Essentials of Services Marketing

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Managing the Customer Interface

PART III focuses on how to manage the link between the customer and the service firm. It covers the additional 3Ps that are unique to service marketing and not found in goods marketing. It consists of the following four chapters:

Chapter 8  Designing and Managing Service Processes

Starts off with the design of effective delivery processes, specifying how the operating and delivery systems link together to create the value proposition. Very often, customers are involved in these processes as co-producers and badly designed processes will lead to a disappointing experience. It will also make it difficult for service personnel to do their jobs well.

Chapter 9  Balancing Demand Against Productive Capacity

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

Chapter 10  Crafting the Service Environment

Focuses on the physical environment, which often creates the first impression on customers. This is also known as the servicescape, which 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. Service firms need to manage it carefully, because it can have a profound impact on customers’ impressions.

Chapter 11  Managing People for Service Advantage

Introduces people. People play a very important role in services marketing. Many services require direct interaction between customers and contact personnel. The nature of these interactions strongly influences how customers perceive service quality. Hence, service firms devote a significant amount of effort to recruiting, training and motivating employees. Happy employees who perform well are often a source of competitive advantage for a firm.
Cora Griffith is a waitress for the Orchard Café at the Paper Valley Hotel in Appleton, Wisconsin. She is excellent in her role, appreciated by first-time customers, famous with her regular customers, and admired and respected by her co-workers. Cora loves her work and it shows. She implements the following nine rules of success:

1. Explain why service staff is so important to the success of a service firm.
2. Understand the factors that make the work of frontline staff so difficult and stressful.
3. Describe the cycles of failures, mediocrity, and success in Human Resource (HR) management for service firms.
4. Understand the key elements of the Service Talent Cycle and know how to get HR right in service firms.
5. Know how to attract, select and hire the right people for service jobs.
6. Explain the key areas in which service employees need training.
7. Understand why empowerment is so important in many frontline jobs, and know the three levels of employee involvement.
8. Explain how to build high-performance service delivery teams.
9. Know how to motivate and energize service employees so that they will deliver service excellence and productivity.
10. Understand the role of service leadership and culture in developing people for service advantage.
1. **Treat Customers like Family.** First-time customers are not allowed to feel like strangers. 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, 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, keeps track of 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.”

5. **Work Smart.** Cora scans all her tables at once, looking for opportunities to combine tasks. “Never do just one thing at a time. And never go from the kitchen to the dining room empty-handed. Take coffee or iced tea or water with you.” When she refills one water glass, she refills others. When clearing one plate, she clears others. “You have to be organized, and you have to keep in touch with the big picture.”

6. **Keep Learning.** Cora makes it an ongoing effort to improve existing skills and learn new ones.

7. **Success is Where You Find It.** Cora is satisfied 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. “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.** She has been working with many of the same co-workers 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 helps out. The wait staff cover for one another, the managers bus the tables, the chefs garnish the plates. “We are like a little family. 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 co-workers. Says Cora, “I have always wanted to do my best. However, the owners really are the ones who taught me how important it is to take care of the customer and who gave me the freedom to do it. The company always has listened to my concerns and followed up. Had I not worked for the Orchard Café, I would have been a good waitress, but I would not have been the same waitress.”

...She is proud of being a waitress; proud of “touching lives”...
SERVICE EMPLOYEES ARE EXTREMELY IMPORTANT

Highly capable and motivated people are at the center of service excellence and productivity. Cora Griffi th 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 topics in Cora Griffi th’s nine rules of success are the result of good HR strategies for service firms. After having read this chapter, you will know how to get HR right in service firms, and how to get satisfied, loyal, motivated and productive service employees.

Why do you think service personnel are so crucially important for the success of service firms? There are the following three main reasons:

- Service personnel help to maintain the firm’s positioning. They are:
  - A core part of the product. Often, service employees are the most visible part of the service. They deliver the service and affect service quality greatly.
  - The service firm. Frontline employees represent the service firm, and from a customer’s perspective, is the firm.
  - The brand. Frontline employees and service are often a core part of the brand. It is the employees who are the ones who either deliver or do not deliver the brand promise. Almost everybody can tell some horror story of a terrible experience they have had with a service business. Many of these same people can also remember a really good service experience. Service personnel typically play a prominent role in such dramas!

- Service personnel are a source of customer loyalty. Frontline employees see what customers need, deliver the service and build personal relationships with customers (Figure 11.2). These lead to customer loyalty.

- Service personnel are a key driver of the productivity of the frontline operation.

- Service personnel are also often crucially important for generating sales, cross-sells and up-sells.

The Frontline in Low-Contact Services

Most research in service management relates to high-contact services. However, many services are moving towards using low-contact delivery channels such as call centers, where contact is voice to voice rather than face to face. A growing number of transactions no longer even involve frontline staff. As a result, a large and increasing number of customer contact employees work by telephone or e-mail, never meeting customers face to face. Are frontline staff really that important for such services?

Few customers call the service hotline of their mobile operator, or their credit card company very often. However, these occasional service encounters with a telephone-based Customer Service Representative (CSR) often are “moments of truth” that affect how the customer views the firm (see Figure 11.3). Typically, such encounters involve an attempt by the customer to resolve a problem or make a special request. At the end of the conversation, a customer’s personal feelings may range from,
"Your firm’s customer service is excellent! When I need help, I can call you, and this is one important reason why I bank with you," all the way to "Your service stinks. I don’t like interacting with you, and I am going to spread the word about how bad your service is!"

To ensure that the CSRs are aware of the important role they are playing—that they are not just telephone operators—contact centers could send their staff for Customer Operations Performance Center (COPC) certification (see Service Insights 11.1).

**SERVICE INSIGHTS 11.1**

**Customer Operations Performance Center Inc. — The Standards Body For Call Centers**

If a company is customer-centric and serious about running a best practice customer contact center, its managers could have heard of Customer Operations Performance Center Inc. (COPC Inc.). COPC Inc. is a leading call center consulting, training, certification and benchmarking company. The company sets the standards in call centers. For more than a decade, it has been helping companies around the world to ensure that they have systems in place that follow best practices. It helps companies to manage their call center operations, and improve performance, leading to increased customer satisfaction and profitability. Companies could achieve results of two to five times return on investment.

How are such results achieved? COPC Inc. has developed a set of standards called the COPC-2000® Family of Standards. It is a performance management and certification system that is the first in the industry. COPC Inc. audits companies to ensure that they continue to meet the standards, which measure all call center customer-touch activities. Among other aspects, included in the system are certification programs of various call center operations like call waiting, call pick-up and call drop; training in customer satisfaction; and Six Sigma in Call Centers.

COPC Inc. has worked with over 200 companies in 50 different countries. Global clients include Accenture, Apple, BT Group, Cable & Wireless, Citigroup, HP, Lenovo, Microsoft, NTT, Sony, Telefónica, Telstra, and Wipro.

**SOURCE**

FRONTLINE WORK IS DIFFICULT AND STRESSFUL

The service-profit chain has high performing, satisfied employees as the main requirement for achieving service excellence and customer loyalty. However, these employees work in some of the most demanding jobs in service firms. We will next discuss the main reasons why these jobs are so stressful.

Boundary Spanning

The organizational behavior literature refers to service employees as boundary spanners. Boundary spanners link the inside of an organization to the outside world. Their roles often pull them in opposite directions causing frontline employees to experience role conflict and as a consequence, role stress. Let us look at the sources of role conflict in more detail.

Sources of Conflict

There are three main causes of role stress in frontline positions: Organization/Client, Person/Role, and Interclient conflicts.

Organization/Client Conflict

Customer contact personnel must attend to both operational and marketing goals. They are expected to delight customers, which takes time, yet have to be fast and efficient at operational tasks. In addition, they may be expected to sell, cross-sell and up-sell too. Sometimes, they are also responsible for enforcing pricing schedules that may upset or frustrate customers. Conflict also arises when customers request services, extras, or exceptions that are against the organizational rules. Service employees often are torn between following the company’s rules and objectives, and satisfying customer demands. Organization/client conflict is more severe in service organizations that are not customer oriented.

Person/Role Conflict

Service staff have conflicts between their job requirements and their own personalities, self-perception and beliefs. For example, the job may require being pleasant even to rude customers. In non-work situations, they may even look down on such people. When their jobs force them to behave differently from what they prefer, they feel stressed.

Interclient Conflict

Conflicts between customers may result from such behaviors as smoking in non-smoking sections, jumping queues, speaking on a mobile phone in a cinema, and behaving obnoxiously in restaurants. When employees are asked to tell the other customer to behave, they may find this a stressful and unpleasant task, as it is often impossible to satisfy both sides.

In short, frontline staff may perform several roles, including producing service quality, productivity and sales. In combination, playing such roles often leads to role conflict and role stress for employees. Although employees may experience conflict and stress, they are still expected to have a pleasant disposition towards the customer. We call this emotional labor, which in itself is an important cause of stress. Let us look at it in more detail in the next section.
Emotional Labor

The term emotional labor was first used by Arlie Hochschild in her book 'The Managed Heart.' Emotional labor occurs when there is a gap between the way frontline staff feel inside and the emotions that management requires them to display to their customers. Frontline staff are expected to be cheerful, friendly, compassionate, sincere or even humble. Although some service firms make an effort to recruit employees with such characteristics, there will definitely be situations when employees do not feel such positive emotions, yet are required to hide their true feelings in order to meet customer expectations (Figure 11.4).

The stress of emotional labor is illustrated in the following story: A flight attendant was approached by a passenger with “Let’s have a smile.” She replied with “Okay. I’ll tell you what, first you smile and then I’ll smile, okay?” He smiled. “Good,” she said. “Now hold that for eight hours,” and walked away.

Forward-looking companies take steps to address the problem of emotional labor. For example, Singapore Airlines (SIA) has a reputation for service excellence. Therefore, its customers tend to have very high expectations and can be very demanding. This puts a lot of pressure on its frontline. The Commercial Training Manager of Singapore Airlines explained:

“We have a motto: ‘If SIA can’t do it for you, no other airline can.’ So we encourage staff to try to sort things out, and to do as much as they can for the customer. Although they are very proud, and indeed protective of the company, we need to help them deal with the emotional turmoil of having to handle their customers well, and at the same time, feel they’re not being taken advantage of. The challenge is to help our staff deal with difficult situations and take the brickbats.”

Firms need to be aware of ongoing emotional stress among their employees and to make sure that their employees are trained to handle emotional stress and to cope with pressure from customers. Figure 11.5 captures emotional labor with humor.

CYCLES OF FAILURE, MEDIOCRITY, AND SUCCESS

Having discussed the importance of frontline employees and how difficult their work is, let us look at the big picture—how poor, mediocre and excellent firms set up their frontline employees for failure, mediocrity or success. All too often, bad working environments are connected to terrible service, with employees treating customers the way their managers treat them. Businesses with high employee turnover are often stuck in what has been termed the “Cycle of Failure.” Others, which offer job security but are rule and procedure based, may suffer from an equally undesirable “Cycle of Mediocrity.” However, if managed well, there is potential for a virtuous cycle in service employment, called the “Cycle of Success.” As we will see, employee satisfaction and customer satisfaction are highly correlated and affect each other.
Chapter 11 • Managing People for Service Advantage

The Cycle of Failure

In many service industries, the search for productivity leads to simplifying work processes and paying the lowest possible wages. Such employees perform repetitive tasks that need little or no training. Among consumer services, department stores, fast food restaurants and call center operations are often examples of this mindset (although there are notable exceptions). The cycle of failure captures the effect of such a strategy. There are two separate cycles, but they affect each other. One involves failures with employees, the second, with customers (Figure 11.6).

