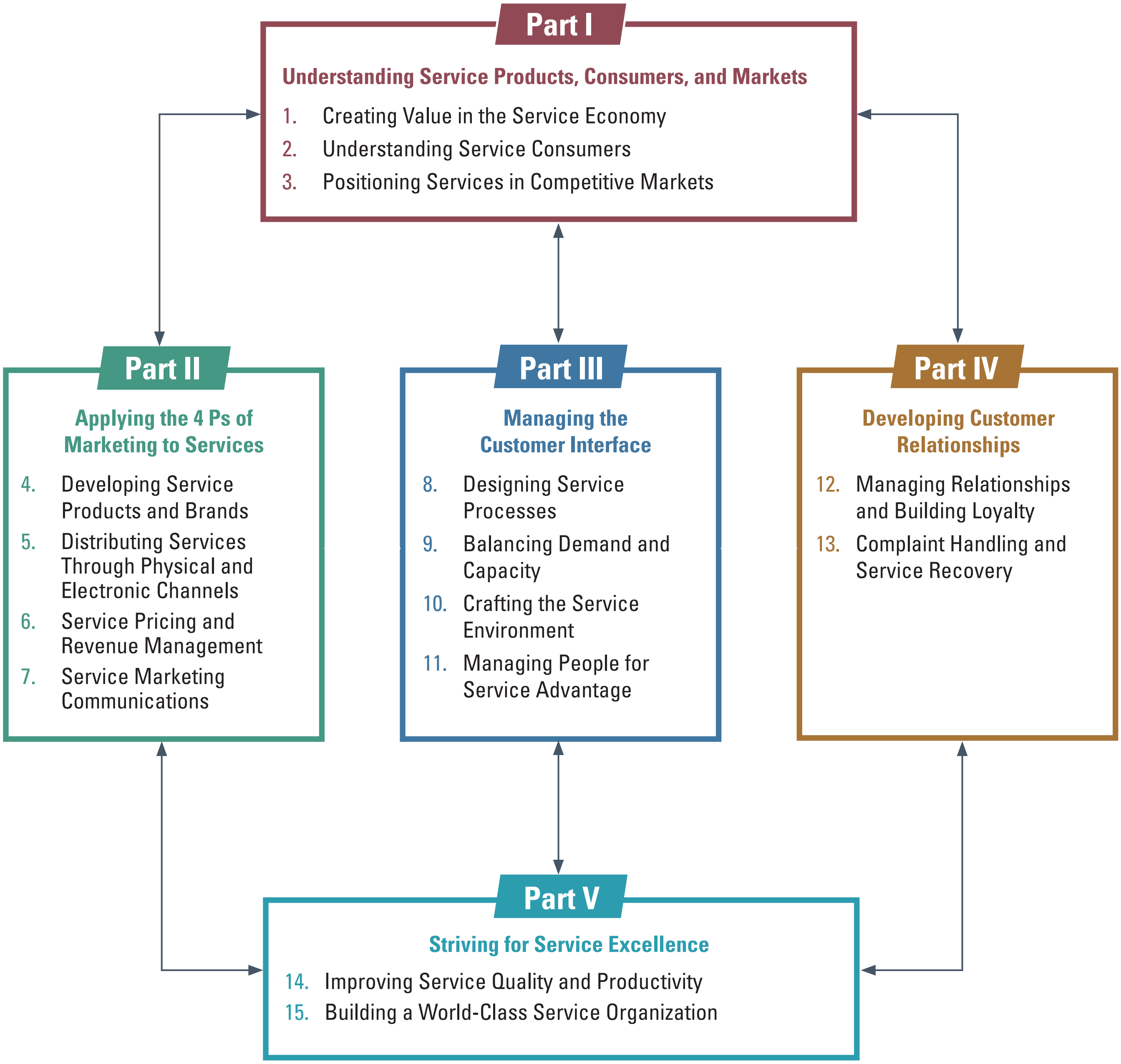


Figure 1.27 Integrated model of Services Marketing

The key contents of the five parts of this book are:

Part I

Understanding Service Products, Consumers, and Markets

Part I of the book lays the building blocks for studying services and learning how to become an effective services marketer.

- **Chapter 1:** defines **services** and shows how we can create value without transfer of ownership.
- **Chapter 2:** discusses **consumer behavior** in both high- and low-contact services. The three-stage model of service consumption is used to explore how customers search for and evaluate alternative services, make purchase decisions, experience and respond to service encounters, and evaluate service performance.
- **Chapter 3:** discusses how a service **value proposition should be positioned** in a way that creates competitive advantage for the firm. The chapter shows how firms can segment a service market, position their value proposition, and focus on attracting their target segment.

Part II

Applying the 4Ps of Marketing to Services

Part II revisits the 4 Ps of the traditional marketing mix taught in your basic marketing course. However, the 4 Ps are expanded to take into account the characteristics of services that are different from goods.

- Chapter 4: **product** includes both the core and supplementary service elements. The supplementary elements facilitate and enhance the core service offering.
- Chapter 5: **place** and **time** elements refer to the delivery of the product elements to the customers.
- Chapter 6: **prices** of services need to be set with reference to costs, competition and value, and revenue management considerations.
- Chapter 7: **promotion** and **education** explains how firms should inform customers about their services. In services marketing, much communication is educational in nature to teach customers how to effectively move through service processes.

Part III

Managing the Customer Interface

Part III of the book focuses on managing the interface between customers and the service firm. It covers the additional 3 Ps that are unique to services marketing.

- Chapter 8: **processes** create and deliver the product elements. The chapter begins with the design of effective delivery processes, specifying how the operating and delivery systems link together to deliver the value proposition. Very often, customers are involved in these processes as co-producers, and well-designed processes need to account for that.

- Chapter 9: this chapter also relates to **process management** and focuses on balancing demand and capacity for each step of a customer service process. Marketing strategies for managing demand involve smoothing demand fluctuations, inventorying demand through reservation systems, and formalized queuing. Managing customer waiting is also explored in this chapter.
- Chapter 10: **physical environment**, also known as the *servicescape*, needs to be engineered to create the right impression and facilitate effective service process delivery. The *servicescape* provides tangible evidence of a firm's image and service quality.
- Chapter 11: **people** play a key role in services marketing when direct interaction between customers and service personnel is part of the service. The nature of these interactions strongly influences how customers perceive service quality. Hence, service firms devote a significant amount of effort to recruit, train, and motivate employees. How to get all this right is explained using the Service Talent Cycle as an integrative framework.

Part IV

Developing Customer Relationships

Part IV focuses on how to develop customer relationships and build loyalty.

- Chapter 12: achieving profitability requires creating **relationships with customers** from the right segments and then finding ways to build and reinforce their loyalty. This chapter introduces the Wheel of Loyalty, which shows three systematic steps in building customer loyalty. The chapter closes with a discussion of customer relationship management (CRM) systems.
- Chapter 13: a loyal customer base is often built from effective **complaint handling** and **service recovery**, which are discussed in this chapter. Service guarantees are explored as a powerful way of institutionalizing service recovery and as an effective marketing tool to signal high-quality service.

Part V

Striving for Service Excellence

Part V focuses on how to develop and transform a firm to achieve service excellence.

- Chapter 14: **productivity** and **quality** are both necessary and are strongly related to financial success in services. This chapter focuses on service quality, diagnosing quality shortfalls using the Gaps model, and strategies to close quality gaps. Customer feedback systems are discussed as an effective tool for systematically listening to and learning from customers. Productivity is introduced as closely related to quality, and it is emphasized that in today's competitive markets, firms need to simultaneously improve both quality and productivity — not one at the expense of the other.
- Chapter 15: this final chapter discusses how we can move a service organization to **higher levels of performance** in each functional area.

CONCLUSION

Why study services? Because modern economies are driven by individual service businesses operating within a remarkable array of industries. Collectively, services are responsible for the creation of a substantial majority of all new jobs, both skilled and unskilled, around the world. Many of these industries are undergoing dramatic transformations, driven by advances in technology, globalization, changes in government policies, evolving consumer needs, and lifestyles (*Figure 1.28*). In such an environment, effective marketing plays a vital role in determining whether an individual organization survives and thrives — or declines and fails.

In this chapter, we've demonstrated that services require a distinctive approach to marketing, because the context and the tasks often differ in important aspects from those in the manufacturing sector. Succeeding as a marketing manager in a service business requires you not only to understand key marketing concepts and tools, but also know how to use them effectively. Each of the **7 Ps** — the strategic levers of services marketing — has a role to play, but it's how well you tie them together that will make the difference. As you study this book, attend classes, and undertake projects, remember that the winners in today's highly competitive service markets succeed by continually rethinking the way they do business, by looking for innovative ways to serve their customers better, by taking advantage of new developments in technology, and by embracing a disciplined and well-organized approach to developing and implementing services marketing strategy.

Figure 1.28 Advances in technology are changing the ways in which the service industry works

CHAPTER SUMMARY

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

LO 2 The principal industries of the service sector include (in order of contribution to GDP):

- Government services
- Real estate services
- Business and professional services
- Wholesale and retail trade
- Transport, utilities, and communications services
- Finance and insurance
- Healthcare services
- Accommodation and food services
- Arts, entertainment, and recreation services

LO 3 Many forces are transforming our economies, making them more *services-oriented*. They include government policies, social changes, business trends, advances in IT, and globalization.