The employee cycle of failure begins with a narrow design of jobs for low skill levels. There is an emphasis on rules rather than service, and the use of technology to control quality. Low wages are paid, accompanied by little investment in selection and training. As a result, there are bored employees who lack the ability to respond to customer problems. They then become dissatisfied and develop a poor service attitude. The results for the firm are low service quality and high employee turnover. Because of low profit margins, the cycle repeats itself with the hiring of more low-paid employees to work in the same unrewarding manner (Figure 11.7). Some service firms can reach such low levels of employee morale that frontline staff engage in ‘service sabotage’ rather than deliver service excellence.7

Figure 11.6 The Cycle of Failure.

Figure 11.7 Employees in the cycle of failure are bored and dissatisfied.

SOURCE
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The customer cycle of failure begins with repeated emphasis on attracting new customers. Since the employees are dissatisfied, the customers become dissatisfied with employee performance. High staff turnover means that customers are always served by new faces, so there is no continuity. Because these customers fail to become loyal to the supplier, they turn over as quickly as the staff, requiring an ongoing search for new customers to maintain sales volume.

Many managers ignore the long-term financial effects of low-pay/high turnover human resource strategies. They often fail to measure three key cost variables: (1) the cost of constantly recruiting, hiring, and training; (2) the lower productivity of inexperienced new workers; and (3) the costs of always attracting new customers (requiring extensive advertising and promotional discounts). Also often ignored are two revenue variables: future revenue if the customer stayed loyal, and income from potential customers who are turned off by negative word of mouth.

**The Cycle of Mediocrity**

Another cycle is the “Cycle of Mediocrity” (Figure 11.8). It is most likely to be found in large organizations that operate on lots of rules and procedures.

![Figure 11.8 The Cycle of Mediocrity.](image)

In such environments, service delivery standards tend to be rule-based. Service is standardized and the stress is on operational efficiencies. Job responsibilities are narrowly defined, and categorized by grade and scope of responsibilities. The unions also have work rules. Salary increases and promotions are largely based on how long...
the person has been working in the company. Successful performance in a job is often measured by lack of mistakes, rather than by high productivity or outstanding customer service. Training focuses on learning the rules and the technical aspects of the job, not on improving relationships with customers and co-workers. Since employees are given very little freedom to do their work in the way they think is necessary or suitable, jobs tend to be boring and repetitive. However, unlike the cycle of failure, most positions provide adequate pay and often good benefits, combined with high security. Thus, employees are reluctant to leave.

Customers find such organizations frustrating to deal with. There are many rules, lack of service flexibility, and unwillingness of employees to make an effort to serve them well. There is little incentive for customers to cooperate with the organization to achieve better service. When they complain to employees who are already unhappy, the poor service attitude becomes worse. However, customers often remain with the organization as there is nowhere else for them to go. This could either be because the service provider holds a monopoly, or because all other available players are seen as being equally bad or worse.

**The Cycle of Success**

Some firms take a longer term view of financial performance, seeking to prosper by investing in their people in order to create a “Cycle of Success” (Figure 11.9).
As with failure or mediocrity, success applies to both employees and customers. Better pay and benefits attract good quality staff. Broadened job designs are accompanied by training and empowerment practices that allow frontline staff to control quality. With more focused recruitment, intensive training and better wages, employees are likely to be happier in their work and provide higher quality service. Lower turnover means that regular customers appreciate the continuity in service relationships and are more likely to remain loyal (Figure 11.10). With greater customer loyalty, profit margins tend to be higher. The organization is free to focus its marketing efforts on strengthening customer loyalty through customer retention strategies.

**Figure 11.10** DLA Piper has a dedicated team of employees who put the client’s interests first, forming service relationships with customers that are likely to result in increased customer loyalty.

**HUMAN RESOURCE MANAGEMENT – HOW TO GET IT RIGHT?**

Any manager who thinks logically would like to operate in the Cycle of Success. What strategies will help service firms to move in that direction? Figure 11.11 shows the Service Talent Cycle which is our guiding framework for successful HR practices in service firms. We will discuss the recommended practices one by one in this section.

**Figure 11.11** The Service Talent Cycle.

**LO 4** Understand the key elements of the Service Talent Cycle and know how to get HR right in service firms.
Hiring the Right People

Employee effort is a strong driver of customer satisfaction, so it is important to have employees who are willing to put in the effort. As Jim Collins said, "The old adage, 'People are the most important asset' is wrong. The right people are your most important asset.' We would like to add to this: '... and the wrong people are a liability that is often difficult to get rid of.' Getting it right starts with hiring the right people.”

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

Be the Preferred Employer

To be able to select and hire the best people, they first have to apply for a job with you and then accept your job offer in preference to offers. That means a firm has to first compete for talent market share, or as McKinsey & Company calls it, "the war for talent." To effectively compete in the labor market means having an attractive value proposition for potential employees, including a good image in the community as a place to work, and delivering high-quality products and services which make employees feel proud to be part of the team. Top people expect above average packages. In our experience, it takes a salary in the range of the 65th to 80th percentile of the market to attract top performers to top companies. See Service Insights 11.2 on how Google has become the Best Company to Work for in 2008!

Select the Right People

There is no such thing as the perfect employee (Figure 11.12). Different positions are often best filled by people with different skill sets, styles and personalities. For example, the Walt Disney Company looks at potential employees and judges how they fit into on-stage or backstage work. The job of on-stage workers, known as cast members, are given to those people with the appearance, personalities, and skills to match the job.

"Allen is an incredible, wonderful, fun, generous, exciting, kind, loving, brilliant, very special human being. This personal reference from your dog is quite impressive."
Google, the Preferred Employer

Google was voted number one in “FORTUNE’S 100 Best Companies to Work for 2008.” So, the immediate question on people’s minds will be: Why so? What makes it the best? What kind of culture does the company have? What kind of benefits do the employees enjoy? What are its employees like? Employees of Google are called Googlers. They are widely perceived as fun-loving and interesting. At the same time, when it comes to work, they are achievement oriented and driven. Google’s culture is one of innovation, of being non-conventional, of being different, of being fun-loving. Googlers are given the freedom to work independently. Google’s experience suggests that pampering employees actually results in increased productivity and profitability. Certainly, Googlers seem willing to work long hours.

What kind of benefits do Googlers enjoy? The list is long, but top on the list is gourmet food for free, and food is just the appetizer! At the company’s headquarters in Mountain View, California, the “campus” offers many free amenities, including Wi-Fi enabled shuttle buses, motorized scooters to get around, car washes, and oil changes. If Googlers are interested in buying hybrid cars, they get a $5000 subsidy for that. Googlers have five free onsite doctors, unlimited sick days, free flu shots, gym to work out at, a pool to do laps with lifeguards on duty. For more domestic activities, there is free onsite laundry or one can drop off laundry at the dry cleaners. There are also child care services. Pets are welcome at the work place on a temporary basis. For leisure and sports, one can play a game of pool, do some rock climbing on the wall, play a game of volleyball at the beach volleyball pit. The list goes on. As a result, Googlers can spend long and productive hours at work. But it must be noted that the benefits offered to employees working at other Google offices tend to be less significant.

Google has a new engineering headquarters in Zurich, Switzerland. Life there is just as fun. There are meeting places that are designed to look like Swiss chalets and igloos. People can get from one floor to another using fireman poles, and there is a slide that allows them to reach the cafeteria very quickly. There are other areas like a games room, a library with architecture in the style of an English country house, and an aquarium where staff can lie in a bath of red foam and look at fish if they feel much stressed out. This building was partly designed by the engineers who work there.

Because the firm is seen as such a desirable place to work, it can be extremely selective in its recruiting, hiring only the best and the brightest. This may work particularly well for its engineers, who tend to get the most kudos. However, despite the company’s stellar reputation as an employer, some observers question whether this very positive environment can be maintained as the company grows and its workforce matures.

Figure 11.13 The Google Campus, Mountain View, California

Figure 11.14 The slide gets people to the cafeteria quickly.

Source:
What makes outstanding service performers so special? Often it is things that cannot be taught. It is the qualities that are part of people's personality. While good manners and the need to smile and make eye contact can be taught, warmth itself cannot.

**Tools to Identify the Best Candidates**

Excellent service firms use a number of methods to identify the best candidates in their applicant pool. They include observing behavior, conducting personality tests, interviewing applicants, and providing applicants with a realistic job preview.

**Observe Behavior**

The hiring decision should be based on the behavior that recruiters observe, not the words they hear. As John Wooden said: “Show me what you can do, don't tell me what you can do. Too often, the big talkers are the little doers.”9 Behavior can be directly or indirectly observed by using behavioral simulations or assessment centre tests. Southwest Airlines observes applicants closely during the day of interview.

Also, past behavior is the best predictor of future behavior: hire the person who has won service excellence awards, received many complimentary letters and has great references from past employers that highlight relevant performance measures.

**Conduct Personality Tests**

Use personality tests that are related to specific jobs. For example, willingness to treat customers and colleagues with courtesy, consideration and tact, sensitivity to customer needs, and ability to communicate accurately and pleasantly are traits that can be measured.

For example, the Ritz-Carlton Hotels Group uses personality profiles to help select staff who have a natural predisposition for working well in a defined service context. Based on her experience, a successful applicant for an assistant concierge job gave the following advice: Tell the truth. These are experts; they will know if you are lying, and then she added:

> On the big day, they asked if I liked helping people, if I was an organized person and if I liked to smile a lot.” “Yes, yes and yes,” I said. But I had to support it with real life examples. To answer the first question for instance, I had to say a bit about the person I had helped—why she needed help, for example. The test forced me to recall even insignificant things I had done, like learning how to say hello in different languages which helped to get a fix on my character.10

**Use Multiple, Structured Interviews**

Successful recruiters use structured interviews built around job requirements. They use two or more interviewers because people tend to be more careful in their judgments when they know that another person will be judging the same applicant. Using two or more interviewers also reduces the risk of 'similar to me' biases—we all like people who are similar to ourselves (Figure 11.15).

**Give Applicants a Realistic Preview of the Job**

During the recruitment process, service companies should let candidates know the reality of the job, thereby giving them a chance to “try on the job” and see whether
it is a good fit or not. At the same time, recruiters can observe how candidates respond to the job’s realities. Some candidates may withdraw if they realize the job is not a good match for them. Au Bon Pain, a chain of French bakery cafes, lets applicants work for two paid days in a café prior to the final selection interview. Managers can observe candidates in action, and candidates can assess whether they like the job and the work environment (Figure 11.16). In the ultimate recruitment and interview process, Donald Trump worked with the NBC network to produce “The Apprentice” TV show where the winner got to join the Trump organization and manage a project selected by Trump himself.

Train Service Employees Actively

Service champions show a strong commitment in words, dollars and action to training. They recognize that employees need to be trained in three key areas:

- **The Organizational Culture, Purpose and Strategy.** Training and mentoring must focus on getting emotional commitment to the firm’s core strategy and promote core values. Teaching must emphasize ‘what’, ‘why’ and ‘how’. For example, new recruits at Disneyland attend the “Disney University Orientation.” It starts with a detailed discussion of the company history and philosophy, the service standards expected of cast members and a tour of Disneyland’s operations.

- **Interpersonal and Technical Skills.** Interpersonal skills cut across service jobs. They include visual communications skills such as making eye contact, attentive listening, body language and even facial expressions. Technical skills include all the required knowledge related to processes (e.g. how to handle a merchandized return), machines (e.g. how to operate the terminal or cash machine), and rules and regulations related to customer service processes. Both interpersonal and

Figure 11.16 Au Bon Pain allows candidates to get a taste of the real job on-site. At the same time, managers can assess their suitability.
technical skills are necessary but neither alone is enough for performing a job well (Figure 11.17).

**Product/Service Knowledge.** Employees must have detailed knowledge of the firm’s products and services. Otherwise, they will be unable to explain product features effectively to customers, to contrast them with competing offerings, and to help customers to make the right choice. In many ways, knowledgeable staff are a key aspect of service quality. For instance, in Service Insights 11.3, Jennifer Grassano of Dial-A-Mattress coaches individual staff members on how to paint pictures in the customer’s mind.

**SERVICE INSIGHTS 11.3**

**Coaching** at Dial-A-Mattress

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

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

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

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

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

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

**SOURCE**

The end-goal of training is to achieve and maintain desired behaviors on the job. To achieve this, practice and reminders are needed. Supervisors can meet with staff to repeat key lessons from recent complaints and compliments (Figure 11.18). Training and learning professionalizes the frontline. A waiter, who knows about food, cooking, wines, dining etiquette, and how to effectively interact with customers (even complaining ones) feels professional, has a higher self-esteem and is respected by his customers. Training thus helps to reduce person/role stress. See how Up Your Service! College enables and energizes front line employees (Service Insights 11.4).

**SERVICE INSIGHTS 11.4**

**Up Your Service! College Builds Cultures that Inspire People to Excel in Service**

Having a service-oriented attitude is not something that comes necessarily naturally to everyone, especially if the culture within the organization does not support a “customer first” mentality. This is where UP Your Service! College (UYSC) comes in.

“All organizations can create a sustainable competitive advantage by building a Superior Service Culture,” notes Ron Kaufman, author of the bestselling book series UP Your Service! and founder of UYSC. He adds, “a powerful service reputation attracts the best customers, the most loyal employees and the highest industry margins.”

UYSC combines customer service training courses with culture building activities that uplift the spirit of service delivery throughout an organization. This creates an atmosphere where staffs are inspired to excel in service delivery to customers and to one another.

The comprehensive UYSC course curriculum includes:

**Course 100: Achieving Superior Service™** teaches fundamental service principles to raise service levels and improve the customer experience at every point of contact.

**Course 200: Building Service Partnerships™** demonstrates the importance of building powerful service partnerships with partners and colleagues.

**Course 300: Increasing Customer Loyalty™** teaches how to increase customer loyalty, manage customer expectations and handle situations professionally when things go wrong.

These courses are closely integrated with Service Leadership Workshops, Service Momentum Events and Service Culture Building Activities. Unlike many other training programs, UYSC builds a common service language throughout all levels of the organization, resulting in everyone applying the same service principles in their work every day. The courses are facilitated by certified course leaders and feature video-based instruction by Ron Kaufman to ensure consistently high quality training.

To date, organizations using the UYSC proven curriculum include major multinationals, large domestic companies and government entities such as: Dubai Bank, Dubai Properties, Lehman Brothers International, ManuLife, Nokia, Riyadh Care Hospital, Singapore Central Provident Fund, Singapore General Hospital, Tatweer, TECOM, Wipro, and Xerox Emirates.

SOURCE

Empower the Frontline

After being the preferred employer, selecting the right candidates and training them well, the next step is to empower the frontline. High empowerment has been linked to higher customer satisfaction. In fact, nearly all excellent service firms have stories of employees who recovered failed service transactions, walked the extra mile to make a customer’s day or avoided some kind of disaster for a client. To allow this to happen, employees have to be empowered. Nordstrom is a company that trains and trusts its employees to do the right thing, and empowers them to do so (see Service Insights 11.5). Employee self-direction has become increasingly important, especially in service firms. This is because frontline staff are often on their own when they face their customers.

Research has shown that empowerment is most important when the following factors are present within the organization and its environment:

- The firm offers personalized, customized service and is based on competitive differentiation.
- The firm has extended relationships with customers rather than short-term transactions.
- The organization uses technologies that are complex and non-routine in nature.

LO 7
Understand why empowerment is so important in many frontline jobs, and know the three levels of employee involvement.
Service failures often are non-routine and cannot be designed out of the system. Front line employees have to respond fast to recover the service.

The business environment is unpredictable and surprises are to be expected.

Existing managers are comfortable with letting employees work on their own for the benefit of both the organization and its customers.

Employees have a strong need to grow and deepen their skills in the work environment, are interested in working with others, and have good interpersonal and group process skills.

**Levels of Employee Involvement**

Empowerment can take place at several levels:

- **Suggestion Involvement** empowers employees to make recommendations through formalized programs. McDonald’s, for example, listens closely to its frontline. Creations ranging from Egg McMuffin, to methods of wrapping burgers without leaving a thumbprint on the bun, were invented by employees.

- **Job Involvement** represents opening up of job content. Jobs are redesigned to allow employees to use a wider range of skills. To cope with the added demands accompanying this form of empowerment, employees require training. Supervisors need to be reoriented from directing the group to supporting its performance.

- **High Involvement** gives even the lowest level employees a sense of involvement in the company’s overall performance. Information is shared. Employees develop skills in teamwork, problem solving, and business operations. They participate in work-unit management decisions. There is profit sharing, often in the form of bonuses.

Southwest Airlines is an example of a high-involvement company. It trusts its employees and gives them the freedom and authority to do their jobs. Southwest mechanics and pilots feel free to help ramp agents load bags. When a flight is running late, it is not uncommon to see pilots helping passengers in wheelchairs to board the aircraft, assisting operations agents by taking boarding passes, or helping flight attendants clean the cabin between flights. In addition, Southwest employees use common sense, not rules, when it is in the best interests of the customer.

**Build High-Performance Service-Delivery Teams**

A team has been defined as “a small number of people with complementary skills who are committed to a common purpose, set of performance goals, and approach for which they hold themselves mutually accountable.” Many services require people to work in teams, often across functions for well-coordinated delivery, especially when different individuals each play specialist roles. For example, healthcare services depend heavily on effective teamwork (see Figure 11.20).
Singapore Airlines’ Team Concept

Singapore (SIA) Airlines understands the importance of teamwork in the delivery of service excellence. This is difficult because many crew members are scattered around the world. SIA’s answer is the “team concept.”

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

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

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

According to Toh Giam Ming, Senior Manager Crew Performance, “What is good about the team concept is that despite the huge number of crew, people can relate to a team and have a sense of belonging—‘this is my team.’ And they are put together for 1–2 years and they are rostered together for about 60–70 percent of the time, so they do fly together quite a fair bit.”

Research confirms that frontline staff feel that lack of interdepartmental support prevents them from satisfying their customers (Figure 11.21). In many industries, firms need to create cross-functional teams and give them the authority and responsibility to serve customers from end-to-end. Such teams are also called self-managed teams.

Teams, training and empowerment go hand-in-hand. Singapore Airlines uses teams to provide emotional support, to mentor its cabin crew, and effectively assess, rewards and promote staff (see Service Insights 11.6).

Figure 11.21 Lack of cooperation within a team will present the staff from satisfying customers.

SOURCE

It is not easy to make teams work well. Skills like cooperation, listening to others, coaching and encouraging one another are needed. Team members must learn how to voice differences, tell one another hard truths, and ask tough questions. All these require training. Management also needs to set up a structure that will move the teams towards success. To succeed in the global economy, managers need to do each of the following:

- Identify what the team will achieve. Goals need to be defined and shared with the team members.
- Select team members with care. All the skills needed to achieve the goal must be found within the team.
- Monitor the team and its team members and provide feedback. This aligns individual goals with that of the organization.
- Keep team members informed of goal achievement, update them, and reward them for their efforts.
- Coordinate with other managers to achieve the overall company objectives.\(^\text{17}\)

**Motivate and Energize People**\(^\text{18}\)

Once a firm has hired the right people, trained them well, empowered them, and organized them in effective service delivery teams, how can it ensure that they will deliver service excellence? Motivating and rewarding strong service performers are key to success.

Unsuccessful service businesses fail to make effective use of the full range of available rewards. Money alone does not pass the test of an effective reward. Paying higher wages beyond what is seen as a reasonably fair salary may only have short term motivating effects. Performance-based bonuses have to be earned again and again, and therefore have more lasting impact. Apart from monetary rewards in the form of bonuses, lasting rewards are the job content itself, recognition and feedback, and goal achievement.

**Job content**

People are motivated and satisfied simply by knowing that they are doing a good job. This is true especially if

- the job also has a variety of different activities,
- needs the completion of ‘whole’ pieces of work,
- it has an impact on the lives of others,
- it comes with freedom and flexibility, and
- there is a source of direct and clear feedback about how well employees did their work (e.g. grateful customers and sales).

**Feedback and recognition**

Humans are social beings, and they like to feel that they belong. This is possible if there is recognition and feedback from the people around them, that is, their customers, colleagues and bosses. If employees are being recognized and thanked for service
excellence, they will want to continue achieving it. If done well, star employee of the month-type of awards recognize high performances and can be highly motivating.

**Goal achievement**

Goals focus people’s energy. Achieving important goals is a reward in itself. Goals that are specific, difficult but achievable, and accepted by the staff are strong motivators (Figure 11.23). They result in higher performance than no goals, or unclear goals (e.g. ‘do your best’), or goals that are impossible to achieve. In short, well communicated and mutually accepted goals are effective motivators.

![Figure 11.23](image)

**SERVICE LEADERSHIP AND CULTURE**

To move an organization towards service excellence, we need a strong service culture that is continuously strengthened and developed by management. ‘Charismatic leadership,’ also called transformational leadership is needed. With this kind of leadership, staff are more likely to perform ‘above and beyond the call of duty,’ because it is in line with their own values, beliefs and attitudes.

Leonard Berry found some core values in excellent service firms. They included excellence, innovation, joy, teamwork, respect, moral and ethical principles, and social profit. These values are part of the firms’ culture. A service culture can be defined as:

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

In order for values and beliefs to be shared by all employees, they may have to be instilled in them and employees have to be reminded of this. For example, Ritz-Carlton translated the key product and service requirements of its customers into the Ritz-Carlton Gold Standards, which include a credo, motto, three steps of service and 20 ‘Ritz-Carlton Basis’ (see Service Insights 11.7).
Ritz-Carlton’s Gold Standards

Ritz-Carlton’s Gold Standards is the cornerstone on which Ritz-Carlton’s success is founded. The devotion to the Gold Standards has seen Ritz-Carlton sweeping all the major awards in the hospitality industry. It is the first and only hotel company twice honored with the Malcolm Baldridge National Quality Award from the United States Department of Commerce.