LO 4 Business services allow manufacturing firms and other service organizations to outsource non-core activities, processes, and assets. What used to be a neglected support activity in a client organization has become the management focus and core competency of an independent service provider. The benefits include:

- Economies of scale and scope, an operation that is way down the learning curve that therefore operates at high quality and productivity levels.
- Tight cost and quality control (performance can be benchmarked across many sites).
- Process improvements and R&D are applied to these services as the benefits can be reaped across multiple sites.
- The rapid growth of business services leads to an increasing specialization of advanced economies with significant gains in overall productivity and standards of living.
- Intangible elements usually dominate value creation (i.e., physically intangible).
- Distribution may take place through nonphysical channels (especially for information processing-type services).
- Services often are difficult to visualize and understand (i.e., mentally intangible).
- Operational inputs and outputs tend to vary widely (i.e., heterogeneous).
- People may be part of the service experience.
- Customers may be involved in co-production (i.e., if people processing is involved, the service is inseparable).
- Most service products cannot be inventoried (i.e., perishable).
- Time factor often assumes great importance.

LO 5 Outsourcing refers to the contracting of services that were previously conducted internally in an organization to an external service provider. Offshoring refers to services that are conducted in one country and consumed in another. Outsourcing and offshoring are independent (e.g., firms can outsource without offshoring to a domestic service provider; or offshore without outsourcing to a foreign subsidiary), but often work in tandem (e.g., a U.S.-based firm outsources a customer contact center to a service provider in the Philippines).

LO 6 What exactly is a service? The key distinguishing feature of a service is that it is a form of rental rather than ownership. Service customers obtain the rights to hire the labor, skills and expertise of personnel, use a physical object or space, or access shared facilities, networks, and systems. Services are performances that bring about the desired results or experience for the customer.

LO 7 Services vary widely and can be categorized according to the nature of the underlying process: Is the service directed at customers or their possessions? Are service actions tangible or intangible in nature? These distinctions have important marketing implications and lead to four broad categories of services:

- People processing
- Possession processing
- Mental stimulus processing
- Information processing

Mental stimulus and information processing can be combined into what is called information-based services.

LO 8 Services have unique characteristics that make them different from goods, including the frequently cited four characteristics of ***i***ntangibility, ***h***eterogeneity (variability of quality), ***i***nseparability of production and consumption, and ***p***erishability of output, or ***IHIP*** for short. These characteristics lead to the following marketing and management challenges:

- Intangible elements usually dominate value creation (i.e., physically intangible).
- Distribution may take place through nonphysical channels (especially for information processing-type services).
- Services often are difficult to visualize and understand (i.e., mentally intangible).
- Operational inputs and outputs tend to vary widely (i.e., heterogeneous).
- People may be part of the service experience
- Customers may be involved in co-production (i.e., if people processing is involved, the service is inseparable).
- Most service products cannot be inventoried (i.e., are perishable).
- Time factor often assumes great importance.

LO 9 Due to the unique characteristics of services, the traditional marketing mix of the **4 Ps** needs to be amended. Some important amendments include:

- Product elements include more than just the core elements.
- They also include supplementary service elements such as the provision of consultation, hospitality, or handling of exceptions.
- Place and time elements refer to the delivery of the product elements to the customer; many information-processing elements are delivered electronically.
- Pricing includes non-monetary costs to the consumer and revenue management considerations.
- Promotion is also viewed as a form of communication and education that guide customers through service processes, rather than focusing mainly on advertising and promotion.

LO 10 Services marketing requires three additional Ps that cover management of the customer interface:

- Process refers to the design and management of customer service processes, including managing demand and capacity and related customer waits.
- Physical environment, also known as the servicescape, facilitates process delivery, and provides tangible evidence of a firm's image and service quality.
- People covers the recruiting, training, and motivating of service employees to deliver service quality and productivity.

LO 11 To be successful, the marketing, operations, human resource, and IT management functions need to be tightly integrated and work closely together in well-coordinated ways.

- Integration means that the key deliverables and objectives of the various functions are not only compatible but also mutually reinforcing.

LO 12 The Service–Profit Chain shows how successful service firms integrate key management functions and deliver high performance in several related areas:

- Customer relationships must be managed effectively and there must be strategies to build and sustain loyalty.
- Value must be created and delivered to the target customers in ways that lead them to see the firm's offering as superior to competing offerings.
- Service quality and productivity must be continuously improved through better processes, systems and tools, and IT.
- Service employees must be enabled and motivated.
- Top management's leadership needs to drive and support all the components of the Service–Profit Chain.

LO 13 A framework for services marketing strategy forms the underlying structure of this book. The framework consists of the following five interlinked parts:

- Part I begins with the need for service firms to understand their markets, customers, and competition.
- Part II shows us how to apply the traditional **4 Ps** to services marketing.
- Part III covers the 3 Ps of the extended services marketing mix and shows how to manage the customer interface.
- Part IV illustrates how to develop lasting customer relationships through a variety of tools ranging from the Wheel of Loyalty and CRM to effective complaint management and service guarantees.
- Part V discusses how to improve service quality and productivity. This part closes with a discussion on how change management and leadership can propel a firm to become a service leader.

Review Questions

1. What are the main reasons for the growing share of the service sector in all major economies of the world?
2. What are the five powerful forces transforming the service landscape, and what impact do they have on the service economy?
3. Is it possible for an economy to be almost entirely based on services? Is it a sign of weakness when a national economy manufactures few of the goods that it consumes?
4. Why would growth in business services help individual firms and entire economies become more productive?
5. "A service is rented rather than owned." Explain what this statement means, and use examples to support your explanation.
6. Describe the four broad "processing" categories of services, and provide examples for each.
7. What is so special about services marketing that it needs a special approach?
8. "The **4 Ps** are all a marketing manager needs to create a marketing strategy for a service business." Prepare a response that argues against this, and support it with examples.
9. What types of services do you think are (a) most affected and (b) least affected by the problem of variable inputs and outputs? Why?
10. Why do the marketing, operations, HR management, and IT functions need to be closely coordinated in service organizations?
11. What are the implications of the Service–Profit Chain for service management?
12. What are the key elements in the framework for developing effective service marketing strategies?

Application Exercises

1. Visit the websites of the following national statistical bureaus: U.S. Bureau of Economic Analysis (www.bea.gov); Eurostat (http://ec.europa.eu/eurostat/web/national-accounts/data/database); and the respective websites for your country if they are not covered here. In each instance, obtain data on the latest trends in services as (a) a percentage of the GDP; (b) the percentage of employment accounted for by services; (c) breakdowns of these two statistics by type of industry; and (d) service exports and imports. Looking at these trends, what are your conclusions for the main sectors of these economies, and within services, for specific service sectors?
2. Legal and accounting firms now advertise their services in many countries. Search for a few advertisements and review the following: What do these firms do to cope with the intangibility of their services? What could they do better? How do they deal with consumer quality and risk perceptions, and how could they improve this aspect of their marketing?
3. Review IBM's annual report, *www.ibm.com/annualreport*, recent quarterly reports, *www.ibm.com/investor*, and other information on its website describing its different businesses. What conclusions do you draw about future opportunities in different markets? What do you see as competitive threats?
4. Give examples of how Internet and telecommunications technologies (e.g., mobile commerce (M-Commerce) and apps) have changed some of the services you use.
5. Choose a service company you are familiar with, and show how each of the **7 Ps** of services marketing applies to one of its service products.
6. Explain how concepts in Chapter 1 are relevant to the marketing of a religious institution, or a nonprofit organization such as World Wildlife Fund.

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CHAPTER 11

Managing People for Service Advantage

Quintessentially we are a people-based company. You couldn't find another consumer brand as dependent on human behavior.

Howard Schultz
CEO of Starbucks

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

Jim Collins
Consultant, teacher, and author of best-selling book "Good to Great"

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 I. Heskett, W. Earl Sasser, Jr., and Leonard L. Schlesinger
Current and former professors at Harvard Business School

LEARNING OBJECTIVES (LOs)

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

- **LO 1** Explain why service employees are so important to the success of a firm.
- **LO 2** Understand the factors that make the work of frontline staff so demanding and often difficult.
- **LO 3** Describe the cycles of failure, mediocrity, and success in HR for service firms.
- **LO 4** Understand the key elements of the Service Talent Cycle of successful HR management in service firms.

Fortunately, his training had prepared him to deal with all types of customers.

- **LO 5** Know how to attract, select, and hire the right people for service jobs.
- **LO 6** Explain the key areas in which service employees need training.
- **LO 7** Understand the role of internal marketing and communications.
- **LO 8** Understand why empowerment is so important in many frontline jobs.
- **LO 9** Explain how to build high-performance service delivery teams.
- **LO 10** Know how to integrate teams across departments and functional areas.
- **LO 11** Know how to motivate and energize service employees so that they will deliver service excellence and productivity.
- **LO 12** Understand what a service-oriented culture is.
- **LO 13** Know the difference between service climate and culture, and describe the determinants of a climate for service.
- **LO 14** Explain the qualities of effective leaders in service organizations.
- **LO 15** Understand different leadership styles, the importance of role modeling and focusing the entire organization on the frontline.