THE RITZ-CARLTON® BASICS

1. The Credo is the principal belief of our Company. It must be known, owned, and practiced by all.
2. Our Motto is: “We Are Ladies and Gentlemen serving Ladies and Gentlemen.” As service professionals, we treat our guests and each other with respect and dignity.
3. The Three Steps of Service are the foundation of Ritz-Carlton hospitality. These steps must be used in every interaction to ensure satisfaction, retention, and loyalty.
4. The Employee Promise is the basis for our Ritz-Carlton work environment. It will be honored by all employees.
5. All employees will successfully complete annual Training Certification for their position.
6. Company objectives are communicated to all employees. It is everyone’s responsibility to support them.

7. To create pride and joy in the workplace, all employees have the right to be involved in the planning of the work that affects them.
8. Each employee will continuously identify defects (M.R.B.V.) throughout the Hotel.
9. It is the responsibility of each employee to create a work environment of teamwork and lateral service so that the needs of our guests and each other are met.
10. Each employee is empowered. For example, when a guest has a problem or needs something special, you should break away from your regular duties to address and resolve the issue.
11. Uncompromising levels of cleanliness are the responsibility of every employee.
12. To provide the finest personal service for our guests, each employee is responsible for identifying and recording individual guest preferences.

THE EMPLOYEE PROMISE

At The Ritz-Carlton, our Ladies and Gentlemen are the most important resource in our service commitment to our guests. By applying the principles of trust, honesty, respect, integrity, and commitment, we nurture and maximize talent to the benefit of each individual and the company. The Ritz-Carlton fosters a work environment where diversity is valued, quality of life is enhanced, individual aspirations are fulfilled, and The Ritz-Carlton mystique is strengthened.

THE RITZ-CARLTON CREDO

The Ritz-Carlton Hotel is a place where the genuine care and comfort of our guests is our highest mission. We pledge to provide the finest personal service and facilities for our guests who will always enjoy a warm, relaxed, yet refined ambiance. The Ritz-Carlton experience enriches the senses, instills well-being, and fulfills even the unexpressed wishes and needs of our guests.
A strong service culture is one where the entire organization focuses on the frontline, and understands that it is the lifeline of the business. Figure 11.24 shows the inverted pyramid, which highlights the importance of the frontline. It shows that the role of top management and middle management is to support the frontline in their task of delivering service excellence to their customers.

In firms with a passion for service, top management is informed and actively involved. They achieve this by regularly talking to and working with frontline staff and customers, even spending time serving customers themselves. For example, Disney World’s management spends two weeks every year in frontline staff jobs such as sweeping streets, selling ice-cream or being the ride attendant, to gain a better understanding of what really happens on the ground. We will discuss service leadership in more detail in Chapter 15.
Managing the Customer Interface

PART III

CHAPTER SUMMARY

LO 1 ▶ Service employees are extremely important to the success of a service firm. They are
- A source of competitive positioning because they are (1) a core part of the service product, (2) they are the service firm in the eyes of the customer, (3) and they deliver the brand promise.
- A source of customer loyalty.
- A key driver of the productivity of the frontline operation.
- Often crucially important for generating sales, cross-sales and up-sales.
- Even in low-contact services, frontline employees are the ones who leave an impression on the customer in those ‘moments of truth’ encounters.

LO 2 ▶ The work of frontline employees is difficult and stressful because they are in boundary spanning positions. They are often caught in
- organization/client conflicts,
- person/role conflict, and
- interclient conflicts.

LO 3 ▶ We used three types of cycles to describe how firms can set up their frontline employees for failure, mediocrity and success:
- The cycle of failure involves high employee turnover and high customer dissatisfaction and defection.
- The cycle of mediocrity offers job security, but not much scope in the job itself. There is no incentive to serve customers well.
- Successful service firms operate in the cycle of success, where employees and customers are both satisfied and happy, and firms enjoy high profitability.

LO 4 ▶ To achieve the Cycle of Success, firms should follow the prescriptions outlined in the Service Talent Cycle. It recommends that firms should
- Work on being seen as a preferred employer, and as a result, receive a large number of applications from the best potential candidates in the labor market.
- Select the best suited candidates using screening methods such as observation, personality tests, structured interviews, and providing realistic job previews.
- Conduct extensive training on (1) the organizational culture, purpose and strategy, (2) interpersonal and technical skills, and (3) product/service knowledge.
- Empower the frontline so that they can respond with flexibility to customer needs and non-routine encounters and service failures.
- Organize them into often cross-functional service delivery teams that can serve the customer from end-to-end.
- Finally, motivate them with a full set of rewards, ranging from pay, satisfying job content, recognition and feedback, to goal accomplishment.

LO 5 ▶ Implementing the Service Talent Cycle correctly will give firms highly motivated employees who are willing and able to deliver service excellence and go the extra mile for their customers, and are highly productive at the same time.

LO 6 ▶ Top and middle management must show service leadership and:
- Focus the entire organization on supporting the front line
- Reinforce a strong service culture that emphasizes service excellence and productivity, and build employee understanding and support for the organization’s goals.
- Drive values that inspire, energize and guide service providers.
UNLOCK YOUR LEARNING

These keywords are found within the sections of each Learning Objective (LO). They are integral in understanding the services marketing concepts taught in each section. Having a firm grasp of these keywords and how they are used is essential in helping you do well for your course, and in the real and very competitive marketing scene out there.

LO 1
1. Customer loyalty
2. Customer Operations Performance Center (COPC)
3. Customer service representative
4. Firm’s positioning
5. Moments of truth
6. Service personnel

LO 2
7. Boundary spanners
8. Role conflict
9. Emotional labor
10. Role stress
11. Interclient conflict
12. Organization/client conflict
13. Person/role conflict

LO 3
14. Customer cycle of failure
15. Cycle of Failure
16. Cycle of Mediocrity
17. Cycle of Success
18. Employee cycle of failure

LO 4
19. Service Talent Cycle

LO 5
20. Assessment center tests
21. Behavioral simulations
22. Hiring the right people
23. Observe behavior
24. Preferred employer
25. Personality tests
26. Realistic preview
27. Structured interviews
28. Talent market share

LO 6
29. Training

LO 7
30. Empower the frontline
31. Empowerment
32. Employee involvement
33. High involvement
34. Job involvement

LO 8
35. Teams
36. Teamwork

LO 9
37. Feedback and recognition

LO 10
38. Goals
39. Goal achievement
40. Job content
41. Monetary rewards
42. Motivators
43. Reward
44. Charismatic leadership
45. Inverted pyramid
46. Inverted organizational pyramid
47. Service leadership
48. Service culture
49. Transformational leadership

How well do you know the language of services marketing? Quiz yourself!

Not for the academically faint-of-heart
For each keyword you are able to recall without referring to earlier pages, give yourself a point (and a pat on the back). Tally your score at the end and see if you earned the right to be called—a services marketeer.

SCORE
0 – 8 Services Marketing is done a great disservice.
9 – 17 The midnight oil needs to be lit, pronto.
18 – 26 I know what you didn’t do all semester.
27 – 35 By George! You’re getting there.
36 – 45 Now, go forth and market.
46 – 49 There should be a marketing concept named after you.
1. Why are service personnel so important for service firms?

2. There is a trend of service delivery moving from high-contact to low-contact. Are service personnel still important in low-contact services? Explain your answer.

3. What is emotional labor? Explain the ways in which it may cause stress for employees in specific jobs. Illustrate with suitable examples.

4. What are the key characteristics of the Cycles of Failure, Mediocrity and Success?

5. Describe the key components of the Service Talent Cycle.

6. What can a service firm do to become a preferred employer, and as a result, receive a large number of applications from the best potential candidates in the labor market?

7. How can a firm select the best suited candidates from a large number of applicants?

8. What are the key types of training service firms should conduct?

9. What are the factors that favor a strategy of employee empowerment?

10. Identify the factors needed to make service teams successful in (a) an airline, (b) a restaurant.

11. How can frontline employees be effectively motivated to deliver service excellence and productivity?

12. How can a service firm build a strong service culture that emphasizes on service excellence and productivity?

1. An airline runs a recruiting advertisement for cabin crew that shows a picture of a small boy sitting in an airline seat and clutching a teddy bear. The headline reads: “His mom told him not to talk to strangers. So what’s he having for lunch?” Describe the types of personalities that you think would be (a) attracted to apply for the job by that ad, and (b) discouraged from applying.

2. Consider the following jobs: emergency ward nurse, bill collector, computer repair technician, supermarket cashier, dentist, kindergarten teacher, prosecuting attorney, server in a family restaurant, server in an expensive French restaurant, stockbroker, and undertaker. What type of emotions would you expect each of them to display to customers in the course of doing their job? What drives your expectations?

3. Use the Service Talent Cycle as a diagnostic tool on a successful and an unsuccessful service firm you are familiar with. What recommendations would you prescribe to each of these two firms?

4. Think of two organizations you are familiar with, one that has a very good and one that has a very poor service culture. Describe the factors that contributed to shaping those organizational cultures. What factors do you think contributed most? Why?
PART IV focuses on four key aspects of implementation. It consists of the following four chapters:

Chapter 12  Managing Relationships and Building Loyalty

Focuses on achieving profitability through creating relationships with customers from the right segments and then finding ways to build and reinforce their loyalty through the Wheel of Loyalty. Loyalty bonds are created to deepen the relationships with customers, but firms also have to reduce customer churn/defections. This chapter closes with a discussion of customer relationship management (CRM) systems.

Chapter 13  Complaint Handling and Service Recovery

Examines how a loyal customer base is often built from effective complaint handling and service recovery. Chapter 13 discusses consumer complaining behavior and principles of effective service recovery systems. Service guarantees are discussed as a powerful way of institutionalizing effective service recovery and as an effective marketing tool signaling high quality service.

Chapter 14  Improving Service Quality and Productivity

Deals with productivity and quality. Both productivity and quality are necessary and related to financial success in services. Chapter 14 covers service quality, diagnosing quality shortfalls using the Gap model, and strategies to close quality gaps. Customer feedback systems are introduced as an effective tool for systematically listening to and learning from customers.

Chapter 15  Organizing for Change Management and Service Leadership

Uses the service profit chain as an integrative model to demonstrate the strategic linkages involved in running a successful service organization. Implementing the service profit chain requires integration of the three key functions of marketing, operations and human resources. We discuss how to move a service organization to higher levels of performance in each functional area. The chapter closes with the role of leadership in both evolutionary and turnaround environments, and in creating and maintaining a climate for service.
Harrah’s Entertainment, the world’s largest gaming company with its three main brands Harrah’s, Caesar’s and Horseshoe, is a leader in the use of highly sophisticated loyalty programs. Harrah’s was first to launch a tiered customer loyalty program.

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

- **LO 1** Recognize the important role loyalty plays in driving a service firm’s profitability.
- **LO 2** Calculate the Life Time Value (LTV) of a loyal customer.
- **LO 3** Understand why customers are loyal to a particular service firm.
- **LO 4** Know the core strategies that are part of the Wheel of Loyalty.
- **LO 5** Appreciate why it is so important for service firms to target the “right” customers.
- **LO 6** Use service tiering to manage the customer base.
- **LO 7** Understand the relationship between satisfaction and loyalty.
- **LO 8** Know how to deepen the relationship through cross-selling and bundling.
- **LO 9** Understand the role of loyalty rewards in enhancing customer loyalty.
- **LO 10** Appreciate the power of social, customization and structural bonds in enhancing loyalty.
- **LO 11** Understand what factors cause customers to switch to a competitor, and how to reduce such switching.
- **LO 12** Understand the part played by Customer Relationship Management (CRM) systems in delivering customized services and building loyalty.