OPENING VIGNETTE

Cora Griffith — The Outstanding Waitress[1]

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 that she believes is the right one 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. I want them to feel they're welcome, that they can get comfortable, and 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? Or do they have a special diet or like their selection cooked in a certain way?"
3. **Anticipate Customers' Wants.** She refills beverages and brings extra bread and butter in a timely manner. One regular customer, for example, who likes honey with her coffee, gets it without having to ask. "I don't want my customers to have to ask for anything, so I always try to anticipate what they might need."
4. **Simple Things Make the Difference.** She 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. 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 glass of water, 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 it 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 positive 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." 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 conventioneers 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, and 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 towards 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."

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 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."

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

SERVICE EMPLOYEES ARE EXTREMELY IMPORTANT

The quality of a service firm's staff — especially those working in customer-facing positions — plays a crucial role in determining market success and financial performance. Frontline employees are a key input for delivering service excellence and competitive advantage. The market and financial results of managing people effectively for service advantage can be phenomenal. That's why the ***People*** element of the **7 Ps** is so important.

Among the most demanding jobs in service businesses are the frontline jobs. Employees working in these customer-facing jobs span the boundary between inside and outside of the organization. They are expected to be fast and efficient in executing operational tasks, as well as to be courteous and helpful when dealing with customers.

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 its top management. Good HR strategies allied with strong management leadership at all levels often lead to a sustainable competitive advantage. It is probably harder for competitors to duplicate high-performance human assets compared to any other corporate resource.

Highly capable and motivated people are at the center of service excellence and productivity. Cora Griffith in our opening vignette is a powerful demonstration of a frontline employee delivering service excellence and productivity, and at the same time having high job satisfaction. Many of the pointers in Cora Griffith's "nine rules of success" are the result of good HR strategies for service firms. After reading this chapter, you will know how to get HR right in service firms, and how to get satisfied, loyal, motivated, and productive service employees. The organizing framework for this chapter is provided in *Figure 11.1*.

Frontline Employees Are Important

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

HR in Service Firms Is Challenging

Frontline Work Is Difficult & Stressful

- Boundary spanning positions
- Link the inside of the organization to the outside world
- Have conflicting roles that cause role stress:
  - Organization/client conflict
  - Person/role conflict
  - Inter-client conflict
- Require emotional labor

Basic Models of HR in Service Firms

- Cycle of Failure
  - Low pay, low investment in people, high staff turnover
  - Result in customer dissatisfaction, defection, and low margins
- Cycle of Mediocrity
  - Large bureaucracies; offer job security but little scope in the job itself
  - No incentives to serve customers well
- Cycle of Success
  - Heavy investment in recruitment, development, and motivation of frontline employees
  - Employees are engaged and productive
  - Customers are satisfied and loyal, margins are improvedpleasure (or displeasure)

How to Get HR Right — The Service Talent Cycle

Hire the Right People

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

Enable the Frontline

Training & Development

- Conduct extensive training on:
  - Organizational culture, purpose, & strategy
  - Interpersonal and technical skills
  - Product/service knowledge
- Reinforce training to shape behaviors
- Use internal communications/marketing to shape the service culture and behaviors
- Professionalize the frontline

Empower the Frontline

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

Organize Frontline Employees into Effective Service Delivery Teams

- Use cross-functional teams that can service customers from end-to-end
- Structure teams for success (e.g., set goals, carefully select members with the right skills)
- Integrate teams across departments and functional area (e.g., cross-postings, and internal campaigns such as "walk a mile in my shoes" and "a day in the field")

Motivate the Frontline

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

Service Culture, Climate, & Leadership

Service Culture

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

Climate for Service

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

Leadership

- Qualities of effective leaders
- Leadership styles that focus on basics versus transformation
- Strong focus on frontline

Figure 11.1 Organizing framework — managing people for service advantage

PART 6

Case Studies

Additional Case Studies Available for Download

The following case studies are available for free download and class distribution on the Instructor's Resource Website for courses that adopt *Services Marketing: People, Technology, Strategy* (Eighth Edition).

CASE 17

LUX*: Staging a Service Revolution in a Resort Chain

Jochen Wirtz and Ron Kaufman

ABSTRACT

LUX* was a successful hospitality group operating in the Indian Ocean as well as other locations. In its previous incarnation, the company suffered from poor financial performance, poor service quality and a weak brand. A change in the leadership of the company led the group through a transformation, which showed positive results within 12 months. This case study describes a service revolution that lead to rapid improvements in service culture and guest experience, which in turn lead to sustained financial improvements on a quarter-on-quarter basis.

INTRODUCTION

With its headquarters in Mauritius, the LUX* hospitality group operated a portfolio of eight resorts and a private island in the Indian Ocean (*Exhibit 1*). The brand promised guests a celebration of life through its new value proposition — luxury resort hospitality that is Lighter.Brighter.

What is the Lighter.Brighter hospitality? Established luxury hotels have come to be associated with stiff upper-lipped service and stuffy opulence. Lighter hospitality meant breaking away from these to offer a more effervescent experience without compromising on its upscale sensibilities. At the same time, LUX* wanted to brighten up guest experiences. For example, instead of having high prices for items from the mini-bar, LUX* wanted to encourage guests to enjoy themselves and just take from it what they fancy. To encourage this, LUX* lowered the prices of items in the mini-bar significantly. By being smarter in the way LUX* operated, both guests and business benefited.

Although LUX* was launched only four years ago, the group's resorts had been doing exceptionally well. Within a short span of time, LUX* successfully transformed its service culture. The group had seen 16 consecutive quarter-on-quarter improvements in its financial performance. The group's resorts also enjoyed a higher occupancy rate than the industry average in the destinations they operated in (measured quarterly by the Market Penetration Index, which compares the hotel's occupancy against its competitive set). The group's financial performance was mirrored by winning multiple accolades for service excellence, including "Indian Ocean Leading Hotel" for LUX* Maldives from World Travel Awards, "Best Resort Hotel Mauritius" for LUX* Belle Mare from International Hospitality Awards, and "Reunion Island's Leading Hotel" for LUX* Ile de la Réunion from World Travel Awards.

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Jochen Wirtz is Professor of Marketing at the National University of Singapore. Ron Kaufman is founder and chairman of UP! Your Service Pte. Ltd.

The support and feedback of the management of LUX* is gratefully acknowledged, including Paul Jones, CEO; Julian Hagger, Chief Sales & Marketing Officer & Executive Director; Marie-Laure-Ah-You, Chief Strategy Officer; Nicolas Autrey, Chief Human Resources Officer; Nitesh Pandey, General Manager and Group Chief Innovation Officer; and Smita Modak, Group Training Manager; and Piers Schmidt, Founder of Luxury Branding. The authors also thank Arthur Lee who provided excellent assistance with the data collection, analysis and the writing of this case study.

All dollar amounts referred to in the text are in US Dollars unless otherwise indicated. The exchange rate used for all currency conversions is MUR100 to USD2.845.


LUX* Belle Mare's Pool


LUX* Belle Mare's Beach


LUX* Belle Mare's Villa


LUX* Le Morne


LUX* Le Morne's Beach

Note: LUX owns eight seaside resorts by the Indian Ocean. Each of them are fitted with an expansive infinity pool, stylish bars and ocean themed furnishings.*

Exhibit 1 Some of the LUX* resorts in the Indian Ocean

THE DARK AGES

However, things were not always this rosy. Before LUX* was launched in 2011, the group was known as Naiade Resorts and the company suffered from poor financial health. None of its hotels were on the list of top 10 hotels on TripAdvisor in their geographic competitive sets. To top it off, the Naiade brand lacked clarity. Its brand name was used for nine different properties, ranging from three to five stars, creating an unclear positioning in the minds of consumers. Problems in its positioning became apparent when the global financial crisis struck in 2008–2009. This led to a large drop in occupancy and room rates (*Exhibit 2*). The group's troubles culminated in 2011 with a criminal case involving the high-profile murder of an Irish hotel guest.

Having witnessed prolonged economic turmoil and a criminal case, the motivation and morale of hotel employees were unprecedentedly low. Financially, the impact of these troubles cumulated in a downward trajectory in the company's performance from 2008 to 2010 (*Exhibit 3*). The company reported a loss in 2010.

After hitting rock bottom, management had to move fast, and Naiade Resorts achieved a turnaround within a very short span of time. By mid-2011, Naiade Resorts saw an improvement in its service and this quickly translated into improved financial performance. Since then, the company had witnessed substantive and consistent service culture improvement and financial performance growth. How did the group manage this turnaround so quickly?

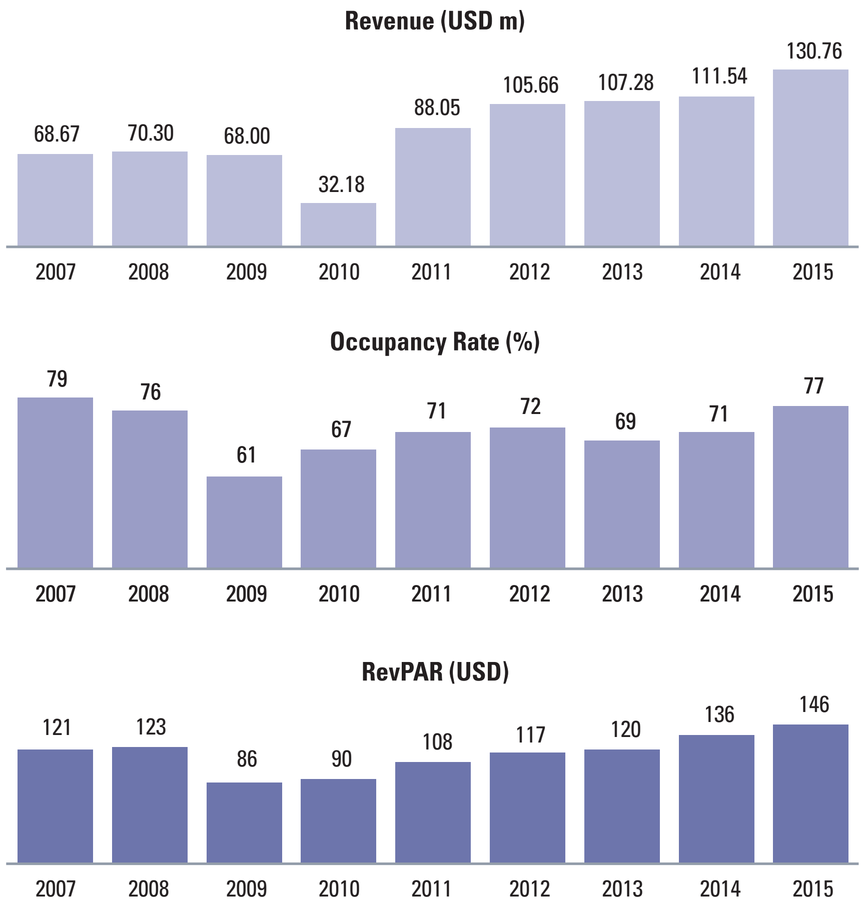
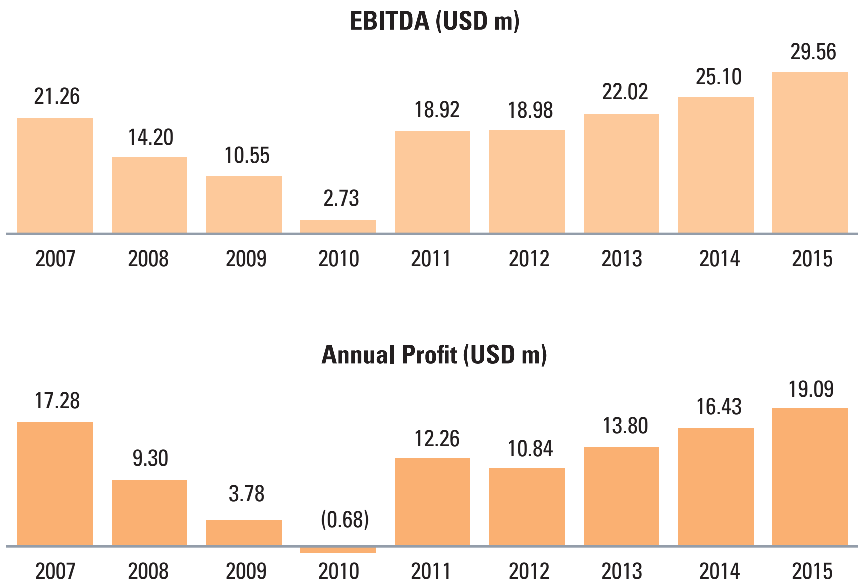


Exhibit 2 Revenue, Occupancy Rates and REVPAR



Note: Up till 2009, the financial year ended on 31 December. For 2010, all financial figures reported are for six months ending on 30 June 2010. From 2011 onwards, the financial year ended on 30 June.

Exhibit 3 Financial Performance of LUX*

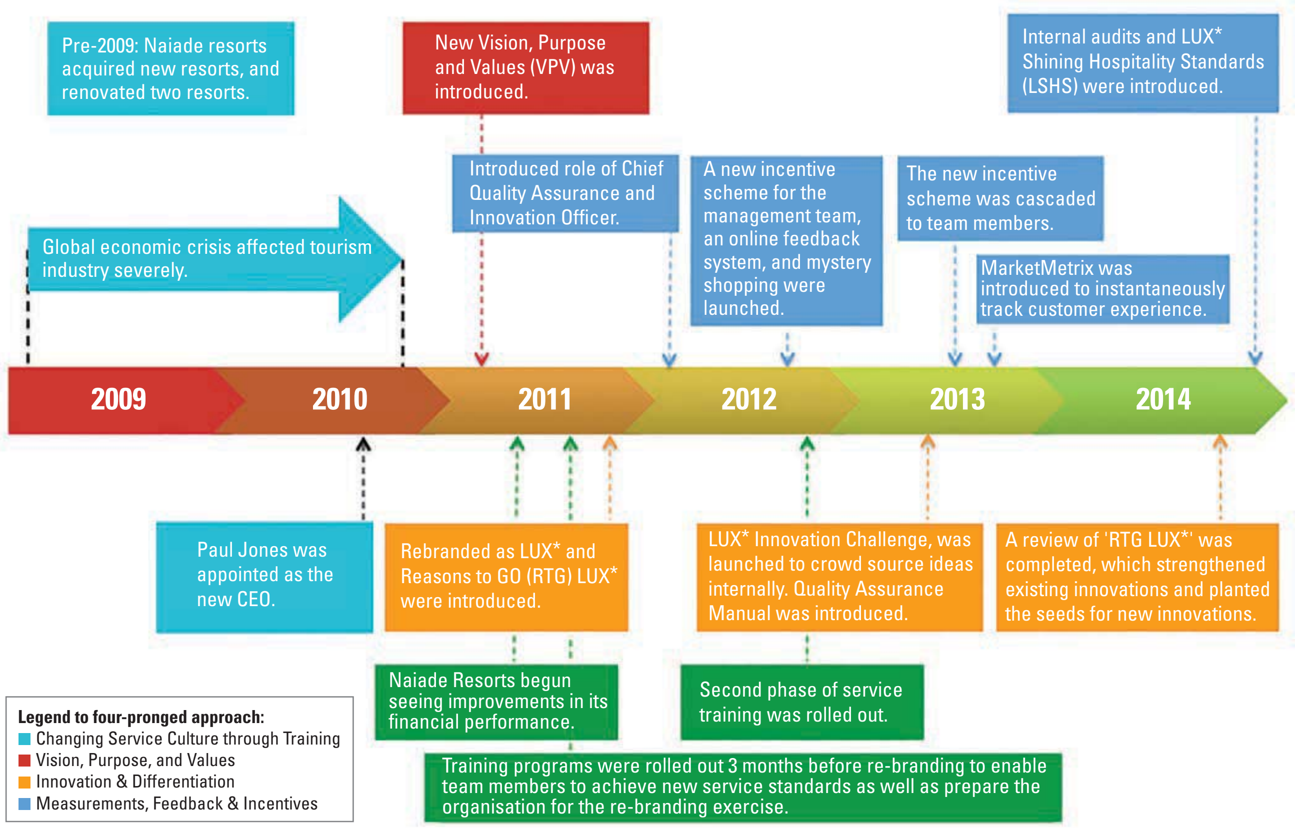
LUX* TRANSFORMATION

The very first step in Naiade's transformation can be traced back to the second half of 2010. In dire straits then, the board of directors of Naiade Resorts made changes to the company's leadership, and appointed Paul Jones as CEO in October 2010.

Under Jones's leadership, many changes were introduced to the organization within the first 12 months of his appointment. They were aimed at rapidly improving the profitability of the business and creating a world-class brand so that it could expand internationally. However, this marked a difficult transitional period for Naiade Resorts, which was in financial doldrums. Every month, Naiade Resorts struggled to pay salaries. Some employees even wondered if the changes would sink the company further.

Observing how dire the situation was, Jones commented, "The numbers pre-2010 were alarming and the company was sinking fast and would have been bankrupt had it not been for the capital injection from shareholders. In addition, the properties were in poor shape and staff morale was exceedingly low".

Together with his team, Jones focused transformation efforts on four main areas through an integrated and congruent strategy (*Exhibit 4*). First, he looked into the company's core strategy as well as company values. Naiade Resorts' business model was shifted from one of owning hotels to managing them, following an asset-light strategy. Amongst others, the new model would reduce the company's cash outlay, as owning hotels can be highly capital extensive. For example, buying a modest-sized resort in Mauritius is estimated to cost upwards of 15 million. The new business model would reduce the company's risk exposure and allow it to expand at a faster rate. This shift provided a critical impetus for the company to concentrate on improving its service delivery.



Note: LUX's service revolution can be encapsulated by a four-pronged approach. After a change of leadership, Jones and his team swiftly introduced important changes in multiple areas that proved to be critical in turning the company around. The company has since continued to build on this momentum to continually improve.*

Exhibit 4 LUX*'s Four-Pronged Approach

To decide how to go forward, Paul Jones flew in the general managers from its resorts and the group's senior management from all over the world. The managers and executives from various levels made important decisions on the company. These include the company's new Vision, Purpose, and Values (VPV), a new name for the business, and redefining service standards. Many of these changes were implemented almost immediately after being agreed upon. This allowed for a progressive rollout of the company's new strategy.

Second, to engage and reinvigorate its staff in the transformation, the top management decided it had to build the company's service culture from scratch. This included extensive training across all levels of the organization, an alignment of expectations of service standards, and a psychological and tangible breakaway from the old Naiade Resorts.

Third, Jones leveraged a fledgling spirit of innovation to build an organization that is bold and open to ideas; one that is open to experimentation and accepting of failure. This was aimed at enabling LUX* to differentiate its value proposition.

Lastly, as CEO, Jones also embedded various performance management tools to sustain transformation. These tools included the measurement of service, and employee incentive schemes to realign a transformed organization.