**HARRAH’S ENTERTAINMENT’S CUSTOMER RELATIONSHIP MANAGEMENT**

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

What is special about Harrah’s is not its loyalty program, but what it does with the information gleaned about its customers when they use their cards to earn points. At the backend, Harrah’s linked all its databases from casino management, hotel reservations and events to allow it to have a holistic view of each of its customers. Harrah’s now has detailed data on over 42 million of its customers. They know the personal preferences of their customers from how much they spend on each type of game, to the preferences in terms of food and drinks, as well as entertainment. Information about the customer is captured real-time.

Harrah’s uses this data to drive its marketing and on-site customer service. For example, it will know when the customer wins a jackpot and can tailor a reward that celebrates that win. Harrah’s knows when a particular customer is approaching his maximum gaming limit on a particular evening upon when the customer will stop playing. Just before the limit is reached, Harrah’s can offer him a heavily discounted ticket via SMS time promoting a show with still available seats. This keeps the customer on the premises (and spending), and makes him feel valued as he gets a very special deal just when he wanted to stop playing. If the customer is celebrating a birthday, then the data will allow employees to know that and surprise the guest with a greeting or a special gift. When a customer makes a call to its call center, the staff have detailed real time information about a customer’s preferences and spending habits and can then tailor promotions that cross-sell or up-sell its services to valued customers.

Harrah’s does not do blanket promotions hitting all its customers. Rather, it uses highly targeted promotions that create the right incentives for each of its different customers. And it uses control groups to measure the success of a promotion in dollars and cents.

With its data-driven CRM, Harrah’s is able to make each customer interaction a personal and differentiated one, leading to a special relationship which its customers value. As a result, Harrah’s increased the share-of-wallet of its Harrah’s Total Rewards card holders to over a highly impressive 50 percent.
THE SEARCH FOR CUSTOMER LOYALTY

Loyalty in a business context describes a customer’s willingness to continue buying from a firm over the long-term, and recommending the firm’s products to friends and associates. Customer loyalty does not just mean behavior. It includes preference, liking, and future intentions.

“Few companies think of customers as annuities,” says Frederick Reichheld, author of The Loyalty Effect, and a major researcher in this field. However, that is what a loyal customer can mean to a firm—a regular source of revenue over a period of many years. The active management of the customer base and customer loyalty is also referred to as customer asset management. This is what Harrah’s Entertainment is good at—managing its customer assets.

In a marketing context, the term defection is used to describe customers who stop buying from a company and transfer their brand loyalty to another supplier. Reichheld and Sasser made the term “zero defections” popular. Zero defections means keeping every customer the company can profitably serve. A rising defection rate shows that something is wrong with quality, or that competitors offer better value. It also shows a fall in profits. Large customers do not just disappear overnight. They may show their increasing dissatisfaction by steadily reducing their purchases and shifting part of their business elsewhere.

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

How much is a loyal customer worth in terms of profits? Reichheld and Sasser analyzed the profit per customer in different service businesses. It was grouped by the number of years that a customer had been with the firm. They found that the longer customers remained with a firm in each of these industries, the more profitable they became. Annual profit increases per customer are shown in Figure 12.2 for a few sample industries. The same loyalty effect was found in the internet context, where profits also increased as customers stayed longer with the firm.

LO 1
Recognize the important role loyalty plays in driving a service firm’s profitability.
There are four factors that cause this growth, say Reichheld and Sasser. These factors are:

1. **Profit from increased purchases** (or, in a credit card or banking environment, higher account balances). Over time, business customers often grow larger and so need to purchase in greater quantities. Individuals may also purchase more as their families grow or as they become wealthier. Both types of customers may decide to consolidate their purchases with their preferred supplier who provides high quality service.

2. **Profit from reduced operating costs.** As customers become more experienced, they make fewer demands on the supplier (for instance, less need for information and assistance, and they self-serve more via the internet). They may also make fewer mistakes when involved in operational processes. This contributes to greater productivity.

3. **Profit from referrals to other customers.** Positive word-of-mouth recommendations are such as free sales and advertising, saving the firm from having to invest as much money in these activities.

4. **Profit from price premium.** New customers often benefit from introductory promotional discounts. Long-term customers however, are more likely to pay regular prices, and when highly satisfied may even be willing to pay a price premium. Moreover, when customers trust a supplier, they are more willing to pay higher prices at peak periods or for express work.

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

It would be a mistake to assume that loyal customers are always more profitable than those making one-time transactions. Loyal customers may not necessarily spend more than one-time buyers and in some instances loyal customers may even expect price discounts. For example, in many B2B contexts, large customers have a lot of bargaining power. Therefore, when contracts are to be renewed, they try to make sure they get lower prices. This forces suppliers to share the cost savings resulting from doing business with a large, loyal customer. DHL has found that although each of its major accounts brings a lot of business, it has below average margins. In contrast, DHL’s smaller, less powerful accounts, show higher profitability (Figure 12.4).

Figure 12.4 DHL prices differently for different market segments.

The challenge is to determine the costs and revenues associated with serving customers from different market segments at different points in their customer lifecycles, and to predict future profitability. To know how to calculate customer value, see the box, “Worksheet for Calculating Customer LTV.”

8 Loyal customers may not necessarily spend more than one-time buyers and in some instances loyal customers may even expect price discounts.
9 DHL has found that although each of its major accounts brings a lot of business, it has below average margins. In contrast, DHL’s smaller, less powerful accounts, show higher profitability.
10 To know how to calculate customer value, see the box, “Worksheet for Calculating Customer LTV.”
Implementing Profitable Service Strategies

PART IV

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

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

### Acquisition Revenues Less Costs

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

### Annual Revenues and Costs

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

#### Value of Referrals

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

#### Net Present Value

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

After understanding how important loyal customers can be for the bottom line of a service firm, let us explore what it is that makes a customer loyal.

Customers are not inherently loyal to any one firm! Rather, we need to give our customers a reason to consolidate their buying with us and then stay with us. We need to create value for them to become and remain loyal. Research has shown that relationships can create value for individual consumers through such factors as inspiring greater confidence, social benefits and special treatment (see Service Insights 12.1). We will next discuss how we can systematically think about creating value for our loyal customers using the Wheel of Loyalty.

How Customers See Relational Benefits in Service Industries

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

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

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

A factor analysis of the results showed that most of the benefits that customers derived from relationships could be grouped into three clusters. The first, and most important, group is concerned about what the researchers labeled confidence benefits, followed by social benefits and special treatment. Confidence benefits included feelings by customers that in an established relationship there was less risk of something going wrong, confidence in correct performance, ability to trust the provider, lowered anxiety when purchasing, knowing what to expect, and receipt of the firm’s highest level of service.
-building customer loyalty is difficult. Just try and think of all the service firms you yourself are loyal to. You are likely to only come up with very few examples. This shows that although firms spend huge amounts of money and effort on building loyalty, they often are not successful in building true customer loyalty.

We use the Wheel of Loyalty shown in Figure 12.5 as an organizing framework for thinking of how to build customer loyalty. It is made up of three sequential strategies.

**THE WHEEL OF LOYALTY**

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

**2. Create Loyalty Bonds**

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

**Enabled through:**
- Frontline staff
- Account managers
- Membership programs
- CRM Systems

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**Social benefits** embraced mutual recognition between customers and employees, being known by name, friendship with the service provider, and enjoyment of certain social aspects of the relationship.

**Special treatment benefits** included better prices, discounts on special deals that were unavailable to most customers, extra services, higher priority when there was a wait, and faster service than most customers.

**SOURCE**
Firstly, you need a solid foundation for creating customer loyalty. This includes having the right mix of customer segments, attracting the right customers, tiering the service and delivering high levels of satisfaction. If done right, this step also generates confidence benefits as described in Service Insights 12.1.

Secondly, to truly build loyalty, a firm needs to develop close bonds with its customers. They can either deepen the relationship through cross-selling and bundling, or add value to the customer through loyalty rewards (delivering special treatment benefits) and higher level bonds (creating social benefits).

Thirdly, service marketers should identify and reduce the factors that result in “churn”—the loss of existing customers and the need to replace them with new ones. We discuss each of the components of the Wheel of Loyalty in the sections that follow.

**BUILDING A FOUNDATION FOR LOYALTY**

**Targeting the Right Customers**

Loyalty management starts with segmenting the market to match customer needs and firm capabilities, in short, identify and target the right customers. “Who should we be serving?” is a question that every service business needs to ask regularly. Companies need to choose their target segments carefully and match them to what the firm can deliver. Managers must think carefully about how customer needs relate to such operational elements as speed and quality, the times when service is available, the firm’s capacity to serve many customers all at once, and the physical features and appearance of service facilities. They also need to consider how well their service personnel can meet the expectations of specific types of customers, in terms of both personal style and technical ability.

Finally, they need to ask themselves whether their company can match or exceed competing services that are directed at the same types of customers (Figure 12.6). As Frederick Reichheld said, “...the result should be a win-win situation, where profits are earned through the success and satisfaction of customers, and not at their expense.”

**Searching for Value, Not Just Volume**

Be selective, focus on acquiring customers who fit the core value proposition! Too many service firms still focus on the number of customers they serve without giving enough attention to the value of each customer. Loyalty leaders are choosy about acquiring only the right customers. Service Insights 12.2 shows how Vanguard Group, a leader in the mutual funds industry, designed its products and pricing to attract and retain the right customers for its business model.
Vanguard Discourages the Acquisition of ‘Wrong’ Customers

The Vanguard Group is a growth leader in the mutual fund industry. As of 25 March 2008, it has total assets of about $1.25 trillion in US mutual funds. It has built its assets by carefully targeting the right customers for its business model. Its large share of new sales and a far lower share of redemptions, which gave it a market share of net cash flows of 55 percent (new sales minus redemptions), made it the fastest growing mutual fund in its industry.

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

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

John Bogle attributes the high customer loyalty Vanguard has achieved to placing importance on customer defections, which are redemptions in the fund context. “I watched them like a hawk,” he explained, and analyzed them very carefully to make sure that Vanguard acquired the right kind of customer. Low redemption rates meant that the firm was attracting the right kind of loyal, long-term investors.

When an institutional investor redeemed $25 million from an index fund which was only bought nine months earlier, he regarded the acquisition of this customer a failure of the system. He explained, “We don’t want short-term investors. They muck up the game at the expense of the long-term investor.” At the end of his chairman’s letter to the Vanguard Index Trust, Bogle repeated: “We urge them [short-term investors] to look elsewhere for their investment opportunities.”

This care and attention to acquiring the right customers is famous. For example, Vanguard turned away an institutional investor who wanted to invest $40 million because it suspected that the customer would churn the investment within the next few weeks, creating extra costs for existing customers.