In the review of this four-pronged approach, the first major change was the introduction of the new VPV.

VISION, PURPOSE, AND VALUES

Before any transformation could occur, Jones needed a guiding compass that would provide a foundation for the new Naiade Resorts. A professional credo would expound the company's aspirations and provide a fundamental rallying zeitgeist for the staff. The Vision, "We Make Each Moment Matter" and the Purpose, "Helping People Celebrate Life" were crafted, and the Values of "People, Passion, Integrity, Leadership, and Creativity" were selected to tie in closely to how staff was expected to behave and interact with guests.

Between February and August 2011, every team member of Naiade was called upon to participate in the VPV foundation course. The course was rolled out over three phases. In the first phase, the CEO personally visited each hotel to share with team members about the new VPV. Hand in hand with the CEO's visits, the general managers of the resorts rolled out engagement workshops to all team members, ensuring that everyone understood the VPV as the foundation of the group's operations. Finally, in the third phase, all staff members were asked to pledge to abide by the ideology.

To support this rollout process, Naiade Resorts developed communication collaterals to support what the staff had heard from its leaders. For example, a visual mnemonic representing the new values in the form of an open hand, was created. Also, the ideology of the group was translated into French, Creole, and Mandarin, the mother tongues of the majority of the employees. Beyond these initiatives, team members were encouraged to incorporate VPV into their lives outside of their work, such as making each moment matter for the staff's family and loved ones.

Even after its initial launch, VPV continued to be emphasized on a day-to-day basis. In many companies, mission and values are rarely looked at. But at LUX*, they were lived out daily. Post-launch, team members from each resort shared actionable examples of how they lived the values, by listing down behaviors they should engage in as well as avoid. These items were selected based on observations of what is needed to drive the new culture and which behaviors have to stop (*Exhibit 5*). Another way in which this was operationalized was through Quote of The Day. Every day, a quote linked to one of LUX*'s values was sent to team members to inspire them (*Exhibit 6*). This initiative was so well received that team members had even asked why they did not receive the quote when there were some operational hiccups during the initial roll-out. This new VPV formed the foundation of the changes at LUX* that were to follow.

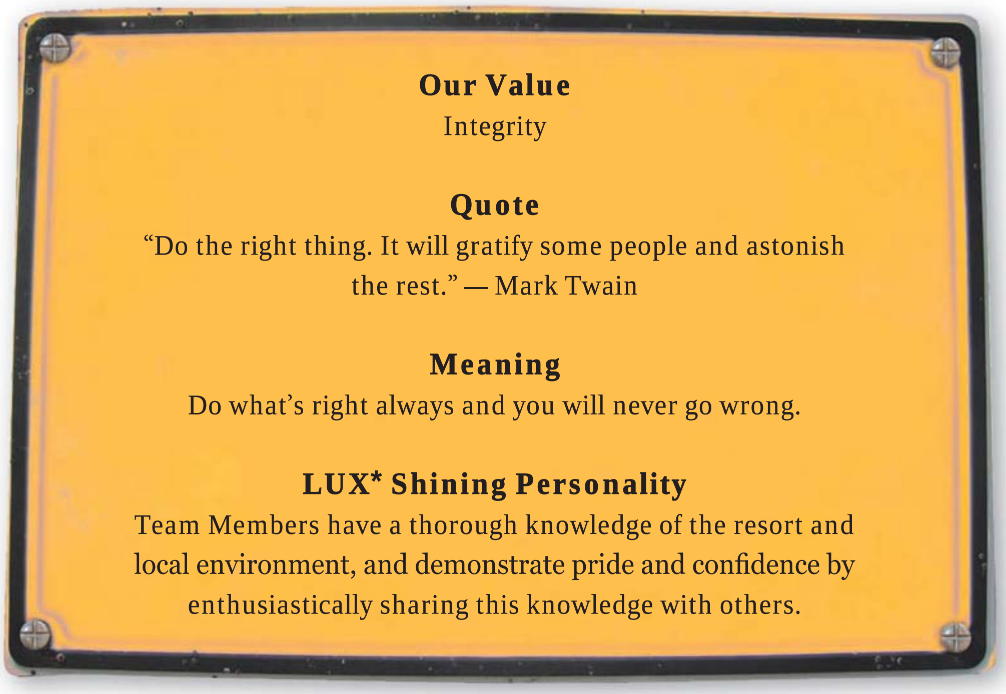
CHANGING THE SERVICE CULTURE THROUGH TRAINING

Guided by the VPV, a pervasive overhaul of Naiade Resorts' service culture was carried out in preparation for its rebranding. Extensive training was conducted across all levels of the company, efforts were made to internally align on service delivery expectations, a rebranding exercise also provided a much needed psychological and tangible fresh start for the employees, and initiatives were introduced to sustain the transformation.

Exhibit 5 Actionable examples from employees on how they live by LUX*'s Values

People		Passion		Integrity		Leadership		Creativity	
Should Do	Should Not Do	Should Do	Should Not Do	Should Do	Should Not Do	Should Do	Should Not Do	Should Do	Should Not Do
Always thank guests when they are leaving	Argue/bad attitude/ rude	Go beyond expectations	Allow laziness to take over	Report any wrongdoing	Participate in any wrongdoings, no matter how insignificant they are	Always taking action	Act irresponsibly	Apply your own final touch	Dismiss colleagues' ideas disrespectfully
Be available to replace sick co-worker	Challenge the guest	Try to meet every guest request	Act in a frustrated or angry manner	Always say the truth regardless of circumstances	Not taking responsibility for a mistake	Attentive and prompt to act	Blame others when things go wrong	Surprise guests	Enter into a routine
Always be polite, caring and attentive	Ignore colleagues because you are busy	Care for the guest	See problems instead of opportunities in situations	Reporting every item found	Be involved in dishonest acts	Lead by example, be a role model & coach the employees, colleagues, team members	Behave in an autocratic manner	Go the extra mile by thinking out of the box & try to be innovative	Merely copy and replicate others' ideas

Note: After the introduction of the new VPV, employees from each resort listed behaviors that they considered to epitomize LUX's values. A sampling of the examples provided is shown above, in no particular order of importance.*



Note: A 'Quote of the Day' is sent to employees every day to remind them of LUX's values as well as to motivate and inspire them.*

Exhibit 6 An Example of a Quote of the Day

Comprehensive training permeated throughout the company. Apart from the senior managers who met to deliberate on the desired service standards — benchmarking against different industries — LUX* partnered with an external service provider to design and deliver training on fundamental service principles. The first course delivered an actionable service education that enabled team members to deliver service valued by guests. As part of the course, employees were introduced to the building blocks of an uplifting service culture. By breaking down an abstract concept like culture into smaller and more tangible parts, it was easier for the organization to achieve its desired culture. Such a training helped LUX* look beyond standard procedures to interact with guests to find out what they truly value. In doing so, LUX* was eventually able to deliver a unique experience to its guests.

Adarsh Grewal, HR and Training Manager at LUX* Le Morne, was one of the many employees who benefitted from the training. Adarsh commented on the training:

> *When you break down everything you do daily and look at it from the eyes of your customer — internal or external; you begin to realize the value of every little step and the loopholes their absence might leave. Soon enough it becomes a habit to break down every service transaction and when it starts happening subconsciously, that is when we really start to 'Make Each Moment Matter'.*

Nagassen Valadoo, Villa Manager of LUX* Belle Mare, shared his reflections on the training, echoing the change in culture at LUX*:

> *As a team member who has gone through the course, I would say that it has been a very rich experience. I have learnt that "Taking Personal Responsibility" in everything that I undertake in my daily duties is of utmost importance. I have understood, we need to adapt our service according to each guest needs in order to offer them an Unbelievable experience of their stay. I have also learnt that the contribution of each of the team members in making "Each Moment Matter" for our guests is essential in making an experience memorable for them.*

The training kicked off with an initiation workshop held for all 2,800 employees across the group. To roll out the training, more than 30 team members underwent a workshop to become certified course leaders. Hailing from diverse backgrounds, the trainers developed entirely in-house a customized version of the generic course materials from an external provider. This created the perception of the training as an internal LUX* product, improving receptivity from team members.

To make the materials more relatable for team members, the examples used were from best practice organizations in the hospitality industry. For instance, case studies of companies such as Disney, The Ritz-Carlton, and Singapore Airlines were used to illustrate service excellence.

The way the training was structured also contributed to the success of re-building the company's service culture. The course was rolled out in two phases with a gap of four months between the end of the first phase and the start of the second (*Exhibit 7*). Structuring the course in such a manner facilitated buy-in from staff as they were able to try out what they learnt in the first phase and then tried it out in their day-to-day work to see the value of the training. An example of this is the Perceptions Points analysis, which taught employees to focus on delivering service by first understanding guests' point of views and what they value rather than be bound by internal procedures. This analytical tool was applied to what is now known as Reasons to Go (RTG) LUX*, explaining the importance of different touch points that contribute to overall guest experience for each reason. The usefulness of tools such as this set the stage for a successful roll out of the second phase of training.

A common service language is an example of one of the building blocks of an uplifting service culture that employees were trained on. During the training, employees were introduced to a "Levels of Service" framework, which maps out different levels of service that LUX* can render. This served to provide employees with a common frame of reference when communicating with each other about service standards. As a case in point, when GMs say, "Let's give that guest an "Unbelievable" experience", team members understand exactly what they need to do. Notably, LUX* also added a 7th level of service, titled "LUX* SHINING is beyond unbelievable" to the original framework (*Exhibit 8*). In doing so, LUX* clearly communicated to employees its vision for its service levels. Beyond communicating desired service standards, LUX* helped employees to connect VPV to service standards, explaining why they needed to deliver on certain service standards based on their company beliefs. This took the form of a pledge that elegantly weaved VPV with service standards (*Exhibit 9*).

PHASE 1

- Introduction to six different levels of service
- Understand why service must continually improve
- Identify actions to improve service

↓

- Learn to enhance service delivery by prioritizing customers' point of view and what they value.
- Analyze and improve service transactions in terms of critical touch points.

↓

- Pledge to 'Take Personal Responsibility' to set the stage for team members to fully contribute to re-branding efforts.

PHASE 2

- Introduction to LUX* Shining Level of Service

↓

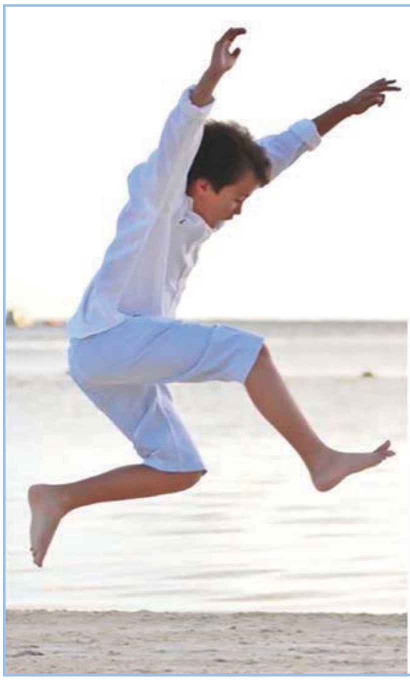
- Understand how guests derive value in four different areas: primary product, delivery system, service mindset, and on-going relationships.
- Understand that the overall service experience is not just delivering service to guests when they are on the resort, but also when they interact prior and after their stay.

↓

- Appreciate the use of appropriate communication styles in different contexts.

Note: To prepare the company for its new direction, employees underwent training in two different phases to learn more about building an uplifting service culture.

Exhibit 7 Training on Service Culture



OUR COMMON SERVICE LANGUAGE

The 7 Levels of Service at LUX*

LUX* SHINING is beyond Unbelievable

UNBELIEVABLE is WOW

SURPRISING is something special

DESIRED is what guests prefer

EXPECTED is just average

BASIC is the bare minimum

CRIMINAL is below the bare minimum

Note: LUX adapted the Levels of Service framework from its training partner, UP! Your Service College, and added a 7th Level of Service.*

Exhibit 8 The 7 Levels of Service

As I believe in ***'Consideration for People;'*** I will always avoid **CRIMINAL** levels of service to my Guests and Colleagues.

As I believe in ***'Serving with Passion;'*** I cannot be satisfied with just giving **BASIC** level of service.

As I have pledged to ***'Make Each Moment Matter'*** for my Guests and Colleagues towards achieving our purpose of **'Helping People Celebrate Life;'** I must go beyond delivering only the **EXPECTED** level of service.

I expect myself and my colleagues always to be ***Honest, Fair, Sincere and Authentic***. Together we will always ***'Insist on Integrity.'***

Our belief ***'Responsibility of Leadership;'*** will Inspire me to **Lead by Example** in always delivering **DESIRED** level of service to my guests and colleagues.

My Curiosity and Imagination will drive my ***'Creativity'*** to deliver; when the opportunity arises; **SURPRISING** and **UNBELIEVABLE** levels of service to my guests and colleagues.

To uphold our promise and become a winning brand; I aim to deliver **LUX* SHINING** level of service to all our guests. I want to convince them that they have made a perfect choice for their vacation.

Exhibit 9 Weaving VPV Into Levels of Service

Three months after the launch of the course, Naiade Resorts was re-branded as LUX* Resorts and Hotels. On the December 3 2011, LUX* opened its doors to journalists and invited the finest magazines from around the world to stay in its resorts. A whole week of events was organized in Mauritius to celebrate the occasion. The launch of LUX* generated a very positive response from its key partners and the media, which helped to generate word-of-mouth.

Over time, the training became more comprehensive and covered five core areas (*Exhibit 10*). Service training continued to be delivered to both new team members as well as veterans. New hires were introduced to the content of the course as part of LUX*'s orientation program. Almost 60–65% of the orientation's content was dedicated to service delivery, and preparing new team members to blend in seamlessly with experienced staff. For veterans, continual training on service culture helped to reinforce the learning. In follow-up sessions, participants shared how they had put the core learning to practice. Together, these revamped and intensified training and coaching programs helped to develop a strong learning culture and better-trained team members who contributed significantly to LUX*'s success.

Exhibit 10 LUX*'s Areas of Focus for Training

Area of Focus	Description
General Training	Ensured that team members were equipped to deal with operations and guest issues.
Service Culture	A large part of LUX*'s training efforts focused on building an uplifting service culture to deliver service that is truly world class.
Technical	Focused on training needed for staff to perform their jobs efficiently in different departments. A large part of the technical training was done in-house.
Leadership	Specific leadership development programs were targeted at different leadership levels in the company. Training was customized and delivered in partnership with training providers that had a strong focus in leadership.
Language	Language training was important to ensure that LUX* was able to customize their service experience to changing market mix — especially since the Chinese and Russian markets had seen fast growth in recent years.

INNOVATION AND DIFFERENTIATION

In order to deliver a truly Lighter.Brighter luxury resort experience, LUX* had to cultivate a service DNA that embraced the invariable experimentation failures along the way, and promote a culture that continually innovated and differentiated itself from the competition (see *Exhibit 11* on how employees embraced creativity).

During the development of LUX*, the management was bold and open to ideas. Paul Jones sought to instill in the LUX* DNA a spirit that is open to experimentation, continually innovating and accepting of failure. This

Exhibit 11 Employees exercise their own creativity in making guests feel special

meant that there were many ideas put to the test when the company re-branded, and even after the launch of LUX*. The company saw continual improvement of its service and performance as an imperative.

At the inception of LUX*, one idea that was experimented with is the use of theatre as an analogy to think about the hotel. Team members of the hotel were thought of as actors who performed while the general managers were producers who directed the show. LUX* intended to use this analogy to motivate staff to give more of themselves to guests. However, they soon realized that it was difficult to bring this idea to fruition. The analogy was confusing to guests, as well as team members.

On this matter, Sydney Pierre, Head of Worldwide Sales, shared:

> *The theatre analogy was a great concept and a game changer in terms of innovative operational approaches; however, the practicality of implementation was low and did not really make any difference to our tour operators.*

Echoing Sydney's thoughts was Caroline Gaud, Marketing Communication Manager, who said:

> *It was confusing for our partners and our guests; some of them expected to see a "show" playing at the resorts and were disappointed. The analogy was misunderstood and created too much confusion, therefore, we decided to get rid of it. Simplifying the brand concept was critical at this stage to raise awareness and attract guests.*

The team coined the term RTG LUX*, which stands for "reasons to go to LUX* and refers to the unique selling points of LUX* resorts. It bore testament to LUX*'s willingness to try and its innovative spirit. When creating LUX*, the leadership team had initially set a bold target of creating 50 RTG. This ambitious goal was met with difficulty, as there were many other initiatives that were concurrently being rolled out.

One RTG LUX* that was dropped was the Secret Bar, a pop-up bar. The bar was found in different parts of the resort at different times of the day and worked on an honor system – guests poured their own drinks and recorded what they consumed. Conceptually, the idea was brilliant but it was beset by operational challenges. One such challenge is that while serving themselves, spillage sometimes occurred, impacting the experience of subsequent guests. Although some properties were able to control the quality of the guest experience, it was difficult to achieve this across all properties. As a result, it had to be retired as a RTG LUX*. Nonetheless, it continues to be offered as a service in some properties that had managed to make it work.

Apart from quality, some RTG LUX* were withdrawn for reasons such as budget and logistics. Eventually, the list of RTG LUX* was organically narrowed down to 20. Some of these reasons became iconic and resonated very well with guests. One of the most documented RTG on social media and TripAdvisor was "Message In A Bottle".

XLuo, a TripAdvisor user, described his experience with Message In A Bottle as follows:

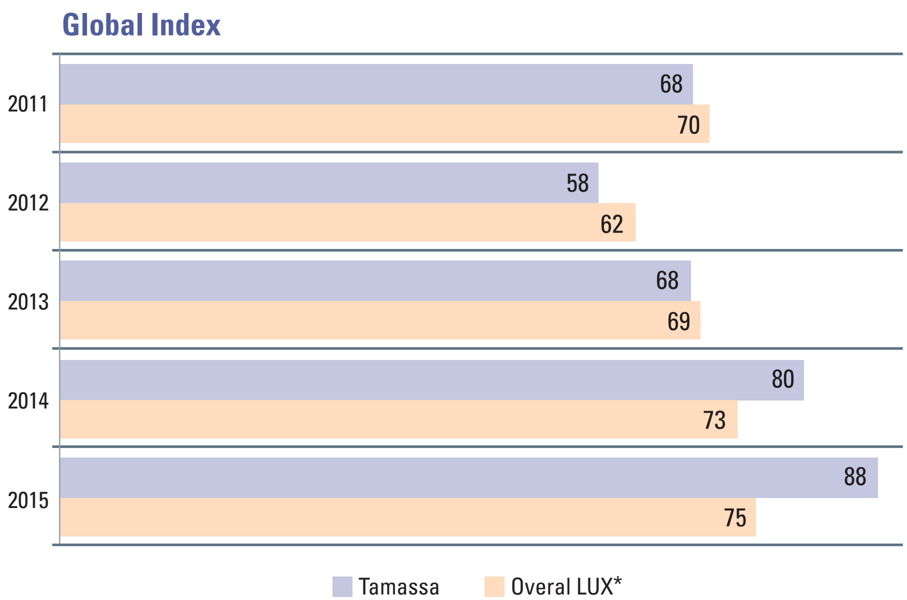
> *We found a total of four secret bottles around the island that include free bottle of wine, free*

pizza for in-villa dining, and free cocktails. We woke up every day around 6.00 a.m. to jog around the island and spend time to find these bottles hidden all around the island, and it was really a fun way to start every day on the island.