Vanguard introduced a number of changes to industry practices which discouraged active traders from buying its funds. For example, Vanguard’s pricing was set up to reward loyal customers. Specifically, redemption fees were added to some funds, and for many of its funds, investors pay a one-time fee upfront. This fee goes into the funds themselves to make up for current investors’ administrative costs of selling new shares. In essence, this fee subsidizes long-term investors, and penalizes short term investors. Another novel pricing approach was the creation of Admiral Shares for loyal investors, which carried an expense fee one-third less than those of ordinary shares. Combined, these pricing policies turned away heavy traders, but made the fund extremely attractive for the long term investor.
Different segments offer different value for a service firm. Like investments, some types of customers may be more profitable than others in the short term. However, others may have more room for long-term growth. Similarly, the spending patterns of some customers may be stable over time, while others may vary, spending heavily in boom times but cutting back sharply in recessions. With its customer analytics, Harrah’s is able to predict spending patterns of segments based on the history of people with a similar profile. A wise marketer seeks a mix of segments in order to reduce the risks associated with variations in demand.14

Also, managers should not assume that the “right customers” are always high spenders. Many firms have become successful by serving customer segments that bigger players did not see as “valuable” enough. For example, Enterprise Rent-A-Car targeted customers who needed a temporary replacement car. For many years, it avoided the more traditional segment of business travelers targeted by its main competitors. Charles Schwab focused on retail stock buyers. Many professional firms target small businesses rather than large ones.

Managing the Customer Base through Effective Tiering of Service

Marketers should adopt a strategic approach to retaining, upgrading, and even terminating customers. Customer retention involves developing long-term, cost-effective links with customers for the mutual benefit of both parties. However, these efforts should not target all customers with the same level of intensity. Customers can be grouped into tiers in terms of profitability. It is important for firms to understand that these tiers often have quite different service expectations and needs.15 Zeithaml, Rust and Lemon show how this can be done through a four-level pyramid (Figure 12.7).

![Customer Pyramid Diagram]

**Figure 12.7** The customer pyramid.

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

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

**SOURCE**
Platinum. These customers form a very small percentage of a firm’s customer base. They are heavy users and contribute a large share of the profits. This segment is usually less price-sensitive, but expects highest service levels in return. They are likely to be willing to invest in and try new services.

Gold. The gold-tier includes a larger percentage of customers than the platinum. However, individual customers contribute less profit than platinum customers. They tend to be slightly more price sensitive and less committed to the firm.

Iron. These customers provide the bulk of customer base. Their numbers give the firm economies of scale. Hence, they are often important so that a firm can build and maintain a certain capacity level and infrastructure, which is often needed for serving gold and platinum customers. However, iron customers are often only marginally profitable. Their level of business is not enough for special treatment.

Lead. Customers in this tier tend to generate low revenues for a firm. However, they often still require the same level of service as iron customers. Therefore, from the firm’s perspective, they are a loss-making segment.

Tiering the service means that the firm delivers different services and service levels to these different customer groups. The benefit features for platinum and gold customers should be designed to encourage them to remain loyal because these customers are the very ones competitors would like most to steal. Among loyal segments, the focus should be on developing and growing the relationship, perhaps via loyalty programs.16

By contrast, among lead tier customers at the bottom of the pyramid, the options are either to move them to the iron segment (e.g. through increasing sales, increasing prices and/or cutting servicing costs) or to end the relationship with them. Imposing a minimum balance or fee that is waived when a certain level of revenue is generated may encourage customers who use several suppliers to consolidate their buying with a single firm. Another way to migrate customers from lead to iron is to encourage them to use low-cost service delivery channels. For instance, lead customers may be charged a fee for face-to-face interactions but the fee is waived when such customers use electronic channels. In the cellular telephone industry, for example, low-use mobile users can be encouraged to use pre-paid packages that do not require the firm to send out bills and collect payments. This also reduces the risk of bad debts on such accounts.

Occasionally customers are fired outright. ING Direct is a no frills bank. It only has a handful of basic products, and attracts customers with high interest rates (its Orange savings account pays 3 percent in May 2008,17 which is higher than the industry average!) (Figure 12.8). To balance that generosity, its business model pushes its customers to online transactions. The bank often fires customers who do not fit its business model. When a customer calls too often (the average customer phone call costs the bank $5.25 to handle),
or wants too many exceptions to the rule, the banks sales associates basically say: “Look, this doesn’t fit you. You need to go back to your community bank and get the kind of contact you’re comfortable with.” As a result, ING Direct’s cost per account is only one-third of the industry average.¹⁸

Each service firm needs to regularly examine its customer portfolio and consider ending unsuccessful relationships. Legal and ethical considerations, of course, will determine how to take such actions. For example, a bank may introduce a minimum monthly fee for accounts with a low balance (e.g. below $1000), but for social responsibility considerations waive this fee for customers on social security.

Customer Satisfaction and Service Quality are Prerequisites for Loyalty

The foundation for true loyalty lies in customer satisfaction. Highly satisfied or even delighted customers are more likely to become loyal apostles of a firm.¹⁹ They consolidate their purchases with one supplier, and spread positive word-of-mouth. On the other hand, dissatisfaction drives customers away and is a key factor in switching behavior. Recent research even showed that increases in customer satisfaction lead to increases in stock prices—see Service Insights 12.3.

The satisfaction-loyalty relationship can be divided into three main zones: Defection, indifference, and affection (Figure 12.9). The zone of defection occurs at low satisfaction levels. Customers will switch unless switching costs are high or there are no other choices. Extremely dissatisfied customers can turn into ‘terrorists’ providing a lot of negative word-of-mouth for the service provider.²⁰ The zone of indifference is found at moderate satisfaction levels. Here, customers are willing to switch if they find a better choice. Finally, the zone of affection is located at very high satisfaction levels, where customers may have such high attitudinal loyalty that they do not look for alternative service providers. Customers who praise the firm in public and refer others to the firm are described as ‘apostles.’ High satisfaction levels lead to improved future business performance.²¹

![Figure 12.9 The customer satisfaction-loyalty relationship.](source)
Implementing Profitable Service Strategies

PART IV

SERVICE INSIGHTS 12.3

Customer Satisfaction and Wall Street — High Returns and Low Risk!

Do a firm’s customer satisfaction levels have anything to do with its stock price? This was the interesting research question Claes Fornell and his colleagues worked on to answer. More specifically, they examined whether investments in customer satisfaction led to excess stock returns (see Figure 12.10). If yes, were these returns associated with higher risks as would be predicted by finance theory? The researchers built two stock portfolios, and measured the return and risks of the firms in those portfolios compared to the firm’s American Customer Satisfaction Index (ACSI) scores.

Their findings are striking for managers and investors alike! Fornell and his colleagues discovered that the ACSI was significantly related to stock prices of the individual firms and outperformed the market. However, simply publishing the latest data on the ACSI index did not immediately move share prices. Rather share prices seemed to adjust slowly over time as firms published other results (perhaps earnings data or other ‘hard’ facts which may lag customer satisfaction). Therefore, acting faster than the market to changes in the ACSI index generated excess stock returns. The results are in line with research in marketing which holds that satisfied customers improve the level and the stability of cash flow.

For marketing managers, this study’s findings confirm that investments (or “expenses” if you talk to accountants) in managing customer relationships and the cash flows they produce increase a firm’s value. Although the results are convincing, be careful if you want to invest in firms that show high increases in customer satisfaction in future ACSI releases. Your finance friends will tell you that efficient markets learn fast! You know this has happened when you see stock prices move as a response to future ACSI releases. You can learn more about the ACSI at: www.theacsi.org.

Figure 12.10 Can customer satisfaction data help to outperform Wall Street?

STRATEGIES FOR DEVELOPING LOYALTY BONDS WITH CUSTOMERS

Having the right mix of customer segments, attracting the right customers, tiering the service and delivering high levels of satisfaction are a solid foundation for creating customer loyalty as shown in The Wheel of Loyalty in Figure 12.5. However, there is more that firms can do to ‘bond’ closer with their customers. Strategies for developing loyalty bonds include (1) deepening the relationship through cross-selling and bundling, (2) creating reward-based bonds through loyalty programs, and (3) higher level bonds such as social, customization and structural bonds. We will discuss each of these three strategies next.

Deepening the Relationship through Cross-selling and Bundling

To tie customers closer, firms can deepen the relationship through bundling and/or cross-selling services. For example, banks like to sell as many financial products into an account or household as possible. Once a family has its current account, credit card, savings account, safe deposit box, car loan, mortgage, and so on with the same
bank, the relationship is so deep that switching becomes a major exercise. Therefore, customers are not likely to switch unless they are very dissatisfied with the bank.

In addition to higher switching costs, there is often value for the customer when buying all particular services from a single provider. One-stop-shopping typically is more convenient and less hassle than buying individual services from different providers. When having many services with the same firm, the customer may achieve a higher service tier and receive better services, and sometimes service bundles do come with price discounts.

**Encouraging Loyalty Through Reward-based Bonds**

Few customers buy only from only one supplier. This is especially true in situations where service delivery involves separate transactions (such as a car rental) rather than being continuous in nature (as with insurance coverage). In many instances, consumers are loyal to several brands (sometimes described as “polygamous loyalty”) but avoid others. Here, the marketing goal becomes one of strengthening the customer’s preference for one brand over the others and gaining a greater share of the customer’s spending on that service category. This is sometimes referred to as “increasing share of wallet.”

Reward-based bonds, either financial or non-financial in nature, can be used to strengthen customer’s preferences. Financial bonds are built when loyal customers are rewarded with incentives with financial value. Service firms ranging from retailers (such as department stores, supermarkets, book shops, and petrol stations), to telecommunications providers, café chains to courier services and cinema chains have reward programs. Some provide their own rewards, such as free merchandise, vehicle upgrades, or free hotel rooms in vacation resorts. Others offer air miles linked to a selected frequent-flyer program. In fact, air miles have become a form of promotional currency in the service sector.

Service Insights 12.4 describes how British Airways has designed its loyalty program, the Executive Club, to encourage the loyalty of its most valuable customers.

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**SERVICE INSIGHTS 12.4**

**Rewarding Value of Use, not just Frequency, at British Airways**

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

As shown in Table 12.1, silver and gold cardholders get special benefits, such as priority reservations and high standards of on-the-ground service. For instance, even if a gold cardholder is only traveling in economy class, he or she will be entitled to first-class standards of treatment at check-in and in the airport lounges. However, while miles can be accumulated for up to three years (after which they expire), tier status is only valid for twelve months from the time it is earned. This means that the right to special privileges must be re-earned each year. The objective of awarding tier status is to encourage passengers to concentrate their travel on British Airways, rather than to join several frequent flyer programs and collect mileage awards from all of them.
Points given also vary according to the class of service. Longer trips earn more points than shorter ones (a domestic or short haul European trip in economy class generates 15 points, a transatlantic trip 60 points, and a trip from the UK to Australia, 100 points.) However, tickets at deeply discounted prices may earn fewer miles and no points at all.

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

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

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

**Table 12.1: Benefits Offered by British Airways to Its Most Valued Passengers.**

*Source*
Rewards programs alone are not enough to retain the most desirable customers. If customers are dissatisfied with the quality of service they receive, or believe that they can obtain better value from another provider, they may quickly become disloyal. No service business should use a rewards program to replace high quality and good value.23

Non-financial rewards provide customers with benefits that cannot be translated directly into monetary terms. Examples include giving priority to loyalty program members for waitlists and queues in call centers, and access to special services. Informal loyalty rewards, sometimes found in small businesses, may take the form of giving regular customers a small treat as a way of thanking them for their business. Important intangible rewards include special recognition and appreciation. Customers tend to value the extra attention given to their needs.