Epitomizing its emphasis on innovation was the decision to introduce the role of a Chief Quality Assurance and Innovation Officer. To stimulate innovation, the incumbent introduced the LUX* Innovation Challenge. Each year, a theme that revolves around business needs such as increasing the loyalty of guests and team members, and improving revenue is set. Teams in each resort as well as the head office then propose ideas, which are rolled-out upon approval. Towards the end of the year, the teams reconvene to present the results of their ideas to a jury. Subsequently, the winning idea is rolled-out across all the resorts, along with other promising ideas that had come out of this challenge.

A particularly impactful idea was FIESTA, which came in first place in the 2014 challenge on innovating to increase the loyalty of team members. FIESTA is a wide-ranging high engagement program that allows employees to benefit from activities in the following areas: ***F***itness, ***I***nnovation, ***E***tiquette and ***M***orale Week, ***S***pa, ***T***hank you, and ***A***ward.

For example, Etiquette and Morale Week, the main highlight of the program and also the world's first, brings together young children of team members for three days for a series of activities. Examples of these activities are tennis classes, mocktail classes, recycling of plastic products, and dedicating poem writings to their parents to express gratitude. All in all, the event created a sense of pride and respect amongst the children for the work their parents do. This ground-up initiative had a significant impact on team member satisfaction (*Exhibits 12a* and *12b*) and also went on to win the Best Initiative in Human Resources at the 15th Edition of the Worldwide Hospitality Awards.



Note: FIESTA was introduced in Tamassa and its impact on the loyalty of team members is reflected in the trend in its Global Index in comparison to other LUX resorts.*

The Global Index is a weighted index of 5 Dimensions of well-being at the workplace that are measured by LUX through its Team Member Satisfaction Survey. The higher the score of the index, the better the performance on these dimensions.*

Exhibit 12a The Impact of FIESTA

Exhibit 12b The Global Index — 5 Dimensions of well-being at the workplace

Dimension	Description
Vital Dimension	Team Member Morale. (State of mind: tense, depressed, happy, etc.)
Existential Dimension	Personal and Professional Accomplishment. (Training, Workload, and Resources)
Social Dimension	Interrelationships, Sense of Belonging, and Recognition.
Material Dimension	Physical Comfort at Work, Ergonomics, Salary, Benefits, Fun and Excitement.
Organizational Dimension	Internal Organization Perception and Degree of Engagement with LUX* Resorts' Vision, Purpose and Values.

LUX* was cognizant of the need to stay different and keep ahead of its competition. This spirit of constant innovation is also exemplified by the decision to review its RTG LUX* three years after its launch. The review served to formally define what a RTG LUX* is and critically evaluate the RTG — by identifying what was done well, what was not so successful and how to improve further. The value of each RTG was assessed using a 5D system (*Exhibit 13*) developed by LUX*.

Exhibit 13 The 5D System: Reasons to Go LUX*

Evaluation Filter	Guiding Questions
1. Does it **DELIVER** the brand experientially on property?	• Vision — Does it make a moment that matters? • Purpose — Does it help people to celebrate life? • Does it substantiate the promise of hospitality that is 'Lighter.Brighter'?
2. Does it **DEMONSTRATE** our creative principles?	• Does it banish thoughtless patterns? • Is it simple, fresh and sensory?
3. Does it **DRAMATISE** the brand concept?	• Does it celebrate 'Locale Life', our nature and culture? • Is it Light Luxury: lightweight and light-hearted?
4. Does it **DIFFERENTIATE** us from our competitors?	• Is it quirky, charming, or cool? • Is it generous, thoughtful, or surprising?
5. How well does it **DISSEMINATE** the word?	• Is it PR-able? • Is it sellable? • Is it shareable?

Note: The 5D system was developed by LUX to evaluate current and future Reasons to go LUX*.*

After the review, the management decided to focus on 11 RTG LUX* (*Exhibit 14*). They each appealed to different types of guests — families, couples, the young and young at heart, as well as niche audiences. These RTG made guests feel different and special. While one single reason may not have triggered guests to choose LUX*, the various reasons worked together to deliver an attractive proposition.

Exhibit 14 Eleven Reasons to go LUX*

Reasons to go LUX*	Description
Ici  **Exhibit 14a**	A holiday without ice cream isn't a holiday at all so we created our own brand called 'ici'. An array of exotic, island flavors are served from retro-styled parlors and mobile carts while a fresh waffle cone is baked right in front of your eyes. Crunch. Munch. Perfect after lunch. (*Exhibit 14a*)
Café LUX*	We believe that great coffee is a must and not a luxury so at the heart of each resort, you'll find a Café LUX*. Enjoy our organic Island Blend, freshly roasted on-site, in a truly different café setting. Flat White or FrappeLux — they're perfect for a seaside sip and surf.
Phone Home	We believe that holidays should be stress and hassle-free, which is why if you explore our resorts you'll find a telephone box and inside a vintage VOIP phone. Here you can make local and international calls free of charge. We just ask one thing: Please do not call the office!
LUX* Me	LUX* Me is an integrated philosophy of well-being, offering a step by step path to an altogether healthier way of life. Naturally, in addition to al fresco classes, our personal trainers specialize in pilates, yoga and meditation classes as well as tailoring programs to you and your requirements. Now stretch!

Reasons to go LUX*	Description
Scrucap	We love a good Burgundy or vintage Bordeaux but the Indian Ocean's a long way from the vineyards of France so we've tapped South Africa for its most exciting contemporary wines. Cape blends survive the short journey in mint condition. Introducing 'Scrucap' and 'Popcap'. Not a corked wine in sight.
Cinema Paradiso	A large screen, fastened between two palms, flickers into life and you're transported to another world — of blockbusters, family classics and world cinema. It wouldn't be the movies without the nibbles, so there's fresh popcorn on the house, 'ici' ice cream and drinks served right to your beanbag. Curtain Up! (*Exhibits 14b and 14c*)

Exhibit 14b

Exhibit 14c

Reasons to go LUX*	Description
Message In A Bottle	You spot a lonely bottle hidden in a bush beside a sandy path. Inside this mysterious vessel, you find a scroll of paper, which reveals a special treat waiting for one lucky guest. Stay alert because it's only if you find the bottle that this daily surprise can be yours.
Thread Lightly	We can't always promise clear skies but, with your help, we can guarantee a clear conscience. LUX* cares about the destinations that are home to its properties. After all, memorable holidays shouldn't cost the earth and that's why we are doing our best to 'Thread Lightly' by offsetting 100% of the carbon emitted during your stay. It's one of a number of measures we're putting in place to help us leave a lighter footprint.
Mamma Aroma	For as long as any of us can remember, amenities have been a staple in every hotel and resort bathroom around the world. Imagine hair lovingly nourished by deep conditioners; lazy baths scented with tropical oils; bodies gently burnished with a patina of sea salt scrub and sun-kissed skin glowing with the natural moisturizing properties of the island's products. LUX* Resorts & Hotels offers you, for your bath experience, something different: an element of surprise, a gasp of pleasure, and a nod to simplicity are behind our selection. And being considerate to the environment, our products and their packaging are as light on the planet as they are on the body.

Reasons to go LUX*	Description
Mamma Aroma	We have also worked with renowned aromatherapist Shirley Page to create an exclusive range of essential oils, using island ingredients- essences, flowers and spices that combine to create a magical world of fragrance. Used in our LUX* Me spa, the oils are also present in interior and linen scents.
Tree of Wishes  **Exhibit 14d**	At every LUX* Resort & Hotel, you'll find a specially commissioned Tree of Wishes sculpture made by local artisans. Upon check-in, you'll be handed a unique ribbon featuring your initials and the date of your visit. Although not compulsory, you are invited to make a donation which will be made annually to a local children's charity. Tie the ribbon around one of the branches whilst making a wish. Whilst we can't guarantee your wish will come true, we can promise that once a year one lucky ribbon will be selected and the lucky person who placed it there will win a free holiday to LUX*. (*Exhibit 14d*)

Note: LUX staff places coupons for complimentary spa treatments, pedicure facial or massages in bottles around the beach. Some messages are written clues directing guests towards the Secret Bar, or offer an opportunity to enjoy a special dining experience for two on the beach. Guests who serendipitously stumble upon these bottles on the beach are in for a treat.*

Exhibit 15 Message In A Bottle

Another outcome of the review was an augmentation of the successful RTG. With Message In A Bottle (*Exhibit 15*), numerous improvements were made in various areas. Execution-wise, bottles were placed at different times to cater to guests with different sleep cycles.