Building Higher-Level Bonds

One objective of reward-based bonds is to encourage customers to consolidate their purchases with a single provider or at least give it the bulk of their purchases. However, reward-based loyalty programs are relatively easy for other suppliers to copy, so they seldom provide sustained competitive advantage. In contrast, higher level bonds offer a longer term competitive advantage. We will next discuss the three main types of higher level bonds which are (1) social bonds, (2) customization bonds, and (3) structural bonds.

Social Bonds

Have you ever noticed how your favorite hairdresser calls you by your name when you go for a haircut or how she asks why she hasn’t seen you for a long time? Social bonds are usually based on personal relationships between providers and customers. There is an element of trust there, which is important for loyalty.24 Social bonds are more difficult to build than financial bonds and may take longer to achieve, but they are also harder for other suppliers to imitate. A firm that has created social bonds with its customers has a better chance of keeping them for the long term. When social bonds include shared relationships (Figure 12.11) or experiences between customers, such as in country clubs or educational settings, they can be a major loyalty driver for the organization.25
Customization Bonds

These bonds are built when the service provider succeeds in providing customized service to its loyal customers. For example, Starbucks’ employees are encouraged to learn their regular customers’ preferences and customize their service accordingly (Figure 12.12). Many large hotel chains capture the preferences of their customers through their loyal program databases. Firms offering customized service are likely to have more loyal customers. For example, when customers arrive at their hotel, they find that their individual needs have already been met. These ranges from preferred drinks and snacks in the mini bar, to the kind of pillow they like and the newspaper they want to receive in the morning. A customer who is used to this special service may find it difficult to adjust to another provider who cannot immediately offer a similar level of service.

Structural Bonds

Structural bonds are commonly seen in B2B settings. They are created by getting customers to align their way of doing things with the supplier’s own processes, thus linking the customer to the firm. This situation makes it more difficult for competitors to draw them away. Examples include joint investments in projects and sharing of information, processes and equipment. Structural bonds can be created in a B2C environment, too. For instance, some car rental companies offer travelers the opportunity to create customized pages on the firm’s website where they can get details of past trips including the types of cars, insurance coverage, and so forth. This simplifies and speeds up the task of making new bookings.

Have you noticed that while all these bonds tie a customer closer to the firm, they also deliver the confidence, social and special treatment benefits customers desire (refer back to Service Insights 12.1)? In general, bonds will not work well unless they also generate value for the customer!
Chapter 12 • Managing Relationships and Building Loyalty

STRATEGIES FOR REDUCING CUSTOMER DEFECTIONS

So far, we have discussed drivers of loyalty and how to tie customers closer to the firm. A complementary approach is to understand the drivers for customer defections, also called customer churn, and work on reducing those drivers.

Analyze Customer Defections and Monitor Declining Accounts

The first step is to understand the reasons for customer switching. Susan Keveaney conducted a large-scale study across a range of services and found several key reasons behind customers’ switch to another provider (Figure 12.13).28 Core service failures were mentioned by 44 percent of respondents as a reason for switching; dissatisfactory service encounters by 34 percent; high, deceptive or unfair pricing by 30 percent; inconvenience in terms of time, location, or delays by 21 percent, and poor response to service failure by 17 percent. Many respondents decided to switch after a series of related incidents, such as a service failure followed by an unsatisfactory service recovery.

Mobile phone service providers regularly conduct what is called churn diagnostics. It includes the analysis of data warehouse information on customers who switched, or those whose business was decreasing. Exit interviews are conducted when customers call to cancel their subscription. Here, call center staff often have a short set of questions, which they ask when a customer cancels an account, to gain a better understanding of why customers defect. In-depth interviews of former customers by a third party research agency also help to gain a more detailed understanding of churn drivers.29

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

Figure 12.13 What drives customers to switch away from a service firm.

SOURCE
Address Key Churn Drivers

Keaveney’s findings show the importance of addressing some general churn drivers by delivering quality service (see Chapter 14), reducing inconvenience and other non-monetary costs, and having fair and transparent pricing (Chapter 6). There are often industry-specific churn drivers as well. For example, handset replacement is a common reason for cellular phone service subscribers to discontinue an existing relationship, as new subscription plans usually come with heavily subsidized new handsets. To prevent handset-related churn, many providers now offer handset replacement programs, offering current subscribers heavily discounted new handsets at regular intervals. Some providers even provide handsets free to high value customers or against redemption of loyalty points.

In addition to measures to prevent churn, many firms take active steps to retain customers. They train call center staff, called ‘save teams,’ who deal with customers who intend to cancel their accounts. The main job of save team employees is to listen to customer needs and issues, and try to address these with the key focus of retaining the customer. But be careful on how to reward save teams—see Service Insights 12.5.

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SERVICE INSIGHTS 12.5

Churn Management Gone Wrong

American Online (AOL) agreed to pay $1.25 million in penalties and costs, and to change some of its customer service practices to settle an investigation by the State of New York. About 300 subscribers filed complaints with the state attorney general’s office, saying that AOL ignored their demands to cancel the service and stop billing them.

What went wrong? AOL had rewarded its call centre employees for ‘saving’ customers who called in to cancel their service. Employees could earn high bonuses if they were able to persuade half or more of such customers to stay with the firm. As claimed by the attorney general’s office, this may have led AOL’s employees to make it difficult for customers to cancel their service. As a response, AOL agreed to a settlement to have service cancellations requests recorded and verified through a third-party monitor. It also agreed to provide up to four months of refunds to all New York subscribers who claim that their cancellations had been ignored. Former Attorney General Eliot Spitzer said in a statement, “This agreement helps to ensure that AOL will strive to keep its customers through quality service, not stealth retention programs.”

SOURCE
Implement Effective Complaint Handling and Service Recovery Procedures

Effective complaint handling and excellent service recovery are central to keeping unhappy customers from switching providers. Well-managed firms make it easy for customers to voice their problems and respond with suitable service recovery strategies. In that way, customers will remain satisfied, and this will reduce the intention to switch.\(^\text{30}\) We will discuss how to do that effectively in Chapter 13.

Increase Switching Costs

Another way to reduce churn is to increase switching barriers.\(^\text{31}\) Many services have natural switching costs. For instance, it takes customers time and effort to change a primary banking account, especially when many direct debits, credits, and other related banking services are tied to that account. Also, many customers are not willing to learn about the products and processes of a new provider.\(^\text{32}\) Loyalty programs add to switching costs for many customers as they do not want to lose their higher tier status or forfeit loyalty points already collected.

Switching costs can also be created by having contractual penalties for switching, such as the transfer fees payable to some brokerage firms for moving shares and bonds to another financial institution. However, firms need to be careful not to be seen as holding their customers hostage. A firm with high switching barriers and poor service quality is likely to generate negative attitudes and bad word-of-mouth.

CRM: CUSTOMER RELATIONSHIP MANAGEMENT SYSTEMS

Service marketers have understood for some time the power of relationship management, and certain industries have applied it for years. Examples include the corner grocery store, the neighborhood car repair shop, and providers of banking services to high net-worth clients. However, mention CRM, and immediately costly and complex IT systems and infrastructure come to mind. But CRM is actually the whole process by which relations with the customers are built and maintained.\(^\text{33}\) It is an integrated framework (Figure 12.14). It should be seen as enabling the successful implementation of the Wheel of Loyalty.

Common Objectives of CRM Systems

CRM systems allow capturing customer information, and delivering it to the various touch points. From a customer perspective, well-implemented CRM systems deliver customization and personalization. This means that at each transaction, the relevant account details, knowledge of customer preferences and past transactions, or history of a service problem are at the finger tips of the person serving the customer. This can result in a vast service improvement and increased customer value. Personalization and improved communication will result in more loyalty.\(^\text{34}\)

From a company perspective, CRM systems allow the company to better understand, segment, and tier its customer base, better target promotions and cross-selling, and even implement churn-alert systems that signal if a customer is in danger of
defecting. It is important to note that CRM should offer a 360° holistic view of the customer where everyone in the company — be it the front line, middle management, or senior management — and even stakeholders in the company (vendors, suppliers or business partners) have the same view of the customer. Service Insights 12.6 highlights some common CRM applications.

**What does a Comprehensive CRM Strategy Include?**

Rather than viewing CRM as a technology, we should view it as a system that focuses on the profitable development and management of customer relationships. Figure 12.14 provides five key processes involved in a CRM strategy:

1. **Strategy development** involves the analysing of business strategy, including the company's vision, industry trends, and competition. It is usually the responsibility of top management. The business strategy should be guiding the development of the customer strategy, including the choice of target segments, customer base tiering, the design of loyalty bonds and churn management (as discussed in the Wheel of Loyalty, Figure 12.5).
2. **Value creation** translates business and customer strategies into value propositions for customers and the firm. The value created for customers includes all the benefits that are delivered through priority tiered services, loyalty rewards, and customization and personalization. The value created for the firm includes reduced customer acquisition and retention costs, increased share-of-wallet, and reduced customer serving costs. Customers need to participate in CRM (e.g., through volunteering information) so that they benefit from the firm’s CRM strategy. CRM seems most successful when there is a win-win situation for the firm and its customers.37

3. **Multichannel integration.** Most service firms interact with their customers through a variety of channels, including multiple face-to-face outlets, call centers, self-service machines, and the Internet. It is difficult to serve customers well across these channels. CRM’s channel integration offers a ‘unified customer interface’ that delivers customization and personalization.

4. **Information management.** Service delivery across many channels depends on the firm’s ability to collect customer information from all channels at the various touch points (Figure 12.15). The information management process includes:

- the data repository which contains all the customer data
- IT systems including IT hardware and software
- analytical tools such as data mining packages

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**Common CRM Applications**

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

• front office applications, which support activities that involve direct customer contact, including sales force automation and call center management applications

• back office applications, which support internal customer related processes, including, logistics, procurement and financial processing.

5. Performance assessment must address three important questions.

• Is the CRM strategy creating value for its key stakeholders (i.e. customers, employees and shareholders)?

• Are the marketing objectives (ranging from customer acquisition, share-of-wallet, retention to customer satisfaction) and service delivery performance objectives (e.g. call center service standards such as call waiting) being achieved?

• Is the CRM process itself performing up to expectations?

Common Failures in CRM Implementation

Unfortunately, most of the CRM implementations in the past have failed. According to the Gartner Group, the implementation failure rate is 55 percent and Accenture claims it to be around 60 percent. Common reasons for CRM failures include:

► Viewing CRM as driven by technology. It is easy to let the focus shift towards technology, with the result that the IT department rather than senior management or the marketing department takes the lead in coming up with the CRM strategy. This often results in a lack of direction, understanding of customers and markets during implementation.

► Lack of customer focus. Many firms implement CRM without the goal of allowing improving service delivery for valued customers across all delivery channels.

► Not enough understanding of customer LTV. Marketing does not take into account the different profitability of different customers. Furthermore, servicing costs of different customers are often not well captured (e.g. by using activity based costing as discussed in Chapter 6).

► Inadequate support from top management. Without ownership and active involvement of top management, the CRM implementation will not be successful.

► Lack of coordination. There is a need for coordination within the organization, between the different entities that are involved in the implementation.

► Failing to reengineer business processes. It is nearly impossible to implement CRM successfully without redesigning customer service and back-office processes. Many implementations fail because CRM is being fitted into existing processes, rather than redesigning the processes to fit a customer-centric CRM implementation. Redesigning also requires changes in management and employee involvement and support, which are often lacking.
Underestimating the challenges in data integration. Firms frequently fail to integrate customer data that usually are scattered all over the organization. However, a key to taking advantage of the full potential of CRM is to make customer knowledge available in real time to all employees who need it (Figure 12.16).