To capture, develop and disseminate new ideas, LUX* created the LUX* Ideas Bank, a depository where ideas could be placed, shared, discussed, measured, and tested. Ideas were contributed by team members and scored. Promising ideas were developed into prototypes and evaluated again. Those ideas that passed the rigorous testing process were finally screened by a senior operator task force that selected them for implementation. This process created an innovation pipeline, allowing the company to launch three new RTG LUX* every quarter and thereby drove continual innovation.

MEASUREMENT, FEEDBACK, AND INCENTIVES

In the transformation journey, measurement of service performance became a priority. Prior to Jones' tenure at LUX*, Naiade Resorts collected guest feedback using written forms and a quality assurance coordinator was appointed in each resort. This system placed certain limitations on what the company could do with feedback. These include delays in terms of consolidating feedback, a lack of central coordination of quality assurance, and hence, low visibility among top management, as well as difficulty in measuring service performance within and between the different properties of the group.

While a basic customer feedback system was in place, service measurement and feedback had become much more sophisticated under Jones' leadership. Within a month of recruiting the Chief Quality Assurance and Innovation Officer, LUX* went online with its feedback form. Although LUX* could not afford to invest heavily in an online feedback system at that point in time, it saw a basic online platform as a step in the right direction.

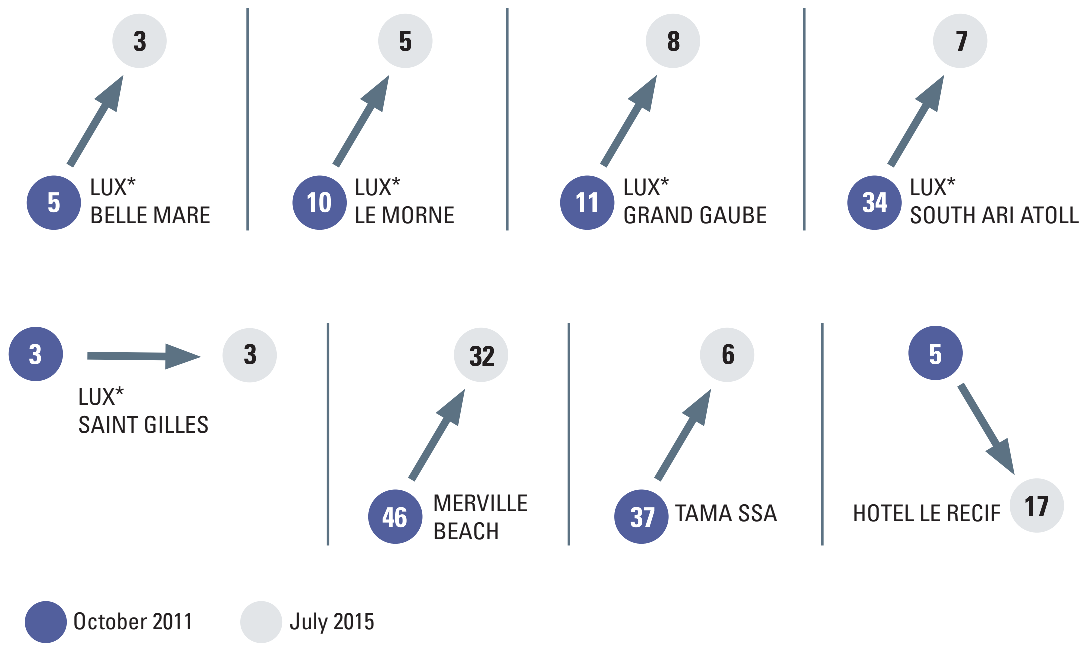
With an online platform, LUX* had visibility on how each resort was performing in terms of service quality, and it also motivated employees to provide better service.

Soon after, LUX* launched a quality assurance manual based on standards of global best practices in hotel and hospitality management. It spelt out clear service targets in all areas of operations, right down to micro-moments such as the amount of time that the restaurant should take to hand guests the restaurant menu. This was accompanied by a mystery-shopping audit to check that standards were met.

In terms of external measurements, the company paid close attention to customer feedback and ratings on TripAdvisor (*Exhibit 16*). For instance, qualitative feedback on TripAdvisor was monitored and responded to by the management personally. The feedback was also discussed with department heads within LUX* when it concerned their line of work. The ratings were even monitored and tracked as part of selected employees' key performance indicators (KPI).

Throughout the transformation, the impact of the changes introduced was seen in the improvements in their financial performance such as the growth in their publicly reported quarterly revenue. This provided satisfaction for staff in the form of indirect feedback for what they had accomplished. In 2012, however, LUX*'s management also realized that there were only a few incentive schemes in place. Sometimes, the incentives did not serve the purpose of getting team members to focus on where they should. This prompted the management to review incentive plans to align the company in achieving its targets.

The new incentive schemes focused on three important things — Guest Experience, Team Member Engagement, and Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA). This was rolled out first to the general managers of each resort in 2012. Subsequently, various schemes were developed for different groups of employees. A sample of the KPIs include targeted EBIDTA, targeted Trip Advisor scores, guest satisfaction related metrics, and a team member satisfaction index.



Note: This chart illustrates the change in ranking of LUX's resorts, from 2011 to 2015. The resorts are segmented by country, with the relevant LUX* resort ranked against other resorts listed on TripAdvisor. Note that TripAdvisor's ranking methodology changed in 2015 for LUX* Saint Gilles and Hotel Le Recif, using a much wider geographic region for the ranking. This lead to many more resorts being included in the ranking and it explains the drop for Hotel Le Recif.*

Exhibit 16 LUX*'s Trip Advisor Rankings Within Each Country (2011 vs. 2015)

In Mauritius, an incentive scheme was extended to all Team Members. Under this scheme, the performance of individual hotels was linked to rewards for 2,000 frontline employees in Mauritius. By 2015, team members were given targets for EBITDA, TripAdvisor ratings, as well as MarketMetrix score (a measure of guest satisfaction). A bonus of 8% of the team member's basic monthly salary was paid when the KPIs were met. Paid out on a monthly basis, the bonus served as a tangible incentive to further motivate frontline staff to meet the company's goals.

While these tools served LUX* well, the group's ambitions have in a short few years evolved from turning around the company to becoming a leading international player. This also meant that some of its management tools had to evolve.

One tool that evolved was how LUX* measured customer satisfaction. In 2013, the LUX*'s online system evolved from a fairly basic system to one that is much more sophisticated. By partnering with MarketMetrix, LUX* was able to track customer experience almost instantaneously on a daily basis. Aspects of customer experience that were tracked included Check In and Check Out, Room, Food and Beverage, as well as Facilities and Amenities. Customer feedback was also taken so seriously that the CEO received metrics on customer satisfaction on his smart phone on a daily basis. LUX*'s partnership with MarketMetrix allowed it to not just benchmark itself across its resorts but also with its key competitors. This strong focus on customer satisfaction helped the company to better monitor and track its performance on a resort by resort basis, and within resorts, on a department by department level.

More recently, LUX* fine-tuned its internal quality standards and developed LUX* Shining Hospitality Standards (LSHS), which served as LUX*'s brand operational standards. In comparison to the LUX* Quality assurance manual, LSHS represented a shift from benchmarking against competitors to delivering service that was distinctively LUX*. For example, LSHS provided guidance to employees in terms of grooming and how they should interact with guests. A company-wide standard, LSHS was adapted to each resort in the form of standard operating procedures. Along with these changes in standards, LUX* also changed the way they tracked these standards such as using internal audits in place of mystery shopping.

FUTURE PLANS

Having successfully revolutionized its service through a four-pronged approach, LUX* was in 2015 in a much better position to implement its asset-light strategy. It already had signed a number of long-term management agreement for upcoming hotels in the Maldives and China.

By the end of 2016, LUX* expected to have close to a-third of its portfolio being owned by third-parties but managed by LUX*. Finally, LUX* entered into a franchise agreement to open Café LUX*, a RTG LUX* concept, outside the hotel. With its strong service culture, LUX* aimed to become more of a global company with a bigger footprint.

Study Questions

1. What were the main factors that contributed to LUX* Resort's successful service revolution?
2. What key challenges do you see in what LUX* did in carrying out its transformation? How were they addressed and what else could have been done?
3. What next steps do you think LUX* should take to cement its strong service culture, continue service innovation, and maintain its high profitability?

Click to view video interviews with Paul Jones, CEO of LUX* Resorts & Hotels:

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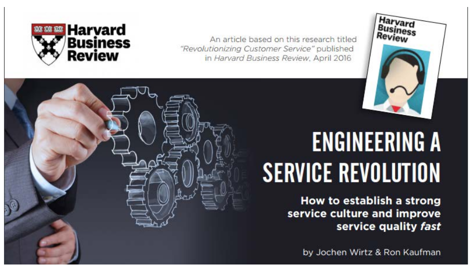

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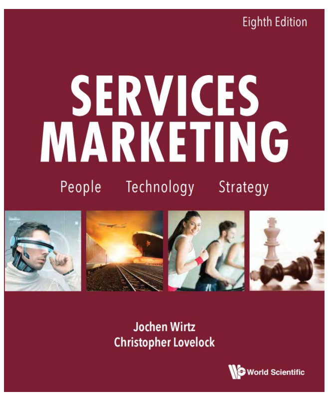

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