In the long run, firms can put their CRM strategies at risk if customers believe that CRM is being used in a way that is harmful to them. Examples include feeling that they are not being treated fairly (including not being offered attractive pricing or promotions that are offered, for example, to new accounts, but not to existing customers), and potential privacy concerns (see Service Insights 12.7). Being aware and actively avoiding these weaknesses is a first step towards successful CRM implementation.

**SERVICE INSIGHTS 12.7**

**CRM Extreme – A Glimpse into Ordering Pizza in 2015**

**Operator:** “Thank you for calling Pizza Delight. Linda speaking, how may I help you?”

**Customer:** “Good evening, can I order …”

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

**Customer:** “Hold on …. it’s ehm … 4555 1000 9831 3213”

**Operator:** “Thank you! Can I please confirm you’re Mr. Thompson calling from 10940 Wilford Boulevard. You are calling from your home number 432-3876, your cellphone number is 992-4566, and your office number is 432-9377.”

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

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

**Customer:** “I would like to order a large seafood pizza …”

**Operator:** “Sir, that’s not a good idea.”

**Customer:** “Why not?”

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

**Customer:** “What?… Then what do you recommend?”

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

**Customer:** “How do you know?”

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

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

**Operator:** “That should be enough for your family of 8, Sir. The total is $47.97.”

**Customer:** “Can I pay by credit card?”

**Operator:** “I’m afraid you’ll have to pay us cash, Sir. Your credit card is over the limit and your checking account has an overdue balance of $2,435.54. That’s excluding the late payment charges on your home equity loan, Sir.”

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

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

**Customer:** “Never mind, just send the pizzas, I’ll have the cash ready. How long is it gonna take?”

**Operator:** “About 45 min, Sir; but if you don’t want to wait you can always come and collect it on your Harley, registration number L.A.6468 …”

**Customer:** “#@$%^&%@

**Operator:** “Sir, please watch your language. Remember, on 28th April 2011 you were convicted of using abusive language at a traffic warden …”

**Customer:** (Speechless)

**Operator:** “Is there anything else, Sir?”

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This story was adapted from various sources, including www.lawdebt.com/gazette/nov2004/nov2004.pdf accessed on June 2008; and a video created by the American Civil Liberties Union (ACLU) available at http://www.aclu.org/pizza. This video aims to show the threats to consumers’ privacy caused by CRM. ACLU is a non-profit organization that challenges government’s and corporations’ aggressive collection of information on people’s personal life and habits.
How to get CRM Implementation Right

In spite of the many horror stories of millions of dollars sunk into unsuccessful CRM projects, more and more firms are getting it right. "No longer a black hole, CRM is becoming a basic building block of corporate success." Experienced McKinsey consultants believe that even CRM systems that have not yet shown results can still be turned around. They recommend taking a step back and focusing on how to build customer loyalty, rather than focusing on the technology itself. Many successful CRM implementations are highly focused and narrow in scope. Often, they focus on clearly defined problems within the customer relationship cycle. These narrow CRM strategies often reveal additional opportunities for further improvements, which taken together, can over time develop into broad CRM implementation extending across the entire company.

Among the key questions managers should ask when defining their customer relationship strategy are:

1. How should our value proposition change to increase customer loyalty?
2. How much customization or one-to-one marketing and service delivery is suitable and profitable?
3. What is the increase in profit from increasing the share-of-wallet with our current customers? How much does this change by customer tier and/or segment?
4. How much time and resources can we provide to CRM right now?
5. If we believe in CRM, why have we not taken more steps in that direction in the past? What can we do today to develop customer relationships without spending on technology?

Answering these questions may lead to the conclusion that a CRM system may at the moment not be the best investment or highest priority. In any case, we emphasize that the system is merely a tool to drive the strategy, and must thus be customized to deliver that strategy (Figure 12.17).
Customer loyalty is an important driver of a service firm’s profitability. The profits derived from loyal customers come from:

- increased purchases
- reduced operation costs
- referral to other customers
- price premiums

However, it is not true that loyal customers are always more profitable. They may expect price discounts for staying loyal. To truly understand the profit impact of the customers, firms need to learn how to calculate the LTV of their customers.

Customers are only loyal if there is a benefit for the customer. Common benefits customers see in being loyal include:

- Confidence benefits, including feeling that there is less risk of something going wrong, ability to trust the provider, and receipt of the firm’s highest level of service.
- Social benefits, including being known by name, friendship with the service provider, and enjoyment of certain social aspects of the relationship.
- Special treatment benefits, including better prices, extra services, and higher priority.

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

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

To build the foundation for loyalty, firms need to:

- Segment the market and target the “right” customers. Firms need to choose their target segments carefully and match them to what the firm can do best.
- Firms need to examine customer value, instead of just going for customer volume.
- Manage the customer base via service tiering. The Customer Pyramid divides the customer base into four tiers, namely platinum, gold, iron and lead. It helps to tailor strategies to the different service tiers. The higher tiers offer higher value for the firm, but also expect higher service levels. For the lower tiers, the focus should be on increasing profitability through building volume, increasing prices, cutting servicing costs, and as a last resort even terminating unprofitable relationships.

Finally, firms have to understand that the foundation for true loyalty lies in customer satisfaction and service quality. The satisfaction-loyalty relationship can be divided into three main zones: defection, indifference and affection. Only highly satisfied or delighted customers will be truly loyal.

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

- Cross-selling and bundling deepen relationships that make switching more difficult and often increase convenience through one-stop shopping.
- Reward-based bonds aim at building share-of-wallet through financial and non-financial rewards, higher-tier service levels and recognition and appreciation.
- Higher level bonds include social, customization and structural bonds.

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

- Customers may leave because of core service failures, dissatisfaction with some service encounters, perceptions that pricing is deceptive and unfair, inconvenience, and poor response to service failures.
- To prevent customers from switching, firms should have good complaint handling and service recovery processes in place.
- Firms can also increase customers’ switching costs.

Finally, CRM systems should be seen as enabling the successful implementation of the Wheel of Loyalty. CRM systems are particularly useful when firms have to serve large numbers of customers across many delivery channels.

An effective CRM strategy includes five key processes: (1) strategy development, (2) value creation, (3) multi-channel integration, (4) information management, and (5) performance assessment.
Loyalty
Customer asset management
Defection
Zero defections
Customer Lifetime Value
Foundation for Loyalty
Wheel of Loyalty
Loyalty rewards
Loyalty leaders
Target the right customers
Four-level pyramid
Gold
Iron
Lead
Platinum
Tiering of service
Apostles
Bundling
Cross-selling
Loyalty bonds
Satisfaction-loyalty relationship
Zone of defection
Zone of indifference
Zone of affection
Loyalty programs
Polygamous loyalty
Reward-based bonds
Customer acquisition
Data mining packages
Data repository
Information management
IT systems
Multichannel integration
Performance assessment
Personalization
Reasons for CRM failures
Relationship management
Strategy development
Share-of-wallet
Value creation

How well do you know the language of services marketing? Quiz yourself!

For each keyword you are able to recall without referring to earlier pages, give yourself a point (and a pat on the back). Tally your score at the end and see if you earned the right to be called—a services marketeer.

**SCORE**

<table>
<thead>
<tr>
<th>Range</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 – 10</td>
<td>Services Marketing is done a great disservice.</td>
</tr>
<tr>
<td>11 – 19</td>
<td>The midnight oil needs to be lit, pronto.</td>
</tr>
<tr>
<td>20 – 29</td>
<td>I know what you didn’t do all semester.</td>
</tr>
<tr>
<td>30 – 39</td>
<td>By George! You’re getting there.</td>
</tr>
<tr>
<td>40 – 50</td>
<td>Now, go forth and market.</td>
</tr>
<tr>
<td>51 – 60</td>
<td>There should be a marketing concept named after you.</td>
</tr>
</tbody>
</table>

Not for the academically faint-of-heart

These keywords are found within the sections of each Learning Objective (LO). They are integral in understanding the services marketing concepts taught in each section. Having a firm grasp of these keywords and how they are used is essential in helping you do well for your course, and in the real and very competitive marketing scene out there.

1. Loyalty
2. Customer asset management
3. Defection
4. Zero defections
5. Customer Lifetime Value
6. Foundation for Loyalty
7. Wheel of Loyalty
8. Loyalty rewards
9. Loyalty leaders
10. Target the right customers
11. Four-level pyramid
12. Gold
13. Iron
14. Lead
15. Platinum
16. Tiering of service
17. Apostles
18. Bundling
19. Cross-selling
20. Loyalty bonds
21. Satisfaction-loyalty relationship
22. Zone of defection
23. Zone of indifference
24. Zone of affection
25. Loyalty programs
26. Polygamous loyalty
27. Reward-based bonds
28. Customization Bonds
29. Structural bonds
30. Social bonds
31. Complaint handling
32. Customer churn
33. Customer defections
34. Customer switching
35. Churn diagnostic
36. Churn drivers
37. Industry-specific churn drivers
38. Reduce churn
39. Save teams
40. Service recovery
41. Switching barriers
42. Churn-alert systems
43. Common CRM applications
44. CRM
45. CRM systems
46. CRM strategy
47. Customization
48. Customer acquisition
49. Data mining packages
50. Data repository
51. Information management
52. IT systems
53. Multichannel integration
54. Performance assessment
55. Personalization
56. Reasons for CRM failures
57. Relationship management
58. Strategy development
59. Share-of-wallet
60. Value creation
Review Questions

1. Why is customer loyalty an important driver of profitability for service firms?
2. Why is targeting the ‘right customers’ so important for successful CRM?
3. How can a firm calculate the LTV of its customers?
4. How do the various strategies described in the Wheel of Loyalty relate to one another?
5. How can a firm build a foundation for loyalty?
6. What is tiering of services? Explain why it is used and what its implications are for firms and their customers.
7. Identify some key measures that can be used to create customer bonds and encourage long-term relationships with customers.
8. What are the arguments for spending money to retain existing customers who are at risk of switching to a competitor?
9. What is the role of CRM in delivering a customer relationship strategy?

APPLICATION QUESTIONS

1. Identify three service businesses that you buy from regularly. Now, for each business, complete the following sentence: “I am loyal to this business because ________________________________.”
2. What conclusions do you draw about (a) yourself as a consumer, and (b) the performance of each of the businesses in Exercise 1? Judge whether any of these businesses managed to develop a sustainable competitive advantage through the way it won your loyalty.
3. Identify two service businesses that you have used several times but have now stopped buying from (or will stop buying from). Complete the sentence: “I stopped using (or will soon stop using) this organization as a customer because ________________________________.”
4. Again, what conclusions do you draw about yourself and the firms in Exercise 3? How could each of these firms avoid your defection?
5. Evaluate the strengths and weaknesses of two loyalty or frequent user programs, each one from a different service industry. Assess how each program could be improved further.
6. Approach service employees in two firms with implemented CRM systems. Ask the employees about their experience of using these systems, and whether the CRM systems help them in understanding their customers better. Does this lead to improved service experiences for their customers? Do interview them about potential concerns and improvement suggestions they may have about their organizations’ CRM systems.